



PSERS VALUE-ADDED REAL ESTATE PROGRAM

**Recommendation for Investment in
Five Arrows Realty Securities V, L.P.**

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Five Arrows Realty Securities V, L.P.

EXECUTIVE SUMMARY

Five Arrows Realty Securities V, L.P. (the “Partnership” or “Five Arrows V”) will be targeting a \$600 million fund size and is intended to provide investors with a 12-15% net annual return. The Partnership is the successor to Five Arrows Realty Securities I, II, III and IV (collectively “Five Arrows I, II, III and IV” and, together with Five Arrows V, the “Five Arrows Funds”), an approximately \$1.4 billion series of funds which has made private placement investments in securities of real estate companies. These funds are managed by the managing principals of Rothschild Realty Managers LLC (the “Manager”), which is affiliated with Rothschild Group (“Rothschild”), and are Rothschild’s primary vehicle for real estate transactions. The Partnership will continue and expand the established investment platform of Five Arrows I, II, III and IV, under the direction of John D. McGurk (President of the Manager), Matthew W. Kaplan (Portfolio Manager), D. Pike Aloian and James E. Quigley 3rd (collectively, the “Managing Principals”).

Five Arrows V is uniquely positioned to achieve superior risk-adjusted returns in the current real estate investment environment based on the Managing Principals’ proven ability to identify opportunities, structure and execute transactions and actively monitor and manage investments. In addition, Five Arrows V will take advantage of the Managing Principals’ existing transaction pipeline, substantial network of domestic and international relationships, capital markets expertise, and execution capabilities. Rothschild and the employees of the Manager will invest at least \$15 million in Five Arrows V.

INVESTMENT STRATEGY

Investment Environment

Real estate ownership is shifting to fully integrated operating companies. In most sectors of the U.S. economy, fully integrated companies have been the norm since early last century. This has been the case for several reasons, in particular the potential for achieving economies of scale and lower overhead expense, utilizing corporate financing techniques which provide for lower cost and more flexible capital, and a greater alignment of interests between managers and ownership. The real estate industry had not historically been integrated due to tax and other considerations; however, developments in the law now provide greater flexibility in the choice of entities and have allowed a shift to integrated ownership structures (including REITs and LLCs).

Real estate today presents emerging market opportunities in a mature asset class. The transition of real estate ownership to fully integrated operating companies is in an early stage; real estate capital markets (primarily REITs and Commercial Mortgage Backed Securities) began assuming their current form in the early 1990s. The transition has created a capital markets environment increasingly on a global basis similar to that of an emerging market with respect to the size of the issuers, liquidity, management’s corporate experience, and the investment community’s collective experience, which has enjoyed less than one full cycle of seasoning. At the same time, however, the inherent risk profile of the industry is underpinned by a mature asset class. Therefore, the temporary dislocations and inefficiencies that characterize an emerging market provide experienced investors with superior investment opportunities.

As many real estate companies are experiencing the initial stages of maturation, they increasingly require significant amounts of growth capital to access expansion or consolidation opportunities. This transition will continue to create numerous opportunities for direct structured investments. This maturation process is occurring in many countries, as many nations are

enacting laws similar to U.S. REIT rules, combined with a growing acceptance of such structures in local and global capital markets.

The market environment described above creates a large number of opportunities for private placements of debt and equity capital to entities active in the ownership, management and enhancement of real estate both in the United States and internationally. Five Arrows V will pursue a broad range of investments with the following attributes:

- ✓ **Proven management teams** - Central to each Five Arrows V investment is a high-quality management team with a proven track record of generating superior returns on investments.
- ✓ **Business plans focused on superior opportunities** - Management teams must have a highly developed, focused business plan, within their realm of expertise, directed at a specific real estate opportunity. This opportunity, directed at a specific product type and/or region, should produce returns in excess of industry norms.
- ✓ **Pricing at or below “Net Asset Value”** - Equity and equity-linked investments will generally be priced to provide Five Arrows V with an investment basis at or below the Manager’s estimate of each company’s net asset value (including property ownership, management contracts, land, working capital and any other future cash flows).

