COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Public Investment Memorandum

# RCG Longview Debt Fund VI, L.P.

Real Estate Commitment

**Laurann H. Stepp**
Senior Portfolio Manager

**May 6, 2016**

## Recommendation:

Staff, together with Courtland Partners, Ltd., recommends the Board commit up to $75 million to RCG Longview Debt Fund VI, L.P. ("Fund" or "RCG VI"). RCG Longview Debt Fund VI Partners, LLC ("RCG" or the "Firm") is sponsoring the Fund to continue the Firm's real estate debt investment strategy.

## Firm Overview:

RCG was established in 1999 to capitalize on dislocations in the real estate lending marketplace in which the sponsor firms operated. The Firm was formed and continues to be jointly controlled by owners of Ramius LLC (now an affiliate of The Cowen Group, Inc.), the Feil Organization, and Estreich & Company (collectively "Sponsors"); all NYC headquartered firms. The ownership of RCG Longview is held 50.6% by the founding Managing members; Jay Anderson, Michael Boxer, Jonathan Estreich, and has expanded to include Richard Gorsky, Managing Director and Head of RCG Longview. The remaining 49.4% ownership is held by Ramius, LLC and Jeffrey Feil.

| Sponsors/Owner Companies | Founded | Primary Business |
|---|---|---|
| Ramius LLC | 1994 | Discretionary investment management firm founded by Peter Cohen and Jeffrey Solomon. Ramius operates as the asset management arm of Cowen Group, Inc. |
| Feil Organization | 1955 | One of largest private real estate owner/operators in United States |
| Estreich & Company | 1986 | Large NYC debt and equity brokerage firm |

RCG operates as an investment manager of commingled funds and separate accounts with total assets under management of $1.78 billion as of December 31, 2015:

| Commingled Funds | AUM[1] |
|---|---|
| RCG Longview Debt Funds | $814M |
| RCG Longview Equity Funds | $866M |
| **Separately Managed Accounts** | |
| Insurance Company Client | $100M |
| Total AUM | $1.78B |

*(1) Carrying value of unrealized investments plus undrawn commitments.*

Since inception RCG has closed 484 debt and debt-oriented transactions, investing capital of approximately $3 billion gross, $1.4 billion net.

## Market Opportunity:

The generally stable and improving economic conditions in the United States has resulted in strong demand and transaction volume for newer, high-quality office space and multi-family product in the largest cities. Operators/developers are interested in improving or redeveloping assets to meet the demand; however, traditional lenders are less able to provide the historical level of loan proceeds due to current regulations. The Fund is positioned to fill this funding gap, albeit with higher cost debt. Their short duration product, typically up to 3 year term, enables the operators to complete and stabilize their investments and then refinance at lower cost with traditional lenders. The current estimation is that over $1.4 trillion in commercial real estate loans will come due through 2017. Although the majority will find ready refinancing dollars, due to the much stricter loan-to-value lender requirements many borrowers will be in search of RCG-type debt products.

## Portfolio Fit:

A commitment to the Fund will be allocated to the Real Estate portion of PSERS' Real Assets portfolio. As of December 31, 2015, and adjusted to include commitments from the March, May and current Board meeting, the Real Estate portfolio is 52.2% Opportunistic, 34.4% Value-Added, and 13.4% Core. Investment in this Fund will increase PSERS' Value-Add real estate exposure, which is currently below a long term target of 50%.

.

The table below summarizes PSERS' projected exposure inclusive of a recommended $75 million commitment to the Fund:

| Investment Type ($M) | Market Value | % | Unfunded | % | Total Exposure | % |
|---|---|---|---|---|---|---|
| **Opportunistic** | 3,245.2 | 58.6% | 1,080.5 | 39.4% | **4,325.7** | **52.2%** |
| **Value-Add** | 1,536.3 | 27.7% | 1,311.2 | 47.8% | **2,847.5** | **34.4%** |
| **Core** | 757.6 | 13.7% | 350.0 | 12.8% | **1,107.6** | **13.4%** |
| **Total** | **$ 5,539.1** | **100.0%** | **2,741.7** | **100.0%** | **8,280.8** | **100.0%** |

## Investment Strategy:

The strategy of the Fund is simply to lend against real estate that they understand well, earn an acceptable all-in rate of return, and get repaid. Their goal of generating equity-like returns while only taking debt-level risk will be obtained by relying on the fifty years of perspective the Sponsors have gained while investing in real estate. At least two-thirds of the targeted IRR of 12% is expected to be current return distributed quarterly.

