BOARD OF INVESTMENTS
MONTANA REAL ESTATE POOL INVESTMENT GUIDELINES

REAL ESTATE INVESTMENT GUIDELINES AND RANGES

The Montana Real Estate Pool (MTRP) was created to permit the nine Montana Retirement Systems to participate in a diversified real estate portfolio. Real estate investments in the MTRP shall be consistent with the following guidelines. (*These guidelines reflect long-term policy expectations and should not be interpreted strictly during the initial building phase of the portfolio.*)

a. **Allocation Size**

The target allocation to real estate shall be approximately 5.0 percent of the total Retirement Systems' assets, or as otherwise authorized by the Board. The real estate target is long-term in nature (i.e., at least five years), and the allocation percentage will fluctuate according to the relative values among real estate and the other asset classes of the Retirement Systems.

b. **Permissible Investment Structures/Vehicles and Public/Private Allocations**

Investment Structures/Vehicles. The MTRP will include real estate investments, consisting of both open-end and closed-end pooled funds, the advantages and disadvantages of which are described in the following table.

VEHICLE	ADVANTAGES	DISADVANTAGES	LIQUIDITY
Open-Ended Fund	1. Property type diversification. 2. Geographic diversification. 3. Existing investment portfolio to evaluate. 4. Existing manager and fund performance record. 5. Infinite life. 6. Can redeem units in fund.	1. Passive investor. 2. Cannot replace manager. 3. Cannot influence manager decisions regarding acquisitions, financings, and sales. 4. Fee level and structures lack alignment of interests. 5. Lack of manager co-investment. 6. Historically have not sold assets to harvest gains.	Typically within 90 days unless there is an investor queue.
Closed-Ended Fund	1. Skilled value/ opportunistic management. 2. Manager organizations and track records. 3. Manager co-investment. 4. Manager-investor enhanced alignment of interests. 5. Asset liquidations by end of term of fund.	1. Illiquid-specified term. 2. Typically blind pools. 3. Cannot redeem interest. 4. Passive investor. 5. Cannot influence manager decisions regarding acquisitions, financings, and sales.	Typically 7 to 10 year terms.

Open-end Commingled Funds. The MTRP portfolio may have a significant exposure to open-end commingled funds. The open-end fund investments shall be made primarily to provide (1) timely access to large existing, well-diversified portfolios, (2) reasonable property type and geographic diversification, (3) exposure to larger properties (i.e., over $50 mil.), and (4) reasonable liquidity (i.e., ability to redeem within 90 days). Reasonable due diligence shall be completed to evaluate open-end commingled funds consistent with these objectives.

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Closed-end Commingled Funds. The MTRP portfolio may have a significant exposure to closed-end commingled funds. The closed-end fund investments may be made to obtain exposure to value and opportunistic investments. Reasonable due diligence shall be completed prior to selecting closed-end fund investments.

Liquidity. The table below describes different levels of liquidity of real estate investments.

PORTFOLIO LIQUIDITY RANGES	Investment Type
LIQUID (i.e., can redeem within 30 days)	Select Open-End Funds
MODERATE LIQUIDITY (i.e., can redeem within 90 to 120 days)	Open-End Funds
ILLIQUID (i.e., no liquidity until fund termination.)	Closed-End Funds

c. **Expected Investment and Portfolio Risk/Returns**.

The risk/return categories utilized to classify real estate investment risk/return levels are:

Core. Equity investment in operating and substantially-leased institutional quality real estate in the traditional property types (apartment, office, retail, industrial and hotel). Net returns historically have been in the 4.0 percent to 6.0 percent range (inflation-adjusted and net of fees) and are typically comprised of greater levels of income (i.e., 67.0 percent of total returns) with appreciation matching or exceeding inflation.

Value. Equity or debt interests in assets requiring rehabilitation, redevelopment, development, lease-up or repositioning. Net returns historically have been in the 8%-10% range (inflation-adjusted and net of fees). Value investments frequently involve the repositioning of distressed assets (i.e., not fully leased and operating). For example, a value investment may be an office building that is 40.0 percent vacant and needs significant capital to rehabilitate and reposition the property. Investment may also include non-traditional property types (e.g., manufactured housing) which may contain greater risk. Value investments typically are expected to generate above-core returns through the leasing-up of a property, which increases the end value by increasing in place income and, in many cases, decreasing the capitalization rate used in selling the asset due to the reduced asset risk resulting from stabilized occupancy. Value returns are typically more dependent than core on appreciation returns with purchase prices based on income in place or asset replacement cost (i.e., at a discount to replacement cost).

Opportunistic. Equity or debt investment in real estate properties, operating companies, and other investment vehicles involving significant investment risk. Risk may include real estate, financial restructuring, and non-real estate risk. Net returns have been in the 12.0 percent or higher range (inflation-adjusted and net of fees). Opportunistic investing includes distressed assets, financial restructurings, and/or financial engineering opportunities (e.g., foreclosing on a mortgage and selling the equity interest) and potentially the purchase of REITs or REOCs. Investment may also be made in non-traditional property types (e.g., self-storage) which typically contain greater risk. Opportunistic returns typically require even greater appreciation returns than value (e.g., 50.0 percent of total returns) and in many cases are originated with minimal income in place.