The Manager will seek to protect invested capital by mitigating risk through structure. Central to the Managing Principals’ continued success is reducing risk through one or more of the following:

- ✓ **Corporate structure** - Either through a single integrated structure or in separate but affiliated entities, the Partnership will invest in real estate companies where managements’ incentives can be effectively aligned with shareholder objectives and subordinated to payment of interest and dividends on the Partnership’s investment. Entity-level investments in multi-property portfolios also substantially mitigate single property and tenant risk.
- ✓ **Active participation in corporate governance** - Where appropriate, investments will provide for direct participation by the Manager in corporate governance. Governance occurs primarily through board seats, often with the potential for additional board representation should certain negative events occur.
- ✓ **Protective provisions** - Transaction documentation contains protective language providing some or all of the following: “springing” board seats in the event the company breaches certain defined covenants or fails to make contractual payments; change of control put provision; anti-dilution; voting rights; and other investor-friendly provisions.
- ✓ **Seniority** - Investments are primarily made in equity oriented senior securities, including preferred stock and corporate debt, which can be converted into common stock of a company at the option of the holder. Seniority in the capital structure provides enhanced protection of principal and cash flows over the life of the investment while the conversion rights allow for the recognition of equity returns by converting into common stock.
- ✓ **Liquidity** - Investments are generally structured to provide for liquidity through transferability and registration rights, including rights to underwritten offerings.

These protective measures can help moderate fluctuations in value over the life of the investment, reducing the risk of loss of principal as well as moderating the volatility of returns. Five Arrows V investments into public and private companies will be in the following two categories:

- **Structured Investments:**
 - Debt or preferred equity convertible into equity
 - High yield debt investments, sometimes including participation rights
 - Limited open market purchases of debt and preferred equity securities
- **Common Equity Investments:**
 - Joint venture investments in conjunction with an investment in the company that manages the joint venture
 - Leveraged management buy-outs
 - Capital for early stage and start up companies
 - Limited open market purchases of common equity

MANAGEMENT OF THE FUND

The predecessor of the Manager, Rothschild Realty, Inc., founded by John McGurk and the Rothschild Group in 1981, has more than two decades of experience building, investing in and growing real estate opportunities. The Managing Principals have built a successful track record over the course of multiple investment cycles. The Managing Principals are a core team of skilled investment professionals who have worked together for over 14 years undertaking real estate investments and acting as financial advisors on a large number of real estate and securities transactions. The Managing Principals were responsible for Five Arrows I, II, III and IV's successful track record.

The Managing Principals form the core of an eight-person professional team that has a unique combination of real estate, capital markets and management skills. These skills are essential to the successful implementation of the Partnership's investment objectives. These professionals have direct experience in a number of real estate oriented capacities including investment management, acquisition, development, leasing, construction, underwriting and financing. The team has broad capital markets expertise including corporate financing and restructuring, equity underwriting, debt financing and mergers and acquisitions. Further, the Managing Principals have experience managing and building successful organizations. The Managing Principals have also acted as fiduciaries, as investment professionals and have collectively occupied 27 board seats on 20 different boards of directors.

The Managing Principals have completed 18 private placement transactions in Five Arrows I, II, III and IV, with aggregate cost basis of approximately \$1.2 billion, including over \$32 million of open market investments.

PARTNER BIOGRAPHIES

John D. McGurk, 63, President. Mr. McGurk founded Rothschild Realty Inc., a Rothschild affiliate which manages FARS I, II, III and IV ("RRI") in 1981. RRI is the predecessor to Rothschild Realty Managers and Mr. McGurk supervises the activities of both entities. He is a member of the National Association of Real Estate Investment Managers, the Urban Land Institute, Pension Real Estate Association and the Real Estate Board of New York, is a director of Denholtz Holdings, Advance Realty Group and Merritt Properties and is a member of the Trustee Committee of The Caedmon School. He graduated from Loyola University in 1965 and received an M.B.A. from the University of Southern California in 1971.

