<u>PSERS OPPORTUNISTIC REAL ESTATE PROGRAM</u>

Recommendation for Investment in
O'Connor North American Property Partners II, L.P.

Charles J. Spiller
Director of Alternative Investments

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O’Connor North American Property Partners II, L.P.

EXECUTIVE SUMMARY

O’Connor North American Property Partners II, L.P. (the “Fund”) is a $750 million ($1 billion cap) fund being established to continue the real estate-related investment activities of O’Connor Capital Partners (‘O’Connor”). This fund will be O’Connor Capital Partners’ sixth institutional real estate opportunity fund, of which four funds were co-sponsored with JPMorgan. O’Connor Capital began its series of private real estate opportunity funds in 1994, and to date has committed an aggregate of $2.0 billion of net equity into 81 real estate transactions with an aggregate cost of $8.0 billion. The return objective of this fund is to provide investors with compounded annual returns of 18 percent (net of all fees and expenses).

The Fund will focus solely on “Direct Investments,” defined as investments in real properties or in entities where the Fund has the right and expectation to realize its investment through the sale of the underlying real estate or controlling interests therein or through other exit alternatives that reflect the value of the underlying real estate. The Fund will not invest in equity securities of real estate operating companies. The Fund will focus in major U.S. and Mexican markets, where economies are diversified and real estate markets are sufficiently liquid for timely exits. Beyond maintaining a geographic diversification, the Fund will also be diversified by property type. It is expected that the Fund will primarily invest in US Urban Multifamily, Mexican Retail and Urban Multifamily, US Retail, and US Office properties. The Fund may also consider investments in Canada.

The management and strategy of O’Connor North American Property Partners II, L.P. generally will be the same as those of its prior funds, of which PSERS is an investor in Peabody Global and O’Connor North American Property Partners, L.P. The investment team consists of 40 professionals, and is distinguished by the fact that its members have strong hands-on real estate backgrounds; including acquisition, asset management, development, rehab/redevelopment, leasing and repositioning. The principals and affiliates of O’Connor Capital Partners will invest an amount equal to 10% of PSERS’ commitment in a parallel fund through their General Partner position. O’Connor’s aggregate commitment will be 2.5% (up to $25 million) of the overall Fund capitalization.

THE SPONSOR

O’Connor is a privately held, independent real estate investment and management firm. Over the past 24 years the firm has acquired or developed more than $12.5 billion of property on behalf of itself and various investment funds and institutional clients, encompassing all major asset types. Since 1994, the firm has managed real estate private equity funds with over $2.0 billion in capital commitments and cumulative investments of an aggregate gross asset cost of over $8.0 billion.

In the 1980s, O’Connor Capital Partners (then known as “The O’Connor Group”) established its reputation as a high-quality regional mall investor, developer and operator by acquiring and developing over 10 million square feet of regional mall properties. Notable projects included The Westchester in White Plains, New York, and Menlo Park in Edison, New Jersey. While expanding its retail operations, O’Connor also established an investment advisory business that acquired and managed assets for separate account clients, focusing on core portfolios. At times, this business unit managed over $5 billion in assets, with investments across all property types, including retail, office, industrial, multifamily and lodging.

In the late 1990s, O'Connor sold its separate account advisory business and almost all its shopping center holdings, and now focuses primarily on principal investing through private equity funds. In 1994, O'Connor entered into a relationship with JPMorgan that resulted in the joint sponsorship and management of four private equity real estate funds. Together, O'Connor and JPMorgan co-sponsored Argo in 1994, followed by Argo II in 1995 and by Peabody International and Peabody Global in 1998. In 2002, O'Connor and JPMorgan mutually agreed to pursue their business initiatives independently and that any future funds would be raised and managed separately. O'Connor and JPMorgan will continue to jointly manage each of the prior Funds.

The prior Funds have invested over $2.0 billion of equity in over $8.0 billion of real estate transactions on behalf of public and corporate pension funds, endowments, foundations, financial institutions and other private equity investors. These transactions include Direct Investments in office, industrial, retail, multifamily, lodging and mixed-use properties, as well as operating company investments, located in the United States, Mexico, Canada, Europe, Argentina and Japan.

