



COMMONWEALTH OF PENNSYLVANIA  
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

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Public Investment Memorandum

**Exeter Industrial Value Fund IV, L.P.**

Real Estate Commitment

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**Laurann H. Stepp**  
Senior Portfolio Manager

**September 7, 2016**



**Recommendation:**

Staff, together with Courtland Partners, Ltd, recommends to the Board a commitment of up to \$100 million to Exeter Industrial Value Fund IV, L.P. (“Fund IV” or the “Fund”). Exeter Property Group (“Exeter” or the “Firm”), a northern Philadelphia headquartered private investment firm, is sponsoring the Fund to make investments in a diversified portfolio of value-add industrial properties.

**Firm Overview:**

Ward Fitzgerald and five additional investment professionals left Liberty Property Trust (“LPT”) and joined with Tim Weber, from Terramics Property Company, to form Exeter Property Group in 2006. Since its formation, seven additional colleagues left LPT and Terramics to join the Exeter team. Over the past twenty years, the Exeter senior team has executed transactions of \$8.3 billion in total gross cost in over 425 big box warehouse, last mile, light industrial, and select flex/office investments in the United States and Europe. A European platform, funded through separate accounts and based out of London, was established in 2014 to meet the needs of Exeter’s global tenant base as they establish world-wide supply chain logistic networks. The vertically integrated Firm has approximately 85 employees, including 15 in Europe, with in-house property and construction management, accounting, leasing, and asset management.

Exeter manages three types of investment vehicles focusing only on industrial properties; core, value-added and European properties. Since 2007, Exeter has invested \$1.8 Billion in equity in the value-add fund series. Following is the breakdown of Exeter mandates as of March 31, 2016:

Mandate	Net Asset Value	Number of Properties	Number of Transactions	Markets	Total Square Feet
Value-Add	\$950M	259	95	25	47.1M
Europe <sup>1</sup>	\$104M	61	39	8	7.5M
Core <sup>2</sup>	0	-	-	-	-
U.S. Managed Accounts	n/a	240	2	25	64.6M

<sup>1</sup> Using a Euro to USD exchange rate of \$1.09

<sup>2</sup> The \$404M Core Fund I was fully realized as of 12/17/2015 with a net IRR of 22.3% and a net MOIC of 1.5x. Core II commenced 3/31/16 and has not yet closed on an investment.

**Market Opportunity:**

There are notable and sustainable long-term demand drivers that are likely to continue to impact industrial demand over time. These demand drivers include; the growth of third party logistics businesses (commonly referred to as “3PL’s”), rising levels of consumption, and e-commerce. 3PL operators have grown market share and demand substantially for functional, well-located properties, as businesses hire them in order to operate more efficiently and reduce their cost of managing and distributing inventories. Consumption increases are driven by the increasing population, and e-commerce has pushed inventory to wholesale from retail, creating demand for additional industrial product. The e-commerce fulfillment model has not yet become as efficient as traditional logistics. The evolution of consumer demand behind e-commerce is driving the need for a range of properties located nationwide. Not only are multiple locations needed for one-day delivery, they are required to meet the consumer driven ‘reverse logistics’ (product returns) demand.

Following several years of rent growth, in-place leases remain below market and will boost industrial property NOI as renewed. After twenty-four straight quarters of positive absorption the national vacancy levels have fallen to 5.2% as of June 30, 2016, the lowest level in fifteen years. The level of annual new supply remains well below levels experienced prior to the financial crisis, representing only 0.77% of the existing stock versus the historical average of 1.9%. Strong investor demand for diversified, income-producing portfolios of large scale continues to drive robust exits.



**Portfolio Fit:**

A commitment to the Fund will be allocated to the Real Estate portion of PSERS' Real Assets portfolio. As of March 31, 2016, and adjusted to include commitments from the March, May, June, and the current Board meeting, the Real Estate portfolio is 49.5% Opportunistic, 32.8% Value-Added, and 17.7% Core. Investment in this Fund will increase PSERS' Value-Add real estate exposure, which is currently below a long term target of 50%.