The policy range targets will be reviewed and adjusted periodically going forward with respect to risk/return exposures. These targets may be adjusted on an annual basis and will be reflected in the MTRP quarterly performance reports. The following table sets forth the long-term risk/return policy ranges for the portfolio.

INVESTMENT AND PORTFOLIO RISK/RETURN RANGES

Risk/Return	**Nominal Return (Net)***	**Policy Range**	**Target**
Core	6-8%	40%-60%	50%
Value	10-12%	20%-30%	25%
Opportunistic	13-15%	20%-30%	25%

* Assumes 3% inflation overall and 100 basis points core management fee, 200 basis points value management fee, and 300 basis points opportunistic management fee.

d. **Income and Appreciation Return Mix**.

Real estate investments, depending on their risk/return level (i.e., core, value, opportunistic), offer varying proportions of expected income/cash yield and appreciation returns. Investments providing higher income/cash yield returns typically will be preferred among investments of comparable expected total returns since income/cash yield returns provide greater return certainty and therefore lower risk. In addition, investments providing preferred or senior income/cash yield returns typically will be preferred among investments providing comparable returns because such features enhance the certainty of return. Core investments have historically provided higher income returns, which equates to greater certainty of return and lower risk. As previously set forth, the core allocation therefore shall comprise the largest part of the Real Estate Portfolio.

e. **Diversification.** The MTRP portfolio diversification is important in reducing portfolio risk and accomplishing superior risk-adjusted returns. The impact of investments on portfolio diversification, portfolio risk, and risk-adjusted returns shall be considered when evaluating prospective investments. Additionally, the portfolio may have over-weighted exposure in select property types or regions as desired.

1. **Property Type**. Property type diversification is one of the most important diversification features in terms of impact on returns. The property types have historically performed differently during economic cycles. Residential and industrial investments have historically outperformed the other property types during economic downturns. Office has historically underperformed during

economic downturns, as reduced tenant demand results in lower rents, higher owner operating and build-out costs, and reduced income and cash flow. Hotels historically also have underperformed during economic downturns.

Diversification ranges are based on the universe of available real estate investments and institutional investor portfolio information. The following table provides a guideline range with respect to the MTRP property type diversification.

PROPERTY TYPE DIVERSIFICATION RANGES	
Property Type	**Policy Range**
Office	10%-45%
Retail	10%-40%
Industrial	10%-40%
Residential	10%-40%
Hotel	0%-5%
Other	0%-10%

2. **Region/Location.** The importance of location to the long-term value of real estate is based on the economic fundamentals and the other risk attributes (e.g., weather, earthquake and local government impact) of U.S. and international regions. The distribution of real estate investments by geographic region shall be monitored for compliance with the broad ranges set forth in the table below.

REGIONAL DIVERSIFICATION RANGES	
Regions	**Policy Range**
West	10%-45%
South	10%-40%
Midwest	10%-40%
East	10%-45%
International	0%-30%

Policy range targets with respect to regional exposures may be established and adjusted on an annual basis.

3. **Other.** In addition to property type and regional diversification, there are other real estate factors that impact the portfolio risk which may be reduced through diversification. These portfolio factors may include, but are not limited to, the following:

   a. **Investment Structure.** Equity, preferred equity, first mortgage debt or mezzanine equity. **Investments in public CMBS and REITs are not preferred**.

b. **Life Cycle.** Land, development/redevelopment, leasing (i.e., less than 90% leased) and operating (i.e., over 90% leased).
c. **Investment Size.** $0-$10 mil., $10-$20 mil., $20-$50 mil., $50-$100 mil., $100 mil.+.

While no formal diversification ranges are set forth for the above portfolio risk factors, these and other factors may be monitored in assessing overall portfolio risk and expected return.

f. **Other Risk Factors**.

1. **Leverage**. Leverage is a significant risk factor. Its importance is magnified during an economic downturn when decreasing property values and stricter lending terms can lead to unexpected increased leverage levels. It may be the case that the leverage level increases as market conditions worsen. Accordingly, the leverage level of the MTRP shall be closely monitored.

   On an individual fund basis, the leverage level can range up to 75.0 percent. Leverage consists of the combined borrowing at the property level and the fund level. On a select basis, the leverage may exceed 75.0 percent for a given investment, if it is determined to be reasonable to do so. The total MTRP portfolio leverage shall not exceed 60.0 percent.

LEVERAGE RANGES AND AVERAGE LTV TARGET		
Risk	**Range**	**Target**
Core	0%-50%	35%
Non-Core	0%-75%	65%
Total Real Estate Portfolio	0%-60%	50%

2. **Monitoring and Control.** All investments will be made through investment vehicles providing full discretion to investment managers.

3. **Manager Concentrations**. The MTRP exposure to each manager shall be reviewed regularly to determine the reasonableness of each. No manager shall have under management more than 25.0 percent of the MTRP on an allocation basis, unless specifically approved by the Board.

4. **Benchmark.** The MTRP benchmark shall be the NCREIF Property Index, reasonably adjusted to provide comparable risk/return with the MTRP portfolio given the level of non-core exposure.