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NEW FUNDS WITH A TWIST

Advisers will raise new funds with strategies specifically designed to take advantage of the current market, spawned by the credit crunch and the nation's economic slowdown. **Boston Capital, Harrison Street Real Estate Capital, Private National Mortgage Acceptance Co.** (PennyMac) and **Perseus Realty Partners** all raise funds with some angle calculated to catch the eyes of pension funds looking to make more allocations to real estate.

These advisers ambitiously play both sides of the equation. They see a long-term upside in various sectors but have to sell pension funds on the idea that now is the time to speed up investment in commercial, and even residential, real estate. It's not surprising that PFs would be willing to dump money into troubled real estate; it doesn't take much to boost returns. But some of these funds verge on making opportunity plays, not something PFs are widely known for. Young manager PennyMac's fund will uniquely target distressed home loans with a value-added strategy. This approach counts on getting borrowers back on track while taking advantage of lenders' desires to push troubled loans off their books.

On the income-producing end, more PF cash could end up in highly specialized funds. The **Arizona Public Safety Personnel Retirement System's** latest round of investments places an allocation in Harrison Street's special purpose real estate fund, which focuses on what might be considered niche investments. While plenty of advisers look to acquire distressed debt notes from owners on the brink of foreclosure, Perseus Realty Partners instead launches a new participating loan program that will provide funding to move financially troubled projects forward. Boston Capital's multifamily fund will take aim at PFs by giving investors an option of setting allocations specifically for affordable housing, as well as market-rate apartments. Regardless of PF interest in affordable housing, Boston Capital will target multifamily, while investors will dictate how socially minded the fund's strategy will end up being. If New York City Comptroller **William C. Thompson**, who manages the New York City Pension Funds, has his way, funds like the one at Boston Capital will get more backing from the PFs and have the bulk of their commitments end up in the affordable housing stack. Thompson recently sent an email out to several dozen major PFs, urging them to make economically targeted investments focused on affordable housing.

Affordable Housing Focus

Boston Capital set up two vehicles under the Multifamily Development Fund III banner, one aimed purely at multifamily development and the other dedicated solely to projects that have 60% of units set for affordable housing. The breakdown between the two will depend on which attracts the most demand, with \$200M as the equity target for total capital raised. The raise is still in the early stages, with about \$35M lined up so far.

Boston Capital Multifamily Development Fund III looks to net a 15% pre-tax IRR for investors and will use leveraging at 70%. The fund originally targeted at only new construction multifamily developments will likely expand its focus to include value-added and rehab acquisitions because the adviser sees attractive opportunities to invest for those strategies. Boston Capital, where **Guy Hubschman** leads as VP of institutional investing, decided to raise the commingled fund after managing several separate accounts for PFs wanting to invest in affordable multifamily.

BlackRock and **Highland Capital Management** unveiled PennyMac in March and the new company plans to invest \$2B for investors including at least one PF, and likely more, for its Mac Mortgage Opportunity Fund. Arizona Public Safety committed \$130M for the fund during its latest round of investments. PennyMac's leadership includes several former associates of **Countrywide**, where PennyMac CEO **Stan Kirkland** served for 26 years and was president until 2006. *Continued on Next Page*

FUND HIGHLIGHTS

<u>Fund Type</u>	<u>Amount</u>	<u>Est. Return</u>	<u>Manager's Co-investment</u>	<u>Location</u>	<u>Property</u>
Value-added	\$758M	15% to 18%	\$20M	Major U.S. markets	Office Multifamily Retail Industrial Hotel

Apollo Real Estate Advisors finished raising its targeted \$750M Value Enhancement Fund VII fund, beating the target by \$8M. Purely focused on acquisitions and adding value through renovation and asset management, Apollo will not invest in ground-up developments. It will consider distressed properties based on the situation. Commitments come from PFs including the Arizona Public Safety Personnel Retirement System and up to \$150M from the Pennsylvania Public School Employees' Retirement System. The \$758M fund holds \$2.5B of buying power and has already started investing. It expects to be fully invested in the next three years, targeting major U.S. markets. Apollo recently purchased a hotel in Dallas for \$72.25M and plans \$30M in upgrades. Typical hold periods are eight years, with returns projected from 15% to 18%.

