

New Jersey State Investment Council December 8, 2011 Regular Meeting Minutes

Minutes of the Regular Meeting

Held December 8, 2011 at 11:00 AM at in the NJ State Museum Auditorium, 205 West State Street, Trenton NJ.

Council Members in Attendance:

Robert Grady, Chair
Marty Barrett
Brendan T. Byrne, Jr.
Guy Haselmann
James Joyner (joined at 11:10)
James Marketti
Peter Maurer
Timothy McGuckin
Jeffrey Oram

The Regular Meeting was called to order by Chair Grady at 11:08 AM.

Roll Call and Meeting Notice

Ms Christine Eckel performed roll call and reported that notice of the Regular Meeting scheduled for December 8, 2011 was posted on the Division's website and faxed to the Times of Trenton, the Star-Ledger, the Bergen Record, the Courier Post and the Secretary of State on November 21, 2011. A copy of the notice was posted at the Division and is on file. Mr. Hanson was not in attendance for this meeting.

Approval of Minutes for Regular Meeting held October 13, 2011

Chair Grady asked the Council Members if they had any comments on the minutes for the October meeting. One comment was a correction to the time of the meeting, which was at 10:00 AM, not PM as stated in original minutes. A motion was made by Chair Grady to approve the minutes for the October 13, 2011 meeting, as so corrected, with Council Member Byrne seconding the motion. All Council Members voted in favor.

Proposed Meeting Schedule for Calendar 2012

The proposed meeting schedule for Calendar year 2012 was presented to Council with six (6) Regular meeting dates and three (3) optional dates listed. Mr. Barrett suggested that all nine dates be scheduled as Regular meetings, with the three dates presented as optional being subject to cancellation by the Chair. Chair Grady also asked that the November 15 date be changed to November 8, 2012. A motion was made by Mr. Marketti to approve the dates for the Calendar year of 2012 as amended, with Mr. Byrne and Mr. Haselmann seconding the motion. All Council Members in attendance voted in favor of the motion.

Directors Report/Update

Director Walsh advised the Council that October was a "Risk On" month across the board as investors worldwide became more optimistic about a favorable outcome of the European debt crisis. Global Equity markets bounced back in with US markets up 10%, developed non-US markets up 10% and emerging markets up 13%.

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Director Walsh stated that the Fund underperformed the benchmark in October by 163 bps. The underperformance was driven by an overweight to Treasuries and investment grade credit. The Director stated that that asset allocation has also been the primary source of the 185 bps of outperformance fiscal year to date. Total assets as of October 31, 2011 were \$69.9 billion, up \$3.4 billion since the end of September.

Deputy Director McDonough advised the Council the Fund, excluding the Police and Fire mortgage portfolio, was down 1.18% for the month of November and down 3.78% for the fiscal year. Chair Grady commented that the Fund was up in the last week from November 30.

Secondary Sales/Purchase

Private Equity Secondary Sales

Jason MacDonald updated the Council on the sale of private equity limited partnership interests, which was proposed by staff earlier in the year. Due to attractive market dynamics, the Division was able to capitalize and sell most of the interests for what it believes to be a positive outcome. The portfolio received a high level of demand from numerous market participants, and priced very well relative to the broader market. The average high bid for buyout funds sold by Cogent in the first half of 2011 was 87% of Net Asset Value. The Division's transaction in the aggregate (for Agreements signed to date) has priced at 97.9% of Net Asset Value. Although the portfolio priced higher due to allowing deferred payments, typical deferred transactions only add about 5-6%, whereas the Division's portfolio added about 10%.

Blackstone Real Estate Partners VI (Secondary Purchase)

Director Walsh updated the Council on the secondary purchase of Blackstone Real Estate Partners VI. The Division made an investment of \$36,059,453 plus \$6,081,686 of uncalled commitments in the Fund. This investment in BREP VI was purchased by the Division from a distressed seller at a 22% discount to the March 31, 2011 net asset value of the Fund. The Division had previously committed \$100 million to BREP VI in 2007 and as of 9/30/11 the fund had generated a multiple of 1.33 and IRR of 12.7%.

Bank Loan Investments

Cerberus/NJ Loan Fund

Director Walsh along with Harshal Shah of Strategic Investment Solutions (SIS) presented the proposed investment of \$300 million in Cerberus/NJ Loan Fund. The Fund is mandated to take advantage of the significant supply/demand imbalance of loans being originated to middle-market businesses. This has created an attractive investment opportunity with potential gross returns in the 9% to 15% range. Cerberus' 16 year track record, with average net returns of 8-12%, compares favorably to other direct lenders and indices. Cerberus has one of the longer tenures as a direct middle-market lender which provides a sourcing advantage against other funds. By structuring the investment as a separately managed account, the Division has greater control over the invested assets and more attractive terms. Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council member Marketti went on record as being opposed to this investment.

