



PSERS OPPORTUNISTIC REAL ESTATE PROGRAM

**Recommendation for Investment in
Carlyle Europe Real Estate Partners III, L.P.**

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Carlyle Europe Real Estate Partners III, L.P.

EXECUTIVE SUMMARY

The Carlyle Group (together with its affiliates, “Carlyle”) is sponsoring its third European real estate fund, Carlyle Europe Real Estate Partners III, L.P. (the “Partnership,” the “Fund” or “CEREP III”). CEREP III is expected to invest in a diversified portfolio of real estate and real estate-related assets throughout Europe, with a concentration in the following markets: France, Germany, Italy, Scandinavia (comprised of Sweden, Denmark, Norway and Finland), Spain, Portugal and the United Kingdom.

The Fund is seeking total capital commitments of €1.5 billion. The Fund’s investment objective is to seek to generate superior capital appreciation through a diverse portfolio of real estate and real estate-related investments within the Target Market, targeting opportunistic returns.

THE SPONSOR

Privately held and founded in 1987 by William E. Conway, Jr., Daniel A. D’Aniello, and David M. Rubenstein, The Carlyle Group is one of the world’s largest private equity firms with more than \$54.5 billion of capital commitments under management through 48 separate investment vehicles. Carlyle has more than 345 investment professionals, in 16 countries. Carlyle invests in buyout, venture, real estate and leverage finance opportunities throughout North America, Europe and Asia. Based in Washington D.C., Carlyle’s real estate team maintains additional offices in New York, Los Angeles, Newport Beach, and Denver.

SPONSOR’S APPROACH TO INVESTING

The current real estate markets offer opportunities for real estate investors to achieve attractive returns without assuming excessive risks. The current uncertain economic climate creates an investing environment in which experience and expertise are at a premium. The objective then is to identify and invest in underpriced assets, where one can take advantage of strong property fundamentals at attractive prices.

Carlyle refers to its real estate investment philosophy as an opportunistic fundamental approach to real estate investing, whereas it can achieve premium returns at a lower risk within a relatively short holding period. This style is focused upon investing in aspects of the real estate market where the fundamentals, which determine value, are believed to be underpriced by the capital markets. This approach also focuses on market and property fundamentals to identify well-located assets in large and undersupplied markets where forecasted vacancies are trending downward and forecasted new construction is unlikely to satisfy fully the projected demand.

The management of the Fund continually analyzes relevant market and property fundamentals (referring to the supply and demand factors that drive market vacancies and rents). In addition, Carlyle analyzes key locational and physical elements of the properties that it is targeting. Assessing the combination of these market and property fundamentals should lead it to an accurate determination of the property’s value.

The management of the Fund currently has an active investment pipeline and is pursuing disciplined and focused strategies to invest in situations in which the capital markets have underpriced a property’s fundamental value. These opportunities occur across various geographies, product types and formats. Different geographic markets within the European arena are experiencing various trends and conditions simultaneously.

Accordingly, the manager will seek to systematically and comprehensively review those sectors or geographic markets that it targets to discern opportunities that are suitable for investment. These sector strategies, combined with a disciplined and focused team, should enable the management of the Fund to implement such an investment strategy.

WELL-DEFINED STRATEGIES

Investment Strategy. The Fund intends to acquire real estate assets that can be transformed over a two- to five-year time period into property that is attractive to long-term investors seeking stable, modernized, “low-risk” assets. This transformation is a function of reducing the risk that is associated with the asset. This “risk” in the Fund’s target assets can manifest itself in several ways, such as (1) a poor physical appearance, (2) the risk associated with planning permission, (3) the leasing risk of an empty building and (4) an existing lease nearing expiration and potential vacancy. Through the process of active asset management, Carlyle can reduce the real or perceived risk and reposition the asset in the market, making the asset attractive to a long-term institutional-type investor. This approach is relatively resistant to downward market cycles because it is not relying on an improved market in rental rates or capital values to achieve returns, but rather is focusing on key asset management milestones over which Carlyle can exercise control to transform the asset. Through its investment approach, Carlyle will be able to achieve attractive returns while minimizing the inherent risks associated with real estate investments.

Investment Approach. Since 2001, Carlyle has made investments in European real estate and has established a record of leading performance by applying a unique investment strategy. Carlyle’s investment approach offers characteristics that, when taken together, represent a distinctive investment strategy that will set CEREP III apart from other real estate investment funds in Europe.

Focused Approach. The Fund’s primary investment strategy will be concentrated on the Target Market. The Management Team has extensive experience investing within this market, and CEREP and CEREP II have operated locally in Paris, Milan, Frankfurt and Luxembourg since 2001 and in London and Stockholm since 2006. As of September 30, 2006, CEREP and CEREP II have invested approximately €934 million of equity in several European Union countries. Additionally, Carlyle’s European buyout fund, Carlyle Europe Partners, has operated locally in Paris, Milan, London and Munich since 1997 and has made significant private equity investments in several of the countries within the Target Market. As a result of extensive presence in Europe, Carlyle has established strong connections to the European real estate and corporate communities.

