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Portfolio Management

**ORG Portfolio Management**

# **Real Estate Portfolio Review and Separate Property Investment Discussion**

November 5, 2014

[www.orgpm.com](http://www.orgpm.com)

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**I.**

## **ORG Portfolio Management Update**

## a. ORG Portfolio Management Update

- ORG remains exclusively committed to real estate consulting services to institutional clients.
- ORG's team remains stable with the majority of our team members having a tenure of more than 10 years.
- ORG's client based remains stable with eight retainer clients and two project only clients. Total Assets Under Advisement is over \$7.6 billion.

## b. ORG Portfolio Management - Organizational Chart

### Edward Schwartz | Principal

- 20+ years experience as Real Estate/Real Assets Consultant.
- ORG for 16 years, prior experience at The Townsend Group and Ernst & Young accounting firm.
- ORG Investment Committee member.
- MBA from Case Western Reserve University. BA from Kenyon College.

### Barbara McDowell, CEBS | Consultant

- 22 years experience in real estate industry as consultant, performance measurement manager and as a plan sponsor. ACRES development.
- ORG for 12 years, prior 10 years plan sponsor experience at AT&T/SBC Communications Inc. Master Pension Trust. Additional experience in the Finance department at SBC included auditing, information systems and accounting positions. 3 years performance and accounting manager at South Texas Money Management.
- ORG Investment Committee member.
- BA from University of Houston.

### Rebecca Morris | Consultant

- 18 years experience in real estate industry as consultant and manager.
- ORG for 8 years, prior experience at Impact Capital and Apollo. Served as the Investment Advisor to the Secretary of Trade and Commerce for the State of California. Served in the United States Army Reserves.
- ORG Investment Committee member.
- MBA from University of California at Los Angeles. Rotary Scholar at University of Leeds, England. BS from California Polytechnic University.

### Katie Zarback | Consultant

- Consultant for ORG's QPAM client.
- ORG for 10 years including consulting support and asset management projects.
- Prior administrative support and marketing experience at MBNA and Health Data & Management Solutions.
- BA from John Carroll University, Master's candidate from John Carroll University with graduation in 2014.

### Erika Mahran | Consulting Support

- Executive assistant to Ed Schwartz.
- ORG for 4 years, prior 12 years experience as an executive assistant and human resources support at Washington Mutual and Aleris International.

### Jennifer Baxley | Administration

- Assistant to Fred Carmen.
- ORG for 1 year, prior 10 years administrative support experience, including obtaining contractors and negotiated various contracts.

### Jonathan Berns | Principal

- 25+ years experience as Real Estate/Real Assets Developer and Consultant.
- ORG for 16 years, prior experience at Berns Properties, Inc., North Coast Energy and Chartwell Real Estate.
- ORG Investment Committee member.
- BS from University of Michigan.

### Fred N. Carmen | General Counsel and Portfolio Manager

- 15 years experience as the Executive VP and General Counsel for Millennium Management responsible for 4.5 million sq. feet of investment properties in multiple states.
- Over 30 years of legal experience in litigation, real estate and landlord/tenant matters at several Ohio law firms including Jones Day. ORG since January 2014.
- Juris Doctorate, cum laude, from Cleveland Marshall College of Law. BA, summa cum laude, from Case Western Reserve University.

### Heathyr Ullmo | Manager-Portfolio Analytics

- Manages ACRES statistical data including cash flows and performance information, prepares client quarterly reports and fund and performance related special projects.
- ORG since March 2014.
- 14 years experience in retail banking, commercial lending and treasury management.
- BA from Malone College.

### Bria Tolbert | Research, Consulting Services

- Database manager of ACRES Manager and Fund profiles.
- ORG for 6 years, prior experience includes support services and analyst at City of Burbank, CA. Manager of Polish Inc., also in Burbank.
- BA from Howard University.

### Marlene Simone | Consulting Services

- Accounting and human resources manager.
- ACRES fund level performance information.
- ORG for 10 years, prior 25+ years experience in accounting and reporting at Rockwell Automation.
- BS from Dyke College (now Chancellor University).

### Tonya Short | Consulting Support

- Executive assistant to Jonathan Berns.
- ORG since June 2014. Prior 16 years administrative support experience, including budgeting, meeting planning and human resources activities.
- AA from West Hills Community College.



**II.**

## **KRS Real Estate Review**

## a. KRS Real Estate Portfolio Financial Highlights

Financial Highlights At September 30, 2014	Market Value	Percent of Fund
<b>Portfolio Market Value - as of June 30, 2014</b>	\$638,056,052	4.0%
<b>Capital Called and Distributions in 3rd Qtr. 2014</b>	\$26,787,007	
<b>Current Unfunded Commitments as of September 30, 2014</b>	\$304,957,988	
<b>Total Market Value and Unfunded Commitments</b>	\$969,801,047	6.1%
<b>Total Fund Market Value</b>	\$16,019,925,808	
Total Allocation to Real Estate	\$800,996,290	5.0%
<b>Total Loan to Value Ratio</b>	42.9%	

