

June 13, 2008

MEMORANDUM TO: State Investment Council

FROM: William G. Clark
Director

SUBJECT: **Proposed Real Estate Investment in Morgan Stanley Real Estate Fund VII Global and TA Associates Fund IX**

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: \$150 million in the Morgan Stanley Real Estate Fund VII Global ("MSREF VII Global") and \$100 million in TA Associates Fund IX.

Please note that these investments will be authorized pursuant to Articles 69 and 71 of the Council's regulations. 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 February 21, 2008 require any potential alternative investment opportunities to be identified and initially evaluated by the applicable staff of the Division of Investment ("DOI") and the applicable Asset Class Consultant (The Townsend Group for Real Estate, or "Townsend") in coordination with the Division of Investment's Investment Committee (Director and the senior staff member for the applicable alternative asset class).

As a result of internal and external sourcing, the DOI Investment Committee identified these 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.

Morgan Stanley Real Estate Fund VII Global (“MSREF VII Global”) is a \$10-12 billion commingled fund focused on opportunistic real estate and real estate-related investments globally. MSREF VII Global is a follow-on investment vehicle to the \$1.8 billion MSREF V U.S. launched in 2005 and the \$8.0 billion MSREF VI International launched in 2006. The two fund series have been combined to create one global opportunistic real estate investment vehicle.

Morgan Stanley’s primary businesses consist of securities, asset management, and credit services. Its platform is comprised of more than 46,000 employees in 34 markets worldwide. The Morgan Stanley Real Estate Investments group (“MSREI”) is the global real estate investment practice and a fully integrated group within the Morgan Stanley Investment Management division (“MSIM”). The real estate group has approximately 500 investment professionals operating from 24 offices on five continents. MSREI has had a long-standing local real estate presence beginning in the U.S. in 1969, Europe in 1987, and Asia in 1989.

The MSIM Team is headed by Jay Mantz, Steve Trevor, and Stuart Bohart, with Jay Mantz and Steve Trevor responsible for the oversight of MSREI. MSREI is co-headed by John Carrafiell and Sonny Kalsi, who have been with Morgan Stanley for 20 and 16 years, respectively. Michael Franco and Brian Carr serve as co-heads of MSREI’s Americas business. Marco Polenta serves as Head of MSREI’s Europe business. Zain Fancy oversees MSREI’s Asia business and Fred Schmidt heads the MSREI Japan business.

The Fund will focus on large, wholly or majority owned positions. Investment themes include corporate and government divestitures, public to private transactions, distress opportunities arising from motivated sellers, and development projects primarily in emerging markets. MSREF VII Global is targeting a 20%+ gross IRR utilizing approximately 70% leverage on a portfolio basis. Expected allocations to the global regions are 25% to the U.S, 25% to developed Asia with a focus on Japan, 25% to Western Europe with a focus on Germany, and 25% to emerging markets with a focus on China.

Morgan Stanley will commit 10% of MSREF VII Global’s total equity, up to \$500 million. Morgan Stanley professionals will also contribute which will be in addition to the company’s commitment. With a \$150 million commitment to the fund, we will pay a reduced fee of 1% as well as secure a seat on the MSREF VII Global advisory board.

All the legal and economic terms associated with MSREF VII Global are fair and consistent with market standards.

TA Associates IX (TA IX) is a \$1.75 billion Enhanced Return fund targeting gross returns of 16-17% (14-15% net) utilizing up to 50% leverage. Fund IX is the successor to eight previous funds sponsored by the senior investment team of TA Associates Realty (“TA”). The first in the series closed in 1987. Since that time, they have raised over \$5.4 billion of equity from investors. NJ DOI committed \$100 million to their prior fund, TA Associates VIII.

Fund IX is a continuation of the successful strategy that TA has employed in its previous seven funds (TA’s first fund invested in core assets). Fund IX will invest in the four major property types (Office, Industrial, Multifamily, Retail) throughout the United States, with a strong emphasis on finding properties in suburban locations of major markets, particularly along the East and West coasts. The team attempts to create a diversified portfolio by property type, location and underlying industry/ credit of tenants to ensure measured risk and return. TA is precluded from placing more than 35% of the capital commitments in any one market.

TA’s value creation approach is to buy at a discount to replacement cost, acquire assets that can generate strong current income and actively manage the leasing to create value. TA focuses on smaller and medium sized assets, typically \$20 to \$50 million in gross value, and will look to acquire in excess of 100 properties for Fund IX. TA estimates that 45%-75% of the investments will be located near the East and West coasts, with another 15%-25% located in the Midwest. TA provides its own internal asset management services and controls all leasing decisions. This approach enables TA to avoid paying a double promote to an operating partner.

TA is targeting a fund size of \$1.75 billion. The planned fund size is similar to that of Fund VIII (\$1.742 billion). TA is aiming for a first close in mid to late June 2008, and final close within a one-year time period.

All the legal and economic terms associated with TA Associates IX are fair and consistent with market standards

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 3 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, these 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 the general partners.

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We look forward to discussing these proposed real estate investments at the Council's July 19, 2008 meeting.

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Attachments