PSERS OPPORTUNISTIC REAL ESTATE PROGRAM

Recommendation for Investment in
Lubert–Adler Real Estate Fund V, L.P.

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Lubert–Adler Real Estate Fund V, L.P.

EXECUTIVE SUMMARY

Lubert-Adler Real Estate Fund V, L.P. (the “Fund” or "Fund V") is a $1.5 billion fund being established to continue the real estate-related investment activities of Lubert-Adler Partners. Fund V will be Lubert-Adler Partners' fifth institutional real estate opportunity fund. Lubert-Adler began this series of Funds in 1997, and to date has an aggregate of $2.3 billion of net equity and $8.0 billion of assets under management.

The objective of Fund V is to provide investors with compounded annual returns of 20% (net of all fees and expenses) and an equity multiple of 2x over the life of the Fund. Fund V will pursue low cost-basis, value-added investment strategies of combining (i) advantageous acquisitions from disinterested sellers with (ii) significant redevelopments with local operating partners, in order to create high-quality assets at cost bases well-below their competitive set.

The management and strategy of Fund V generally will be the same as those of Funds I, II, III and IV, of which PSERS is an investor in Funds II, III and IV. The investment team consists of 21 professionals, and is distinguished by the fact that its members have strong hands-on real estate backgrounds; including acquisition, asset management, refinancing, redevelopment, and repositioning. The principals and affiliates of Lubert-Adler have committed to invest $80 million to Fund V.

THE SPONSOR

Lubert-Adler Partners is a real estate investment company co-founded by Ira M. Lubert and Dean S. Adler in March 1997. Messrs. Lubert and Adler collectively have almost 50 years of experience in underwriting, acquiring, repositioning, refinancing and exiting real estate assets. They have an extensive network of industry relationships and a proven ability to create opportunities within this sector. These relationships create significant transaction flow and access to strategic operating partners. Since its formation, Lubert-Adler Partners, through Funds I, II, III and IV, has committed over $2.0 billion of equity in 325 investments representing interests in $8.0 billion of real estate related assets. These assets include multifamily, office, industrial, retail, hospitality and residential resort properties.

Messrs. Lubert, Adler and other principals of Lubert-Adler will make personal commitments in Fund V of at least $80 million. The incentive compensation to all team members will be tied significantly to the performance of Fund V, and such compensation will be earned based upon performance of the portfolio as a whole rather than that of individual transactions. Lubert-Adler will be engaged exclusively in principal activities with no advisory, underwriting or investment banking roles.

In addition to the fund’s dedicated management team, Fund V will operate as a member of Independence Capital Partners ("ICP"). ICP is a family of private investment management firms comprising Lubert-Adler, LLR Partners, Quaker BioVentures, Chrysalis Capital Partners, LBC Credit Partners and LEM Capital (the "Member Firms"). Each Member Firm is individually and separately owned by its senior investment managers and makes active investments in distinct, non-competitive asset classes. Operating under the ICP umbrella, the Member Firms receive both scale and efficiency benefits. Because the

Member Firms have complimentary investment approaches, the managers are able to proactively cross-fertilize ideas, leverage internal expertise and share networks and resources. Specifically, ICP is able to leverage support functions across Member Firms to deliver quality services in the most cost effective manner.

Formed in 1997, ICP has approximately $6.0 billion of capital under management by its Member Firms, spanning real estate, venture capital, structured debt and buyout transactions. Collectively, the ICP Member Firms have over 60 investment professionals. The principals of the ICP family have personally committed over $150 million to their respective Member Firms.

INVESTMENT STRATEGY OF THE FUND

Institutional investors generally avoid complex transactions, such as acquiring assets through the bankruptcy court or acquiring vacant buildings in need of major development; yet such institutions are natural buyers of such properties upon stabilization. Lubert-Adler will seek to be the bridge to the institutional marketplace by first targeting acquisitions in these venues, then applying its redevelopment strategies and finally selling stabilized properties into the institutional marketplace.

