PSERS VALUE-ADDED REAL ESTATE PROGRAM

Recommendation for Investment in
Fillmore West Fund, L.P.

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Fillmore West Fund, L.P.

EXECUTIVE SUMMARY

Fillmore West Fund, L.P. ("Fund") is being formed to acquire, manage, enhance and dispose of structured investments in, and related to, real estate assets and real estate operating companies located primarily in the United States. The Fund is being formed by Fillmore Capital Partners, LLC ("FCP") as the successor to Fillmore East Fund, L.P. ("FEF") with the intent of continuing and expanding on the successful investment strategies developed and employed by FCP for FEF and other clients. In this regard, it is intended that the Fund's portfolio will be yield-focused and balanced, in terms of duration and volatility, with a blend of structured investments at various strategic points in the capital spectrum for real estate-related assets. Fund investments will typically feature one or more of the following characteristics:

- *Non-commodity property type or special situation (such as lodging and healthcare)*
- *Integrated operating business or platform*
- *Transaction structures with multiple capital tranches*
- *Sustainable cash-on-cash return*
- *Variable investment duration with multiple exit strategies*

Eligible investments may include first mortgage loans, junior participations in first mortgage loans ("B Notes"), mezzanine loans, corporate debt, distressed debt, preferred equity and equity. The Fund will seek to achieve an annual rate of return for its investors of at least 14% over the life of the Fund, net of investment management fees and distributions to the general partner of the Fund.

The Fund will be a newly organized Delaware limited partnership seeking to raise $600 million in capital commitments which the Fund intends to leverage to provide an aggregate of between $1.5 billion and $2.5 billion for investment. Fillmore West Management, LLC, which will be owned and managed by FCP, will be the general partner of the Fund. The General Partner or its affiliates will invest 1% of the aggregate capital commitments of the Fund up to $6.0 million. In addition, a significant portion of each FCP management team member's compensation will be based on the overall performance of the Fund.

INVESTMENT STRATEGY

FCP's response to spread compression is to avoid market indexing and to focus the Fund on more specific but scalable opportunities where the Fund's capital can be deployed quickly and immediately to begin generating attractive returns. The Fund will feature relatively large investments pursuing the following strategy:

> **<u>Non-commodity Focus</u>:** While the Fund will be able to invest in most commercial property types, it will primarily target non-commodity sectors and operating business-intensive properties, such as lodging, senior housing, healthcare and special situations. As of the end of 2006, these sectors represented a combined 18.6% of total CMBS debt outstanding, or $117.4 billion. In terms of relative percentages, however, certain sectors, most notably healthcare (0.8% of total outstanding CMBS), remain underserved by the market. Fund investors may benefit from FCP's position as a nationally recognized lender and investor and a respected capital partner within many of these target sectors, resulting in the potential for a strong flow of attractively priced investment opportunities. Further, by focusing on target sectors that are potentially less inundated with capital, the Fund may realize a "premium" in terms of both investment spread and transaction structure.

Demographic Trends: The Fund will emphasize property types and markets supported by favorable demographic trends. The population of the U.S. is aging, driven largely by a generation of "baby boomers" moving toward their retirement years. As an example, a major trend affecting future Fund strategy will be the growing demand for senior housing and healthcare. For an increasing share of our aging population, this is a non-discretionary expenditure. Moreover, the senior housing and healthcare sectors will increasingly be supported by a well-entrenched entitlement system, especially within the higher acuity sectors, thereby providing stability to demand, revenue growth and sustained bottom line performance. The Fund will also target sectors catering to the leisure and lifestyle demands of an aging population, including resort properties, age-restricted communities and properties economically dependent on various forms of entertainment.

Special Situations: It is expected that a portion of the Fund's portfolio will consist of investments that fall outside conventional financing parameters due to dollar size, structure complexity or credit stress, which typically requires a component of both debt and equity investments to accomplish a successful investment structure. Spread compression, and the market's tolerance, at times, for excess risk, will eventually come to an end, thereby limiting opportunities for arbitrage in the capital markets and causing some financings on the margin to fail. With loan defaults among CMBS loans currently below their 10-year historic average, a reversion to the historic mean should be expected. There is some evidence that such a reversion has already begun within the residential housing markets and it is possible that a similar correction could occur within the commercial markets as well. This scenario could present a significant opportunity for the Fund because many lenders and special servicers are generally reluctant to become engaged in sustained workouts on complex operating assets. Special situations could also include investments in large private and public platforms where the values of the real estate and operating components have been marginalized by their present corporate structures. In certain cases, value can be accessed with improved financing and operational efficiencies.

