



State of Rhode Island
Office of the General Treasurer

GEM Realty Fund VII, L.P. - Staff Recommendation
April-2022

RECOMMENDATION: Approve a commitment of up to \$25 million to GEM Realty Fund VII, L.P.

ASSET CLASS: Non-Core Real Estate

SUB-STRATEGY: Diversified Value-Add/Opportunistic

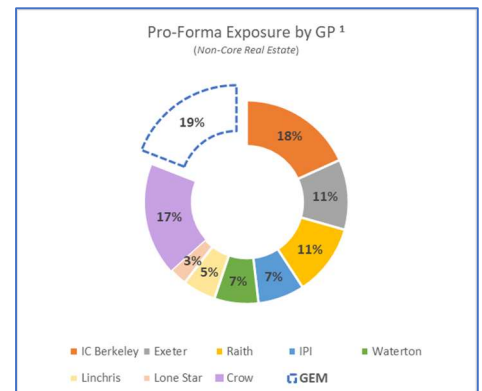
ALLOCATION: The target allocation to Non-Core Real Estate is 2.5% effective 7/1/2021, and the actual allocation as of 3/31/2022 is 2.1%. The pacing plan for Non-Core Real Estate is \$70-80 million per year. If approved, GEM VII would be ERSRI's first 2022 Non-Core Real Estate commitment. ERSRI made a \$50 million commitment to GEM Realty Fund V in 2013 and a \$20 million commitment to GEM Realty Fund VI in 2016.

PORTFOLIO FIT: The ERSRI Non-Core Real Estate portfolio contains a mix of sector focused and diversified funds that bring operational expertise to value-add and opportunistic asset acquisitions; ERSRI allocates to diversified funds that mitigate portfolio sector concentration, provide differentiated exposures, and ultimately enhance Non-Core Real Estate portfolio diversification. Diversified funds also offer the flexibility to move into and out of sectors based on relative attractiveness more quickly than the rate at which ERSRI can directly allocate. Fund VII can be categorized as a diversified value-add/opportunistic strategy – the fund will allocate across a variety of U.S. geographies and sectors in which the GEM team possesses property type expertise.

While Fund VII will be broadly diversified across property types, we anticipate that the fund will be anchored by exposure to residential, hotel, and office assets (~80% of Fund VII's prospective allocation, in aggregate). As of 9/30/2021, ERSRI's Non-Core Real Estate portfolio is underweight both residential and office property types relative to the NFI-ODCE Index. GEM also allocates to less-trafficked specialty and emerging property types (anticipated 20% Fund VII allocation) to which ERSRI has de minimis exposure. These specialty property types include production studios, marinas, and R&D facilities, amongst others, which can be highly fragmented sectors with favorable tailwinds. GEM is complementary to ERSRI's other diversified value-add GP, Crow, whose strategy is anchored by industrial and residential assets. We do not anticipate that industrial assets will represent a meaningful component of GEM's strategy. Additionally, Crow's residential assets are predominately multi-family apartments, whereas GEM's residential exposure is expected to be diversified across multi-family, single-family, and senior housing assets. GEM and Crow also target different specialty property types; Crow's strategy targets convenience and gas, student housing, and self-storage, for example.

Upon approval, GEM Realty Fund VII would represent 6% of the Non-Core Real Estate portfolio's exposure. GEM, inclusive of ERSRI's investment in Funds V and VI, would represent 19% of the Non-Core Real Estate portfolio.¹

Manager	Strategy	Sector
IC Berkeley	Value-Add	Light Industrial
GEM	Value-Add/Opportunistic	Diversified
Exeter	Value-Add	Industrial
Raith	Opportunistic	Diversified
Crow (Diversified)	Value-Add	Diversified
IPI	Core/Value-Add/Opportunistic	Data Centers
Crow (Retail)	Value-Add	Retail - Food & Service
Waterton	Value-Add	Residential
Linchris	Value-Add	Hotel
Lone Star	Distressed	Diversified



MERITS:

Platform – GEM has built a well-established platform with a long history of consistently executing its strategy. GEM’s three founders continue to be actively engaged in the business and they are supported by a deep and tenured team of fifteen senior executives who boast an average of 23 years of industry experience and 14 years with the firm. GEM’s well-resourced team has a demonstrable ability to dynamically invest across an extremely diversified array of property types throughout all parts of the capital structure. GEM’s reputation and large relationship network have provided the firm with market intelligence and access to investment opportunities; nearly half of GEM’s Fund VI deals were sourced off-market.