The table below summarizes PSERS' projected exposure inclusive of a recommended \$100 million commitment to the Fund:

Investment Type (\$M)	Market Value	%	Unfunded <sup>(1)</sup>	%	Total Exposure	%
<b>Opportunistic</b>	3,242.6	57.7%	1,037.5	34.4%	<b>4,280.1</b>	<b>49.5%</b>
<b>Value-Add</b>	1,406.2	25.0%	1,429.6	47.3%	<b>2,835.8</b>	<b>32.8%</b>
<b>Core</b>	974.9	17.3%	550.8	18.3%	<b>1,525.7</b>	<b>17.7%</b>
<b>Total</b>	<b>\$ 5,623.7</b>	<b>100.0%</b>	<b>\$ 3,017.9</b>	<b>100.0%</b>	<b>\$ 8,641.6</b>	<b>100.0%</b>

<sup>(1)</sup> Includes post Q1'2016 pending/closed commitments, and the three deals to be presented to the Board on October 7, 2016 (Cabot IVF V, Exeter IVF IV and Bell Institutional Fund VI)

**Investment Strategy:**

The Fund will build a diversified portfolio of single asset and multi-building packaged industrial property transactions. Exeter will acquire, reposition, lease, develop, operate and sell industrial and business park assets in primary metropolitan, high growth major markets, as well as intermodal, air and seaport distribution hubs in the United States, select Canadian markets (Vancouver, Calgary, Toronto), and select Mexican markets (along U.S. border, or Mexico City). Equity investments of \$2M - \$22M will include (i) big box warehouses, (ii) last mile, and (iii) light industrial assets. Similar to Funds II and III, emphasis will be placed on high cash-flowing assets in primary industrial markets with modern, single-tenant big box, bulk warehouses. Development is expected to be an attractive strategy at this point in the real estate markets, but will be limited to 20% for projects less than 75% leased. The following themes will also be considered:

Theme	Description
<b>Acquire Under-Performing Properties at Discounts</b>	Discounts to current market values can still be achieved with assets in distress due to vacancy, lease expirations, over-leverage and refinancing defaults.
<b>Pursue Single-Asset Acquisition Discount</b>	Non-industrial investment specialists do not pursue these smaller one-off acquisitions, causing reduced competition. Exeter's large team can source, close and manage large volumes of deals. For example, of 225 value fund deals, the average equity has been less than \$8M.
<b>Aggregate Single-Assets as Portfolio</b>	Once purchased, Exeter mitigates the single asset/tenant risks and inefficiencies by aggregating investments to create a portfolio with product, credit, tenant, and geographic diversification.
<b>Add Value Through NOI Growth, Strong Cash Flows</b>	Funds II and III invested over 55% in well-leased, albeit short term leases, assets and took advantage of the highly accretive low cost debt. They expect that Fund IV will invest approximately the same in this area to achieve the best risk adjusted portfolio returns.
<b>Build to Suit and Speculative Development</b>	Low vacancy, high absorption, rising rents and aged stock have enabled a re-start of industrial development. Speculative (limited to 20%) and build to suit facilities may reach 30% of Fund IV. Exeter's in-house team has expertise required for complicated LEED construction, environmental, and engineering challenges. Exeter's national corporate tenant relationships are expected to result in additional, compelling, build to suit or pre-leased opportunities.
<b>Renovation, Redevelopment, Repositioning</b>	Exeter's construction expertise provides key insights into critical design and functionality requirements when identifying redevelopment, renovation or repositioning opportunities in desirable in-fill locations where scarcity of land or high barriers for approvals of bulk distribution exist. The cost trade-off is critical in these projects.



Once Exeter has executed their investment plan and optimized property income and lease duration they will consider single asset, small portfolio, or major national portfolio sales. They have proven capabilities with multiple exit options and will determine the best outcome based upon the current market conditions. Since industrial properties are more difficult to aggregate, it is highly likely that the currently available portfolio premiums will continue in the future.

**Investment Instruments:**

Investments are expected to be real estate industrial properties held through fee or note ownership in special purpose entities.

**Investment Structure:**

The Fund is a Delaware Limited Partnership, sponsored by Exeter Property Group LLC. The General Partner, Exeter Property Group IV, L.P. ("GP"), is a Delaware Limited Partnership.

The Fund will be managed by Exeter Property Group, LLC. ("Manager"), which is controlled by the Firm's Senior Principals through their ownership of the GP.

**Investment Team:**

Exeter's investment activities will continue to be led by Ward Fitzgerald and Tim Weber, and the Portfolio Managers for the Value Fund series remain Rob Jones and Matt Brodnik. In total, Exeter value-added platform will have the support of an experienced team of 31 dedicated investment professionals located in Conshohocken, PA (headquarters), DC, Louisville, Memphis, Indianapolis, Columbus, Chicago, Atlanta, Miami, Dallas, San Francisco, and Los Angeles. Exeter is a fully integrated manager that manages and operates the assets internally. Exeter is 100% owned by fourteen senior employees, and twenty-five senior employees will invest in and receive profit share from the Fund.

