C.6. Reporting Requirements for Investment Managers

Investment Managers of Liquid Mandates

Monthly Reporting Requirements

A. Within five business days of the occurrence of any of the following, submit a written explanation of the circumstances that resulted in:

(1) Transactions that result in the Custodian charging the ERS overdraft charges.

(2) Transactions that are extraordinary and warrant disclosure to the ERS (also include items not reflected in the financial statements, e.g. significant changes in forward contracts, etc.).

B. Reconciliation of Manager's Monthly Report with Custodian's Monthly Report

(1) To assist the Custodian with the reconciliation of asset position for both the number of shares/par value and book value, income realized and gain/loss, and pricing, (in U.S. dollar and local currency for foreign managers), managers must provide the required information in a reasonable format (e.g. diskette, direct transmission, etc.). Contact the Custodian for file format and layout.

(2) Each investment manager must reconcile its records to the Custodian's reports. A copy of the manager's reconciliation report must be received within 30 days of the close of the reporting month.

C. Fees

(1) Investment Manager's fees are based on the Custodian's reports. Fees are paid quarterly and after-the-fact. Invoices are sent to the ERS and processed for payment from the investment manager's portfolio.

(2) Failure to submit written explanations of charges (e.g. bank overdraft) listed in B.1. and B.2. above, may result in fees being adjusted at the discretion of the ERS.

(3) Fees may be adjusted if the market value of the portfolio presented in Custodian's reports is subsequently revised for pricing errors or other adjustments.

(4) On an annual basis, the applicable investment consultant shall write to the investment managers inquiring whether the ERS is receiving the lowest fee structure (favored nation clause). The investment consultant will inform the ERS of any instance where the ERS is not receiving the lowest fee and recommend a course of action.

Quarterly Performance Reporting Requirements

A. Reporting Requirements

All of the information listed below shall be included in quarterly performance reporting. Performance results shall be placed at the beginning of the report.

(1) A Statement of Assets.

(2) Performance results for the quarter, calendar year to date, fiscal year to date, and preceding 1-year, 3-year and 5-year periods.

(3) An analysis of the positive and negative aspects of the investment strategy during the quarter and how it affected the investment results.

(4) An economic outlook and investment strategy for the next quarter and/or year.

(5) One report is to be sent to the Investment Office in electronic format.

B. Organizational Changes

Important changes in an investment manager's organization, staff and investment strategy should be reported within 5 business days of their occurrence. Investment managers must also promptly report any involvement in litigation, claims, assessments, regulatory investigations, etc.

C. Registration Statement

Investment managers must also send the ERS annually a copy of part II of their registration statement (Form ADV) on file with the Securities and Exchange Commission.

D. Presentations to the Board of Trustees

Except as stated in Section C.5.A. of this Manual, the Board of Trustees does not require investment managers to meet with the Board on a regular basis. However, the Board, at its discretion, may invite managers to discuss appropriate matters pertaining to the ERS account. Attendance by manager representatives at the Board's Annual Manager's Conference is required.

Investment Managers of Illiquid Mandates

Investment managers of illiquid mandates must abide by the reporting requirements stated within the corresponding strategic/sub-component sections of this Manual.

APPENDIX: CORE REAL ESTATE SUB-COMPONENT

TABLE OF CONTENTS

1. Real Estate Investment Objectives

A. Investments In Real Estate

The Employees' Retirement System of the State of Hawaii ("ERS") completed a strategic allocation study for the investment of its assets. This analysis demonstrated that, over the long term, inclusion of investments in private equity real estate and debt positions in real estate properties would enhance the ERS's expected portfolio investment characteristics while reducing expected total portfolio volatility.

In general, the ERS desires to obtain the optimum return on the portfolio consistent with the assumption of prudent risk. While safety of principal is given primary consideration, the ERS recognizes the need to use active asset management strategies in order to obtain the highest attainable total investment return (income plus appreciation) within the ERS's framework of prudence and managed risk.

Core real estate investments of ERS shall be made in a manner consistent with the fiduciary standards of the prudent person rule: (1) to safeguard and diversify the core real estate portfolio; and, (2) for the sole interest of the participants and their beneficiaries. The selection of investment managers and development of investment policy will be guided to enhance diversification within the portfolio of the ERS's core real estate investment program ("Core Real Estate Investment Program") thereby limiting exposure to any one investment, organization, real estate property type and geographic region (Refer to Section II: Program Management).

1. **Real Estate Defined -** Real estate assets are defined as those investments that are unleveraged or leveraged, private equity or debt positions in real property. The ownership structure(s) should be consistent with any rules, regulations, or law, as applicable, governing the ERS. The ERS will pursue both discretionary separate account investment management and discretionary commingled fund investment management for its core real estate allocation.

B. Core Strategic Allocation

The ERS allocation to real estate shall remain within the limits authorized by the ERS Board of Trustees. Core real estate allocations should be in line with those that are detailed in their respective categories referred to in Section D: Broad Growth Program. Core real estate is classified in the Stabilized Growth allocation.

C. Core Portfolio Return Objectives

The core real estate return objectives will follow their respective assignments as detailed in Section D.3. Return Objectives & Risk Profile.

2. Program Management

A. Overview

In compliance with current ERS investment philosophy, the Real Estate Investment Program will primarily utilize discretionary separate account relationships and discretionary commingled fund investment vehicles that are sponsored by real estate investment managers ("Investment Managers"). Under this program, the Investment Managers acquire, operate and dispose of real estate assets in accordance with a work assignment that is outlined in their investment management contract with the ERS (the "Contract") and in the Annual Tactical Plan for separate accounts and the fund documents for commingled funds. The Contract describes the acceptable property types, geographic restrictions, investment structures, leverage and other specific investment parameters. The Annual Tactical Plan is the Investment Manager's "working plan" for each fiscal year and must be reviewed by Investment Staff and Real Estate Consultant (Refer to Exhibits accompanying this Section) and approved by the Board of Trustees. Commingled fund documents typically refer to the fund's offering memorandum or private placement memorandum, limited partnership or LLC membership agreement, and subscription agreement.

B. Participant Roles and Responsibilities

The ERS's Real Estate Investment Program shall be implemented and monitored through the coordinated efforts of the Board of Trustees; through the Investment Staff; the ERS's general investment consultant ("General Investment Consultant"); the ERS's real estate consultant ("Real Estate Consultant"); the Investment Manager(s). Specific responsibilities that fall outside the general responsibilities highlighted in Section B.5. are listed below:

1. **Investment Manager** - Qualified real estate organizations, registered as Investment Advisors under the 1940 Act that provide institutional real estate investment management services to the ERS. ERS may invest in commingled fund vehicles that are not registered, however, it is preferred that the commingled fund be sponsored and/or managed by a Registered Investment Advisor.

   Separate Account Manager Responsibilities - The separate account Investment Manager, acting as a fiduciary on behalf of ERS, acquires, manages and disposes of real estate properties and/or originates or acquires, manages, and realizes upon real estate debt investments in accordance with the annual Tactical Plan and Contract.

