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PFs READY FOR BUMPY RIDE

Expect pension funds to invest in properties that prove hardier through economic crises, such as apartment complexes and other commercial properties in the four food groups with good historic performances. Look for PFs to shift strategies and diversify portfolios for more stability and higher returns. Real estate, private equity, alternative investments as well as new strategies will likely get attention from investment committees as the public markets, where the bulk of investments tend to lay, lack the appeal they had only a year ago. Count on pension funds to weather the economic storms ahead, as many retirement systems with strong performances over the last several years expect their solid investments to get them through the current profit drought.

Hawaii Employees' Retirement System's new investment officer **Rodney June** isn't fazed by the current financial markets, and while he comes to the retirement system with new ideas to increase returns and diversify investments, he will focus on tweaking the fund's long-term investment strategy. Several funds, including **Pennsylvania Public School Employees' Retirement System** and **Oregon Public Employees' Retirement Fund** will adjust their allocations and increase their real estate target. Pennsylvania State Employees Retirement System did very well in 2007, while **San Diego County Employees' Retirement System** earned respectable returns.

Strategy Study

The Hawaii Employees' Retirement System board and its general adviser, **Pension Consulting Alliance**, will study potential investments in long/short strategies, buyouts, venture capital, distressed debt, mezzanine financing, derivatives and private infrastructure. If any of these strategies prove attractive for Hawaii Employees, it will invest through investment funds rather than direct investments. While infrastructure has good liability matching features for Hawaii Employees, the PF will target international investments if they make any allocations, since the current U.S. market provides scant opportunities for infrastructure deals. June's focus at his new position is to see the PF reach its actuarial return objectives of 8% through further diversification of investments — expecting to increase annual returns by at least 1% while assuming small amounts of incremental risk. While current investments have performed well by beating benchmarks, June expects a broader global outlook on investments with a strategy to take advantage of new investment opportunities to help Hawaii Employees achieve greater returns.

Hawaii Employees' total returns for the calendar year stood at 10.58% versus a benchmark of 9.51%, while the fourth quarter saw a -43% return on investments versus a -28%. The three- and five-year total returns benchmark for the \$11.6B PF stood at 10.86% and 13.38% versus respective benchmarks of 10.39% and 13.29%. Real estate saw a 15.02% return versus a 17.3% benchmark, and a fourth quarter return of 1% versus a 3.56% benchmark.

Allocation Increase

The Oregon Public Employees' Retirement Fund, with approximately \$63.4B, saw a 9.66% return on investments for the 2007 calendar year, versus a 10.51% benchmark. The three- and five-year returns for the fund stood at 12.69% and 14.98% versus respective benchmarks of 11.71% and 14.29%. The PF increased its real estate allocation last year from 8% to 11%, and has already made several commitments to real estate funds during first quarter 2008. Real estate allocations so far this year include a \$200M distribution to a commingled, opportunistic fund being raised by **GI Partners** targeting European investments, a \$100M investment to **CB Richard Ellis** for its value-added domestic Fund V — the PF's first investment with the PF adviser, a \$100M commitment to the global Lone Star Real Estate Fund I and \$100M to KTR Industrial's Fund II. Expect the retirement system, where **S. Bradford Child** is senior investment officer, to shop patiently for opportunities while looking to take advantage of current market conditions.

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FUND HIGHLIGHTS

<u>Fund Type</u>	<u>Amount</u>	<u>Est. Return</u>	<u>Manager's Co-investment</u>	<u>Location</u>	<u>Property</u>
Value-Added	\$150M	Mid 20s+	N/A	Sacramento Phoenix	Distressed land

Carlton Advisory Services kicks off a distressed land fund, DR Stephens Land Company. It will target pension fund capital from domestic and foreign PFs and PF advisers. DR Stephens & Company. It will buy distressed, entitled residential lots in stages three and four, taking advantage of the surplus of distressed land on the West Coast, and particularly focus on Sacramento and Phoenix. The maximum hold period is set for five years. Risk is diminished because land targeted will be zoned, with necessary infrastructure for construction. With a dramatic price drop from just two years ago, DR Stephens plans to start buying between mid-2008 and the beginning of 2009.

