February 13, 2008 – ***As presented to the Council***

MEMORANDUM TO: State Investment Council

FROM: William G. Clark, Director
O. Ike Michaels, Jr., Deputy Director

SUBJECT: **Proposed Real Estate Investments in Westbrook Real Estate Fund VIII; Apollo Domestic Emerging Markets Fund; PLA Residential Fund III; Walton Street Mexico Fund I; and Walton Street Real Estate Fund VI**

This due diligence memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9 to report proposed real estate investments of: a) $100 million in the Westbrook Real Estate Fund VIII ("Fund VIII"); b) $50 million in the Apollo Domestic Emerging Markets Fund ("ADEM"); c) $50 million in the PLA Residential Fund III, LP ("PLA III"); d) $25 million in the Walton Street Mexico Fund I ("Fund I"); and e) $25 million in the Walton Street Real Estate Fund VI ("Fund VI").

Please note that these investments will be authorized pursuant to Articles 69 and 71 of the Council's regulations, which became effective on June 20, 2005. All the recommended investments will be considered "non-core real estate" investment as defined under N.J.A.C. 17:16-71.1.

The Alternative Investments Procedures adopted by the Council on January 20, 2005 require any potential alternative investment opportunities to be identified and initially evaluated by the Head of Alternative Investments of the Division (Bill Clark in an acting capacity) and the applicable Asset Class Consultant (The Townsend Group for Real Estate, or "Townsend") in coordination with the DOI Investment Committee (Bill Clark and Ike Michaels).

As a result of internal and external sourcing, the DOI Investment Committee identified the proposed investments, and Townsend and Division staff proceeded to undertake extensive due diligence on the proposed investments. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council.

Based on this due diligence, the Division has determined that the proposed investments meet the criteria for investments set forth in the Alternate Investment Procedures.

__Westbrook Real Estate Fund VIII ("Westbrook VIII")__ is a $2.5 billion global high return follow-on fund to the 2006 vintage Westbrook VII ("Fund VI"), which was the third fund sponsored by Westbrook Group to pursue opportunistic real estate investments resulting from: a) undervalued assets and portfolios, b) corporate and government divestitures, c) urgent recapitalizations, and d) ineffective ownerships. Westbrook VIII is projecting annual returns in excess of 20% IRR before fees and excess of 15% after fees and carried interest.

Westbrook VIII has a clear strategy of executing smaller off-market transactions in selected key markets that Westbrook believes are deep, liquid, vibrant and growing such as London, Paris, Tokyo, Washington DC, New York and San Francisco, and that may not be targets for some of the larger institutional sources of capital. In addition, Westbrook seeks to source transactions through its own systematic cataloging of targeted opportunities, local operating partners and third-party service providers who have an established presence in local markets, thus avoiding the more highly bid auction markets. The Westbrook funds are capitalized by a diverse group of 16 domestic institutional investors who are expected to invest Westbrook IV.

The management team - Westbrook Partners - consists of 40 professionals located in New York, San Francisco, London, Paris and Tokyo. Westbrook Partners and its key principals have a very successful track record of generating strong returns. Since 1994, Westbrook professionals have invested over $6.7 billion of equity in seven previous funds. The gross IRR on all realized and partially realized investments, representing $5.2 billion of equity invested, is 36.3%. The projected gross IRR on all realized, partially realized and unrealized investments over Funds I to Fund VII is 36.1%.

All the legal and economic terms associated with Fund VIII are fair and consistent with market standards.

__Apollo Domestic Emerging Markets Fund, L.P ("ADEM")__ is a $500-$525 million fund sponsored by Apollo Real Estate Advisers ("Sponsor") to invest in urban sub-markets and metro areas within major U.S. metropolitan areas that are experiencing a resurgence including New York, New Jersey, Los Angeles, San Francisco-Oakland-San Jose, Washington-Baltimore, Philadelphia, Boston, and Detroit. The Sponsor views these "domestic emerging markets" as being underserved by institutional investment and management. The Fund will target value add projects that can produce a 14-18% gross IRR over an anticipated holding period of seven to ten years with 55% to 65% leverage. The Fund held its first and interim closings to date for $420 million with $15 million commitment from the Sponsor.

