RESOLUTION NO. 86-007

Adopted by the Administration, Investment
and Fiscal Management Board of the
Sacramento City Employees' Retirement System
on June 23, 1986

**A RESOLUTION AMENDING RESOLUTION NO. 82-014,
RELATING TO THE BOARD'S GUIDELINES
FOR REAL ESTATE INVESTMENTS**

WHEREAS, on December 20, 1982, the Board adopted Resolution No. 82-014 relating to guidelines for real estate investments; and

WHEREAS, the Board desires to add to its policy guidelines, provisions for real estate equity purchases involving new debt or assumption of existing debt as part of a leveraged transaction;

NOW, THEREFORE, BE IT RESOLVED that Resolution No. 82-014 is hereby amended so that a new section "H" is added to Paragraph III of Exhibit "A", to read as follows:

H. On all purchases requiring either new debt or assumption of existing debt on the property, the following criteria apply:

1. Maximum debt will be limited to 75% of the value of the property as determined by the sale price.

2. The debt service ratio will be a minimum of 1.15% of net operating income.

3. The loan will be non-recourse to the System.

4. Only office buildings, retail and industrial properties will be considered.

5. The debt financing will not exceed 50% of the System's portfolio investment at cost.

6. Because of other portfolio risks involved, the loan is to be brought back to the Board for review 15 months prior to the expiration of the loan.

7. If possible, the loan terms shall include a provision allowing prepayment without penalty.

Donald E Sperling
for THOMAS FRIERY, CHAIR

ATTEST:

Richard E. Snyder
RICHARD E. SNYDER
Secretary to the Board

APPROVED AS TO FORM:

William P. Carnazzo
WILLIAM P. CARNAZZO
Deputy City Attorney

SACRAMENTO CITY EMPLOYEES' RETIREMENT SYSTEM
POLICY STANDARDS & CRITERIA
FOR REAL ESTATE EQUITY INVESTMENTS

I. ACCEPTABLE INVESTMENTS:

A. OFFICE BUILDINGS - Minimum 10,000 square feet either garden or high-rise structures with the potential of an income stream that will complement long term ownership and future growth. To be considered, properties must have exhibited a strong rental market acceptance of at least 60% to 70% preleased on a satisfactory variable rate basis or have strong ownership and development capabilities to guarantee the income stream.

B. LIGHT INDUSTRIAL BUILDINGS - Location in a master planned industrial park is preferred. Short-term leases or long-term leases with cost of living adjustment clauses or other indexed adjustments are acceptable. Taxes and operating expenses must be the obligation of the tenant after the base year.

C. SHOPPING CENTERS -

1. Regional Shopping Centers - These centers should generally contain a minimum of 100,000 square feet with at least one major anchor tenant who has a strong regional or national rating.

2. Neighborhood or Specialty Centers - These centers should generally contain a minimum of 35,000 square feet and have exceptional investment characteristics such as current below market rents which can be increased within 3 years, outstanding location and be an overall quality real estate project.

The majority of leases in any shopping center whether regional or neighborhood, should provide for minimum guaranteed rentals, percentage rent clauses, and prorata participation in real estate taxes, insurance and maintenance (structural and common areas) by tenants. The income from major anchor tenants in a regional center should account for at least 50% of the debt service requirement and/or 60% of the total space in the project.

It's recognized that sometimes these major tenants will not be a part of the portion of the center which is being purchased but the requirement for the space occupied by the major tenant will be taken into consideration for the qualification of the project for investment.

D. RETAIL STORES - Must be leased, on a triple net basis to either a large national or strong regional retailer. The lease must contain provisions for periodic increases in rents and/or meaningful percentage rent clauses. Additional rental above minimum rental should reasonably be projected to be effective during the first five years.

E. APARTMENT PROJECTS - Projects may be either high-rise or garden-type apartments, should contain a minimum of 50 units and include such amenities as swimming pools, tennis courts, carports and built-in appliances to maintain its competitive market position.

II. GENERALLY UNACCEPTABLE PROPERTIES FOR REAL ESTATE INVESTMENT:

A. Properties on leased ground or air rights unless the lease has an option to purchase the land or a remaining term of over 60 years.