The senior executives of FCP have successfully invested in all the aforementioned scenarios, in both debt and equity, and continue to believe that the strategies offer strong relative value in terms of spread premiums and attractive risk-adjusted returns.

The Fund's objective is to generate total net leveraged returns of 14% for investors, with an emphasis on current cash distributions, through a portfolio of commercial real estate-related debt and equity investments. The Fund will be balanced, in terms of duration, between short and intermediate term investments. Downside mitigation will be sought by several means, including, but not limited to, meaningful levels of subordinate equity and/or debt, defensive loan structures, financially strong/high integrity sponsors, and/or below reproduction cost point of entry. Investment structures will include, among others, first mortgage loans, junior participations in first mortgage loans ("B notes"), mezzanine loans, asset backed securities, preferred equity, and equity.

Leverage will be used by the Fund to enhance returns and create greater portfolio diversity. The Fund will primarily utilize bank warehouse lines and other leverage strategies, to directly or synthetically match the nature of the investment being leveraged.

The chart below indicates the projected weighting of the Fund's capital within the real estate capital spectrum. While the Fund will be yield-focused, the Fund's asset mix will likely include more equity positions than is typically found in structured real estate investment funds.

Increasing the emphasis on equity provides an effective counterbalance to debt investments which have recently displayed short-term durations and the opportunity to expand the overall return multiple on the Fund's capital. Full bandwidth coverage also increases the nimbleness of the Fund to respond to market changes and deploy capital in a timely manner toward risk tranches offering the most attractive returns.

Projected Weighting of Fund Capital

Transaction Structure	% of Equity	% of Portfolio	LTV	Rate/Spread	Leverage Factor	Structured Return (1)
Equity/Distressed	17.5%	7.0%	0%	18 - 22%	NA	18 -22%
Preferred Equity	20.0%	8.0%	85-95%	10 - 16%	0.25:1	15 -20%
Jr and Sr Mezzanine/ABS	50.0%	60.0%	70-85%	L+300 - 500	2:1	14 -20%
B- Notes, BBB/BB (CMBS)	7.5%	10.0%	60-70%	L+150 - 300	3:1	12 -18%
Senior Debt (CMBS)	5.0%	15.0%	50-60%	L+100 - 225	4:1	12 -16%
Target Blending →	**100%**	**100%**	**80%**	**L+600**	**2.1**	**17.5%**

MANAGEMENT OF THE FUND

FCP is an investment management firm that serves institutional investors and high net worth individuals, with a continuing goal of offering access to attractive risk-adjusted high-yield structured real estate investments. A recognized leader in the real estate finance sector, FCP's management team has completed in excess of $4.4 billion of high yield investments for institutional tax-exempt funds since January 2000. FCP is currently the investment manager of FEF, a $420.3 million structured investment fund primarily focused on the hospitality and healthcare sectors. FCP is also the investment manager for Fillmore Strategic Investors, a $606 million investment partnership targeting large structured real estate debt, equity and entity-level investments within operating intensive property sectors.

The Fund will be managed by FCP, an experienced real estate investment management firm founded by Ronald E. Silva, its President and CEO. FCP's management team is represented by career investors and fiduciaries with combined transaction experience in excess of $8 billion. The management team successfully invested in a variety of lodging and commercial equity and debt investments throughout the 1990s, before focusing exclusively on a structured-finance private equity platform concurrent with FCP's formation in 2003. FCP currently manages investment partnership, investment fund and separate account portfolios with a combined gross value in excess of $3.7 billion. To date, FCP's structured investment activities have focused primarily on hospitality, senior housing, healthcare and other non-commodity real estate investments and entity-level investments.