By using its in-house originations team and relying on the Sponsor's relationship network, fund investments will be made to borrowers who are engaged in: (i) acquisition, (ii) refinancing, (iii) discounted payoff of an existing loan, (iv) restructuring of existing debt, (v) note financing, or (vi) recapitalization or partner buyout. At times debt proceeds may include a "good news" facility that would provide borrowers with additional proceeds if certain performance thresholds are met. The fund will consist of approximately 30-45 loans with an estimated average size of $16M per deal.

The Firm's owner-operator approach to lending comes from their long term "real world" history of owning and managing real estate. This history is applied as underwriting expertise, using actual experiences to inform future decision-making. The extensive history of the Sponsor's representatives who serve on the investment committee, combined with key personnel within RCG has enabled the Firm to successfully invest throughout market cycles.

## Investment Structure:

The General Partnership of the Fund is RCG Longview Debt Fund VI Partners, LLC, a Delaware limited liability company.

The Fund will be structured as a Delaware Limited Partnership.

The Fund's investment manager, RCG Longview Management, LLC, is registered as an investment adviser with the SEC.

## Investment Instruments:

The Fund will use multiple instruments to arrange flexible debt options for its borrowers. Borrowers looking for acquisition loans, refinancing or a special situation would typically use shorter-term senior mortgage loans, B-notes, mezzanine financing or preferred equity. The table below provides a summary of the investments that fall within the Fund's investment mandate, and their estimated allocation.

| Instrument | Anticipated Allocation | Description |
|---|---|---|
| **Mezzanine Loans** | 65% | Subordinated debt instruments- senior to the borrower's equity, but subordinated to senior or any second lien loan |
| **Senior Mortgage** | 20% | Represent the most senior claim on a property and its cash flows |

| | | |
|---|---|---|
| **B-Notes** | 10% | Second-ranking security on a property, typically carved out and sold-off to a conduit or commercial lender. They represent a claim which is junior to senior secured loans and senior to other subordinated debt (mezzanine and high yield debt) and common and preferred equity |
| **Preferred Equity** | 5% | Generally used when any subordinated debt is prohibited by the senior lender, and typically the investment would otherwise have been a more traditional structured debt product. In these cases the Fund's rights and remedies are embedded in the Borrower's operating agreement |

## Investment Team:

The founding members of RCG (Michael Boxer from Ramius, Jay Anderson from Feil, and Jonathan Estreich from Estreich & Co) remain, and with the addition of Richard Gorsky comprise the Investment committee. Richard Gorsky joined the firm in March 2003, and as Managing Director and Head of RCG Longview oversees all their investment related activities. The NYC headquartered RCG team is comprised of 17 investment professionals who source, structure, underwrite, close and service investments.

The table below summarizes the experience of RCG's investment committee:

| IC Members | Role with Affiliate/RCG | Yrs. Experience | Prior Experience |
|---|---|---|---|
| Jay Anderson | COO of Feil, CPA | 33 | Deloitte, W.R.Grace & Co |
| Michael Boxer | Partner and Head of Real Estate for Ramius | 23 | Victor Capital Group, Atty for Shea&Gold |
| Jonathan Estreich | Founder/President Estreich & Company | 33 | Nat'l Westminster Bank, Mellon Bank |
| Richard Gorsky | Managing Director, Head of RCG Longview, CPA | 20 | Belvedere Capital, Scott Cove Capital, Ernst & Young |

An Administrator, Citco Fund Administration Limited, will be hired to provide certain administrative, accounting, registrar and transfer agency services for the Fund.