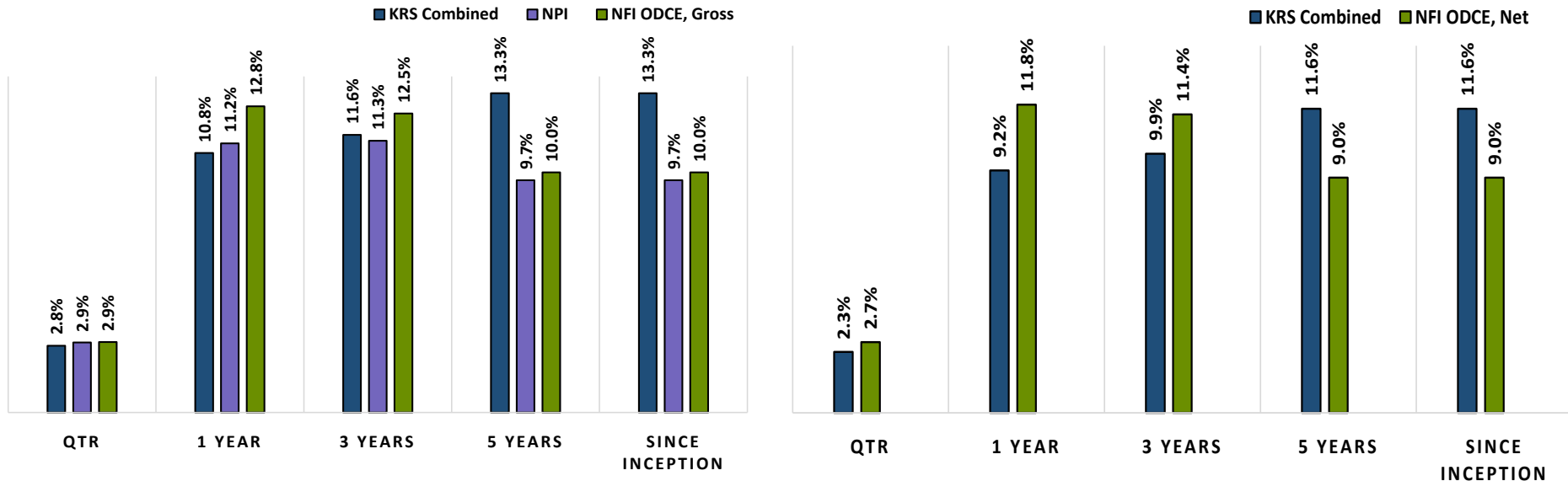
- The KRS Real Estate Portfolio made its initial investments in 2009.
- KRS has made \$913.0 million of real estate commitments to various open and closed end funds.
- The market value of the current investments, plus the unfunded commitments for these investments, equates to \$969.8 million or about 6.1% of the total allocation to real estate. However, ORG does not expect that all funds will call 100% of their commitment. Some of the older funds have begun returning capital.

## b. KRS Real Estate Performance

### Time Weighted Returns, Gross of Fees

### Time Weighted Returns, Net of Fees

As of June 30, 2014



- The KRS real estate portfolio continues to perform well.
- The 5-year returns and the since inception returns are 260 basis points greater than the NCREIF ODCE index, net of fees.

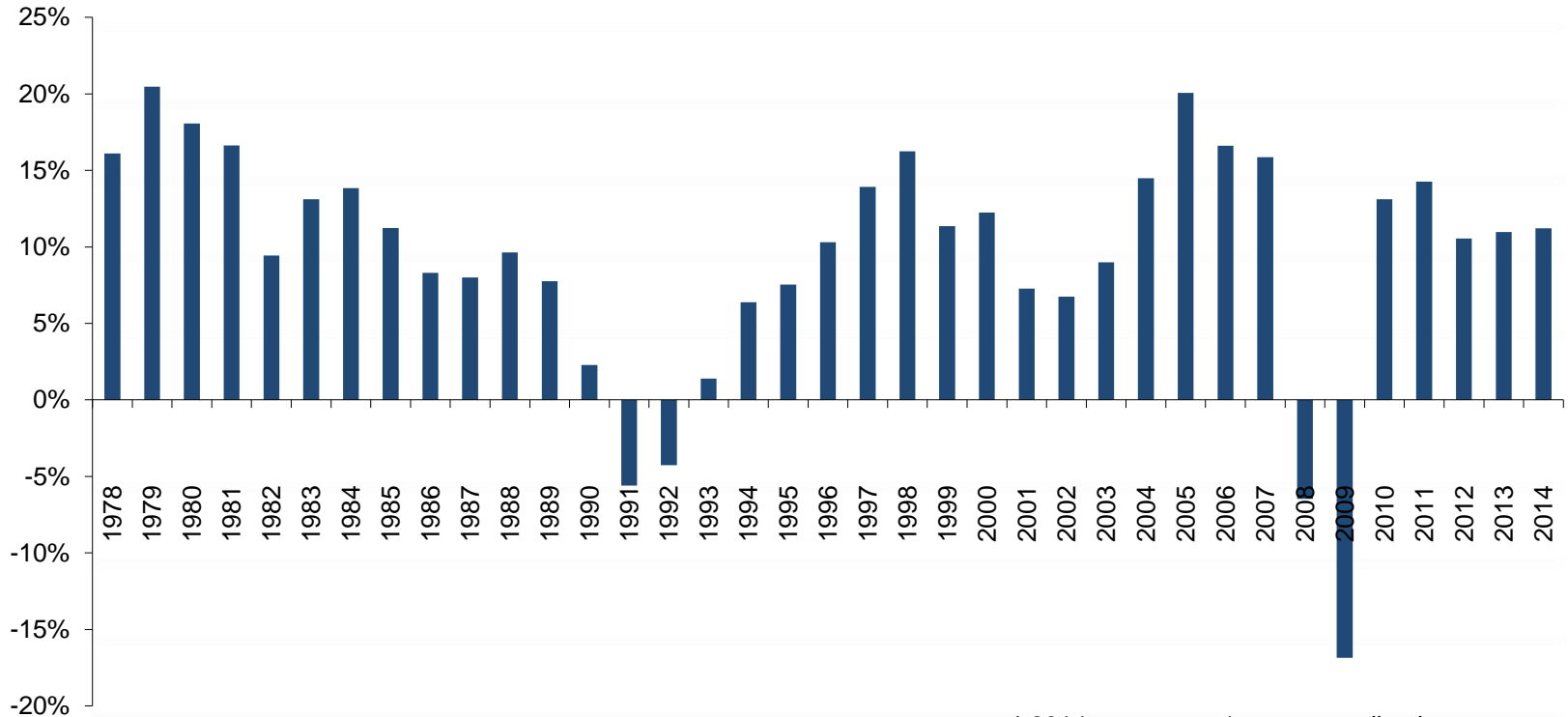


C.