   Commingled Fund Manager Responsibilities – The commingled fund Investment Manager, acting as a fiduciary on behalf of ERS, acquires, manages and disposes of real estate properties and/or originates or acquires, manages, and realizes upon real estate debt investments in accordance with the terms of the investment vehicle documents.

C. Core Portfolio Composition

1. **Core Portfolio** - Core investments include equity or debt investments on existing, substantially leased income-producing traditional property types located principally in metropolitan areas that exhibit reasonable economic diversification. Core properties, therefore, must have the following characteristics:

    - Traditional institutional quality property types including office, industrial, retail and multifamily; also included are medical office, senior housing, storage, and student housing properties that demonstrate core characteristics;
    - Operating and stabilized properties that demonstrate predictable income flows with a high proportion of anticipated total return arising from current income and cash flow;
    - At least 70% leased upon purchase of the asset;
    - Located in institutional markets and in economically diversified metropolitan areas;
    - High credit quality tenants and a staggered lease maturity schedule;
    - Quality construction and design features;
    - Reasonable assurance of a broad pool of potential purchasers upon disposition;
    - Properties requiring quality asset and portfolio management but not requiring specialized operating expertise which is not readily available in the market;
    - Investments structures using all cash or low leverage. Leverage is limited to 50% on each investment;
    - Total gross return expectations between 6% and 8% per year.

D. Investments and Risk Management

The ERS shall manage the investment risk associated with real estate in several ways:

1. **Institutional Quality** - All assets within the Core portfolio must be of institutional investment quality as evidenced by a history of institutional investment in similar properties; expert analysis which supports the economic viability of the market; high quality construction and design features; and a current or potentially competitive position within the property's immediate market area.

2. **Diversification** - The real estate portfolio shall be diversified by geographic region and property type. Diversification reduces the impact on the portfolio of any one investment or any single Investment Manager's style to the extent that an adversity affecting any one particular area will not impact a disproportionate share of the total portfolio.

Target Portfolio

Although the real estate portfolio has been split between stabilized growth allocation (where core real estate resides) and private growth allocation (where noncore real estate resides, the long-term real estate strategy is for the ERS real estate portfolio to be diversified by geographic regions and property type taking into account the following diversification guidelines:

Property Type - The Plan seeks to minimize the risk of its real estate portfolio by allocating its assets across the spectrum of property types. The real estate portfolio shall be diversified with the majority of investments comprised of the four traditional property types: office, industrial, retail, and multifamily (apartment). No single traditional property type shall account for greater than 50% of the portfolio. In addition, the allowable range of property type allocations will be 0.5x – 1.5x the NFI-ODCE's weight in each property type. Other property types, such as hotels, motels, residential housing, senior housing, medical office, storage student housing, and raw land are allowed but (on a combined basis) should not exceed 20% of the total real estate portfolio.

Geographic - The Plan seeks to minimize the risk of its real estate portfolio by allocating its investments across the geographic spectrum. Within the United States, the allowable range of geographic allocations will be 0.5x – 1.5x the NFI-ODCE weight in each region. International Investments (Non US and Canada) will range between 10-20% of the total real estate portfolio.

3. **<u>Ownership Structure</u>** - The ownership structure for Core investments includes leveraged and unleveraged equity and debt investments owned 100% by ERS or owned jointly with Suitable Investment Partners. "Suitable Investment Partners" include public, corporate and union pension plans, foundations and endowments, insurance company general accounts or separate accounts, and other tax-exempt institutions, having the same or greater standards of fiduciary care and responsibility as those imposed by ERS guidelines. When dealing with non core investments that are directly owned, Operating Partners shall be added to the list of "Suitable Investment Partners." The ownership structure of non core assets within commingled funds will be governed by the fund documents.

4. **<u>Leverage</u>** - Leverage may be utilized in a constrained manner in the Core portfolio in order to enhance yields of the various investments and/or facilitate the diversification of the portfolio. The use of debt must result in positive leverage where cash flow is in excess of debt service. The total expected return to ERS over the term of the investment must be expected to increase a minimum of 2 basis points for each 1% of leverage, as a result of leverage. For example, leverage returns on an acquisition with 50% debt should be higher than the unleveraged returns for the same property by a minimum 100 basis points. The total level of debt for any single investment will not exceed fifty percent (50%) of the value of that asset for core investments. Total portfolio debt will be limited to forty percent (40%) in the core portfolio. The single investment debt level will be measured for compliance at the point leverage is added to the portfolio. The total portfolio debt levels will be measured for compliance at the

point leverage is added to the portfolio or a portfolio asset is purchased or sold.

5. **Manager Concentration** – ERS shall limit its exposure to any single manager. No single Investment Manager shall be permitted to manage more than 35% of the total allocation to real estate at the time of investment (i.e., purchase). In the case of the Separate Account Manager(s), concentrations are likely to exist, and be allowed, during build up or wind down periods of such accounts.

6. **Investment Size** – There is no minimum investment size. The maximum net investment in a single property within the separate account shall be limited to 33% of the allocation to the core real estate program at the time of investment. The maximum investment in any single commingled fund shall be limited to 25% of the allocation to the core real estate program at the time of investment. The ERS's investments in a single commingled fund shall not exceed 20% of the total net market value of the commingled fund at the time of investment. If the commingled fund is in the process raising assets (versus being an open-ended fund), the 20% threshold will be based on target fund size.

3. Real Estate Investment Process

A. Manager Selection

In an effort to maintain program simplicity and ensure appropriate underwriting of investment management organizations, the ERS shall utilize only ERS approved real estate investment management firms for the acquisition, asset management and disposition of property and origination, management, and realization of debt investments. In addition to the existing separate account Investment Managers, the ERS has approved a program of commingled fund investing. Each Investment Manager will be provided a specified capital allocation. Investment Manager capital commitments shall periodically be balanced in accordance with the overall real estate strategic allocation objectives as discussed elsewhere in the real estate sections of the Broad Growth policy.

B. Transaction Review And Closing - Separate Accounts

1. **Investment Identification** - Upon identifying a specific investment that meets the program guidelines and Tactical Plan objectives, the Investment Manager must provide to the Investment Staff and Real Estate Consultant, a written summary of the property characteristics, investment structure and notification of joint venture partners and/or investment partners in the format provided in Exhibit 1.

2. **Property Closing and Funding** - Once the Investment Manager identifies an investment that meets portfolio objectives, the Investment Manager shall provide to the Investment Staff and Real Estate Consultant a Critical Dates list which includes scheduled funding dates, wire transfer instructions and other important timing information. In addition, the Investment Manager shall prepare a Closing Report as appropriate. Upon close of the investment, the Investment Manager shall provide to ERS a summary of all uses of capital funded by the ERS.

C. Asset Management - Separate Accounts

In conjunction with its asset management responsibilities, the Investment Manager must comply with the reporting requirements as outlined in Exhibit 2. Revisions to the original ten year pro forma and capital budget that require unscheduled capital fundings must be presented to the Investment Staff for review; however, it is not necessary to present to staff unscheduled capital fundings that were already described in the annual property plans. Refinancing or partial dispositions that were not approved as a part of the Annual Tactical Plan must also be presented to the Investment Staff.

