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MAR 28 2012
AGENDA ITEM
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Memorandum

Date: March 21, 2012

To: CCCERA Board of Retirement

From: Robert Helliesen, Milliman; Chih-chi Chu, Investment Analyst

Subject: Torchlight Debt Opportunity Fund IV

Recommendation
We recommend the Board make a capital commitment of $60 million to Torchlight Debt Opportunity Fund IV, with the assets to fund the strategy to be withdrawn from PIMCO Total Return and the Goldman Sachs core plus portfolio.

Overview
Torchlight (formerly ING Clarion) is currently raising capital for its Debt Opportunity Fund IV (Fund IV), which will invest in commercial real estate debt. CCCERA invested in the predecessor funds. First was ING Clarion Debt Opportunity Fund (Fund I) in early 2004 with a commitment of $66 million. In July of 2006, CCCERA committed $85 million to ING Clarion Debt Opportunity Fund II (Fund II), and subsequently increased the commitment by another $43 million after the capital in Fund I was returned, bringing the total commitment to Fund II to $128 million. In December of 2008, CCCERA committed $75 million to ING Clarion Debt Opportunities Fund III (Fund III). All committed capital to Fund II and Fund III has been called.

Fund I was fully realized in 2007. It was very successful, with a 25% Net IRR and a 1.5X investment multiple. Fund II and Fund III are current investments. Fund II began in 2006 and Fund III in 2008. Due to the difficult real estate markets of 2007 to present, returns on Fund II and Fund III will not come close to those of Fund I. Based on current management estimates, Fund II is likely to have a zero to slightly positive net return, while Fund III is projected to have mid-teen returns. We consider these achieved and prospective returns to be quite an achievement given the difficult environment. Current yields to maturity for Fund II and Fund III are 9.3% and 13.2% respectively (yield to maturity of the Merrill Lynch High Yield Index is 8.6% and of the Barclays US Fixed Income Aggregate 2.2%.)

Torchlight (formerly ING Clarion Capital, LLC.) was founded in 1995 by Dan Heflin. Torchlight has acquired and managed nearly $20 billion in commercial real estate-related investments over the past 17 years. In 2010, Mr. Heflin and his partners repurchased a minority stake, 40%, from ING Group, a Dutch insurance and banking conglomerate, and currently own 100% of the firm. ING had held the minority stake in Mr. Heflin's firm since 2002. (Following the financial crisis, ING was required by the Dutch government to sell most of its non-core investments as one of the conditions to receive the bailout money.) After the repurchase of the ING stake, the name of ING Clarion Capital was changed to Torchlight Investors, LLC.

Fund IV's investment objective is to achieve significant capital appreciation and current income by investing in a diversified portfolio of commercial real estate-related investments, including debt instruments or to a limited extent, equity stakes in commercial real estate. Fund IV may use leverage not to exceed 30% of total assets at the fund level to enhance fund return. It is targeting a total net return of 15% or greater.

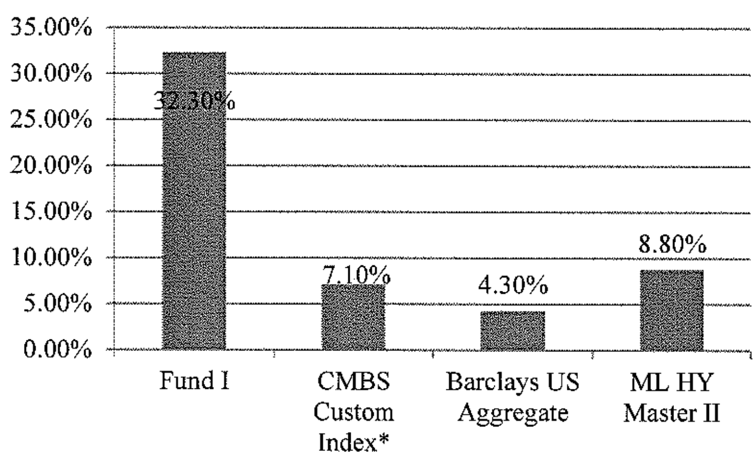
This memo provides a review of Fund I, II, and III, discussion of the impact of making a commitment to Fund IV on the overall CCCERA fixed income portfolio and a summary of the key terms of Fund IV.

