

May 16, 2008

MEMORANDUM TO: State Investment Council

FROM: William G. Clark, Director

SUBJECT: **Proposed Real Estate Investment in CT High Grade Partners II, LLC**

This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9 (a) to report on a proposed real estate investment of up to \$500 million in the CT High Grade Partners II, LLC (“the Fund”), explained below. The Fund is managed by Capital Trust Investment Management Co., a wholly-owned subsidiary of Capital Trust, Inc. (“CT”).

Please note that this investment will be authorized pursuant to Articles 69 and 71 of the Council’s regulations. This fund will be classified as a non-core real estate investment as defined under N.J.A.C. 17:16-71.1.

The Alternative Investment 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, in coordination with the DOI Investment Committee (Director, Deputy Director and senior fund staff member). The DOI Investment Committee for this transaction was Kathy Jassem, Senior Portfolio Manager responsible for public REIT investments, and myself. The Division worked with General Motors Asset Management (“GMAM”) to structure and diligence this opportunity (as discussed below). SIS assisted the Division in reviewing the diligence materials provided by GMAM and Capital Trust, all of which were supplied to the Council’s Investment Policy Committee.

CT High Grade Partners II, LLC will seek to provide real estate debt exposure. The Fund will invest in “high grade” commercial real estate debt and related investments (“Investments”). Investments may include both loans and securities: (a) Loans are defined as whole interests and senior, pari passu, and junior participations in first mortgages, bank loans, unsecured corporate obligations and other similar debt instruments backed by commercial real estate; and (2) Securities are defined as commercial mortgage backed securities and publicly-traded securities issued by REITs.

The market opportunity for these investments has arisen due to the global liquidity crisis and credit crunch, and the corresponding de-leveraging and re-pricing of risk. CMBS issuance has dropped substantially and spreads of 10-year AAA rated senior CMBS securities to 10-year Treasuries rose from a low of 22 bps in April 2007 to a high of 310 bps in early 2008 (they are currently about 225 bps). BBB- rated paper is trading at approximately 2000 bps over Treasuries (vs. ~100 bps in March 2007). Additionally, high-grade REIT debt spreads have widened from less than 100 bps to over 400 today.

Part of this dramatic widening is the result of credit concerns and a lack of confidence in the credit rating agencies with respect to securitized products. This has been exacerbated by the absence of liquidity due to the disappearance of leveraged investors, the withdrawal of CMBS buyers, the unwillingness and/or inability of commercial banks to extend credit due to capitalization issues and the break-down of the securitized market: securitized lenders originated ~ 50% of all commercial RE debt in 2006-mid 2007.

Capital Trust seeks to capitalize on this opportunity because the current lending universe has insufficient capacity to address financing demand. High grade investors such as CT (and, correspondingly, NJDOI and GMAM) can gain a return advantage due to the market dislocation, with principal protection gained from the high quality collateral, tighter loan covenants, and lower loan-to-value ratio (67% max) of targeted deals originated over the next several years. The proposed fund will not employ leverage.

Capital Trust, Inc.

Capital Trust was founded in 1997 by Sam Zell and John Klopp. It is the largest dedicated commercial real estate subordinated debt investor in the US. CT is a publicly traded REIT and investment manager for over \$2 billion in private equity capital across six funds (NYSE: "CT"). CT has originated over \$10 billion of investments, with senior management averaging 21 years of experience.

In similar fashion, NJDOI has already capitalized on opportunities in the RMBS (with PIMCO), securitized bank loan (with Blackrock, Oak Tree and TPG), and distressed debt markets within the alternative investments portfolio. The investment in the Fund would be a logical extension of this strategy.

Fund Structure: This is a buy-and-hold strategy: CT has discretion to make purchases but GMAM/NJDOI will need to direct CT to dispose of assets prior to maturity. GMAM will act as the General Partner, with NJDOI as the sole Limited Partner in "GM/NJ LP". GM/NJ LP will invest alongside the GM Pension Plan as Ordinary Members in CT High Grade Partners II, LLC, with a management contract established with Capital Trust Investment Management Co, the Managing Member. The investment period is one year (which can be extended by the Ordinary Members) and GMAM anticipates a 9-10 year life.

Return Objective: The expected net return is LIBOR + 300 bps for the overall portfolio, with a minimum return requirement of LIBOR + 150 bps for individual investments.

