THE CHALLENGE OF CREATING A SUCCESSFUL EMERGING REAL ESTATE MANAGER PROGRAM

CalPERS asked Crosswater to assist the Real Estate Unit in designing and ultimately implementing a successful emerging real estate investment manager ("EM") program. The purpose of research into EM programs is to explore the opportunities that might be created for CalPERS to achieve superior returns by accessing underserved and overlooked market opportunities with managers who are "fresh talent". Since minority- or women-owned business enterprises ("MWBEs") are more likely to be EMs, implementation of an EM program can support CalPERS' diversity goals and tap into markets that may fall "under the radar" of more established firms.

Interestingly, there is no consistent definition of what an emerging manager is. It can be described as a 1st, 2nd or 3rd time fund, and/or by assets under management ("AUM"). Some definitions go as high as $3B and some define emerging managers exclusively as MWBEs.

The first phase of this assignment is Research and Program Design. To accomplish this phase, Crosswater interviewed staff of other large public pension funds that are active in the EM space. We interviewed all of the most experienced managers-of-managers. Finally, we interviewed a number of EMs. We also researched available data or research pertaining to the EM universe. Our findings follow.

SUMMARY OF RECOMMENDATIONS

•CalPERS should not attempt to run a real estate EM program internally, because analyzing, underwriting, mentoring and monitoring EMs is very staff intensive.

•Crosswater recommends that CalPERS define EMs as first through third funds with no greater than $1B AUM. This definition would allow EM managers to achieve a size that allows financial stability, without becoming so large that they are no longer "emerging".

•While it would be desirable for CalPERS to ultimately adopt a comprehensive EM program, this market space is still relatively undeveloped. Crosswater recommends that CalPERS take a "walk before you run" approach, with two program elements.

•The first element would have one or two of CalPERS proven, trusted partners with certain competencies (such as operating in inner city areas and other underserved markets) source local developer/operators who are entrepreneurial "value creators" and

have appropriate property level skills. The CalPERS partners would mentor these EMs and, if necessary, provide back office and other assistance. At some point, some of these managers will develop the capability to become free-standing managers of capital. We suggest a focus in California in larger population centers like Southern California and the Bay area where there is ample room for the emerging managers to compete with larger firms in locating attractive opportunities.

Crosswater recommends the following parameters

- $200 million program allocation
- California urban focus
- Seasoned investment manager(s) to select, oversee, and mentor emerging managers
- Program may consist of more than one investment strategy
- Program implementation must establish a process to identify up to four seasoned managers, which will in turn be responsible for investing with emerging managers
- Five year term
- Modest co-invest from emerging managers
- 50% leverage limit at the asset and fund level
- Opportunistic risk classification consisting of multiple property types
- Relationship structure between the seasoned manager and emerging manager will be developed
- Definition of emerging manager: Investment managers with less than $1 billion AUM and raising their 1st, 2nd, or 3rd commingled fund and/or separate account investment strategy

•The other element of the program comes from the recognition that EMs with the capability to serve institutional needs are likely to come from spin-outs from large, existing real estate firms. In order to further CalPERS diversity goals, it should institute an ongoing process to track the workforce diversity of existing investment manager firms, with a focus on key competency positions, where individual expertise and successful track records could be established creating the potential for spin offs.

At the same time, CalPERS can continue to explore opportunities to develop more comprehensive programs in association with its peers.

PENSION FUNDS WITH REAL ESTATE EMERGING MANAGER PROGRAMS

Crosswater interviewed the large public funds with EM programs to ascertain the size of the commitment, the definition of EM, and the structure being used. The universe of funds with a formal EM program is quite small.

New York City Retirement System

NY City committed $250 M to an EM program. They used a fund of funds approach and invested in AVP. AVP defines an EM as having limited or no experience managing institutional capital, managing less than $500M of institutional equity, and seeking under $250M in capital for an emerging fund. While AVP does not mandate minority- and women- owned business enterprises (MWBE) participation, they have a “soft” target of 30%.

Illinois Emerging Real Estate Consortium

The consortium includes the Illinois Municipal Retirement Fund, State Universities Retirement System, and the Public School Teachers’ Pension Fund of Chicago. The Consortium is mandated to fund MWBEs and Disabled-owned firms, all either emerging or established. They have committed $200M to this effort. They define EMs as firms with under $3B in assets. They do not limit managers by the number of funds they have raised. The Consortium issued an RFP and hired Franklin Templeton to manage the program in a fund of funds format. They expect to make their first commitment shortly, in the $25-35M range.