## Investment Highlights:

| **Experience of the RCG Team** |
|---|
| Able to use in-house expertise to generate, evaluate, underwrite, structure and close potential transactions. Also, servicing, legal, accounting and asset management are primarily handled internally. Approximately 42% of the loans completed in Fund V were sourced from existing direct relationships. |
| **Market Knowledge** |
| Deep understanding of the markets and properties in which they invest. This experience is necessary to fully understand properties that are transitioning from one type to another. They have established deep relationships within the lending community and with borrowers as a consistent facilitator for "one-stop shopping" to arrange and secure debt needed for the most appropriate capital stack. The Sponsors are also deeply entrenched in their focus markets, especially NYC – providing a consistent, stable, long term source of knowledge and deals to the RCG team. |
| **Flexible Structuring and Ability to React Quickly** |
| Many times RCG is lender of choice due to their ability to accommodate tight time constraints of the borrowers. RCG works with Borrowers to solve problems through flexible structuring, while ensuring that the Fund's investments are properly collateralized. |
| **Track Record / Low Loss Ratio Since Inception** |
| Since inception in 1999 through December 31, 2015, RCG has invested over $3 B of capital on a gross basis, $1.4B net capital, in debt or debt-oriented transactions. These investments have achieved a since inception net IRR of 9% and net multiple of invested capital of 1.4x.<br>RCG invested two funds throughout the financial crisis, Funds III and IV. Fund III suffered a loan loss rate of 4.7%, but as of December 31, 2015 achieved a 7.3% net IRR and a 1.4x multiple on invested capital, with 97% of the investments realized to date. Fund IV, invested from 2007-2012, suffered from a loan loss rate of 2.1%, but has achieved a current inception to date net IRR of 6.54% and a net multiple of 1.3x, with 95% realized. |

## Investment / Risk Considerations:

| Competition and Supply |
|---|
| RCG's platform is differentiated due to their experienced team, local sourcing model, and niche expertise. Although the 'shadow banking' real estate debt markets have seen many new entrants over recent years, many of the lenders focus on much larger opportunities and have replaced the lack of capital from CMBS lenders. The average deal size in Fund V was $16M, which is much smaller than most of the institutional funds that have recently started investing in real estate debt. Fund VI will continue lending in the range of $5M to $25M per deal. |
| **Market Dislocation** |
| RCG has consistently displayed its ability to respond to changing market conditions. Since 1999, the team has originated investments that in the aggregate displayed appropriate risk/return profiles to withstand all market cycles. They have established an investment philosophy that they believe will achieve their business objectives during typical cycles of growing and softening markets, and that will not lose investor capital during turbulent periods. |
| **Possible Lack of Diversification** |
| RCG's proven area of strength has been with the broader NYC market. As one of the most resilient markets in the world, NYC downturns tend to be the least severe and rebound the most robustly. |
| **Subordination of Investments** |
| The typical RCG mezzanine loan would stand behind a first lien secured lender. However, RCG has established a strong track record with lenders who sign an inter-creditor agreement which allows for RCG to lead the efforts to resolve the asset, assume control over the asset, and /or prosecute its remedies to protect its position. |

## PSERS History & Performance:

PSERS previously committed to two RCG debt funds, multiple debt co-investments and one equity fund. The table below summarizes PSERS' investments and RCG performance as of December 31, 2015:

| Fund ($,M) | Portfolio | Vintage | Commitment | Contributions | Distributions | NAV | Net IRR | MOIC |
|---|---|---|---|---|---|---|---|---|
| RCG Debt Fund IV | RE | 2007 | 175.0 | 199.3 | 219.7 | 17.9 | 6.5% | 1.2x |
| RCG Debt Fund V | RE | 2013 | 75.0 | 57.8 | 9.5 | 59.9 | 10.9% | 1.2x |
| RCG Debt Co-inv | Co-invest | 2013 | 21.0 | 21.0 | 23.8 | 0 | 18.3% | 1.13x |
| **Total PSERS/RCG Debt Investments** | | | **271.0** | **278.1** | **252.9** | **77.7** | **7.2%** | **1.2x** |
| RCG Equity Fund | RE | 2006 | 125.0 | 90.3 | 73.7 | 48.2 | 5.5% | 1.4x |

