



State of New Jersey

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January 29, 2015

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in TGM Separate Account**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$300 million in a separate account to be managed by TGM Associates, L.P. (“TGM”). 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:

Exclusive Focus on Value-Added Multifamily Investing: TGM is a vertically integrated operating company which manages every aspect of the value chain and has been exclusively focused on multifamily investing since the firm’s inception in 1991, with no strategy-creep or aggressive assets under management growth ambitions (currently \$1.3 billion). The firm provides property management services only to its investors and has acquired approximately \$2.2 billion of properties over the past 20 plus years.

Vertically Integrated Capabilities: TGM is a fully integrated operating company across every aspect of the multifamily value chain. In today’s highly competitive, thin-margin environment, TGM’s internal capabilities are a major competitive advantage over advisors who outsource management capabilities. TGM’s approach provides substantially greater awareness of on-site issues at properties for immediate feedback and response, and allows TGM to benefit from shared lessons learned while also avoiding a double layer of fees. The firm has also developed a proprietary renovation program that allows them to renovate 3-5 occupied units per day, which minimizes vacancy loss and increases income. They buy supplies in bulk directly from the manufacturer and use one contractor for an entire project. This process leads to reduced costs relative to its peers while still maintaining full control over investment and operating decisions.

Strong Track Record: TGM has demonstrated strong risk-adjusted returns with an overall net IRR of 9.9% and a 1.8x multiple of invested capital since the firm’s inception. Since 1993, TGM has managed a separate account for a large public plan which has delivered a 10.5% Net IRR and a 1.9x multiple of invested capital since inception with average leverage of 12%; and TGM’s next two separate accounts, managed on behalf of a US corporation, are both are top-quartile performers. The two corporate separate accounts have generated a 14.4% Net IRR and a 2.1x

multiple, and a 15.5% Net IRR and a 1.5x multiple, respectively. It should also be noted that only four (4) of 123 transactions in their history are expected to lose money.

Complementary Portfolio Exposure: The average multifamily exposure across the NCREIF-ODCE Fund Index is approximately 25%, while New Jersey's Real Estate portfolio has only 16% in the multifamily sector. This new mandate will allow the Division to add exposure to an underweight property type, while doing so with a much more attractive fee and governance structure than a traditional commingled fund.

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.

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. We have obtained a preliminary Disclosure Report of Political Contributions in accordance with the Council's regulation governing political contributions (N.J.A.C. 17:16-4) and no political contributions have been disclosed. We will obtain an updated Disclosure Report at the time of closing.

Please note that the investment is authorized pursuant to Articles 69 and 71 of the Council's regulations. The TGM Separate Account will be considered a non-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 January 14, 2015. 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 January 29, 2015 meeting.

Attachments

Fund Name: TGM Separate Account

January 29, 2014

Contact Info: Michael Frazzetta, 650 Fifth Avenue, 28th Floor, New York, NY 10019

Fund Details:

Total Firm Assets (\$bil.):	\$2.2 billion	Key Investment Professionals: Tom Gochberg , Co-Founder/Chief Executive Officer, Mr. Gochberg co-founded TGM with Steve Macy in 1991. Mr. Gochberg is co-head of acquisitions, chairs the Investment Committee, and is responsible for the overall management of the firm. Mr. Gochberg first entered the real estate investment management area when he joined Smith Barney in 1969. Steve Macy , Co-Founder/Senior Acquisitions Officer, Mr. Macy co-founded TGM with Tom Gochberg in 1991, and is a member of the Investment Committee. During TGM's formative years he was head of Asset and Property Management and since 2005 he has devoted the majority of his time to property acquisitions. John Gochberg , Chief Operating Officer, Mr. Gochberg originally joined TGM in 2000 as an Acquisitions Analyst, was promoted to Acquisitions Officer in 2001, and was Director of Property Operations from 2003 to 2008 when he became Chief Operating Officer. Mike Frazzetta , Chief Financial Officer, Mr. Frazzetta joined TGM in May of 2002 as Chief Financial Officer, responsible for TGM's treasury, accounting, and control functions, as well as oversight of investor relations. He is a member of the Investment and Operating Committees. From 2000 through 2001, Mr. Frazzetta was Chief Financial Officer/Chief Administrative Officer for Barnard & Co., LLC.
Strategy:	Non-core real estate	
Year Founded:	1991	
Headquarters:	New York	
GP Commitment:	1% - up to \$3 million	

Investment Summary

TGM Associates, L.P.'s ("TGM") sole focus of investing in and operating rental apartment communities throughout the United States. The firm is a fully integrated operating company which staffs and manages all properties in its clients' portfolios, including in-house market research, deal sourcing, acquisitions, due diligence, asset management, property management, centralized purchasing, renovations and rehab, general contracting, and disposition capabilities. TGM employs approximately 275 people, which includes 45 people in the NY HQ and regional offices, as well as over 230 on-site property staff. TGM has acquired 123 properties (\$2.2 billion) in 60 cities and 28 states over its history, with 93 properties sold, resulting in a return of \$735.5 million of equity and generating \$1.82 billion in cash and a multiple of 2.5x. Over this time, there have been no foreclosures, involuntary exits or legacy issues.

Existing and Prior Funds

<i>Funds</i>	<i>Vintage Year</i>	<i>Strategy</i>	<i>Returns as of 9/30/2014</i>
Pre-Fund	1991	Non-core	16.4% Net IRR, 2.2x MOIC, 243.4% DPI
Separate Account #1	1994	Non-core	10.5% Net IRR, 1.9x MOIC, 167.0% DPI
Separate Account #2	1999	Non-core	14.4% Net IRR, 2.1x MOIC, 212.2% DPI
TGM MF Fund	2007	Non-core	3.2% Net IRR, 1.2x MOIC, 42.8% DPI
Separate Account #3	2010	Non-core	15.5% Net IRR, 1.5x MOIC, 18.7% DPI
Separate Account #4	2013	Non-core	N/A

IRR = Internal Rate of Return, MOIC = Multiple on Invested Capital, DPI = Distributions to Paid-In

Vehicle Information:

Inception:	2015	Auditor:	KPMG LLP
Fund Size (\$mil):	\$303 million	Legal Counsel:	Paul, Hastings, Janofsky & Walker LLP
Management Fee:	0.75% on invested capital; 3.875% property management fee (on collected revenue)		
Carry:	15%		
Hurdle Rate:	9%		

NJ AIP Program

Recommended Allocation (\$mil.):	\$300,000,000	LP Advisory Board Membership:	Yes
% of Fund:	99%	Consultant Recommendation:	Yes
		Placement Agent:	No
		Compliance w/ Division Placement Agent Policy:	N/A
		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.