LACERA

LACERA has looked for EMs in all asset classes since the late 1990s. They have not targeted MWBE firms, but believe there are more of them in the EM space. They did a real estate EM search in 2001-2 and hired 3 firms in separate accounts. One was an MBE firm. They have invested in one commingled fund and also in a few small firms that target inner-city L.A. They have had mixed results. LACERA defines EMs as newer, independent firms that may not have substantial assets under management (generally, less than $2B) nor a long-term investment performance record (generally, less than 5 years). EMs can include, but are not limited to, minority-, women- and disabled veteran-owned organizations. The funding target is 0-20% of the real estate allocation. After funding, the EM can have no more than $4B AUM.

University of California Pension Fund

While they have no specific EM policy, staff has the authority to engage smaller, emerging firms and does so. They generally follow the LACERA guidelines (see above). They have $100M in a separate account (funded in 2008) and $400M in 8 commingled

funds (2006-2008). They are currently negotiating a contract for $150M with a separate account manager.

Texas Teachers' Pension Fund

Texas Teachers' committed $200M in a separate account to Credit Suisse to invest in real assets (mostly real estate, but also pipelines, energy, timber and so forth). Their definition of an emerging manager is that they have to be raising $500 million or less in fund 1, 2, or 3. While MWBE participation is not mandated, Credit Suisse tries to find MWBE firms and help them become ready to receive institutional capital. The program has been successful with good returns. Texas Teachers' staff is now working on a larger program with more direct investment with EMs, to be managed in house.

Texas ERS

TERS put out an RFP for an EM program last year, pursuant to a legislative directive. This directive defines EMs as managers with $2B AUM (it does not distinguish by asset class). For real estate, the staff and consultant narrowed that to $1.5B and either a first, second, or third fund. While there is a "focus" on MWBEs, there is no specific guidance.

However, the retirement system is directed to report to the board of trustees on the methods and results of the system's efforts to hire EMs, including data disaggregated by race, ethnicity, gender, and fund size. The program will invest $50M, to be placed with around ten managers. Morgan Creek Capital was selected to manage in a fund of funds format.

New York Common Fund

The New York Common established a $200M EM fund. They defined EMs as mangers working on their first, second, or third fund with under $750M of capital raised in each. The fund primarily targeted Europe and Asia, with 25% committed to the U.S. Within the U.S., they targeted funds in New York and MWBEs.

The fund put out an RFP in 2010 to solicit ideas on how to set up and manage an emerging manager program for their real estate portfolio. They are in the process of doing due diligence on the responses. They sought proposals from qualified, professional firms with expertise in the EM landscape and innovative ideas. They noted that they would consider separate accounts, fund of funds, commingled funds, co-investment or other investment structures. They did not specify a definition of EMs, but

asked applicants for their definition. Most responses emphasized firm size and newness to the institutional arena. While many had a MWBE component, it was not central to the definition. In general, the size limit was around $750M in committed capital. The managers would be raising capital for funds one, two, and three. The applicants generally proposed a fund of funds format. While New York suggests a $300M commitment to the program, some applicants suggest this is too high.

LA Fire and Police

The fund has had an EM policy since 1992, but the MBE real estate managers they use do not fit within that policy due to their size. In their stock and bond EM programs, all the EMs are MWBE's. Their criteria for an EM are $1.5-2.0B assets under management. Their results have been mixed.

Maryland ERB

Maryland issued an internally generated RFP last year, but has not acted on it, possibly because of the departure of the CIO.

NY Teachers

NY Teachers will be making a commitment to a WBE EM in the near future. This investment is not pursuant to a formal program. They occasionally host and attend conferences on MWBEs.

MANAGERS OF EM PROGRAMS

In our interviews, Crosswater learned of more than a dozen firms that manage separate accounts or funds of funds in the EM space for their clients. (NY Common received 13 responses to its RFP). However, most commentators named the same four or five firms as being the most experienced (not all of them have a MWBE focus). This is consistent with the NY Common preliminary analysis of the proposals it received. (Crosswater interviewed the five firms mentioned most frequently. We also interviewed a consultant to pension plans who has assisted clients in selecting these managers.)

One pension staff member noted that there is an "EM problem" with the managers of separate accounts and fund of funds themselves. When the fund put out an RFP for such managers, "some of the respondents were themselves emerging" and had

sponsorship risk. The pension fund wanted an established manager with strong back office capability and capital on the balance sheet. They wanted to know that the manager “will be there down the road”.

