

NEW MEXICO STATE INVESTMENT COUNCIL

Real Estate Investment Policy

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The New Mexico State Investment Council (the “SIC”) has been authorized to allocate a portion of the New Mexico Land Grant Permanent Fund and the Severance Tax Permanent Fund (collectively the “Funds”) to the real estate asset class. This Real Estate Investment Policy sets forth the objectives, investment guidelines and processes governing the SIC Real Estate Portfolio (the “Portfolio”). This Real Estate Investment Policy also sets forth the purpose of the Real Estate Portfolio allocation and the standard of care governing the management of the Real Estate Portfolio. It additionally describes the roles and responsibilities of the Council, the SIC’s investment staff (the “Staff”), and the SIC’s external real estate consultant (the “Consultant”) relating to the oversight and management of the Real Estate Portfolio.

The New Mexico Legislature first approved investments in real estate starting in fiscal year 2003, and expanded those investment abilities as of July 1, 2005, with the approval of the Uniform Prudent Investor Act. The State Investment Council (the “SIC”) has established a target allocation to real estate of 10%. The target was set within the Funds’ asset allocation framework and the ranges allow for flexibility as investments are funded over time.

For purposes of this Real Estate Policy Statement, “real estate” includes, but is not limited to: (1) private equity real estate investments (including but not limited to undivided interests owned through joint ventures and pooled funds), (2) private debt investments secured by first liens (i.e., mortgages or deeds of trust) on real property (“First Mortgage Debt”) and (3) private and public interests in real estate (including but not limited to First Mortgage Debt and Mezzanine Debt) owning and/or operating entities (e.g., real estate investment trusts-“REITs”, real estate operating companies-“REOCs” or limited partnerships). The real estate investments of the Funds may be either direct (i.e., interests in a real estate property asset, such as an office building) or indirect (i.e., interests in owning and operating entities such as REITs and REOCs, or investment through commingled funds), as further described below. Direct investments may include those identified by (1) investment managers granted separate account allocations or (2) the Staff with advisory assistance from the Consultant or a Staff-approved investment manager. In sum, the Real Estate Portfolio shall consist of private/public and equity/First Mortgage Debt real estate investments made on either a direct or on an indirect basis through separate account or commingled fund vehicles.

I. OBJECTIVES OF THE REAL ESTATE PROGRAM

A. Role of Real Estate

The primary objectives of the SIC’s Real Estate Portfolio, in order of priority, are as follows:

1. Provide diversification benefits and volatility reduction to the overall portfolio;
2. Provide an inflation hedge;

3. Generate stable, reliable income;
4. Produce an attractive risk-adjusted return; and
5. Preserve capital

All real estate investments shall be subject to the prudent investor rule as codified in the New Mexico statutes and shall comply with applicable local, state, and federal statutes.

B. Investment Philosophy

The Real Estate Portfolio's investment philosophy with respect to the Permanent Funds is to:

1. Achieve the objectives identified above; and
2. Avoid imprudent risks.

The Real Estate Portfolio will pursue both Strategic and Tactical investments. Strategic investments will provide the Portfolio's "keel in the water" real estate exposure. The Strategic Portfolio will have a target range of 40% to 70% of SIC's real estate allocation. SIC will construct a complementary Tactical Portfolio with a target range from 30% to 60% of its real estate allocation in order to target higher returns and drive alpha. Publicly traded Real Estate Investment Trusts (REITs) may also be used up to a maximum of 10% of the total Real Estate Allocation.

The Fund may allocate up to 30% of the total real estate allocation in assets outside of the U.S.

C. Return Target

The Fund's objectives are to generate a total return, net of investment management fees, from private real estate:

- In excess of the NCREIF Open End Diversified Core Equity Fund Index ("NFI-ODCE") net of fees ("the benchmark") over rolling five-year periods.

To accomplish this objective, the Fund will invest 30% to 60% of its real estate allocation in Value Add and Opportunistic (collectively "Tactical") investments. These investments incorporate higher degrees of leverage and more property risk than what is contemplated in the Strategic Portfolio. The Fund will allow an over commitment to the Tactical Portfolio to achieve the targeted level due to the fact

that closed-end funds draw capital gradually, may not draw their full commitments and generally begin to return capital long before they are liquidated.

II. RISK MANAGEMENT POLICIES

A. Strategic Portfolio

The lowest risk class of real estate that will attain the objectives of the real estate program are operating and substantially leased (typically 80% or more) institutional quality properties, which are defined as “Core” investments. These investments are institutional quality, well-located assets in the traditional property types: office, apartment, retail, and industrial. They generally offer relatively high current income returns (long-term average of 5%-7%), and as a result, a greater predictability of total returns. The income component typically represents a significant majority of the expected total return of Core investments. These investments are of comparatively lower risk and provide a stable foundation for the SIC’s real estate portfolio.