Review of Fund I
CCCERA committed $66 million to the $280 million Fund I and began investing in February 2004. Within three years, by the fourth quarter of 2006, ING Clarion Fund I was almost entirely liquidated. This investment was very profitable and significantly exceeded expectations.

The following table displays the aggregate cash flows for CCCERA with the ING Clarion Fund I investment:

Torchlight Debt Opportunity Fund I			
Year	**Contributions**	**Distributions**	**Ending Valuation**
2004	$36 million	$0.7 million	$36 million
2005	$19 million	$4 million	$56 million
2006	$11 million	$93.5 million	$1.3 million
2007		$0.2 million	$.7 million

CCCERA's realized IRRs for ING Clarion Fund I are 32.3% gross of fees and 24.7% net of fees. The following chart compares Fund I's gross IRR to cash flow-adjusted IRRs of the CMBS Custom Index, the Barclays US Aggregate and the Merrill Lynch High Yield Master II.



*The CMBS Custom Index uses the returns of the CMBX Series 2 BBB. When data is not available, the CMBS Custom Index uses the Barclays Capital CMBS BBB Index.

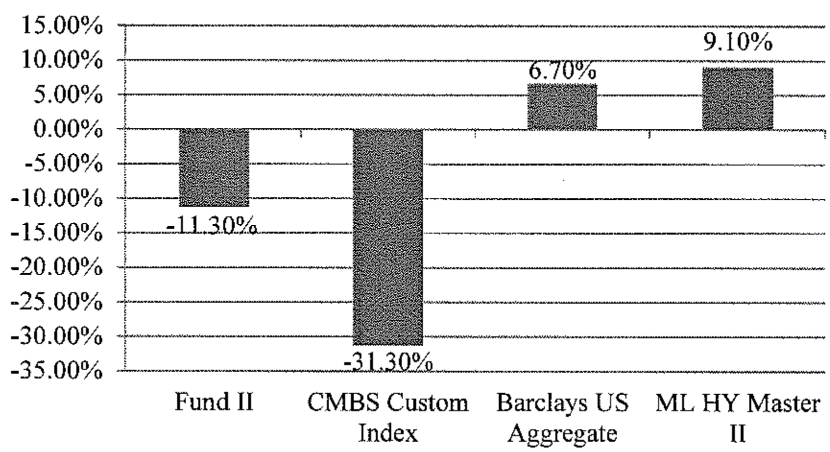
Review of Fund II
CCCERA committed a total of $128 million to the $732 million Torchlight Fund II and began investing in 2006. Through the financial crisis, Fund II has been able to maintain its portfolio

due to the avoidance of leverage and the quality of its assets, although returns are below the stated expectations.

The following table displays the aggregate cash flows since inception for CCCERA with Torchlight Fund II investment:

Torchlight Debt Opportunity Fund II			
Year	**Contributions**	**Distributions**	**Ending Valuation**
2006	$11.4 million	$30 thousand	$11 million
2007	$56.3 million	$3.2 million	$57.5 million
2008	$60.3 million	$5 million	$37 million
2009		$8 million	$39 million
2010		$7 million	$45 million
2011		$1.5 million	$53 million

CCCERA's IRRs for Torchlight Fund II on a book value basis are -11.3% gross of fees and -13.4% net of fees. (These numbers have been rapidly moving up and do not reflect expectations for eventual returns.) The following chart compares Fund II's gross IRR to cash flow-adjusted IRRs of CMBS Custom Index. It also compares to cash flow-adjusted IRRs of Barclays US Aggregate and Merrill Lynch High Yield Master II.