In the past eight years, Lubert-Adler has focused in the niche of low cost-basis, value-added redevelopment of real estate assets. Lubert-Adler intends to implement these concepts in Fund V. This investment approach included the following:

Targeting "Non-Real Estate" Sellers – Lubert-Adler opportunistically pursues assets owned by sellers who are not in the business of maximizing the value of real estate – i.e., either real estate is not their primary business, or they do not have the expertise nor infrastructure to execute a value-added strategy. These sellers often include lenders, bankruptcy court trustees, "asset rich" retailers, municipalities, estates, distressed partnerships, corporations, and land owners.

Redeveloping or Changing Use – Lubert-Adler creates value through the redevelopment or change of use of underutilized properties. Lubert-Adler has converted obsolete office buildings into luxury apartments; warehouses into office or residential uses; large-scale land holdings into highly amenitized residential resorts; vacant department stores into multi-tenant retail uses; and industrial neighborhoods into vibrant, master-planned, 24/7 mixed-use communities. These examples highlight Lubert-Adler's strategy of creating income streams, not acquiring them from others.

Executing through Local Partners – Lubert-Adler's value creation programs require substantial real estate expertise and local market knowledge. Lubert-Adler has long-standing joint venture relationships with 52 operating partners who are experts by property strategy and geographic region. Lubert-Adler has created and continues to build strong operating partner platforms that promote entrepreneurship, build expertise, capture local market knowledge and permit the successful execution of high margin redevelopments. Lubert-Adler's successful operating partner platforms are a critical component of its investment approach.

Concentrating on High Barrier-to-Entry Markets – The quality assets in high barrier-to-entry major markets can provide superior risk-adjusted returns. These markets are more protected from competition, as they are characterized by a difficult zoning entitlement process and a limited supply of available land for new development. The Funds have concentrated their investment activities predominantly in high barrier-to-entry areas of the east coast and west coast, and other areas that have protective geographic and political barriers to new supply.

Creating a Competitive Cost Advantage – It is the combination of an opportunistic acquisition with superior execution of a value enhancement program that allows for competitive cost advantage. Lubert-Adler targets a competitive cost advantage of 70% of the competitive set. This competitive cost advantage results in greater downside protection, as well as the potential for higher profit margins.

Pursuing Risk-Mitigating Strategies – In addition to this lower cost basis, value-orientated approach, Lubert-Adler focuses thoroughly on additional risk-mitigating strategies. Phasing developments, pre-selling assets, pre-leasing space, obtaining available third party contributions and subsidies, and underwriting based on conservative densities, are all integral parts of Lubert-Adler's value-oriented philosophy.

Achieving Dual Liquidity Options – Upon the completion of a high margin value-added redevelopment, Lubert-Adler expects to profitably harvest value through: 1) **Refinancing**: generally a high margin redevelopment can be attractively refinanced at stabilization, which may return all invested equity, allowing the pursuit of profits without equity capital at risk, and/or 2) **Sale**: Lubert-Adler often sells at stabilization to capture an asset's final profit.

These fundamental strategies continue to be viable in the current real estate environment. Passive "financial buyer" investors generally avoid complex transactions, such as acquiring assets through the bankruptcy court or acquiring vacant buildings in need of major redevelopment; yet they are natural buyers of such properties upon stabilization. Lubert-Adler seeks to be the entrepreneurial bridge to this marketplace.

EXECUTION OF THE STRATEGY

The key to Lubert-Adler's value-oriented investment approach is the quality, durability and growth of its operating partner network. Lubert-Adler does not acquire income streams, but creates them. Entrepreneurial high-margin strategies require not only local knowledge and access, but also superior execution.

Lubert-Adler's competitive advantage is the establishment of joint ventures with operating partners who have the expertise not only to buy but also to redevelop and execute. Because such high-margin redevelopments are so time intensive, Lubert-Adler's operating partners focus on executing fewer, but higher-margin opportunities, as contrasted to a lower-margin, higher-volume acquisition approach.

To date, Lubert-Adler has developed over 50 operating partner relationships. Many of these relationships have grown into major investment platforms. Others are in the emerging phase and have the opportunity to significantly grow over time. Each of its operating partners has a geographic and/or asset class expertise, and share the risk of each transaction, as well as the upside.