D. Disposition – Separate Accounts

Annually, the Investment Manager must review each property managed by it on behalf of ERS and complete a "hold" or "sell" analysis. Assets targeted for sale are identified and documented and a brief explanation of the sell decision and strategy is provided to the Investment Staff, the Real Estate Consultant, and the Board at the annual Tactical Planning presentation. In addition, the Investment Manager must submit to the Investment Staff and Real Estate Consultant notification of any unsolicited sales offers. Once an offer is accepted by the Investment Manager, the Investment Staff and the Real Estate Consultant must be provided with a Critical Dates list that details the disposition activities.

E. Commingled Fund Investments

The ERS does not anticipate using the commingled fund vehicle for additional Core investing unless a specific niche strategy makes it otherwise compelling (e.g., specialty debt investing). Rather, separate accounts are the preferred vehicle for Core investments. The selection process used to invest in commingled funds is similar to the process used to retain separate account Investment Managers. Selection criteria for commingled funds shall include minimally conflicted fee structures and maximum investor controls. In addition, the ERS shall use similar strict control and monitoring systems to evaluate the commingled fund Investment Managers as used for evaluating the separate account firm.

4. Control and Monitoring Systems

In real estate investing, separate and distinct from other strategic classes, the Investment Manager has direct control over the operations of the assets. This inherent conflict of interest contributes to the lower volatility associated with the strategic class but also creates a need for greater oversight by the ERS. The Board of Trustees shall be notified by the Investment Staff and the Real Estate Consultant of Investment Manager reporting problems, significant organizational changes such as mergers, and prolonged under-performance. Investment Managers performing below expectations in any of the before mentioned areas shall be placed on the "watch list" outlined below. All Investment Managers will be subject to an annual review in Hawaiʻi and may also be called in by the Investment Staff or Board for a special review. Finally, the ERS also recognizes that it may elect to terminate separate account Investment Managers within thirty (30) days for "cause" as outlined in the Contracts. The ERS shall manage the Real Estate Investment Program in the following manner:

A. Annual Reporting Requirements

Separate Account Investment Managers

1. **Tactical Plans** - Annually, the separate account Investment Manager prepares a Tactical Business Plan, an outline of which is in Exhibit 3. In the Tactical Plan, the Investment Manager outlines its targeted investment plan including the basis upon which targets have been established. The Plan must include property/investment type, investment structure, return expectations and exit strategies as well as any other pertinent strategy specific parameters. This Plan is to be completed or revised every year and submitted to the Investment Staff and the Real Estate Consultant. The plan shall be presented to the ERS Board of Trustees in July of each year, unless otherwise directed by the Investment Staff or Board, and, if appropriate, shall be approved by the Board.

2. **Asset Management Plans** - The separate account Investment Manager must also prepare annual asset management plans for each managed by the firm and owned by the ERS. Asset management plans include property-specific operating budgets; estimates of cash to be distributed to the ERS, management fees, debt service, lease expirations and rollover, and all other relevant property information. A sample outline is included as Exhibit 4. Asset management plans are due to the ERS's Board of Trustees in July of each year along with the Tactical Plan(s). When submitting the annual asset management plan, the Investment Manager should review any significant line item variances (greater than 10% and $25,000) from the prior year.

B. Quarterly Reporting

1. On a quarterly basis, the Consultant will prepare a Performance Measurement Report which is a comprehensive report on and evaluation of each investment and/or asset, Investment Manager. The evaluation shall provide such information as may be required by the ERS to understand and administer its investments and Managers.

   The content of the report shall include attributes for the assets individually (separate accounts), the investment managers and the total portfolio including, but not limited to: income, appreciation, gross and net returns, cash-flow, internal rate of return, diversification, comparisons to relevant industry performance indices and information reporting standards, and real estate investment policy compliance. Each investment will be reviewed for significant events and projected performance and an opinion provided with respect to Manager performance. Budget and Management Plan variances, as reported by Separate Account Managers, will also be provided upon request.

The Performance Measurement Report will be presented to the ERS's Board of Trustees within ninety (90) days following the last day of each quarter, except for year-end reporting which will be prepared and forwarded to ERS within 180 days following year-end.

Performance Measurement - Within 45 days for separate accounts and 60 days for commingled funds of the quarter close, the Investment Manager is required to submit to the Real Estate Consultant an investment position work sheet and distribution worksheets for use in the calculation of performance figures for that period.

2. **Operations Report -** The Investment Manager shall analyze financial statements quarterly comparing budgeted operations to actual investment performance. This analysis must be available at Investment Staff's request within 60 days of the quarter close.

C. Property Valuations

1. **Valuations/Appraisals** – Valuations/Appraisals shall be conducted in accordance with the ERS approved Investment Manager contracts (or commingled fund documents).Investment Staff, on behalf of the ERS, reserves the right to obtain and review the list of appraisers and their qualifications. Generally, ERS recommends the following appraisal policy for its commingled and separate account managers.

   a. **Commingled Funds** - Investment Managers sponsoring commingled fund vehicles in which ERS may own or consider acquiring an interest should include in the offering documents a valuation/appraisal policy detailing internal policies that are independently audited on at least an annual basis or such that independent MAI valuations are also conducted at least annually. If fees are paid based on "market value" of an investment, then in no case should annual independent MAI appraisals be waived.

   b. **Separate Accounts -** For separate account structures: all investments in account an will be marked to market quarterly by the separate account manager and independently appraised annually by a qualified expert (certified MAI). All valuations may be used for performance measurement purposes. Separate account managers should adhere to the most recent version of the NCREIF PREA Reporting Standards established jointly by the National Council of Real Estate Investment Fiduciaries ("NCREIF") and the Pension Real Estate Association ("PREA") ("Reporting Standards"). Separate Account Managers should provide quarterly, written certification of compliance with these standards.

2. **Performance Measurement -** For performance measurement purposes, both the MAI appraiser's and the Investment Manager's interim internal estimates of value will be used to calculate returns.

3. **Notification of Variance** - Should the appraised value of any separate account asset vary by more than 10% of the Investment Manager's internal appraised value, the Investment Manager must provide to the Investment Staff and the Real Estate Consultant a written explanation for the variance. This report is due to Investment Staff within 30 days of the final property appraisal.

D. Audit Process

1. **Unrelated Business Income Tax ("UBIT")** - As a tax-exempt entity, the ERS hereby instructs its Investment Managers to avoid transactions generating UBIT. Should ERS be at any time invested in real estate or other assets that result in UBIT, the Investment Manager is to provide immediate notification and an evaluation of the financial impact to the Investment Staff who will then provide a report to the Board.

2. **Audited Financial Statements** - On an annual basis, the Investment Manager will provide ERS with a combined audited financial statement for the total portfolio it manages, to be prepared by a nationally recognized audit firm. The auditor shall complete an income statement, balance sheet and changes in cash position analysis.

E. Accounting and Cash Management

1. **Accounting Policies** - All accounting data shall be computed in accordance with generally accepted accounting principles prepared on a current value basis, not historical cost accounting. Therefore, the carrying value of real estate assets shall be adjusted annually to reflect the most recent current value based on the most recent independent appraisal value or internal estimate of value. Accrual based accounting is also generally used to allocate revenues and expenses to the appropriate periods.

