State of New Jersey

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May 10, 2013

MEMORANDUM TO: The State Investment Council

FROM: Timothy Walsh
Director

SUBJECT: **Proposed Investments in M&G Real Estate Debt Fund II, LP and M&G Real Estate Debt Fund III, LP**

The New Jersey Division of Investment ("Division") is proposing an investment of £75 million in M&G Real Estate Debt Fund II, LP (mezzanine fund) and £125 million in M&G Real Estate Debt Fund III, LP (senior tranche).

M&G (along with its senior lending affiliates) is one of the largest direct lenders in Europe, and a subsidiary of Prudential plc, (which has £405 **billion** in assets and an approximate market cap of £30 billion.) The M&G funds provide an attractive risk-adjusted substitute for lower yielding fixed income investments and are a prudent diversifier for the portfolio as presently the Division has a small exposure to European real estate debt.

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 these investments based on the following factors:

Opportunity for Real Estate Financing in Europe: Since the global financial crisis, financing available in the European real estate market, apart from the most senior tranches of real estate debt, has been scarce. In addition, real estate-related debt refinancings are set to begin this year, with an estimated €250 billion per annum for the next 4 – 5 years. Given this mismatch of opportunities (demand) and restricted funding from banks and insurance companies and a severely-limited CMBS market (supply), financing terms and potential returns have improved dramatically for those participants who are still active and well-capitalized, such as M&G.

Whole-Loan Solution: M&G Investment Management, together with its senior first mortgage lending affiliates, is one of the few providers of whole-loans in the European market. By providing underwriting and supplying an entire debt structure, M&G reduces complexity and costs for borrowers, making them an attractive capital source. The ability for M&G to provide

the entire debt structure to a borrower, without any syndication risk of its own, is a tremendous competitive advantage.
This is the M&G process:

- *The borrower obtains M&G's "whole-loan solution"*
- *M&G allocates the loans internally to levels which suit each fund's risk/return objectives.*
  The loans are typically allocated into 3 specific buckets: a senior tranche for M&G's parent company insurance fund balance sheet and third party clients (Libor+ 200 – 300 targeted returns), a senior subordinated or "stretch senior" tranche for Fund III (7 – 10% targeted returns) and a mezzanine tranche for Fund II (12 – 15% targeted returns).
  The allocation of debt tranches is done on a formulaic basis and is approved by several investment, risk and allocation committees.

Sourcing Advantage: M&G through its association with Prudential plc, has a significant sourcing advantage in Europe. PRUPIM, M&G's real estate equity management arm, has a substantial European footprint with over 700 assets that provide insight into real estate fundamentals and tenant credit quality across the target markets.

Focus on Current Income: Rather than using the Payment-In-Kind (PIK) system used by less profitable competitors, M&G structures investments with a large percentage of current pay. This helps de-risk the investments on a shorter timeframe. M&G Real Estate Debt Fund I ("REDF I"), the predecessor vehicle to REDF II and REDF III, had 89% of interest receivable as current pay.

Attractive Terms: With this allocation size, the Division will pay a 0.70% management fee for the Fund III allocation and 1.25% for the Fund II allocation, all on invested capital only. These terms are substantially better than market and also better than the terms offered to other smaller investors in the M&G funds.

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 First Avenue Partners LLP (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 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 Council's regulations. The M&G Real Estate Debt Fund II, LP and M&G Real Estate Debt Fund III, LP will be considered non-core real estate investments, 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 May 6, 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 May 16, 2013 meeting.

Attachments

Fund Name: M&G Real Estate Debt Fund II, LP and M&G Real Estate Debt Fund III, LP — May 10, 2013

Contact Info: Andreas Schaefer, Governors House, Laurence Pountney Hill , London, United Kingdom EC4R 0HH

Fund Details:

Total Firm Assets ($bil.):	£200 billion
Strategy:	Opportunistic non-core real estate
Year Founded:	1931
Headquarters:	London, England
GP Commitment:	10%

Key Investment Professionals:

John Barakat ,(Fund Manager and Head of Real Estate Finance): Mr. Barakat joined M&G in September 2008 as Head of Real Estate Finance. In 2007, John successfully raised a European real estate mezzanine fund (Resource Europe Realty Finance) in partnership with Resource America (NASDAQ:REXI). Prior to raising that fund, John spent 17 years at Goldman, Sachs & Co.

Jamil Farooqi , (Director, Origination & Execution): Mr. Farooqi joined M&G in January 2010 as a Director in Real Estate Finance. Prior to joining M&G, Jamil worked as an Executive Director in the Real Estate Structured Finance Group at JPMorgan.

Peter Foldvari , (Director, Origination & Execution): Mr. Foldvari joined M&G as a Director in Real Estate Finance in September 2009. Before joining M&G, Peter worked at Goldman Sachs with Mr. Barakat and focused on originating, structuring, executing and selling European real estate debt products including Senior Loans, Junior Loans, CMBS issuances, bridge loans and other structured financings.

Daniel Riches , (Associate Director, Origination & Execution): Daniel joined M&G in June 2010. Daniel was previously an Associate Director in the Structured Finance Group of Standard & Poors.

Investment Summary

M&G Investment Management Limited (“M&G”) is a wholly-owned subsidiary of Prudential plc (NYSE:PUK), its parent organization. M&G represents Prudential plc’s investment management division in Europe. M&G believes raising REDF II and REDF III in tandem is the most efficient way to provide debt capital to equity sponsors while allowing investors to tailor their investment exposures based on their particular risk tolerances and return requirements. REDF II’s principal investment objective is to originate and to acquire a diversified portfolio of junior notes (B-notes), mezzanine debt, preferred equity, CMBS, and other real estate-related debt and debt-like instruments collateralized by commercial real estate-related assets throughout Western Europe, with primary focus on the United Kingdom and secondary focus on Germany. REDF III intends to acquire, originate, hold, finance, and dispose of stretch senior tranche real estate debt capital to the United Kingdom and Western European commercial property market.

Existing and Prior Funds

Funds	Strategy	Vintage Year	Projected Net IRR	Projected Net MOIC
REDF I	Opportunistic	2010	12.30%	1.48x

Vehicle Information:

Inception:	2012
Fund Size ($mil.):	REDF II: £750M;REDF III: £750M
Management Fee:	REDF II: 1.25% (Invested Equity);REDF III 0.70% (Invested Equity)
Carry:	REDF II: 20%;REDF III: 15%
Hurdle Rate:	REDF II: 8.0%;REDF III: 6.0%
Auditor:	Ernst & Young LLP
Legal Counsel:	Hogan Lovells International LLP

NJ AIP Program

Recommended Allocation ($mil.):	£75 million to REDF II and £125 million to REDF III
% of Fund*:	REDF II: 10% ; REDF III: 16.66%

** assuming the manager raises GBP 750 million in each fund*

LP Advisory Board Membership:	REDF II
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.