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The company plans to acquire distressed residential loans at a discount from financial institutions overexposed to the sector and work with borrowers to bring them back up to performance to eventually resell. This is essentially a value-added strategy on debt. While the first reaction to PennyMac's links with Countrywide may cause some investors to shirk the new fund manager, a strategy that looks to help homeowners in a jam should attract more PFs, often known to invest for more than just the fiscal bottom line. Expect the fund to target an IRR hovering around 15% for investors.

Arizona Public Safety also committed \$80M to Harrison Street's Fund II. The specialty real estate adviser, led by Managing Director **Chris Merrill**, started raising the follow-on fund to invest with its specialty real estate strategy aimed at recession-resistant real estate, including healthcare, student housing and self-storage properties.

Perseus Realty Partners' new participating loan program will take advantage of a slow real estate market full of attractive deals that lack the capital to move forward. The idea is to provide developers a one-stop capital shop and cut out the difficulties of third-party financing in the current market. While sourcing attractive deals right now remains tough, Perseus will use the program to help invest its Perseus Realty Partners Fund II, funding both equity joint ventures as well as providing senior mortgage loans from \$20M to \$75M, with three- to five-year terms and loan-to-cost of up to 95%. The pay/accrual rate for the fund is at 7.5% for fixed, and 4.5% over LIBOR with a 7.5% floor for floating. The fund will take a 10% preferred return on the investments and targets new development, acquisition/rehab and recapitalizations. Perseus will take a minimum 50% participation on operating cash flow as well as a 50% share of sale or refinance proceeds over its preferred return, while the borrower maintains ownership of the asset.

Perseus should see a steady investment pace considering the lack of liquidity in the market, with an anticipated investment period of two years. The phone's been ringing of the hook with inquiries — so the pipeline on the lending side is certainly robust. Expect Perseus, where **Paul Dougherty** leads as CEO, to commit \$400M in capital, leveraged at 75%, by the end of the year. Total equity for the fund should be around \$250M, with a target for total capital investments at \$1B. With a hefty target for investments and a strong demand from developers for what Perseus offers, the adviser seems pretty keen on this strategy as a way to find attractive deals in a less-than-attractive real estate market. The adviser targets opportunistic returns for the fund, with a gross IRR over 20%. Perseus made its first investment for Fund II recently, partnering with **Hathaway Properties** for a JV to develop a 206-unit, Class A, garden-style multifamily complex in Atlanta, Ga., dubbed Ansley at Princeton Lakes. Perseus committed \$4.6M from Fund II for an equity stake in the development, expected to be capitalized at \$29.7M.

New York City Comptroller Thompson's office will soon act on a request for qualifications to hire one or more real estate advisers for the **New York City Board of Education Retirement System**. The PF intends to deploy \$130M for real estate investments and has set a broad net for vehicle types, considering fund of funds, manager of manager funds, LPs, open-ended real estate funds or similar investments, with strategies ranging from core to opportunistic. The deadline for submissions was July 30.

PF ADVISERS ACQUIRE MORE OFFICE

Pension funds and advisers will look for office deals that include more stable assets and stable existing debt even as they expect the office market to awaken from the past year of sluggishness. Adviser **UrbanAmerica** paces its way toward fully investing its second fund, which should happen during the first half of 2009. Swiss PF adviser **AFIAA** expands its U.S. presence westward with office acquisitions. Meanwhile, adviser **Transwestern Investment Co.** targets the bulk of its current fund at office acquisitions.

Advisers will still take it slow, but those with a long-term outlook aim to take advantage of distressed sellers with properties that are sure to gain value. UrbanAmerica has kept its eyes on office properties with stable tenants, generally coming from government and higher education sectors. The adviser recently closed a large portfolio buy, with existing debt being the clincher for that acquisition. The urban-focused fund includes several PF investors, with commitments from **Los Angeles City Employees' Retirement System, San Francisco Employees' Retirement System, California Public Employees' Retirement System** and **Chicago Teachers' Pension Fund**.

