

**HB**

**373**

**SFIN**

**FILE**

# SENATE FINANCE COMMITTEE REPORT

DATE: 4/8/94

FURTHER:

DATE TURNED INTO OFFICE: 4-27-94

The Finance Committee considered **HOUSE BILL NO. 373**

"An Act relating to investments of the permanent fund involving equity interests in and debt obligations secured by mortgages on real estate; and providing for an effective date."

and recommends:

replace with 3 CS HB373 (FINANCE)  
 or  adopt previous CS \_\_\_\_\_  
 attaches amendment(s)

same title  
 new title  
 technical title change (HB only)

adopts SFC Letter of Intent

further referral to the \_\_\_\_\_

do pass

do not pass

no recommendation

individual recommendations

**NEW FISCAL NOTES**

| Department | Date | Zero | Fiscal |
|------------|------|------|--------|
|            |      |      |        |
|            |      |      |        |
|            |      |      |        |
|            |      |      |        |
|            |      |      |        |
|            |      |      |        |

**PREVIOUS FISCAL NOTES**

| Department | Date           | Zero     | Fiscal |
|------------|----------------|----------|--------|
| <u>DOR</u> | <u>1/31/94</u> | <u>0</u> |        |
|            |                |          |        |
|            |                |          |        |
|            |                |          |        |
|            |                |          |        |
|            |                |          |        |

Appropriation No Fiscal Note

DO PASS:

Tina Kelly  
Steve Kim  
Bob Sharp

OTHER RECOMMENDATIONS:

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

1. Should do pass  
 Co-Chair: Signature/Recommendation

2. Ince/Grace 10/233  
 Co-Chair: Signature/Recommendation

# FISCAL NOTE

No. 1  
 Bill Version: HB 373  
 (H) Publish Date: 3/7/94

**STATE OF ALASKA**  
**1994 LEGISLATIVE SESSION**

**BILL NO.**

Revision Date: \_\_\_\_\_  
 Title: \*An Act relating to Investments of the permanent fund involving equity interests in and debt obligations secured by mortgages on real estate; and providing for an effective date.\*  
 Sponsor: House Rules Committee by Request of the LB&A Committee  
 Requestor: House State Affairs

Dept. Affected: Department of Revenue  
 BRU: APFC  
 Component: APFC  
 COMPONENT SERIAL NO. 109

**Expenditures/Revenues:**

(Thousands of Dollars)

| OPERATING                   | FY95       | FY96       | FY97       | FY98       | FY99       | FY00       |
|-----------------------------|------------|------------|------------|------------|------------|------------|
| PERSONAL SERVICES           | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| TRAVEL                      | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| CONTRACTUAL                 | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| SUPPLIES                    | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| EQUIPMENT                   | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| LAND & STRUCTURES           | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| GRANTS, CLAIMS              | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| MISCELLANEOUS               | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| <b>TOTAL OPERATING</b>      | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> |
| <b>CAPITAL:</b>             | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> |
| <b>REVENUE FUND SOURCE:</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> |

**FUNDING:**

(Thousands of Dollars)

|                          |            |            |            |            |            |            |
|--------------------------|------------|------------|------------|------------|------------|------------|
| 1002 Federal Receipts    | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| 1003 GF Match            | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| 1004 GF                  | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| 1005 GF/Program Receipts | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| 1006 GF/MHTIA            | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| Other                    | -0-        | -0-        | -0-        | -0-        | -0-        | -0-        |
| <b>TOTAL</b>             | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> | <b>-0-</b> |

**POSITIONS:**

|           |     |     |     |     |     |     |
|-----------|-----|-----|-----|-----|-----|-----|
| FULL TIME | -0- | -0- | -0- | -0- | -0- | -0- |
| PART TIME | -0- | -0- | -0- | -0- | -0- | -0- |
| TEMPORARY | -0- | -0- | -0- | -0- | -0- | -0- |

Estimate of current year (FY94) impact: \$ -0-

**ANALYSIS:** (Attach a separate page if necessary)

Prepared by: William H. Scott, Executive Director *[Signature]* Phone: 465-2047  
 Division: Alaska Permanent Fund Corporation Date: January 31, 1994  
 Approved by: Darrel J. Rexwinkel, Commissioner *[Signature]* Date: 1/31/94  
 Agency: Department of Revenue

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**COMMITTEE COPY**

4/27/94  
Adopted

Offered in the Senate by  
Senator Rieger

4/20/94

Letter of Intent

It is the intent of the Legislature that the Permanent Fund Corporation Board of Trustees act in a fiduciary capacity with respect to the management of the Permanent Fund's assets.

WORK DRAFT

WORK DRAFT

WORK DRAFT

8-LS1525NK  
Cook  
4/20/94

*ordered by  
MMW 4-27  
9:30am*      *4-27-94  
SR  
moved  
Adopted  
R/O*

SENATE CS FOR HOUSE BILL NO. 373( )  
IN THE LEGISLATURE OF THE STATE OF ALASKA  
EIGHTEENTH LEGISLATURE - SECOND SESSION

BY

Offered:  
Referred:

Sponsor(s): HOUSE RULES COMMITTEE BY REQUEST OF THE LEGISLATIVE BUDGET AND  
AUDIT COMMITTEE

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to investments of the permanent fund involving equity interests  
2 in and debt obligations secured by mortgages on real estate; and providing for  
3 an effective date."

4 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

5 \* Section 1. AS 37.13.120(g)(16) is amended to read:

6 (16) equity interests in, and debt obligations secured by mortgages  
7 granting a first lien on, real estate improved by completed and substantially rented  
8 buildings and located in the United States [,] if the total value held by the fund in  
9 each investment does not exceed \$150,000,000, and, if the total value held by the  
10 fund in each investment exceeds \$150,000,000, these investments are made

11 (A) in a corporation, partnership, trust, or other entity in which,  
12 at the conclusion of each investment transaction, at least 33 [60] percent of the  
13 beneficial ownership interests are held by other institutional investors, and  
14 which is organized and operated for the purpose of making real estate

1 investments by a bank, insurance company, or other manager of institutional  
2 funds that has had at least five years of experience in the management of real  
3 estate investments of institutional investors; or

4 (B) with corporations, partnerships, trusts, or entities in which,  
5 at the conclusion of each investment transaction, at least 33 [60] percent of the  
6 beneficial ownership interests in the co-investing entity or entities as a whole  
7 are held by institutional investors, and if

8 (i) at the time of investment the fund has no more than  
9 a 67 [40] percent beneficial ownership interest in the real estate  
10 invested in as a whole;

11 (ii) the rights and obligations of the fund are  
12 substantially similar to those of the other institutional investors, except  
13 for the percentage interest in the property; and

14 (iii) the property is managed and operated by an entity  
15 that has had at least five years of experience in the management of real  
16 estate investments of institutional investors;

17 \* Sec. 2. This Act takes effect immediately under AS 01.10.070(c).

