Opportunistic Real Estate Fund Commitment

Carlyle Realty Partners VII, L.P.

March 13, 2014

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Portfolio Manager, Real Estate

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Carlyle Realty Partners VII, L.P. – Opportunistic Real Estate Fund

Overview

- Fund size: $3.0 to $4.0 billion
- Opportunistic real estate fund targeting a broad range of real estate and real estate-related investments, focused primarily on US markets
- Founded in 1987, The Carlyle Group is a global private equity firm which has $180 billion in AUM across 118 funds and 81 fund of funds
- Carlyle employs more than 1,400 employees in 34 offices in Africa, Asia, Australia, Europe, Japan, the Middle East, Latin America and North America

Fund Strategy

- Acquisitions, value enhancements and disposition of mispriced and undervalued real estate assets in the U.S.
- Single asset transactions primarily focused on office, residential, senior living, hotel and retail properties
- Target Returns: 20%+ IRR (gross) / 16%+ IRR (net)

Investment Team

- Established in 1997, the real estate team is based in Washington, DC
- 80 professionals located in offices in Washington, DC, New York, San Francisco and Los Angeles
- Since inception, US real estate team has invested over $7.8 billion of equity in over 400 investments / $28 billion total capitalization

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GP "Value Add"

- Leadership– senior investment professionals have an average tenure at Carlyle of over 14 years with 24 years of real estate investment experience
- Strong Sponsorship – well-capitalized firm, one of the world's largest and most diversified multi-product global alternative asset management firms
- Consistent Strategy – very little "creep", focused on what they do well
- Well-disciplined approach to leverage – no cross-collateralization, very limited fund-level recourse and guarantee obligations
- Adherence to six key fund construction principles: 1) diversification, 2) profit margins, 3) sector choice, 4) leverage levels, 5) exit flexibility and 6) return of capital

Performance (in-place)

- CRP III (2000) 2.43 net MOIC and 32.29% net IRR
- CRP IV (2005) 0.92 net MOIC and -2.15% net IRR
- CRP V (2007) 1.29 net MOIC and 8.05% net IRR
- CRP VI (2011) 1.29 net MOIC and 24.39% net IRR

Market Opportunity

- Improving economy and real estate demand
- Very limited new supply has created a shortage of new functional real estate
- Significant distress remains in the system
  - owners under distress unable to pay or refinance short-term debt
- Tremendous opportunity to "manufacture" core properties and sell into a very liquid market

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Risks and Considerations

Investing a large fund in a recovering market

- although the Fund will focus on major markets, the 80 member team has demonstrated patience investing through many economic cycles
- 5-year investment period
- average deal size $15-30 million
- no deal > 5% of capital commitments
- 90% of deals have been made off-market
- majority of deals in high exit liquidity markets

Leverage

- use of leverage may enhance returns or magnify losses
- track record demonstrates team has utilized leverage in a prudent manner over time
- expect Fund will utilize 50-60% LTV, consistent with past practice
- cellular capital structure - each transaction stands on its own

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History with PSERS

- PSERS has previously committed to Carlyle CRP III, CRP IV, CRP V, CRP VI, CEREP III (Europe) and Carlyle Energy Mezzanine

Board Issues

- Pennsylvania Presence –
  - ➢ CRP Funds own two properties in Philadelphia, PA – Chestnut Hill (senior living) and Greystar Rushwood/Winchester (multifamily)
- Placement Agents –
  - ➢ None used in respect to PSERS' commitment
  - ➢ None used in connection with U.S. Governmental Pension Plans
  - ➢ May use third-party agent to raise capital in respect to certain other limited partners
- PA Political Contributions – None
- Relationship with Consultant – No

Recommendation

- Staff, together with Courtland Partners Ltd., recommends that the Board invest an amount not to exceed $100 million plus reasonable normal investment expenses

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February 20, 2014

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

Re: Carlyle Realty Partners VII, L.P.

Dear Trustees:

Courtland Partners, Ltd. ("Courtland"), having been duly authorized by the Board of PSERS, has evaluated Carlyle Realty Partners VII, L.P. (the "Fund"). The Fund will invest in debt or equity interests in real estate and real estate-related companies across all major property-types, including residential, hotel, retail, office and senior housing. Carlyle tends to focus on acquiring single assets and investing in situations where it maintains control over decisions affecting property performance with a goal of achieving liquidity at its targeted exit price. It is anticipated that the Fund will be invested with similar diversification strategies as employed in prior Carlyle funds in terms of size, sector, and geography. Carlyle has a broad-based investment platform across all property sectors in over 30 major markets, with attractive realized results.

Carlyle continues to uncover compelling opportunities in U.S. real estate. Carlyle's current primary target markets in the United States include New York City, Washington D.C., Southern California, Northern California, and Florida. Carlyle has been consistently active in additional markets, including Boston, Seattle, Dallas, Houston, and Atlanta. Other markets may also be considered if consistent with Carlyle's approach to investing. Carlyle will remain focused on markets that exhibit strong demand trends, diverse economic "contributors," supply constraints, and institutional liquidity for exit. Carlyle intends to remain patient, though, and it will seek reliability of demand in a given market (in the form of sustainable job growth and stabilizing housing prices) as it considers a new investment.

Carlyle is currently focused on eleven real estate sectors: senior living, multifamily residential, for-sale residential, distressed residential, student housing, manufactured housing, hotel, retail, office, industrial, and self-storage. In each sector, Carlyle seeks to employ its investment philosophy to capitalize on attractive asset- and market-specific conditions. Carlyle expects to identify assets that are in need of recapitalization or are encountering stress based on difficult capital markets conditions. Carlyle will adjust its tactics based on the specific characteristics of an opportunity. As it relates to relative exposure to various sectors, Carlyle may adjust its exposure to various sectors at different times based on market conditions as it determines appropriate.

With housing at the center of the Great Recession, Carlyle has dedicated significant focus toward gaining a full view of housing fundamentals. After establishing a view of the potential housing recovery, Carlyle invested decisively into areas of the housing sector that it believed offered assets whose fundamentals were undervalued. In addition, Carlyle believes that a shortage of new and functional real estate exists in many target markets due to the convergence of the following factors: (i) dramatically reduced levels of new real estate construction during the Great Recession, (ii) occupancy declines during this period stemming from demand contraction, as opposed to excessive new supply, and (iii) the natural obsolescence of existing real estate. Exacerbating this situation, Carlyle expects that "pent-up" demand exists in many sectors.

Carlyle expects that debt issuances in 2013 may amount to $250 billion ($150 billion below the norm established in 2005), and that $1.7 trillion of real estate debt will mature between 2013 and 2017. The combination of lower asset prices, low volumes of prospective debt issuances, and high levels of debt maturities creates continued pressure on the capital structures of many real estate properties.

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 Carlyle management team members, and review of all relevant materials provided by Carlyle.
- Evaluation of the Fund's proposed investment strategy within the context of the current investment environment.
- Evaluation of Carlyle'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 $100 million to the Fund. Courtland 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. Courtland does not provide legal or other non-investment-related advice.

Sincerely,

Steven Novick
Principal-Chief Operating Officer

COURTLAND PARTNERS, LTD.