2. **Cash Management** - The Investment Manager shall provide strict control over cash transactions and balances ensuring that all excess funds are continually invested in accordance with the ERS's approved specifications as outlined in the manager's Contract. Cash balances will be swept to an account designated by ERS in compliance with a previously agreed-upon schedule and in accordance with maximum balance restrictions.

F. Quantitative Guidelines for Real Estate Manager "Watch List" or Termination

The performance of the Board's Investment Managers will be monitored on an ongoing basis. The Board may place an Investment Manager on a "Watch List" or terminate a manager at any time.

Investment Managers may be terminated or placed on a "Watch List" for a variety of reasons: personnel changes, violation of policy and investment guidelines, underperformance, strategic allocation changes and non-disclosure of material information. The ERS has two clearly stated investment portfolio performance objectives: the preservation of capital and consistent positive returns. These "Watch List"/termination guidelines were formulated with these objectives as a foundation. Various factors should be taken into account when placing a manager on a "Watch List" or recommending termination. These can be separated into two broad categories - qualitative and quantitative factors. The former focuses on personnel, organizational and legal issues while the latter addresses performance. Qualitative factors are detailed in Section C: D. The Quantitative Factors for real estate managers are detailed below.

When possible, the Board will issue a warning letter to underperforming Investment Managers prior to placement on the "Watch List". However, the Board may place an Investment Manager on the "Watch List" at any time whether or not a warning letter has been issued. Placing an Investment Manager on the "Watch List" is an intermediate step towards either resolving the problem or terminating the Investment Manager. Investment Managers may only be removed from the "Watch List" under these two conditions.

Real Estate Manager Watch List Guidelines - Quantitative Factors

Below are the *quantitative* factors to be considered in determining the appropriateness of terminating an Investment Manager or placing the Investment Manager on the "Watch List."

PERFORMANCE TEST	BENCHMARK	FAIL CRITERIA
Test 1: Peer group comparison, for trailing 3 and 5 years	Performance compared to the NCREIF Fund Index – Open End Diversified Core Equity ("NFI-ODCE")	Fail if cumulative performance is at 65% percentile or lower over relevant time frames.
Test 2: Peer group comparison of income for trailing 3 and 5 years	Performance compared to the NCREIF Fund Index – Open End Diversified Core Equity ("NFI-ODCE") index	Fail if cumulative performance is at 65% percentile or lower over relevant time frames.

The quantitative guidelines above refer to core separate accounts and a minimum time frame of three years. Any underperformance for three years relative to any or all of the above referenced benchmarks should trigger a review with the corresponding Investment Manager. Commingled fund managers will be evaluated against the stated return objective of the fund at the time of the original investment (as included in the fund documents). All of the qualitative criteria should be reviewed along with an explanation of the underperformance from the manager.

The explanation of underperformance is to be accompanied by a plan to resolve the performance issues. The plan should include specific objectives that can be measured by the Board and an appropriate timeframe to accomplish the objectives. The Board can choose to allow the Investment Manager to resolve the issues or terminate.

EXHIBIT 1

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII
REAL ESTATE INVESTMENT BRIEF FORMAT

Date:
Manager:
Property Name/Property Location:
Property Type:
(Scheduled) Funding Date(s) and Amounts (Net Investment)df
Third Party Debt:
Gross Investment:
Investment Structure:
Investment Partners and Ownership Share:
Expected Return (Year 1 Cash-On-Cash and Nominal IRR both gross and net of fees):

Investment Summary: Elaborate on sellers, investment structure, and major business points.

Real Estate Description: Describe the competitive market area, improvements, and major tenants (if applicable); when available include maps, aerial and surface pictures of building interior and exterior.

Expected Return: In addition to the Investment Manager's base case pro-forma, include a forecast that is consistent with the investment strategy utilizing the ERS's CPI assumption and both before and after fee scenarios.

Pro Forma Assumptions: Describe key assumptions such as investment period, growth rates and residual capitalization rate.

Investment Strategy: Outline the real estate investment strategy including a review of the anticipated future hold term, financing, development, or redevelopment plans, and any other relevant issues. Also, discuss the investment's classification as core or specialty and the associated risk level (low, moderate, high).

Major Investment or Property Risks: List the major investment risks on a market, property, tenant and transaction level.

Potential Conflicts of Interest: Discuss any potential conflicts of interest and how they will be resolved.

Program Compliance: Discuss the acquisition or disposition rationale and its consistency with the program guidelines, the current Tactical Plan and other governing documents.

EXHIBIT 2

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII REAL ESTATE SEPARATE ACCOUNT INVESTMENT MANAGER REPORTING REQUIREMENTS

REPORT	DUE DATE	RECEIVER	COMMENTS
ACQUISITION			
1. Investment Brief	As Identified	Staff[6]	Copy to Consultant
2. Critical Dates List	3 Weeks BF Close	Staff	Provide ASAP
3. Closing Report	Before Closing	Staff	As Required
4. Sources/Uses of Capital	Upon Closing	Staff	For Each Capital Call
DISPOSITION			
1. Unsolicited Sales Offer	As Occur	Staff	Report as Received
2. Critical Dates List	Offer Accepted	Staff	Provided ASAP
ANNUALLY			
1. Tactical Plan	Annually	Staff	Governs Ensuing Year
2. Annual Asset Plans	Annually	Staff	Governs Ensuing Year
4. External Financial Audits	After Fiscal Year End	Staff	Nationally Recognized Firm
5. Independent Appraisals	Anniversary	Staff	External Every 3 Years
6. Variance Notice	As Occurs	Staff	Within 30 Days
QUARTERLY			
1. Investment Worksheets	Quarter End	Consultant	45-60 Days After Close
2. Portfolio Operations Report	Quarter End	Consultant	60 Days After Close

[6] "Staff" refers to ERS investment staff and "Consultant" refers to the ERS real estate consultant.

EXHIBIT 3

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII
REAL ESTATE SEPARATE ACCOUNT
TACTICAL BUSINESS PLAN OUTLINE

PURPOSE: The Tactical Business Plan provides the manager an opportunity to articulate its capital allocation objectives for the ensuing 12 month period relative to the Work Assignment as outlined in each contract. Once a year the Tactical Plan is revised and all interim manager work should comply with the business plan. Variances should be discussed with the Investment Staff and Investment Committee. The following is the Tactical Business Plan outline for direct investments:

II. INVESTMENT OBJECTIVES AND OPPORTUNITIES

1. Targeted Property Type (within work assignment);
2. Targeted Markets and Rationale;
3. Leasing Exposure - Occupancy and Rollover Pattern;
4. Tenant Mix Preferences;
5. Leverage; and
6. Special Opportunities.

III. SELL DISCIPLINE

1. Factors That Would Initiate a Sell; and
2. Properties Targeted For Sale and Rationale.

IV. CAPITAL DEPLOYMENT

1. Acquisition Objectives; and
2. Portfolio Repositioning.

V. PROGRAM ADMINISTRATION AND TIMING

1. Appraisals - Scheduled Internal or External;
2. Audits - Firm and Timing;
3. Insurance; and
4. Other Special Notices.

EXHIBIT 4

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII ANNUAL REAL ESTATE SEPARATE ACCOUNT ASSET MANAGEMENT PLAN

PURPOSE: The Annual Asset Management Plan should be prepared for each strategic class held in the ERS. The Investment Managers are typically reviewed in core and specialty investment groups in early spring and late fall. Generally, the following information will be requested.

