

COURTLAND PARTNERS, LTD.

INSTITUTIONAL REAL ESTATE SERVICES

200 PUBLIC SQUARE
SUITE 2530
CLEVELAND, OH 44114

TELEPHONE: (216) 522-0330
FAX: (216) 522-0331
www.courtland.com

November 14, 2012

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

Re: LEM Real Estate High-Yield Debt and Preferred Equity Fund III, L.P.

Dear Trustees:

Courtland Partners, Ltd. ("Courtland"), having been duly authorized by the Board of PSERS, has evaluated LEM Real Estate High-Yield Debt and Preferred Equity III, L.P., ("Fund III"). Fund III will purchase and originate real estate structured finance investments, which primarily will consist of preferred equity, mezzanine loans, and first mortgages. Fund III will also consider B-Notes, joint venture equity and entity level investments in real estate operating companies. Individual investments are generally expected to range between \$5 to \$20 million in size with an average investment size of \$8 million. LEM Capital ("LEM") anticipates completing 12 to 24 deals per year, depending on the size of Fund III.

Fund III investments are expected to be mostly preferred equity investments in multifamily assets, but may also invest in office, retail, industrial and hotel properties. LEM's strategy for Fund III includes using its real estate expertise to identify "best of market" properties for investment. Fund III generally will invest in quality core and core plus properties with strong current cash flow and solid leasing and rent growth opportunities. Fund III will generally not make investments in land, condominium conversions, new construction or similar properties that have little or no current cash flow or that could require substantial additional development or rehabilitation expenditures.

LEM believes multifamily is the most resilient asset class and offers the most attractive risk-adjusted return in the current market environment. LEM's previous two funds invested over 65% of their capital in multifamily assets. For office properties, LEM will seek assets in strong infill locations with a diverse tenant base where rents are at or below the then-prevailing market rates. Similarly, for retail LEM will focus on dominant assets within the trade area with a history of strong sales per square foot. Hotels will have a major flag (generally Marriott, Starwood, Hilton or Hyatt) and be in or near a major 24-hour city.

Fund III's investments are expected to be predominantly in infill markets with high barriers to entry, primarily on the East and West Coasts, the Southeast, metropolitan Chicago and in selective markets in Texas. These are markets that are well-known to LEM and are in locations in which the firm has deep relationships to assist in sourcing and gathering market knowledge on the property, submarket, borrower and other important investment details. Fund III also will focus on investing in markets with high employment centers and properties with proximity to amenities, good visibility, and access to major transportation systems.

LEM invests alongside operating partners throughout the U.S. Including Lubert-Adler's operating partner network, the total operating partners available to LEM is over 75. The Fund III strategy is premised on investing with top quality sponsors/borrowers. LEM believes the value of hands-on ownership and management cannot be overstated and is a key factor in maximizing operating performance and value. In making Fund III investments, LEM will seek experienced local sponsors with strong management organizations and excellent reputations, not only as owner/operators but also as good partners/borrowers who are financially sound. LEM has seen firsthand how borrowers that know their markets and who maintain a hands-on focus on their properties can make a difference to the success of its investment.

LEM currently manages three high-yield real estate funds. Day-to-day operations of LEM are led by two managing partners, Jay Eisner and Herbert Miller. Additionally, Ira Lubert provides advice and oversight with respect to Fund III investments and other significant issues. Messrs. Eisner, Miller, and Lubert founded LEM in 2002 and have maintained a strategy of originating and managing a diversified portfolio of commercial real estate structured debt and equity investments secured by multifamily, office, retail, industrial, and hospitality properties across the United States and Canada.

Courtland's recommendation is based upon the following factors and is made within the context of PSERS' investment guidelines.

- Detailed due diligence, including interviews with key LEM management team members, and review of all relevant materials provided by LEM.
- Evaluation of Fund III's proposed investment strategy within the context of the current investment environment.
- Evaluation of LEM's track record and organizational resources.
- Discussion and review of the market conditions in markets relative to the proposed investment strategy.
- The strategy proposed for the Fund is appropriate for the real estate component of the portfolio.

Based on the above, Courtland recommends that PSERS commit up to \$75 million to Fund III. Courtland makes this recommendation considering LEM's qualifications and PSERS' overall investment guidelines.

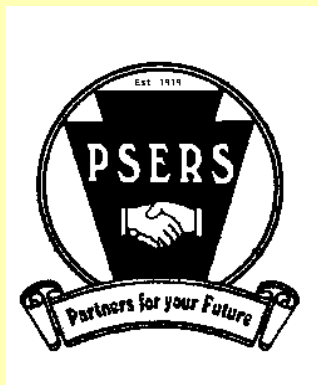
This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in the Fund, since their needs, objectives and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits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

Sincerely,



Steven Novick
Principal-Chief Operating Officer

COURTLAND PARTNERS, LTD.