B. Free standing specialty buildings, such as movie theaters, cold storage houses, restaurants, motels, hotels, casinos and recreation facilities.

C. Properties which are primarily intended for use or valued as agricultural, horticultural, farm, ranch or mineral property.

D. No special purpose properties - special purpose shall mean any properties which require substantial cash expenditure to renovate properties suitable for other uses.

III. GENERAL PARAMETERS:

A. Properties must have above average potential for future appreciation in market value.

B. Basic requirements:

1. Prime location and in established urban areas.

2. Geographic Area - anywhere in the United States where economic and demographic factors are favorable; however, California and preferrably Northern California properties are specifically preferred.

3. Quality construction with modern design.

4. Properties to be considered should have a value of $500,000 or more.

C. On properties to be built for future purchase the developer/builder/joint venture partner in the project must have sufficient financial strength and previous experience in developing a like project.

D. All legal fees relating to any real estate equity transaction are to be paid by the seller/borrower of the property.

E. The major form of joint venture which will be considered is the participating convertible mortgage which will provide for an internal rate of return approved from time to time by the Sub-Committee on Real Estate Equity Investments. The internal rate of return will be on assumptions considered satisfactory to the staff and will depend on the term of the transaction as well as the credit quality of the tenant. Nothing in this section will preclude the System from participating in ownership and/or lending with other pension funds.

F. Long term goals for diversification of the Real Estate Equity Investments should be approximately:

   1. Office buildings - 50% - 70%

   2. Light Industrial buildings - 10% - 20%

   3. Shopping Centers - 5% - 15%

   4. Freestanding Retail Stores - 10% - 20%

   5. Apartments - 2.5% - 7.5%

   It's intended that these percentages will be guidelines only and will be reviewed from time to time by the Committee.

G. On properties to be built for future investment the System will consider funding the construction of the project through a certificate of deposit vehicle with a major bank. The System will not be involved in directly funding the construction loan and that will be the responsibility of the construction lender.

   The rate on the certificate of deposit will be competitive with other rates available for similar investments. Currently, it's considered to be 25 basis points above the one year C.D. rate at the time of the commitment.

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IV. PROPOSAL REQUIREMENTS:

The System's staff and the real estate consultants will use the criteria established in the industry in making prudent and proper due diligence decisions on all real estate equity investment properties.

V. INFORMATION REQUIRED IN REAL ESTATE EQUITY PROPOSALS:

A. Prior to letter of intent:

1. A review of the projected or existing income and expenses.

2. A review of area data relative to vacancies, rental rates and expenses.

3. Copies of all leases and modifications or amendments with all tenants of the property.

4. Current rent rolls showing the name of each tenant, the commencement and expiration dates of each lease, the rent (including percentage rents, if any), and current expense reimbursement and rental escalation amounts.

5. A complete description of the improvements.

6. A report on the location and site of the subject property.

7. A map of the city or area showing location of the subject building and competing buildings.

8. A list of comparable buildings showing competing rental rates.

9. Photographs of subject property and of properties in the surrounding areas.

10. A review of the title reports.

11. On any new construction a set of complete working plans and specifications.

B. Prior to closing:

1. A list of all existing and proposed easements, covenants, restrictions, agreements, contracts and other documents which effect the property and are not disclosed by the preliminary title report.

2. An appraisal of the property prior to purchase.

3. A review of the mechanical engineers survey relating to the adequacies of the heating, air conditioning and ventilation systems of the building.

4. On any new construction evidence of compliance with applicable zoning and land use regulations and environmental law and regulations.

5. Estoppel certificates from existing tenants.

6. List of all documents, agreements, plans or contracts relating to outside contractors for repairs and maintenance as of the date of the sales agreement.

7. Copies of all policies of casualty insurance and certificates in sellers possession evidencing the liability coverage for all insurance which is required to be carried by any tenant of the property or which is carried by the seller and will remain in effect after the closing, if any.

8. Real estate purchase agreement.

As amended and adopted by the
Administration, Investment and Fiscal Management Board
June 23, 1986