Real Estate in a Long-term Investment

Cycles of Real Estate Returns Can Last for Several Years

NCREIF Property Index Annual Total Return  
1978-2014\*

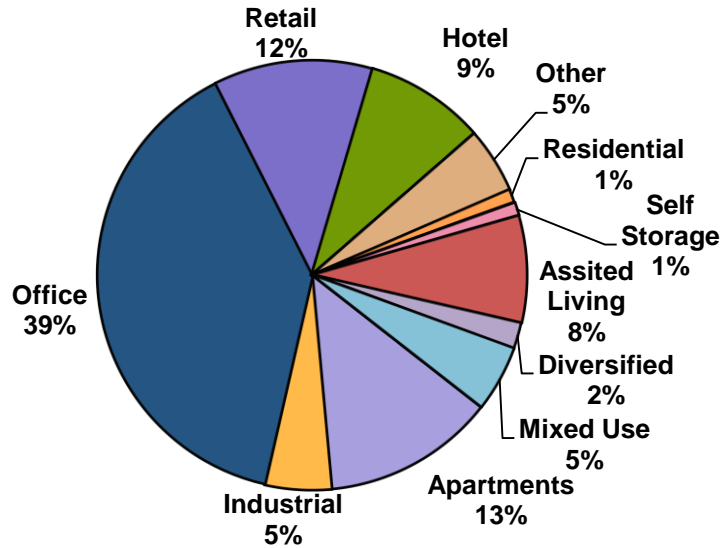


\* 2014 represents 1 year annualized returns for the period ending June 30, 2014.

Source: National Council of Real Estate Investment Fiduciaries (NCREIF)

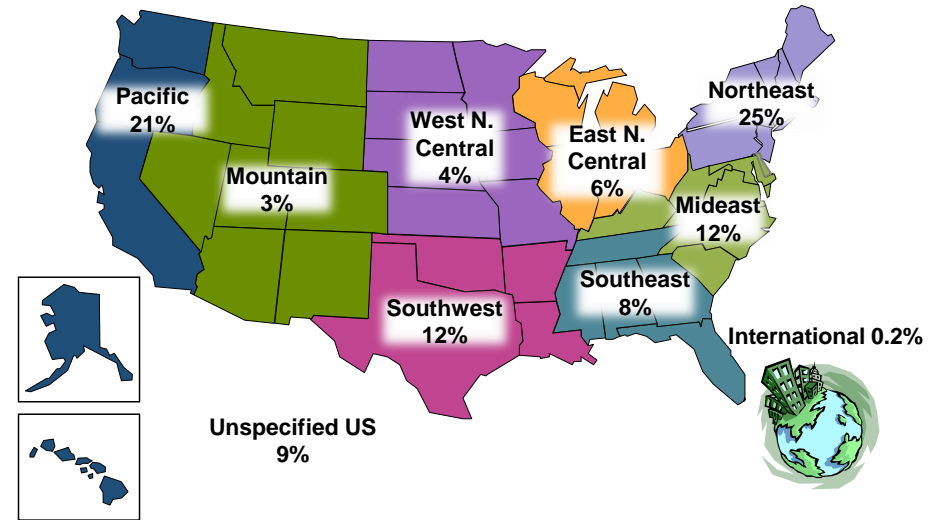
# d. KRS Real Estate Portfolio Diversification

## Property Type Diversification



## Geographic Diversification

Based on Market Value as of June 30, 2014



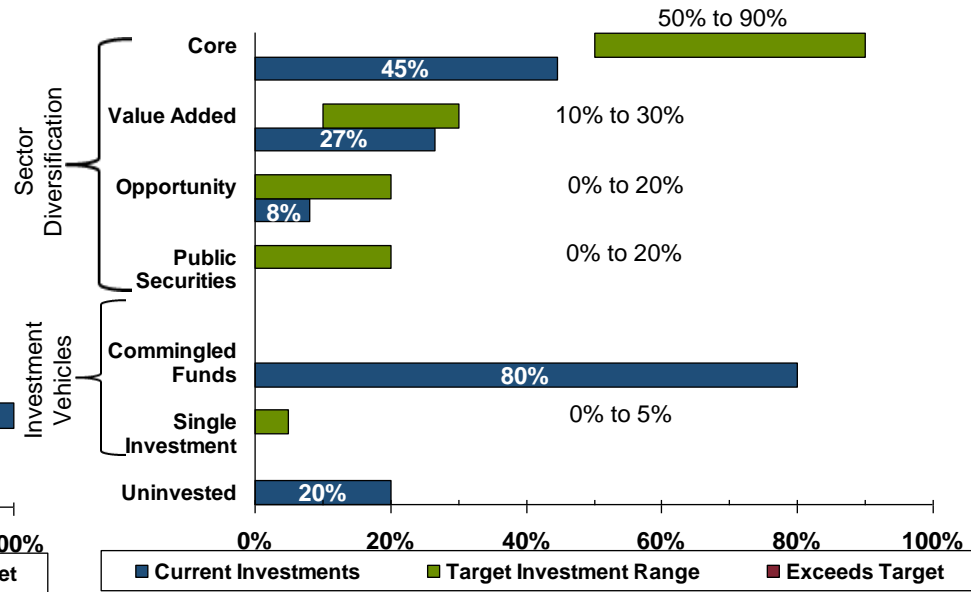
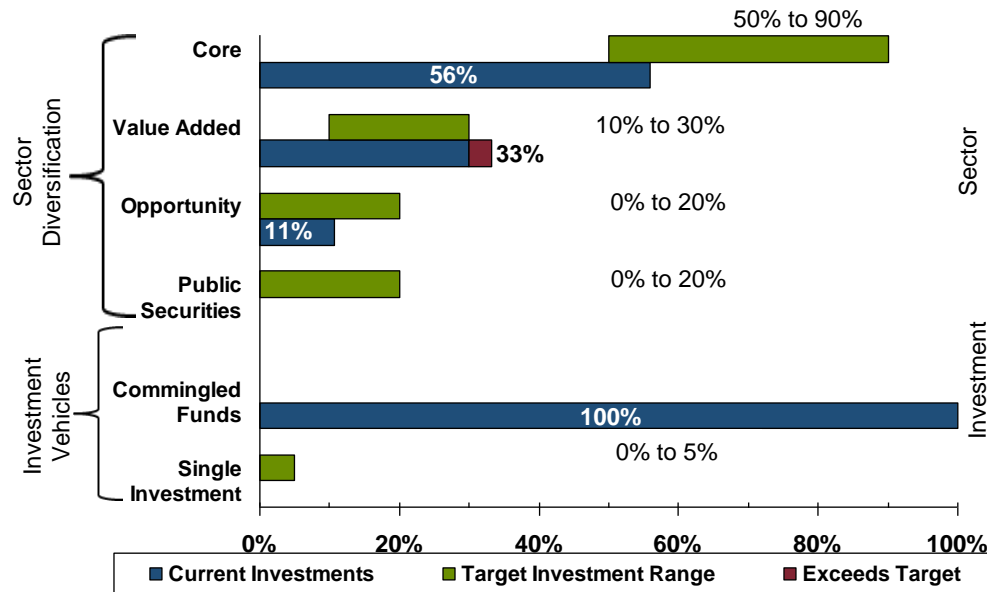
e.