ADEM's strategy is to acquire urban properties with constrained cash flows due to governmental regulation, capital neglect, product obsolescence, and/or long-term below-market leases at below replacement cost, and then implement a value-added program of revitalization, rehabilitation, and repositioning (physical improvements, security systems, etc) to bring the assets to market standards. Apollo will also review the properties' operational expenditures, seeking opportunities to operate and finance the properties more efficiently.

James Simmons, Partner and Investment Committee member, and a former CIO and interim CEO of the Upper Manhattan Empowerment Zone, which was responsible for much of the revitalization of Harlem and surrounding communities, will be primarily responsible for the investment activities of the fund. Mr. Simmons joined Apollo in 2003 to develop and head its Domestic Emerging Markets platform. Apollo's investment vehicles span across debt and equity, value and opportunity, domestic, Europe, and Asia. The firm has 55 investment professionals based in New York, Los Angeles, Chicago, Atlanta, London, and Mumbai. Since 1993, Apollo has invested $8.9 billion in over 450 transactions. Apollo's opportunity and debt funds have realized a 22.4% cumulative gross IRR, its value added funds have realized a 21.3% cumulative gross IRR, and its institutional joint ventures have realized a 41.2% cumulative gross IRR.

All the legal and economic terms associated with ADEM are fair and consistent with market standards.

PLA Residential Fund III, LLC ("PLA" or the "Fund") is a $1.5 billion closed end, commingled fund focused on making high return investments in residential real estate in Mexico and other select countries of Latin America. The Fund will be denominated in Mexican pesos, although will accept commitments and contributions in U.S. dollars. The Fund is targeting gross returns (before fees, expenses and taxes) in local currency of 25-35% which is expected to result

in a gross (after expenses and taxes) U.S. dollar IRR of 18-23% (15-20% net of all fees and currency adjustments). PLA III may utilize up to 70% leverage.

PLA III is the third in a series of residential funds focused on Mexico. PLA III seeks to capitalize on attractive demographic trends and strong economic drivers expected to fuel continued growth and development of the residential markets. Central to this thesis is the expansion of the mortgage market which will help further promote home ownership in a country where more than 700,000 households are being created annually and it is estimated that only 12.6% of the housing stock is leveraged. PLA III will seek to develop a diversified portfolio of residential investments, with a focus on for-sale homes, apartments for rent and finished residential lots. A minimum of 80% of PLA III will be invested in Mexico, with up to 20% invested in Brazil and other countries of Latin America.

PLA III is sponsored by Prudential Real Estate Investors ("PREI"), the real estate investment and advisory unit of Prudential Investment Management, Inc., and Prudential Financial, Inc., (collectively, "Prudential"). Prudential was founded in 1875 and is among the world's largest financial services institutions with over $630 billion in assets under management as of March 31, 2007. Prudential is publicly traded on the NYSE under the ticker symbol "PRU". The Fund will be managed by PREI Latin America, a unit of Prudential based in Mexico City, Mexico and overseen by PREI headquartered in Parsippany, New Jersey. PREI Latin America employs over 80 professionals and also has offices in Miami and Rio de Janeiro. Prudential has been managing investments in Mexico since 2000. Since that time it has raised five investment funds totaling approximately $1.25 billion of equity and has invested approximately $500 million thus far. PREI Latin America is led by a management committee comprised of the senior Principals and CEO of Latin America, Roberto Ordorica. The Fund will have a dedicated portfolio management team led by Mr. Salvador Magana. He has 14 years experience, most recently running the northern division of the former Pulte Homes Mexico. He will be supported by seven dedicated individuals and will leverage off of the other functional areas of PREI Latin America including acquisitions, research and finance.

All the legal and economic terms associated with PLA III are fair and consistent with market standards.