AFIAA expects to see increased demand from its Swiss pension fund investors for foreign real estate and looks to double its portfolio size soon. With several low-leveraged deals closing this year, including a recent office acquisition, expect U.S. properties to fit into its expansion strategy. AFIAA also likes stable properties with strong tenant bases and recently closed an all-cash deal for an office building in Austin, Texas, near the state Capitol building, with a solid tenant base including lobbyists. Swiss PFs invested in its fund include **BVK, ASGA, GastroSocial**, and **SRG SSR idée Suisse**. Transwestern adds to its office portfolio with two value-added Class A buildings in Culver City, Calif., measuring 440,000 s.f.

Stabilized Property Strategy

UrbanAmerica uses a stabilized asset strategy for Fund II, but also looks to make value-added and development plays. Leveraging for Fund II is at 66%. Average deals are \$30M, with the minimum at \$15M and large single-asset deals in the \$300M range. UrbanAmerica, where **Richmond McCoy** is founding partner, has seen its expected holds for new deals shift from three to four years to five to seven years. The adviser sees a robust pipeline and is looking predominately at office and multifamily and also some retail. Considering the risk for development right now, don't expect UrbanAmerica to enter into any new development projects for another 18 to 24 months.

Expect UrbanAmerica to lean toward the conservative end of deals right now, as it pursues distressed sellers that have stabilized properties with existing debt attached. With about \$170M of equity left to invest for its \$400M Fund II, UrbanAmerica will focus its efforts on spending the cash before it begins raising a follow-on fund, which should happen next year.

Swiss PF adviser AFIAA recently gained some exposure farther west for its U.S. presence with the acquisition of the 17-floor Wells Fargo Tower in Austin. The adviser acquired the city's Central Business District for a cap rate of 5.2%. AFIAA acquired the tower with all cash and will refinance to have it leveraged at 60%. The 96% occupied property will see some capital improvements, but the real value-added potential lies in its current below-market rents, which are expected to roll during the next 12 months. AFIAA generally holds for the long-term, and it looks to see the building stabilize at an 8% cap rate.

AFIAA, which focuses on foreign real estate investments for Swiss PFs, plans to double its portfolio holdings by 2010, and that in turn means it will be looking to raise more capital to invest in the United States. AFIAA has at least 13 investors, made up of several city, state, trade and corporate PFs.

Transwestern Investment Co., investing for Aslan Realty Partners IV, acquired two Class A office buildings at 400 and 600 Corporate Pointe in Culver City, Calif. The seller on the Corporate Pointe deal was **GE's Arden Realty**, which has been on a selling spree, recently unloading several properties in Beverly Hills and San Diego to PF advisers. The property had occupancy in the low 90s and, contrary to some speculators' guesses, it actually closed for under \$100M. Transwestern is targeting 65% of Aslan Realty Partners IV for office sector investments. The fund's first closing totaled \$250M in April, with allocations coming from a mix of PFs and endowments. The adviser, where **Stephen Quazzo** leads as CEO, is targeting \$800M to \$1B in equity for Fund IV, which has yet to see its final closing.

PF RETURNS LOOKING DOWN

Count on pension funds to shift their real estate strategies to improve returns after many PFs saw the latest quarterly returns fall. Expect PFs to seek safer real estate investments such as apartments and government-leased properties while the economy slumps. They will be cautious with retail, industrial and hotel investments to prevent taking too big of a hit. PFs such as the **Teacher Retirement System of Texas** and **Pennsylvania Public School Employees' Retirement System** had less than stellar quarters, while the **Denver Public Schools Retirement System** finished with mixed results.

The \$108B TRS of Texas did not reach all of its return benchmarks for the 12 months ending March 31, 2008. The overall return for that period was 2.1%, missing its benchmark of 2.4%. The fund's overall return for Q1 of the 2008 calendar year was -4.5%, falling below its -3.9% benchmark. The real estate benchmark for the 12 months ending March 31 was 13.75%, while the PF beat it with an 18.5% return. The Q1 2008 benchmark for real estate was 1.7% and the PF returned 0.4%.