AVAILABILITY OF INVESTMENT OPPORTUNITIES

Crosswater researched the availability of data on the number of EMs and MWBE and similar firms in real estate. While there was no definitive listing (and definitions of these firms may vary), there were some sources of information.

CalPERS and CalSTRS are founding subsribers of the Altura Emerging Manager Information platform, which collects data on EMs and diversity managers across different asset classes. The data shown below is as of July 2011. A Real Estate EM is defined as a firm with $3B or less AUM. The firm must have a minimum of 45% employee ownership or must be majority owned by ethnic minorities and/or women and/or disabled veterans.

According to this database, there are 130 Real Estate EMs and diversity managers, some of which have more than 1 fund with over $10.4B total AUM in the Real Estate space. Of these, 32 (24%) are MBE/WBE, as follows:

Women-owned	12, with $20M AUM
Hispanic-owned	6, with $35+M AUM
African-American-owned	12, with $973+M AUM
Asian	7, with $661M AUM

A white paper prepared by Morgan Creek Capital on real estate EMs noted Prequin data as of August 2010 listing 109 sponsors in the market raising repeat funds and 96 sponsors raising first-time funds. Morgan Creek estimates that over 200 U.S.-based EMs are fundraising (as of August 25, 2010). Over a period of 18 months, Morgan received material from over 200 emerging manager funds, many of which are “spin outs”. They also estimate that the number of MWBE funds has more than doubled since 2008. They believe that there are around 40 MWBE managers raising capital for 70 funds.

In an interview with another manager of real estate EM programs, he noted that he has met with 140-150 different groups. They are start-ups, spin-offs, groups that have never raised a commingled fund, partners in national firms that want to branch out on their own, and separate account managers who want to go commingled. About 25% of these

firms are MBE/WBE. In total, he is aware of 80-90 firms that are MWBE. He noted that not all of the EMs are ready for investment and he is currently doing a "deep dive" on 30.

Similarly, another manager noted that they have met with over 400 EM firms since 2006, covering the entire spectrum of property type, sector, geography, and experience. They reviewed 250 proposals and funded 8 (there were others that were qualified).

A third interviewee has managed an EM program for a pension fund and now works for a real estate EM manager. She said the fund was successful in finding EMs and that the pipeline has grown since then (2007-8). She is aware of at least 50 funds she believes could be qualified.

Conversely, some other commentators mentioned that it took a great deal of due diligence to find qualified EMs (with MWBE as a subset).

EVIDENCE, IF ANY, THAT EMs ACHIEVE SUPERIOR RETURNS

There have been a number of studies that indicate that small managers can produce better returns for institutional investors (i.e. PCA Research Brief: A Review of Developing Managers and Developing Manager Programs). However, we could not find any such comparable analysis specific to real estate. The Morgan Creek Capital report notes that since the RTC era, smaller real estate funds have generated stronger returns than their larger counterparts and notes that based on performance tracked by Prequin, "over 50% of U.S. funds under $1B in size have been able to achieve 1st and 2nd quartile performance, relative to only 34% of funds larger than $1B". A report by Franklin Templeton on real estate EMs also concludes that the median and top-quartile performance of emerging real estate funds may exceed that of more established funds, but cautions that "the performance of small funds has typically been more dispersed, showing a broader range of performance on both the upside and the downside". (We note that Franklin Templeton and Morgan Creek are in the business of raising money to invest in EM programs.)

ADVANTAGES, IF ANY, OF INVESTING IN EMERGING REAL ESTATE MANAGERS

In addition to the theoretical potential for additional alpha, as discussed above, the studies referenced previously and the people we interviewed mentioned many possible additional benefits. The underlying concept is that "fresh talent" with new ideas, new strategies, new energy, and new structures have the potential to successfully deliver attractive returns and additional diversification to a real estate portfolio. As the Franklin Templeton report notes, "smaller managers have tended to be more focused on their strategy, better aligned with investors and more adaptable to changing market

conditions than their larger rivals, thus potentially supporting favorable relative performance in downturns as well as upturns". Further, "Emerging managers in real estate tend to be strongly motivated to exploit market inefficiencies, as they are intent on proving themselves in order to build a track record. Thus, frequently these managers are intensely focused on generating "best ideas" and have often been able to build liquid portfolios of "below-the-radar" opportunities, owing to the smaller amounts of capital available per investment."