Direct Deal Sourcing. Carlyle’s presence in Europe will give CEREP III a competitive advantage in its ability to source transactions directly. As mentioned above, the Management Team has a long history of operating within the Target Market and has established many long-term relationships with local developers, corporate real estate owners, institutional investors and private individuals. These relationships have traditionally resulted in the ability of the senior members of the Management Team to source investments on a proprietary basis. Furthermore, local relationships established through Carlyle’s existing European operations and relations with Carlyle investors in Europe are expected to provide additional sources of proprietary deal flow.

Proactive Investment Philosophy and Process. Carlyle’s entrepreneurial approach towards investment decision-making should result in attractive real estate investment opportunities and that its ability to analyze, structure and close complex transactions

quickly is an integral part of securing value-added opportunities within inefficient real estate markets.

The Management Team has a successful history of working together as an entrepreneurial, cohesive unit with a focused opportunistic approach. This approach is complemented by an in-depth understanding of the key factors affecting real property markets, flows of domestic and cross-border capital and macroeconomic trends, which should allow the Fund to identify, analyze and evaluate potential investments quickly and creatively.

In order to successfully employ Carlyle's investment philosophy, CEREP III will invest in a disciplined and proactive manner and utilize Carlyle's unique direct deal sourcing capabilities to target assets with motivated sellers. The Carlyle Europe Real Estate team will perform legal, financial and physical due diligence on potential investments, with a further review by the asset management team. Prior to making the investment, the final review of the asset will be performed by the General Partner's Investment Committee. This process enables Carlyle to effectively and thoroughly review and assess the risks and merits of a potential investment prior to the commitment by the Fund.

Active Management. Many of the Fund's targeted investment opportunities will require active management in order to uncover and create value. Accordingly, Carlyle has developed an experienced in-house asset management team that will work closely with CEREP III's acquisition professionals to effectively formulate and implement strategic management plans. The asset management team will focus on adding value and the strategic repositioning of assets through analysis and execution of capital expenditure programs, development projects, lease negotiations, operating cost reduction programs and asset dispositions.

The day-to-day property management and maintenance of portfolio assets will be handled through the appointment of qualified local property management firms selected by Carlyle in each individual market. This will enable the Management Team to ensure a successful mix of strategic asset management and local presence.

Timely Exits. The Fund intends to invest in assets with value-added investment horizons of two-to-five years from the date of the initial investment, although actual holding periods of the investments may vary from these targets. The "management of the exit" is as important as traditional asset management in order to take full advantage of the typically short windows of opportunity created by temporary imbalances in capital market forces. Furthermore, the Management Team's strong knowledge of both the global capital markets as well as the local capital markets within Europe should assist in identifying and securing attractive exit opportunities for the Fund.

THE INVESTMENT OPPORTUNITY IN EUROPE

The investment climate for European real estate remains positive and will continue as such for a number of years due to the favorable alignment of: (i) an increase in real estate dispositions by the corporate and public sectors; (ii) an improving real estate market cycle; and (iii) the strong performance by the European real estate capital market.

Increasing Corporate and Public Sector Dispositions. There is increasing pressure throughout Europe for public and private institutions to dispose of their non-core real estate holdings. Over the past four years, France, Germany and Scandinavia have experienced growth in public sector dispositions, and the United Kingdom, Spain and Italy have experienced growth in corporate dispositions over this same period. Currently,

Carlyle estimates that corporate and public sector dispositions represent over 50% of the transactions in the real estate investment market. Consistent with this trend, over 70% of the transactions completed by CEREP and CEREP II are a result of corporate and public sector dispositions. It is expected that this trend will continue, and CEREP III plans to take advantage of these opportunities for real estate investment.

Improving Real Estate Market Cycles. The major European real estate markets are continuing to improve and are at an attractive point in their cycle. The office leasing market is experiencing an increase in lease-up activity and a decrease in vacancy levels, and, as a result, an increase in rental rates and improved cash flows are expected. In addition, the retail and logistics leasing markets are continuing to improve as a result of consolidation and expansion. CEREP III is uniquely positioned to take advantage of these trends.

Strong Real Estate Capital Market. Institutional and retail investors will continue to have a strong interest in the real estate investment market due to various changes in the real estate capital market environment. These changes include the development and growth of new real estate investment trust (“REIT”)-type structures in Europe, which are creating a new paradigm of more capital, increased transparency and enhanced liquidity. It is expected that these changes will strengthen the real estate capital market and result in an increase in exit opportunities for the Fund.

MANAGEMENT OF THE FUND

Eric E. Sasson is a Managing Director and has been the head of the Carlyle Europe Real Estate team since its inception in 2001. He is based in Paris. Prior to joining Carlyle, Mr. Sasson was a Managing Director at LaSalle Investment Management, where he was responsible for real estate private equity in Europe and built and managed a 20-member team. From 1999 to 2000, Mr. Sasson was responsible for the creation, investment and management of a €300 million equity fund targeting European real estate, as well as a €150 million pan-European hotel fund. Prior to LaSalle, Mr. Sasson worked for a real estate development arm of Compagnie Bancaire and has 14 years of relevant real estate experience.