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Real Estate Investments

Exeter Core Industrial Venture

Director Walsh along with Sally Haskin of Callan Associates presented a proposed investment of \$200 million in Exeter Core Industrial Venture. The Division believes an investment in the Fund is attractive for several reasons. First, as one of two prospective Limited Partners of the Fund, the Division will benefit from increased transparency regarding investment decisions of the fund. Secondly, the fund is led by a team that has a demonstrated track record of acquiring and managing industrial real estate. The team's experience ranges from managing private, commingled investment vehicles, to overseeing the operations of a publicly-traded Industrial real estate investment trust. Finally, the fund will focus on the more stable end of the growing industrial real estate segment, and will target cash yields of 7% to 7.5% and a leveraged gross internal rate of return between 9% and 12%. This investment will provide increased diversification of the real estate portfolio by accessing an attractive market segment that is underrepresented in the real estate portfolio. Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council member Marketti went on record as being opposed to this investment.

Private Equity Investments

American Industrial Partners Capital Fund V

Christine Pastore along with Harshal Shah of SIS presented a proposed investment of up to \$100 million in American Industrial Partners Capital Fund V (AIP). The Division is recommending this investment of a number of reasons. The AIP team consists of experienced investment and operating professionals with a majority of the partners working together for 10 or more years. This strong team allows AIP to focus on complex transactions and companies with operational challenges. Fifty percent of their transactions have been sourced on a proprietary basis. The team has been able to add value to their portfolio companies by implementing cost reductions through meaningful operational improvements, rather than relying on financial engineering to generate returns. EBITDA has doubled, on average, during AIP's ownership of portfolio companies. All this has resulted in top quartile performance in their recent funds. Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council member Marketti went on record as being opposed to this investment.

General Catalyst Group VI

Christine Pastore along with Harshal Shah of SIS presented a proposed investment of \$25 million in General Catalyst Group VI, L.P. As part of the Division's mandate to find top quality venture capital firms to commit to on a direct basis, staff and SIS have identified General Catalyst (GC) as a firm that fits those goals. Staff reported that the Division views GC as a firm that is positioned to capture 'best in class' opportunities over the next cycle and an attractive investment for New Jersey. GC has established itself as a formidable, entrepreneur-friendly VC with wide breadth and depth of expertise. GC has proven its ability to create significant, proprietary investment opportunities by "hatching" startups internally, and gaining significant ownership in portfolio companies at attractive valuations.

to date, long-term investors committing their pro-rata share to all prior GC funds have received top-quartile returns (as measured by the aggregate total value relative to their paid-in-capital); and the

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potential for further upside in prior funds remains, especially as a number of portfolio companies of prior GC funds are currently in registration for initial public offerings.

General Catalyst's recent geographic expansion to Silicon Valley and the New York metro area promises to increase the Firm's access to unique early-stage opportunities and provides an opportunity for successful breakthrough, industry-shifting investments. Chairman Grady and staff discussed a smaller amount to be invested, ranging between \$15 and \$20 million. Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council member Marketti went on record as being opposed to this investment.

Hedge Fund Investments

Regiment Capital

Deputy Director McDonough along with Jake Walthour of Cliffwater proposed an investment of \$150 million in Regiment Capital Ltd. Fund. Regiment's philosophy is to conduct disciplined, credit-intensive research with a particular focus on risk-adjusted returns and protecting capital. Mr. McDonough stated that, given the portfolio's current tilt towards stressed and distressed type managers, Regiment's capital protection theme and market neutral strategy lends itself to diversifying the credit hedge fund and overall hedge fund portfolio. Regiment has maintained a stable investment team, and the three portfolio managers have all worked together since the inception of the firm. The fund has better than average fees compared to other top tier credit funds, charging a 1.25% management fee and a 20% performance fee. In addition, the fund has a preferred return equal to 3-month LIBOR. Director Walsh commented this fund has a very conservative track record. Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council member Marketti went on record as being opposed to this investment.

Arden

Jake Walthour of Cliffwater presented the Division's proposed add-on investment of \$150 million to its existing investment in Arden Institutional Advisors, LP Fund. The Division is recommending this investment for a number of reasons. The Pension Fund is \$800 million underweight in absolute return hedge funds and this add-on investment will move the allocation closer to target in a segment of the portfolio that should benefit from the current macro driven environment. The proposed portfolio will be managed by a very seasoned portfolio manager, Shakil Riaz, who joined Arden in 2009 after 15 years of managing an internal hedge fund of funds for J.P. Morgan's proprietary capital. The customized account provides the Division with access to closed top tier global macro managers and access to funds with improved liquidity. Also, the Division will have the ability to review all proposed additions and redemptions within the portfolio. This will allow the Division to have input into the structuring of the portfolio in a manner that will complement the Pension Fund's direct investment portfolio. Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council member Marketti went on record as being opposed to this investment.