One advantage of hiring MBE emerging managers is that they may be able to identify superior opportunities in areas underserved or overlooked by larger firms. Final advantages mentioned by pension fund staff were that by funding early stage managers, you have greater flexibility in negotiating terms to align interests, you build relationships from the beginning and engender loyalty, and you have the opportunity to stay with them as they emerge.

CHALLENGES TO DEVELOPING A SUCCESSFUL EM PROGRAM

SOURCING SUCCESSFUL CANDIDATES

Every year, scores of small groups of people attempt to become an emerging manager endorsed by respected institutional investors. Other EMs may be raising capital for a new fund. Virtually everyone we interviewed mentioned the intensive due diligence necessary to review such proposals. Most pension plans we talked with mentioned pension staff capacity issues. Typically, they, or their consultant prepared an RFP for a manager of their EM program (in a fund of funds format or separate account). As noted previously, there are only a handful of well-qualified managers. Only one pension plan is moving to add in-house capability in this area.

The fund of funds and separate account managers also referenced the intensity of the due diligence process. In some cases, after reviewing hundreds of proposals, only a few were found to be fundable.

Underwriting provides special challenges. Many EM managers do not have documentable track records. Also, when a group spins out of 1 or more established firms to create an EM program, how does the institutional investor determine attribution for deals that were done in the previous firm? Most established managers have a complex decision-making process involving acquisition staff, asset management staff, investment committees, and often more processes. Success or failure of an investment is due to a team effort. Determining whether the new manager's executives were actually the key participants in a cited successful investment strategy for an institutional manager can be difficult to verify.

REAL ESTATE IS DIFFERENT FROM OTHER ASSET CLASSES

Real estate is different than other asset classes in that the Investment Manager either directly or indirectly actually runs the asset. It must be managed, maintained, and improved. Thus, the management of real estate assets is more capital intensive, management intensive, and organizationally complex than other asset classes. Furthermore, emerging managers in other asset classes are likely to come from established firms and have experience dealing with the needs of institutional investors. Because real estate EMs are also likely to be local developer entrepreneurs, that leads to the next challenge:

MENTORING

As noted above, it is difficult to find EM proposals that are ready to be funded. It has been Crosswater's experience in working with several of PERS' emerging managers, and it has been confirmed in interviews, that many emerging managers need considerable help in adjusting to the requirements of the institutional investor world. Many of the emerging managers arise out of a more entrepreneurial environment, such as development, or from larger firms where the EM founder was not the most senior executive. These new managers require help managing those parts of the enterprise needed to comply with the demands of their institutional clients. (A classic example of this is the "no surprises" monthly/quarterly reporting that an institutional client expects from its managers.)

It has been Crosswater's experience that many emerging managers need mentoring from someone (an individual or firm) that is experienced in the institutional money management world and can provide a fiduciary "wrap" and help the manager navigate through the challenges of their early years of business. The EM program managers we interviewed provide such services: they may provide back office services themselves and help the managers to develop them, or recommend third-party providers.

EMERGING MANAGER FIRM ECONOMICS

While there is no precise level of assets under management that is needed to comfortably support an emerging manager's operations, it is, in Crosswater's view, somewhere between $500M and $1B. Without that AUM size, it is difficult for an emerging manager to fund the size, and more importantly, the quality of staff that an institutional investor would expect.

Many entrepreneurs who try to move into the institutional advisory business grossly underestimate the costs of legal compliance, institutional reporting, and client services involved in this business. If their revenues fall short, they face the choice of either cutting back their support functions or their investment functions, neither of which is in the interest of their investors. This need for an early infusion of capital leads to the next challenge:

RAISING CAPITAL

EM program managers and the managers themselves all referred to the lengthy, cumbersome, and expensive process of raising capital. One commenter pointed out that it can take $5-7M a year in revenue to support an operation while capital is being sourced. To limit their exposure, many investors will take only a piece of the offering or will tell the manager that they will commit when a threshold amount has been raised. The manager must then go to many institutions, each with its own due diligence process, trying to secure sufficient funds. The managers face a “chicken or egg” situation: raising a small amount of money may be a recipe for financial failure or taking an extended period of time to raise the requisite level of funds may be too costly for a start up or cause them to miss good opportunities in the meantime. (Some EMs have avoided this problem by finding a significant equity partner to support them through the fund-raising period.)