# KRS Real Estate Portfolio Compliance

## Current Portfolio by Sector

## Including Uninvested Capital

Based on Market Value as of June 30, 2014



Compliance with Policy:

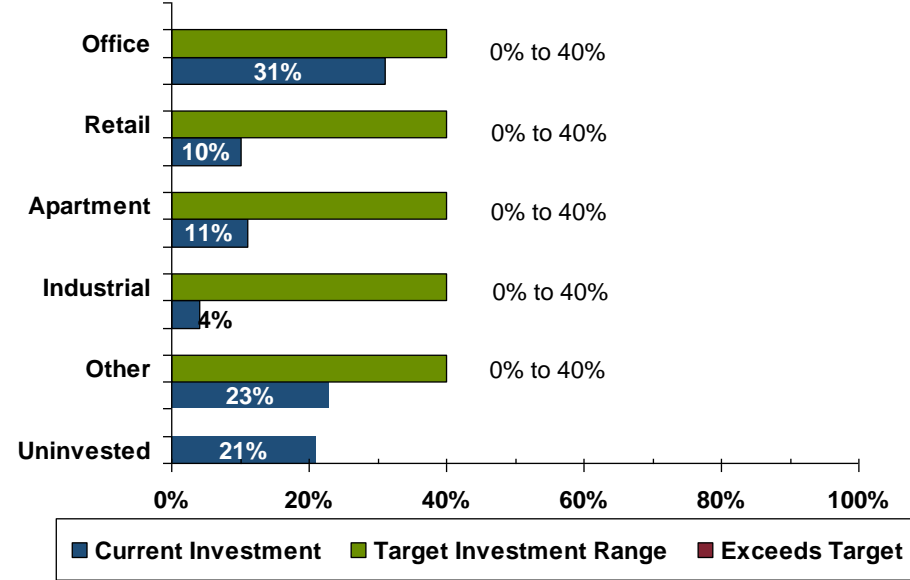
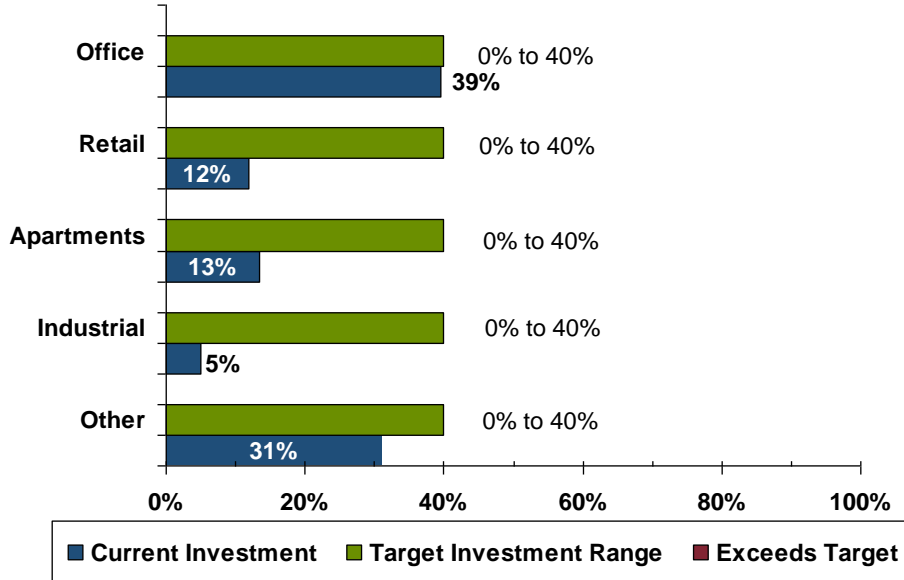


# f. KRS Real Estate Portfolio Compliance

## Current Portfolio by Property Type

## Including Uninvested Capital

Based on Market Value as of June 30, 2014



Compliance with Policy:

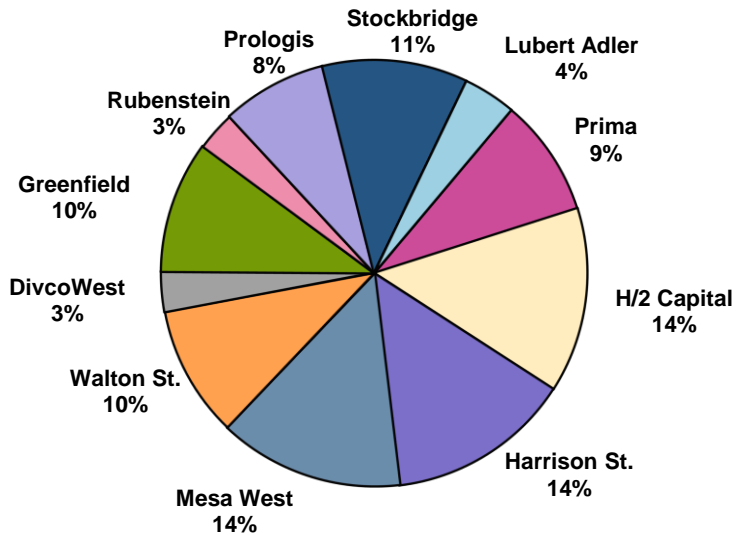


**g.**

# KRS Real Estate Portfolio Compliance

## Manager Diversification

Based on Commitments as of June 30, 2014



Policy Target is 20% Committed (\$160.2 million) to One Manager

## Leverage Ratio

Based on Market Value as of June 30, 2014

Portfolio Investments	Leverage Ratio	Policy Maximum
Core Funds	33.3%	50.0%
Value Added Funds	52.4%	65.0%
Opportunistic Funds	49.6%	75.0%+
<b>Total Portfolio</b>	<b>42.9%</b>	<b>65.0%</b>

Policy Target is 65% Total Portfolio Leverage

Compliance with Policy:





**V.**

## **Separate Investments Review**

### ***Commingled Funds***

- Investment vehicles where pension funds pool capital.
  - Diversify risk.
  - Gain access to additional investment types.
- Two types of commingled funds:
  - Closed end funds – low liquidity if pension fund requires an unplanned exit.
  - Open end funds – generally limited to core strategies, provide liquidity on a quarterly basis.
- Effective investment tool for core, value added or opportunistic strategies.
- Investment manager fees generally higher than separate accounts.