As discussed above, the Portfolio will target a 40% to 70% range for Core investments. Core investments may include separate accounts and joint venture properties as well as commingled funds, such as those included in the NCREIF Open-End Diversified Core Index.

B. Tactical Portfolio

A secondary objective of the SIC’s real estate program is to capture superior risk-adjusted returns caused by imbalances in the relatively inefficient real estate and capital markets. To access these opportunities, the SIC will make investments that have more risk, and correspondingly higher expected returns, than the Strategic investments. Consistent with the SIC’s desired risk profile, the Portfolio will target a range of 30% to 60% for these Tactical investments.

The Tactical Portfolio has traditionally consisted of a wide range of investments representing differing levels of risk and return derived from the underlying real estate assets. Risks may include higher property-level risk (leasing, renovation, development or repositioning required); a degree of business or operating risk (*e.g.*, hotels, senior housing or investments in real estate operating companies); or non-traditional formats or properties (*e.g.*, distressed assets, private-to-public activities). The Tactical component of the Portfolio can be further divided into Value Added and Opportunistic strategies. The chart below describes the underlying attributes of investments in each of the subcategories.

Real Estate Investment Styles (Net of All Fees)

| Expected Return ↑ | Core 6%-8% Implied Return | Value Added 9%-12% Implied Return | Opportunistic 12%+ Implied Return |
|-------------------|--|---|---|
| | <ul style="list-style-type: none"> - Stabilized, Income-Producing - Equity and Equivalent - Well-Leased - Modest Capital Expenditures - No Obsolesce - Primary Markets - Leverage 40% or Less - Longer Investment Period | <ul style="list-style-type: none"> - Leasing Risk - Partial Obsolesce - Rehab Risk - High Yield Net Lease - Forward Commitments / New Construction - Ownership Restructuring, Recapitalization - All Markets - Leverage 40%-60% - Shorter Hold than Core | <ul style="list-style-type: none"> - Redevelopment Risk - International Investments - High Leasing Risk - Development - Functional/Economic Obsolescence - Entity Investments - Leverage 65%+ - Shorter Hold than Value Added |

The SIC may make investments in either Value Added or Opportunistic strategies while targeting 40% to 60% of the total allocation to the Tactical Portfolio.

C. Control

The SIC recognizes that private market real estate is illiquid relative to stocks and bonds and real estate vehicles are generally only as liquid as the markets in which they invest. The SIC will balance its preference for control against its other risk management policies in the implementation of the real estate program. The Funds may utilize any legally permissible vehicle including separate accounts (including wholly owned and joint venture investments), collective investment vehicles and public securities.

D. Program Implementation

The Funds shall acquire real estate exposure primarily through commingled fund vehicles (open end and closed end) and, to a lesser extent, joint venture limited partnerships and separate accounts. The appropriate structure shall be determined by the Staff and Consultant in developing and managing the performance and liquidity of the Real Estate Portfolio.

Commingled fund investments by nature are discretionary relationships, where the sponsor or manager of the fund has control over the investment decision-making process, and the investor typically has limited rights with respect to the management of the commingled fund. The SIC's specific investment criteria, risk management policies and investment procedures shall be set forth in the following

documents:

1. *Real Estate Investment Policy.* The Investment Policy sets forth certain investment criteria and risk management policies that apply to the entire real estate portfolio. The Investment Policy establishes the broadest parameters for real estate investments for the Fund.
2. *Real Estate Investment Plan.* The Council shall have the opportunity to review and approve the Real Estate Investment Plan (the “Investment Plan”) prepared by the Consultant which sets forth the proposed investment activity for the Fund for the ensuing year. The Investment Plan shall be reviewed and updated at least annually, and more frequently if necessary or appropriate, to reflect the composition of the Portfolio and the prevailing real estate and capital market conditions.

E. Monitoring Risk Management Policies

Consultant and Staff shall monitor compliance with risk management policies quarterly through the performance measurement process.

1. *Property Type Diversification*

The SIC prefers to establish broad ranges for each property type within the Strategic Portfolio. The ranges will ensure prudent diversification among the property types but will enable the Funds to capitalize on opportunities caused by shifts in the real estate and capital markets while also ensuring compliance over the long term. The following represent the ranges for property types in the Strategic Portfolio:

| Property Type | Range |
|-----------------------------|-------------------|
| Office | NFI-ODCE +/- 15% |
| Industrial | NFI-ODCE +/- 15% |
| Multifamily | NFI-ODCE +/- 15 % |
| Retail | NFI-ODCE +/- 15 % |
| Hotels | NFI-ODCE +/- 15 % |
| Other (specialty and other) | NFI-ODCE +/- 15 % |

* For example, a 25% weighting to a particular property type in the NPI would allow a range of 10% to 40% in the Plan.