INCLUSION OF MINORITY- AND WOMEN-OWNED BUSINESSES

While California (following the enactment of Proposition 209) prohibits the selection of state contractors (including investment advisors) on the basis of sex or ethnicity, it is likely that a well-designed EM program will include minority- and women-owned firms as they are generally well-represented in the types of firms trying to break into the institutional business. Most fund of funds managers Crosswater interviewed had investments in MWBE firms, even if that was not a specific target. (The underwriting for all prospective investments was the same.) A few investors, like the Illinois consortium, are mandated by Illinois law, to target MWBEs.

STRUCTURING EM PROGRAMS

We found that the institutions doing EM programs used an EM program manager under either a separate account or a fund of funds format. Neither is ideal. Both expose the managers to protracted fund-raising. Theoretically, CalPERS or another institutional investor could put a sizable contribution into a single manager or manger-of-managers (as has been done in other real estate asset classes), but putting such an amount into an unproven team and/or strategy might not be considered prudent.

One EM program manager firm has a fund of funds model in which they gathered core investors before going out to seek managers. The firm believes that a passive, patient investor (group) whom the managers will eventually buy out is key to success. The investor needs to be supportive by lowering the cost of entry for the managers. The approach should be strategy-driven and then the managing fund should seek out the best people to carry out that strategy.

In this model, the investors provide managers (in addition to their allocation) $10 million in operating capital to fund and grow operations. The investors hold an equity position, but at some point, the managers can buy them out at a discount. The program manager fund takes a fee for the work it does for the managers. They provide infrastructure, mirror all the pieces the EMs must have to service institutional capital, and work with the EMs to develop these capabilities in practices and procedures.

The investors have a right to 70% of a manager's subsequent fund. The goal is to then launch them on their own.

Another suggested model was to have the EMs providing property-level execution while a consultant or another firm is the intermediate fiduciary, providing support services and mentoring. This intermediate fiduciary could take an equity position with the general partner and retain approval rights until sufficient additional capital was raised and those rights were ratcheted back. (This could solve the problem in the fund of funds approach of the investor giving up governance. More than one commentator remarked on the need for "adult supervision".)

NOT ALL EMERGING MANAGERS ARE ALIKE

If the goal of the EM program is to serve as a feeder program into the core real estate category, there will be EMs at various stages on the continuum of acquiring that capability. Some will be truly new, first stage, and will require smaller capital allocations and more mentoring and help with back office services. Other will be further along (perhaps on a second fund). Still others may be newly emerging but because of principals' experience with larger firms and/or an investment by a GP partner, may look more like a second-stage fund. A robust EM program should include all of them and treat each category differently, as appropriate.

FOCUS AND DISCIPLINE

Through Crosswater's actual experience with several of PERS emerging managers and through our interviews, we conclude that EMs who maintain a highly focused and disciplined strategy are more likely to succeed. EMs usually pursue a strategy based on their personal investment experiences, such as specific property types or locations.

Crosswater observed that several EMs PERS had invested in because they had successful, focused programs drifted far afield from their core competencies and into new markets or property types, which usually led to failure.

Further, some commenters noted that EMs who received institutional capital in the past were developers and operators, not asset managers. The DNA is different. A well-designed EM program should recognize the distinction and assign managers to roles that play to their strengths and competencies and design ways to mitigate their weaknesses.

RECOMMENDATIONS

As was discussed above, not all EMs are alike. Some may be entrepreneur/developers who should be involved in the program at the operating level with oversight (and perhaps grown into asset managers). Some are true start ups that may not be ready to manage institutional capital. Others may be able to do so with mentoring and back office and/or other assistance. Others may be ready for their first funding, but face the challenge and difficulties of fund raising. Some of these may have secured significant GP funding and thus seem more like a second fund. Others may be second-fund (or third-fund, if included in the definition) ready. A comprehensive EM program should accommodate all of these. CalPERS may choose to implement such a comprehensive program, or initiate elements of it and grow into it over time. Crosswater is suggesting a range of options that will allow it to do either.

GENERAL RECOMMENDATIONS

• CalPERS staff should not attempt to initiate the elements of an EM program internally. As noted, analyzing, underwriting, mentoring, and monitoring EMs is very staff-intensive.

•The most comprehensive and efficient method of initiating all or most of the elements of an EM program will be to select one of the experienced practitioners already operating in this space. There are only a handful of such firms currently serving institutional clients.

•EMs are likely to be more costly in terms of fees an other capital support initially. CalPERS should be prepared to incur these costs and recoup them in the form of preferences, reduced ongoing fees, and superior returns.

•To allow EM managers to achieve the economics required for comfortable sustainability, Crosswater recommends that CalPERS define EMs as first through third fund and no greater than $1B AUM.