Mr. O'Connor and other principals and affiliates of O'Connor Capital Partners will make financial commitments to O'Connor North American Property Partners II, L.P. of $25 million. The incentive compensation to all team members will be tied significantly to the performance of this fund, and such compensation will be earned based upon performance of the portfolio as a whole rather than that of individual transactions. Compensation to each partner and associate will consist of a base salary, annual incentive based upon performance, and a share of the carried interest earned by the General Partner.

OPPORTUNITIES IN NORTH AMERICA

The current uncertain economic climate, defined in part by a deteriorating housing market, political instability in the Middle East, and uncertainty surrounding the severity of the inflation threat, will provide significant opportunities to pursue a number of attractive investment strategies. The Fund will seek to invest in assets which are not fully stabilized – and hence not a target for core investors – and properties that need major physical improvements and have "pricing power." The Fund will also seek opportunities in distressed assets, as well as urban infill development. Other opportunities are expected to include: assets in recovering markets; corporate and real estate operating company asset sales; and generally, Mexico.

Asset Repositioning. Opportunities will exist to acquire assets that, while well–located and with pricing power, require capital investment and asset management to improve the level of quality and increase rental growth to a level that will attract significant institutional interest. Repositioning is expected to range from simple re-tenanting of a property to full-scale redevelopment. The criteria that O'Connor will apply for such investments will include: strong market and location; functionally flexible improvements; total budgeted cost (including acquisition plus anticipated improvements) below replacement cost for new product; and an experienced local partner to execute the strategy.

Distressed Assets. Uncertain economic conditions may create more distressed opportunities over the investment period for the Fund than in the Prior Funds. Within the office sector, for example, owners of assets with significant lease expirations in the next few years and a high cost basis, who are currently able to service debt on a cash flow basis due to low interest rates on existing debt, may be unable to refinance at maturity. The potential for a slow-down in retail sales caused by a reduction in consumer spending due to the weakening of the housing market may ultimately impact retail owners generally. More directly, the housing sector slow-down may provide opportunities to purchase out-of-the-money land options, to acquire failed condominium developments that can be managed as rental product, and to participate in the restructuring of projects that may be "out of balance." Given its background and range of skills, O'Connor is well– positioned to provide transitional capital in these cases.

Corporate and Real Estate Operating Company Asset Sales. Major corporations are still large holders of real estate in North America. In order to raise capital, reduce costs and become more efficient, many are selling owned and occupied properties, either in sale/leaseback transactions or as part of relocating to more modern, efficient space. In the latter case, assets which may be well–located in attractive markets may be offered vacant or with only short-term leases. Within the real estate investment trust and real estate operating company investing universe, there will continue to be opportunities to sell to or purchase from these companies as they deal with structural inefficiencies.

Urban Infill Development. Selected development opportunities exist for well-located and well-conceived urban infill development projects. As an example, the historically wide affordability gap in housing in most major U.S. markets foreshadows significant rental growth in the for-rent sector over the coming years in markets with high barriers to entry. O'Connor expects to focus particularly on the New York City metropolitan area where it has a strong position and deal flow typically is good.

Recovering Markets. Despite the strong demand for high quality real estate assets and the overall health of the commercial real estate sector today, there will be select opportunities to acquire leased assets in good, but temporarily distressed, markets. In these investments, O'Connor will seek to identify trends signaling an inflection point and broad market recovery for a particular product type and identify assets that should benefit from a turnaround. O'Connor expects such transactions to be a limited but important component of the Fund's portfolio, as income generated by these investments complements the reversionary nature of many of the other investment opportunities.

Mexico. Since 1997, O'Connor has committed to invest over $172 million in equity in real estate transactions in Mexico having an aggregate gross value of $540 million on behalf of the Prior Funds. These include investments in office, residential, retail and industrial properties. Through the Prior Funds, O'Connor has forged a strong relationship with G. Acción, S.A. de C.V., Consorcio ARA, and Grupo Aryba. In the current environment, demographic trends and institutional capital flows offer opportunities in single family and second home/resort developments, as well as the development of quality retail assets. O'Connor maintains an office in Mexico City with four investment professionals.

REAL ESTATE MARKET CONDITIONS

The current real estate investment environment is a challenging one for the value investor. Real estate continues to attract a high level of debt and equity capital, particularly the highest quality assets. The capital markets continue to reflect the belief that real estate is attractive relative to other investment classes, perhaps as a result of the fact that real estate has outperformed both the public and private equity markets as well as bonds over the past five years. While pricing has, in some instances, reached new heights, fundamentals for most product types remain strong, with rental growth rates accelerating in many markets. Although the "capitalization compression" cycle appears to be over, “momentum” investors are still active, purchasing ever-larger asset pools, driven by ever-larger sources of capital.