In addition to these ranges, the SIC recognizes that private real estate is relatively illiquid and properties are not of uniform size and quality; furthermore, the SIC is currently invested in collective investment vehicles

where it has limited control over the property type distribution other than through selection of the strategy itself. As a result, the SIC portfolio may exceed (above or below) these ranges for any property type on a temporary basis. It is expected that the SIC will allocate tactically among the property types in response to real estate and capital market conditions and overall Portfolio considerations.

2. *Location Diversification*

Numerous studies have been conducted which validate the benefit of distributing investments by location. To this end, the open-end commingled fund ("OECF") investments in the Strategic Portfolio will provide superior diversification within the U.S. These Strategic Portfolio investments will define the character of the Portfolio. A maximum of 30% of the total real estate allocation may be invested in assets outside of the U.S.

3. *Size of Investments*

The Fund does not want the failure of a single investment to have a significant or material impact on the performance of the total real estate program. The amount of equity that may be invested in a single investment is limited to no more than 25% of the total real estate allocation determined at the time of initial investment.

F. Fund Sponsor

The Fund does not want to have excessive exposure to any individual fund sponsor and/or its affiliated entities. As a result, the Fund will limit a single Fund Sponsor to managing no more than 35% of the total real estate allocation.

A Fund Sponsor's acquisition, management and disposition of real estate investments will be guided by a standard acceptable to the SIC, Staff and Consultant. This shall be a standard of care required of all Fund Sponsors and set forth in documents governing the relationship between the SIC and each Fund Sponsor.

G. Fund Sponsor Compensation

The SIC will structure the compensation that it pays to Fund Sponsors in such a manner so as to align the interests of the Fund Sponsors with the Funds. Fundamentally, the SIC will seek to pay the Fund Sponsors a base management fee intended to reimburse its costs with additional revenues payable contingent upon successful performance of the investments.

Each compensation structure will be evaluated by Staff and Consultant on a case-by-case basis and will vary in part by the investment strategy to be executed. The SIC will seek to use performance-based compensation for Fund Sponsors that predominantly invest in Value Added or Opportunistic strategies. For Core investments (which typically have simpler strategies), an incentive component might not be included.

H. Return Requirements

Return requirements for the overall real estate portfolio are to produce a level of return to the Funds that is accretive to attaining the targeted rate of return over the long-term, while still satisfying the goals and objectives for including real estate in the Funds' investment portfolio. Currently, the Funds' target rate of return is 7.5%.

I. Leverage

Fund sponsors will utilize leverage as a part of executing their respective property investment mandates. Leverage will be monitored in the Strategic Portfolio to ensure that it does not exceed 50% loan to value. The Tactical Portfolio has no formal constraints; however SIC will target a maximum LTV of 75% on the Tactical portfolio in aggregate (capitalization weighted). The overall risk profile of the real estate portfolio is also determined by the Strategic and Tactical Portfolio ranges, which inherently limit the amount of risk the Program can assume. The use of leverage by Fund Sponsors will be monitored by the SIC Staff and Consultant to mitigate imprudent risks.

III. RISK MANAGEMENT PROCEDURES

The risk management procedures set forth below are divided into roles and responsibilities, reporting and search procedures.

A. Roles and Responsibilities

The real estate program will be planned, implemented and monitored through the coordinated efforts of the Council/Investment Committee, Staff, Fund Sponsors, and Consultant. The description of the major responsibilities of each participant is set forth below.

1. Council/Investment Committee

The role of the Council/Investment Committee is to ensure that the assets of the Funds are effectively managed in accordance with the laws of the State of

New Mexico and the Investment Objectives and Policies of the Council. The responsibilities of the Council/Investment Committee include:

- Establish the objectives and risk management policies for the real estate program. It will perform this role by reviewing and approving, or amending and approving, the Real Estate Investment Policy submitted by the Consultant before or during the First Quarter of the year;
- Review and approve, or amend and approve, the Investment Plan, for the real estate program before or during the First Quarter of the year. During the Fourth Quarter of the year, the Council/Investment Committee will review the Investment Plan for its appropriateness and to identify any desired changes;
- Select, retain and remove the Fund Sponsors and any other parties deemed appropriate. The Council/Investment Committee shall approve any capital allocations to individual Fund Sponsors;
- Review the performance of the real estate program, along with the Fund Sponsors, and its compliance with the objectives and policies established by the Council/Investment Committee. For this review, the Consultant will provide the Council/Investment Committee with Quarterly Performance Measurement Reports;
- Review and approve new investments;
- Review and monitor the investment activity in the Portfolio; and