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The Pennsylvania Public School Employees' Retirement System generated a total return of 13.82% for the 2007 calendar year. The three-, five- and 10-year returns for the fund were respectively at 14.4%, 16.57% and 9.48%. However, the fund saw a -.74% return for the fourth quarter. U.S. equity saw a 4.78% return for the year and non-U.S. equity investments earned a 16.26% return for the year. Real estate saw a 19.04% return for the calendar year. Private markets did exceptionally well, with a 39.96% return. The pension fund grew by more than \$5B during 2007. The target allocation for U.S. equity was reduced from 27% to 22.5% in April, while the real estate allocation rose from 8% to 10% and private markets rose from 11% to 13%. Non-U.S. equity saw a slight increase to 27.5% from 27%. Recent real estate allocations from Pennsylvania Public Schools include a commitment of up to \$75M to the CS Strategic Partners IV Real Estate Fund, a commitment of up to \$150M to **Lubert-Adler's** opportunistic Real Estate Fund VI, a €200M commitment to **Blackstone's** Real Estate Partners Europe III, and a \$75M commitment to Oculus Small Cap Real Estate Fund I.

Pennsylvania State Employees' Retirement System earned \$5.2B in 2007 and saw a 17.2% return for the calendar year versus a 12.7% benchmark. However, the fund saw investments suffer some along with the rest of the pension world during the fourth quarter, garnering a humble return of 1.6%.

The San Diego County Employees Retirement Association, with about \$8.9B, saw an 11.2% return for the 2007 calendar year versus a 11.4% benchmark, while only seeing a 3.8% return for the second half. The fourth quarter saw a .5% return versus a .4% benchmark. The three-, five- and 10-year numbers were all ahead of their benchmarks, respectively at 11.9%, 16.2% and 9.5%.

PFS TO BUY SHOPPING CENTERS

Expect pension funds to invest in more Class A neighborhood and community centers this year as development tapers off, reducing risk. Insiders believe development will decrease by about 30 million s.f. this year compared to last year, but builders will increase activity in large shopping centers. Overall vacancy and asking rents will rise. Neighborhood and community centers will do better than other retail submarkets, and PFs are banking on those for better returns. Some focus on upper-scale retail centers that attract affluent customers, which tend to not be as affected by market ups and downs. A San Antonio PF picked up a community center in Boerne, Tex., while PF investors **JP Morgan** and **Phillips Edison & Company** decide to invest in grocery-anchored retail. The **Teachers' Retirement System of Illinois** closed a portfolio including three shopping malls; two of which are top lifestyle centers in the Southeast, and the **Florida Retirement System** follows suit. All four investors will follow the trend to acquire Class A and dominant centers in both metropolitan and suburban areas.

A San Antonio PF bought the 77,402 s.f. Class A 100% leased Hill Country Square Shopping Center in Boerne from the venture **HSMEP Hill Country Ltd.**, where **Henry S. Miller Commercial** is a general partner. The PF ventures into the retail sector after exclusively buying office properties. It likes to stay close to home, acquiring the property in a suburb of San Antonio, in a high-growth area, with mostly national tenants. The PF looks for income and tenant stability for core, long-term investments like Hill Country Square.

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PFs To Buy Shopping Centers...

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A joint venture between **AmREIT** and JP Morgan Strategic Property Fund purchased the 616,372 s.f. 80% leased grocery-anchored Shadow Creek Ranch Town Center in Pearland, Texas. The venture plans to hold long-term. The JP Morgan fund includes PF investors from **Arkansas Teacher Retirement System**, **Ohio Police & Fire Pension Fund** and **Virginia Retirement System**. The JV looks for irreplaceable corners like Shadow Creek, which is the second largest HEB-anchored center in the state. It looks for good demographics and growth, along with well-anchored credit tenants. The selling venture **Transwestern Investment Management**, **WCF Development** and **Buchanan Street Partners** bought the property in 2006 with approximately \$18M of equity.

PF adviser Phillips Edison & Company launches Fund IV with two retail acquisitions — the 83,483 s.f. Orchard Plaza in Altoona, Pa., and the 150,396 s.f. Hermiston Plaza in Hermiston, Ore., a dominant grocery-anchored shopping center. Targeted returns for the fund are 13% to 15%, and typical hold periods are 18 to 36 months. Orchard Plaza held appeal because of the quality location within Altoona and the opportunity to acquire more value-added centers in central Pennsylvania. Hermiston held its own with its annual population growth, pro-growth business climate, strong employment base and infill location. There are at least four acquisitions in the pipeline for the \$500M value-added fund in Pennsylvania, New York and Nebraska. Phillips Edison currently experiences favorable acquisition opportunities because of fewer buyers as a result of tightened lending standards and a larger amount of sellers.

