PSERS PRIVATE INVESTMENT PROGRAM

Recommendation for Investment in
Avenue Asia Special Situations Fund IV, L.P.

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Avenue Asia Special Situations Fund IV, L.P.

EXECUTIVE SUMMARY

Avenue Asia Special Situations Fund IV, L.P., a Cayman Islands exempted limited partnership (the “Fund”), is being formed to make investments in the Asian Region in securities and assets that are undervalued (“Special Situations”). Investments are expected to include, without limitation, the securities or assets of companies that are: (i) undergoing restructuring, reorganization or bankruptcy; (ii) operationally sound, but financially troubled due to bad balance sheets, inadequate capitalization or poor access to capital; or (iii) otherwise being sold for less than their intrinsic value. Investments will be made in single securities and assets as well as in concentrated pools of securities and assets. Based on current market conditions, the Fund is expected initially to have a particular focus on China, India, the Philippines and Indonesia.

The Fund will be managed by Avenue Asia Capital Management, L.P. (“Avenue Asia” or the “Firm”), one of the most experienced investors in Asian distressed securities. Avenue Asia has one of the largest dedicated local teams focused on Asian Special Situations investments outside of Japan. The team comprises approximately 40 experienced investment professionals who operate out of offices in Beijing, Hong Kong, Shanghai, New Delhi, Manila, Jakarta, Bangkok and New York. Avenue Asia’s superior due diligence and sourcing capabilities differentiate it from its competitors, many of whom lack the Firm’s resources and/or local presence.

Compelling Asian Special Situations Investment Opportunity

Market conditions for investing in Asian Special Situations investments are highly compelling. The major Asian (ex-Japan) non-performing loan (“NPL”) markets are estimated at over $550 billion with China alone accounting for in excess of $400 billion. China’s current NPL market is presently the largest in Asia (ex-Japan), and, as shown in the chart below, is also larger than the total Asian (ex-Japan and ex-China) NPL market was immediately following the Asian economic crisis of 1997.

The sheer volume of NPLs has prompted many banks and governments to sell off a portion of their loans to third party investors. Many of these sellers are classified as non-economic sellers, meaning that their decision to sell NPLs is not driven primarily by the intrinsic value of the loans, but rather significantly influenced by considerations such as political or competitive pressure and/or the need for liquidity. Non-economic sellers are frequently willing to dispose of NPLs at a significant discount to their intrinsic value, creating attractive investment opportunities.

In addition to NPLs, the Asian Region presents a number of other substantial Special Situations investment opportunities. A variety of factors including structural and economic reform and poor access for many Asian companies to well-developed capital markets has led to a convergence of some parts of the distressed debt, equity and real estate markets in the Asian Region. This convergence has created numerous opportunities to acquire securities or assets at substantial discounts to their intrinsic value, often from distressed or non-economic sellers.

Sustainable Investment Strategy and Approach

The cornerstone of Avenue Asia’s approach is an unrelenting focus on thorough due diligence and analysis, which allows the Firm to maintain rigorous pricing discipline.

Focus on the Asian Region. The Fund will focus on the Asian Region, and the Firm expects that based on the current market conditions it will initially have a particular focus on China, India, the Philippines and Indonesia. Avenue Asia’s strategy is to carefully study each potential target market and to develop significant expertise and often a local presence prior to investing a substantial amount of capital in that market. Avenue Asia has achieved this in each of its primary target markets and has offices in Beijing, Hong Kong, Shanghai, New Delhi, Manila, Jakarta and Bangkok.

Target Securities or Assets Being Sold at a Discount by Non-Economic Sellers. Many situations targeted by Avenue Asia involve assets that are being sold by non-economic sellers for whom price alone is not the single most important motivating factor. Non-economic sellers are frequently willing to dispose of assets at significant discounts to their intrinsic value, thus creating attractive investment opportunities for firms capable of accurately analyzing and pricing these assets. The Asian Region provides a rich target environment, as broader structural, political, liquidity-related and economic objectives often play a major factor in sellers' pricing decisions. For example, China's major state-owned banks are under increasing pressure to improve their balance sheets and significantly reduce their NPLs in preparation for the entry of foreign banking competition into China in 2007 and for the listing of a number of these banks.

Generate Strong Deal Flow. Avenue Asia's strong local presence, superior due diligence and sourcing capabilities, and strategic relationships provide a substantial competitive advantage in generating deal flow. Each of the Firm's offices in the Asian Region is headed by one or more country managers local to that country and responsible for sourcing investment opportunities. The China team alone includes four dedicated sourcing professionals. In addition, Avenue Asia benefits from strategic relationships with two brokers of distressed product: Amroc Investments, LLC ("Amroc Investments"), which has offices in New York, and Amroc Investments Asia, Ltd. ("Amroc Asia"), which has offices in Tokyo, Singapore and Hong Kong. Finally, the Firm is often considered a preferred buyer as a result of its reputation, strong relationships and track record. These factors will provide the Fund with a significant number of attractive proprietary investment opportunities as well as a significant bidding advantage in those transactions that are subject to an auction process.

Conduct Rigorous Proprietary Analysis. Avenue Asia has due diligence and sourcing capabilities differentiate it from its competitors. Few competitors have the local resources to conduct extensive due diligence internally, and are therefore significantly more reliant on third party service providers. Avenue Asia favors conducting its due diligence internally because third party service providers often may be less incentivized than, or have divergent interests from, the Firm's own professionals. This approach has allowed the Firm to develop a cumulative stock of knowledge and experience, which is vital to its investment success. The breadth and experience of Avenue Asia's team also allows the Firm to evaluate a broader range of opportunities that many competitors do not have the internal resources to adequately analyze.