PROPOSED PROGRAM ELEMENTS

FORM A COALITION OF LIKE-MINDED FUNDS

Theoretically, Crosswater believes that the most effective model to address the challenges described above would be for CalPERS to join with a group of 3-5 like-minded pension funds to form a “consortium” that would hire a single EM program manager (or consultant) to initiate the EM program on behalf of all of them. As a practical matter, it may be extremely difficult to get 3-5 pension funds to agree on the details of such a program. At best, it will be time-consuming.

While this format would necessitate some loss of control, it provides for risk-sharing and eliminates the need for selected EM managers to spend the time and resources on protracted fund raising. It also streamlines the due diligence process for the EMs. The EM program manager firm would perform the following:

•Source EMs along the entire spectrum described above.

Developer/operators would be sourced and selected for their ability to tap into underserved areas of the real estate market, such as the inner cities and Hispanic and Asian neighborhoods. Those deemed to have the capabilities would be groomed, with the assistance of the EM program manager, to take on asset allocation responsibilities.

If the EM program manager discovers potential EMs that have promise but are not yet ready to manage institutional capital, the manger would remain in contact and assist the manger in finding the resources to help them develop the skills they need.

For those managers who, based on the EM program manager’s underwriting, are fundable but need assistance in developing institutional level capabilities, the EM program manager would provide the back office and other support services needed (or help the manager find third-party providers), with the goal of enabling them to become completely self-sufficient over time.

For managers deemed fully ready for institutional capital, the EM program manager would perform the underwriting and negotiate the terms on behalf of the “consortium”.

•Work with the consortium to develop underwriting for EMs at all stages of the spectrum, including the ability to attribute performance to individuals spinning out of established firms.

•Work with the consortium to develop mechanisms to serve the capital needs of the EM managers. As discussed earlier, it is costly for EMs to operate while they are growing sufficient AUM to be sustainable. The consortium should be willing to commit necessary upfront capital to assist these managers, and perhaps higher initial fees, with mechanisms to recoup those costs, such as preferences on subsequent funds, reduced ongoing fees, capital return preferences, etc. (And, of course, the expectation of superior returns.

ASK MANAGERS OF EM PROGRAMS TO WORK COOPERATIVELY

Another means of obtaining some of the benefits described above without entering into an arrangement with other pension funds is to join with them to encourage the firms that operate EM programs to act in concert with respect to funding qualified EMs. If one firm finds a prospect, they could facilitate bringing that EM to the others to shorten the funding process. They might also be able to standardize some of the due diligence.

INTERIM EM PROGRAM WHILE EXPLORING MORE COMPREHENSIVE ALTERNATIVES

While CalPERS considers and potentially acts on these alternatives (and allows the EM market to further mature), it could initiate an EM program that could later be subsumed into a more comprehensive program. This EM initiative would have two components.

The first is having one or two of CalPERS' proven, trusted partners with certain competencies (such as operating in inner city and other potentially underserved markets) source the local developer/operators who are entrepreneurial "value creators" and have appropriate property level skills. This approach would have the advantage of increasing MBE, and possibly WBE, participation in the program. The CalPERS partners could mentor these managers and provide back office and other assistance. At some point, a few of these managers will develop the capability to become free-standing managers of capital.

CalPERS should be prepared to adjust fee percentages upward to reflect the smaller size of these investments. CalPERS should also be prepared to take a preferred position in the emerging manager's platform as well as in their real estate investments, with mechanisms to recoup these costs.

The other element of the program would come from the recognition that EMs with the capability to serve institutional needs are very likely to come from spin-outs from large, existing firms. In order to further CalPERS' diversity goals, it should institute an on-

going, rigorous monitoring program to ensure that these firms that serve CalPERS are hiring, mentoring, and developing the skills of talented minorities and women in the core competencies of the business. This program could also be incorporated into the RFP process.

CROSSWATER RECOMMENDATION

Given the relative newness of the real estate EM marketplace and the challenges we have described, Crosswater recommends a “walk before you run” approach. We believe CalPERS should implement the last model described above; that is, having its trusted partners’ source and mentor EMs. We suggest a focus in California in larger population centers like Southern California and the Bay Area where there is ample room for the emerging manager to compete with larger firms in locating attractive opportunities. CalPERS should also design and implement the program to encourage the career development of women and minorities in core real estate firms. At the same time, CalPERS can continue to explore opportunities to develop more comprehensive programs in association with its peers.