



State of New Jersey

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November 15, 2013

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Acting Director

SUBJECT: **Proposed Investment in Hammes Partners II, L.P. Fund**

The New Jersey Division of Investment (“Division”) is proposing an investment of \$100 million in Hammes Partners II, L.P. Fund (the “Fund”). 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:

Market Opportunity: The Fund is being established to capitalize on the strategic shift undertaken by healthcare systems around the US in adopting an “asset-light” approach in order to streamline their operations and focus on allocation of capital to expand their networks. Healthcare systems accomplish this by expanding their slate of services through acquisition of new equipment and physician network expansion that is often funded by monetization of real estate assets. Given the current market dynamics and Hammes Company Health Care’s (“HCHC”) extensive relationship with these healthcare systems through its captive services platform, the Fund stands to benefit from its unique access to decision makers resulting in significant deal flow. It should also be noted that the Division currently has minimal exposure to healthcare real-estate, while the total market for US medical office buildings is estimated by Green Street at \$250 billion.

Unique Platform: Jon Hammes founded HCHC in 1991 and has grown the firm into a leading national healthcare advisor and real estate operator, providing strategy and management services to over 360 healthcare systems around the US. HCHC has developed over 500 healthcare facilities and manages 4 million square feet of healthcare real estate. HCHC has built a dedicated team of over 250 investment and asset management professionals headquartered in Brookfield, Wisconsin which is supported by 15 property management offices nationwide. This gives the Fund a significant advantage and unique insight into the market for these properties and tenant specifications. Its industry focus has made HCHC a leader in the space and a trusted partner for many of the major healthcare systems. The Fund intends to leverage HCHC and the team’s established network of senior executives across multiple healthcare systems nationwide to access key market information and generate off-market or lightly-marketed deal flow.

Successful Track Record: While this Fund is the firm’s first institutional private real estate fund, HCHC has invested capital in the past on behalf of third-party investors, including high net worth individuals, family offices, and publicly-traded health care real estate investment trusts.

Since 2001, HCHC has produced a 2.2x Multiple on Invested Capital and a 27.6% Gross Internal Rate of Return (as of June 30, 2013). It is also important to note that no realized investment has lost money nor would any unrealized investment lose money if sold at the current valuations. Twenty-three of 28 investments made to-date have been development projects, which inherently contain more risks than acquisition projects making HCHC's investment track record even more impressive. To mitigate development risk, HCHC requires a potential development to be 50% pre-leased. Furthermore, HCHC made no investments during 2008 and 2009 due to challenging real estate market and the change in political administration which prioritized healthcare reform. As the real estate market improved and the uncertainty surrounding healthcare legislation abated, HCHC returned to the market in earnest in 2010. As a result of HCHC's disciplined investment approach, the team has no legacy problem assets with which to contend. We note, however, that a significant proportion of HCHC's investments to-date are unrealized.

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.

The fund utilized Probitas Funds Group, LLC (the "placement agent") as third-party solicitor in connection with the potential investment. Staff has determined that the placement agent and its representatives met the registration, licensing and experience requirements set forth in the Division's Placement Agent Policy (the "Policy"). Pursuant to the Policy, the fund has disclosed the contract between the fund and the placement agent, specifying the scope of services to be performed by the placement agent and the fee arrangement between the placement agent, the general partner and any other third party.

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 Hammes' current AUM, the Division will require contractual provisions that prevent its total investments from exceeding 20% of Hammes' 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 Hammes Partners 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 November 8, 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 November 21, 2013 meeting.

Attachments

Fund Name: Hammes Partners II, L.P.

November 21, 2013

Contact Info: Jon Hammes, 18000 West Sarah Lane, Suite 250, Brookfield, WI 53045

Fund Details:

Total Firm Assets (\$bil.):	\$575 million	Key Investment Professionals: Jon Hammes , Founder, Managing Director & CEO. Mr. Hammes is also Managing Partner of Hammes Company Health Care ("HCHC"). HCHC is a nationally recognized leader in the development, financing, and management of strategic real estate assets, specifically in the healthcare industry. Prior to forming Hammes in 1991, he was a Managing Partner at Trammell Crow. Todd Kibler , Principal, Investments & Financing. Mr. Kibler will be primarily responsible for investment and financing activities. He is also a Partner of HCHC and currently serves as its Senior Vice President of Finance & Investments, Chief Financial Officer as well as a member of its management board.
Strategy:	Non-core Real Estate	
Year Founded:	1991	
Headquarters:	Brookfield, WI	
GP Commitment:	2% up to \$6 million	

Investment Summary

Founded by Jon Hammes in 1991, Hammes Company Health Care ("HCHC") originally focused on offering project management services to health care-related entities. Today, HCHC has expanded its slate of services to include direct investment in healthcare real estate assets on behalf of investors as well as providing strategic planning and property management services to over 360 healthcare systems by leveraging a large, national team of professionals across 15 offices nationwide. The Fund will focus on investments in select Outpatient Facilities that HCHC believes are well-positioned within their geographic market and that are expected to remain so from a strategic, operational and tenancy perspective.

Existing and Prior Funds

Funds	Vintage	Strategy	Projected Returns
Hammes Partners, L.P.	2001	Non-core Real Estate	22.3% Net IRR, 1.9x Net MOIC

IRR = Internal Rate of Return
MOIC = Multiple on Invested Capital

Vehicle Information:

Inception:	2013	Auditor:	PricewaterhouseCoopers LLP
Fund Size (\$mil.):	\$430 million estimated	Legal Counsel:	Gibson, Dunn & Crutcher LLP
Management Fee:	1.4% per annum on committed capital during the investment period; 1.4% on invested capital thereafter		
Carry:	20%		
Hurdle Rate:	8.75%		

NJ AIP Program

Recommended Allocation (\$mil.):	\$100 million	LP Advisory Board Membership:	TBD
% of Fund:	23.26%	Consultant Recommendation:	Yes
		Placement Agent:	Yes
		Compliance w/ Division Placement Agent Policy:	Yes
		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.