September 15, 2006
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MEMORANDUM TO: State Investment Council

FROM: O. Ike Michaels, Jr. s/*O. Ike Michaels, Jr.*(crb)
Associate Director

SUBJECT: **Proposed Real Estate Investment in Prudential Property Investment Separate Account (PRISA)**

This due diligence memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.12 to report on proposed real estate investment of $300 million in the Prudential Property Investment Separate Account ("PRISA") managed by Prudential Real Estate Investors ('PREI").

Please note that this investment will be authorized pursuant to Articles 69 and 71 of the Council's regulations, which became effective on June 20, 2005. This investment will be considered a real estate investment as defined under N.J.A.C. 17:16-71.2 (a).

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 myself).

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.

The investment we are proposing represents a core open-end commingled fund which fits well within the Strategic Portfolio established in 1970, *Prudential Property Investment Separate Account (“PRISA”)* is the oldest pooled real estate fund for institutional investors in the U.S. With a current pool of high quality, well diversified real estate assets with a net asset value of $7.9 billion ($10.1 billion gross asset value), PRISA makes investments in office, retail, industrial, apartment, hotel and self storage properties and has a 35 year track record of executing a core strategy and performance that has consistently been favorable relative to the NCREIF Property Index (“NPI”) and PRISA’s competitive set. PRISA follows a diversification strategy intended to reduce risk and maintain a broadly diversified portfolio.

PRISA is managed by Prudential Real Estate Investors (“PREI”), a business unit of Prudential Investment Management, Inc. (“PIM”) which is an indirect subsidiary of Prudential Financial, Inc. (“Prudential”). PREI has over $18.8 billion in real estate assets under management. PREI has been managing real estate for US institutional clients since 1970 and has a domestic staff of 280 individuals, including over 150 investment professionals with expertise in office, residential, industrial, multifamily and hotels in the domestic and international markets and a research team of 14 (10 in the US and 4 overseas). The firm is headquartered in Parsippany, New Jersey, and has offices in Atlanta, Chicago, San Francisco and Boston. Teams of Research Professionals are located in the U.S. and overseas and are fully integrated not only portfolio construction, but into the ongoing investment analysis as well. All the legal and economic terms associated with this Fund are fair and consistent with market standards.

Even though we have been told that PRISA will make a significant call nearing $1.5 billion in late September, we do not expect to be able to invest the full $300 million commitment in the foreseeable future. Based on our discussions with Prudential, $200 million is a more reasonable expectation. If we are able to invest the full $300 million, we would likely recommend at some point that a portion of the investment be liquidated to fund an investment in either PRISA I and/or PRISA II, both opportunistic funds also managed by Prudential. Unlike PRISA, these funds do not operate with a queue; existing investors with Prudential have the first right if and when capacity opens up.

The DOI Investment Committee held a meeting on September 6, 2006 to review the due diligence reports prepared by Townsend and Division staff and other information for the proposed investment. After reviewing this material, the DOI Investment

Committee approved the above-referenced commitment amount of $300 million in PRISA.

Formal written due diligence reports for these proposed investments were sent to each member of the Investment Policy Committee of the Council on Friday, September 8, 2006, and a meeting of the Committee was held on September 13, 2006. In addition to the formal written due diligence reports, all other information obtained by the Division on these investments was made available to the Investment Policy Committee.

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 this proposed investment 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 this investment. In addition, this proposed investment 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 will not be reached with the general partner.

We look forward to discussing the proposed real estate investments at the Council's September 21, 2006 meeting.

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