CBL & Associates and the Teachers' Retirement System of Illinois finalized its North Carolina office and retail portfolio with the acquisition of the 355,000-s.f. retail Renaissance Center in Durham, N.C., for \$90M. The center is at least 89% leased. This completed the total \$540.8M purchase of The Renaissance, the Friendly Center, and The Shops at Friendly Center along with six Class A office buildings located in Greensboro, N.C. This included capital from the \$356.6M 50/50 JV and a non-recourse \$81.6M long-term fixed-rate loan with an interest rate of 5.77% for The Renaissance Center and The Shops at Friendly Center. The retail acquisitions fit CBL's strategy of acquiring dominant malls across all markets.

Targeting Upside Potential

Ramco-Gershenson Properties Trust teams with Florida Retirement System to acquire the renovated 253,330 s.f., 90% leased Olentangy Plaza in Columbus, Ohio, and the 91% leased and renovated 162,705 s.f. Market Plaza in Glen Ellyn, Ill. Total price for both properties adds up to approximately \$69M, and typical returns for Ramco-Gershenson are in the low to mid-teens. The \$450M fund will be fully invested by mid-2009. At Ramco-Gershenson, where **Dennis Gershenson** is president and CEO, the draw for Olentangy Plaza, anchored by Sunflower Market, was the metropolitan area including consumers with above-average incomes. Market Plaza, anchored by a leading Chicago grocer, satisfied the JV's terms to acquire in an infill location with significant barriers-to-entry, and near densely populated Chicago. Additional acquisition strategies for the JV are to buy shopping centers with upside potential and be able to expand an anchor, add retail and/or make value-added improvements.

Another recent acquisition for Ramco-Gershenson was Mission Bay Plaza, a 273,000-s.f. Class A grocery-anchored center in Boca Raton, Fla. The firm sold the 97% leased property for \$74M to its JV with **ING**, the Ramco/Lion Venture LP, which includes PF allocations where the core, open-ended Clarion Lion Properties Fund has majority ownership. The JV's \$528M fund is now fully invested. The fund will acquire assets at infill locations and reinvest dollars for higher returns. Typical returns for the fund are low- to mid-teens.

PFs, ADVISERS TO TARGET INDUSTRIAL

Count on pension funds and PF advisers to form more joint ventures for industrial investments as they expect the market to be strong despite a slow first quarter. **First Industrial** and **CalSTRS** have been busy this year with several JVs, including an acquisition on behalf of one of their older partnerships. **Sydney Partners**, a newer industrial investment firm, will make investments for distressed industrial properties through JVs with PF advisers.

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Expect these JVs to make long-term industrial investments in markets with population growth and increased demand for warehouse space nearby. The First Industrial/CalSTRS JV bought a property with a strong location in the Orlando market, with routes to Miami and Georgia. Sydney Partners will find smaller deals for value-added industrial, which it's betting on to garner returns in the mid- to high teens. While industrial has been pretty strong through the credit crunch, Sydney Partners looks to score higher returns from distressed properties than from more stable ones.

FirstCal 1 Buys Orlando Land

CalSTRS and First Industrial Trust acquired 134 acres in the Orlando market for development projects. The partners tapped their FirstCal 1 JV which targets development and repositioning opportunities. The development, dubbed First Park Groveland, will include some build-to-suit and speculative developments, with possible land sales as well. Infrastructure and utility work will get under way in the fall, with vertical development to start in early 2009. While a lot of industrial will target port activity, First Park Groveland is more of an infill deal in a consumption zone.

First Industrial, where **Robert Krueger** is regional director of the Central Florida region, expects the local transportation network in the area to attract corporate customers with supply chain needs. Projects will likely range between 200,000 s.f. and 1 million s.f., with possibility for multiple facility types since the site features a range of industrial zoning. Expect the location's proximity to Interstate 75 and the Florida Turnpike, putting it within 20 minutes from Orlando, to give the industrial park an advantageous spot, specially for bulk distribution.