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Blackstone Strategic Relationship

Director Walsh along with Pete Keliuotis of SIS proposed investments in three commingled funds, Blackstone Energy Partners (\$150M), GSO Special Situations Fund (\$100M), and Blackstone Capital Partners VI (\$50M), and four opportunistic separate accounts, GSO Energy LP (\$250M with a cap of \$500M), GSO Credit Opportunities Fund (up to \$250M) and BX-NJ Tactical Private Equity Opportunities LP segregated with an account for Private Equity and an account for Real Assets (tactical accounts will have an initial aggregate commitment up to \$750M, with an aggregate cap of \$1 billion). The four opportunistic accounts will not exceed \$1.5 billion in the aggregate, but the Division will maintain investment flexibility with respect to \$250 million of the amounts allocated between the GSO Energy and the two Tactical Opportunities accounts.

The Division has a long history of successful investments with the Blackstone Group and is seeking to develop an investment program with Blackstone that adds value across the alternative investment platform. The Division expects to derive significant benefits from the relationship, including expanded investment opportunities, an experienced investment management team focused on the relationship, enhanced support to Division resources, a discounted fee structure, alignment of interest and the Division's ability to retain veto influence over separate accounts. Chair Grady reported that the Investment Policy Committee has determined that appropriate and adequate due diligence was performed. Council members Marketti and Maurer went on record as being opposed to this investment. A motion was made by Chair Grady to approve the Blackstone investments described above. The motion was seconded by Council Member Oram. Seven Council members, Messrs. Grady, Barrett, Byrne, Haselmann, Joyner, McGuckin and Oram, voted in favor of the motion and two Council members, Messrs. Marketti and Maurer, voted against the motion. The motion carried.

Adoption of Proposed Amendments to N.J.A.C. 17:16-62, 62, 67 and 69

There were no comments on the proposed amendments to N.J.A.C. 17; 16-62(Common Pension Fund A), 63 (Common Pension Fund B), 67 (Common Pension Fund D) and 69 (Common Pension Fund E), filed with the Office of Administrative Law (OAL) that appeared in the New Jersey Register. Chair Grady motioned to approve this Adoption and was seconded by Council Member Haselmann. A vote was taken, with all Council Members in favor of the adoption.

Proposed Amendments to N.J.A.C. 17:16-71

Director Walsh, along with Christine Pastore and Susan Sarnowski, proposed amendments that would: permit debt related investments in real estate and real assets in addition to currently allowed equity investments; expand the definition of real assets to include energy, water, mining, utilities and agriculture investments as well as related investments in products, services and technology; and expand permissible investments to include commodity-related investments (e.g. exploration, production, processing, transportation, storage or trading of commodities, or other similar activities). This would allow the Division to add exchange-traded funds in the future, to allow for greater diversification. A motion to approve the proposed amendments to N.J.A.C. 17:16-71 was made by [Chair Grady] and seconded by Council Member Haselmann. A vote was taken with eight Council members, consisting of

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Messrs. Grady, Barrett, Byrne, Haselmann, Joyner, Maurer, McGuckin and Oram voting in favor of the motion. Mr. Marketti, who had stepped out of the meeting at the time, did not vote on the motion.

After the discussion of the Proposed Amendments to N.J.A.C. 17:16-71 described below, Chair Grady made an additional motion that the Council clarify that, pending final adoption of such proposed amendments, any energy-related investments made through the Blackstone entities described above shall be treated as real assets for purposes of, and are hereby approved pursuant to, N.J.A.C. 17:16-71.2(b). The motion was seconded by Mr. Haselmann. A vote was taken with all members in attendance voting in favor of the motion except Mr. Marketti, who voted against the motion.

Presentation by John Megariotis

John Megariotis, Deputy Director for the Division of Pensions and Benefits presented the Council with an update on the pension system, including revenues and net cash flows.

Mr. Megariotis next gave an overview of the components and expected results of recent pension reform legislation. Mr. Megariotis reported on the resulting increase in contributions to date as well as projected increases and the impact on unfunded liability.

Several members of the audience and the Council commented on various aspects of the pension reforms.

Report from the Treasurer

Chris Jeter stated that there was no report from the Treasurer.

Opportunity for Public Comment

Mr. Abella, of Investment Partners Asset Management, spoke about the Pension Funds' Total Assets and projected rates of return. Mr. Abella provided Council with a written copy of his speech to the Council, which the Council has on file.

Chair Grady motioned to adjourn meeting, with Council Member Oram seconding the motion. All voted in favor. The meeting was adjourned at 3:07 pm.