



# State of New Jersey

DEPARTMENT OF THE TREASURY  
DIVISION OF INVESTMENT  
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*State Treasurer*

March 18, 2011

MEMORANDUM TO: The State Investment Council

FROM: Timothy Walsh  
Director

SUBJECT: **Proposed add-on to Och-Ziff Structured Credit**

This due diligence memorandum is presented to the Investment Policy Committee pursuant to N.J.A.C. 17:16-63.9, to propose an additional \$200 million commitment to the already existing \$300 million in Och-Ziff Structured Credit, an NJDOI separate account, to be managed by Och-Ziff Capital Management Group based in New York.

The Division of Investment ("Division") Staff and its hedge fund consultant, Cliffwater, undertook extensive due diligence on these proposed additional investments. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council.

**Och-Ziff Capital Management Group ("OZ" or the "Firm")** is a top tier hedge fund management firm founded in 1994 by Daniel Och and the Ziff family. The firm is an SEC registered investment firm since 1998, and currently has ~400 employees globally. OZ manages ~\$28 billion in multi-strategy, capital structure arbitrage, and special situations funds. In the summer of 2007, Och-Ziff began to build an investment team to focus on structured credit. The structured credit team consists of 12 full-time dedicated employees, and currently manages \$3.9 billion in assets. The objective of the OZ Structured Credit separate account is to achieve low to mid-teens unlevered returns by investing opportunistically across a variety of structured credit securities, including residential and commercial mortgage-backed securities ("CMBS" and "RMBS"), cash and synthetic Collateralized Debt Obligations ("CDOs"), and certain non-mortgage asset-backed securities ("ABS"). OZ pursues a long-biased approach with very limited use of tactical index shorting. OZ seeks to purchase securities which have asymmetric expected return distributions, and selectively apply leverage to certain securities to enhance yields when the downside risk is perceived to be limited.

In April of 2010 a separate account of \$300 million was created to make investments in structured credit securities with Och-Ziff Management Group. Staff is proposing to invest an additional \$200 million to this account. This account provides a unique exposure to primarily US mortgage, asset backed and other structured credit securities for the fixed income portfolio in Common Fund B. Since the investment, the OZSC fund has generated steady and positive returns through a combination of positive carry, trading gains and spread tightening. The fund has earned a cumulative net return of ~18% with an NAV of ~\$385 million, and the manager continues to believe that there are attractive opportunities in a variety of asset types and structures as many legacy risk holders continue to unwind their positions. The terms of the separate account are also very attractive in comparison to the multi-strategy fund (Management fee - 75

bps, Carry – 20% and 8% preferred return). The firm and the partners of the firm have also personally invested a substantial amount of money into these strategies alongside its LPs.

We will work with representatives of the Division of Law and outside counsel to review and negotiate specific terms of the legal documents to govern each investment. In addition, each proposed investment must comply with the Council's "pay to play" regulation (N.J.A.C. 17:16-4).

Formal written due diligence reports for the proposed investments were sent to each member of the Investment Policy Committee and a meeting of the Committee was held on March 17, 2011. In addition to the formal written due diligence reports, all other information obtained by the Division on the investments was made available to the Investment Policy Committee.

We look forward to discussing this proposed structured credit investment at the Council's March 24, 2011 meeting.

Attachments

**State Investment Council Fund Review Memo**

**To:** State Investment Council  
**From:** Division of Investment  
**Date:** March 24, 2011  
**Subject:** Och-Ziff Structured Credit Separate Account, LP  
**Recommendation**

**Fund Facts**

Fund Name:	OZSC, L.P.
Fund Type:	Structured Finance Securities
Current Fund Size	\$389.3 million as of January 31, 2011 (inclusive of capital attributable to affiliates of Och-Ziff and accrued carried interest)
Inception:	April 2010
Fund Address:	9 West 57th Street New York, New York 10019

**Investment Rationale:**

This is an additional investment to a structured credit strategy in the fixed income portfolio of Common Fund B. NJ invested \$300 million with Och-Ziff Capital Management Group in April of 2010 in a separate account that makes investments in structured credit securities and instruments. This investment is intended to provide exposure to primarily US mortgage, asset backed and other structured credit securities and instruments for the fixed income portfolio in Common Fund B. Since the investment, the OZSC fund has generated steady and positive returns through a combination of positive carry, trading gains and spread tightening. The fund has earned a cumulative net return of 18.46% as of January 31, 2011. The manager continues to believe that there are attractive opportunities in a variety of asset types and structures as many legacy risk holders continue to unwind their positions.

**Summary of Terms and Investment Strategy**

<b>Investment Strategy:</b>	<p>The objective of the fund is to achieve absolute returns over the duration of the term, primarily by seeking to purchase stressed or distressed structured credit securities and other structured credit instruments. The fund invests and trades primarily in a portfolio of structured credit securities, but its portfolio also includes debt instruments, options, futures, swaps and other derivatives. The fund may use leverage in the investment program, subject to agreed-upon limits, and its portfolio may include both long and short positions.</p> <p>The fund will invest its assets in an investment program implementing a multi-strategy approach to U.S. structured products including, without limitation, asset-backed securities (including, without limitation, residential mortgage backed securities, commercial mortgage backed securities, and non-mortgage asset backed securities), collateralized debt obligations ("CDOs") (including, without limitation, collateralized loan obligations, trust preferred CDOs, commercial real estate CDOs, collateralized synthetic obligations, multi-sector CDOs, other corporate CDOs and asset-backed securities CDOs), re-securitizations, re-remics, synthetic versions of any of the foregoing and other structured finance securities or instruments.</p> <p>The investment program may also include residential and commercial whole loans (and related structured transactions in which the underlying credit risk is based on such whole loans). The fund may invest any uninvested capital in cash and cash equivalents including, without limitation, money market funds, short-term government bonds or Treasury bills, marketable securities, commercial paper and any other similar investment the general partner determines in its discretion is appropriate. The fund may enter into hedging transactions relating to the assets and liabilities of the fund.</p>
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<b>Fee Terms:</b>	
Management and Performance Fees	Management fee - 0.75% Performance fee - 20% of realized proceeds in excess of an 8% preferred return, subject to GP catch-up
Other Fees:	Audit fees, legal fees, organizational expenses and professional fees (not including brokerage commissions and other transactional costs) - 0.19% of aggregate committed capital as of December 31, 2010.
Hurdle Rate:	8% preferred return
Service Providers	
Prime Broker(s)	Credit Suisse, JP Morgan
Administrator(s)	Citico
Auditor(s)	Ernst & Young
Legal Counsel	Skadden Arps

<b>Liquidity/Redemption Terms</b>	
Lock-up	The fund is structured as a private equity fund, partners are not entitled to withdraw capital
Redemption	

**Side Pocket:** N/A - Private equity structure

**NJ AIP Program:**

Recommended Allocation (Lumina)	\$200 million (allocation to Lumina) / \$200 million (original investment) (Jan 31, 2011 NAV) / \$324.1 million (inclusive of capital attributable to affiliates of Och-Ziff and accrued carried interest)
% of Fund	90.41%
% of New Jersey State Pension Plan	0.71%
% of Common Fund B Fixed Income Allocation (\$25b)	2.00%

Consultant Recommendation	Yes
See due diligence memo	
Compliance with SIC "Play to Play" Prg	Addressed in partnership agreement

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