## Finance Committee Disclosure:

| | |
|---|---|
| **Relationship with Courtland Partners, Ltd.:** | None Disclosed |
| **Introduction Source:** | Fund Sponsor |
| **Placement Agent:** | Ascalon Capital Managers-marketing and placement services for potential Australian investors |
| **PA Political Contributions:** | None Disclosed |
| **PA Presence:** | No |
| **Potential Conflicts:** | Beyond items discussed in the Courtland Recommendation we are not aware of RCG having any investment conflicts |
| **First Time Fund With PSERS:** | No |
| **PSERS Internal Alpha Committee Approval:** | May 9, 2016 |

## Oversight Responsibility:

| | | |
|---|---|---|
| **Investment Office:** | Charles J. Spiller | Deputy CIO, Non-Traditional Investments |
| | Laurann H. Stepp | Senior Portfolio Manager |
| **External Consultant:** | Courtland Partners, Ltd. | |

**127 PUBLIC SQUARE**
**SUITE 5050**
**CLEVELAND, OH 44114**

**TELEPHONE: (216) 522-0330**
**FAX: (216) 522-0331**
**www.courtland.com**

May 2, 2016

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

**Re: RCG Longview Debt Fund VI, L.P.**

Dear Trustees:

Courtland Partners, Ltd. ("Courtland"), having been duly authorized by the Board of PSERS, has evaluated RCG Longview Debt Fund VI, L.P. ("RCG Debt VI" or the "Fund"). The Fund's strategy is to seek to provide the limited partners of the Fund with "equity-like" net returns while taking only debt level risk by investing in debt and debt-like investments in real estate assets. Fund investments will generally take the form of whole loans, bridge first mortgages, B-Notes, participations, mezzanine loans, preferred equity, mortgage purchase financings and senior loans secured by existing mortgages.

The Fund will pursue an investment strategy that continues the strategy of five prior debt funds sponsored by RCG. The RCG Debt Funds have originated approximately $3.1 billion in loans, and established themselves as reliable providers of debt and debt-like solutions to borrowers who have limited access to more traditional financing sources, are under restrictive time constraints, require higher leverage than that which is available from conventional lenders, or are buying properties in a transitional state.

The average transaction size for the Fund is expected to be around $10 million to $15 million, focusing on making investments in the $5 million to $25 million range. There may be a few occasions when a potential transaction may be deemed too large for the Fund. In those cases, the Manager will seek co-investors, which may include the Fund's Limited Partners that have made the largest capital commitments to the Fund. The Manager typically makes loans ranging from 60%-85% loan to value. Mezzanine loans may be in the 75%-85% range and senior loans are at 50%-60% of the capital stack. The Fund intends to use only modest leverage, where prudent. While the Fund does not intend to utilize significant long-term leverage at the fund-level, the Fund may utilize such leverage to add efficiency to Fund operations, fund investments on an interim basis to accommodate tight timetables, and to further enhance investment returns where appropriate. The GP intends generally to limit the maximum aggregate indebtedness incurred by the Fund, on average over a fiscal year, to 35% of the fair value of the Fund's Assets.

RCG seeks to lend against real estate that it understands well, earn an acceptable all-in rate of return, and get repaid. It has a reputation and record as a provider of creative and flexible financing solutions. RCG Longview originates most of its investments by utilizing its in-house origination team and relying upon its vast relationship network.

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

- Detailed due diligence, including interviews with key RCG management team members, and review of all relevant materials provided by RCG.

- Evaluation of the Fund's proposed investment strategy within the context of the current investment environment.

- Evaluation of RCG'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 $75 million to the Fund. Courtland makes this recommendation considering RCG'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.**