Back-up




**Alaska Permanent Fund Corporation**

P.O. Box 25500 Juneau, Alaska 99802-5500  
(907) 465-2047

**MEMORANDUM**

DATE: April 11, 1994

TO: Senator Drue Pearce  
Co-Chair, Senate Finance Committee

FROM: William H. Scott   
Executive Director

SUBJECT: **House Bill No. 373**

This is to request that you schedule House Bill 373 for a hearing in Senate Finance at your earliest convenience.

HB 373 is a bill to amend the Permanent Fund's list of authorized investments to provide for up to 100 percent ownership in real estate investments. Originally introduced by the Legislative Budget & Audit Committee at the unanimous request of the Board of Trustees, HB 373 passed the House nearly unanimously with only one vote in opposition. It passed from Senate Judiciary with no votes in opposition.

For the information of the members of the Senate Finance Committee, I have attached a number of supporting documents which thoroughly describe the rationale for this legislation. In addition, I would offer the following comments.

As of February 28, 1994, the Permanent Fund had a market value of \$15.7 billion – \$1.0 billion of which is invested in real estate. That means real estate investments equal less than 7 percent of the total value of the Fund. The Legislature in 1983, when it originally approved real estate investments for the Fund, authorized the Board of Trustees to invest up to 15 percent of the Fund in real estate; the Trustees, by Board resolution, have further limited real estate investments to 10 percent, plus or minus 2 percent.

Senator Drue Pearce  
April 11, 1994  
Page 2

The primary reasons your Fund managers are seeking changes to the existing real estate statute are: (1) to gain increased management control over the Fund's real estate investments; and (2) to help the Board of Trustees reach their real estate asset allocation target. We have been trying to reach that 10 percent target for about ten years and have never come much closer than we are today. It is our view that the Fund will be unable to reach its desired real estate asset allocation until there is relief provided from the 40 percent ownership rule.

**Attachment #1** is the Board of Trustees resolution dated December 6, 1993 in support of this proposed change. The Trustees adopted this resolution unanimously.

**Attachment #2** is a memorandum dated November 18, 1993 addressed to the Board of Trustees from our Real Estate Investment Officer, Pete Jeans. It describes the specific proposed change in the Permanent Fund statutes and explains the need for the change from an historical perspective.

**Attachment #3** is a letter dated November 9, 1993 addressed to Mr. Jeans from the Corporation's outside real estate consultant, Paul Saylor. This letter provides the consultant's fiduciary opinion in support of the proposed change.

**Attachment # 4** is a letter dated November 16 addressed to Mr. Jeans from the Corporation's outside law firm, Morrison & Foerster, which also provides a fiduciary opinion in support of the proposed change.

**Attachment # 5** is a copy of an article which appeared in the July 1993 issue of *The Institutional Real Estate Letter*. The article, I think, makes a compelling case from an uninterested but expert third-party perspective that the concept of co-investing as currently practiced by the Alaska Permanent Fund Corporation is not necessarily in the Fund's best long-term interest.

**Attachment #6** is a listing of the real estate holdings of the Permanent Fund, broken down by size of investment and percentage of ownership.

**Attachment #7** is another memorandum from Mr. Jeans to myself addressing the issue of lost investment opportunities.

Senator Drue Pearce

April 11, 1994

Page 3

The Fund invests in real estate to maximize the risk and return benefits of diversification. There is nothing in the bill which would hinder that, and much that would enhance it. On the other hand, the current restriction creates significant opportunity costs and places the Permanent Fund and the Fund's beneficiaries at a competitive disadvantage. PERS and TRS, the state's pension plans for example, do not operate with such a restriction.

On behalf of the Board of Trustees, I request that you give their concerns serious consideration.



==H 1

**Alaska Permanent Fund Corporation**  
P.O. Box 25500 Juneau, Alaska 99802-5500  
(907) 465-2047

**RESOLUTION OF THE BOARD OF TRUSTEES  
OF THE ALASKA PERMANENT FUND CORPORATION  
PERTAINING TO LEGISLATIVE CHANGES IN THE ALASKA STATUTES  
RELATING TO REAL ESTATE INVESTMENTS BY THE  
ALASKA PERMANENT FUND CORPORATION**

**RESOLUTION 93-11**

WHEREAS, the Fund is limited in directing business decisions on real estate investments as a 40% participant; and

WHEREAS, the Alaska Permanent Fund Corporation is impaired in its ability to reach its targeted real estate asset allocation within current parameters; and

WHEREAS, the Alaska Permanent Fund Corporation has lost opportunities to acquire high return, low risk real estate investments;

NOW, THEREFORE, BE IT RESOLVED, THAT the Board of Trustees unanimously directs staff to seek legislative changes to provide for up to 100% ownership in real estate investments.

PASSED AND APPROVED by the Board of Trustees of the Alaska Permanent Fund Corporation, this 6th day of December, 1993.

Handwritten signature of Joseph C. Keenan in cursive.

Chairman, Board of Trustees  
Alaska Permanent Fund Corporation

ATTEST:

Handwritten signature of the Corporate Secretary in cursive.

Corporate Secretary



# 1

**Alaska Permanent Fund Corporation**  
P.O. Box 25500 Juneau, Alaska 99802-5500  
(907) 465-2047

**RESOLUTION OF THE BOARD OF TRUSTEES  
OF THE ALASKA PERMANENT FUND CORPORATION  
PERTAINING TO LEGISLATIVE CHANGES IN THE ALASKA STATUTES  
RELATING TO REAL ESTATE INVESTMENTS BY THE  
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**Chairman, Board of Trustees  
Alaska Permanent Fund Corporation**

ATTEST:

  
**Corporate Secretary**

Alaska Permanent Fund Corporation  
P.O. Box 25500 Juneau, Alaska 99802-5500  
(907) 465-2047

MEMORANDUM

DATE: November 18, 1993  
TO: Board of Trustees  
Alaska Permanent Fund Corporation  
FROM: Pete Jeans *[Signature]*  
Real Estate Investment Officer  
THROUGH: William H. Scott  
Executive Director

SUBJECT: Recommended Legislative Changes, Real Estate

I am recommending a change to Title 37, Chapter 13, Section 37.13.120, the Alaska statute that authorizes the Fund's investments in real estate. The reference to real estate investment responsibilities of the Board of Trustees will be changed to read:

- (g)(16) equity interest in, and debt obligations secured by mortgages granting a first lien on, real estate located in the United States.
- (16)(A) deleted
- (16)(B) deleted
- (16)(B)(i) deleted
- (16)(B)(ii) deleted
- (16)(B)(iii) deleted

This change removes the 40% restriction on real estate acquisitions. The real estate "investment list" is stricken from the Statute and transfers to the Board of Trustees, the responsibility for establishing prudent investment standards and guidelines through the annual real estate resolution.