Focus on Concentrated Pools of Assets and Single Assets. Prior to making an investment decision, Avenue Asia dedicates considerable time and resources to accurately assessing the intrinsic value of the asset(s) under consideration. This approach is consistent with Avenue Asia's commitment to extensive due diligence and rigorous fundamental analysis, and reduces the risk of loss on investments. As a result, the Firm has a strong preference for single assets and concentrated pools of assets in which a relatively small percentage of the underlying assets constitutes a large proportion of the aggregate portfolio value.

Leverage Multiple Exit Strategies. Avenue Asia spends considerable time developing exit strategies for each investment opportunity before completing an acquisition. An important element of this planning involves an analysis of the company's ability to repay Avenue Asia's investment through operating cash flow. Historically, a significant portion of the Firm's investments has been exited through principal payments and debt buy-backs. Avenue Asia expects a large number of the Fund's non-performing loans investments to be exited in this manner, thus expanding the Firm's exit options beyond traditional sales and IPO exits. Avenue Asia also has experience exiting investments through market sales, out-of-court foreclosures, court sanctioned settlements, negotiated discounted pay-offs, financial restructurings, debt-to-equity conversions, third party loan sales, asset swaps and guarantor repayments, and expects these methods to be an integral part of the Fund's exit strategy.

Maintain Flexible Investment Approach. The Fund will employ a flexible approach to making and structuring its investments. This approach is expected to allow the Fund to participate at the appropriate time and in the appropriate security type for each individual investment in order to maximize potential return while minimizing principal risk. As a result, investments will include, but not be limited to, senior secured and unsecured debt, subordinated debt, bank debt, debt secured by real estate, convertible securities, and preferred and common stock or common stock equivalents.

Stable, Experienced Leadership. The Avenue Asia team has been led since inception by Malcolm Robinson, Avenue Asia's Senior Portfolio Manager, Marc Lasry, Avenue Capital's Managing Partner, and Sonia Gardner, Avenue Capital's Partner and General Counsel (collectively, the "Senior Principals"). Mr. Robinson has over 18 years of relevant investment experience, and has been actively investing in Asian distressed securities for approximately 12 years. Mr. Lasry is a pioneer of the distressed debt market. Mr. Lasry and Ms. Gardner are the co-founders of Avenue Capital, Amroc Investments and Amroc Asia, and have 21 and 19 years of experience in the distressed industry, respectively.

One of the Largest Local Teams Focused on Asian Special Situations Investments outside of Japan. The Avenue Asia team is comprised of approximately 40 experienced investment professionals who are dedicated to Asia. Avenue Asia's China team includes professionals who have worked on most of the major Chinese non-performing loan transactions to date. The scale and experience of the team allow Avenue Asia to conduct extensive due diligence internally, making the Firm less reliant on third party service providers when sourcing and analyzing investment opportunities. This factor provides Avenue Asia with a significant competitive advantage throughout all phases of the investment process, from sourcing to exit.

Local Presence. Avenue Asia has offices in the following cities in the Asian Region: Beijing, Hong Kong, Shanghai, New Delhi, Manila, Jakarta and Bangkok. Each of these offices is staffed primarily by professionals, including one or more country managers, who are native to the target market and who have strong local networks and investment experience.

Multidisciplinary Skill Sets. The Avenue Asia team has been carefully selected to ensure that its members together possess the necessary skill sets to successfully execute Asian Special Situations investments. Avenue Asia's professionals have extensive experience analyzing investments across all layers of the capital structure and in distressed debt, restructurings, private equity, real estate and collections.

Strategic Sourcing Relationships. Avenue Asia benefits from strategic relationships with two brokers of distressed product: Amroc Investments, which has offices in New York, and Amroc Asia, which has offices in Tokyo, Singapore and Hong Kong. Amroc Investments is an affiliate of Avenue Capital and is owned and controlled by Marc Lasry and Sonia Gardner. Mr. Lasry and Ms. Gardner sold Amroc Asia in May 2003 to its management team. As part of the sale, Amroc Asia and Avenue Asia entered into an arrangement whereby Avenue Asia has a right of first refusal on all distressed product sourced by Amroc Asia. Avenue Asia will have priority access to proprietary deal flow and pricing intelligence provided by Amroc Asia, which is expected to provide the Fund with a powerful competitive advantage.

INVESTMENT STRATEGY

The Fund is being formed to make investments in the Asian Region in securities and assets that are undervalued ("Special Situations"). Investments are expected to include, without limitation, the securities or assets of companies that are: (i) undergoing restructuring, reorganization or bankruptcy; (ii) operationally sound, but financially troubled due to bad balance sheets, inadequate capitalization or poor access to capital; or (iii) otherwise being sold for less than their intrinsic value. Investments will be made in single securities and assets as well as in concentrated pools of securities and assets. Based on current market conditions, the Fund is expected initially to have a particular focus on China, India, the Philippines and Indonesia.

The Fund will employ a flexible approach to making and structuring its investments. This approach is expected to allow the Fund to participate at the appropriate time and in the appropriate security type for each individual investment in order to maximize potential return while minimizing principal risk. As a result, investments will include, but not be limited to, senior secured and unsecured debt, subordinated debt, bank debt, debt secured by real estate, convertible securities, and preferred and common stock or common stock equivalents.

The cornerstone of Avenue Asia's approach is an unrelenting focus on thorough due diligence and analysis, which allows the Firm to maintain rigorous pricing discipline. The core elements of the Fund's investment strategy are set forth below:

Target Securities or Assets Being Sold at a Discount by Non-Economic Sellers. Many situations targeted by Avenue Asia involve assets that are being sold by non-economic sellers for whom price alone is not the single most important motivating factor.

Non-economic sellers are frequently willing to dispose of assets at significant discounts to their intrinsic value, thus creating attractive investment opportunities for firms capable of accurately analyzing and pricing these assets. The Asian Region provides a rich target environment, as broader structural, political, liquidity-related and economic objectives often play a major factor in sellers' pricing decisions. For example, China's major state-owned banks are under increasing pressure to improve their balance sheets and significantly reduce their non-performing loans in preparation for the entry of foreign banking competition into China in 2007 and for the listing of a number of these banks.