I. PROPERTY SUMMARY

Narrative discussion of the specific property, including changes to market environment, leasing status, occupancy rate, property manager, renovation or scheduled maintenance details, and other relevant operational issues.

II. BUDGETS

The Annual Asset Management Plan should include at least the following information and more as the manager deems appropriate:

1. REVENUE
   - Base Rent
   - Overage Rents
   - Recoveries
   - Interest or Other Income

2. EXPENSES

   Operational
   - Real Estate Taxes
   - Common Area Maintenance
   - Insurance
   - Utilities
   - Ground or Other Rent
   - Building Maintenance
   - General & Administrative
   - Property Management Fees

   Non-Operating
   - Capital Reserves
   - Leasing Commissions
   - Tenant Improvements
   - Management Fees

3. DEBT SERVICE AND FINANCING

4. PROJECTED PERFORMANCE FOR SHORTER AND LONGER TIME PERIODS

APPENDIX: PRIVATE GROWTH COMPONENT

TABLE OF CONTENTS

1. Program Management

Responsibilities

The Private Growth program shall be implemented and monitored through the coordinated efforts of the Board of Trustees ("Board of Trustees" or "Board") of the Employees' Retirement System of the State of Hawaii ("ERS"), the ERS investment staff ("Investment Staff"), the ERS general investment consultant ("General Investment Consultant"), the ERS private equity consultant ("Private Equity Consultant"), the ERS real estate consultant ("Real Estate Consultant"), and the ERS specialty managers ("Specialty Managers"). Specific responsibilities that fall outside the general responsibilities highlighted in Section B.5. are listed below:

Specific Responsibilities: Board of Trustees

Investment Selection

a. Evaluate all proposed activities or investments that may fall outside the parameters and direction of the annual Strategic Plans;
b. Mediate any disputes regarding investment selection that may take place between Investment Staff, the Private Equity Consultant(s) and/or Specialty Managers

2. Investment Objectives

A. Portfolio Construction

The ERS has determined that, over the long term, inclusion of private markets investments (private equity, non-core private real estate, certain private debt opportunities, etc.) would enhance the ERS's expected portfolio investment characteristics. Specifically, as a result of the possibility of enhanced rates of return over publicly traded securities and returns that have a relatively low correlation with those associated with other major strategic classes, the use of private equity investments tends to increase the portfolio's overall long-term expected real return, and reduce year to year portfolio volatility.

Private growth investments of the ERS shall be made in a manner consistent with the fiduciary standards of the prudent expert rule: (1) for the sole interest of the ERS's participants and their beneficiaries; and, (2) to safeguard and diversify the Private Growth portfolio. The selection and management of Private Growth assets will be guided to preserve investment capital and to maintain prudent diversification of assets and management responsibility. The diversification objective is required to manage overall market risk and the specific risks inherent in any single investment or management selection.

B. Target Allocation

The allocation of ERS assets to Private Growth investments shall remain within the limits authorized by the Board of Trustees. As of July 2015, the long-term target allocation of 29% of the Broad Growth class was adopted by the Board of Trustees (based on net asset value of allocated capital). Allocated capital will be defined as invested capital (based on market value). The Board of Trustees recognizes that it will be necessary to make capital commitments in excess of the target allocation in order to achieve and maintain progress toward its long-term target.

The goal of the ERS is to spread out the timing of new commitments so as to avoid an undue concentration of commitments in any one year. Over the long-term, it is expected that barring any unforeseen events approximately equal amounts of new funding will be committed each fiscal year to garner the benefits of vintage year diversification.

C. Benchmarking / Return Targets

The ERS shall use the following rate of return tests to evaluate the performance of the Private Growth portfolio:

<u>Total Return (Realized and Unrealized Gain/Loss plus Income)</u>

1. Over rolling 10-year periods, the total Private Growth portfolio is expected to generate a minimum total dollar-weighted rate of return (internal rate of return or IRR) that exceeds an equivalent public global equity return (MSCI ACWI IMI) by 200 basis points ("bps") per year, net of all investment management fees and expenses
2. Any individual fund investment is expected to produce a commensurate return that contributes to the overall Private Growth portfolio return objectives
3. The ERS will also measure the portfolio employing a time-weighted rate of return calculation
4. The primary investment strategies included in the allocation will provide the opportunity for long term capital gains. The allocation will include investment

strategies that provide an element of predictable cash flow to the ERS that is not dependent on non-recurring events such as the permanent disposition of assets

5. The portfolio and individual investments shall also be benchmarked against generally accepted and utilized private equity or non-core real estate benchmarks (e.g., published by Preqin, Inc., NCREIF, Venture Economics Inc., etc.).

D. Risk Management

The selection and management of assets in the Private Growth portfolio will be guided to generate a high level of risk adjusted return, to provide a moderate amount of current income, and to maintain prudent diversification of assets and specific investments.

With private growth investments, there is an inherent risk that the actual return of capital, gains and income will vary from the amounts expected. The ERS shall manage the investment risk associated with private growth investments in several ways:

1. Strategic Structure

    a. <u>Allocation by strategic component</u>. The Private Growth component consists of three segments: (i) private equity, (ii) non-core real estate, and (iii) other private investments. Descriptions and characteristics of these segments are discussed in the appendix to this section. The allowable allocation range for Private Equity is 50% to 100% of total Private Growth; and the allowable range for Non Core Real Estate is 0% to 50% of total Private Growth.

    b. <u>Commitment pacing into each segment over time</u>. It is expected that the private equity component will have scheduled annual commitments that are a multiple of the non-core real estate commitments. However, certain annual commitment amounts among these segments may vary significantly, depending upon the capital investment opportunities within each component.

2. Manager Selection / Institutional Quality

    c. All assets must be of institutional investment quality. Institutional quality will be defined as being of a quality whereby the investment would be considered acceptable by other prudent institutional investors (e.g. insurance company general accounts and separate accounts, commercial banks and savings institutions, public employee retirement systems, corporate employee benefit plans - domestic and foreign, and other tax-exempt institutions).

    d. It shall be expected that "foundation managers" to the ERS private equity portfolio (that is, are expected to comprise a significant subset of total ERS private growth assets) periodically report to the Board of Trustees and/or Investment Staff on the progress of ERS investments under their management.