Risk Control: Loans will have a maximum “last dollar” LTV of 67%. CMBS and REIT debt will have a minimum rating of BBB-; non-rated securities will have a maximum implied LTV of 67%. Portfolio-level risk will be mitigated through a 10% maximum single investment concentration. The maximum single-state exposure will be limited to 30% of capital commitments (50% for each of New York and California) and will focus on North American opportunities.

Historical Performance: This is a new product; as such there is no historical performance track record. However, CT has managed several similar funds in the past, with the combined gross IRR across seven funds totaling \$10.5 billion equaling 21% (and ranging from 7% unlevered to 24%). The loss experience has been 0.3% of capital (only one fund experienced any losses, equaling 0.5%). About 56% of total originations were realized, through 12/31/07. Four funds with over a 40% realization rate have average gross IRRs of about 20%.

While CT invests in higher-risk mortgages for its own balance sheet, the performance of CTs equity in recent months is also indicative of the strength of CTs mortgage underwriting expertise. From June 30, 2007 through May 7, 2008, CTs common equity has generated a total return of -6.96%, versus a return of -39.05% for the Bloomberg REIT Mortgage Index

Fees and Expenses: Management fees are 0.47% per annum (0.40% for Capital Trust; 0.07% for GMAM), which we believe is extremely attractive and well within market standards.

Co-Investments: GMAM (\$166 million, including a Delphi pension plan contribution) will invest alongside NJDOI (\$500 million).

Based on this due diligence, the Division has determined that the proposed investment meets the criteria for investments set forth in the Council’s Alternative Investment Policy. The Division believes it will benefit from the Fund’s investment returns and it will help diversify the real estate investment program.

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Attached to this memorandum is the SIC Investment Committee Fund Review Memorandum for each proposed investment.

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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 this investment. In addition, the proposed investment 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 will not be reached with this manager.

We look forward to discussing this proposed real estate investment at the Council's May 22, 2008 meeting.

WGC/:lt

Attachment

*SIC Investment Committee Fund Review Memo

To: State Investment Council
From: SIC Investment Committee
Date: May 6, 2008
Subject: GMAM/CT Recommendation

Fund Facts

Fund Name:	CT High Grade Partners II Fund
Fund Type:	Distressed investment-grade commercial real estate debt and low LTV whole loans
Current Fund Size:	\$666 million
Previous Fund Size/Vintage:	N/A
Final Close:	Upon execution of NJDOI documents
Fund Address:	767 Fifth Avenue (GMAM) and 410 Park Ave, 14th Floor (Capital Trust) New York, NY 10153 New York, NY 10022

GP Contact Info

Name:	Carlos Rosa (GMAM)
Telephone:	(212) 418-6473
Email:	carlos.rosa@gmam.com

Summary of Terms and Investment Strategy

Investment Strategy:	The Fund will be a Delaware limited liability company formed to invest opportunistically in "high grade" commercial real estate debt and related investments. The managing member will be CT High Grade MM, LLC, owned directly or indirectly by CT Investment
Geographic Focus:	North America (primarily US)
GP Co-Investment Amount:	None
Terms:	No set term as this is a buy-and-hold strategy but estimated at 9-10 years; Ordinary Members may dissolve the fund or appoint replacement members at any time but may face an early withdrawal penalty if assets must be sold.
Term:	
Investment period:	One year, subject to extension by mutual agreement
Management Fee:	0.47% per annum (0.40% for Capital Trust; 0.07% for GMAM)
Other Fees:	Organization expenses (~\$100k) plus exit fee upon early withdrawal if liquidations required (0.40% for investments sold during years 1-3; drops to 0.10% for year 6)
Hurdle Rate:	Swaps + 300 bps for Fund; swaps + 150 bps for individual securities. "Kick-out hurdle" still being negotiated.

NJ AIP Program:

Recommended Allocation:	\$500 million
% of Fund:	75.08%
% of New Jersey State Pension Plan:	0.60%
% of AIP Real Estate allocation (\$2 b)	25.00%
% of Private Equity Commitments for FY08 (\$1.1 b):	45.00%

LP Advisory Board Membership:	N/A
Consultant Recommendation:	Yes
Compliance with SIC "Pay to Play" Reg:	Side letter required

*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.