Focus on Concentrated Pools of Assets and Single Assets. Prior to making an investment decision, Avenue Asia dedicates considerable time and resources to accurately assessing the intrinsic value of the asset(s) under consideration. This approach is consistent with Avenue Asia's commitment to extensive due diligence and rigorous fundamental analysis, and reduces the risk of loss on investments. As a result, the Firm has a strong preference for single assets and concentrated pools of assets in which a relatively small percentage of the underlying assets constitutes a large proportion of the aggregate portfolio value.

Generate Strong Deal Flow. Avenue Asia has several competitive advantages that allow the Firm to source attractive investment opportunities in each of its primary target markets:

- **Extensive Asian investment experience and established reputation.** Malcolm Robinson, Avenue Asia's Senior Portfolio Manager, has been investing in Asia since 1994, and Avenue Asia has one of the largest dedicated local teams focused on Asian Special Situations investments outside of Japan. The Firm's superior sourcing capabilities and considerable investment experience in Asia often allows it to learn of investment opportunities in advance of the broader public, to identify many proprietary, non-competitive opportunities, and to begin due diligence in advance of other potential buyers in competitive situations. In addition, Avenue Asia is considered a preferred buyer as a result of its reputation, strong relationships and track record.
- **Strong local networks.** Each of the Firm's offices in the Asian Region is headed by one or more country managers local to that country and responsible for sourcing

investment opportunities. The China team alone includes four dedicated sourcing professionals. Avenue Asia has investment professionals, and in particular country managers, who are fluent in the local language(s), familiar with local customs, and who generally have strong local contacts, provides the Firm with a significant competitive advantage when sourcing investment opportunities.

Investment Process

Avenue Asia employs a rigorous investment process, which creates value through proactive proprietary sourcing, intensive analysis, opportune execution and disciplined portfolio monitoring and management. This investment process allows Avenue Asia to capitalize on Special Situations investments in Asia while at the same time minimizing investment risk. Avenue Asia employs a disciplined four-pronged approach to investing: (i) screening of potential investment opportunities; (ii) comprehensive due diligence and rigorous fundamental analysis; (iii) active portfolio management; and (iv) opportune exits. This approach is described in further detail.

(i) Screening of Potential Investment Opportunities

Avenue Asia employs a disciplined investment methodology, which begins with the screening of each investment opportunity sourced by the Fund's country managers and by its other dedicated sourcing specialists. Malcolm Robinson, the Fund's Senior Portfolio Manager, leverages his considerable experience investing in Asian Special Situations investments to analyze each opportunity, and to determine whether it warrants further consideration. If the Firm decides to proceed with a particular opportunity, then extensive due diligence begins.

(ii) Comprehensive Due Diligence and Rigorous Fundamental Analysis

Avenue Asia has one of the largest and most experienced local due diligence teams focused on Asian Special Situations investments outside of Japan. The team is comprised of experienced professionals with the multi-disciplinary backgrounds and skill sets necessary to successfully execute Asian Special Situations investments. Avenue Asia's professionals have extensive experience analyzing investments across all layers of the capital structure and in distressed debt, restructurings, private equity, real estate and collections. Avenue Asia's due diligence process seeks to uncover hidden value and/or risk, thereby reducing the risk of loss on investments.

(iii) Active Portfolio Management

Investment timing with regard to the purchase and sale of a given asset or security can significantly affect value. Avenue Asia seeks to anticipate market reactions, buy early based on its rigorous analysis, and exit investments at the opportune moment in each cycle. While the Firm's objective is to earn a strong rate of return relative to the risk assumed, it is equally concerned with the preservation of capital. This philosophy results in the continuous monitoring of investments. Avenue Asia often takes a pro-active role in its investments via membership on creditor committees, advisory committees and boards of directors. The Firm also maintains a regular dialogue with its investee companies, and conducts a thorough analysis of all portfolio company financials.

(iv) Opportune Exits

Avenue Asia spends considerable time developing exit strategies for each investment opportunity before completing an acquisition. An important element of this planning involves an analysis of the company's ability to repay Avenue Asia's investment through operating cash flow. Historically, a significant portion of the Firm's investments has been exited through principal payments and debt buy-backs. Avenue Asia expects a large number of the Fund's non-performing loan ("NPL") investments to be exited in this manner, thus expanding the Firm's exit options beyond traditional sales and IPO exits. The firm's extensive due diligence and to closely manage the NPL collection process internally gives the Firm a significant advantage during the collection process. During due diligence, Avenue Asia becomes intimately familiar with the debtor and is therefore better positioned to maximize value. Avenue Asia also has experience exiting investments through market sales, out-of-court foreclosures, court sanctioned settlements, negotiated discounted pay-offs, financial restructurings, debt-to-equity conversions, third party loan sales, asset swaps and guarantor repayments, and expects these methods to be an integral part of the Fund's exit strategy.

INVESTMENT OPPORTUNITY

Asian Non-Performing Loans

The major Asian (ex-Japan) NPL markets are estimated at over $550 billion with China alone accounting for greater than $400 billion. China's current NPL market is presently the largest in Asia (ex-Japan) and is also larger than the total Asian (ex-Japan and ex-China) NPL market was immediately following the Asian economic crisis of 1997. China, India and the Philippines have made little progress in substantially reducing the number of NPLs within their financial systems. Other countries, including Indonesia and Thailand, have made some progress in resolving their NPL situations, yet a considerable number of NPLs remain in these countries. Moreover, aggressive lending policies in countries such as China have created a significant number of new NPLs.

