

COURTLAND PARTNERS, LTD.

INSTITUTIONAL REAL ESTATE SERVICES

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December 22, 2014

Board of Trustees
Pennsylvania Public School Employees' Retirement System
5 North 5th Street
Harrisburg, PA 17101

Re: Cabot Industrial Core Fund L.P.

Dear Trustees:

Courtland Partners, Ltd. ("Courtland"), having been duly authorized by the Board of PSERS, has evaluated the Cabot Industrial Core Fund L.P., ("the Fund"). The Fund will focus exclusively on the industrial sector, targeting a limited number of select markets with growing demand and asset scarcity. Underwriting will focus on minimizing risk and maintaining value through active management and providing attractive current income. Consistent with the tactics it has employed over time, Cabot will generally pursue transactions smaller than \$50 million and will seek to assemble portfolios for future sales at premium prices. Cabot anticipates investing \$750 million in equity and will endeavor to create a portfolio of industrial properties with a fully capitalized value of \$1.1 billion (assuming 40% leverage). The portfolio is generally expected to consist of 80 to 120 buildings totaling 17 to 20 million square feet. There is a 10% non-industrial carve-out. This provides some flexibility if there is a non-industrial use in what would otherwise be an industrial building. Some tenants use a portion of their warehouse space for office or retail portions.

Cabot Core is targeting net returns of 8-10%; with anticipated initial current yields of 5-6% which would grow over the duration of the fund. As a result, 70-80% of the return is expected to be from current income with the balance of the return resulting from appreciation driven by the growth in income. Although Cabot has been successful in achieving portfolio premiums, this is an additional source of potential return that is not assumed in its underwriting.

Core opportunities, including core industrial opportunities, have become more competitive. The most expensive core industrial opportunities tend to be portfolios that are \$100 million or more in size. There is less competition, from the traditional core investors (such as the open ended core funds and the large pension advisors) for single property investment opportunities. Historically, Cabot has been able to source these opportunities from tenants, smaller non-institutional owners, and smaller institutions. This approach helps Cabot to avoid over-paying for assets. Cabot is a disciplined investor and closes on a small portion of the opportunities under review.

The majority of assets will be high quality industrial properties that can accommodate single tenants and multiple tenants. Cabot anticipates that single tenant buildings will be 30% to 50% of the portfolio. Cabot projects building sizes will typically be 100,000 square feet to 700,000 square feet and that the tenant size may average 200,000 square feet.

Cabot has several distinct advantages as far as generating proprietary deal flow. Cabot has been in business, focused exclusively on industrial properties, for 25 years. Since 1998, Cabot has completed

over 350 industrial transactions with a wide range of brokers. The industrial brokerage community knows Cabot. Cabot has also sourced properties directly from sellers and made hundreds of unsolicited offers. Cabot is known as being easy to deal with because they close so many smaller transactions. Cabot has an efficient due diligence process and since they buy on an “all cash” basis, there is not a need to obtain financing.

The Fund will target core industrial assets in the U.S. Cabot believes a core investment strategy is attractive at this time, given the economic recovery, improving industrial market fundamentals, relatively attractive pricing for core buildings given low in place rents, low interest rates, and strong performance of high quality, stabilized distribution buildings during the recession. Cabot does not use operating partners for acquisition or asset management and generally does not require the use of operating partners for development transactions.


Courtland’s recommendation is based upon the following factors and is made within the context of PSERS’ investment guidelines.

- Detailed due diligence with key Cabot management team members, and review of all relevant materials provided by Cabot.
- Evaluation of the Fund’s proposed investment strategy within the context of the current investment environment.
- Evaluation of Cabot’s track record and organizational resources.
- Discussion and review of the market conditions in markets relative to the proposed investment strategy.
- The strategy proposed for the Fund is appropriate for the real estate component of the portfolio.

Based on the above, Courtland recommends that PSERS commit up to \$100 million to the Fund. Courtland makes this recommendation considering Cabot’s qualifications and PSERS’ overall investment guidelines.

This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in the Fund, since their needs, objectives and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits of the Fund. Courtland does not provide legal or other non-investment-related advice.

Sincerely,



Steven Novick
Principal-Chief Operating Officer

COURTLAND PARTNERS, LTD.



Core Real Estate Fund Commitment

Cabot Industrial Core Fund, L.P.

January 21, 2015

Cabot Industrial Core Fund, L.P. – Core Real Estate Fund

**Proposed
PSERB Resolution 2015-_____
Re: Cabot Industrial Core Fund, L.P.
January 21, 2015**

RESOLVED, that the Finance Committee of the Public School Employees' Retirement Board (the "Board") hereby recommends that the Board invest an amount not to exceed \$150 million plus reasonable normal investment expenses, in Cabot Industrial Core Fund, L.P., in accordance with the recommendation of Laurann H. Stepp, Senior Portfolio Manager, dated January 21, 2015 and Courtland Partners recommendation dated December 22, 2014. The final terms and conditions of the investment must be satisfactory to the Investment Office, the Office of Chief Counsel, and the Executive Director, as evidenced either by the appropriate signatures on, or by a memo to that effect appended to, the implementing investment contract.

