PORTFOLIO ADVISORS, LLC

February 16, 2012

Board of Trustees
Pennsylvania Public School Employees' Retirement System
5 North 5th Street
Harrisburg, PA 17101

Re: Apollo European Principal Finance Fund II, L.P.

Dear Trustees:

Apollo Management International LLP ("Apollo" or the "Firm") is seeking to raise capital commitments of €2.5 billion (hard cap) for its Apollo European Principal Finance Fund II, L.P. (the "Fund" or "EPF II"). EPF II will continue the investment strategy of the previous Fund by primarily purchasing portfolios of European non-performing loans ("NPLs") and to a lesser extent, performing loans at attractive discounts to both the unpaid principal balance and the liquidation value of the underlying collateral. The EPF Team has identified three key elements to successfully execute its investment strategy: 1) sourcing portfolios at attractive purchase prices; 2) underwriting NPL portfolios at conservative recovery rates; and 3) actively managing its portfolios through Lapithus, the Fund's captive special servicer, to maximize returns. The NPL portfolios are expected to be similar to those acquired by Fund I and therefore will continue to include residential and commercial real estate loans, unsecured consumer loans, and small corporate loans.

The size of the European NPL market has grown considerably since the onset of the global economic crisis and has been exacerbated in recent months by the sovereign debt crisis in the peripheral euro zone economies including Greece, Ireland, Portugal, Spain, and more recently Italy. From a recent stress test conducted on 90 European financial institutions, aggregate exposure to peripheral European sovereign and domestic borrowers was estimated at over €6.0 trillion. Apollo estimates that the current European non-performing loan ("NPLs") market has grown to €1.0 trillion, up from an estimated €400 billion at the launch of EPF I. The slow and often uncoordinated reaction of many European governments to the recent sovereign debt crisis has greatly contributed to this current opportunity.

As a result, European financial institutions are under significant pressure from regulatory and competitive forces to focus on their core activities and strengthen their balance sheets, including through the sale of NPL portfolios. Due to the experience in EPF I, Apollo has developed a reputation with European financial institutions as a preferred partner by structuring creative solutions which satisfy financial institutions need to sell assets while minimizing near term losses. Additionally, the presence of Lapithus' provides selling institutions with assurance that EPF can responsibly manage portfolios following a sale, particularly in cases where the seller retains an economic interest. EPF II's core target geographies remain consistent with EPF I and include the U.K., Germany, and Spain. The Fund will opportunistically look to make investments in other European jurisdictions including Portugal, Ireland, Italy, and the Netherlands.

Portfolio Advisors' recommendation is based upon the following analytical factors and is made within the context of PSERS' investment guidelines.

- Detailed due diligence, including interviews with industry peers, private equity professionals and CEOs of portfolio companies.

- Evaluation of the composition of the investment team, how they work together, compensation structure and other factors that help determine whether a group is likely to be able to replicate past successes as currently configured.

- Evaluation of the Fund's proposed investment strategy within the context of the current investment environment.

- The strategy proposed for the Fund is appropriate for the Private Equity Partnership component of the portfolio.

Based on the above, Portfolio Advisors recommends that PSERS commit to up to $200 million of limited partnership interests in Apollo European Principal Finance Fund II, L.P. Portfolio Advisors makes this recommendation considering the General Partner's qualifications and PSERS' overall investment guidelines.

This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in the Fund, since their needs, objectives and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits of the Fund. Portfolio Advisors does not provide legal or other non-investment-related advice.

