



State of New Jersey

PHILIP D. MURPHY
Governor

SHEILA Y. OLIVER
Lt. Governor

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
P.O. BOX 290
TRENTON, NJ 08625-0290
Telephone (609) 292-5106
Facsimile (609) 984-4425

ELIZABETH MAHER MUOIO
Acting State Treasurer

CHRIS MCDONOUGH
Director

March 23, 2018

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in TPG Real Estate Partners III, L.P.**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$100 million in TPG Real Estate Partners III, L.P. (“Fund III”). This memorandum is presented to the State Investment Council (“Council”) pursuant to N.J.A.C. 17:16-69.9.

TPG Real Estate (“TPG RE”) is the real estate investment platform of TPG Group. TPG RE was formed in 2009 tapping the real estate experience of the firm’s senior executives. The Division capitalized on its private equity relationship with TGP Group and has been investing with TPG RE since 2013. Fund III will be a continuation of the TPG RE’s successful investment strategy and will be managed by the same investment team utilizing the same disciplined underwriting standards.

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

Platform Investment Approach: TPG RE will typically acquire/build entities that manage underlying real estate assets or are real estate-intensive operating companies. This differs substantially from the practice of most opportunistic funds, which tend to focus on direct acquisition of individual properties. The firm’s approach taps TPG’s particular advantages and provides additional value-add levers to create value beyond the usual property-level optimization. This includes streamlining operations, upgrading management teams, aggregating assets to achieve scale, and optimizing the corporate balance sheet.

Research and Theme Driven Strategy: TPG RE since its beginning has taken a thematic approach to its overall investment strategy and practice. Theme development is accomplished collaboratively and is a core responsibility for all senior staff. This research-driven approach identifies both high-conviction investment themes as well as attractive investment targets. Additionally, it enables the firm to identify out-of-favor sectors, less efficient markets, and better positions the firm for off-market transactions.

Strong, Risk-Adjusted Returns: Across \$4.7 billion of equity invested to date, TPG RE has returned 111% of capital generating gross returns of 26.3% internal rate of return and 2.1x multiple and net returns of 19.9% and 1.7x multiple.

Experienced Senior Management and Stable Team: Messrs. Davis and Banyasz, co-heads of TPG RE, have experience gained through multiple economic and real estate cycles. To date there has been minimal turnover at the firm which suggests sound alignment, organizational commitment, growth opportunities, and competitive compensation.

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

Division Staff and its consultant, TorreyCove Capital Partners, 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. We have obtained a preliminary Disclosure Report of Political Contributions in accordance with the Council’s regulation governing political contributions (N.J.A.C. 17:16-4) and no political contributions have been disclosed. We will obtain an updated Disclosure Report at the time of closing.

Please note that the investment is authorized pursuant to Articles 69 and 71 of the Council’s regulations. TPG Real Estate Partners III, L.P. 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 March 15, 2018. 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 March 28, 2018 meeting.

Attachments

Fund Name: TPG Real Estate Partners III, L.P. **March 23, 2018**

| | | |
|-----------------------------|------------------------|---|
| Contact Info: | | <p>Key Investment Professionals: Kelvin Davis, Partner, Mr. Davis is the Founder and Co-Head of TPG RE. He is based in San Francisco and is a member of TPG’s Management Committee. From 2000 to 2009, Mr. Davis led TPG’s North American Buyout Group, encompassing investments in all non-technology industry sectors. Prior to joining TPG in 2000, Mr. Davis was President and Chief Operating Officer of Colony Capital, LLC. Prior to Colony Mr. Davis worked with the Founders of TPG, David Bonderman and James Coulter, at Robert M. Bass Group. Avi Banyasz, Partner and Co-Head of TPG RE, Mr. Banyasz is based in New York City. Prior to joining TPG RE in 2011, Mr. Banyasz served as a Managing Principal and member of the Investment Committee of Westbrook Partners, where during his 13-year tenure, Westbrook invested \$8 billion of equity in over \$35 billion of real estate transactions.</p> |
| Fund Details: | | |
| Total Firm Assets (\$bil.): | \$77 billion | |
| Strategy: | Non-core real estate | |
| Year Founded: | 1992 | |
| Headquarters: | San Francisco, CA | |
| GP Commitment: | 2%, up to \$55 million | |