APPENDIX: PRIVATE EQUITY SUB-COMPONENT

TABLE OF CONTENTS

1. Investment Objectives & Structure of the Private Equity Program

A. Benchmarking/Return Targets

The ERS shall use the following rate of return tests to evaluate the performance of the Private Equity sub-component portfolio:

<u>Total Return (Realized and Unrealized Gain/Loss plus Income)</u>

6. Over rolling 10-year periods, the total Private Equity portfolio is expected to generate a minimum total dollar-weighted rate of return (internal rate of return or IRR) that exceeds an equivalent public global equity return (MSCI ACWI IMI) by 200 basis points ("bps") per year, net of all investment management fees and expenses
7. Any individual fund investment is expected to produce a commensurate return that contributes to the overall Private Equity portfolio return objectives
8. The ERS will also measure the portfolio employing a time-weighted rate of return calculation
9. The primary investment strategies included in the allocation will provide the opportunity for long term capital gains. The allocation will include investment strategies that provide an element of predictable cash flow to the ERS that is not dependent on non-recurring events such as the permanent disposition of assets

The portfolio and individual investments shall also be benchmarked against generally accepted and utilized private equity or non-core real estate benchmarks (e.g., published by Preqin, Inc., Venture Economics Inc., etc.).

B. Investment Structures

The following are considered allowable investment structures for the private equity program. It shall be noted that the Private Equity Consultant or Specialty Manager are expected to act as fiduciaries on behalf of the ERS and the investment structures mentioned below must be within accordance of the investment policies set forth in this Manual and the annual Strategic Plan. Such investment activity is subject to active review by the Board of Trustees and Investment Staff on a regular basis.

1. <u>Co/Direct Investments</u>: Co-investments may be sourced by the Private Equity Consultant, Specialty Manager, or Investment Staff, and must be approved by the Board of Trustees
2. <u>Primary Investments in Private Equity Funds</u>: Capital commitments to limited partnerships and/or limited liability companies established for the purpose of private equity investment are managed through the Private Equity Consultant or a Specialty Manager
3. <u>Secondary Investments</u>: Purchasing an existing interest in a private equity fund (generally at a discount) is managed through the Private Equity Consultant or a Specialty Manager
4. <u>Separate Accounts</u>: investment vehicles typically set up for a single limited partner where the investment manager constructs a diversified portfolio of private market investments that are tailored specifically to the needs and objectives of the investor. Separate accounts should offer the ERS access to economics that are below generally prevailing rates and/or target strategies that are traditionally difficult for the ERS to access directly (e.g., Venture Capital)

C. Investment Strategies

The following private equity strategies and investment types will be considered eligible for the ERS's portfolio:

1. Corporate Finance/Buyout: Partnerships/LLCs which provide funding to acquire majority or controlling interests in a business or product lines from either a public or private company. Buyout sub-strategies are classified by total capital commitments and include Small, Mid, Large and Mega buyouts
2. Fund-of-Funds: Blind pool partnerships/LLCs that evaluate, select and monitor investments in other limited partnership/LLC investments
3. Mezzanine Debt: Partnerships/LLCs which invest in unsecured or junior obligations in financings. These generally take the form of subordinated debentures or preferred stock. They typically earn a current coupon or dividend and have warrants on common stock or conversion features
4. Distressed Debt: Partnerships/LLCs which invest in non-investment grade privately placed debt securities. Common sub-strategies include Distressed For Control, Non-Control and Trading
5. Project Finance: Partnerships/LLCs which invest in industrial leveraged or unleveraged lease or project financings. These can include participation in equity, mezzanine, or senior debt investments. Investments should be made after the development phase, as part of the project's permanent financing, when projects are going operational
6. Special Situations: Partnerships/LLCs with investment strategies which have gained an institutional following, but where sporadic opportunities do not justify a separate long-term strategic allocation. Categories includes partnerships/LLCs which make strategic block investments, have very broad mandates, focus on restructuring/recovery or focus on specific industries or which seek to exploit opportunities created by changing industry trends or governmental regulations
7. Venture Capital: Investments in start-up companies generally exhibiting promising potential and/or high-growth characteristics. Such investments generally exhibit minimal leverage and can consist of the following stages: Seed/Early, Middle, Late-Stage and Growth Equity
8. Other: Partnerships/LLCs which invest in publicly-traded securities or which employ strategies different from those cited above such as, hedge fund strategies, commodity trading, post-venture equities, investments in commercial leases, and other non-traditional strategies. The purchase of secondary partnership/LLC interests is also allowed

D. Diversification Requirements

The private equity portfolio shall be diversified as to investment strategy, timing of investment, size and life cycle of investment, industry sector, investment sponsor organization (e.g., general partner group), capital structure and geographical location. Diversification reduces the impact on the portfolio of any one investment or any single investment style to the extent that an adversity affecting any one particular area will not impact a disproportionate share of the total portfolio.

These limits are subject to waiver on a case-by-case basis by the Board of Trustees. It is also recognized that during the portfolio development and wind-down stages the full investment parameters may not, of necessity, be met.

The scope and size of the ERS program is such that significant investments in fewer, more concentrated "foundation" managers are preferred to smaller, more numerous managers. While ERS has not set a minimum dollar amount per partnership/LLC, the Private Equity Consultant and/or Specialty Manager will be charged with deploying the capital efficiently, such that funding targets are achieved with a minimal number of partnership/LLC holdings. Long-term diversification targets among eligible investment strategies will be set forth in the annual Strategic Plan document, and reviewed and updated as necessary.

1. Geographic

   Over the long-term, the ERS portfolio should seek portfolio diversification with regard to major regional areas both domestically (e.g., Northeast, Mid-Atlantic, Southeast, Midwest/Plains, Southwest/Rockies, West Coast, Pacific Northwest), and internationally (e.g., Europe, Asia Pacific, South and Latin America, Middle East and Africa).

   The portfolio shall primarily target investments domiciled within North America. In line with the ERS's total international allocation, the portfolio shall seek to limit international investments (outside of North America) by targeting no more than 35% of the private equity investment allocation to such investments. The currency exposure to the ERS from the non-dollar aspect of the allocation is expected to be negligible.

2. Industry

   The ERS portfolio will seek to diversify by industry sector (as outlined through the Global Industry Classification Standard) and shall target that no one industry classification represent more than 35% of the private equity portfolio.

3. Life Cycle

   Commitments to partnership/LLC investments generally will be staged over time. It is the long-term goal of ERS to spread out investment timing such that new commitments will be made each fiscal year. This policy will have the effect of dollar cost averaging the ERS's portfolio over business cycles to help insulate the portfolio from event risk.

4. Strategic

   The private equity portfolio shall target that no single private equity investment sub-strategy (as highlighted in Section II(f) above) comprise more than 50% of the total allocation.

5. General Partner

   The ERS portfolio will seek to diversify by issuer of limited partnership/LLC securities, and other specific investments sponsors. No more than 20% of the ERS's private equity portfolio net asset value will be invested with any one investment sponsor organization.
   It is the intention of ERS to keep the total holdings of the portfolio to a reasonable number. Given the significant total dollar size of the ERS's private equity net asset value target, large concentrated investments in fewer partnerships/LLCs, are preferred to smaller investments across numerous partnership/LLC securities.

6. Single Investment

   No single private equity commitment shall comprise more than 100bps of total ERS assets under management or greater than 20% of targeted annual commitment pace per the annual Strategic Plan. An exception to this limitation may be offered for separate accounts, subject to approval by the Board of Trustees.

7. Limited Partner

   The ERS is permitted to own up to 20% of any particular partnership/LLC subject to the General Partner limitation (item v) above.