**Investment Highlights:**

<b>Experienced, Stable &amp; Cohesive Team</b>
The management team has been together over an average of seventeen years, and has more than twenty-three years' average experience, which covers multiple market cycles since the late 1980's. Exeter has not lost any critical professionals during or after the financial crisis, and has exhibited very low employee turnover.
<b>Track Record / Strong Cash Flow</b>
Throughout multiple market cycles Exeter has displayed strong results, and exhibit a value-add track record within their fund series of 21.4% gross IRR (appx 16.5% net) and 2x gross MOIC (1.8x net MOIC). Returns have far exceeded expectations with PSERS' investment in Fund II, with a net IRR of 30.8% and net MOIC of 1.9x, and 62 of 72 investments realized as of March 31, 2016. Both Fund I and II are reported to be in the top 5% of performance using the Cambridge vintage year data.
<b>Market Knowledge</b>
Leasing success with national, and global tenant relationships, as well as local market knowledge and relationships, give Exeter the ability to favorably source, lease and price deals. Due to extensive relationships, historically over 60% of the Exeter investments have been sourced off-market or were limited competition situations. Their reputation has instilled a sense of confidence in their markets regarding their integrity and performance.
<b>Entrepreneurial, Action Oriented</b>
As a privately owned vertically integrated company, Exeter's entrepreneurial team provides swift execution in their markets. Expertise in repositioning, redeveloping and developing properties allows them to select investments that others may avoid, at more attractive pricing, and across various times in the economic cycle. Exeter capitalizes on local market knowledge, in-house asset management, and on-going tenant discussions to determine the best execution for the investments. Their diverse tenant and owner connections enable them to respond quickly to opportunities. After developing, renovating and leasing, Exeter creates core investments to extract disposition premiums upon exit.



**Investment Considerations:**

<b>Competition From Other Capital Sources</b>
Although there are multiple capital sources searching for yields, access to the fragmented industrial marketplace at the level that Exeter enjoys is hard to replicate. Their sole industrial focus that is executed through regional offices, as well as expertise in repositioning, redeveloping and developing properties provides a competitive advantage.
<b>Growth of Firm</b>
The hard cap (maximum targeted capital raised) for Fund IV is \$1.15 billion, up from \$833M raised for Fund III. Additionally, the Firm raised \$575M for their new Core mandate in 2016. Investor demand is strong due to Exeter's reputation and track record so there is a high likelihood they will hit their hard cap for Fund IV. Growth of the firm has thus far been handled appropriately and their style of investing has not yet been impacted. For example, in December 2015, Exeter sold 210 assets in a \$3.15 billion transaction to two international investors. This sale included assets from Value Funds I and II, and Core Fund I and contributed substantially to the outperformance of those investments, as well as showing Exeter's ability to take advantage of current market conditions to sell assets under management, as well as grow assets under management.
<b>Development Risk</b>
While there is always risk in real estate associated with potential development, industrial property has the added risk of the short period of time required to develop the projects. However, at this point in the cycle, when existing property pricing is approaching or exceeding replacement value, and demand is strong, development can be the best value-add execution option. The Exeter team's track record includes 74 developments, with \$1.1 billion in project cost. Their team includes six development and construction experts that are responsible for all ongoing projects. Within the Exeter value-add Funds, they have realized 13 of the 33 development/redevelopment projects, achieving a gross 29.4% IRR and a gross MOIC of 2.34x.

**PSERS History & Performance:**

Since 2011, PSERS has committed \$150 million to two Exeter Value partnerships, and \$100 million to Exeter Core Club Fund II, L.P. The following table summarizes PSERS' historical performance with the Exeter Value funds as well as Exeter Core Fund II, as of March 31, 2016:

<u>Fund (\$,M)</u>	<u>Vintage</u>	<u>Fund Size</u>	<u>Commitment</u>	<u>Contributions</u>	<u>Distributions</u>	<u>NAV</u>	<u>Net IRR</u>	<u>MOIC</u>
Exeter Value Fund II, LP	2011	615.0	75.0	73.5	127.1	15.7	30.8%	1.9x
Exeter Value Fund III, LP	2014	832.8	75.0	33.8	1.6	37.8	16.5%	1.2x
<b>PSERS Sub-Total (Value Add funds)</b>			<b>\$150.0</b>	<b>\$107.3</b>	<b>\$128.8</b>	<b>\$53.5</b>	<b>29.4%</b>	<b>1.7x</b>
Exeter Core Club Fund II, LP	2016	574.8	100.0	0	0	0	n/a	n/a

**Finance Committee Disclosure:**

<b>Relationship with Courtland:</b>	None Disclosed
<b>Introduction Source:</b>	Fund Sponsor
<b>Placement Agent:</b>	Yes, Hodes Weill for potential Asian investors. Not used for existing clients including PSERS
<b>PA Political Contributions:</b>	None Disclosed
<b>PA Presence:</b>	16 investments totaling 4.2 million square feet, \$379M market value
<b>Potential Conflicts:</b>	We are not aware of Exeter having any investment conflicts