Sydney Partners will form traditional partnerships with a 5% or 10% equity stake with a focus on industrial properties. The Chicago-based JV partner recently acquired an industrial redevelopment project in Chicago, where it sees a lack of Class A industrial in the market. The project will consist of a 330,000 s.f. multi-tenant building, which is already 50% preleased. Total cost is expected to be \$35M. Sydney Partners will work with PF adviser **Alex Brown Realty**, investing with one of its commingled funds. So far, the JV has acquired a three-building, 354,000 s.f. industrial park in Indianapolis and more than 200,000 s.f. of industrial space in Des Moines, Iowa. The JV with Alex Brown will target \$70M to \$100M in total capital investments, with each investment generally in the \$5M to \$30M range. Expect the JV to be fully invested by year's end.

Sydney Partners, where **Jeffery Josephs** is a founding partner, expects more distressed industrial properties to come on the market at mid- to end-year 2008, with expectations of cap rates in the low 7s rising by 1%. The industrial partner will use leverage of around 65% and will target returns in the high teens. Holds on its investments will be from five to seven years. Sydney's focus will be on value-added industrial deals near airports and interstates in the Midwest and Southeast — primarily Illinois, Wisconsin, Iowa and Indiana with plans to expand to Tennessee and possibly Texas and Missouri. Sydney will give Alex Brown first dibs on its projects, but will work with partners on projects outside their JV's \$30M max target, particularly on deals in the \$50M to \$100M range. Sydney and its partners will consider the acquisition of a 175,000 s.f. building in the Chicago area and a 300,000 s.f. bulk distribution center in St. Louis. The industrial investor will source about 90% of its deals off market, but will look at brokered buys. Since its formation in Q2 2007, Sydney has completed four partnerships. Expect to see PFs and advisers partner with Sydney as the company looks to grow, with an appetite for private equity partnerships.

PF ADVISERS TO FUEL SUBURBAN APARTMENT DEMAND

Look for pension funds to go after more suburban apartments this year, including luxury complexes, taking advantage of lower-risk buys as demand grows. Apartments are the most popular food group and look attractive to both renters and investors, as rents push up. PF advisers will prefer long-term apartment investments especially as a wave of echo boomers enter the housing market and older baby boomers downsize their homes. PF advisers **TGM Associates** will purchase both core and value-added properties. **American Realty Advisors** will buy luxury apartment properties in upscale suburban communities. **Federal Capital Partners** will purchase properties in need of rehab in its value-added strategy.

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PF ADVISERS TO FUEL SUBURBAN APARTMENT DEMAND...*Continued from Previous Page*

TGM will ignore the herd mentality of most investors and use a counter-cyclical strategy to acquire properties with a small number of bidders. The adviser will also purchase foreclosed properties which have accounted for about 50 of 107 properties acquired since its founding. TGM Associates bought Plantation Ridge, a 91%-leased, 330-unit luxury complex in Worcester, Mass., for \$60.5M with its \$400M TGM Multifamily Fund. The hold period for the fund is six years. The core and value-added institutional fund includes seven PFs, along with endowments and foundations. It is 50% invested with a buying power of \$1.14B and expects to be fully invested next March. Worcester attracts the PF adviser with strong fundamentals, including a large biotech park and medical school close by coupled with a high-end tenant base. TGM will target Florida's west coast, after recently purchasing two properties in Jupiter on Florida's east coast. Developers built the property as condos, but TGM bought the property as rental apartments — at a rental apartment price.

American Core Realty Fund will target multifamily, office, retail and industrial properties in the \$10M to \$150M range in and around major metropolitan markets and submarkets. American Realty Advisors acquired ALARA Harbour Pointe, a 230-unit complex in the affluent Mukilteo, Wash. — a submarket of Seattle. The expected hold period is seven to 10 years. Funding is provided by American Realty's core commingled fund, which includes investments from more than 100 PFs. Mukilteo attracts American Realty with its skyrocketing employment growth, the supply-constrained area with high barriers to entry and proximity to schools.