2. Implementation of Private Equity Program

A. Annual Strategic Plan

1. Annually, the Private Equity Consultant and Specialty Managers (if applicable), in conjunction with Investment Staff, will prepare a Strategic Plan which reviews the current status of the portfolio, recent historical and prospective market conditions, and proposes the actions to be taken over the next approximately twelve month period. This document will recommend general capital allocations to each investment strategy and the rationale and expectations for inclusion
2. The annual Strategic Plan will then be presented to the Board of Trustees for approval

B. Investment Approval Process

The following steps shall be followed in order for the ERS to commit to any prospective private equity investment opportunity:

1. Private Equity Consultant sources and performs comprehensive due diligence on attractive investment opportunities consistent with criteria set forth in the annual Strategic Plan
2. If, as a fiduciary of the ERS, the Private Equity Consultant determines that the investment merits a commitment from the ERS, the Private Equity Consultant will take the following steps:
    - Discuss with Investment Staff the key findings during due diligence, including investment merits, risks and key conclusions
    - Follow-up with Investment Staff on additional requests for information based on this discussion and complete an Investment Disclosure Form
    - In conjunction with the ERS's legal review process, facilitate legal negotiation and closing into the investment opportunity
3. The Board of Trustees shall be notified in the event of a disagreement between Investment Staff and the Private Equity Consultant on an investment recommendation
4. The Specialty Manager (if applicable) will be expected to operate on a discretionary basis
    - The Specialty Manager is to operate under the oversight of and provide regular updates to the Board of Trustees, Staff and the Private Equity Consultant

C. Monitoring and Reporting

1. Reporting System

    There shall be a comprehensive reporting and monitoring system for the entire portfolio, Private Equity Consultant, Specialty Manager(s) and individual investments. Situations of underperforming investments, portfolio diversification deficiencies from the Policies & Procedures, and conflicts of interest can then be identified, facilitating active portfolio management.

2. Performance Measurement

    The Private Equity Consultant and Specialty Manager(s) will provide cash flow, valuation, and any other requested information to Investment Staff and the Private Equity Consultant quarterly, and the ERS's custodian bank ("custodian") on a monthly basis, and will notify Investment Staff of any instances of materially different carrying values from those reported by general partners.

Performance will be calculated on both a time-weighted and dollar-weighted (internal rate of return or IRR) basis, with primary emphasis being placed on the internal rate of return. The rate of return calculations will be net of all partnership/LLC fees and expenses, but gross of Private Equity Consultant and/or Specialty Manager fees and expenses. So that the performance numbers reported by the manager and the custodian are the same, the manager will be responsible for reviewing the custodian's figures as to timing, amount, value of in-kind securities at distribution and reported net asset value, and reconciling and explaining any discrepancies.

Investment Staff and/or the appropriate designated retained Private Equity Consultant will provide performance measurement information, if requested by the Board, on all other private markets investments outside of the authority of the Private Equity Consultant or Specialty Manager(s).

In-kind Distributions: Partnerships/LLCs will be valued on the distribution price of the in-kind security or other valuation method stipulated in the partnership/LLC membership agreement. Any change from distribution price to realized price of the in-kind distributions will then be monitored as a separate component of the total portfolio return.

Benchmarks: For IRR calculations, the Vintage Year methodology developed by Preqin, inc. and/or Venture Economics, Inc. will be used for purposes of performance comparisons to the industry. For time-weighted returns, comparable publicly traded market indicators (such as small cap indices) will be employed.

APPENDIX: NON-CORE REAL ESTATE SUB-COMPONENT

TABLE OF CONTENTS

1. Non Core Real Estate Investment Objectives

A. Investments In Real Estate

The Employees' Retirement System of the State of Hawaii ("ERS") completed a strategic allocation study for the investment of its assets. This analysis demonstrated that, over the long term, inclusion of investments in private equity real estate and debt positions in real estate properties would enhance the ERS's expected portfolio investment characteristics while reducing expected total portfolio volatility.

In general, the ERS desires to obtain the optimum return on the portfolio consistent with the assumption of prudent risk. While safety of principal is given primary consideration, the ERS recognizes the need to use active asset management strategies in order to obtain the highest attainable total investment return (income plus appreciation) within the ERS's framework of prudence and managed risk.

Non core real estate investments of ERS shall be made in a manner consistent with the fiduciary standards of the prudent person rule: (1) to safeguard and diversify the non core real estate portfolio; and, (2) for the sole interest of the participants and their beneficiaries. The selection of investment managers and development of investment policy will be guided to enhance diversification within the portfolio of the ERS's non core real estate investment program ("Non Core Real Estate Investment Program") thereby limiting exposure to any one investment, organization, real estate property type and geographic region (Refer to Section II: Program Management).

1. **Real Estate Defined** - Real estate assets are defined as those investments that are unleveraged or leveraged, private equity or debt positions in real property. The ownership structure(s) should be consistent with any rules, regulations, or law, as applicable, governing the ERS. For the Non Core Real Estate Program, the ERS will utilize discretionary commingled fund investments.

B. Non Core Real Estate Strategic Allocation

Noncore real estate allocations will be established and managed via scheduled annual commitment pacing approved as a result of the annual strategic plan (see item 2.C. below). As a segment of the larger Private Growth component, commitment pacing will be influenced by Non Core Real Estate's potential to contribute long-term risk-adjusted returns relative to that of Private Equity, the other (and larger) component of Private Growth. Non Core Real Estate is not allowed to exceed 50% of the Private Growth component, based on the market value of current investments.

C. Portfolio Return Objectives

The noncore real estate return objectives will follow their respective assignments as detailed in Broad Growth Section D.3. Return Objectives & Risk Profile.

2. Non Core Real Estate Program Management

A. Overview

In compliance with current ERS investment philosophy, the Non Core Real Estate Investment Program will primarily utilize <u>discretionary</u> commingled fund investment vehicles that are sponsored by real estate investment managers ("Investment Managers"). Under this program, the Investment Managers acquire, operate and dispose of real estate assets in accordance with the fund documents for specified commingled funds. These documents typically describe the acceptable property types, geographic restrictions, investment structures, leverage and other specific investment parameters. Commingled fund documents typically refer to the fund's offering memorandum or private placement memorandum, limited partnership or LLC membership agreement, and subscription agreement. The commingled funds' activities will be reviewed annually by Investment Staff, Real Estate Consultant, and the Board of Trustees (Refer to Section IV)

B. Participant Roles and Responsibilities

The ERS's Non Core Real Estate Investment Program shall be implemented and monitored through the coordinated efforts of the Board of Trustees; through the Investment Staff; the ERS's general investment consultant ("General Investment Consultant"); the ERS's real estate consultant ("Real Estate Consultant"); and the Investment Manager(s). Specific responsibilities are listed below:

Investment Manager - Qualified real estate organizations, registered as Investment Advisors under the 1940 Act that provide institutional real estate investment management services to the ERS. ERS may invest in commingled fund vehicles that are not registered, however, it is preferred that the commingled fund be sponsored and/or managed by a Registered Investment Advisor.