D. Pike Aloian, 52, Managing Director. Mr. Aloian joined RRI in 1988 and is responsible for the origination, economic analysis, closing and on-going review of RRI's real estate investments. From 1980-1988, he was a vice president at The Harlan Company, where he was responsible for property acquisition, development and financing. Mr. Aloian is a director of Denholtz

Holdings, Victory Real Estate Investments, Advance Realty Group, EastGroup Properties, Merritt Properties and Brandywine Realty Trust. He currently is an adjunct professor of the Columbia University Graduate School of Business. Mr. Aloian graduated from Harvard College in 1976 and received an M.B.A. from Columbia University in 1980.

Matthew W. Kaplan, 44, Managing Director. Mr. Kaplan joined RRI in 1992 where he is responsible for its securities investment activities as the Portfolio Manager of the Five Arrows Realty Securities Partnerships. From 1990 to 1992, he served in the Corporate Finance Department of RRI's affiliate, Rothschild Inc. Mr. Kaplan is a director of Encore Hospitality, National RV Communities and Parkway Properties Inc. Mr. Kaplan has been a director of Ambassador Apartments Inc., CNL Financial Services, CNL Hospitality Properties and WNY Group. Mr. Kaplan has been a member of the Urban Land Institute and of the Institutional Investor Council to the NAREIT Board of Governors. From 1988 to 1990, he was a management consultant at Touche Ross & Co. Mr. Kaplan graduated cum laude from Washington University in 1984 and received an M.B.A. from The Wharton School in 1988.

James E. Quigley 3rd, 50, Senior Vice President/Treasurer. Mr. Quigley joined RRI in 1988 and has served as Senior Vice President and Treasurer of RRI since 1990, where he has been responsible for internal accounting, tax reporting and control, and portfolio management. From 1987-1988, he was an accountant with Coopers & Lybrand, where he specialized in auditing real estate entities. He is a Certified Public Accountant, a member of the American Institute of Certified Accountants and the New York State Society of Certified Public Accountants and is a director of Victory Real Estate Investments, Encore Hospitality and Merritt Properties. He has been a director of Morningstar Storage Centers and Pacific Gulf Properties. Mr. Quigley graduated from Siena College in 1985 and received an M.S. from State University of New York in 1987.

John B. Ryan, 44, Director. Mr. Ryan joined RRI in 2001 and is responsible for marketing the FARS investment platform. From 1998 to 2000, he was a senior vice president with Lend Lease, most recently with their Global Advisors unit where he was responsible for running and coordinating the money raising efforts, primarily in North America, for Lend Leases' international real estate initiatives. Previously, he was a vice president of marketing at Prudential Real Estate Investments where he was responsible for establishing and executing a marketing plan designed to present strategies and services to the largest corporate pension plans in the East, South and Midwest regions. Mr. Ryan graduated from the University of South Carolina in 1985.

Ilse L. Gehrman, 43, Vice President. Ms. Gehrman joined RRI in 1989 where she has been responsible for internal accounting of RRI's real estate portfolios, client relations and administration. From 1984-1988, she was an Administrator/Systems Operator for El Al Israel Airlines, where she had responsibility for administrative support and systems department staff supervision. Ms. Gehrman is the Treasurer for Animals for Life, Inc., a volunteer animal rescue group. Ms. Gehrman graduated from Johnson & Wales College in 1984.

CONCLUSION/RECOMMENDATION

Based upon the successful track record and experience of the principals and the recommendation of PSERS' consultant, Courtland Partners, Ltd., staff recommends that the Board invest an amount equal to 25 percent of the committed capital, but not to exceed \$100 million plus reasonable normal investment expenses, in Five Arrows Realty Securities V, L.P. The final terms and conditions of the investment must be satisfactory to the Investment Office, the Office of Chief Counsel, and the Executive Director.