



COMMONWEALTH OF PENNSYLVANIA
PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM

Public Investment Memorandum

Ares U.S. Real Estate Fund IX, L.P.

Real Estate Commitment

William P. Stalter
Senior Portfolio Manager

February 10, 2017



Recommendation:

Staff, together with Courtland Partners, Ltd, recommends to the Board a commitment of up to \$100 million to Ares U.S. Real Estate Fund IX, L.P. ("Fund IX" or the "Fund"). Ares Management ("Ares", the "Manager" or the "Firm"), a Los Angeles headquartered investment firm, is sponsoring the Fund to invest in a diversified portfolio of value-add properties in the United States.

Firm Overview:

Ares Management, L.P. (NYSE: ARES) is a publicly traded, global alternative investment manager with approximately \$97 billion in assets under management ("AUM") and approximately 915 employees in over 15 offices across the United States, Europe, Asia and Australia (as of September 30, 2016).

Founded in 1997, Ares manages three distinct but complementary investment groups in Credit, Private Equity and Real Estate ("Real Estate Group") that have the ability to invest in all levels of the capital structure – from senior debt to common equity. The synergies from this multi-asset strategy provide the Firm's professionals with insights into industry trends, access to significant deal flow and the ability to assess relative value.

In July 2013, Ares enhanced its Real Estate Group through the strategic acquisition of AREA Property Partners ("AREA") and assumed the investment management function associated with AREA's existing group of real estate debt and private equity funds. The AREA acquisition brought a top-tier real estate investment management firm with a 20-year track record and approximately 60 investment professionals in the U.S. and Europe into the Ares organization. AREA brought to Ares a diversified real estate private equity platform spanning the risk spectrum, with core-plus, value-add and opportunistic private equity and debt strategies as well as a global footprint. From 1993 until being acquired by Ares, AREA led the investment of multiple real estate funds and joint ventures, through which it invested approximately \$14 billion of equity in more than 600 transactions across a variety of property types and geographies. Funds sponsored by AREA (also known as Apollo Real Estate Advisers) to which PSERS previously committed capital include Apollo AREFIN (2007), AREFIN Co-investment Corporation (2008), AREA Value-Enhancement Fund VII (2007) and AREA European Real Estate Fund III (2007).

Ares' Real Estate Group's equity team has extensive private equity and property experience in the United States and Europe. The team has approximately 50 investment professionals across nine offices and primarily invests in the repositioning of assets and selective new developments with a focus on control or majority-control investments. As of September 30, 2016, the Ares real estate equity team advised approximately \$7.8 billion in AUM.

Ares' Real Estate Group's debt team of approximately 20 professionals directly originates and invests in self-originated financing opportunities for middle-market owners and operators of U.S. commercial real estate. As of September 30, 2016, the team advised approximately \$2.6 billion in AUM. In addition to managing private investment vehicles, the team makes investments through a specialty finance company, ACRE, primarily focused on directly originating, managing and servicing a diversified portfolio of commercial real estate debt-related investments.

A summary of each Investment Group is illustrated below:

Investment Group	AUM	Investment Professionals	Markets	Current Portfolio
Credit	\$62.0 billion	207	US & Europe	1,000+ companies
Private Equity	\$24.9 billion	84	US, Europe & China	~30 companies, 75 power and energy infrastructure assets
Real Estate	\$10.4 billion	71	US & Europe	~170 properties



Market Opportunity:

The continued improvement of the U.S. economy and the current composition of real estate capital flows provide a compelling environment in which to execute a value-add investment strategy. Even as property and capital market conditions have improved in recent years, there remains a number of owners lacking the time horizon, capital requirements or operating expertise to effectively own, manage and improve assets across multiple property sectors and high growth markets. There are also opportunities for further improvement in property fundamentals, including rent growth as assets are physically changed to create value. Additionally, the fluid capital market for real estate is an ideal environment to acquire assets with moderate levels of low-cost debt, with a plan to improve the assets during its holding period. This same environment is also supportive for liquidating assets once business plans have been achieved, as there remains strong demand for stabilized real estate assets.

Portfolio Fit:

A commitment to the Fund will be allocated to the Real Estate portion of PSERS' Real Assets portfolio. As of September 30, 2016, and adjusted to include commitments from previous and the current Board meeting, the Real Estate portfolio is 46.2% Opportunistic, 33.3% Value-Added, and 20.5% Core. Investment in this Fund will increase PSERS' Value-Add real estate exposure, which is currently below a long term target of 50%.