<b>First Time Fund With PSERS:</b>	No
<b>PSERS Allocation Implementation Committee Approval:</b>	September 7, 2016

**Oversight Responsibility:**

<b>Investment Office:</b>	Charles J. Spiller      Deputy CIO, Non-Traditional Investments Laurann H. Stepp      Senior Portfolio Manager
<b>External Consultant:</b>	Courtland Partners

# COURTLAND PARTNERS, LTD.

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August 30, 2016

Board of Trustees  
Commonwealth of Pennsylvania,  
Public School Employees' Retirement System  
5 North 5<sup>th</sup> Street  
Harrisburg, PA 17101

**Re: Exeter Industrial Value Fund IV, L.P.**

Dear Trustees:

Courtland Partners, Ltd. ("Courtland"), having been duly authorized by the Board of PSERS, has evaluated Exeter Industrial Value Fund IV, L.P. (the "Fund" or "EIVF IV"). The Fund's strategy is to acquire, develop, redevelop, reposition, operate, lease, and sell industrial properties (big box warehouse, last mile, light industrial, and related flex/office properties) in major markets throughout the United States and select markets in Canada and Mexico. Like its predecessor funds, EIVF IV is anticipated to have a geographic mix of primary population and e-commerce distribution markets, with the remaining investments in high growth niche markets. Densely populated primary markets provide the stability of large baseline demand, while e-commerce, international trade, increased domestic production ("on-shoring"), and the resultant high volume movement of goods drive warehouse demand in key air cargo, interstate and rail hubs.

Exeter will seek to aggregate a diverse portfolio of assets in order to disperse risk across many types of investments and provide maximum disposition attractiveness. The facets of such diversity include: (i) targeting a variety of value-add strategies including lease-up of vacant to partially leased assets; fully leased, short term let assets requiring re-tenanting or renewals; and repositioning, redevelopment and development opportunities in a 25%/50%/25% proportion respectively; (ii) investing across a variety of markets spanning the United States, with an emphasis on primary population, e-commerce and high growth markets in a 50%/30%/20% proportion respectively; (iii) investing across a variety of product types, such as big box warehouse, light industrial and flex/office in a 60%/35%/5% proportion respectively; (iv) investing across a variety of tenant types representing a multitude of industries, which buffers overall tenant credit risk from fluctuations in different sectors of the economy; and (v) acquiring single assets or small packages of assets, which reduces exposure in any one deal, facilitates debt procurement, and allows for both aggregated disposition opportunities as well as selling on a one-off basis to users.

In particular, the Fund will seek to invest at favorable cost by acquiring under-leased and under-managed properties at highly discounted pricing, as well as partially-to fully-leased assets with growth potential at value-oriented pricing. An emphasis on this latter profile of short term let, well-leased acquisitions will provide immediate cash flow to mitigate leasing risk, and also provide upside opportunity upon renewal/let. The Fund will also pursue development and redevelopment opportunities which serve the current pent-up demand for modern warehouses while ensuring the Fund pays no more than replacement cost for best-in-submarket assets. Exeter intends to generate strong income returns by actively managing the properties to increase occupancy and reset trough rental rates to market levels.

While creating a diverse portfolio, the Fund will emphasize single-tenant, modern bulk industrial assets, which include big box warehouses for regional distribution and last mile warehouses for local distribution, because tenant demand is deepest for this building profile. Such facilities attract large, stable corporate

tenants that are more likely to have strong credit, sign long term leases and provide repeat leasing opportunities in multiple locations. Furthermore, such assets carry the least operational risk due to the “triple net” lease structure which requires tenants to bear all operating expenses, and also carry lower capital expenditures because of recent construction, economies of scale, limited office finish, and generic design that serves a wide variety of users without the need for modification. Their Class A property profile will include high quality construction and physical condition, the most sought-after core locations within a submarket, and efficient site access, all of which contribute to providing tenants the best functionality across the competitive set.

A key component of the Fund’s investment strategy entails acquiring or developing individual assets and aggregating them into portfolios to obtain diversification benefits, borrowing efficiency, and maximization of disposition pricing due to the premium paid for well-balanced, large scale portfolios. Additionally, Exeter’s large scope and industrial sector focus make it uniquely positioned to periodically acquire large portfolios that may trade inefficiently because of their disparate geographies and product attributes, for which other buyers are often ill-equipped to manage profitably.


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 Exeter Property Group management team members, and review of all relevant materials provided by Exeter.
- Evaluation of the Fund’s proposed investment strategy within the context of the current investment environment.
- Evaluation of Exeter’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 factors, Courtland recommends that PSERS commit up to \$100 million to the Fund. Courtland makes this recommendation considering Exeter’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.**