## b. **Separate Account Investments – Invest with a Manager**

### ***Separate Account Investments***

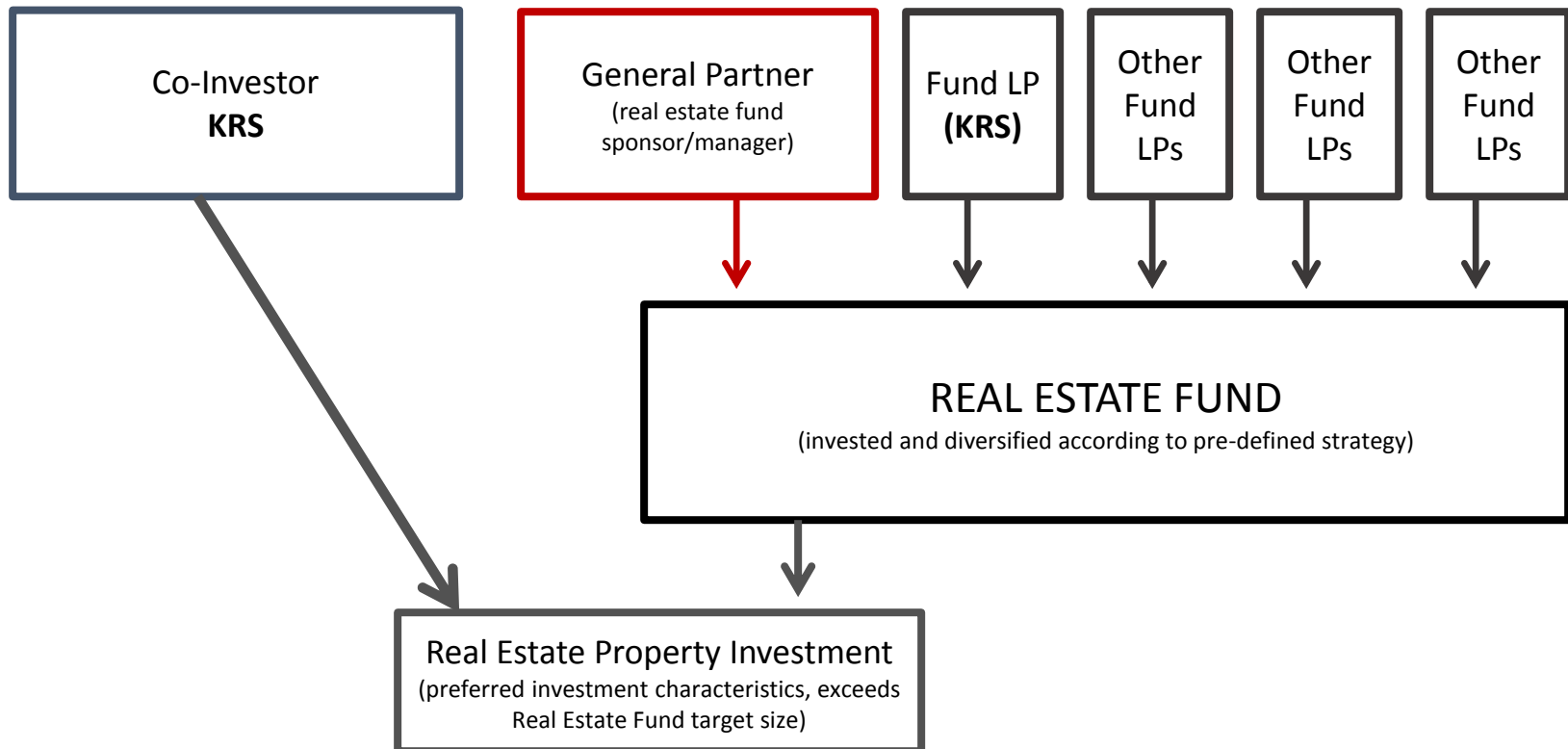
- Wholly owning and controlling specific properties.
  - Permits investor to buy/sell, finance properties.
  - Investor can replace manager or other investment decisions.
  - No need to consider another investor's objectives.
  - Yield maintenance and pre-payment penalties.
- Reasonably good liquidity for dispositions that take approximately six months.
- Diversification limited for large properties.
  - Regional malls and large downtown office properties.
- Tailor investment strategies to capitalize on current market.
  - Consider investor's remaining portfolio balance.
- Costs generally lower than commingled funds.



## C. Separate Account Investments - Co-Investments

### Co-Investments with a Fund

- “A co-investment occurs when two or more pension funds or groups of funds share ownership of a real estate investment. It could also refer to an arrangement in which an investment manager or an advisor co-invests its own capital alongside the pension plan either as an equal partner or on a subordinated basis.” – PREA Research



## d. Separate Account Investments - Co-Investments

### ***Co-Investments with a Fund***

- Real estate funds seek co-investment capital when a new acquisition is deemed to be too large for a fund to acquire the entire investment.
- The co-investment environment may be active when managers are experiencing difficulty with fund raising.
- Ideal structure for midsized funds (i.e., funds ranging in size from \$250 million to \$1 billion) that have unique and attractive deal flow greater than their commitments.
- Co-investment is often offered only to existing fund partners with discounted fee arrangements.
- Co-investments can effectively complement the existing real estate portfolio and provide access to unique opportunities on an attractive cost basis.

## e. Separate Account Investments - Co-Investments

### ***Co-Investments with a JV Partner – Direct Investment***

- Local real estate operators should have extensive knowledge of the property activities in their area.
- The co-investment environment may be active when the local real estate operators are experiencing difficulty with fund raising.
- A direct investment in a Joint Venture structure with local real estate operator would require the KRS staff to be well versed in all aspects of property management in order to determine the success of the investment.