In order to justify this recommendation it is necessary to give a brief description of the Fund's real estate experience over the past ten years, along with my views on the changes that are taking place in the industry.

In 1983, the year the Alaska Permanent Fund Corporation made its first investment in real property, the Board of Trustees had allocated 6% of the \$3 billion Fund to real estate. The Board of Trustees hired a real estate consultant to assist

in selecting three real estate advisors. From 1983 through 1987, the Fund took a passive role in real estate investing and relied almost exclusively on the recommendations of the consultant and advisors. Additionally, the 40% co-investment requirement created a high comfort level for the Trustees. By co-investing with larger, more sophisticated pension funds and endowments, the Permanent Fund took advantage of their expertise and leadership in real estate investing. During this period, control and involvement in property decisions were not priorities for the APFC.

In the later part of the 80's, there was a turnover in Permanent Fund real estate staff. Soon after, the Fund employed new real estate consultants and attorneys, all of which resulted in a more directive approach to real estate investing. The Fund has become more involved in the real estate investment process, from requiring certain controls and buy-sell arrangements on each real estate transaction to initiating disposition activities. Even as a 40% player, the Fund has been able to negotiate either equal or favorable terms and receive coequal treatment from larger investors.

Historically, market conditions played an important role in negotiations for favorable terms. During the recent market decline in the industry, many pension funds sat on the side lines, offering little competition for deals. Now that the market has shown signs of recovery, pension funds are re-entering the markets. Like the APFC, our institutional partners are gaining knowledge and confidence in their abilities to control investments and they no longer allow us to participate as an equal partner in a 40/60 deal. The only way to secure the same level of control that the Fund historically obtained with past investments is to acquire an equal or majority interest.

~~Control is by far the "greatest" benefit of holding a "majority" position in an investment.~~ Timing of major capital events, such as a property sale or the funding of a mall redevelopment designed to head off new competition, is often crucial to enhancing returns on a property. The inertia of some institutional partners has caused numerous missed opportunities for the Permanent Fund in the past.

~~Other advantages also exist. The real estate asset allocation set by the Board of Trustees will be more easily attainable.~~ Unless a single deal is exceptionally large, the acquisition of a single property will not materially affect the diversification strategy. Through resolution, the Board of Trustees will continue to maintain control over the diversification goals.

~~Legal costs will be reduced substantially by eliminating or decreasing the negotiations over control issues in partnership agreements.~~ Complications in replacing investment advisors are directly correlated with the number of partners in a deal. The replacement process is simplified in a 50/50 to 100% investment.

Board of Trustees  
November 18, 1993  
Page 3

~~By having the option to take 100%~~ of an investment; we anticipate an increase in ~~deal flow~~. With only one or two investors involved, advisors will be more likely to propose acquisitions to us, particularly those with short closing time frames.

This proposed change to the Statute will give the Board of Trustees the flexibility to direct the real estate staff by board resolution. Attached is a letter from our legal counsel and real estate consultant recommending these changes.

RECEIVED #3

DEC 6 1993

ALASKA PERMANENT  
FUND CORPORATION

*SAYLOR PROPERTY CAPITAL, INC.*

EIGHT PIEDMONT CENTER  
SUITE 320  
ATLANTA, GEORGIA 30305

TEL: (404) 261-8049  
FAX: (404) 261-0271

NEW YORK OFFICE  
437 MADISON AVENUE, 40TH FLOOR  
NEW YORK, NEW YORK 10022-7380  
TEL: (212) 754-6260  
FAX: (212) 754-6264

PAUL H. SAYLOR

November 9, 1993

Mr. Pete Jeans  
Investment Officer  
The Alaska Permanent Fund Corporation  
801 West Tenth Street  
Suite 302  
Juneau, AK 99801

RE: **Proposed Legislation**

Dear Pete:

You have asked that I give a few thoughts why I am in favor of a legislative change to allow you to take up to a 100% interest in an investment.

1) *Control*

Although co-investment documentation is evolving to the point where a minority investor will not necessarily be disadvantaged as to influence or control, there is no such thing as a 40% gorilla. In other words, it would be preferable for the APFC to invest on a basis that would allow it to control major investment, management and divestment decisions in its own best economic interests, rather than be influenced by one or more investors which may, at least over time, have differing objectives.

While I believe the APFC has been advantaged by retaining discretion over major investment, management and divestment issues, it is currently required to be totally aligned with one or more partners in order for activities which best serve it to occur. Examples include the inability to close recent transactions because of (what I consider) minor differences with a 60% partner, and your lack of influence in matters associated with Boston Real Estate Counsel assets in a situation where at least one of your partners was lethargic and bureaucratically hamstrung from acting in all partners' best interests.

2) *Maximum New Opportunities*

As property markets turn back in favor of sellers, the APFC will receive

increasingly fewer high quality investment opportunities, as investment managers will be less in need of the APFC's capital and wish to conclude transactions with either one investor or a commingled format over which they have discretion. Currently, it is relatively complicated for a transaction originator to identify an asset for the APFC with the condition the APFC will only pursue due diligence or the consummation of a transaction once a compatible investment partner has been identified. Recently, transactions have gone elsewhere to avoid this process.

Additionally, there are increasing concerns regarding potential incompatibility of APFC requirements with those of certain other active investors. Although the multi-asset co-investment opportunity which we have collectively pursued for the last several months will go a long way to establish levels of overall compatibility among several investors and standardized processes, sellers or transaction originators generally attempt to avoid the unknowns associated with due diligence and documentation requirements of multiple investors.

3) *Management Changes*

Since the APFC appropriately exercises rights of management oversight, it is more likely to recognize management program weaknesses and to move to correct them than most other institutional investors. Existing assets and portfolios need to be intensively managed in order to improve their performance and occasionally to position assets for sale. Managers who are ineffective should be replaced, and manager replacement is most difficult to accomplish for the APFC as a minority investor especially since most partners of the APFC are required to live with an "approved list" of investment managers.

I do not at all advocate that the APFC should only pursue acquisition of full interests in individual assets and portfolios, but I believe a change of legislation to allow you to do so is most important. It is my view that the immediate effect of such change will not be termination of your co-investment programs, but rather a gearing up of the process contemplated by your co-investor conference this past April. Your ability to be a major partner, rather than (always) a minor partner is most important to the achievement of your objectives set forth for the asset class of real estate and to your competitiveness in the marketplace.