Mr. Sasson has an engineering degree from Ecole Supérieure des Travaux Publics (ESTP, a French civil engineering school), an M.S. from MIT and an M.B.A. from INSEAD.

Robert Hodges is a Managing Director responsible for Carlyle’s real estate asset management strategy across Europe and the acquisition of real estate properties in the United Kingdom. He is based in London. Prior to joining Carlyle, Mr. Hodges was a Director of LaSalle Investment Management with responsibility for portfolio management of European commingled funds. He was responsible for the portfolio management of the Euro 5 Portfolio, which included predominately office properties, totaling €850 million, and the “Francilienne” fund of office properties in and around Paris, totaling \$400 million. Before moving to France in 1995, Mr. Hodges worked in LaSalle’s London office on the acquisition and asset management of London office properties and U.K. regional shopping centers. Mr. Hodges has 13 years of relevant real estate experience.

Mr. Hodges graduated from the London School of Economics and Political Science with a B.S. degree in economics.

Guido Audagna is a Managing Director responsible for the acquisition of real estate properties in Italy. He is based in Milan. Prior to joining Carlyle, Mr. Audagna was at BNL

Fondi Immobiliari SGR in Milan (a subsidiary of the BNL Banca Nazionale del Lavoro Group) where he was a Fund Manager of Italian real estate funds. Prior to that, he worked at REAG Real Estate Advisory Group (a subsidiary of American Appraisal) in Milan and Padua where he was an Area Manager for northeast Italy. Mr. Audagna has 13 years of relevant real estate experience.

Mr. Audagna completed his undergraduate degree in architecture at the Polytechnic of Turin and has a graduate degree in town planning and real estate market from COREP of Turin.

Marc Demumieux is a Managing Director responsible for the acquisition of real estate properties in France and Benelux. He is based in Paris. Prior to joining Carlyle, Mr. Demumieux was an Associate Director at LaSalle Investment Management in Paris where he was in charge of real estate acquisitions in France and Italy, involving office buildings, warehouses, commercial centers and hotels. Prior to that, he worked principally on the distressed Barclays' mortgage loan portfolio at Lafayette Partenaires, a joint venture of LaSalle Partners and the French bank Société Générale. Mr. Demumieux gained additional experience in real estate with A3C (subsidiary of Caisse des Dépôts et Consignations) and a subsidiary of Compagnie Générale des Eaux (CGE group). Mr. Demumieux has 11 years of relevant real estate experience.

Mr. Demumieux received his master's degree in bank and finance from the University of Paris Panthéon-Assas in 1994 and holds a four-year degree in economics from Paris II University.

Thomas Lindström is a Managing Director responsible for the acquisition of real estate properties in Scandinavia. He is based in Stockholm. Prior to joining Carlyle, Mr. Lindström was at GE Real Estate Nordic where he was Head of Business Development and responsible for acquisitions in the Nordic region. Prior to that, he was responsible for all sales activities in the Nordic region for GE, managing all of its joint ventures and loans in the region. Before GE, Mr. Lindström was at DTZ Sweden where he was a senior member of the Swedish investment team. Prior to that, Mr. Lindström was Vice President and Head of Transactions at Realia (Sweden) AB, a listed real estate company. Mr. Lindström has 12 years of relevant real estate experience.

Mr. Lindström received an M.S. in engineering from the Royal Institute of Technology, Stockholm, Sweden, having specialized in real estate economics.

Wulf Meinel is a Managing Director responsible for the acquisition of real estate properties in Germany and Central Europe. He is based in Frankfurt. Prior to joining Carlyle, Dr. Meinel was head of the German LaSalle Investment Management operations. Dr. Meinel has 13 years of real estate experience as an investment manager, banker and lawyer. Before joining LaSalle, he was head of the International Strategic Management Department of Dresdner Bank's real estate lending arm.

Dr. Meinel holds a Ph.D. in European law and an M.A. in social science from the University of Freiburg, Germany.

Catherine Simoni is a Managing Director responsible for the asset management of real estate properties across France and Benelux. She is based in Paris. Prior to joining Carlyle, Ms. Simoni was a Director at SARI Development, the development arm of Nexity, where she was responsible for implementing business plans for several major French office developments, including leasing and sale of such developments. Prior to SARI Development, Ms. Simoni was a Director at Finestate & Robert, a subsidiary of J.E. Robert Company, where she worked on transactions in real estate and real estate-backed

loan portfolios in France, Spain, Belgium and Italy. Ms. Simoni has 14 years of relevant real estate experience.

Ms. Simoni received an engineering degree from Nice University, France.

Oussama Daher is a Director and acts as chief financial/administrative officer for the European real estate team. He is based in London. Prior to joining Carlyle in July 2001, Mr. Daher was at LaSalle Investment Management in Paris and Amsterdam where he was a financial controller for European real estate funds. Prior to that, Mr. Daher was with Ernst & Young. Mr. Daher received a degree in accounting and finance from Dauphine University in Paris.

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 €200 million plus reasonable normal investment expenses, in Carlyle Europe Real Estate Partners III, 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.