### ***Co-Investments - Benefits***

- Fund (General Partner) benefits:
  - Opportunity for the Fund to acquire an investment in a property that may otherwise be too large or create portfolio concentrations.
  - Spreads risk of Fund to co-investors so underlying Fund is less concentrated and more diversified.
  - Ability to earn fees from additional capital raised from LP's compared to alternative of sharing a portion of the transaction with a competitive fund manager.
  
- Investor (Limited Partner) benefits:
  - Opportunity to gain additional exposure to an attractive property.
  - Opportunity to increase exposure in controlled and discretionary manner.
  - Can help improve diversification exposure at the total portfolio level.
  - Typically lower fees and no J-curve impact on performance.

### ***Co-Investments - Risks***

- Fund (General Partner) risks:
  - Same risk as underlying investment.
    - Initial due diligence of manager process mitigate this risk.
  - Additional scrutiny and reporting requirements for co-investments.
    - Further review is a net positive to financial analysis process.
  
- Investor (Limited Partner) risks:
  - Compounds risk of underlying investment through concentration to a particular asset or pool of assets.
    - Mitigated by ability of investor to do specific financial analysis.
    - Preferred for investments in property portfolios where risk can be spread across numerous properties.
  - No additional control over the asset than fund investors.
    - Potentially greater confidence through additional scrutiny of investment.
  - Time frame to review investment opportunity may be short.
    - Investment is discretionary and investor can pass if not provided sufficient time.

## h. Separate Account Investments – Invest with Existing Manager

- KRS has an existing relationship with Manager. Board has already approved Manager.
- Manager establishes a Separate Account for KRS investments only. Manager duties can be negotiated and are outlined in a separate contract.
- Generally, KRS would be the sole owner of the investment.

	Advantages	Disadvantages
<b>Ownership Rights</b>	KRS controls	KRS controls
<b>Contract</b>	KRS negotiates separate contract with Manager to outline KRS requirements.	More KRS oversight to ensure all contract items are completed.
<b>Diversification</b>	KRS controls.	May increase concentration in one investment type.
<b>Reporting</b>	Manager is familiar with institutional reporting requirements.	Additional tracking required by staff.
<b>Investment Type / Size</b>	May be limited to smaller investments based upon dollars available for investment.	Large properties may not be viable based upon dollars available for investment.
<b>Leverage</b>	KRS can outline requirements in separate account contract.	May require identification of actual property owner to obtain loans.
<b>Ownership Name</b>	Properties should be owned in a manner to protect KRS Pension/Insurance Plans	Easier for outsiders to identify the actual owner of the property.

## i. Separate Account Investments – Co-Invest with Institutional Manager

- Manager may/may not be known to KRS. KRS staff and Board would have to review and approve any new manager.
- KRS co-investment would be side by side a Manager's Fund.
- Investment would be controlled by the Manager.

	Advantages	Disadvantages
<b>Ownership Rights</b>	Same as limited partner in Fund	No control of property investment by KRS.
<b>Contract</b>	KRS negotiates co-investment contract.	More KRS oversight to ensure all contract items are completed.
<b>Diversification</b>	KRS can select the co-investment opportunities offered by manager.	None
<b>Reporting</b>	Manager is familiar with institutional reporting requirements.	Additional tracking required by staff for co-investment.
<b>Investment Type / Size</b>	Limited to co-investment selected by manager.	May increase concentration in one investment type.
<b>Leverage</b>	Manager controls.	None
<b>Ownership Name</b>	Manager controls	None

## j. Separate Account Investments – JV with Local Operator – Direct Investment

- Local operator would have to be reviewed and approved by Board.
- KRS would have to approve each property and negotiate controlling interest in property.
- KRS would be more ‘hands-on’ in the property operations, e.g., budget reviews, lease negotiations, tenant issues.

	Advantages	Disadvantages
<b>Ownership Rights</b>	KRS would have to negotiate ownership with JV Partner.	KRS may not control ownership of property.
<b>Contract</b>	KRS negotiates JV contract.	More KRS oversight to ensure all contract items are completed.
<b>Diversification</b>	KRS controls selection of property.	None
<b>Reporting</b>	Unknown	Operator may not be familiar with institutional reporting requirements
<b>Investment Type / Size</b>	Limited to investment presented by JV Partner.	May increase concentration in one investment type.
<b>Leverage</b>	KRS may be involved in leverage negotiations.	May require identification of actual property owner to obtain loans.
<b>Ownership Name</b>	Properties should be owned in a manner to protect KRS Pension/Insurance Plans	Easier for outsiders to identify the actual owner of the property.