Yours very truly,



Paul H. Saylor

CC: Llewellyn Lutchansky

#4

MORRISON & FOERSTER

LOS ANGELES  
SACRAMENTO  
ORANGE COUNTY  
PALO ALTO  
WALNUT CREEK  
SEATTLE

ATTORNEYS AT LAW

345 CALIFORNIA STREET  
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NEW YORK  
WASHINGTON, D.C.  
DENVER  
LONDON  
BRUSSELS  
HONG KONG  
TOKYO

November 16, 1993

DIRECT DIAL NUMBER  
(415) 677-7048

VIA FACSIMILE

Mr. Pete Jeans  
Real Estate Investment Officer  
Alaska Permanent Fund Corporation  
P.O. Box 25500  
Juneau, Alaska 99802-5500

Dear Pete:

You have asked us to review the proposed legislative amendments to Section 37.13.120(g) of the Alaska Statutes in the context of our experience as investment counsel for the Alaska Permanent Fund Corporation (the "APFC"). We understand that the legislative amendment to be reviewed by the Board would modify subsection (g)(16) of Section 37.13.120 to provide:

(g) Subject to the limitations contained in this section, the board may invest fund assets at the competitive national market rates or prices that are applicable to each investment only in

...  
(16) Equity interests in, and debt obligations secured by mortgages granted a first lien on, real estate located in the United States.

We believe that this proposed amendment would be beneficial in carrying out the investment policies of the APFC for several reasons. First, it would allow the APFC to effect real estate investments that fulfill its investment objectives without imposing legal constraints that may not be relevant to ensuring that the investments are prudent. Second, the existing provisions of Section 37.13.120 that would remain unchanged by this legislative proposal ensure that sufficient fiduciary safeguards are present in connection with the acquisition of real estate by the APFC. Third, and perhaps most significantly, the proposed

## MORRISON &amp; FOERSTER

Pete Jeans  
November 16, 1993  
Page Two

amendment would allow the APFC to invest in real estate on terms that are comparable to the terms available to ERISA-regulated corporate and Taft-Hartley (union) retirement plans and a majority of governmental retirement systems. By adopting the standards utilized by most tax-exempt institutional investors, the APFC will be poised to compete more effectively with such investors for real estate opportunities and to exert the degree of control that many of such investors have viewed as conducive to maximizing return and minimizing risk in their real estate portfolio investments.

The current provisions of Section 37.13.120(g)(16) include specific limitations that mandate, among other requirements, that the APFC not hold greater than a 40 percent beneficial ownership interest in a real estate investment at the time of acquisition, that the real estate investment is improved by completed buildings and that such buildings are substantially leased. These types of restrictions are typically referred to as "legal list" statutes and were commonly used in state statutes applicable to public and private retirement plan investments prior to 1974.

The enactment of the federal ERISA statute in 1974 eliminated the applicability of these legal list statutes to private corporate and union retirement plans. ERISA imposed general fiduciary standards applicable to all types of investments. The foundation of these fiduciary standards is the prudence and diversification rules of Section 404 of ERISA. These rules are incorporated into Sections 37.13.120(a) and (c) of the Alaska Statutes and are fully applicable to the APFC's real estate investments.

The drafters of ERISA abandoned the legal list statutes in favor of general rules of prudence and diversification for two reasons. First, to the extent that a restriction found in a legal list is a restriction appropriate to effecting a prudent and diversified investment, the legal list restriction is merely duplicative with the general fiduciary standards. Moreover, to the extent that the restriction was unnecessary to ensuring that appropriate fiduciary caution was exercised in effecting an investment, the legal list restriction was viewed as impeding the plan's ability to pursue prudent acquisition opportunities.

## MORRISON &amp; FOERSTER

Pete Jeans  
November 16, 1993  
Page Three

Since the enactment of ERISA, a majority of public retirement systems have adopted legislative changes that substitute general fiduciary standards for legal list statutory restrictions. The rationale underlying these changes has been similar to the legislative intent of Congress in enacting ERISA, that the legal list restrictions are either duplicative with the general standards of prudence and diversification, are obsolete interpretations of such standards or are general examples of such standards that may not be appropriate in specialized investment contexts.

It would be beneficial to the APFC to pursue investment opportunities in real estate under standards similar to the fiduciary standards applicable to the majority of institutional investors competing for these investment opportunities. Because the APFC will be fully obligated to pursue real estate investments that satisfy the prudence, diversification and other standards applicable under Section 37.13.120, to the extent that the legal list restrictions of current subsection (g)(16) are appropriate to ensure prudence or diversification, these restrictions will still apply to real estate investments of the APFC. Thus, for example, if a purchase of more than forty percent of the beneficial ownership of a particular real estate investment would not be consistent with the standard of maintaining a reasonable diversification among investments, the "forty percent rule" would continue to apply. If, however, it was not only prudent and consistent with diversification standards to invest in a larger percentage of a particular real estate investment, but would allow greater controls with respect to operating budgets, leasing decisions and other control features determined relevant to enhance the APFC's investment return, the forty percent rule would operate to limit potential investment returns in the APFC real estate portfolio.

In summary, the legal list restrictions of subsection (g)(16) are generally redundant with the prudence and diversification standards of sections (a) and (c) of Section 37.13.120. In those instances where these restrictions do not duplicate the general standards, but provide more onerous restrictions, it is difficult to justify rules that do not further the standards of prudent real estate acquisitions or may impede such acquisitions.

It is widely recognized that the current real estate acquisitions market demands a greater scrutiny of

MORRISON & FOERSTER

Pete Jeans  
November 16, 1993  
Page Four

current income opportunities than was the case in years where capital appreciation in real estate could be more easily projected. It is significant to note that the APFC's ability to control decisions that are economically relevant to both income and potential capital appreciation is limited by its current inability to acquire a majority interest in its real estate investments. By allowing the board and, to the extent delegated by the board, the APFC staff, the ability to balance the economic benefits of control against the costs of such a percentage acquisition, the APFC will be able to maximize its investment objectives in a context relevant to each particular investment opportunity it reviews for potential acquisition.

Please contact me if we can be of further assistance in this matter.