| Investment Summary | Existing and Prior Funds | | | | | | | | | | | | | | | | |
|--|--|-----------------|--|-----------------|--------------------------------|----------|------|----------|--|-----------------------|------|----------|--|-----------|------|----------|--|
| <p>Fund III will pursue the same strategy as its predecessors and focus on property-rich real estate platforms and real estate-intensive operating companies rather than individual property purchases. The firm’s primary focus is building platforms and growing enterprise value rather than acquiring single assets and creating value only at the property-level. Platform build-outs can be executed outside the competitive bidding process more easily than individual value-add assets, and provide greater financing flexibility and exit opportunities. Key attributes of the Firm’s strategy include: complexity and operational intensity, large size and scale, discount valuations, avenues for operational improvements, financing flexibility, and multiple exit alternatives. By targeting investments with these attributes, the Firm believes it can source investments at discounted asset valuations. The firm primarily targets real estate investments needing \$100 to \$300 million in equity, but will make initial smaller equity investments to purchase a platform with future growth capital needs.</p> | <table border="1"> <thead> <tr> <th><u>Funds</u></th> <th><u>Vintage Year</u></th> <th><u>Strategy</u></th> <th><u>Returns as of 9/30/2017</u></th> </tr> </thead> <tbody> <tr> <td>TPG RE I</td> <td>2009</td> <td>Non-core</td> <td>19.3% Net IRR, 1.85x Net TVPI, 1.33x DPI</td> </tr> <tr> <td>TPG/NJ RE Partnership</td> <td>2013</td> <td>Non-core</td> <td>20.6% Net IRR, 1.55x Net TVPI, 0.59x DPI</td> </tr> <tr> <td>TPG RE II</td> <td>2014</td> <td>Non-core</td> <td>38.3% Net IRR, 1.40x Net TVPI, 0.54x DPI</td> </tr> </tbody> </table> <p>IRR = Internal Rate of Return; TVPI= Total Value to Paid-In; DPI = Distributions to Paid-In</p> | <u>Funds</u> | <u>Vintage Year</u> | <u>Strategy</u> | <u>Returns as of 9/30/2017</u> | TPG RE I | 2009 | Non-core | 19.3% Net IRR, 1.85x Net TVPI, 1.33x DPI | TPG/NJ RE Partnership | 2013 | Non-core | 20.6% Net IRR, 1.55x Net TVPI, 0.59x DPI | TPG RE II | 2014 | Non-core | 38.3% Net IRR, 1.40x Net TVPI, 0.54x DPI |
| <u>Funds</u> | <u>Vintage Year</u> | <u>Strategy</u> | <u>Returns as of 9/30/2017</u> | | | | | | | | | | | | | | |
| TPG RE I | 2009 | Non-core | 19.3% Net IRR, 1.85x Net TVPI, 1.33x DPI | | | | | | | | | | | | | | |
| TPG/NJ RE Partnership | 2013 | Non-core | 20.6% Net IRR, 1.55x Net TVPI, 0.59x DPI | | | | | | | | | | | | | | |
| TPG RE II | 2014 | Non-core | 38.3% Net IRR, 1.40x Net TVPI, 0.54x DPI | | | | | | | | | | | | | | |

Vehicle Information:

| | | | |
|-----------------------------|---|-----------------------|------------------|
| Inception: | 2018 | Auditor: | KPMG LLP |
| Fund Size : | \$3.0 billion | Legal Counsel: | Ropes & Gray LLP |
| Management Fee: | Invested Equity: 1.5% of first \$50 million, 1.25% on next \$150 million. Uninvested Equity during Commitment Period: 80% of blended rate on Invested Equity. | | |
| Carry: | 20% | | |
| Preferred Return: | 8% | | |
| Additional Expenses: | 100% management fee offset | | |

NJ AIP Program

| | | | |
|---|---------------------|---|-----|
| TPG Real Estate Fund II Recommended Allocation (\$mil.): | up to \$100 million | LP Advisory Board Membership: | TBD |
| % of Fund: | 3.33% | 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.