



State of New Jersey

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February 3, 2014

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Acting Director

SUBJECT: **Proposed Investment in Wheelock Street Real Estate Fund II,
L.P. Fund**

The New Jersey Division of Investment (“Division”) is proposing an investment of \$140 million in Wheelock Street Real Estate Fund II, L.P. (the “Fund”). The Division previously committed \$100 million to Wheelock Street Real Estate Fund, L.P. in October 2011. 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:

Successful Track Record: Since its formation in 2008, Wheelock has completed 27 transactions, investing approximately \$624 million of peak equity across three investment vehicles, with two of these vehicles being separate accounts for a large Boston-based hedge fund. In total, these investments are projected to return 27% gross Internal Rate of Return (“IRR”) and 2.4x gross Multiple on Invested Capital (“MOIC”). The Pension Fund’s investment in Wheelock Street Real Estate Fund, L.P. (2011 vintage fund) is projected to achieve a 26% gross IRR and a 2.3x MOIC and is currently marked at 23% net IRR and 1.3x net MOIC as of 6/30/13. Wheelock has been able to accomplish this top quartile track record only utilizing 38% leverage (equity weighted) on a Loan to Value basis.

Operating Expertise: Wheelock pursues a focused, fundamentally-driven investment strategy by utilizing its verticals in its chosen areas of focus. The verticals give Wheelock a competitive advantage in sourcing opportunities, identifying value, driving operating performance, and working seamlessly between vertical teams and local operating partners. Current verticals include (i) hospitality, (ii) residential land and homebuilding, and (iii) retail. Investments sourced through the verticals are especially accretive to the Fund’s Limited Partners, as the transaction and incentive fees typically paid to the operating partners are minimized, as vertical heads and their teams play a significant role in overseeing the projects through an investment’s life cycle (acquisition, asset management, and disposition). Wheelock also pursues selective opportunistic investments in other major real estate asset classes where the firm’s principals have extensive experience, including office, multifamily, and student housing.

Disciplined Approach: Wheelock is raising a maximum of \$625 million for Fund II, which is only slightly larger than its first commingled fund. By keeping its funds small, Wheelock can continue to patiently invest in opportunities that the manager feels are most attractive and where it can generate the best risk-adjusted returns. As previously noted, the firm employs modest leverage (38% loan-to-cost on a \$1.4 billion portfolio). Moreover, 81% of the portfolio's return is attributable to current income, and the hotel and multifamily portfolios were acquired at an estimated discount to replacement cost of 35%.

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 accordance with N.J.A.C. 17:16-69.9(c), given Wheelock's current AUM, the Division will require contractual provisions that prevent its total investments from exceeding 20% of Wheelock's total assets. 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 Wheelock Street Real Estate Fund II, L.P. 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 December 17, 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 February 3, 2014 meeting.

Attachments

Fund Name: Wheelock Street Real Estate Fund II, L.P.

February 3, 2014

Contact Info: Lawrence Settani, 660 Steamboat Road, 3rd floor, Greenwich, CT 06830

Fund Details:

Total Firm Assets:	\$893 million	Key Investment Professionals: Merrick Kleeman: Mr Kleeman has over 22 years of real estate experience. Before founding Wheelock, he spent over 15 years at Starwood Capital Group, where he was one of the early partners and Head of Acquisitions. He was involved in the majority of Starwood's investments. Jonathan Paul: Mr Paul is a founding partner of Wheelock. Prior to founding Wheelock, he spent 18 years in real estate private equity. Most recently, he was a Managing Member and Founder at Rockpoint Group LLC, which manages over \$5 billion in real estate equity. From 2004-2007, he oversaw Rockpoint's investments in Europe. Prior to Rockpoint, Mr Paul was a Managing Member of Westbrook Partners. Patrick Campbell: Mr Campbell joined Wheelock in 2009 and is responsible for the hospitality investments. He has 27 years of experience in hospitality and was most recently EVP, CIO and Head of Asset Management at Highland Hospitality Corporation, a public REIT. Daniel Green: Mr Green joined Wheelock in 2008 and is responsible for the residential land and homebuilding investments. He has 28 years of experience and was previously Regional Vice President of Land Acquisition at KB Home. Joyce Storm: Ms Storm joined Wheelock in 2013 and oversees the retail investments. She has over 29 years of retail experience.
Strategy:	Opportunistic Real Estate	
Year Founded:	2008	
Headquarters:	Connecticut	
GP Commitment:	2.5%	

Investment Summary

The Division is proposing a commitment of up to \$140 million in Wheelock Street Real Estate Fund II, L.P. The Division previously committed \$100 million to Wheelock in October 2011. Wheelock intends to continue its opportunistic approach of investing across the capital structure and targeting out-of-favor real estate sectors where the manager can establish a competitive edge by leveraging its in-house operating platforms. Wheelock's investment strategy focuses on US real estate assets with a specific focus on hospitality, retail and residential land assets.

Existing and Prior Funds

<u>Funds</u>	<u>Strategy</u>	<u>Returns*</u>
WS Investors I	Opportunistic	27% projected gross investor IRR
WS Investors II	Opportunistic	31% projected gross investor IRR
Wheelock Street Real Estate Fund	Opportunistic	26% projected gross investor IRR

IRR = Internal Rate of Return

* Current returns for all vehicles are in-line with projected returns

Vehicle Information:

Inception:	2013	Auditor:	PriceWaterhouseCoopers LLP
Fund Size:	\$625 million cap	Legal Counsel:	Goodwin Procter LLP
Management Fee:	1.5% on committed capital		
Carry:	20%		
Hurdle Rate:	8%		

NJ AIP Program

Recommended Allocation (\$mil.):	\$140 million	LP Advisory Board Membership:	Yes
% of Fund:	22.40%	Consultant Recommendation:	Yes
		Placement Agent:	No
		Compliance w/ Division Placement Agent Policy:	NA
		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.