Very truly yours,

*Rachel Markun pmd*

Rachel Markun

RM:pmd

# THE INSTITUTIONAL REAL ESTATE LETTER

The Information Source For Industry Insiders

Volume 5, Number 7

ISSN 1044-1662

July 1993

## PROSPECTUS

**Securitization** — REITs have outperformed everything lately. Can it last? (It didn't the last time REITs were hot.)

Page 1

**Co-Investment** — Does it really improve investment manager performance and investor control?

Page 1

**Editorial** — An investment manager's non-responsiveness may be an indicator.

Page 2

**People** — Steven Wheeler joins Copley; changes at Utah State Retirement, Rhode Island and District of Columbia.

Page 7

**Legal** — Acquisition and performance fees: new Department of Labor ruling.

Page 8

**Debut** — Freedom Home Equity Partners are bringing back reverse annuity mortgages for institutional investors.

Page 11

**Investment News** — Updates on pension plans and others in the real estate investment community.

Page 18

**Portfolio Management** — Tailoring the risk/reward profile for an asset.

Page 20

**Securitization** — Martin Cohen explains common myths of REITs.

Page 24

**Mortgages** — Commercial rates are cheap and supplies are adequate.

Page 29

**Advisor Fees** — Frank Russell Company reports on its 'Fairness' study.

Page 29

**Trends** — Dr. Gruen on the price of tulip bulbs, the merger mania of the Eighties and other speculative bubbles.

Page 32

## SECURITIZATION

by Steve Bergsman

# REITs On a Tear

## Déjà Vu—Have We Been Here Before?

*Real estate investment trusts have been on a tear. For the first quarter of 1993, REITs posted returns of 19.1 percent, easily outdistancing the S&P 500 which only managed a 4.3 percent return. This was an even faster start than in 1992 when REITs*

*blistered the market for a 20.7 percent return, again showing up the S&P 500 which only notched a decent 7.7 percent return.*

It's not just the market performance of REITs that has caught the eye of the investor—last year, the REIT market raised \$6.6 billion, nearly \$2 billion greater than the previous record year of \$4.8 billion. More than half of that \$6.6 billion was raised by existing REITs which were extremely active in the real estate market, acquiring \$2 billion worth of properties. REITs suddenly became the Japanese of the Nineties. The paradox is, after mugging the U.S. real estate market with a seemingly inexhaustible supply of capital, the Japanese have disappeared. Will the same thing happen

*Continued, Page 5*

## CO-INVESTMENT

by Steve Bergsman

# The Dark Side

## Co-Investment May Be Trendy, But It's Not All Wine and Roses

*The concept of co-investing has been around for decades, but recently, it seems to have become the "in" thing to do.*

*Increasingly, over the past three years, investors and investment managers alike have been dressing their portfolios up with co-investments—the institutional investment community's analog of the "grunge" look.*

The "grunge look"—ripped jeans and flannel shirts—may be popular in some circles today, but it certainly isn't for everyone. Neither is co-investment. Even if co-investment is particularly well-suited to the needs of your fund, there are numerous issues which must be considered to make sure your beneficiaries don't end up in rags and tags.

Like the grunge look, the trendsetter for co-investment came out of the Pacific Northwest. Since the mid-1980s, the **Alaska Permanent Fund**—a \$15 billion endowment organized for the benefit for

*Continued, Page 15*

## COVER STORY

## Co-Investment

*Trendy, But It's Not All Wine and Roses**Continued from page 1*

all the citizens of Alaska and funded by taxes on mineral extraction revenues—has been the leader in the U.S. co-investment movement.

The reason? As always, necessity is the mother of invention. By statute, the maximum interest the Permanent Fund can hold in any single property is 40%. This means that, in order to make separate account investments work—and the Alaska Permanent Fund's Real Estate Investment Officer, **Pete Jeans**, very much wants his fund to be a separate account investor—the Fund has no choice but to co-invest (join with other tax-exempt funds to make a purchase).

As a result, for the last eight years, Jeans has made co-investment after co-investment, bringing into his real estate plays more than 100 pension fund investment partners. The approach has worked well for the Alaska Permanent Fund, and now Jeans has come south to spread his gospel throughout the "Lower 48." (More than 40 pension, foundation and endowment funds recently attended a private conference on co-investment in Dallas, sponsored by the Alaska Permanent Fund and its advisors.)

Obviously, Jeans is having some success spreading the word. He credits this success to the discontent so many pension plans have been feeling over the real estate investment programs in which they invested during the early to mid-1980s. During those formative years, Jeans explains, the institutional investor community enthusiastically embraced the concept of blind pool commingled fund investing. With this approach, a group of tax-exempt investors would invest their capital in a specified group trust, insurance company separate account or limited partnership organized and managed by an investment manager in order to enable those investors to acquire a diversified portfolio of real estate assets. The problem with these funds, says Jeans, is that investment decisions and management responsi-

bilities were left in the hands of a third party who had ultimate discretion over the funds—and who almost always had significant conflicts of interest. To make matters worse, when the real estate market collapsed, funds trying to escape the calamity discovered they were blocked by poorly conceived exit strategies.

Today, pension plans, still tangled in the webs of commingled funds but anxious to get in on the buying opportunity of a lifetime, are looking for new paradigms—alternative forms of real estate investment that can offer greater control and liquidity. Of course, the ultimate control results when a pension fund acquires properties directly with no partners. Some funds are unable or disinclined to go that route, however, which, according to Jeans, is what makes co-investment so appealing today.

If one considers investment structures on a continuum, notes **Allen Andersen**, a Principal with the Dallas office of **Arthur Andersen Real Estate Service Group**, they will fall somewhere between sole ownership and commingled funds. Where on the continuum co-investment lies—especially in regards to the control issue—is still subject to debate. Andersen, for one, says he would place co-investment closer to commingled funds on the spectrum, rather than placing it squarely in the middle.

Of the many forms of co-investment, the least popular have been those which require advisors, operating partners or developers to put their own capital at risk alongside the investors. While some investors now require such arrangements, others shy away because of the obvious inherent conflicts of interest. (As **Bob Burke**, a Principal of **AMB Institutional Realty Advisors** likes to point

out, the investment management industry appears to have come full circle. The real estate investment management industry really took off, explains Burke, when the Employee Retirement Income Security Act of 1974 (remember ERISA?) mandated that pension funds interject a fiduciary between pension plan assets and deal promoters. Today, notes Burke, pension funds requiring their advisors to co-invest effectively are requiring them to become promoters—creating, once again, precisely the kinds of conflicts the provisions of ERISA sought to eliminate.)

An examination of many of these structures also will reveal that the advisor/developer/operator often stands to receive back in fees during the first few years of the investment, an amount equal to or exceeding the capital it generally committed to the partnership. In such cases, the pension fund's co-investment "partner" may have little or no capital at risk after the first few years.

To make matters worse, warns **Allen Andersen**, when the other partner is not a tax-exempt fund there usually is a disproportionate level of investment. The tax-exempt investor typically funds something akin to 90-95% of the investment and the advisor, 5-10%. Those kinds of splits don't

***Of the many forms of co-investment, the least popular have been those which require advisors, operating partners or developers to put their own capital at risk alongside the investors.***

really do what the pension fund wants them to do.