PARTNER BIOGRAPHIES

Ronald E. Silva, President and CEO. Mr. Silva has spent the past 25 years investing on behalf of institutional clients in a variety of real estate and operating company opportunities. Mr. Silva's responsibilities consist of directing all investments for FCP, managing the firm growth initiatives and communicating with clients. In forming FCP, Mr. Silva fulfilled a lifelong desire to build a firm that operates according to his high standards for investment performance and service. Under his leadership, the company has experienced an eight-fold increase in assets under management since 2003. Prior to forming FCP, Mr. Silva served as Executive Vice President of Lowe Enterprises, Inc., and was responsible for investments exceeding $2 billion in contributed equity. While at Lowe, he formed the structured finance team, which subsequently led to the formation of FCP. Prior to joining Lowe Enterprises, Inc., Mr. Silva developed his fundamental real estate and credit skills as a Vice President for Wells Fargo Bank. Mr. Silva has spent the majority of his professional career within the pension real estate industry and served on the governing board of the Pension Real Estate Association. He is currently Chairman of the Board of the largest privately held long-term care company in the United States. Mr. Silva received a B.S. from the University of California at Berkeley, in Organic Chemistry and a J.D. from the John F. Kennedy University School of Law, where he graduated with honors.

Timothy C. Getz, Executive Vice-President. Mr. Getz heads the company's business development, strategic planning/implementation and client communication efforts. He is responsible for much of the investment philosophy and strategy that governs FCP's investment activities. Prior to the formation of FCP, Mr. Getz served as a Senior Vice President for Lowe Enterprises, Inc., and together with Mr. Silva developed the structured finance, distressed debt and corporate investment programs. Previously, Mr. Getz worked in the REIT industry serving as the Chief Investment Officer and Treasurer for Glimcher Realty Trust. He is also a former board member of the National Association of Real Estate Investment Trusts. In addition, Mr. Getz was the principal architect and director of the real estate and alternative investment programs for the Public Employees Retirement System of Ohio. His endeavors resulted in the investment of $4 billion of public capital over a fourteen-year period. Mr. Getz received a B.A. in Economics from the College of Wooster and an M.B.A. from Emory University.

Michael O. Reinardy, Senior Vice-President. Mr. Reinardy has been with FCP since the company's formation and leads one of FCP's two production teams. His responsibilities are primarily centered on the origination and oversight of investment opportunities for FCP's commingled funds and separate account investors. Prior to the formation of FCP, he served as a Vice President for Lowe Hospitality Group and was an original member of the structured finance group formed by Mr. Silva. Previously, Mr. Reinardy was an Assistant Vice President and loan officer at Deutsche Banc Mortgage Capital, where he originated, structured, underwrote and closed mortgage loans secured by commercial real estate. Mr. Reinardy holds a B.A. in Finance from Santa Clara University and an M.S. in Finance from New York University's Real Estate Institute.

James R. Hjort, Senior Vice-President. Mr. Hjort joined FCP concurrent with the company's formation and presently manages one of FCP's production teams. His responsibilities include sourcing, structuring and underwriting investment opportunities, and asset management for FCP. Previously Mr. Hjort served as an Assistant Vice President for Fremont Investment & Loan, where he originated mortgage financings secured by hospitality, office, retail, industrial, special purpose and multifamily assets. His experience as both a construction and permanent lender provides an added dimension to FCP's sourcing and underwriting capabilities, particularly within the non-hospitality sectors. He received his B.A. from the University of California, Los Angeles.

Milton B. Patipa, Senior Vice-President, Finance. Mr. Patipa is responsible for corporate finance and control, client reporting and other financial activities for FCP. Mr. Patipa brings a deep understanding of financial management and administration and is a Certified Public Accountant with thirty-three years of experience in accounting, finance and taxation. Prior to joining FCP, Mr. Patipa held senior management positions in several industries including real estate, financial services, technology, retail and public accounting and has served on the Executive Board of Directors of several not-for-profit organizations. He has had a twenty-seven year association with Mr. Silva in various endeavors. His education includes undergraduate studies at the University of California, Berkeley.

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 $100 million plus reasonable normal investment expenses, in Fillmore West Fund, 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.