The table below summarizes PSERS' projected exposure inclusive of a recommended \$100 million commitment to the Fund:

Investment Type (\$M)	Market Value ¹	%	Unfunded	%	Total Exposure	%
Opportunistic	2,816.0	47.7%	1,075.3	42.8%	3,891.2	46.2%
Value-Add	1,649.7	27.9%	1,150.2	45.8%	2,799.9	33.3%
Core	1,443.2	24.4%	285.7	11.4%	1,728.9	20.5%
Total	\$ 5,908.88	100.0%	\$ 2,511.22	100.0%	\$ 8,420.10	100.0%

¹Includes Gross PTRES exposure

Investment Strategy:

The Fund's principal objective will be to generate current income and long-term capital appreciation by creating a diversified portfolio of real estate investments across major property types, which primarily includes multifamily, industrial, retail, and selective office properties. The Fund will focus on the acquisition of institutional-quality, cash flowing assets that are undermanaged and/or undercapitalized with opportunities to improve net operating income through renovations, repositioning and re-tenanting. The Manager will target real estate investments projected to provide a meaningful yield component, with an emphasis on capital preservation and portfolio diversification. The Ares's investment philosophy has been consistent over time:

	Description
Liquid Markets With Diversified Economies	Ares intends to be most active in markets with multiple drivers of growth and liquidity. Management will consider select opportunities in secondary growth markets
Major Real Estate Classes	Ares intends to invest primarily in the four major property types and focus on the acquisition of single assets and acquisition and aggregation of regional portfolios
Internally-Generated Investment Flow	Majority of transactions are sourced with an Ares edge to improve pricing and execution
Value Creation	Ares targets investments with opportunities to create value throughout the life cycle of the investment, from an attractive entry point through execution of business plan and monetization
Portfolio Construction	Rigorous portfolio construction with ability to make tactical changes based on changing



	market conditions. Ares targets investment sizes requiring \$50-150 million of equity. Ares seeks to limit fund-level exposure by using non-recourse debt, not cross-collateralizing across investments and limiting position size in relation to fund size
Disciplined On Exit	Identify multiple exit strategies upfront and sell/monetize upon successful business plan completion, rather than timing the market

Investment Instruments:

Investments are expected to be made through a variety of structures, including direct property acquisitions, joint venture transactions, preferred equity and/or mezzanine loan investments. The Fund will invest primarily through a subsidiary REIT.

Investment Structure:

The Fund is a Delaware Limited Partnership, sponsored by Ares Management, L.P. The General Partner, Ares US Real Estate IX Advisors, L.P. ("GP"), is a Delaware Limited Partnership.

The Fund will be managed by Ares Real Estate Management Holdings, LLC. ("Manager"), which is affiliated with the GP. The Manager is registered with the U.S. Securities Exchange Commission as an investment adviser.

Investment Team:

The Ares Real Estate Group manages comprehensive public and private equity and debt strategies and offers real estate products across the risk-spectrum with a focus on major property types, and, as of September 30, 2016, had approximately \$10.4 billion in AUM. The group provides investors access to its capabilities through several vehicles: U.S. and European real estate private equity commingled funds, a publicly traded commercial mortgage real estate investment trust ("REIT"), Ares Commercial Real Estate Corporation (NYSE: ACRE), and real estate private equity and debt separately managed accounts.

The Real Estate Group is a global, multi-strategy real estate franchise with approximately 70 investment professionals located across nine offices. The group is positioned to source and take advantage of long-term market opportunities through its core capabilities, including:

Investment Highlights:

Experienced and Cohesive Leadership
Stable and deep team that has been market cycle-tested and is established in many local markets across the U.S. and Europe. Key contributors to Ares' Real Estate Group's demonstrated track record have been the length and breadth of the team's investment experience. The Fund will be supported by approximately 45 U.S. real estate investment professionals with extensive and diverse real estate expertise and led by portfolio managers who each have over 30 years of relevant real estate experience and have worked together for more than a decade. Each senior investment professional has "hands on" experience across changing real estate market cycles and in a broad range of property types and geographies as owners, operators, developers, borrowers and lenders. Additionally, the Ares U.S. real estate debt team provides support on market research and helps to source opportunities.
Track Record Across Cycles
In the aggregate, the US Real Estate Funds have achieved their targeted returns while generating attractive current income. As of September 30, 2016, the two most recent funds were projected to generate a combined 19.0% gross IRR and a 1.8x gross MoC (13.7% net IRR and 1.6x net MoC). Based on current market values, these funds achieved an aggregate return of a 20.4% gross IRR and 1.6x gross MoC (14.2% net IRR and 1.4x net MoC). Ares US VII is currently a first quartile Courtland Partners Index performer, while Ares US VIII is currently a second quartile performer.
Investing Across Sectors
The U.S. team has managed over \$4.0 billion in equity in 35,800+ multifamily units and approximately 52 million square feet of industrial, retail, office and other assets across approximately 190 investments in more than 80 cities in the U.S.