When pension funds do require their investment managers to put their own capital at risk in the deal, adds **Jim Curtis**, a Principal with San Francisco-based workout specialist **The Bristol Group**, they typically are seeking to align the interests of their partners with their own. The hope, explains Curtis, is that, by having their capital at risk alongside the pension fund's capital, the operating partner will be more attentive to the management of the pension fund's investments. "That's the hope,"

*Continued, Next Page*

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notes Curtis. "We've learned, however, that people can make equally as bad investment decisions with their own money as with somebody else's." Clearly, therefore, having capital at risk is no guarantee that things will go well.

Curtis also cautions that frequently the partner doesn't even have its own capital at risk. "They raise it from other sources or they borrow it. The problem is, when the capital contributed is non-recourse, the investment manager or promoter really isn't at risk at all. In such cases," warns Curtis, "all that these co-investment requirements really create is the illusion of comfort."

In addition, an incompatibility of incentives often exists in these types

involves more than one investor (the typical co-investment involved between three to five investors). Therein lies co-investment's strength—and its weakness.

For a smaller pension plan, co-investment offers the opportunity to participate in transactions larger than those the plan otherwise would be able to execute on its own. "Small funds may not be able to invest in large projects simply because their allocation is insufficient," explains **Terry Ahern**, a Principal with the Cleveland-based **Townsend Group**. It also enables a larger investor to achieve more diversification than otherwise would be possible by investing directly. According to its Chief Real Estate Investment Officer, **Gravson Sanders**, for example, the **Ameritech Pension Trust** has assembled a roughly \$1.2 billion real estate portfolio over the past ten years. Sanders notes, however, that because it has acquired much of that

portfolio by co-investing with other tax-exempt funds, Ameritech's \$1.2 billion position is covered by a portfolio of more than \$14 billion in real estate assets.

Investors who have done co-investments often say they like being involved with other participants with similar goals because there is a comfort with being associated with other entities that have the same investment strategy. Or, as **Andy Smith**, President of **L&B Real Estate Counsel Inc.** says, "There is a warm and cozy feeling about doing a large investment with others." Why? For one thing, there is a lot more due diligence, explains Smith. Each partner gets to scrutinize the deal; there are more checks and balances so it's less likely there will be any surprises.

Despite the lack of surprises, there also is going to be a lot more work—and fiduciary liability—for the co-investors. By co-investing rather than commingling, for example, tax-exempt investors not only have to review the potential investments, but also must participate in the decision to acquire. In addition, they must be

involved in decisions concerning the ongoing management of the property, and when and how eventually to divest. The problem is, without a third party fiduciary to share the risks, a pension fund subject to ERISA provisions must shoulder the fiduciary liability associated with making these decisions alone.

Despite the extra work and liabilities, however, this is precisely the kind of control that was lacking in the commingled funds, and precisely the kind of control that many tax-exempt investors now want. When investors were passively investing in commingled funds, advisors and managers made those decisions. When advisors became promoters, and began structuring funds as partnerships to avoid being subjected to fiduciary liability under ERISA, they still made the decisions, but investors no longer enjoyed any insulation from fiduciary liability. When investors realized they weren't going to receive any fiduciary insulation, they started questioning why they should give up control. This issue, and this issue alone, is the primary driving force behind the co-investment trend. "Investors were very concerned about the lack of control in commingled funds," explains Alaska's **Pete Jeans**. "They wanted to be part of the process. Co-investment gives the investor more control."

Or does it?

#### LESSONS LEARNED

The old axiom of real estate used to be "location, location, location." But, counters **Tim Getz**, Investment Officer with the **Ohio Public Employees Retirement System**, the axiom really should be "control, control, control. You're not going to get that control," warns Getz. "by sharing your decision-making power." Getz speaks from experience—his fund was a pioneer in both the early commingled fund and co-investment movements. "One of the lessons that we learned from commingled funds was that the investor didn't make portfolio decisions. The decisions were always being made by someone else. When things got difficult, it was impossible to achieve consensus." Getz warns that the problem is no different with co-investments, which he says are

#### **... co-investments ... are nothing more than a commingled fund warmed over.**

of investments, according to **Ron Karp** of the Summit, NJ-based consulting firm **Ronald A. Karp & Associates**. Karp notes that there is a mismatch in the long-term stability and financial staying power of the pension plan versus the investment advisor or operating partner. "If the investment gets into trouble, who is going to fund the losses? Obviously, it's going to be the pension plan. And that is going to create a problem when it comes to decision-making."

The most popular form of co-investment, however, is between similar investors with similar objectives and resources, such as two or more pension plans. Even here, however, there are variations and concerns. One type of co-investment, for example, relies on an advisor who brings together investors with a common investment strategy. The advisor then executes transactions accordingly. A second type of co-investment occurs when investors unite under their own initiative—when the co-investment is investor-driven, rather than manager-driven.

The principal feature of every co-investment, however, is that it in-

"nothing more than a commingled fund warmed over."

As noted before, one of the strengths of co-investment is the added layer of scrutiny. This also is a weakness, however, because it often can be difficult if not impossible to get multiple parties to come to a decision. And, since co-investors don't always have equal shares, by definition, someone is bound to end up with a minority interest. Obviously, that can be a real problem if the majority investors have a different point of view than the minority investors.

"Co-investment complicates every single aspect of a transaction," says **Susan Hudson-Wilson**, Director of Portfolio Strategy for Boston-based **Aldrich, Eastman and Waltch**. "All of a sudden there are two or more parties—very interested parties—that need and ought to be satisfied on every single aspect of the investment." As Hudson-Wilson points out, however, a hot button for one co-investor may not be so hot for another. This can make it extremely difficult to structure a transaction.

Once a co-investment has been completed, however, there essentially are five decisions upon which co-investors have to agree: leasing; capital improvement; budget; sale; and an exit strategy. In a co-investment, the way for the investors to feel their way through those processes, says L&B's Smith (who has been putting together co-investment deals since the 1970s) is to make sure that one participant never has more than 50 percent of the vote. To make a co-investment program work, explains Smith, a reasonable level of democracy must be established.

**Michael Evans**, National Director with **Ernst & Young's** Real Estate Advisory Services in San Francisco, counters that co-investment adds another, unneeded level to problem solving over the life of the asset. "When there are decisions to be made by different investors who have changing objectives and strategies, there is always going to be the potential for conflicts of interest."

Hudson-Wilson concedes that co-investment may be a great way for a small pension plan to participate in larger investments, but reiterates that, "there is true lack of control when you need it most." At the point when you

most need and want to do something big—like invest more or reduce the size of your investment—you discover that your options aren't much different than if you had invested in a commingled fund.

### A FORMULA FOR SUCCESS

Co-investors typically try to avoid the problem of potential conflicts of interest by finding other investors with similar investment objectives. "The big key to success in co-investment is picking your partners," admits Jeans. "It does little good to find a partner who wants to hold properties for the long term, if you want to sell after three years."