The sheer volume of NPLs has prompted many Asian banks and governments to sell off a portion of their loans to third party investors. Sellers of Asian distressed debt can be categorized into three groups: (i) local and foreign banks that originated the loans; (ii) local governments that acquired the loans through closed-down or nationalized banks; and (iii) asset management or reconstruction companies established by Asian governments to combat the NPL problem and help banks restore liquidity. Many of these sellers are classified as non-economic sellers, meaning that their decision to sell NPLs is not driven primarily by the intrinsic value of the loans, but rather significantly influenced by considerations such as political or competitive pressure and/or the need for liquidity. For example, China's major state-owned banks are under increasing pressure to improve their balance sheets and significantly reduce their NPLs in preparation for the entry of foreign banking competition into China in 2007 and for the listing of a number of these banks. Non-economic sellers are frequently willing to dispose of NPLs at a significant discount to their intrinsic value, creating attractive investment opportunities.

Other Special Situations Investment Opportunities

In addition to NPLs, the Asian Region presents a substantial number of other Special Situations investment opportunities. A variety of factors including structural and economic reform and poor access for many companies to well-developed capital markets has led to a convergence of some parts of the distressed debt, equity and real estate markets in the Asian Region. This convergence has created numerous opportunities to acquire securities or assets at substantial discounts to their intrinsic value, often from distressed or non-economic sellers. Examples of non-NPL Special Situations investment opportunities include the following:

- **Distressed debt as an entry point for acquiring equity and other assets.** Distressed debt has increasingly become an advantageous entry point for equity and real estate-related investments. As debtors restructure, they often sell non-core assets (e.g. equity holdings in subsidiaries and real estate assets) and/or require equity capital. As a holder of a company's NPLs, Avenue Asia is often in an advantageous position to purchase assets at a discounted price for cash or through a debt-for-asset swap, or to acquire equity either for cash or by converting debt to equity.

- **Opportunities resulting from substantial economic and structural reform.** Substantial economic and structural reform has created a number of attractive Special Situations investment opportunities across the Asian Region. These opportunities include, but are not limited to, acquisitions of significantly discounted shares of corporations in connection with governmental privatization efforts and corporate restructurings, and private investments in concessions or build-operate-transfer arrangements (contractual arrangements undertaken to construct, finance, operate and maintain a given infrastructure facility for a fixed term).
- **Operationally sound companies with limited access to capital.** Avenue Asia has identified a large number of public and private Asian companies with strong operations that are poorly capitalized due to limited access to developed, sophisticated capital markets. These companies are often unable to obtain appropriately structured financing to meet their business objectives. In combination with high capital costs, this situation has created an opportunity for Avenue Asia to provide capital, either in an initial financing or in a refinancing, using creative structures that meet the needs of the underlying company while simultaneously generating highly attractive returns for Avenue Asia's investors.

REGIONAL OPPORTUNITIES

The Fund will focus on the Asian Region, and the Firm expects that based on current market conditions it will initially have a particular focus on China, India, the Philippines and Indonesia. The potential investment opportunities in each of these countries are described in greater detail below.

China

Avenue Asia has been studying the Chinese Special Situations market for over six years. Recognizing the potential investment opportunities in China, Avenue Asia opened an office in Beijing in early 2003, and Malcolm Robinson, the Firm's Senior Portfolio Manager, moved there in January 2004. Avenue Asia's Beijing-based team of over 20 investment professionals is the one of the largest and most experienced teams dedicated to Special Situations investments in China. The team includes professionals who have worked on most of the major Chinese NPL transactions to date.

Market Overview

China is an extremely attractive target market for Special Situations investments as a result of both its scale and the substantial structural and economic changes currently being undertaken by the Chinese government. Recent reforms have led to a number of attractive opportunities to acquire securities or assets at substantial discounts to their intrinsic value, often from distressed or non-economic sellers.

Size of the Chinese NPL Market

China's current NPL market is presently the largest in Asia (ex-Japan) with in excess of $400 billion of NPLs and is also larger than the total Asian (ex-Japan and ex-China) NPL market was immediately following the Asian economic crisis of 1997. As of year-end 2004, China's NPL market was equivalent to approximately 24% of China's 2004 GDP and exceeded its aggregate stock market capitalization by approximately 30%.

Origin of the Current China NPL Market

The origin of China's NPL market can be traced back to the policy of directed lending in the 1980s and 1990s by China's state-owned commercial banks (SOCBs) to state-owned enterprises (SOEs). China's banks were overstaffed, under-capitalized and heavily reliant on government support. Consequently less importance was attributed to the recovery of loans than would be expected in a normal commercial banking system. Furthermore, the market was closed to foreign competition, which yielded little incentive for change. This environment created ideal conditions for generating NPLs. Following the Asian financial crisis of 1997, the Chinese government recognized that its NPL level posed unacceptable risks to the continued growth of the national economy. China responded by restructuring its four SOCBs in 1999 in order to separate a substantial number of NPLs from the ongoing operations of these banks.

Asset Management Companies

As part of the restructuring in 1999, four asset management companies (AMCs) were created (one for each bank) to which NPLs were transferred. A fifth AMC, Huida Asset Trust Company ("Huida"), was created in 2005 to serve as the AMC for the People's Bank of China. The 1999 transfers consisted of approximately $170 billion in loans (approximately 20% of the gross loan book of the four SOCBs), of which $83 billion is still held by the four original AMCs. An additional $154 billion of NPLs were transferred to the AMCs in 2004 and 2005.

Substantial Number of Additional NPL Holders

While the SOCBs and AMCs hold the majority of China's NPLs, there are hundreds of other holders of NPLs in China. These include various financial institutions, comprising private banks, commercial city banks and the International Trust and Investment Corporation, as well as foreign banks, provincial governments, metropolitan governments, and large SOEs. Currently, local banks are unable to sell NPLs directly to third parties, and are instead required to sell directly to the AMCs. This is likely to change over the Fund's investment period as Chinese banks attempt to conform to international banking standards. These additional sellers will provide an attractive source of less competitive transactions, because many potential NPL investors do not have the resources that are necessary to source and conduct due diligence on these smaller transactions.