2. *Staff*

The Staff's role shall be to monitor the activities of the Consultant and to provide input to the Council/Investment Committee on such matters where the Staff retains control and authority. The Staff's monitoring responsibilities shall include the following:

- Review the Real Estate Investment Policy and annual Investment Plan prepared by the Consultant and submit these to the Council/Investment Committee for approval;
- Monitor Fund Sponsors and other professional searches conducted by the Consultant;

- Review any specific capital allocation recommendations contained in the Investment Plan or otherwise prepared by the Consultant and submit the same to the Council/Investment Committee for approval;
- Prepare funding procedures and coordinate the receipt and distribution of capital with the Fund Sponsors with the assistance of Consultant; and
- Monitor the performance of the real estate program, its Fund Sponsors, Consultant, and the compliance of the Program with the investment planning and management documents.

3. *Fund Sponsors*

Fundamentally, the Fund Sponsors will acquire, sell and manage real estate investments consistent with the respective documents governing the relationship between the Fund and Fund Sponsors and any other program documentation developed by Consultant and/or Staff and approved by the Council/Investment Committee. The Fund Sponsors shall provide the Council/Investment Committee, Staff and Consultant with such information as may be required to properly monitor the Fund Sponsors and its investments.

A Fund Sponsor may serve the SIC as a fiduciary, or may serve as fiduciary to the pooled vehicles in which the SIC invests. Fund Sponsors will perform this role in compliance with the investment planning and management documents created by the SIC. Each quarter the Fund Sponsors shall provide performance measurement data in the form and substance as required by the SIC and its Consultant and in compliance with this Real Estate Investment Policy.

4. *Consultant*

The Consultant has the active day-to-day role of the Staff in the real estate program. Thus, the Consultant shall perform the following services:

- Prepare the Real Estate Investment Policy and annual Investment Plan and provide its review and recommendation to the Council/Investment Committee and Staff;
- Perform searches for Fund Sponsors and other professionals, and report on such searches to the Staff and Council/Investment Committee as required under the applicable search policy;

- Evaluate and recommend commingled fund, Joint Venture and Separate Account investments to the Council;
- Prepare Quarterly Performance Measurement Reports for relevant measurement periods for the real estate program, its Fund Sponsors and investments; and
- Review and monitor the investment activity in the Portfolio and the performance of the Fund Sponsors and the Portfolio.

The Consultant will promptly advise the Council/Investment Committee and Staff of any material changes in the real estate and capital markets that would influence its Real Estate Investment Policy or Investment Plans. The Consultant will inform the Council/Investment Committee and Staff of any significant changes with respect to the organizations of its Fund Sponsors that might influence the Fund Sponsors' ability to continue to provide services to the Funds. The Consultant shall provide the Council/Investment Committee with relevant research materials as needed or as directed by the Council/Investment Committee or Staff. The Consultant will serve the New Mexico State Investment Council as a fiduciary to the Funds.

B. Reporting

The Council/Investment Committee and Staff will receive reports from its Fund Sponsors and Consultant that will contain information to enable the Fund to evaluate the performance of its real estate program.

1. *Quarterly Report.* The Fund Sponsors will submit to Consultant and Staff its quarterly report within 60 days of the end of each quarter (except for the fourth quarter of each year). The report will record the performance for the relevant measurement periods, the performance relative to indices and benchmarks, cash flow information, fees, costs and market value. The Consultant shall report any major issues to the Council/Investment Committee.
2. *Quarterly Performance Data.* The Fund Sponsors will also submit its quarterly performance data to the Consultant within 75 days of the end of each quarter. The Consultant relies on the timely submission of this data by the Fund Sponsors in order to deliver its performance report to the Council/Investment Committee and Staff.
3. *Audited Annual Financial Statements.* Each Fund Sponsor will submit a consolidated annual financial statement to the Consultant and Staff within 120 days of the end of the fourth quarter.

4. *Performance Measurement and Portfolio Analytics Report.* Following each quarter, the Consultant shall submit to the Staff the Performance Measurement Report (“PMR”), which contains quantitative performance of the real estate program using data as provided by the Fund Sponsors.

The Consultant will submit its portfolio management report to Staff and Council/Investment Committee within 90 days of the end of the quarter or 10 days after last manager submission. It will evaluate the compliance of the real estate program with the Strategic and Investment Plans; the performance of the real estate program, its Fund Sponsors, and the investments for the relevant measurement periods and relative to indices and benchmarks; a statement of significant initiatives being undertaken; a statement of relevant real estate and capital market information; and a statement of significant events in the real estate program.

5. *Other Reports.* The Consultant and Fund Sponsors shall provide, in a timely manner, such other reports as the SIC may determine useful to the administration of the real estate program. The Fund Sponsors shall provide reports and other disclosures as set forth by the documents governing SIC’s investment with each Fund Sponsor.