Against this backdrop of continued positive capital flows to real estate, the overall U.S. economy appears to be at an inflection point. The economy is decelerating with second quarter 2006 U.S. GDP growth at 2.9% vs. 5.3% in the first quarter. Key metrics for the U.S. economy are beginning to show the effects of this deceleration: the housing market continues to soften, the savings rate is expected to increase, and consumer spending should slow. Despite these metrics, the direction of monetary policy remains unclear as the Federal Reserve tries to avoid a hard landing while at the same time seeks to contain the rate of inflation. Overall, the combination of increased interest rates and a slowing economy is beginning to level the playing field between the users and suppliers of capital, and these trends should continue for the foreseeable future, creating opportunities for the value investor.

In Mexico, the economy continues to show stable macroeconomic conditions. Annual GDP growth for 2005 was 3.0%, with GDP growth of 4.3% projected in 2006. Inflation is expected to remain stable, with a small increase from 3.3% in 2005 to a projected 3.6% in 2006, and the currency has remained in a tight trading range since 2003. The recent confirmation of a new president should enhance these moderate economic trends by providing a stable political foundation for the country. Similarly, investing conditions in Mexico continue to look favorable, with major demographic trends as well as increased institutional capital flows supporting investment in housing, retail, industrial and resort development.

INVESTMENT STRATEGY

Focus on Direct Investments. The Fund will focus exclusively on Direct Investments, consisting of investments in real estate properties or in real estate joint ventures or other entities where the Fund expects to realize the underlying real property values through sales of the real estate or interests therein. In no event will the Fund invest in equity securities of real estate operating companies. In this way, O’Connor will seek to avoid the capital markets and operating risks often associated with investments in real estate operating companies.

The Prior Funds have invested $937.0 million of equity, $5.0 billion gross, in North American Direct Investments, involving 53 transactions. The projected deal-level IRR for these investments is currently 31% with a 1.9x multiple of equity invested.

Strong Deal Pipeline. Current real estate market conditions are unlikely to continue and that there will be abundant opportunities for investors to achieve attractive returns without assuming excessive risk during the investment period for the Fund. O’Connor has been an active but cautious investor during a difficult market, committing $430.8 million of equity over the past three years on behalf of ONA I at an overall projected deal-level IRR of 26% with an equity multiple of 1.9x.

Strong Industry Relationships. O’Connor has access to the extensive network of financial and real estate relationships cultivated by its senior management for more than three decades. This network, which is expected to be an important source of investment opportunities for the Fund, encompasses relationships with several strategic operating partners in North America who have completed investments with the Prior Funds. These elationships have allowed O’Connor to close many attractive deals without competitive bidding.

Identifying and Managing Risk. As an opportunistic investor, the Fund will incur a certain amount of real estate and capital market risk. One of O'Connor's competitive strengths is its capacity to carefully analyze investments to identify the associated risks, and then to take appropriate action to price and manage those risks. O'Connor typically employs a number of strategies designed to achieve a margin of safety in its investments including: acquiring assets at a discount to replacement cost; investing in properties that are leased below current market rents; and pricing investments with unleveraged yields at a significant spread to prevailing debt rates.

Constraint on Supply. Fully developed "24-7" cities with limits on development such as zoning, high replacement costs or physical barriers are particularly attractive markets for investment. These markets tend to create a supply-and-demand dynamic in favor of and permit greater security for existing investments.

Stringent Underwriting. The Fund will thoroughly underwrite all assets prior to making any investment decision, beginning with a market review and ending with a check against relevant barometers, such as price per square foot, to ensure reasonable pricing.

Margin of Safety. The Fund will seek to manage the risks inherent in real estate investing by employing strategies designed to achieve a margin of safety in its investments, including: acquiring assets at a discount to replacement cost; investing in properties that are leased to strong tenants at or below current market rates; and pricing investments with unleveraged yields at a significant spread to prevailing debt rates.