The since inception annualized return for Torchlight Fund II, -11.3%, has improved from -44% in the summer of 2008 when Fund III was under consideration by CCCERA. In addition to the backward-looking IRR, fixed income investors also look at a forward-looking return indicator, nominal yield-to-maturity (YTM). Fund II's nominal YTM is currently 9.3%, compared to Barclays US Aggregate's 2.2% and ML HY Master II's 8.6%.

Fund II's performance also compares favorably to other real estate debt funds in the same or similar vintage year, according to the data source from Preqin provided by Torchlight. Below is the equity multiple comparison between Torchlight Fund II and its peers. The competitors' average multiple is 0.38 versus Torchlight II's 0.59. Initials have been substituted for competitors' names.

U.S. Real Estate Debt Funds 2006-2007 Vintage	**Equity Multiple**
J IV	0.75
G Fund III	0.74
Torchlight Debt Opportunity Fund II	**0.59**
M Mezzanine Partners	0.48
N Real Estate Debt Fund	0.31
P Value Investors	0.18
C Special Situations Mortgage	0.15
G Structured Real Estate Fund II	0.02

For fund level performance outlook, the net equity multiple of Fund II under Torchlight management's scenario analysis ranges from 0.77X to 1.25X. Below is the IRR projection:

	FUND II		
	Downside Case	**Base Case**	**Upside Case**
Net IRR	-2.5%	0.0%	2.1%
Gross IRR	-1.6%	1.0%	3.1%
Net Equity Multiple	0.77	1.00	1.25
Gross Equity Multiple	0.87	1.10	1.35

The downside case calls for a severe, 2008-like economic downturn. The base case calls for a flat economy, while the upside case is for continued economic expansion. Under current economic condition, Torchlight management believes returning our capital for Fund II is attainable.

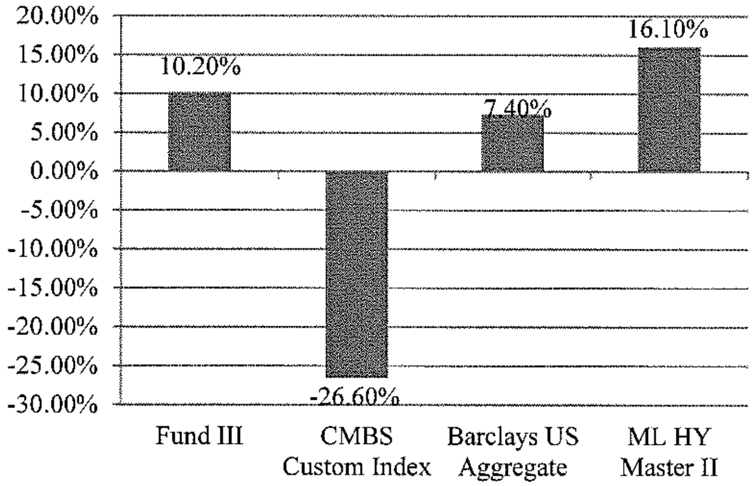
Review of Fund III

CCCERA committed total of $75 million to the $764 million Torchlight Fund III and began investing in 2008. Coming out of this prolonged recession, Fund III's performance has been getting closer to the expectation under normal economic condition.

The following table displays the aggregate cash flows since inception for CCCERA with Torchlight Fund III investment.

Torchlight Debt Opportunity Fund III			
Year	**Contributions**	**Distributions**	**Ending Valuation**
2008	$7.5 million		$7.5 million
2009	$11 million	$0.2 million	$24 million
2010	$32.5 million	$2.4 million	$54 million
2011	$24 million	$4.2 million	$74.5 million

CCCERA's book value IRRs for Torchlight Fund III are 10.2% gross of fees and 6.5% net of fees. The following chart compares Fund III's gross IRR to cash flow-adjusted IRRs of the CMBS Custom Index. It also compares the fund to cash flow-adjusted IRRs of the Barclays US Aggregate and the Merrill Lynch High Yield Master II.



