



State of New Jersey

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July 2, 2013

MEMORANDUM TO: The State Investment Council

FROM: Timothy Walsh
Director

SUBJECT: **Proposed Investment in Prologis European Properties Fund II**

The New Jersey Division of Investment (“Division”) is proposing an investment of €140 million (approximately \$185 million) in Prologis European Properties Fund II (“PEPF II”). 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:

High Quality Existing Portfolio: The Division believes that this investment presents a rare opportunity to buy into an existing portfolio of 222 Class-A logistics facilities in 40 key European markets as of March 31, 2013. Approximately 73% of the assets are located in the UK, Germany, France and Poland - Europe’s leading industrial markets. The average age of the facilities is 5.8 years and the portfolio is 96% leased. Tenants include Tesco, DHL, Hutchison Whampoa, LG Electronics and Kraft. The Division and RV Kuhns & Associates, Inc. evaluated a number of the assets in Amsterdam, Paris and London. In addition, the Division’s in-house Real Estate Investment Trust expert, Kathy Jassem, is familiar with Prologis and its management given that she’s been covering the company for many years.

Attractive Basis: This is the first time that the fund is open to new investment since its inception in 2007. The entry price for this investment results in an approximate current cash yield of 7-8%, which the Division believes is high given that the assets are almost fully leased. In comparison, Prologis’ common stock yields only 2.89% (as of 6/17/13). The value proposition as determined by the Division is as follows:

- Current value implies a discount to replacement cost of up to 15 – 20%.
- The current 7.5% cap rate is approximately 15% higher than market peak and is applied to rents that are 20% lower.
- Market rents are currently 10-15% below replacement cost rents, enabling upside and discouraging competition.
- Net Asset Value per unit has yet to recover from the 40% drop since 2008, as is the case with most industrial property in Europe. Retail and office meanwhile have seen significant recoveries.

In total, the Division believes this presents an attractive entry valuation even with the possibility of improving fundamentals.

Experienced Operator: Prologis is a global industrial real estate owner/operator with \$47 billion under management and has been operating European property funds since 1999. Today, PEPF II is the largest pan-European logistics platform for Prologis with 222 operating properties and 5.1 million square meters. Prologis' European team is comprised of 350 local employees stationed across 12 regional markets. Additionally, the Division believes Prologis' global network of leasing relationships provides current market intelligence and enables efficient re-leasing.

Alignment of Interests/Attractive Terms: Prologis will maintain a minimum of a 20% commitment to the fund; its commitment is 31% as of March 31, 2013. The Division will pay a 0.75% management fee per annum, which reflects a reduction for scale due to the aggregated RV Kuhns commitments. This management fee is charged on "un-adjusted" invested equity (invested equity is fixed and not subject to changes in asset valuation).

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

Division Staff and its real estate consultant, RV Kuhns & Associates, Inc., 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. 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 Prologis European Properties Fund II will be considered a 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 June 26, 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 July 11, 2013 meeting.

Attachments

Fund Name: Prologis European Properties Fund II

July 2, 2013

Contact Info: James Green, Pier 1, Bay 1, San Francisco, California 94111

Fund Details:

Total Firm Assets (\$bil.):	€17.8 billion	Key Investment Professionals: <i>Simon Nelson</i> , Senior Vice President of Fund Management is responsible for managing and growing Prologis European Properties Fund II ("PEPF II"). Mr. Nelson joined Prologis in 2001, with initial responsibility for third party acquisitions in Southern Europe. In 2008, he took over the European Fund Management role for PEPF II. <i>Daan van den Hoven</i> , Director of portfolio management for PEPF II. He is responsible for managing Prologis European Properties Fund II, as well as for formulating and implementing a short and long-term fund management strategy to optimize the Fund's financial performance. Mr. van den Hoven joined ProLogis in 2007 during which he worked for five functional areas including due diligence, property management, development, fund and asset management, and global services. <i>Seth Kaplan</i> , Senior Associate for PEPF II. He assists the team on managing and reporting for the Fund as well as managing the Fund's forward-looking financial models. Prior to joining Prologis, Mr. Kaplan worked as a mortgage underwriter for UBS in New York. <i>Philip Dunne</i> , President, Europe for Prologis. Mr. Dunne is responsible for all aspects of Prologis' European operational performance, including investments and development. He is also chairman of Prologis' European Management Committee. Previously, Mr. Dunne was the company's chief operating officer, Europe and the Middle East.
Strategy:	Core open-ended	
Year Founded:	1983	
Headquarters:	San Francisco, CA	
GP Commitment:	20% minimum	

Investment Summary **Existing and Prior Funds**

Prologis (NYSE: PLD) is an \$18 billion market cap company and global owner, operator and developer of industrial real estate properties. Prologis owns and operates 560 million square feet of industrial property in 21 countries. They lease to over 4,500 customers and manage a total of \$47 billion in assets. The Division has the opportunity to buy into a portfolio (not a blind pool) of top-quality European logistics facilities at an attractive price in the Division's view, with notably LP-friendly terms that is managed by a leading industrial real estate firm. The fund's strategy is to invest in core industrial real estate assets in Europe's key markets, targets a net levered internal rate of return of 9-10% and will focus on modern facilities that are over 90% leased. An investment in PEPF II provides immediate access to an established, well diversified portfolio of stabilized industrial properties in key global and regional trade markets across Europe.

<u>Funds</u>	<u>Strategy</u>	<u>Returns</u>
PEPF II	Core	9-10 % Targeted Net Internal Rate of Return

Vehicle Information:

Inception:	2007	Auditor:	KPMG
Fund Size (\$mil.):	approximately €1,963 million*	Legal Counsel:	Linklaters LLP, and Arendt & Medernach
Management Fee:	0.75% on invested equity		
Carry:	20%		
Hurdle Rate:	8.75%		
Acquisition Fee:	1% on new acquisitions from third party sources; 0.5% from Prologis affiliates.		

* March 31, 2013 net asset value plus additional fund raise amount

NJ AIP Program

Recommended Allocation (\$mil.):	up to €140 million	LP Advisory Board Membership:	No
% of Fund:	7%	Consultant Recommendation:	Yes
		Placement Agent:	No
		Compliance w/ Division Placement Agent Policy:	N/A
		Compliance w/ SIC Political Contribution Reg:	Yes