Lubert-Adler's business is based on growing with these operating partners. To do so, it is critical that Lubert-Adler continually adds value to all of its partners through financial and due diligence support, acquisition and disposition strategies, strategic operational insights and responsive, attentive communications. By building operating partner platforms, Lubert-Adler is enhancing its ability to access and execute on superior opportunities.

MARKET OPPORTUNITY AND INVESTMENT PIPELINE

There are numerous demographic, financial and strategic trends that will allow the management team to continue to implement its value-added redevelopment strategies for Fund V. Through Funds I, II III and IV, Lubert-Adler has focused on its acquisition philosophy of buying from disinterested owners and performing substantial redevelopment to create assets having a cost-basis significantly below their competitive set. Fund V should substantially benefit from the established relationships, credibility and investment platforms developed by the activities of Funds I, II III and IV. Several of these trends and opportunities are identified below:

Multifamily - Lubert-Adler focuses on high-margin multifamily strategies, where active redevelopment and a competitive cost advantage are critical. Lubert-Adler has historically been able to create significant value and gain a cost advantage through the acquisition and conversion of vacant office/warehouse properties into multifamily use. Through redevelopment, Lubert-Adler is able to create income streams, rather than acquiring them, thereby capturing higher margins. Lubert-Adler's multifamily program has three main platforms: (a) High Barrier-to-Entry Multifamily Redevelopments - The majority of Lubert-Adler's multifamily activity has been within the High Barrier-to-Entry platform. Lubert-Adler focuses on those major metropolitan markets, such as Philadelphia, New York, Los Angeles, Baltimore and San Francisco, where 24/7 urban environments are growing, and density and zoning restrictions significantly limit competitive supply. Additionally, these markets have historic infrastructure in place – older, infill obsolete office, industrial and mill buildings – that are suitable for adaptive re-use.

Over the past decade, there has been an increasing demand for urban infill residential housing, which has created a strong market for the adaptive re-use of well-located, but obsolete office/warehouse buildings. Lubert-Adler JV's specialize in converting these obsolete buildings into modern residential apartments at very attractive yields. In many instances, the cost of redeveloping historic buildings may be reduced through the sale of historic tax credits that reduces the cost basis of an asset.

Lubert-Adler also focuses on existing properties needing significant renovations in high barrier-to-entry suburban markets, where zoning is difficult, single-family housing costs are high, and there is a shortage of available land for competitive development. These markets include suburban Philadelphia, New York, Connecticut, Boston, Baltimore and Southern California.

Finally, Lubert-Adler seeks to identify buildings that can be acquired and redeveloped into condominium properties at attractive values. Rather than renting units, there are certain cases where higher values may be obtained through sale as condominiums.

(b) University Multifamily Redevelopments - There are significant opportunities for the redevelopment of multifamily properties adjacent to urban universities. In general, universities are experiencing expanding enrollments and a shortage of housing for their students. Often, the older, existing housing stock lacks modern life-safety systems. In certain cases, universities lack the expertise to build new housing or redevelop existing housing effectively. Urban university settings are particularly attractive because of the existence of vacant historic structures that are eligible for historic tax credits, and the scarcity of competitive development parcels. In joint venture with its operating partners, Lubert-Adler has established a university multifamily housing program in Philadelphia, PA, New Haven, CT and Columbia, SC.

(c) New Multifamily Developments - In select situations, Lubert-Adler may invest in the development of new apartments and/or condominiums. Lubert-Adler seeks its competitive advantage and pursues its risk mitigation philosophy through:

- Cost Advantages – i) financial incentives provided by municipalities, ii) shifting the cost of infrastructure – roads, utilities, parking – through newly created tax-exempt districts, and iii) creating value through wholesale land assemblages.
- Uniqueness of Product – The product needs to be differentiated from the commodity product, through superior architecture, design, branding and amenities.
- Infill Location – The location needs to be "well-protected" to allow for faster absorption.
- Phasing – The ability to develop in phases is critical. A series of five-story buildings that can be phased over time has much less risk than the same number of units in one high-rise tower.
- Pre-Selling – A substantial pre-sale of units helps to mitigate market risk.