Fund III's gross IRR outperformed the CMBS index significantly, and has been able to add value to the core/core + fixed income market (represented by Barclays US Aggregate) even after the huge rallies in Treasuries in recent years. For a more forward-looking return indicator, Fund III's nominal YTM is currently 13.2%, compared to the Barclays US Aggregate's 2.2% and the ML HY Master II's 8.6%.

Fund III's performance also ranks highly among real estate debt funds in the same or similar vintage year, according to the data source from Preqin provided by Torchlight. Below is the equity multiple comparison between Torchlight Fund III and its peers. The competitors' average multiple is 0.93 versus Torchlight III's 1.08. Initials have been substituted for the competitors' names.

U.S. Real Estate Debt Funds 2008-2010 Vintage	**Equity Multiple**
B Capital III	1.09
Torchlight Debt Opportunity Fund III	**1.08**
B Real Estate Special Situations Fund II	1.04
S Partners III	1.01
R Debt Fund IV	1.00
S Debt Fund II	0.98
M Real Estate Income Fund II	0.74
F Fund	0.64

Torchlight projects the net equity multiple of Fund III to range from 1.4X to 2.7X in its scenario forecasting. It forecasts IRRs as follows:

	FUND III		
	Downside Case	**Base Case**	**Upside Case**
Net IRR	5.7%	14.1%	20.3%
Gross IRR	7.5%	17.6%	24.3%
Net Equity Multiple	1.44	2.06	2.73
Gross Equity Multiple	1.57	2.43	3.25

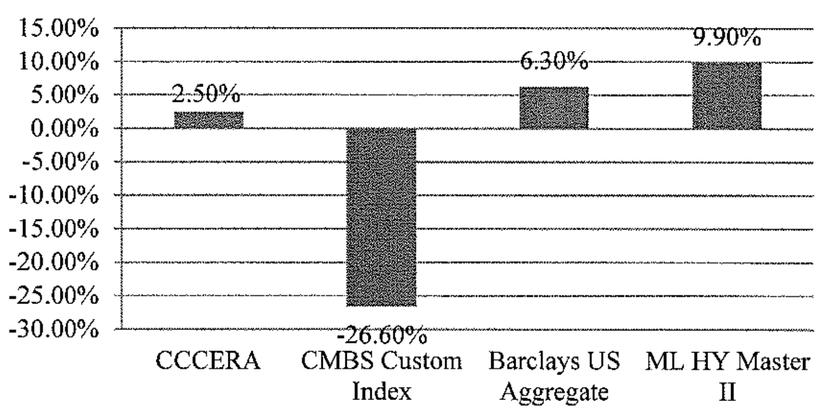
The downside case calls for a severe, 2008-like economic downturn. The base case calls for a flat economy, while the upside case is for continued economic expansion. Under current economic condition, Torchlight management believes Fund III can deliver excellent returns.

Review of all Torchlight Funds

Overall, CCCERA committed a total of $269 million to Torchlight's Debt Opportunity Funds. The following table displays the aggregate cash flows since inception for CCCERA with Torchlight Fund I, II, and III.

Torchlight Debt Opportunity Fund Series			
Date	**Contributions**	**Distributions**	**Valuations**
2004	$36 million	$0.7 million	$36 million
2005	$19 million	$4 million	$56 million
2006	$22.5 million	$94 million	$12.5 million
2007	$56.3 million	$3.5 million	$58 million
2008	$68 million	$5 million	$45 million
2009	$11.2 million	$8.2 million	$63 million
2010	$32.5 million	$9.5 million	$99 million
2011	$24 million	$5.7 million	$127 million

CCCERA's IRRs for all Torchlight Funds III are 2.5% gross of fees, and -2.4% net of fees. (Again, we expect actual achieved results to be much higher.) The following chart compares CCCERA's combined gross IRR to cash flow-adjusted IRRs of CMBS Custom Index. It also compares to cash flow-adjusted IRRs of Barclays US Aggregate and Merrill Lynch High Yield Master II.