Track record – GEM has invested nearly \$3 billion of fund equity, completing over 150 acquisitions across its flagship diversified value-add/opportunistic fund series to build a strong track record covering multiple decades and market cycles. As of 12/31/2021, GEM’s 120+ realized investments have achieved a gross IRR of 24.5%.

as of 12/31/21				
GEM Fund	Vintage	GEM Net IRR	GEM Net Multiple	Quartile
I	1994	21.6%	1.6x	1st
II	2001	22.3%	2.0x	3rd
III	2005	9.9%	1.6x	1st
IV	2009	19.8%	1.9x	1st
V	2013	5.5%	1.3x	3rd
VI	2017	20.5%	1.3x	1st

**Quartile rankings are relative to the Cambridge Value-Add Real Estate Universe*

Research – GEM marries its sourcing process with a top-down perspective that is informed by its dedicated Market Research function led by the firm’s Director of Research. The Director of Research pursues broad-based research initiatives in both private and public real estate markets to guide GEM’s investment strategy and due diligence. Through GEM’s research function, they have established a track record of targeting specialty or emerging property types at the early stages of institutional capital penetration. For example, Fund II included four senior housing acquisitions in 2004 (average gross senior housing deal IRR of 29%). More recently, GEM has successfully executed deals in R&D facilities, marinas, and production studios, which are property types that we anticipate will be included in Fund VII.

CONCERNS:

Key person and succession risk – GEM was formed in 1994 by Norman Geller, Michael Elrad, and Barry Malkin. These three founding partners make up the firm’s Management Committee and continue to steer the business. They also occupy three of GEM’s seven Investment Committee seats. Mr. Malkin has acted as CIO for GEM Realty Properties since its inception. GEM VII mitigates this risk via a key-person provision that identifies the applicable personnel. The Firm’s succession risk is mitigated by GEM’s promotion of Derek Lopez, who was named Co-CIO of GEM Realty Properties in 2021 as part of its succession plan. Additionally, GEM employs a deep team of tenured professionals who work alongside the firm’s founders on various GEM committees that are integral to its investment process and serve to prepare senior employees for future corporate leadership roles.

Fund V performance – GEM Realty Fund V has failed to meet ERSRI’s expectations; the Fund’s as-of-12/31/2021 5.5% net IRR ranks in the 3rd quartile. Fund V’s underperformance was driven in-part by large allocations to hotel and office properties (collectively ~70% of the Fund’s equity commitments), which include properties that have encountered COVID-related challenges. One of Fund V’s largest equity investments involved a heavy renovation to transform a Class-B office to Class A+. Construction complications created a 2-year project delay that resulted in March 2020 delivery, when the pandemic halted leasing activity. The property had no current income to mitigate construction delays. This project resulted in multiple lessons learned and GEM’s subsequent office acquisitions have had in-place cash flow. To date (as of 12/31/2021), GEM VI is currently a top quartile fund, valued at a 20.5% net IRR.

ESG: GEM is categorized as an ESG **Integrator**. GEM has a formal policy and ESG is being incorporated into the investment decision making process. ESG risks and considerations have been integrated into GEM’s Due Diligence Checklist. Post-acquisition, GEM’s Chief Compliance Officer monitors each asset’s compliance with the firm’s ESG policy. GEM began an engagement with an ESG consultant in 2021; in conjunction with GEM’s internal ESG Committee, their ESG Consultant is working to implement and standardize ongoing KPIs to track and monitor progress. GEM is in the

¹ Exposure measured on a pro-forma basis; fair market value + unfunded commitments to-date, calculated as of September 30, 2021

process of collecting water, energy, and waste consumption data for all assets and benchmarking the data in ENERGY STAR. Additionally, GEM has introduced a Diversity and Inclusion Steering Committee who is working to identify opportunities to foster a more diverse and inclusive firm culture. The Steering Committee also works with GEM's D&I consultant to provide training and guidance as they strive to build a comprehensive Diversity & Inclusion program.

FEES: The fees are in accordance with industry standards. ERSRI will pay a management fee of 1.5% on 90% of committed capital during the Commitment Period, and 1.5% on invested capital thereafter. The Fund charges carried interest of 20%, subject to a 9% preferred return with a 50/50 catch-up.