Retail - Many traditional retailers are facing substantial competitive pressures that are forcing the consolidation, downsizing or bankruptcy of these entities. These retailers often control, via ownership or leasehold, valuable infill real estate assets. Alternatively, there are many growth retailers who are seeking these valuable infill locations. Lubert-Adler seeks to capitalize on this situation by acquiring either the distressed retailers themselves, based upon their underlying real estate value, or the "excess" real estate of these distressed retailers at significant discounts, and then redeveloping them for use by growth retailers.

Lubert-Adler and its operating partners have proven their expertise in this complex arena through the acquisition of 558 properties totaling 43 million square feet from "distressed" or "asset rich" retail sellers, at substantial discounts. Notable investments include the acquisition of the Mervyn's Department store chain, Service Merchandise, Kmart, Levitz Furniture, Montgomery Ward, Hechinger and The May Company.

Lubert-Adler and its partners have established a competitive advantage within this investment niche by creating significant credibility with the retailers who seek to occupy these assets; establishing a dedicated team of retail real estate professionals to implement a comprehensive underwriting, due diligence and execution process; and developing an ability to convert leaseholds into owned real estate assets. In addition, Lubert-Adler is joint venturing with private equity groups in order to broaden its access to transaction flow. Lubert-Adler expects to see additional opportunities for the benefit of Fund V.

Urban Land Assemblage - There are significant opportunities to assemble contiguous industrial parcels for large-scale redevelopment in high barrier-to-entry urban locations. The goal of an assemblage is to amass a significant land area permitting the transformation of a neighborhood from often dormant or unattractive industrial uses into a master-planned, mixed-use community, with modern residential, retail and office uses.

The key to the strategy is there are value creation opportunities in every step of the process - assemblage, entitlement, land planning, brownfield grants, remediation, redevelopment and new development – allowing Lubert-Adler and its partners to achieve a competitive cost advantage in every step of the investment cycle.

Commercial Redevelopments - Over the last eight years, Lubert-Adler has had significant success in identifying well located, often obsolete office and industrial properties. These properties, which were acquired at wholesale prices because of existing condition or vacancy, have been redeveloped and repositioned at a competitive cost advantages. To-date, Lubert-Adler has acquired and upgraded 91 office and industrial buildings, comprising 28 million square feet and $304 million in equity.

Residential Resort - Demographically, baby boomers are a strong source of demand for retirement homes, second homes, resort destinations and income-oriented investments. Lubert-Adler, in joint venture with its resort residential operating partner, seeks to capitalize on these strong demographic fundamentals by creating large-scale, residential communities in markets where new entitlements are difficult to obtain. In many cases, the JV seeks to provide residential and hospitality amenities side-by-side, as opposed to traditional private second home communities. To-date, the JV is developing 24 residential resort communities, master-planned for over 22,000 residential units.

The JV's integrated approach seeks to minimize risk, while maximizing profitability, as follows:

- Acquire land wholesale;
- Enhance value through envisioning and entitling;
- Pre-sell lots and condominiums;
- Develop the site in phases;
- Realize returns primarily from real-estate sales; and
- Enhance returns through destination rental resort and ancillary acquisitions.

This business favors operators that are vertically integrated, with full in-house capabilities in acquisitions, entitlement, sales & marketing, development and hospitality operations. The JV has invested in the infrastructure and built the necessary platforms to deliver superior execution for this business plan.

The JV has also identified a new opportunity in this sector: to acquire established, but partially completed communities with major infrastructure in place, at significant discounts to actual costs. Utilizing its existing operating capabilities, the JV is able to re-envision the communities, enhance the amenities, and execute a pre-sales strategy to turn around the community. Because most of the infrastructure and amenities are already in place, the timeframe between acquisition and sellout is reduced, which helps to mitigate risk.

This is an area where competitors may be scarce as distressed opportunities become available. This business requires substantial operating expertise, which may limit passive "financial buyer" investors.