The TRS of Texas recently increased allocations to alternative investments, which include private equity, real estate, hedge funds, global inflation-linked bonds and commodities. At the same time, it reduced allocations to U.S. stocks and core/core-plus fixed income. It specifically looked to take advantage of dislocation in the markets for its recent real estate and debt investments. However, it normally invests in all property types and uses core, value-added and opportunistic strategies. The PF targets a 10% allocation to real estate and has plenty ways to go with an actual allocation of 3%. It also has 5% in other real assets, which include infrastructure, timber, farmland, fixed assets and land.

Pennsylvania PSERS showed returns losses as well, with the total calendar year Q1 performance at -5.16% and the fiscal year-to-date return at -2.35%. Real estate returns didn't fare well either, with Q1 performance at -3.86% and the FYTD return at -.38%. The actual allocation to real estate as of the end of Q1 was 9.9% and the PF's target is 11%. This target is up from its FY 2007 target of 8%, when the actual allocation was at 5.7%.

The Service Employees' International Union's Pennsylvania State Council, which shares some members with Pennsylvania PSERS, recently called on the PF to withdraw investments — including in a real estate fund — with Lazard Asset Management, which has a past of union-busting. The PF recently allocated \$350M to Lazard Asset Management's Emerging Income Plus Ltd. Fund and has invested with Lazard since 1998. However, the union alleges the real estate fund has shown less than stellar returns. The **Illinois Municipal Retirement Fund**, invested in Lazard's opportunistic Strategic Realty Investors Fund II, reported its benchmark for opportunistic real estate for Q1 2008 was 3.5% while reports have Fund II's return at -2.7%. The benchmark for the 12 months ending March 31 was 16.5% and Fund II returned 1.7%. Since inception in 1998, the Lazard fund has shown a -.5% return. The SEIU will protest the investments at Pennsylvania PSERS' next board meeting on August 14.

The Denver Public Schools Retirement System, though smaller with a total asset value of \$2.8B, showed positive real estate returns for Q1 2008 — something hard to come by as of late. The Denver PF yielded .64% for the quarter ending March 31, with a 12.61% one-year return, 18.15% three-year return and 15.88% five-year return. Overall Q1 returns for the PF dipped in the red, below the -4.78% benchmark to -5.19%. And on the real estate end, there have not been any recent real estate allocations because the PF is slightly overweighted in that portfolio. Its target allocation is 9%. However, it currently considers putting capital into a global real estate fund. The PF typically invests in core and value-added U.S. properties.

CALSTRS BUSY IN SLOW INDUSTRIAL MARKET

Pension funds with capital to spend rely on their joint venture partners to line up more industrial acquisition volume as a slow market allows them to cherry pick the best deals. **California State Teachers' Retirement System's** industrial JV partner **First Industrial Realty Trust** is busy investing capital this year while many industrial players have slowed down. Expect First Industrial to invest \$500M in new starts for 2008, split 50/50 between specs and build-to-suits. Achieving that volume will be aggressive for the CalSTRS' JV partner, since the industrial giant's record for new starts was \$578M, which it hit last year.

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CALSTRS BUSY IN SLOW INDUSTRIAL MARKET...*Continued from Previous Page*

While the \$500M isn't limited to domestic projects, First Industrial has yet to announce any starts in its foreign markets, with FirstCal JVs targeting Europe and Canada formed earlier this year. Meanwhile, First Industrial has also been growing FirstCal's massive land inventory and targets properties in strong markets with an intermodal component, which should gain value as fuel costs push demand for rail.

The industrial partners are particularly attracted to markets that are strong transportation hubs. Properties near rail and ports will likely gain in demand from tenants shipping long-haul cargo, with trains providing a cost-effective alternative to trucking, which is hurting from growing fuel costs. Expect intermodal centers with rail access to see some of the strongest demand from industrial players like First Industrial and CalSTRS.