**Cal Grayson**, Managing Director of **CB Commercial Realty Advisors**, feels that establishing a pre-existing association for co-investment can greatly enhance the success of the co-investment. "These associations of like-minded investors agree in advance to a defined real estate investment strategy, acquisition process, standardized contracts covering the decision-making powers of investors and transferability of interests, and pre-negotiated investment management fees that are performance-based and aligned with the investors' interests. The associations and the predefined process allow the investment manager to move quickly and to better negotiate with the seller. CB completed its first co-investment in 1981 and has created an active co-investment association of like-minded investors. **Scott Tracy**, Grayson's partner at CB Commercial, adds that, "The association prompts the co-investors to address most of the issues beforehand, and minimizes the difficulties in gaining consensus. Investors agree that, once the initial acquisition decision has been made, the advisor is given a defined level of discretion on operating decisions, thereby reducing disputes.

When constructing the co-investment, it is critical that the rights of the co-investors be stated clearly and definitively. "You must have a mechanism for resolving disputes among the participants," warns **Jim Snyder**, President of **Kennedy Associates Real Estate Counsel**, a Seattle-based advisor that has been putting together co-investments for the past 15 years.

Snyder explains that the problem-solving process among the co-investors should be formalized as a general part of the co-investment agreement. Sometimes the process could be as simple as a majority vote among the co-investors, but it also should include a way to allow an unhappy investor to exit the co-investment. As noted, liquidity is one reason why pension plans are looking at co-investment. Investors, therefore, need to be assured that there is an easy out if they want to leave.

"Our experience," says Jeans, "has been that, if we're having a problem or disagreement with a partner, we call a meeting and sit down together face-to-face. Ninety-nine percent of the time we can solve the problem. In those few instances where it absolutely doesn't work out, the partner can leave." According to Jeans, that usually means the other partners will buy out the disgruntled party.

The **New York State Teachers Retirement System** also has been involved in co-investment transactions in the past, but none recently. "We're not saying we won't do anymore, but when we have a choice, we prefer to invest on our own," notes **Jim Campbell**, Assistant Real Estate Officer at NYSTRS. The Fund wants to control its own destiny, Campbell explains, and it is tougher to do that when hooked into other investors. "I can be frustrating to be in a deal with an investor who has a shorter term horizon or is handicapped by political decision-making processes."

The bottom line is, co-investment is a little like "the Force"—that wonderful source of power that Luke Skywalker discovers in George Lucas' *Star Wars*. Like the Force, co-investment can be either of great benefit, or great harm to the user—depending on how you approach it. And, as with all sources of power, investors must not forget that co-investment has its dark side. ❖

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**Steve Bergman** is a freelance real estate writer in Mesa, Arizona.

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Alaska Permanent Fund  
Real Estate Portfolio  
Direct Investments

| Property                     | Permanent Fund Ownership | Number of Partners | Permanent Fund Investment | Cost of 100% of Investment |
|------------------------------|--------------------------|--------------------|---------------------------|----------------------------|
| 1 Hampton Woods              | 19.6%                    | 6                  | 1,242,642                 | 6,333,549                  |
| 2 Williamsburg Apartments    | 19.6%                    | 6                  | 1,617,407                 | 8,243,666                  |
| 3 Chatham's Mark             | 19.6%                    | 6                  | 1,676,581                 | 8,545,264                  |
| 4 Avalon Park Apartments     | 40.0%                    | 2                  | 3,444,725                 | 8,611,812                  |
| 5 Logan's Mark               | 19.6%                    | 6                  | 1,696,305                 | 8,645,796                  |
| 6 Park at Wells Branch Apts  | 19.6%                    | 6                  | 1,814,652                 | 9,248,992                  |
| 7 Amberwood Apartments       | 39.4%                    | 2                  | 3,742,210                 | 9,500,407                  |
| 8 Lemay Lake Apartments      | 19.6%                    | 6                  | 1,893,550                 | 9,651,122                  |
| 9 The Springs Apartments     | 19.6%                    | 6                  | 1,913,275                 | 9,751,654                  |
| 10 Brookstone Apartments     | 19.6%                    | 6                  | 1,932,999                 | 9,852,187                  |
| 11 Hunt's View Apartments    | 19.6%                    | 6                  | 1,972,448                 | 10,053,252                 |
| 12 Plaza Port West           | 13.4%                    | 5                  | 1,370,297                 | 10,241,381                 |
| 13 Goldbelt Building         | 40.0%                    | 2                  | 4,161,831                 | 10,404,576                 |
| 14 Zia Vista Apartments      | 40.0%                    | 2                  | 4,165,180                 | 10,412,950                 |
| 15 Conservatory Apartments   | 19.6%                    | 6                  | 2,366,938                 | 12,063,902                 |
| 16 Tree Tops Apartments      | 40.0%                    | 2                  | 4,955,649                 | 12,389,122                 |
| 17 Tri-County Corp. Center   | 33.3%                    | 3                  | 4,130,595                 | 12,391,786                 |
| 18 Eastridge Apartments      | 40.0%                    | 2                  | 4,985,158                 | 12,462,895                 |
| 19 Royal Farms Apartments    | 40.0%                    | 2                  | 5,432,099                 | 13,580,247                 |
| 20 Bridgewater Apartments    | 33.3%                    | 3                  | 4,965,889                 | 14,897,666                 |
| 21 Overlook Apartments       | 40.0%                    | 2                  | 4,973,706                 | 14,934,266                 |
| 22 Skyler Ridge Apartments   | 40.0%                    | 2                  | 6,126,795                 | 15,316,988                 |
| 23 Innesbrook Apartments     | 40.0%                    | 2                  | 6,349,682                 | 15,874,204                 |
| 24 Villages of Forest Ridge  | 40.0%                    | 2                  | 5,467,086                 | 16,401,257                 |
| 25 MNTX Business Center      | 33.3%                    | 2                  | 7,130,326                 | 17,825,816                 |
| 26 Club at Tanasbourne       | 40.0%                    | 2                  | 7,210,300                 | 18,025,750                 |
| 27 Waterford Place Apts.     | 40.0%                    | 2                  | 7,401,600                 | 18,504,000                 |
| 28 Bank of California Center | 40.0%                    | 2                  | 8,014,113                 | 20,035,281                 |
| 29 Amador Oaks Apartments    | 39.7%                    | 3                  | 8,105,813                 | 20,417,665                 |
| 30 Siesta Key & Cedar Key    | 16.7%                    | 2                  | 3,455,269                 | 20,733,686                 |
| 31 Bristol Place Apartments  | 40.0%                    | 2                  | 8,535,550                 | 21,338,875                 |
| 32 Riverbend Apartments      | 40.0%                    | 2                  | 9,505,718                 | 23,764,295                 |
| 33 Mill Pond & Conifer Creek | 40.0%                    | 2                  | 9,662,512                 | 24,156,280                 |
| 34 Paragon Building          | 25.0%                    | 2                  | 6,513,231                 | 26,052,926                 |
| 35 Crystal Creek Apartments  | 40.0%                    | 2                  | 10,779,871                | 26,949,678                 |
| 36 Lakefront Apartments      | 40.0%                    | 2                  | 11,024,930                | 27,562,325                 |
| 37 Arboretum Lakes           | 40.0%                    | 2                  | 11,255,740                | 28,139,349                 |
| 38 37 West 57th Street       | 40.0%                    | 2                  | 11,441,158                | 28,602,896                 |
| 39 Island Club Apartments    | 40.0%                    | 4                  | 13,491,470                | 33,728,676                 |
| 40 Blue Ash Business Park    | 23.7%                    | 5                  | 8,155,945                 | 34,485,734                 |
| 41 Club Apartments           | 33.3%                    | 2                  | 12,363,540                | 37,090,620                 |
| 42 Alameda Industrial Prop.  | 40.0%                    | 2                  | 15,098,981                | 37,747,453                 |
| 43 Dallas Industrial Port.   | 40.0%                    | 4                  | 15,393,732                | 38,484,330                 |
| 44 Frontier Building         | 19.0%                    | 8                  | 8,171,630                 | 42,963,352                 |
| 45 Westwood Place            | 31.8%                    | 2                  | 14,141,683                | 44,442,748                 |
| 46 One Corporate Plaza       | 40.0%                    | 3                  | 17,934,596                | 44,836,490                 |
| 47 Danada Centers            | 40.0%                    | 3                  | 18,400,000                | 46,000,000                 |
| 48 MIW-OPUS Properties       | 33.1%                    | 4                  | 17,940,559                | 54,213,859                 |