Identifiable Exits. The management of the Fund will identify its exit strategy in the underwriting of each prospective investment. The role of asset management and disposition is as critical to successful investing as is the role of investment sourcing. Its structured asset management process will include formulation of a detailed asset management plan for each investment and regular reviews of market conditions to determine the optimum timing for dispositions. It is expected that plans will typically call for the dispositions to occur within three to five years after acquisition.

Diversification. The Fund's investment portfolio will be diversified by geography, property type and deal structure, while maintaining its focus on major markets. The intention is to limit development risk within the Fund's portfolio. Although the Fund may invest anywhere in North America, it will not be permitted to invest more than 25% of its aggregate capital commitments outside the United States. Not more than 15% of the Fund's capital commitments will be invested in any one investment.

MANAGEMENT OF THE FUND

The management of O'Connor Capital Partners consists of experienced professionals, with strong backgrounds in acquisition, redevelopment, asset management, capital markets, and finance and control. The most senior members of the Fund's management team (including the members of the Investment Committee) have worked together for an average of 10 years and have an average of 22 years of real estate investment experience. These members have been integrally involved in the investment, asset management and realization of ONA I. Below, are the biographies of the senior members of the management team:

Jeremiah W. O'Connor, Jr. Mr. O'Connor is Managing Partner of O'Connor. As Managing Partner, Mr. O'Connor is the individual most responsible for determining the policies and strategic direction of O'Connor. He is chairman of the Investment and Executive Committees of Argo and Argo II and of the Operating Committee and the

Executive Board of Peabody International and Peabody Global. Prior to founding O'Connor in 1983, Mr. O'Connor was a founder and Trustee of CPI. Upon graduation from business school, he joined Lazard Frères & Co. where he was active in corporation financings and underwritings as well as real estate acquisitions. He departed Lazard in November 1970 to help manage Peerage Properties Incorporated, a small real estate holding company then controlled by Lazard and the predecessor entity to CPI. Mr. O'Connor is currently a director of Grupo Empresarial Metropolitano, S.A. de C.V. and Grupo Acción S.A. de C.V. In addition, Mr. O'Connor is a trustee of The Manhattan Institute, The Catholic Community Fund, The Papal Foundation and the College of the Holy Cross, where he also serves as Chairman of its endowment fund, and is a past Chairman of the International Council of Shopping Centers. Mr. O'Connor is a graduate of the College of the Holy Cross (A.B. 1963) and the Harvard Business School (M.B.A. 1967).

Andrew J. Murray. Mr. Murray is a Partner of O'Connor and head of new business development, acquisitions and financial structures for the firm's investments. He joined O'Connor in 2006 from Lehman Brothers where he worked for 11 years, most recently as a Senior Vice President and Deal Manager in Lehman's Global Real Estate Group ("GREG"). While at Lehman, Mr. Murray had production responsibilities for investing Lehman's capital across GREG's various product lines: CMBS, structured finance, mezzanine debt and joint venture equity. Prior to joining Lehman, his capital market experience includes six years of investment banking and private placement work with Sonnenblick Goldman, and two years of direct mortgage lending and joint venture equity investment work with American International Group. Mr. Murray is a graduate of Georgetown University (B.S.B.A. 1979) and Stern Graduate School of Business at N.Y.U. (M.B.A. 1985).

John E. Phelan, Sr. Mr. Phelan is a Partner of O'Connor, responsible for development activities. Mr. Phelan has been associated with O'Connor since 1984 and has had direct responsibility for many of O'Connor's development projects, including The Westchester Mall and Menlo Park Mall. Mr. Phelan had served as Chairman of O'Connor's shopping center property management business prior to its disposition in 1996. Prior to his association with O'Connor, from 1977, Mr. Phelan was President, Chief Executive Officer, and co-founder of Pembrook Management Inc., a property management firm, which managed the assets of CPI. Prior to the creation of Pembrook, Mr. Phelan was a Senior Vice President at CPI, where he was charged with the management of its commercial properties. Prior to his tenure at CPI, Mr. Phelan was with Lazard Frères & Co., where he was involved with the supervision of joint ventures in the development of shopping centers and high-rise multifamily properties. Mr. Phelan began his career with Helmsley Spear Inc., where he was actively involved in the management of six million square feet of commercial properties.