CCCERA's overall performance with Torchlight is held back because a greater amount was committed to the lower performing Fund II than to Fund I or Fund III.

Torchlight projects CCCERA's combined performance outlook with Torchlight on Funds I, II and III to have a net equity multiple of from 1.1X to 1.7X. The IRR is projected as follows:

FUND AGGREGATE			
	Downside Case	**Base Case**	**Upside Case**
Net IRR	2.3%	6.4%	9.5%
Gross IRR	4.8%	9.8%	13.1%
Net Equity Multiple	1.13	1.42	1.72
Gross Equity Multiple	1.25	1.60	1.95

Again, the downside case calls for a severe, 2008-like economic downturn. Under current economic condition, Torchlight management believes, with Fund II's recovery and Fund III's upside, the combined annualized return for all of CCCERA's Torchlight investments could reach the range between high single digit and low teens.

Impact on CCCERA Overall Domestic Fixed Income Portfolio
As of January 31, 2012, CCCERA's total fund had a market value of approximately $5.3 billion. The domestic fixed income asset class has an adjusted target of 19.6% of the total fund or approximately $1 billion. The following table shows the recently adopted adjusted target allocations for Domestic Fixed Income and the actual allocations as of January 31, 2012.

Total Fund Assets as of 1/31/12: $5,289 million

Domestic Fixed Income	Adjusted Target % of Total	% of Fixed	Target Assets (millions)	Actual Assets (millions)
AFL-CIO HIT	3.2%	16%	$169	$165
PIMCO	5.5%	28%	$291	$287
Goldman Sachs "Park"	0.0%	0.0%	$0	$11
Goldman Sachs	4.2%	21%	$222	$214
Lord Abbett	4.2%	21%	$222	$218
Torchlight Fund II	0.8%	4%	$43	$54
Torchlight Fund III	1.7%	10%	$90	$75
Total Domestic Fixed	19.6%	100.0%	$1,037	$1,024

Any commitment to Torchlight Debt Opportunities Fund IV increases the expected risk and expected return of the domestic fixed income program. Fund IV's targeted net return is 15%, which is significantly higher than Milliman's expected total return of 3.6% for the domestic fixed income asset class in the 2011 asset allocation study prepared for CCCERA. Today, that figure (expected total return of domestic fixed income) is even lower at 3.0%.

With investments seeking returns in the mid-teens, there are clearly risks involved. For fixed income securities the major risk is credit. Similar to corporate bonds' credit risk residing in the issuing corporations, the credit risk of commercial mortgage backed securities (CMBS) comes from the underlying commercial real estate: tenant, location, operator, collateral, control rights, etc. Another risk in Fund IV is liquidity, since this is a closed-end fund investment vehicle. On the other hand, there is not as much interest rate risk as with traditional fixed income securities, as the current income for CMBS is typically high, which lowers duration.

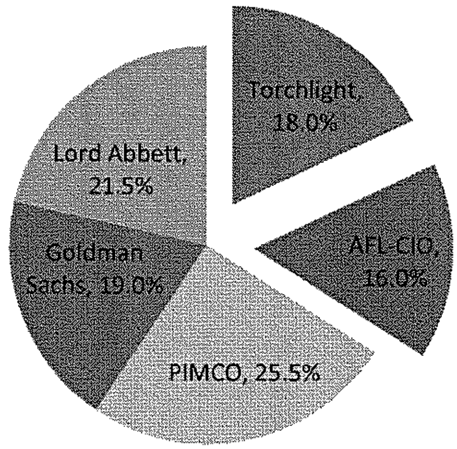
A consideration when determining the proper amount to commit to Fund IV is the amount already invested in this strategy through Torchlight. With the current dislocation and distressed pricing in the CMBS market, there may be some temptation to gain significant exposure to Fund IV. However, given the recent experience with mark-to-market pricing volatility experienced in Fund II and Fund III, it would not be prudent to expose more than 20% of the domestic fixed income assets to this type of strategy. Furthermore, on the total fund level, two of CCCERA's recently hired real estate managers, Oaktree and Siguler Guff, also have exposures to CMBS.