| Property                   | Permanent Fund Ownership | Number of Partners | Permanent Fund Investment | Cost of 100% of Investment |
|----------------------------|--------------------------|--------------------|---------------------------|----------------------------|
| 49 Oakwood Mall            | 16.7%                    | 3                  | 9,964,000                 | 59,784,000                 |
| 50 ARA Reading Center      | 31.4%                    | 3                  | 18,785,746                | 59,851,424                 |
| 51 Ontario Place           | 40.0%                    | 4                  | 23,960,000                | 59,900,000                 |
| 52 Beaverton/Redmond Tech. | 40.0%                    | 2                  | 25,259,853                | 63,149,632                 |
| 53 Walnut Building         | 38.2%                    | 3                  | 24,933,348                | 65,235,707                 |
| 54 Fiesta Mall             | 40.0%                    | 4                  | 26,232,300                | 65,580,750                 |
| 55 919 North Michigan      | 40.0%                    | 3                  | 28,554,686                | 71,386,714                 |
| 56 Harman International    | 40.0%                    | 2                  | 32,014,143                | 80,035,357                 |
| 57 South Park Tower        | 40.0%                    | 2                  | 32,045,962                | 80,114,906                 |
| 58 University Square Mall  | 21.0%                    | 6                  | 19,509,524                | 93,011,894                 |
| 59 One O'Hare Center       | 40.0%                    | 6                  | 38,551,026                | 96,377,564                 |
| 60 Owings Mills            | 25.3%                    | 4                  | 25,491,300                | 100,955,644                |
| 61 IBM's SWMD Headquarters | 40.0%                    | 2                  | 41,416,084                | 103,540,209                |
| 62 St. Louis Center        | 16.6%                    | 5                  | 18,494,089                | 111,449,115                |
| 63 McKinley Mall           | 10.6%                    | 4                  | 15,037,838                | 141,363,617                |
| 64 Monroeville Mall        | 17.1%                    | 3                  | 26,009,927                | 152,058,063                |
| 65 1818 Market Street      | 16.1%                    | 7                  | 25,724,266                | 159,829,672                |
| 66 135 East 57th Street    | 22.7%                    | 3                  | 37,573,374                | 165,322,851                |
| 67 Westside Pavilion       | 12.3%                    | 7                  | 29,796,506                | 242,186,977                |
| 68 Tysons Corner Center    | 38.0%                    | 6                  | 145,049,462               | 381,709,112                |



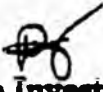
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**Alaska Permanent Fund Corporation**  
P.O. Box 25500 Juneau, Alaska 99802-5500  
(907) 463-2047

**MEMORANDUM**

**DATE:** December 27, 1998

**TO:** William H. Scott  
Executive Director

**FROM:** Pete Jeans   
Real Estate Investment Officer

**SUBJECT:** Elimination of 40% restriction on real estate acquisitions

This memorandum should be attached to the memorandum dated November 18, 1998 to the Board of Trustees as additional information.

The following three investment opportunities are examples that were lost by APFC during the past three months due to the 40% restriction on real estate acquisitions.

1. Park 227  
Industrial Property  
Kent, Washington

This proposal was received from the L & B Group. The proposed investment included 89 acres with 5 industrial buildings, 100% leased. The total purchase price was \$26,500,000 and the initial cash on cash was 9% after fees.

After preliminary review, APFC decided to move forward and hired Saylor Capital to perform in-depth due diligence. APFC was considering 40% and the Public Employees Retirement Association of Colorado (PERA) was considering the remaining 60%. The due diligence was completed by both APFC and PERA and the decision was made to proceed with documentation. During this process, APFC and its attorneys could not negotiate acceptable buy-sell arrangements and were forced into backing out of this investment. PERA is proceeding to do 100%. The interesting thing on this investment is that it was presented to the APFC first, and we recommended PERA to the L & B Group as a potential partner.

Mr. William H. Scott  
December 27, 1993  
Page 2

2. 278 Post Street  
San Francisco, CA  
(Retail Property on Union Square)

This proposal was received from LaSalle Advisors. The property is being converted to Nike Town and other upscale retail. The cash on cash is projected to be over 9% after the renovation. The total investment was \$34,600,000. The same situation occurred as above and PERA is doing 100%.

3. Sequoia Station Shopping Center  
Redwood City, CA

This proposal was received from TCW Realty Advisors. The total purchase price was \$33,725,000. The initial cash on cash after fees was 9.33%. The proposal was presented to APFC toward the end of October and the seller required a closing by December 15, 1993. We looked at the property and were interested in proceeding. TCW was unable to locate co-investors that could close by the December deadline. As a result, we lost the opportunity to consider this investment.

As more institutional dollars are made available for real estate, it is going to become more and more difficult for APFC to become involved in the better investments unless we can control the investment. In order to do this, we need to have the flexibility to go up to 100% on some of the smaller investment opportunities.