



State of New Jersey

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Governor

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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Lt. Governor

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State Treasurer

May 11, 2011

MEMORANDUM TO: New Jersey State Investment Council

FROM: Timothy Walsh
Director

SUBJECT: **Proposed Investment in Lone Star Real Estate Fund II (U.S.), L.P.**

The New Jersey Division of Investment is proposing an investment of \$100 million in Lone Star Real Estate Fund II (U.S.), L.P. This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9.

The Division of Investment ("Division") Staff and its real estate consultant, The Townsend Group, undertook extensive due diligence on the proposed investment. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council.

Lone Star Real Estate Fund II, comprised of Lone Star Real Estate Fund II (U.S.), L.P., and Lone Star Real Estate Fund II (Bermuda), L.P. (together, LSREF II) is a \$5.5 billion global opportunity fund with a focus on North America, Western Europe and Japan. LSREF II will invest in a broad range of commercial real estate and commercial real estate related investments including, but not limited to, investments in secured and unsecured debt, high leverage debt financing, real estate-related debt and equity assets. In comparison to its predecessor fund, LSREF I, LSREF II will have the ability to invest in and intends to principally target distressed debt strategies specific to commercial real estate.

Lone Star estimates the vast majority of LSREF II will be comprised of portfolios of commercial mortgage debt, principally non-performing commercial real estate loans (Whole Loans). The balance of LSREF II will be comprised of senior securitized products (CMBS) and direct equity investments.

This investment combined with an investment in Lone Star Fund VII (U.S.), L.P. will reduce our management fee to 90 bps with a 10% preferred return and a 45 bps management fee post the investment period. Our combined commitment will also provide us an advisory board seat on

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both funds. Lone Star and its previous affiliates have raised eight prior funds. The prior funds have collectively invested/committed approximately \$24.7 billion of partnership equity.

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 each investment. In addition, each proposed investment must comply with the Council's regulation governing political contributions (N.J.A.C. 17:16-4).

Please note that these investments are authorized pursuant to Articles 69 and 71 of the Council's regulations. Lone Star Real Estate Fund II will be considered a non-core real estate investment, as defined under N.J.A.C. 17:16-71.1.

Formal written due diligence reports for the proposed investments were sent to each member of the Investment Policy Committee and a meeting of the Committee was held on May 5, 2011. In addition to the formal written due diligence reports, all other information obtained by the Division on the investment was made available to the Investment Policy Committee.

We look forward to discussing the proposed investments at the Council's May 19, 2011 meeting.

Attachments

***SIC Investment Committee Fund Review Memo**

To: State Investment Council
From: SIC Investment Committee
Date: May 19, 2011
Subject: Real Estate Investment Recommendation

Fund Facts

Fund Name:	Lone Star Real Estate Fund II
Fund Type:	Co-mingled
Current Fund Offering:	\$100 million
Current Fund Size/Vintage:	Fund II -- \$5.5 billion
Previous Fund Size/Vintage:	Fund I -- \$2.4 billion/ 2007
Final Close:	May-11
Fund Address:	2711 N. Haskell Avenue, Suite 1700 Dallas, TX 75204

GP Contact Info

Name:	Louis Paletta, Executive Vice President
Telephone:	(214) 754-8300

Summary of Terms and Investment Strategy

Investment Strategy:	Opportunistic/ Distressed Commercial Real Estate Debt Products and Equity
Geographic Focus:	US/Europe/Japan
GP Co-Investment Amount:	1% of total commitments
Terms:	
Term:	Ends May 2019 with two 1-year extensions at General Partner's Discretion
Investment Period:	3 years from final closing
Management Fee:	90 bps during investment period/ 45 bps thereafter on outstanding invested capital achieved through aggregate of \geq \$400 million to LSF VII and LSREF II combined
Preferred Return:	10% achieved through aggregate of \geq \$400 million to LSF VII and LSREF II combined
Catch Up:	80%/20% LP/GP split up to a 13% return 50%/50% LP/GP split after a 13% return up to a 20% return 80%/20% LP/GP split thereafter
Back Office/Service:	Hudson Advisors
Fund Attorney:	K&L Gates LLP
Auditor:	Ernst & Young

NJ AIP Program:

Recommended Allocation Current:	\$100 million
% of investment in Fund II:	1.8%

LP Advisory Board Membership:	Yes
Consultant Recommendation:	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.