Taking into considerations the possible impacts on the total domestic fixed income portfolio and the current assets invested with Torchlight, we recommend the Board consider committing $60 million to Fund IV. The new proposed targets for domestic fixed income are provided in the *pro forma* table below. The proposed target for Fund IV is achieved by reducing the target to PIMCO Total Return and to Goldman Sachs core + each by ½%. The proposed allocation keeps the combined amount to Torchlight to less than 20% of the total domestic fixed income allocation.

Total Fund Assets as of 1/31/12: $5,289 Million

Domestic Fixed Income	*Proposed Adjusted Target % of Total*	% of Fixed	Target Assets (millions)	Actual Assets (millions)
AFL-CIO HIT	3.2%	16%	$169	$165
PIMCO	5.0%	25.5%	$264	$287
Goldman Sachs "Park"	0.0%	0.0%	$0	$11
Goldman Sachs	3.7%	19%	$195	$214
Lord Abbett	4.2%	21.5%	$222	$218
Torchlight Fund II	1.0%	5%	$53	$54
Torchlight Fund III	1.4%	7%	$74	$75
Torchlight Fund IV	1.1%	6%	$60	
Total Domestic Fixed	19.6%	100.0%	$1,037	$1,024

The resulting target is a balanced fixed income portfolio with 16% of the assets in a safe, agency-backed multi-family mortgage portfolio managed by AFL-CIO, 66% in traditional core/core + fixed income portfolios, divided among PIMCO, Goldman Sachs, and Lord Abbett, and the remaining 18% in return enhancing CMBS portfolios managed by Torchlight. This allocation will also leave CCCERA some capacity (parked in PIMCO and Goldman Sachs) to consider other compelling debt funds that may be coming to the market in the near future. The chart below illustrates CCCERA's domestic fixed income allocation post $60 million commitment to Fund IV.



Summary of Key Terms of Torchlight Debt Opportunity Fund IV, LLC

Managing Member:	Torchlight Debt Opportunity IV GP, LLC
Fund Name:	Torchlight Debt Opportunity IV, LLC
Targeted Assets:	Debt and other interests relating to commercial real estate and entities of which the majority of the assets consist of commercial real estate-related debt and other interests. The investments may be encumbered, leveraged, or securitized, secured or unsecured, performing or non-performing, and on a cash or synthetic basis.
Target Return:	In excess of 15% (net of expenses, management fees and the incentive allocation)
Size:	$1 billion
Closings:	After the Fund's initial closing, subsequent closings may occur no later than 15 months after the initial closing.
Commitment Period:	Three years after the final closing.
Term:	Eighth anniversary of its final closing, possible two additional one-year periods to permit the orderly liquidation of the Fund's assets.
Management Fee:	1%~1.5% stated

Distributions:	Return of Capital; then Preferred Return – 9%; then Incentive Allocation Catch-up - 50% to the Managing Member until the Managing Member has received 20% of the cumulative amounts of income distributed pursuant; then Incentive Allocation - 80% to the Member and 20% to the Managing Member.
Diversification:	15% limit on a single asset

Other Considerations

After the financial crisis there are fewer competitors left in the CMBS market, and the underwriting standards have gone up. For example, the average loan-to-value ratio has improved from 73% in 2007 to 61% in 2011. Back in 2007, 98% of the CMBS had partial or full, interest-only loans; today that number is below 20%. Torchlight has a special place in CCCERA's high performing domestic fixed income program as a return enhancer. Its high coupon rate is mostly fixed, and the targeted 9% distribution rate (income) also above the actuarial rate of 7.75%.