Multi-Asset Class Experience and Flexible Capital

Ares' proficiency at evaluating every level of a capital structure, from senior debt to common equity, across companies, structured assets and real estate projects enables its business platforms to effectively assess relative value. This proficiency is complemented by Ares' flexibility in deploying capital in a range of structures and different market environments in an effort to maximize risk-adjusted returns.

Investment Considerations:

Competitive Market

The Fund will be competing for investments with many other real estate investment vehicles, as well as publicly-traded REITs, private investment funds, advisers managing pension fund separate accounts, foreign investors, institutional investors, family groups and wealthy individuals. Further, this competition could limit the number of suitable investment opportunities offered to the Fund or the number of properties that it is able to acquire, and may also increase the bargaining power of property owners seeking to sell to the Fund, making it more difficult for the Fund to acquire new properties on attractive terms.

The Ares team has demonstrated patience in investing the capital of US Real Estate Funds VII and VIII. Additionally, the investment period for Ares US Real Estate Fund IX ends three years following the final close, affording the team adequate time to deploy Fund capital in a thoughtful manner.

Long-Term Investment Horizon

The term of the Fund will be 8 years from the final closing, which may be extended for one (1) year at the General Partner's discretion and thereafter for an additional one (1) year with approval of a Majority-in-Interest of the Limited Partners. While the Fund will target an 8-10% current yield, it is possible that cash flows will occur only after the partial or complete financing, refinancing or sale of an investment, delaying returns to the investors.

The team has demonstrated its ability to provide solid risk-adjusted returns over the past decade. US Fund VII (vintage 2007) is fully deployed and has returned 148% of investors' capital, with remaining value expected to bring total proceeds to 164% of investor's capital. US Fund VII is projected to generate a 2016 property-level yield of approximately 13%. US Fund VIII (vintage 2013) is approximately 80% deployed and since the first capital call in December 2014 has made 12 distributions totaling \$60 million, of which 90% is attributable to operating cash flow. US Fund VIII is projected to generate a 2016 property-level yield of approximately 12%.

Development, Redevelopment and Construction Risks

The Fund may invest in real property requiring construction, new development or redevelopment activities that could subject the Fund to a number of risks, including risks associated with: construction delays, costs overruns, permitting delays, difficulty in obtaining construction financing and/or disruptions in labor availability and material shortages.

The team is well-experienced with projects of this ilk, and to mitigate risks, the Fund is prohibited from investing in speculative ground-up development projects.



PSERS History & Performance:

Since 2007, PSERS has committed \$225 million to two Ares US value-add real estate partnerships. Additionally, PSERS has made commitments to Ares European Real Estate Funds III and IV, Apollo Real Estate Finance Corporation (“AREFIN”) and AREFIN Co-investment Corporation. The following table summarizes PSERS’ historical performance with the Ares US value-add real estate funds, as well as other Ares-sponsored funds, as of September 30, 2016:

Fund (\$,M)	Vintage	Fund Size	Commitment	Contributions	Distributions	NAV	Net IRR	MoC
Ares U.S. Real Estate Fund VII, L.P.	2008	756.2	150.0	146.4	213.1	30.3	15.3%	1.7x
Ares U.S. Real Estate Fund VIII, L.P.	2013	823.5	75.0	35.9	4.2	35.1	13.2%	1.1x
PSERS Sub-Total (Ares U.S. funds)			\$225.0	\$182.3	\$217.3	\$65.4	15.3%	1.6x
Apollo Real Estate Finance Corp	2006	621.4	150.0	150.2	95.2	56.1	0.1%	1.0x
AREFIN Co-Invest Corporation	2008	310.7	83.0	69.2	97.0	-	12.1%	1.4x
Ares European Real Estate Fund III, L.P.	2007	600.7	112.3	134.8	129.6	26.3	3.5%	1.2x
Ares European Real Estate Fund IV, L.P.	2013	1,302.4	100.0	44.4	4.8	41.9	5.3%	1.1x