Sincerely,

Portfolio Advisors, LLC

High Yield Fixed Income Allocation

Apollo European Principal Finance Fund II

March 8, 2012

James H. Grossman, Jr., CPA, CFA
Deputy Chief Investment Officer

See Page 7 for Disclaimer

Apollo European Principal Finance Fund II

Overview of Apollo Global Management LLP

- Founded in 1990
- A leading global alternative asset management firm
  - Over $75 billion in AUM in private equity, real estate, natural resources, and other strategies as of Dec. 31, 2011
  - 201 investment professionals and 548 total employees in 9 offices globally
  - Over 1,400 active carry fund investors from 72 countries

Investment Team

- The Apollo European Principal Finance Fund (EPF) team has 16 professionals including three senior origination advisors engaged as consultants who operate out of Frankfurt, London, Dublin, and New York
- David Abrams and a number of the key professionals previously worked together at Credit Suisse's European Distressed Investment and NPL Group

See Page 7 for Disclaimer

Apollo European Principal Finance Fund II

Investment Strategy

- Acquire European Non-performing Loans (NPLs)
  - NPLs are whole loans held by a financial institution that are in default of principal or interest for 90 days or more
  - Commonly sold in portfolios ranging from a few to over a thousand claims comprising various types of loans
  - European banks are traditional lenders and hold these loans on their balance sheet

Market Opportunity

- Apollo estimates that the current European NPL market has grown to €1.0 trillion, up from €400 billion at the launch of Fund I
- European financial institutions are under significant pressure from regulatory and competitive forces to dispose of their NPL portfolios
  - Regulatory requirements of Basel III
  - Strategic retrenchment by financial institutions away from non-core businesses
  - Requirements to repay equity capital (state aid)
  - Withdrawal of liquidity support by central banks

See Page 7 for Disclaimer

Apollo European Principal Finance Fund II

Keys to successful implementation

- Sourcing portfolios at attractive purchase prices – EPF has dedicated origination advisors (former European bank CEOs and senior executives)
- Underwriting NPL portfolios at conservative recovery rates – done by individual pricing of every loan and property
- Actively managing its portfolios through Lapithus, the Fund's captive special servicer
  - The Lapithus Group represents EPF's captive pan-European loan servicing and real estate asset management platform
  - Represents a competitive advantage for EPF as they can approach financial institutions and provide both a financial and operational solution
  - Lapithus focuses on consensual solutions
    - Pay the loan off at some discount to face value
    - Ask the borrower for a power of attorney to sell the property and release the borrower from further liability
    - If the borrower is only temporarily impaired, put borrower on monthly payment plan, bring the loan back to par, and sell it as a performing loan
    - Final option would be to foreclose on the collateral

See Page 7 for Disclaimer

Apollo European Principal Finance Fund II

Investment Performance

- Fund I returns were top quartile performance for all 2007 EU Private Equity funds on that vintage year per the ThomsonOne benchmark

History with PSERS

- This will be the first fund for the EPF team; however, PSERS previously approved Fund I in 2008 but pulled the investment due to PSERS liquidity constraints at that time
- PSERS has previously committed to the following Apollo funds:
  - Apollo Europe Real Estate Fund III, LP: $148.5 million
  - Apollo Real Estate Finance Corporation: $150.0 million
  - Apollo Real Estate Co-Invest Corporation: $69.2 million
  - Apollo Value Enhancement Fund VII, LP: $150.0 million

Note: The real estate group separated from Apollo and is now called AREA

See Page 7 for Disclaimer

Apollo European Principal Finance Fund II

PSERS Objective

- To earn low- to mid-teens net returns over the life of the Fund
- To broaden the high yield allocation into higher potential return opportunities

Portfolio Use

- Staff recommends a commitment of $200 million to the Apollo European Principal Finance Fund II and to include this investment in the High Yield fixed income allocation

See Page 7 for Disclaimer

Apollo European Principal Finance Fund II

Other

- Relationships with Portfolio Advisors: None
- Placement Agents: None
- Political Contributions in PA: None
- Introduction Source: Current relationship with manager

See Page 7 for Disclaimer

Apollo European Principal Finance Fund II

Recommendation

Staff, together with Portfolio Advisors, LLC, recommends that the Board invest $200 million plus reasonable normal investment expenses in the Apollo European Principal Finance Fund II

See Page 7 for Disclaimer

High Yield Fixed Income Allocation

Apollo European Principal Finance Fund II

March 8, 2012

James H. Grossman, Jr., CPA, CFA
Deputy Chief Investment Officer

See Page 7 for Disclaimer