Latest on the list of First Industrial's land grabs is the recent acquisition of 262 acres in Joliet, Ill., serving the Chicago market, for its FirstCal 3 strategic land and development JV, which CalSTRS committed an additional \$200M to earlier this year. Chicago handles about 40% of the nation's freight cargo annually, making it the central hub for U.S. rail. Like Southern California, Chicago — besides being an important distribution hub — attracted the industrial partners because it is a substantial regional consumption area.

With a broader outlook on the market, demand for Seattle and Tacoma, Wash., industrial properties are poised for growth as well, with railway from those areas feeding inbound containerized cargo from ports to major markets in the Midwest and on the East Coast. The partners are keen on Washington coastal markets. They acquired 261 acres in the Seattle market to develop First Park Northwest Landing earlier this year for their FirstCal 1 JV, following their entry into that market a year ago with a 45-acre land acquisition near the ports of Tacoma and Olympia, Wash. to develop First Park Meridian Campus.

FirstCal 1, which targets development and repositioning investments, recently snatched up a 177,000 s.f. distribution center on the Alameda Corridor, a 20-mile rail cargo expressway that connects the Ports of Los Angeles and Long Beach to the transcontinental rail network near downtown Los Angeles. Late last year, that partnership acquired 140 acres in Salt Lake City to develop First Park Mountainview, which is near a Union Pacific Railroad intermodal center — the first point of intersection for freight traveling from the largest West Coast ports: Los Angeles, Long Beach, Calif., Seattle, Tacoma, Wash., and Oakland, Calif.

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PFs SEEK RESIDENTIAL DEVELOPMENT

Count on some well-capitalized pension fund advisers to take aggressive measures toward residential development despite an almost nonexistent for-sale housing market. These investors bank on the market turning around in at least the next couple of years as they build for-sale condos and purchase lots to build single-family homes. From the lot perspective, land is pretty cheap right now in the Golden State, especially in Southern California. Condo developments are particularly risky right now, especially considering the mass amounts of condo conversions in the past few years, due to overbuilding that is still far from recovery.

PF adviser **The Carlyle Group** decided to build some condos nonetheless, but only in an extremely core market, on the Upper West Side of Manhattan. **Kennedy Wilson** also takes the condo plunge into the San Francisco Bay Area, along with purchasing finished lots designed for single-family homes in SoCal.

A partnership between **Extell Development Company**, **RREEF Alternative Investments** and The Carlyle Group plan to complete about 600 for-sale condos and also for-rent product. Carlyle used its \$950M Realty Partners IV fund, with PFs including the **Teachers' Retirement System of Illinois**, **Seattle City Employees' Retirement System** and the **Ohio Public Employees' Retirement System**. Carlyle's fund has yielded a net IRR of 33.4% as of July 2008. The construction loan recently secured was for \$613M — the largest construction loan for 2008 in the United States so far. The land was purchased for a staggeringly high \$1.8B back in 2005. About 70% of the luxury for-sale condos have sold, at a total value of \$788M. This is all before completion slated for the second quarter of 2010.

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Kennedy Wilson has also been busy recently, buying an interest in two condo projects in Richmond, Calif., with Emerald Fund. The two condo properties contain a total of 712 units, of which 196 have sold. Funding came from two of its commingled funds: KW BASFG II and KW Fund III, which include union PFs. The firm sought out a value-added opportunity and found it through the interest in the two condo conversions, with recent upgrades, selling for around \$400,000 per home. Admittedly a slow condo market for California, Kennedy Wilson still claims to find relative value in housing right now. The hold period has a five-year horizon, with returns in the double digits. Kennedy Wilson invested \$50M of equity so far this year and plans to invest another \$150M by the end of 2008.

One of Kennedy's subsidiaries, Kennedy Wilson Residential Development and Investments Group, just purchased 138 finished lots in Lancaster, Calif., and 163 lots in Victorville, Calif., for single-family homes. The firm pooled equity from a variety of Kennedy Wilson's commingled funds and partners, including public, private and union PFs. Typical leveraging for lot deals is 50% and the Residential Development and Investments Group is aggressively buying condo developments and finished lots at below replacement costs. The adviser targets short-term hold periods for lots from one to three years. The firm expects the market to improve over the next three years and will then sell the lots to builders.

