



State of New Jersey

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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State Treasurer

November 15, 2013

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Acting Director

SUBJECT: **Proposed Investment in Northwood Real Estate Partners, L.P.
(Series IV)**

The New Jersey Division of Investment ("Division") is proposing an investment of \$200 million in Northwood Real Estate Partners, L.P. (Series IV) (the "Fund"). The Division previously made a \$75 million commitment in Northwood Real Estate Partners L.P (Series III) and \$75 million commitment in Northwood Real Estate Co-Investors, L.P. for a total of \$150 million in December 2012. This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9.

The Division is recommending this investment based on the following factors:

Track Record: Northwood Investors LLC ("Northwood") manages its assets through a series of fund raises and co-investments. As of June 30, 2013, Northwood has invested approximately \$2.1 billion of equity to achieve a 17% gross Internal Rate of Return ("IRR") and 2.3x gross Multiple on Invested Capital ("MOIC"). We note, however, given that the majority of investments were made starting in 2010, the track record to date is largely unrealized. Of the \$2.1 billion invested, \$171 million has been realized for a 17% gross IRR and a 1.5x gross multiple.

As the former President and CEO of Blackstone Real Estate Advisors, John Kukral has successfully invested through several real estate and economic cycles. During Mr. Kukral's tenure at Blackstone from 1994 to 2005, he oversaw the firm's real estate investments of approximately \$5.8 billion of equity in over 160 separate transactions; achieving a 37% gross IRR on realized and partially realized investments as of December 31, 2005. Furthermore, of the \$5.8 billion invested, only \$40 million in principal losses were realized (0.7% of invested capital).

Demonstrated Investment Discipline: Northwood has demonstrated a disciplined investment approach during the real estate market downturn. Despite finishing its initial capital raise of \$1.25 billion in 2008, Northwood only made one investment during the 2007 to 2010 time period. Many of Northwood's competitors invested in heavily leveraged transactions during this

period of hyper-liquidity and consequentially lost substantial capital as the result of the market correction. As previously noted, Northwood's only investment in this time period, made in August 2008, was participation in the senior mezzanine tranche collateralized by a global portfolio of Hilton hotels and other corporate assets which delivered a 14% gross IRR and 1.7x MOIC.

Northwood's focus on capital preservation and resiliency to short-term volatility lead to conservative leverage across its portfolio. The current portfolio leverage (as of June 30, 2013) is 47% on a Loan to Value basis.

Opportunistic investment structure: Northwood is structured to invest through market cycles by opportunistically investing in multiple property types and across the capital structure (i.e., debt and equity). The fund's ability to execute on its long-term value creation plans and emphasis on attractive unlevered yields provides superior risk-adjusted returns. Additionally, Northwood drives substantial value by internally managing operationally intensive property types, including office, residential, retail and hospitality.

A report of the Investment Policy Committee ("IPC") summarizing the details of the proposed investment is attached.

Division Staff and its real estate consultant, R.V. Kuhns and Associates, Inc., undertook extensive due diligence on the proposed investment in accordance with the Division's Alternative Investment Due Diligence Procedures.

As part of its due diligence process, staff determined that the fund has not engaged a third-party solicitor (a "placement agent") in connection with New Jersey's potential investment.

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 the investment. In addition, the proposed investment must comply with the Council's regulation governing political contributions (N.J.A.C. 17:16-4).

Please note that the investment is authorized pursuant to Articles 69 and 71 of the Council's regulations. The Northwood Real Estate Partners, L.P. (Series IV) Fund will be considered a non-core real estate investment, as defined under N.J.A.C. 17:16-71.1.

A formal written due diligence report for the proposed investment was sent to each member of the IPC and a meeting of the Committee was held on November 8, 2013. In addition to the formal written due diligence report, all other information obtained by the Division on the investment was made available to the IPC.

We look forward to discussing the proposed investment at the Council's November 21, 2013 meeting.

Attachments

Fund Name: Northwood Real Estate Partners, L.P. Series IV

November 21, 2013

Contact Info: Vivian Tongalson, Managing Director, 575 Fifth Avenue, 23rd Floor, New York, NY 10017

Fund Details:

Total Firm Assets (\$bil.):	\$3.0 billion	Key Investment Professionals: John Z. Kukral , President and Chief Executive Officer: Mr. Kukral has been an active real estate investor for over 30 years, and serves as the Chairman of the Investment Committee. Prior to Northwood, Mr. Kukral was the former President and CEO of Blackstone Real Estate Advisors from 2002 to 2005. Erwin K. Aulis , Chief Operating Officer: Mr. Aulis has been active in the real estate investment management business for over 27 years. He is responsible for the day-to-day operations of Northwood, including asset management, capital markets, finance and control, investor relations and human resources. Michael P. Sullivan , Chief Financial Officer and Chief Compliance Officer: Mr. Sullivan has overall responsibility for financial reporting, tax compliance and property accounting. Previously, Mr. Sullivan served as Chief Financial Officer at J.C. Flowers & Co for five years.
Strategy:	Non-core real estate	
Year Founded:	2006	
Headquarters:	New York	
GP Commitment:	\$25 million	

Investment Summary

Northwood Investors, LLC, a privately-owned, private equity real estate investment firm headquartered in New York. Northwood is led by John Kukral, who while he was at Blackstone from 1994 to when he retired in 2005, ran five funds: BREP I-IV and BREP International. Northwood expects to opportunistically pursue real estate investments on a global basis by investing in various levels of the capital structures of assets and companies, with a particular focus on major metropolitan areas of the U.S. and super-regional markets in Europe. Within these markets, Northwood expects to focus on assembling a portfolio that is diversified across multiple product types and fits their investment strategy of seeking investments that have limited downside risk, while generating superior risk-adjusted returns with upside potential through capital appreciation or repositioning.

Existing and Prior Funds

Funds	Vintage	Strategy	Projected Returns
Northwood Real Estate Fund & Co-Invest Fund	2007	Non-core real estate	11.7% Net IRR/ 1.8X Net MOIC
IRR = Internal Rate of Return MOIC = Multiple on Invested Capital			

Vehicle Information:

Inception:	2008	Auditor:	Ernst & Young LLP
Fund Size (\$mil.):	\$800 million	Legal Counsel:	Simpson Thacher & Bartlett LLP
Management Fee:	1.5% on committed capital during commitment period; 1% on invested capital thereafter		
Carry:	75% LP ; 25% GP - LP's receive all invested capital, fees/expenses and preferred return before any carry is paid to GP		
Hurdle Rate:	6%		
Additional Expenses:	100% fee offset		

NJ AIP Program

Recommended Allocation (\$mil.):	\$200 million	LP Advisory Board Membership:	Yes
% of Fund (Series):	25.0%	Consultant Recommendation:	Yes
		Placement Agent:	No
		Compliance w/ Division Placement Agent Policy:	N/A
		Compliance w/ SIC Political Contribution Reg:	Yes

*This review memorandum was prepared in accordance with the State Investment Council rules governing the Alternatives Investment Program and the policies and procedures related thereto.