To: Pennsylvania State Employees' Retirement System Board Members ("SERS")

From: NEPC, LLC ("NEPC")

Date: December 5, 2023

Subject: Commitment to Ares US Real Estate Opportunity Fund IV, LP and Co-Investment

Recommendation

NEPC recommends that the Board of the Pennsylvania State Employees' Retirement System consider a commitment of up to $70 million to Ares US Real Estate Opportunity Fund IV, LP ("Fund IV" or the "Fund") and up to $30 million in co-investments alongside the Fund (for a total commitment of $100 million) at the December 12, 2023 Board meeting. NEPC has identified the following positive attributes for the Fund, among others:

- Strong performance
- Deep and tenured investment team
- Hybrid operator/allocator model
- Ability to leverage larger Ares platform
- Attractive strategy in the current market environment

Overview

Ares Management LLC ("Ares," the "Firm," or the "Manager") is targeting $3.0 billion of investor commitments for Ares Real Estate Opportunities Fund IV. Ares Management Corporation (NYSE: ARES) is a publicly traded, global alternative investment manager with approximately $352 billion of assets under management as of December 31, 2022. Ares has approximately 2,500 employees in over 30 global offices across North America, Europe, Asia Pacific and the Middle East. Ares operates integrated businesses across Credit, Private Equity, Real Assets, Secondary Solutions and Strategic Initiatives.

The Fund is the fourth in the Ares series of opportunistic real estate funds focused on the United States. The Fund's investment strategy is opportunistic and focuses on three main investment pillars: Enhancing and repositioning assets and portfolios, development of core quality assets, and pursuing distress and special situations. The Fund expects to employ average leverage of approximately 60-65% loan-to-cost. Ares has been evolving into a hybrid operator/allocator model by either acquiring or building out verticals.

Ares is able to leverage their deep team and the overall Ares platform including credit, private equity, and secondaries to source quality off-market investments and develop relationships with lenders in what has been a more constrained financing market. Ares ability to pivot between development, acquisition/repositioning, and distressed/special situations depending on the market environment should benefit it during all stages of the market cycle and especially if the market environment continues to display choppiness. Ares will target 15-25 opportunistic investments with average equity generally ranging from $50 to $250 million and holding periods ranging from three to six years. Fund IV has a target IRR of 18% to 20% gross or 15% to 17% net, and a target net multiple of 1.6-1.7x.

NEPC Due Diligence

NEPC's Real Assets Research Team has conducted due diligence on the Firm, including the following items (among others):

- Consideration of portfolio fit within the SERS Real Estate Portfolio
- Consideration of the Fund relative to others in its peer universe (including strength of team, strategy, track record, and fees/terms, among other factors)
- Onsite meeting conducted at the Manager's offices
- A review of the Manager's track record, including both fund- and investment-level performance
- Operational due diligence review

Disclaimers and Disclosures

- Past performance is no guarantee of future results.
- The opinions presented herein represent the good faith views of NEPC as of the date of this report and are subject to change at any time.
- Information used to prepare this report was obtained directly from the investment manager, and market index data was provided by other external sources. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.
- NEPC may provide background information on fund structures or the impact of taxes but you should contact your legal counsel or tax professional for specific advice on such matters.

In addition, it is important that investors understand the following characteristics of non-traditional investment strategies including hedge funds, real estate and private equity:

1. Performance can be volatile and investors could lose all or a substantial portion of their investment
2. Leverage and other speculative practices may increase the risk of loss
3. Past performance may be revised due to the revaluation of investments
4. These investments can be illiquid, and investors may be subject to lock-ups or lengthy redemption terms
5. A secondary market may not be available for all funds, and any sales that occur may take place at a discount to value
6. These funds are not subject to the same regulatory requirements as registered investment vehicles
7. Managers may not be required to provide periodic pricing or valuation information to investors
8. These funds may have complex tax structures and delays in distributing important tax information
9. These funds often charge high fees
10. Investment agreements often give the manager authority to trade in securities, markets or currencies that are not within the manager's realm of expertise or contemplated investment strategy