The Residential Development and Investments Group expects double-digit returns, after paying much less for lots than they sold for two to three years ago. It has invested \$35M of equity so far this year and plans \$200M more by year's end. The PF adviser has several Southern California deals in the pipeline and targets California lots in particular.

INVESTOR NOTES...

Pension fund adviser **AFIAA** recently brought on **Hans Brauwers** to take the place of CEO **Hans Juerg Stucki**, who'll retire from his post on August 18. Brauwers comes in time to help lead the portfolio's expansion. He brings 28 years of experience with him, most recently as a partner at **BBP Rothenbaum Real Estate**, a Swiss consulting firm specializing in the development of international real estate projects. Managing Director **Christopher Duisberg** handles U.S. investments for AFIAA at the firm's New York City office.

Shorenstein Properties, investing for its \$2B Shorenstein Realty Investors IX Fund, has partnered with San Francisco-based developer **SKS Investments** to acquire Oyster Point Business Park and Oyster Cove Marina in San Francisco. The acquisition gives the partners six flex/industrial buildings leased at 88%. In the short-term, Shorenstein will keep the properties running to continue generating revenue, while plans are in place to rezone the area as part of South San Francisco's larger city-wide rezoning plans.

While Shorenstein is in talks with current tenants to set up three- to four-year leases and the properties pose some lease up potential, the partners' long-term intentions for the property will be to redevelop the site for office, biotech and life science use. Specifics on the plans aren't yet in place, with an architect not selected and the entitlement phase not done. Shorenstein's development group, where Todd Sklar heads as SVP, will work with SKS on the redevelopment of the site. This isn't SKS' and Shorenstein's first JV. Currently, they are in the final stages of completing the new FibroGen headquarters, another life science campus in Mission Bay, San Francisco.

Rumor has it that PF adviser **DRA Advisors**, where **Francis Tansey** leads as president, is in the hunt for a 29-property portfolio placed on the market by Australia-based **Centro Properties Group**. The adviser will likely invest its \$1.25B Growth & Income Fund VI to hopefully grab the portfolio with a \$714M price tag. DRA has used overall leveraging of about 76% for its previous funds, with retail taking a 17% chunk of investments historically.

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Fund VI, which closed during the first quarter, includes a \$150M commitment from the **Pennsylvania Public School Employees' Retirement System** and a \$10M commitment from the **Los Angeles City Employees' Retirement System**. DRA's targeting a net IRR of 13% to 15% for Fund VI and has a 1% equity stake in the fund. DRA's fund uses a REIT structure for tax purposes but is non-traded, functioning similarly to the usual commingled funds for institutional investors.

The **New York State Common Retirement Fund** continues its long-standing relationship with the **Community Preservation Corp.**, which invests in affordable and workforce housing. The pension fund most recently wrote a \$4.7M mortgage for a 50-unit affordable housing property in West Sayville, N.Y. The PF expects strong risk-adjusted returns on its deals, achieving higher yields than traditional affordable housing transactions. The PF has worked with the CPC since 1991 and has committed \$500M to the firm since the partnership's inception. It invests in newly developed or rehabilitated properties that include apartment rental units and facilities for disabled adults. It has contributed funding for 8,803 units through the partnership since 1991. Loans originated for the CPC range from \$250T to \$15M.

California Public Employees' Retirement System and **Miller Capital Advisory** joint venture **Institutional Mall Investors (IMI)** will take a bigger look at mixed-use investments after taking a 40% interest in a Fort Worth, Texas project, which will include a hotel. IMI invests in highly dominant malls and lifestyle centers, excluding community shopping centers. It usually holds properties about 10 years, but evaluates after five years, and typically expects double-digit returns. IMI found a plethora of off-market deals this year but still makes very careful choices. Ironically, it found more opportunities this year than 2006 through 2007, which were pretty quiet, comparatively. It plans to invest \$100M of equity for 2008, likely a much larger number than the past two years. It targets major U.S. markets from coast to coast, including Boston, Miami, Phoenix and Seattle, and sees Houston as very hot right now.

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