Walton Street Mexico Fund I ("Fund I") is a $350 million closed-end commingled fund focused on making high return investments in Mexico with the potential to invest up to 25% in other markets in Latin America (including but not limited to Brazil, Argentina, Chile and Columbia

Brazil). Fund I will target gross returns of 25% (20% net of local taxes and all fees) while utilizing up to 75% leverage. Fund I seeks to capitalize on a favorable economic and political environment expected to generate sustained demand for institutional quality real estate and real estate related assets in Latin America. Investments in Mexico will make up at least 75% of the Fund, with approximately 40% targeted at the for-sale residential sector (affordable housing, middle income and second home/resort residential).

Favorable demographic trends, a growing economy with stable interest rates and the rapidly expanding availability of home mortgage financing is expected to fuel continued strong demand for housing. The remaining investments are expected to be in retail (20%), hospitality (20%) and 20% in a combination of office, industrial, mixed-use properties and land. Fund I will pursue acquisitions, repositioning/rehabilitations and entity-level investments, but due to the for-sale residential strategy and lack of modern institutional quality commercial buildings, the focus will be on new ground-up development. While most of the capital is expected to be committed to Mexico, up to 25% of the Fund may be invested in other countries in Latin America including but not limited to Brazil, Argentina, Chile and Columbia.

Fund I is the first investment fund raised by Walton Street Capital LLC ("Walton Street") to target Mexico and Latin America, although it will follow a strategy consistent with the successful series of prior domestic funds sponsored by Walton Street (the last two with 10% exposures to Latin America). Walton Street is a privately owned and managed real estate investment firm headquartered in Chicago, Illinois, and founded in 1994 by Neil Bluhm, Ira Schulman, Eric Mogentale, Jeff Quicksilver and Jay Weaver. The Managing Principals have worked together for the past 19 years (covering both Walton Street and JMB periods), and have an average of 26 years of real estate experience. The Managing Principals are supported by a staff of 64 professionals in Chicago. In 2006, together with Sandor Valner, Walton Street formed Walton Street Capital Mexico ("Walton Mexico") to source and manage real estate investments in Latin America. Headquartered in Mexico City, the team has expanded to include five acquisition and asset management professionals ("Mexico Team"), all of whom will be dedicated to the Fund.

All the legal and economic terms associated with Fund I are fair and consistent with market standards.

Walton Street Real Estate Fund VI, L.P ("Fund VI") managed by Walton Street Capital L.L.C. ("Walton Street") is a successor fund to five previous successful funds with a strong track record executing fundamentally the same investment strategy under the direction of the same senior management team which has remained intact for the last 19 years with an average of 25 years of real estate experience. Consistent with prior funds, Walton Street is exploring several strategies in the United States (80%), Latin America (10%) and India (10%) for Fund VI including: single asset and asset portfolios, targeted developments, international joint ventures, private equity platform investments with strong operating partners, complex ownership situations, and entity recaps.

Walton Street has extensive experience with similar types of investments, and their track record with these investment strategies is strong. The prior Walton Street funds are projected to generate a 36% gross IRR.

The management fees are reasonable, and all the legal and economic terms associated with Fund IV are fair and consistent with market standards.

A formal written due diligence report for the proposed investments and all other information obtained by the Division on the investments were sent to each member of the Investment Policy Committee of the Council on Friday, February 8, 2007, and the Committee held a meeting on February 13, 2007 to review the due diligence report prepared by Townsend and Division staff and other information for the proposed investments.

After review of the extensive due diligence and the approval of the commitment amounts referenced above, the Investment Policy Committee of the Council has decided to report on the proposed investments to the full Council pursuant to Step 4 of the Alternative Investments Procedures. Under these procedures, the Council may adopt or otherwise act on this report.

We will work with representatives of the Division of Law and outside counsel to review and negotiate specific terms of the legal documents to govern these investments. In addition, the proposed investments must comply with the Council's "pay to play" regulation (N.J.A.C. 17:16-4). While we are confident that we will work through these issues, the potential exists that a successful resolution may not be reached with one or more of these general partners.

We look forward to discussing the proposed real estate investments at the Council's February 21, 2008 meeting.