Commingled Fund Manager Responsibilities – The commingled fund Investment Manager, acting as a fiduciary on behalf of ERS, acquires, manages and disposes of real estate properties and/or originates or acquires, manages, and realizes upon real estate debt investments in accordance with the terms of the investment vehicle documents.

C. Annual Strategic Plan

1. Annually, the Real Estate Consultant, in conjunction with Investment Staff, will prepare a Strategic Plan which reviews the current status of the portfolio, recent historical and prospective market conditions, and proposes the actions to be taken over the next approximately twelve-month period. This document will recommend general capital allocations to the Non Core Real Estate Program and the rationale and expectations for inclusion.
2. The annual Strategic Plan will then be presented to the Board of Trustees for approval and will typically take place in conjunction with the presentation of the Core Real Estate Strategic Plan.

D. Non Core Real Estate Portfolio Composition

Non core real estate investments represent equity or debt investments in those properties and/or investment strategies that require specialized acquisition and management expertise or skill to mitigate the business and leasing risk that may be associated with individual investments. Non core investments which may be referred to as Value Added or Opportunistic have greater volatility compared to core investments and as such are expected to provide yields higher than those associated with core investments.

Value Added – Value added investments include equity or debt investments in institutional quality assets that offer the opportunity to enhance value through rehabilitation, redevelopment, development, lease-up or repositioning. A significant portion of return is from appreciation and includes moderately higher leverage than core. Value added investments typically exhibit one or more of the following characteristics:

- Properties located in primary as well as secondary and tertiary markets which may not be economically diversified and may have accompanying susceptibility to imbalance of demand and supply;
- Traditional as well as non-traditional property types including hotels, motels, senior housing, student housing, manufactured and residential housing;
- Properties that are undermanaged with specific problems that require specialized management skills;
- Properties that are less than 70% leased upon purchase or where more than 30% of leases expire in the first three years of purchase
- Properties which are considered to be in a "work out" mode;
- Properties involving significant appreciation, lease-up, development and/or redevelopment risks;
- Properties using moderate leverage between 50% and 65%;
- Investments in institutional quality properties located in mature real estate markets showing high levels of market transparency outside of the United States and Canada;
- Total gross return expectations are between 11% and 13%

Opportunistic – Opportunistic investments include equity or debt investments in real estate properties, real estate operating companies and other investment vehicles that offer the opportunity to capitalize on the disequilibrium of the real estate markets caused by dramatic shifts in capital flows or other fundamental real estate characteristics. Opportunistic investments not only include distressed assets in need of lease up but also assets that provide returns from financial restructuring. Opportunistic investments typically exhibit one or more of the following characteristics:

- Strategies that seek to exploit inefficiencies in the capital and real estate markets
- Strategies that involve financing or acquisition of real estate assets, operating companies, portfolio of real estate assets
- Properties with substantial leasing, development and entitlement risk
- Distressed assets
- Distressed debt
- Major financial re-structuring required
- High leverage of between 65% and 75%
- Investments in emerging real estate markets driven by growth and continued improvements in market transparency, located outside of the United States and Canada
- Total gross return expectations are in excess of 15%

E. Investments and Risk Management

The ERS shall manage the investment risk associated with non core real estate in several ways:

1. **Institutional Quality** - All assets within the Non Core portfolio must be of institutional investment quality as evidenced by a history of institutional investment in similar properties; expert analysis which supports the economic viability of the market; high quality construction and design features; and a current or potentially competitive position within the property's immediate market area.

2. **Ownership Structure** - The ownership structure for Non Core investments includes leveraged and unleveraged equity and debt investments owned indirectly by ERS on a pro rata basis through institutional-quality commingled funds. The ownership structure of non core assets within commingled funds will be governed by the fund documents. When dealing with non core investments that are directly owned, Operating Partners shall be added to the list of "Suitable Investment Partners."

3. **Leverage** – Within the Non Core segment, it is expected that significant amounts of leverage may be utilized in order to enhance yields of the various investments and/or facilitate diversification of a specific commingled fund. In aggregate, the ERS Non Core portfolio of commingled funds will have a maximum debt limit of 75% of aggregated assets. Depending on the strategies of specific commingled funds, the debt level of a specific commingled fund may exceed the 75% level.

5. **Manager Concentration** – ERS shall limit its exposure to any single manager. No single Investment Manager shall be permitted to manage more than 35% of the total allocation to Non Core real estate at the time of investment (based upon total committed capital).

6. **Investment Size** – The ERS's investments in a single commingled fund shall not exceed 20% of the total net market value of the commingled fund at the time of investment. If the commingled fund is in the process raising assets (versus being an open-ended fund), the 20% threshold will be based on target fund size.

3. Non Core Real Estate Investment Process

The following steps shall be followed in order for the ERS to commit to any prospective non core real estate investment opportunity:

1. Real Estate Consultant sources and performs comprehensive due diligence on attractive investment opportunities consistent with criteria set forth in the annual Strategic Plan.
2. If, as a fiduciary of the ERS, the Real Estate Consultant determines that the investment merits a commitment from the ERS, the Real Estate Consultant will take the following steps:
    - Discuss with Investment Staff the key findings during due diligence, including investment merits, risks and key conclusions;
    - Follow-up with Investment Staff on additional requests for information based on this discussion and complete an Investment Disclosure Form;
    - In conjunction with the ERS's legal review process, facilitate legal negotiation and closing into the investment opportunity.

3. Upon successful review of the investment by the Real Estate Consultant and Investment Staff, the investment shall be recommended to the Board of Trustees for approval. This recommendation shall contain a summary of the due diligence and a prospective commitment level for the investment.
4. The Investment Manager of the recommended commingled fund will be expected to operate on a discretionary basis.
    - The Investment Manager of each commingled fund is to operate under the oversight of and provide regular updates to the Board of Trustees, Staff and the Real Estate Consultant.

4. Monitoring and Reporting

1. Reporting System

    There shall be a comprehensive reporting and monitoring system for the entire portfolio, Real Estate Consultant, Investment Manager(s) of commingled funds, and individual investments. Situations of underperforming investments, portfolio diversification deficiencies from the Policies & Procedures, and conflicts of interest can then be identified, facilitating active portfolio management.

2. Performance Measurement

    The Real Estate Consultant and Investment Manager(s) will provide cash flow, valuation, and any other requested information to Investment Staff and the Real Estate Consultant quarterly, and the ERS's custodian bank ("custodian") on a monthly basis, and will notify Investment Staff of any instances of materially different carrying values from those reported by Investment Manager(s)/general partner(s).

    Performance will be calculated on both a time-weighted and dollar-weighted (internal rate of return or IRR) basis, with primary emphasis being placed on the internal rate of return. The rate of return calculations will be net of all fund/partnership/LLC fees and expenses, but gross of Real Estate Consultant fees and expenses. So that the performance numbers reported by the manager and the custodian are the same, the Investment Manager(s) will be responsible for reviewing the custodian's figures as to timing, amount, value of in-kind securities at distribution and reported net asset value, and reconciling and explaining any discrepancies.

Benchmarks: For IRR calculations, a Vintage Year methodology will be used for purposes of performance comparisons to the industry. For time-weighted returns, comparable publicly traded market indicators may be employed.