Increased Pace of Disposals

Avenue Asia expects the pace of NPL disposals to increase significantly over the Fund's investment period as a result of the following factors:

- **Simplification of the NPL Disposal Process.** In 2004, the National Development and Reform Commission ("NDRC") simplified the NPL disposal process for international investors by requiring that direct sales to offshore entities be registered with only the NDRC and the State Administration of Foreign Exchange ("SAFE"), as opposed to with numerous government agencies whose approval was formerly required.

- **Acceleration of the Deadline for NPL Disposal by the AMCs.** Upon their creation in 1999, China's four largest AMCs acquired NPLs totaling $170 billion from China's SOCBs, and were given a mandate to dispose of their entire NPL portfolios by 2009. Official numbers indicate that after almost six years, the AMCs have resolved only 55% of these NPLs.

  Recently, the AMCs have come under increasing political pressure to dispose of the remaining $83 billion of 1999 NPLs by the end of 2006. An additional $154 billion of

NPLs were transferred to the AMCs in 2004 and 2005. The AMCs are required to dispose of the 2004 and 2005 NPLs by the end of 2007, a significantly shorter window than was provided for the 1999 transfers. In addition to increasing the supply of NPLs available for purchase, the 2004 and 2005 transfers will lead to a faster pace of disposals. The AMCs were created for the sole purpose of disposing of China's NPLs. Prior to the 2004 and 2005 NPL transfers, the official position of the Chinese government was that the NPL problem of the four SOCBs had been resolved, and, therefore, that the original AMCs would not receive any further NPLs. Thus, once the 1999 NPLs were resolved, the AMCs would have lost their raison d'être. Recently, this dynamic had caused some AMCs to be reluctant to rapidly dispose of NPLs, and that the additional transfers in 2004 and 2005 have mitigated this issue.

- **Banking Reform has Become One of the Chinese Government's Top Priorities.** Due to poorly developed capital markets, China's banking system still provides Chinese businesses with 90% of their funding. Financial reform is therefore necessary to drive continued economic growth, and is considered the main focus of structural policy. In addition, per the terms of China's accession agreement with the World Trade Organization, Chinese banks will become subject to unfettered competition from foreign banks in 2007. Chinese banks are therefore in need of both substantial capital injections as well as foreign expertise and modern management practices to remain competitive and to prepare for overseas stock market listings. In order to achieve these goals, Chinese banks need to improve their balance sheets and rapidly resolve their NPL situations.

Other Special Situations Investment Opportunities

A combination of structural and economic reform, rapid growth and poorly developed capital markets has led to the creation of a substantial number of non-NPL related Special Situations investment opportunities in China. These opportunities include, but are not limited to, purchases of assets or equity in connection with an NPL investment, acquisitions of significantly discounted shares of corporations in connection with governmental privatization efforts and corporate restructurings, and creative financing structures designed to meet the needs of operationally sound companies with limited access to capital.

For example, in early 2005, the China Securities and Regulatory Committee ("CSRC") took a significant step towards adopting international standards with respect to ownership structure, corporate governance and professional management. The CSRC announced a pilot program aimed at unlocking state holdings through the conversion of non-tradable shares ("NTS") held by the Chinese government, state-owned entities, and other shareholders into tradable shares. At present, these NTS are valued at approximately $285 billion and account for nearly two-thirds of the equity of approximately 1,400 companies listed on the Shanghai and Shenzhen stock exchanges. The NTS opportunity may be compelling due to the fact that the State is a non-economic seller for whom an important motivation behind divesting its holdings is a desire to achieve long-term economic and structural reform objectives. Also, many other current NTS shareholders are themselves under financial duress.

In addition, recent market reforms in China have led to a rapid increase in the number of privately-owned companies. Many of these companies require capital to fund their growth. However, viable bank financing is often not widely available, because loans tend to be inappropriately structured and/or the cost of capital is prohibitively high. This makes it difficult and expensive for even established companies with strong cash flows to obtain long-term financing from banks, resulting in a favorable pricing environment for sophisticated providers of flexible capital such as Avenue Asia.

India

Avenue Asia has monitored the Special Situations market in India for over two years. During this period, the Firm has maintained a close dialogue with a leading team of Indian Special Situations professionals who were ultimately hired by Avenue Asia to establish its India office.

India is the fourth largest NPL market in Asia after Japan, China and Korea, with an estimated $30 billion of NPLs as of December 2004. This was equivalent to approximately 4% of India's 2004 GDP. Given the discretionary manner in which banks apply the NPL classification in India, these numbers can be significantly understated. A large portion of India's NPLs is secured by fixed assets such as property, plants and machinery. The primary sellers are state-owned commercial banks, financial institutions, domestic private banks, foreign banks and Asset Reconstruction Companies ("ARCs").

The Indian government has taken a number of steps towards addressing its NPL problem. Prior to legal reforms implemented in 2002, debt recovery in India was problematic, mainly due to the country's protracted legal process. The inability to recover debt in a timely manner was a major deterrent to investors. In an effort to resolve the problem, the Indian government passed an act in 2002 entitled the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (the "SARFAESI Act"), which aids secured creditors in enforcing security interests by foreclosing and selling underlying assets without court intervention. The SARFAESI Act, which was subsequently affirmed as constitutional by the Indian Supreme Court, also created an enabling environment for ARCs. Two ARCs have been established to date: (i) Asset Reconstruction Company (India) Limited ("ARCIL") established in 2003 by the State Bank of India, ICICI Bank and the Industrial Development Bank (the three largest lenders in India) and (ii) the Asset Care Enterprise. Several more ARCs are awaiting approval from the Reserve Bank of India ("RBI").