Hospitality - Lubert-Adler and its partners selectively pursue the redevelopment of hospitality properties. To date, the JVs have acquired more than 61 hotels at a total cost of $1.3 billion, pursuant to four major platforms:

- Redevelopment – Turnaround of financially troubled hotels through renovations and operations;
- Select Service – Redevelopment of vacant buildings and new development in prime locations;

- Public/Private – Hotel developments or redevelopments subsidized by municipalities; and
- Resort – Development or redevelopment that is substantially financed by residential pre-sales;

Within each of the strategies, Lubert-Adler focuses on building or redeveloping in high barrier markets or in locales with strong demand generators. The goal is to obtain a competitive cost advantage by creating the best product through superior execution with local, entrepreneurial operating partners.

MANAGEMENT OF THE FUND

Lubert-Adler Partners consists of twenty-one (21) experienced professionals, with strong backgrounds in acquisition, redevelopment, asset management and capital markets. On average, senior members have over 15 years of hands-on real estate experience and have worked together in Funds I, II, III and IV. Below, are the biographies of the senior members of the Fund V management team:

Ira M. Lubert—BS, Pennsylvania State University

- Chairman and co-founder of Lubert-Adler Partners
- Founder of the Independence Capital Partners fund family: (i) Lubert-Adler Real Estate Funds; (ii) LLR Partners (buyout/growth equity); (iii) Quaker BioVentures (bio sciences/healthcare); (iv) LEM Mezzanine (real estate mezzanine); (v) Chrysalis Capital (distressed LBO) and (vi) LBC Credit Partners (structured debt)
- Founded GF Management, Inc., Telemarketing Concepts, Rose Glen Capital, and Sterling Bank; also founding managing director of TL Ventures and Radnor Venture Partners

Dean S. Adler, CPA—BS, Wharton School of the University of Pennsylvania; JD, University of Pennsylvania Law School

- Senior Managing Principal and co-founder of Lubert-Adler Partners (1997)
- Head of the Investment Committee and responsible for leading the strategic direction of the firm
- Previously a principal and co-head of the private equity group of CMS Companies; also was associated with Ernst & Whinney and the law firm of Baker & Hostetler
- Serves on the board of directors of Developers Diversified Realty and Bed Bath & Beyond

Gerald A. Ronon—AB, Princeton University

- Joined the firm in 1998
- Managing Principal, acquisitions and responsible for leading the major operational functions of the firm
- Previously a portfolio manager and principal of LaSalle Advisors Limited, an office leasing broker for Williams Real Estate and a senior associate of The Linpro Company/LCOR (development firm)

Michael Braver—BS, The Wharton School of the University of Pennsylvania; MBA, University of Chicago

- Joined the firm in 2001

- Managing Principal, acquisitions
- Previously senior vice president of Charlesbank Capital Partners (successor of Harvard Private Capital Group) and vice president of Aldrich, Eastman & Walch

Stuart A. Margulies—BA, Franklin and Marshall College; MBA, Temple University

- Joined the firm in 1997
- Principal, head of asset management
- Previously a vice president in real estate workouts at First Union Bank and an analyst at Transact Property and Greenwood Group

Pennock J. Yeatman—BS, Babson College; MS, MIT

- Joined the firm in 1999
- Managing Principal, acquisitions
- Previously senior portfolio manager for Berkeley Investments, Inc., and multifamily analyst with Winthrop Financial

Adam Miller—BA, University of Pennsylvania

- Joined the firm in 2001
- Principal, West Coast acquisitions and asset management
- Previously vice president of Starwood Cerruzzi and an associate of Greystone Realty and The Rubin Organization

Dr. Peter Linneman—MA, PhD, University of Chicago

- Research Consultant
- Founding director of the Wharton Real Estate Center at the University of Pennsylvania (1985-1998), former director of Wharton’s Zell-Lurie Real Estate Center and member of Wharton’s faculty (Albert Sussman Professor of Real Estate, Finance and Public Policy)
- Former senior managing director of Equity International Properties, a global real estate investment firm

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% of the committed capital, but not to exceed $100 million plus reasonable normal investment expenses, in Lubert–Adler Real Estate Fund 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.