Finance Committee Disclosure:

Relationship with Courtland:	None disclosed
Introduction Source:	Fund Sponsor
Placement Agent:	No, Ares utilizes an internal marketing affiliate
PA Political Contributions:	None disclosed
PA Presence:	Ares U.S. Real Estate Funds have investments in a 292,888 sq. ft. retail property in Warrington, PA, a 212 unit multifamily property in Philadelphia, PA and a 202 unit multifamily property in Langhorne, PA
Potential Conflicts:	We are not aware of Ares having any investment conflicts
First Time Fund With PSERS:	No
PSERS Allocation Implementation Committee Approval:	February 10, 2017

Oversight Responsibility:

Investment Office:	Charles J. Spiller William P. Stalter	Deputy CIO, Non-Traditional Investments Senior Portfolio Manager
External Consultant:	Courtland Partners	

COURTLAND PARTNERS, LTD.

INSTITUTIONAL REAL ESTATE SERVICES

200 PUBLIC SQUARE
SUITE 2530
CLEVELAND, OH 44114

TELEPHONE: (216) 522-0330
FAX: (216) 522-0331
www.courtland.com

February 3, 2017

Board of Trustees
Pennsylvania Public School Employees' Retirement System
5 North 5th Street
Harrisburg, PA 17101

Re: Ares US Real Estate Fund IX, L.P.

Dear Trustees:

Courtland Partners, Ltd. ("Courtland"), having been duly authorized by the Board of PSERS, has evaluated Ares US Real Estate Fund IX, L.P. (the "Fund"). The Fund will pursue an investment strategy that continues the strategy of prior Ares US Real Estate Funds VII and VIII. The Fund's mandate is a continuation of the strategy to create a diversified portfolio of real estate, including multifamily properties, industrial properties, hotels, retail centers, and office assets with a solid current income component.

The Fund will focus on the disciplined acquisition of institutional-quality, cash flowing assets that are undermanaged and/or undercapitalized with opportunities to improve net operating income through renovations, repositioning, and re-tenanting.

The Fund will primarily pursue investments in U.S. growth markets that have diversified economies, well-developed transportation networks, long-term growth potential and/or high barriers to entry, as Ares believes such investments have reduced downside risk. The Fund may acquire 100% interests in assets or structure its investments through joint ventures as well as make preferred equity investments. Ares typically targets investments requiring between \$50 million and \$100 million of equity.

Ares believes that the continued improvement of the U.S. economy and the current composition of real estate capital flows provide a favorable environment in which to execute its value-add investment strategy. Even as property and capital market conditions have improved in recent years, Ares believes that there remain a number of owners lacking the time horizon, capital requirements, or operating expertise to effectively own, manage, and improve assets across multiple property sectors and geographies. Ares also sees opportunities for further improvement in property fundamentals, which provides opportunity for rent growth as assets are physically changed to create value.

Ares plans to implement its investment strategy for the Fund by continuing to adhere to its flexible value-added investment philosophy and its targeted asset selection process which emphasizes capital preservation, portfolio diversification, modest leverage, and risk minimization. Ares expects to invest primarily in major property types, including multifamily, industrial, retail and selective office and other sectors, and is cautious of niche sub-classes that may be less liquid in down cycles or more operationally intensive or specialized.

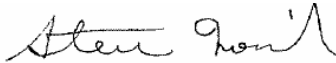
Courtland's recommendation is based upon the following factors and is made within the context of PSERS' investment guidelines.

- Detailed due diligence, including interviews with key Ares management team members, and review of all relevant materials.
- Evaluation of the Fund's proposed investment strategy within the context of the current investment environment.
- Evaluation of Ares' track record and organizational resources.
- Discussion and review of the market conditions in markets relative to the proposed investment strategy.
- The strategy proposed for the Fund is appropriate for the real estate component of the portfolio.

Based on the above factors, Courtland recommends that PSERS commit up to \$100 million to the Fund. Courtland makes this recommendation considering Ares' qualifications and PSERS' overall investment guidelines.

This recommendation is given solely for the benefit of PSERS and cannot be relied upon by other investors considering an investment in the Fund, since their needs, objectives and circumstances may not be identical to those of PSERS. The scope of this recommendation is limited to the investment merits of the Fund. Courtland does not provide legal or other non-investment-related advice.

Sincerely,



Steven Novick
Managing Principal

COURTLAND PARTNERS, LTD.