The RBI has also put in place a Corporate Debt Restructuring ("CDR") system to provide a framework for banks and financial institutions to restructure their NPLs. While the CDR process was primarily created to benefit banks, it also represents an opportunity for ARCs and NPL investors. In the past, the CDR process has allowed banks to avoid taking write-offs by increasing their loan repayment periods. Many banks are now looking at options to liquidate these long tenure loans to investors and/or ARCs. Since its inception in March 2002, CDR has produced 94 restructurings involving aggregate debt of approximately $14.2 billion.

India's nascent NPL market has recently begun to emerge, partially as a result of guidelines issued by the RBI to facilitate banks' NPL disposal efforts. These guidelines allow banks to sell NPLs to buyers other than ARCs and set terms on which loan transfers can be made. As a result, the general willingness of banks to sell or resolve their NPLs has increased.

The Indian government continues to make structural improvements that should result in increased activity for investors in distressed securities, and, based on its recent experience, opportunities will be of a higher quality than were available in the past. With the Indian economy poised for a long period of strong growth, there is an increased emphasis by the RBI on the improvement of asset quality and capital adequacy in order to attract fresh capital to India's banking sector.

In addition to the compelling NPL opportunity outlined above, India represents an attractive environment for non-NPL Special Situations investments due to a variety of factors including structural and economic reform and poor access for many companies to well-developed capital markets. There are currently a large number of operationally sound companies in India that require capital to fund their growth. However, viable bank financing is often not widely available, because loans tend to be inappropriately structured and the cost of capital is often high. This makes it difficult and expensive for even established companies with strong cash flows to obtain long-term financing from banks, resulting in a favorable pricing environment for sophisticated providers of flexible capital such as Avenue Asia. In addition, the universe of Indian publicly listed companies that are not traded or are traded infrequently on the stock exchange is large. This high level of illiquidity makes it difficult for many Indian companies to raise capital through the public markets to fund their growth. This dynamic may provide the Fund with an attractive opportunity to acquire the shares of these companies at less than their intrinsic value from non-economic sellers.

The Philippines

Avenue Asia's Manila-based team is one of the largest groups focused on Special Situations investments in the Philippines. The Firm expects this market to provide the Fund with a continuous flow of attractive investment opportunities.

As of December 2004, NPLs within the Philippine banking sector were estimated at approximately $9 billion. This was equivalent to approximately 10% of 2004 GDP. Little progress has been made in substantially reducing the number of NPLs in the Philippines when compared to a number of other Southeast Asian markets, thus creating a sizeable investment opportunity for the Fund.

The Asian financial crisis of 1997 did not have as severe an effect on the Philippines as it did on neighboring countries. In part, this was due to financial reform pursued by the government during the period leading up to the crisis, a short concurrent period of increased GDP growth, the country's limited access to foreign debt, and, consequently, a relatively low level of total leverage in the banking system relative to GDP at the start of the crisis.

Although the Philippine banking sector faired relatively well during the Asian crisis, it was not spared from currency depreciation and higher interest rates both during and after the crisis. This led to a steady deterioration in the health and asset quality of the Philippine banking sector between 1997 and 2002, the insolvency of a number of domestic banks and an increase in the level of NPLs. While other nations affected by the financial crisis quickly implemented policy measures to reduce their NPL levels, the Philippine government adopted a largely passive stance and exerted little pressure on domestic banks to dispose of their NPLs.

Recognizing the importance of foreign investment in stimulating growth and driving reform of the country's financial system, the Philippine government recently enacted laws and provided fiscal incentives aimed at reducing the number of NPLs. Two laws have been passed to date to facilitate the resolution of NPLs. The first, the Special Purpose Vehicle Act of 2003 (the "SPV Act"), provides tax exemptions and fee privileges for the primary holders of NPLs to dispose of them by April 2005. It also allows banks to amortize losses related to their NPLs. The second, the Securitization Act of 2004, implemented a framework for the securitization of NPLs. The Philippine central bank, Bangko Sentral ng Philipinas, has also proposed more strict regulations in terms of the restructuring of loans, a redefinition of NPLs to more accurately reflect international standards, general loan loss provision requirements and higher specific provisions for classified loans.

Following the implementation of these measures, the pace of NPL sales increased in the latter half of 2004 and 2005, with six major transactions amounting to $690 million taking place during this period, as banks have attempted to take advantage of the financial benefits associated with the SPV Act. Two bills have now been proposed to extend the deadline mandated by the SPV Act. The Bankers Association of the Philippines estimates that an extension of this deadline would lead to the disposal of approximately $3.7 billion of NPLs by the country's 42 largest banks over the next two years. The proposed changes to banks' capital provision requirements outlined above would likely lead to a further increase in deal flow, particularly given the attractive characteristics of the Philippine distressed market, which include a relatively transparent legal framework and the increasing availability of ancillary services. Banks that are expected to dispose of NPLs and foreclosed assets in 2006 include Philippine National Bank, Development Bank of the Philippines, Metropolitan Bank and Trust Company, United Coconut Planters Bank, Equitable PCI Bank, China Banking Corporation, Land Bank of the Philippines, Bank of Commerce, and Manila Banking Corporation.

The Philippines represents a number of other Special Situations investment opportunities of the nature described previously in this section. For example, debt-for-asset swaps occur frequently in the Philippines, as debtors look to reduce debt by disposing of non-core businesses or assets received from their shareholders, affiliates or guarantors. As a holder of a company's NPLs, it is often in an extremely advantageous position to purchase assets at a discounted price for cash or through a debt-for-asset swap, or to acquire equity either for cash or by converting debt to equity.