Federal Capital Partners grabs a 598-unit complex, Park Berkshire Apartments in Forestville, Md., for about \$30M and plans a \$14M rehab. The deal was made for the \$600M value-added FCP Fund I, which includes PFs and uses leveraging up to 75%. Debt for the deal came from a \$24M loan from **Wells Fargo**. Fund I will be fully invested by mid-year 2008. The hold period will range from five to seven years and a 16% to 18% levered return is targeted for the fund. Federal Capital chooses Park Berkshire because of the dense area and its distressed property status. The PF adviser looks for under-managed, under-capitalized properties that need full-scale renovations because they can be stabilized through proper repositioning to create stable cash flow while being acquired at below-market rates.. Federal Capital's pipeline includes Northern Virginia, suburban Maryland and the Baltimore, Md., area. The Park Berkshire renovation will be completed by 2012.

PFs TO SPARK GREEN OFFICE DEVELOPMENT

Expect more major pension funds to embrace green office development and redevelopment over the next year as demand grows for the product. PFs see a growing trend in California developments, while the East Coast is ripe for acquisitions for green redevelopment. **SKS Investments** forms a joint venture with a PF to develop a Class A office building in Oakland, Calif. **California State Teachers' Retirement System** partners with developer **IDS Real Estate Group** to target green office in Southern California. **New Boston Fund** makes its final deal for its Fund VI with a sale/leaseback acquisition on the East Coast, but it will eventually redevelop the property.

With development of new office usually taking a couple years to complete, PFs and their partners aren't worried about current economic instability affecting new projects under way and will back large Class A developments in strong markets, especially in California. While green development plays to the current environmental atmosphere in the nation, investors in new developments see green construction playing into their properties' valuations and impacting their overall bottom line. The trend is certainly market-driven, with tenants looking to bolster their public images as eco-friendly companies and also attract hot shot graduates that care about things like being near public transit and an environmentally sustainable workplace.

San Francisco-based developer SKS Investments attracts PF capital for equity to develop a \$200M, 320,000 s.f. office tower at 1100 Broadway in downtown Oakland. The partners bank on the value of at least Silver LEED certification, with their eyes on Gold, and a strong transit-hub location to draw tenants. The project will also include the adaptive reuse of the adjacent landmark Key System Building, which should add some aesthetic appeal to the development. While green office looks more to be the staple for Class A space, the partners know that corporate tenants like the perception of an environmentally friendly company.

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SKS has a strong market focus on the San Francisco Bay Area, where there are hard barriers to entry for new development. The development company, where **Steve Wolmark** is a VP, will partner with institutional investors like PFs and fund managers, having worked with approximately 10 since the late 1990s. The partners expect 1100 Broadway to be attractive for corporate tenants as Oakland sits in the middle of the largest 45-minute commute shed in the area, with access to a wide variety of housing, one of the nation's most educated workforce populations and one of the most business-friendly CBDs in the Bay Area when it comes to taxes. Additionally, office rent rates in Oakland are historically 13% lower psf to similar space in San Francisco, where deals trade at more than \$100 psf. Leveraging for the project has yet to be decided.

The partners will ramp up marketing with hopes of locking in a corporate anchor tenant over the next year as plans for the final design are made. Expect vertical development to begin by second quarter 2009, and a completed project within 18 to 24 months. SKS also JVs on a two-building, 450,000 s.f. life science project in San Francisco's Mission Bay with PF adviser **Shorenstein**. While busy with these projects, the development company always keeps its eyes out for new projects.

CalSTRS JV Develops SoCal Offices

CalSTRS will target office development with its Realty JV partner IDS Real Estate Group in Southern California. While U.S. office development slows down, the partners won't have trouble sourcing deals, with one project in the works and another still on the drawing board. Corporate Pointe Tower in Culver City, Calif., is the partners' eighth project since they started working together three years ago. IDS will build the 12-story, 277,607 s.f. Class A office building to meet LEED Silver standards with a projected price tag of \$115M, land included. Expect at least \$40M of that to be in equity, with the partners limiting debt leveraging to a 65% max on their projects. It will be part of the larger 1.6 million s.f., eight-building Corporate Pointe campus, strategically located off the 405 Freeway.