## k. Separate Account Investments – ORG Experience

### ***ORG Experience***

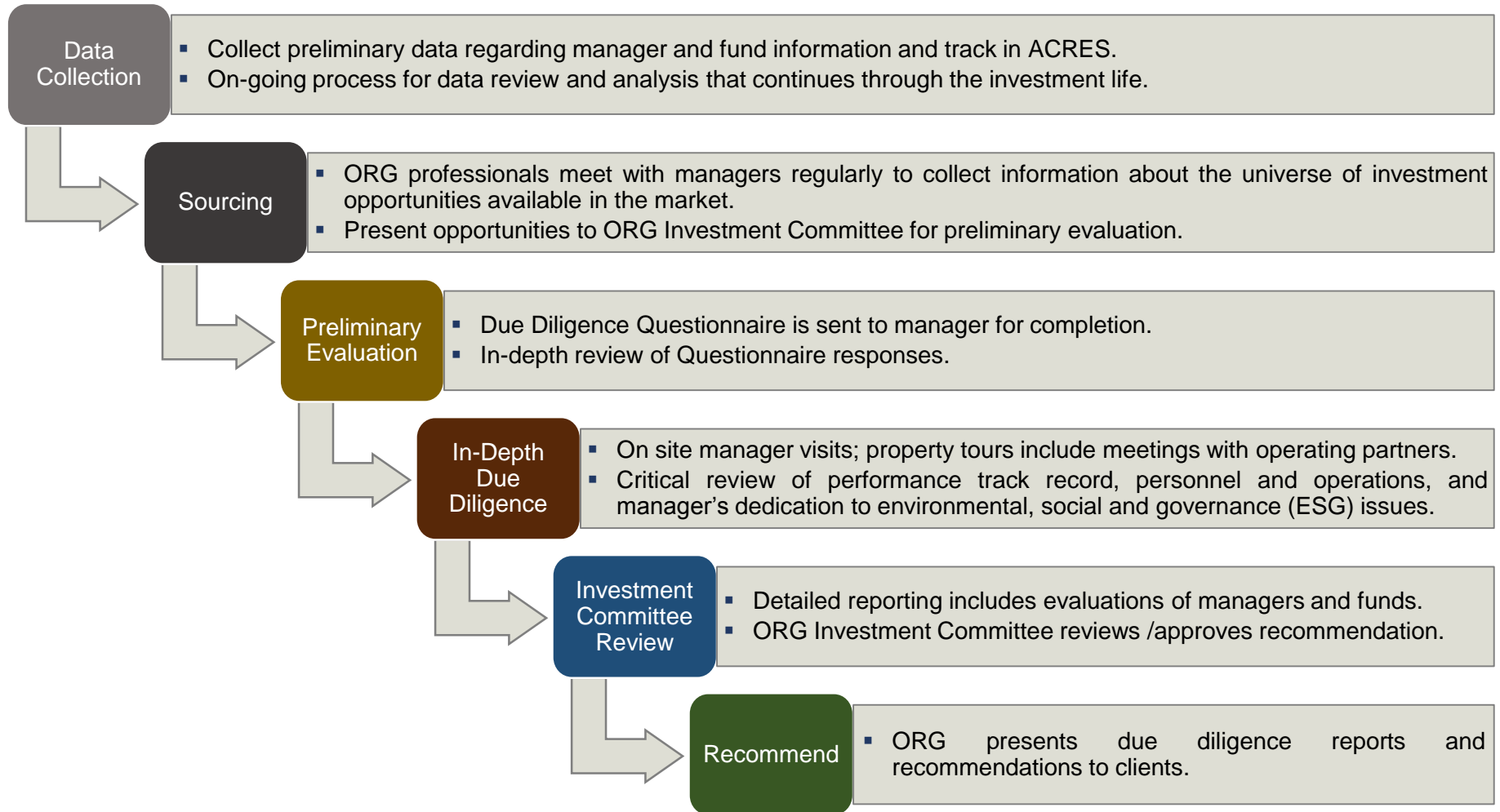
- ORG has extensive experience working with all types of separate accounts.
- Separate Accounts with managers.
  - ORG has managed several client relationships with separate account portfolios.
  - In these cases, ORG was very involved in reviewing all aspects of the properties.
- Co-investments
  - ORG has a long and successful track record of sourcing co-investment opportunities, including the underwriting and structuring of numerous deal transactions.
  - Since 2007, ORG has sourced over \$250 million of co-investment opportunities.
- JV with Local Operators
  - The ORG principals have over 20+ years experience working with JV partners in the underwriting and structuring of numerous deal transactions.

## I. Separate Account Investments – ORG Due Diligence

### ***ORG Due Diligence and Reporting***

- ORG performs due diligence on the manager/operator as well as the individual investments in the separate account prior to making the investment commitment.
- During the life of the investment, ORG continuously monitors the managers and investments:
  - Ensure that the investment program remains consistent by size and strategy
  - Maintain clear understanding of changes in staff and the effect of such changes on manager's probability of continued success.
- ORG reviews manager/operator monthly/quarterly financial reports to ensure that the investment stays on track.
- ORG can include the separate account investments in the current quarterly performance reporting or can prepare a separate report for these types of investments.

## m. ORG Investment Due Diligence



***NTS Investment***

- ORG conducted a site visit with NTS personnel and toured several properties.
- ORG completed a preliminary write-up and identified the following next steps:
  - Need to obtain a legal opinion related to past operations and any issues related to headline risk.
  - Completion of background checks of key personnel.
  - Underwriting of real property investments.



**V.**

**Appendix**

## a. KRS Real Estate Performance Returns – Pension Plan

Based on Market Value as of June 30, 2014

Investment	Vintage Year	Strategy	Commitment	Capital Contributions	Distributions	Net Asset Value	Net Multiple	Net IRR
DivcoWest Fund IV REIT, LLC	2013	Opportunistic	\$20,800,000	\$4,889,384	(\$2,261)	\$4,877,158	1.0x	-4.3%
Greenfield Acquisition Partners VI, L.P.	2012	Value Added	38,120,000	35,278,452	(4,096,237)	40,417,175	1.2x	19.9%
Greenfield Acquisition Partners VII, L.P.	2013	Value Added	27,800,000	0	0	0		
H/2 Core Debt Fund, LP	2014	Core	21,100,000	4,992,939	(771,901)	5,102,497	1.0x	5.0%
H/2 Credit Partners, L.P.	2011	Value Added	76,900,000	82,500,000	(5,600,000)	97,783,623	1.3x	8.5%
Harrison Street Core Property Fund, L.P.	2011	Core	92,540,000	85,962,941	(6,593,582)	94,949,596	1.2x	9.5%
Lubert-Adler VII, L.P.	2014	Opportunistic	27,800,000	0	0	0		
Mesa West Core Lending Fund, L.P.	2013	Core	57,500,000	51,142,234	(1,882,912)	53,133,385	1.1x	7.8%
Mesa West Real Estate Income Fund II, L.P.	2008	Value Added	36,000,000	30,035,381	(24,795,627)	19,463,523	1.5x	17.4%
PRIMA Mortgage Investment Trust	2008	Core	48,000,000	48,000,000	(12,498,564)	57,006,335	1.4x	10.7%
Prologis Targeted US Fund, L.P.	2013	Core	51,000,000	0	0	0		
Rubenstein Properties II, L.P.	2013	Value Added	20,800,000	3,536,000	(23,098)	4,840,392	1.2x	38.7%
Stockbridge Smart Markets Fund, L.P.	2013	Core	69,000,000	38,068,966	(319,699)	38,472,489	1.0x	11.6%
Walton Street Fund VI, L.P.	2008	Opportunistic	36,000,000	25,403,198	(1,860,871)	35,563,250	1.4x	10.7%
Walton Street Fund VII, L.P.	2012	Opportunistic	38,120,000	13,697,424	(87,116)	15,069,335	1.1x	27.2%
			\$661,480,000	\$423,506,919	(\$58,531,869)	\$466,678,759		