Indonesia

Avenue Asia has been an active investor in Indonesia since 2000 when it opened its Jakarta office. As of December 2004, the Indonesian NPL market was estimated at approximately $22 billion, which was equivalent to approximately 9% of Indonesia's 2004 GDP. Although the Indonesian government has achieved a degree of success in reducing the size of the country's NPL market, Indonesia will continue to be an attractive market for the Fund.

Indonesia was severely affected by the Asian economic crisis of 1997, which subsequently led to the insolvency of many of the country's banks and to substantial defaults on high-yield corporate bonds and loans issued prior to the crisis. In 1998, in an attempt to rehabilitate the banks and recover bank assets, the Indonesian government formed the Indonesian Bank Restructuring Agency ("IBRA") to take over and control financially distressed banks and dispose of their NPLs.

Following its formation, IBRA closed 78 of the private and state-owned banks operating in Indonesia prior to the crisis. IBRA ceased operations in February 2004, and a new state-owned asset management company, Perusahaan Pengelola Asset, was assigned the task of managing and disposing of IBRA's remaining state-owned assets.

Several factors, including high interest rates, and a recent surge in loan growth and in corporate bond issuance will provide the Fund with a number of attractive investment opportunities. In addition, given the relaxed lending criteria inherent in the Indonesian banking system at the time of the Asian economic crisis, major shareholders of debtors in default were often able to borrow additional funds to buy back the debt from Indonesian banks and from IBRA. The loans made to these shareholders often had high interest rates and short maturities. As a result, some of these loans have already defaulted and Avenue Asia expects further defaults to occur over the Fund's investment period.

Other Special Situations Investment Opportunities in the Asian Region

In addition to China, India, the Philippines and Indonesia, Avenue Asia expects to see continued investment opportunities in several other countries in the Asian Region. For example, the Firm has historically made a number of successful investments in Thailand, and expects to continue to make select investments there despite the maturity of Thailand's NPL market. The Firm is also currently studying a number of additional markets in the Asian Region that may generate attractive investment opportunities over the Fund's investment period.

SENIOR MANAGEMENT

Marc Lasry is based in New York and is one of the pioneers of the distressed debt market, which has been the exclusive focus of his professional career over the last 21 years. Mr. Lasry is a Founder and Managing Partner of Avenue Capital Group, which currently has approximately $8.5 billion under management. He is also the founder of Amroc Investments and Amroc Asia. Prior to operating Amroc Investments as an independent entity, Mr. Lasry managed capital in excess of $100 million for Amroc Investments, L.P. Mr. Lasry and Amroc Investments were affiliated with Acadia Partners L.P., an investment partnership whose general partners include Keystone, Inc. (an investment firm that was associated with the Robert M. Bass Group, Inc.), American Express Company and the Equitable Life Assurance Society of America. From 1988 to 1990, Mr. Lasry was Co-Director of the Bankruptcy and Corporate Reorganization Department at Cowen & Company. Prior to that time, he served as Director of the Private Debt Department at Smith Vasiliou Management Company. Mr. Lasry also clerked for the Honorable Edward Ryan, former Chief Bankruptcy Judge of the Southern District of New York. Mr. Lasry received a B.A. in History from Clark University (1981) and a J.D. from New York Law School (1984).

Sonia Gardner is based in New York and is a Founder and Partner of Avenue Capital Group. Distressed investing has been the focus of her professional career over the last 19 years. She is also a founder of Amroc Investments and Amroc Asia. From 1991 to 1997, Ms. Gardner was also a Senior Portfolio Manager responsible for the Trade Claims Investment Pool at Amroc. From 1989 to 1991, Ms. Gardner was a Managing Director and General Counsel of Amroc Investments, L.P., the predecessor firm affiliated with the Robert Bass Group, Inc. Previously, Ms. Gardner served as Senior Attorney and Director of the Trade Claims Department at Cowen & Company. She was also associated with Barst, Mukarnel & Babbit, a New York law firm specializing in bankruptcy and immigration law.

Ms. Gardner has been active in the review and trading of the claims of hundreds of bankruptcies. Ms. Gardner is also a frequent guest speaker at industry trade credit groups. Ms. Gardner received a B.A. with Honors in Philosophy from Clark University (1983) and a J.D. from the Cardozo School of Law (1986).

Malcolm Robinson is based in Beijing and is the Managing Director and Senior Portfolio Manager of Avenue Asia. Mr. Robinson is responsible for directing the investment activities of the Avenue Asia funds. From 1996 to 1998, Mr. Robinson worked for Richmond Parly Investment Company, a Hong Kong based investment company that invests in the private and public equity and distressed debt obligations of Asian companies, where he last served as Chief Investment Officer. From 1994 to 1996, Mr. Robinson was a Vice President and served as a portfolio manager at The Pacific Group, a large Hong Kong based hedge fund that was partially owned by the U.S. based Tiger Management Corporation. Prior to that, Mr. Robinson was with the Prudential Investment Corporation ("Prudential"), the investment arm of The Prudential Life Insurance Company of America. During his seven years at Prudential, Mr. Robinson was involved in over $600 million of investments while working in the Private Placement Group of Prudential and the Merchant Banking/LBO Group of PruBache, Prudential's investment banking subsidiary. Mr. Robinson received a B.S. in Business Administration with Honors from Florida A&M University (1987) and an M.B.A. from The Wharton School, University of Pennsylvania (1994).

Campbell Korff is based in Hong Kong and is a Managing Director and the Head of Legal - Asia for Avenue Asia. Before joining Avenue Asia, Mr. Korff worked at Clifford Chance, where he was a partner and the joint head of the firm's Asia Restructuring and Insolvency Group, and focused on large corporate bankruptcies in the region and the growing Asia distressed debt market. Mr. Korff worked on numerous landmark deals with clients including Avenue Capital, Citigroup and Deutsche Bank. Prior to that, Mr. Korff worked at Minter Ellison, where he specialized in large scale financial services litigation, bankruptcy and restructuring. Mr. Korff received a Bachelor of Law from the University of Technology in Sydney, Australia (1995) and was admitted as a solicitor in that same year.