Although fourth quarter 2007 saw some slowing in the West Los Angeles office market, with negative net absorption of 212,300 s.f. and an 8.6% vacancy rate expected to hit 10% by year's end, the partners are optimistic about their project in the Lower West Side and are attracted by the opportunity to build a premium quality property in a growing Southern California submarket as well as the chance to be part of a larger development at an attractive discount to similar projects in other L.A. markets. Meanwhile, a market with current vacancy rates in the mid 90s is nothing to scoff at and it's only expected that growing areas — there is more than \$2B committed to new projects within a mile of Corporate Pointe — see some increase in vacancy rates as more space hits the market. With a projected two-year buildout on the development, the market should see some stabilization from current impact of new developments and any economic instability right now, which will only add to property values in the long run.

CalSTRS and IDS expect the more affordable project to attract tenants by offering sustainable Class A space at rental rates several dollars less psf than comparable space further north. IDS Real Estate, where **David Saeta** is SVP, expects the green development trend to grow with potential tenants consistently asking about the sustainability of space in their RFPs and including it as part of overall property evaluations. Vertical development is scheduled to start later this year, with doors set to open sometime in Q2 2010. Meanwhile, about 20 miles to the northeast in the Tri-City market, the West Coast player and its PF partner plan for another office building in Pasadena, Calif. Land has been acquired for the project but design plans for the 153,000 s.f. office building are still under development. The risk on these projects should be pretty minimal considering their overall strong-market locations and quality of the assets.

PF adviser New Boston Fund will acquire more properties along the Eastern Seaboard, spearheaded by a recent \$24.5M office buy in Cambridge, Mass. The transaction was a sale/leaseback deal with Abt Associates, which has occupied the 55 Wheeler St. building since the mid 1960s. New Boston was attracted by the 10-year lease for the income-generating property acquired at a 7.5% cap rate, but it has a long-term vision for a redevelopment project to include both 55 Wheeler St. and the adjacent 70 Foster St. building, which it also acquired for Fund VI. That redevelopment option, however, won't be on the table for at least seven years. New Boston will prefer a mixed-use redevelopment play due to the strong infill location in a growing market. New Boston, where **Robert Kirschner** is VP of acquisitions, is a vertically integrated adviser, with both development and property management arms. The PF adviser is investing and raising funds for its \$350M Fund VII. New Boston will target returns in the mid- to high teens for investments, with core, value-added and development primarily for office, industrial and residential.

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INVESTOR NOTES...

PF adviser **Coventry Real Estate Advisors** brings **Devin Murphy** on board as a managing partner. He will increase capital volume for the firm through new strategies and extensive relationships developed in the industry. He will raise money and close deals on behalf of investors. Murphy plans to work with managing partners **Peter Henkel** and **David Hirschberg** and significantly expand the firm into international markets. At the moment, returns in U.S. markets hold less risk for Coventry than other countries, but an international plan is still brewing on the back-burner. Murphy last worked as global head of real estate investment banking at Deutsche Bank and before that held a similar position at Morgan Stanley as head of its U.S. Real Estate Investment Banking Business.

Current strategies at Coventry target retail and public retailers who have little or no access to capital right now. It will focus on acquiring public retailers and taking them private. Coventry also will invest in property assets, mostly retail and some mixed-use. Prices are lower right now, and Coventry will require joint venture partners to commit more equity. In today's market it is able to get 70/30 preferential splits in contrast to 50/50 splits a year ago. The PF adviser will tap its closed-end commingled Fund III which will be fully invested before 2009. Typical leveraging is about 67%, and equity raised for Funds I and II ranged from \$300M to \$400M. Coventry looks to acquire both value and high-end retail properties in markets with large populations, good transportation infrastructure and visibility.

Developer and owner **Forest City Enterprises** refinances with **New York State Teachers' Retirement System** for The Galleria at Sunset in Henderson, Nev. The 10-year \$160M loan refinances a renovated 1 million s.f. center about eight miles from the Las Vegas strip. Forest City falls back on PFs for financing and other traditional resources given the fallout of CMBS. Typically a long-term holder, Forest City expects the same for The Galleria, with steady, low-risk returns. The firm finds retail development challenging at the moment and takes cautions. It focuses on metropolitan areas with strong demographics in growing and underserved markets, to not wedge into markets with a significant amount of retail. Core markets include New York, Boston, Los Angeles and San Francisco. Current developments include projects in Yonkers, N.Y., Tampa, Fla., and Texas.

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