Cabot Industrial Core Fund, L.P. – Core Real Estate Fund

Overview

- Fund will be seeking \$750M in capital commitments
- Fund objective is to provide superior risk adjusted returns by investing in industrial properties located in 16 target markets within the United States
- Cabot has realized all investments from the Cabot REIT, and Cabot Industrial Value Funds I & III which represents 73% of the \$4.9 billion in investments made since 1998; the net realized results of each vehicle exceeded 11% and the combined net realized IRR is 13.6%

Fund Strategy

- Operator driven strategy with a focus on acquisition, operating, leasing and selling industrial properties. Targeted investments will be stabilized industrial buildings that have attractive current income, are located in the strongest growing markets, underwritten to minimize risk, and actively managed to maintain value
- 60-70% of the stabilized returns will be from current income

Investment Team

- The Fund has a dedicated Portfolio Manager supported by a team of 22 professionals, including the 5 Senior Members who have worked together since 1996
- The entire team has an average of 18 years in the real estate industry and 13 years with Cabot

Cabot Industrial Core Fund, L.P. – Core Real Estate Fund

GP “Value Add”

- Cabot's experienced and cohesive team has been focused on the industrial arena for over 25 years and has demonstrated the ability to capitalize on a large network of national relationships as well as broad local market relationships
- Extensive experience in pursuing various exit routes. In 1998 created publicly traded Cabot REIT, and subsequently sold in 2001. Fund I, established in 2002, was sold in a single transaction in 2005, realizing a net IRR of 120% and a 2.2x equity multiple for the fund investors. The remaining \$1.5 billion of Fund III assets were sold in one transaction in 2013, realizing a net IRR of 21% and a 1.5x equity multiple

Performance (as of June 30, 2014)

- Since 1998, Cabot has liquidated over 75% of their investments producing an unlevered gross IRR of 14.8%
- Value Fund I (2003) Liquidated: net 2.2x MOC and a net IRR of 120%
- Value Fund II (2005) Current: gross 1.0x MOC and a 0.14% net IRR to date. Projected to achieve 2.8%-4.1% net IRR and a net 1.3x-1.5x MOC
- Value Fund III (2008) Liquidated: net 1.5x MOC and a 21% net IRR
- Value Fund IV (2013) targeting 12-14% levered net IRR
- Core Fund will target an 8-10% levered net IRR

Cabot Industrial Core Fund, L.P. – Core Real Estate Fund

Market Opportunity

- Market dynamics will be favorable as economic conditions continue to improve. Additionally, there are long term demographics and trends that increase the opportunities available in the industrial markets. These positive longer term trends include: growing population, increasing domestic energy supplies (and current drop in energy prices), improving housing markets, and growing ecommerce
- Lowest industrial vacancy rates since 2001, leading to rents rising 4% year over year as of September. This trend is expected to continue in most markets for several years

Potential Risks

- First designated “Core” fund for Cabot

Cabot has analyzed their deal flow for the year ended 9.30.14 and determined that they had reviewed \$2.2B in core transactions during the year, 43% of which were stellar deals that fell within the parameters of the Core Fund. Due to the higher return requirement of the Value Fund, bids were either not successful or not made. This fund would allow them to take advantage of their relationships and expand investment options for their limited partners

- Potential increase in Supply

Although industrial property can be quick to build, Cabot will be focusing on key markets that have sufficient supply constraints. The constraints can include cost or availability of land, access to deal flow (relationships with brokers), and knowledge of tenant base. Additionally, after four years of positive net space absorption with limited new supply, the industrial markets are starting at a low base of availability

Cabot Industrial Core Fund, L.P. – Core Real Estate Fund

History with PSERS

- PSERS relationship with Cabot began in 1998, when directly held industrial properties were traded for 5.5 million shares of the public Cabot company. The shares were tendered in 2001 for a gain of \$22 million and a net IRR of 11.29%
- In 2008 PSERS committed \$100 million to Cabot Industrial Value Fund III, L.P., in 2013 PSERS committed \$75 million to Cabot Industrial Value Fund IV, LP

Board Issues

- Pennsylvania Presence – Since 1998 Cabot acquired 8 PA assets totaling over \$130 million. PA continues to be a target market
- Placement Agents – Cabot has hired Greenhill to focus on potential Asian and Australian investors. PSERS commitment has been excluded from any contract
- PA political contributions – N/A
- Relationship with Consultant – N/A

Recommendation

- Staff, together with Courtland Partners, recommends that the Board invest an amount not to exceed \$150 million plus reasonable normal investment expenses

NOTICE: This document was presented to the Public School Employees' Retirement Board at the public meeting at which the Board acted on the resolution to which the information relates. The sole purpose for posting the presentation information on this website is to enable the public to have access to documents that were utilized at a public meeting of the Public School Employees' Retirement Board, and no other purpose or use is intended.