Thomas E. Quinn Mr. Quinn is a Partner and Chief Financial Officer of O'Connor. He will be responsible for, among other things, the Fund's finance, treasury, insurance, accounting and tax matters. Mr. Quinn serves on the Peabody Partners Review Committee. Mr. Quinn has been associated with O'Connor since 1988 and has served as Chief Financial Officer for many of its sponsored funds including the Retail Property Trust, both Argo funds and both Peabody funds. Prior to joining O'Connor in 1988, Mr. Quinn was associated with Butler International Inc. beginning in 1980, and he served as its Chief Financial Officer from 1985 to 1988. Prior to that, Mr. Quinn held various positions at Touche Ross & Company, a predecessor firm to Deloitte & Touche. Mr. Quinn is a graduate of Rutgers University (B.A. 1974) and is a Certified Public Accountant.

William Q. O'Connor Mr. O'Connor is a Principal of O'Connor. He had been based in London since 1999 where he was a senior acquisition officer responsible for Peabody's investment activity in Europe, and relocated to the United States in January 2003. Mr. O'Connor represents Peabody's interests on the boards of Iniziative Negozi S.r.l. and Cutlers Gardens. Prior to joining O'Connor in 1996, Mr. O'Connor was an Associate in the Real Estate Investment Banking Group of Merrill Lynch & Co., based in New York. Mr. O'Connor is a member of the Urban Land Institute and the International Council of Shopping Centers. Mr. O'Connor is a graduate of the College of the Holy Cross (B.A. 1991) and the Columbia Business School (M.B.A. 1996).

Andrew A. Attinson. Mr. Attinson is a Principal of O'Connor. Mr. Attinson serves as an in-house design and development resource to O'Connor's acquisitions team. He has over 20 years of experience in the field of mixed-use development in major cities and communities across the United States. Mr. Attinson's work has generally focused on the integration of residential, retail, commercial-office, hotel and civic uses that are part of a large-scale, master-planned development. Prior to joining O'Connor in 2005, Mr. Attinson was a Senior Partner and responsible for the Development Consulting Group at Street-Works, LLC, based in White Plains, NY. It was during his tenure that the company worked on such recognized projects as Mizner Park in Boca Raton, FL, Santana Row in San Jose, CA, Bethesda Row in Bethesda, MD and Blue Back Square in West Hartford, CT. Mr. Attinson is a graduate of the University of Pennsylvania with degrees in Architecture (M.Arch. 1983) and Environmental Design (B.A. 1979).

Brett G. Buehrer. Mr. Buehrer is a Principal of O'Connor, principally responsible for investments in the United States. Prior to joining O'Connor in 2000, he served as a Regional Manager for both Wilder Richman Management and Wesley Housing Corporation. Over the last 14 years, Mr. Buehrer has been directly responsible for or participated in the management and/or development of 10,000 residential units. Mr. Buehrer is a graduate of Ohio State University (B.A. 1990) with degrees in Finance and Real Estate and University of Memphis Business School (M.S. 1994).

Martin B. Caverly. Mr. Caverly is a Principal of O'Connor and head of the Los Angeles office. He oversees real estate acquisitions and dispositions for the West Coast. He is a member of the Investment Committee of ONA I. Mr. Caverly joined O'Connor in 2005 from Tishman Speyer, where he was head of european acquisitions based in London and he was responsible for over $800 million of direct property investments, as well as capital raising for new ventures. Prior to that, he was cofounder of Centric Telecom, a $100 million joint venture real estate technology company owned by Goldman Sachs and Providence Equity Partners, and also served as a Vice President for Security Capital Group, overseeing over $1 billion of platform investments in the U.S. and Europe. Prior to attending business school, he worked as a Vice President for Citigroup's real estate office in Los Angeles, participating in other real estate owned workouts and dispositions. Mr. Caverly is a sustaining member of the Urban Land Institute, International Office Council. He is a graduate of Harvard College (A.B. 1989) and Northwestern University's Kellogg Graduate School of Management (M.B.A. 1997).

CONCLUSION/RECOMMENDATION

Based upon the successful track record and experience of the principals and the recommendation of PSERS' consultant, Courtland Partners, Ltd, staff recommends that the Board invest an amount equal to 25 percent of the committed capital, but not to exceed $150 million (plus a 10 percent reserve) plus reasonable normal investment expenses, in O'Connor North American Property Partners II, L.P. The final terms and conditions of the investment must be satisfactory to the Investments Office, the Office of Chief Counsel, and the Executive Director.