Value-Added Real Estate Commitment

LEM Real Estate High-Yield Debt and Preferred Equity Fund III, LP

December 5, 2012

See Last Page for Disclaimer

William Stalter
Portfolio Manager, Real Estate

LEM Real Estate High-Yield and Preferred Equity Fund III – Value- Added Real Estate

Overview

- Fund size: \$300 million (\$500 million cap)
- Third in a series of dedicated closed-end commingled real estate debt funds, over \$500 million AUM
- Sponsored by LEM Capital, a provider of senior equity, preferred equity, mezzanine loans, subordinate financing and other structured debt and equity solutions to commercial real estate owners

Fund Strategy

- To finance sponsor's equity through either debt, preferred equity or senior equity investments, where the sponsor's cash is subordinate to the Fund
- Focus on current cash flow, with predictable distributions to Fund investors (target 8% annual return paid quarterly)
- Structure preferred equity investments with upside participation, potentially enhancing Fund returns
- Emphasis on multifamily assets, selectively invest in office, retail, hospitality, industrial, student housing and senior housing
- Focus on middle market opportunities where transactions providing attractive risk-adjusted returns can be found "below the radar" of large investors
- Invest primarily in the US, selectively in Canada

Investment Team

- The Fund will be managed by Jay Eisner and Herb Miller, co-founders of LEM Capital (2001), who together oversee LEM's activities and are supported by more than 10 investment professionals
- LEM's team of professionals bring over 90 years of experience in real estate investing including lending, development, ownership, loan servicing, finance and operations
- Operations further augmented vis-à-vis its relationship with Independence Capital Partners (ICP Services) – investor relations, information technology, risk management, regulatory and tax
- Headquartered in Philadelphia, PA

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LEM Real Estate High-Yield and Preferred Equity Fund III – Value- Added Real Estate

GP “Value Add”

- Senior management actively involved in every deal
- Hands-on asset management, not reliant on 3rd party providers
- Deals structured so that LEM controls exit timing, along with major decision rights related to property sale/refinance, capital improvements, budgets and property management
- LEM’s experience and market presence provides the Fund with quality deal flow
- Top-tier performance amongst 2005-2008 vintage real estate debt funds
- Focus on small/mid-size transactions provides meaningful diversity to the Fund

Performance (as of June 30, 2012)

- LEM Real Estate Mezzanine Fund I, LP (2002) currently has a net 1.25x MOC and a 7.3% net IRR
- LEM Real Estate Mezzanine Fund II, LP (2006) currently has a net 1.06x MOC and a 1.8% net IRR

Market Opportunity

- Funding gap in US capital markets providing unprecedented opportunity to issue preferred equity and mezzanine debt where unleveraged mid-teens returns can be achieved with significant downside protection
- Senior debt being issued at lower loan-to-value ratios, requiring larger equity checks from borrowers, resulting in further equity cushion to preferred lenders
- Multifamily is the least volatile real estate asset class with solid fundamentals (strong cash flow, limited new supply, decreasing levels of homeownership, favorable demographics)

LEM Real Estate High-Yield and Preferred Equity Fund III – Value- Added Real Estate

History with PSERS

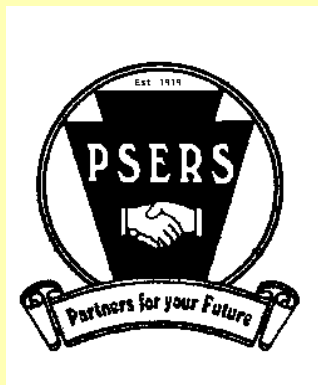
- PSERS previously invested in LEM II (2006)
- The LEM platform is part of the Independence Capital Partners umbrella organization, to which PSERS has made commitments to various funds sponsored by Lubert-Adler Partners, LLR Equity Partners, Versa Capital, Quaker Bio-Ventures and LBC Credit Partners

Board Issues

- Pennsylvania Presence –
 - **Sherwood Apartments** is a 428-unit multifamily portfolio in Bethlehem, Pennsylvania. Fund I has \$1,300,000 mezzanine loan on this portfolio
 - **Thunder Hollow** is a 301-unit multifamily property located in Bensalem, Pennsylvania. Fund I has a \$2,000,000 mezzanine loan on this property
 - **Oaks at McCandless** is a 187-unit multifamily property located in McCandless Township, a suburb of Pittsburgh, Pennsylvania. Fund II has a \$1,015,000 mezzanine loan on this property
 - **McKee Place** is a student housing project comprised of 132 residential units and one commercial building located in Pittsburgh, Pennsylvania. Fund II has a \$770,000 mezzanine loan on this property
- Placement agents –
 - LEM's fundraising is conducted by its affiliate fundraising team at Independence Capital Partners
- PA political contributions – None
- Relationship with consultant – None

Recommendation

- Staff, together with Courtland Partners, Ltd, recommend that the Board invest an amount not to exceed \$75 million plus reasonable normal investment expenses



Value-Added Real Estate Commitment

LEM Real Estate High-Yield Debt and Preferred Equity Fund III, LP

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[NEXT](#)

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