Eduardo Gana is based in Manila and is the Philippines Country Manager for Avenue Asia. Prior to joining Avenue Asia, Mr. Gana was a Vice President for AIG Global Investments Corp. (Asia) Ltd., where he was responsible for monitoring direct investment portfolios in Asia and for originating investments in the Philippines. Before that, he was a Vice President of The Pacific Group, a large Hong Kong based hedge fund that was partially owned by the U.S. based Tiger Management Corporation. Prior to that, Mr. Gana worked in the Investments Division of Philippine American Life & General Insurance Company, and before that in corporate finance at PaineWebber Inc. Mr. Gana received a B.S. in Industrial Management Engineering with Honors from De La Salle University in Manila, Philippines (1977) and an M.B.A. with distinction from The Wharton School, University of Pennsylvania (1987).

Eric Hui is based in Beijing and is a China Country Manager for Avenue Asia. Prior to joining Avenue Asia, Mr. Hui was an Investment Manager for ABN AMRO Asia Capital Investment Ltd., where he made private equity investments in the Greater China region, Thailand, the Philippines, Australia, Sri Lanka and Korea. Previously, Mr. Hui was a Research Analyst at The Pacific Group, a large Hong Kong based hedge fund that was partially owned by the U.S. based Tiger Management Corporation, where he focused on Asian equities, debt and currencies.

Mr. Hui received a Bachelor of Mathematics (Actuarial Science) with Honors from the University of Waterloo (1994) and is holder of the Chartered Financial Analyst designation (1999).

Annat Jain is based in New Delhi and is the India Country Manager for Avenue Asia. Prior to joining Avenue Asia, Mr. Jain founded Payard Partners, an Indian investment advisory firm that partnered with Lehman Brothers and other international institutional firms to purchase Indian NPLs. Prior to this, he worked for Enron International and Enron Broadband Services as a Senior Director, and was responsible for direct investments and the development of Energy and Telecom businesses in India. Mr. Jain received a Bachelors of Architecture and a Masters of Architecture simultaneously from Savannah College of Art and Design in Savannah, Georgia (1993) and a Masters of Public Administration (International Finance) from Columbia University, New York (1996).

Susan Rui is based in Beijing and is a China Country Manager for Avenue Asia. Prior to joining Avenue Asia, Ms. Rui was the China Business Manager for Tippins, Inc. USA, where she oversaw supplier relations, developed sales leads and negotiated with the Jiangsu provincial government regarding patent-related issues. In addition, Ms. Rui managed Tippins' branch offices in Thailand and China. Previously, Ms. Rui was a Research Specialist at the School of Pharmacy at the University of Pittsburgh. Ms. Rui received an MD from the China Beijing Second Medical University (1984), and completed her studies for her degree in Gynecology and Obstetrics at the Haidian Women's Hospital in Beijing, China (1987). *Ivy Santoso* is based in Jakarta and is the Indonesia Country Manager for Avenue Asia. Prior to joining Avenue Asia, Ms. Santoso was a Vice President of Institutional Research for PT GK Goh Ometraco where she covered consumer, retail, and agriculture companies. Previously, Ms. Santoso was an Associate Director of Research for PT Deutsche Morgan Grenfell, where she covered the same sectors. Prior to that, she was a research analyst for PT GK Goh Ometraco. Ms. Santoso also worked for PT Adindo Foresta Indonesia where she was a Chief Accountant in her last position. Ms. Santoso graduated with a B.S. in Accounting from Oklahoma State University (1991).

Jack So is based in Beijing and is a China Country Manager for Avenue Asia. Prior to rejoining Avenue Asia, Mr. So co-founded Vaseland International, a consulting company assisting international investors with investments in Chinese NPLs. Previously, Mr. So was a Director of Metilda Finance Company Limited, and was a key member of the management team that established Kaili Asset Servicing Company. Kaili is a joint venture, majority owned by Morgan Stanley, focused on NPL due diligence and collections in China. Before that, Mr. So worked for Avenue Asia as a Country Manager of the Greater China Region. Previously, Mr. So was an

Assistant Manager for New World Infrastructure, and before that he was a Research Analyst at The Pacific Group, a large Hong Kong based hedge fund that was partially owned by the U.S. based Tiger Management Corporation. Mr. So received a B.A., *summa cum laude*, with distinction in dual majors of Business Economics and Mathematics Applied Science from UCLA (1994) and an M.S. in Investment Management from the University of Science and Technology of Hong Kong (2004).

Kittiwuth Vathanakamsang is based in Bangkok and is the Thailand Country Manager for Avenue Asia. Prior to joining Avenue Asia, Mr. Vathanakamsang was a consultant for LPN Plate Mill Public Co. Ltd., where he helped renegotiate the company's indebtedness. Previously, Mr. Vathanakamsang was the Executive Vice President for Siam Strip Mill Public Co. Ltd., where he was a Senior Finance Officer.

Prior to that, Mr. Vathanakamsang worked for LPN Plate Mill Public Co. Ltd. as Deputy Managing Director. He also worked for Southern Engineering Company in the U.S. as a Project Manager and as a Financial Analyst. Mr. Vathanakamsang received a B.A. in Finance with Honors from Georgia State University (1978) and an M.B.A. from Georgia State University (1981).

CONCLUSION/RECOMMENDATION

Based upon the successful track record and experience of the principals and the recommendation of PSERS' consultant, Portfolio Advisors, staff recommends that the Board invest an amount equal to 25 percent of the committed capital, but not to exceed $300 million plus reasonable normal investment expenses, in Avenue Asia Special Situations Fund IV, 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.