## b. KRS Real Estate Performance Returns – Insurance Fund

Based on Market Value as of June 30,2014

Investment	Vintage Year	Strategy	Commitment	Capital Contributions	Distributions	Net Asset Value	Net Multiple	Net IRR
DivcoWest Fund IV REIT, LLC	2013	Opportunistic	\$9,200,000	\$2,162,612	(\$1,001)	\$2,157,204	1.0x	-4.3%
Greenfield Acquisition Partners VI, L.P.	2012	Value Added	16,755,000	15,506,045	(1,798,732)	17,764,684	1.2x	19.9%
Greenfield Acquisition Partners VII, L.P.	2013	Value Added	12,200,000	0	0	0		
H/2 Core Debt Fund, LP	2014	Core	8,900,000	2,106,027	(325,589)	2,152,239	1.0x	5.0%
H/2 Credit Partners, L.P.	2011	Value Added	22,800,000	22,800,000		27,827,351	1.2x	8.4%
Harrison Street Core Property Fund, L.P.	2011	Core	31,010,000	28,092,757	(2,073,844)	32,378,426	1.2x	9.7%
Lubert-Adler VII, L.P.	2014	Opportunistic	12,200,000	0	0	0		
Mesa West Core Lending Fund, L.P.	2013	Core	25,500,000	22,680,469	(843,643)	24,408,613	1.1x	7.7%
Mesa West Real Estate Income Fund II, L.P.	2008	Value Added	4,000,000	3,337,265	(2,755,071)	2,162,611	1.5x	17.4%
PRIMA Mortgage Investment Trust	2008	Core	34,000,000	34,000,000	(2,616,881)	35,192,937	1.1x	8.2%
Prologis Targeted US Fund, L.P.	2013	Core	19,000,000	0	0	0		
Rubenstein Properties II, L.P.	2013	Value Added	9,200,000	1,564,000	(33,876)	2,140,943	1.2x	38.7%
Stockbridge Smart Markets Fund, L.P.	2013	Core	26,000,000	14,344,827	(120,466)	14,617,341	1.0x	21.7%
Walton Street Fund VI, L.P.	2008	Opportunistic	4,000,000	2,822,698	(206,884)	3,951,472	1.4x	10.7%
Walton Street Fund VII, L.P.	2012	Opportunistic	16,755,000	6,020,471	(38,290)	6,623,471	1.1x	27.2%
			\$251,520,000	\$155,437,170	(\$10,814,277)	\$171,377,293		

## C. KRS Real Estate Performance Returns – Combined - Net of Fees

Portfolio Investments	Market Value	Manager Projected IRR	Current Value IRR	Manager Projected Equity Multiple	Current Value Equity Multiple	Time Weighted Returns - Net of Fees				
						Qtr.	1 Year	3 Years	5 Years	Since Incept.
<b>Core Funds</b>										
Harrison St. Core Prop.	\$127,328,022	*	8.7%	*	1.2x	1.8%	10.3%			9.2%
H/2 Core Debt	7,254,737	*	5.0%	*	1.0x	1.6%				3.2%
Mesa West Core Lending	77,541,998	*	17.4%	*	1.2x	1.4%	6.6%			6.6%
PRIMA Mortg. Inv. Trust	92,199,272	*	10.2%	*	1.3x	2.0%	5.1%	5.2%	11.1%	11.1%
Prologis US Logistics ##	0	*		*						
Stockbridge Smart Mkts. #	53,089,831	*	14.3%	*	1.0x					
<b>Total Core</b>	<b>\$357,413,860</b>	<b>*</b>	<b>10.5%</b>	<b>*</b>	<b>1.2x</b>	<b>1.8%</b>	<b>7.6%</b>	<b>6.7%</b>	<b>12.1%</b>	<b>12.1%</b>
<b>Value Added Funds</b>										
Greenfield Partners VI	58,181,859	16.0%	21.8%	1.7x	1.3x	7.0%	17.1%			20.4%
Greenfield Partners VII ##	0	13.0%		2.0x						
H/2 Credit Partners	125,610,974	*	8.5%	*	1.3x	1.7%	8.0%	6.7%		6.7%
Mesa West II	21,626,134	13.3%	17.4%	1.4x	1.5x	-1.7%	-1.6%	15.7%		19.2%
Rubenstein II	6,981,335	13.0%	36.5%	1.8x	1.2x	3.2%				25.0%
<b>Total Value Added</b>	<b>\$212,400,302</b>		<b>12.2%</b>		<b>1.3x</b>	<b>2.8%</b>	<b>9.8%</b>	<b>11.4%</b>		<b>16.0%</b>
<b>Opportunistic</b>										
Divco West IV	7,034,362	12.0%	-4.3%	1.6x	1.0x	-0.2%				-0.2%
Lubert-Adler VII ##	0	18.0%		1.7x						
Walton Street VI	39,514,722	12.0%	10.7%	2.0x	1.4x	2.6%	15.3%	12.3%	-52.2%	-52.2%
Walton Street VII	21,692,806	16.0%	27.2%	1.0x	1.1x	5.7%	28.6%			28.6%
<b>Total Opportunistic</b>	<b>\$68,241,890</b>		<b>11.3%</b>		<b>1.2x</b>	<b>3.2%</b>	<b>17.1%</b>	<b>12.9%</b>	<b>-52.1%</b>	<b>-52.0%</b>
<b>Total Portfolio</b>	<b>\$638,056,052</b>		<b>10.8%</b>		<b>1.2x</b>	<b>2.3%</b>	<b>9.2%</b>	<b>9.9%</b>	<b>11.6%</b>	<b>11.6%</b>
NCREIF ODCE Index - Net of Fees						2.7%	11.8%	11.4%	9.0%	9.0%

Note: \* - Open ended fund does not provide IRR or Equity Multiple data.

## - No capital calls through 06/30/14

# - Performance is not reported for a partial quarter.

Walton Street Fund VI Note: The negative Since Inception return relates to a 2009 significant write down of several major assets including the West Coast Industrial Portfolio which was totally written off at that time.



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