



## State of New Jersey

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July 27, 2012

MEMORANDUM TO: State Investment Council

FROM: Timothy Walsh  
Director

SUBJECT: **Proposed Investment in Och-Ziff Separate Accounts**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$600 million in various **Och-Ziff separate accounts**. This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

The Och-Ziff investments will consist of an increased investment in an existing separate account and four new separate accounts managed by Och-Ziff Capital Management Group (“OZ” or the “Firm”): an additional commitment of up to \$200 million to the existing bank loan fund OZSC, LP with an extension of the current investment period, \$200 - \$500 million in bank loan fund OZSC II, LP, up to \$400 million in a hedge fund account OZNJ – Credit Strategies, up to \$200 million in a real estate account OZNJ – Real Estate, and up to \$150 million in a real assets account OZNJ – Real Assets. The investments will be partially funded through a \$100 million redemption from the existing hedge fund investment in OZ Domestic Partners II, L.P. (the “Master Fund”) and a new commitment of \$500 million. The aggregate new capital allocated across these four accounts will not exceed \$600 million.

The Division is recommending this investment based on the following factors:

**Significant Under-Allocation to High Yield and Real Assets:** The Division is under its targeted exposure to high yield, real estate, and real assets in the FY 2013 Investment Plan. The proposed commitment would help the Division get closer to the target allocation in each of these areas as well as continue to foster the close working relationship and increase the information sharing with the Manager, thus enhancing Staff’s ability to make more informed investment decisions when implementing the overall asset allocation plan.

**Alignment of Interest and Enhanced Governance:** OZ and OZ’s partners have committed 10% of the Division’s existing investment in OZSC, L.P. and will commit to the separate account platform an aggregate amount equal to 5% of Limited Partner capital commitments, subject to an aggregate maximum commitment of \$100 million. Additionally, Division staff will retain significant input into separate account transactions, retaining (i) a full veto right on private investments, (ii) ability to suspend the investment period at regular intervals, and (iii) ability to

adjust committed amounts to the most attractive investment opportunities. This significant level of influence provides the Division with the ongoing ability to better manage its portfolio risk exposures, to regulate the pace of investments, to respond to changing market opportunities, and to ensure that the Division continues to receive the highest level of attention on an ongoing basis.

**Discounted Fee Structure and Favorable Terms:** As of June 1, the Division has approximately \$626 million invested through a separate account and is proposing to add up to \$600 million at 75 bps on invested capital (with no fee on committed capital) with a 6% preferred return. This discounted fee arrangement will allow the Division to invest the first \$267 million of the new capital without increasing the management fees paid to OZ as we will be moving \$100 million out of the higher cost Master Fund and into the lower cost separate accounts. Additionally, netting of all investment returns across the separate accounts and payment of carried interest at the end of the investment term should significantly reduce the likelihood of paying performance fees unless the overall separate account relationship is profitable.

**Strong Performance from one of the Division's Long Standing Relationships:** The Division has been investing with OZ for more than six (6) years and has approximately \$838 million in net asset value (as of May 2012) invested across two (2) products, the Master Fund and OZSC, L.P. (current separate account), a single investor limited partnership which has a high yield/bank loan investment mandate. The net IRR of the Division's investment in the Master Fund through May 2012 is 6.23%. This compares very favorably with a 4.44% return to the Dow-Jones Credit Suisse Multi-Strategy Index over the same period. The net IRR of the current separate account through May 2012 is 15.43%. The Barclays High Yield Index returned 9.34% over the same period.

**Expanded Investment Opportunities with a Primary Focus on High Yield Assets:**

Broadening the mandate will allow the Division to increase its access to the broader credit/high yield expertise of OZ while providing an opportunity to invest in other product types within the Firm that have generated strong returns. The Division believes that it is an opportune time to further expand the relationship with OZ, given the market dislocation and capital constraints that have created investment opportunities that match OZ's capabilities. OZ continues to believe that there are attractive opportunities in a variety of asset types and structures, as many legacy risk holders continue to unwind positions and as firms seek to raise their liquidity profile.

A report of the Investment Policy Committee ("IPC") summarizing the details of the proposed investment is attached.

Division Staff and its hedge fund consultant, Cliffwater LLC, undertook extensive due diligence on the proposed investment in accordance with the Division's Alternative Investment Due Diligence Procedures. As part of its due diligence process, staff determined that the fund has not engaged a third-party solicitor (a "placement agent") in connection with New Jersey's potential investment.

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 the investment. In addition, the proposed investment must comply with the Council's regulation governing political contributions (N.J.A.C. 17:16-4).

Please note that these investments are authorized pursuant to Subchapters 23, 63, 69, 71 and 100 of the Council's regulations. The bank loan accounts, OZSC, LP and OZSC II, LP will be classified as bank loan funds as defined under N.J.A.C. 17:16-23.1. The hedge fund account,

OZSC/NJ – HF, will be classified as a credit-oriented hedge fund as defined under N.J.A.C. 17:16-100.1. The real assets account, OZSC/NJ – RA, will be classified as a real asset investment as defined under N.J.A.C. 17:16-71.1. The real estate account, OZSC/NJ – RE, will be classified as a non-core real estate investment as defined under N.J.A.C. 17:16-71.1.

A formal written due diligence report for the proposed investment was sent to each member of the IPC and a meeting of the Committee was held on July 18, 2012. In addition to the formal written due diligence report, all other information obtained by the Division on the investment was made available to the IPC.

We look forward to discussing the proposed investment at the Council's August 2, 2012 meeting.

Attachments

Fund Name: Och-Ziff New Jersey Separate Account Investment Platform

Contact Info: **JK Brown, jkbrown@ozcap.com**

**Fund Details:**

Firm AUM (\$bil):	\$29.3 billion (as of July 1, 2012)
Strategy:	Opportunistic
Year Founded:	1994
Headquarters:	New York
GP Commitment:	10% existing; 5% new

**Structure Outline**

<u>Separate Accounts</u>	<u>Strategy</u>
OZSC	Credit (up to \$200 million of additional)
OZSC II	Non- US Credit (\$200 - \$500 million)
OZHF - NJ	Credit and Private Debt (up to \$400 million)
OZRE - NJ	Real Estate (up to \$200 million)
OZRA - NJ	Real Assets (up to \$150 million)

**Key Investment Professionals:**  
**Daniel Och, (CEO) Chairman of the Board of Directors and the Partner Management Committee.** Prior to founding the firm in 1994, was co-head of proprietary equity trading at Goldman, Sachs & Co.  
**David Windreich, (Executive Managing Director) Head of U.S. Investing for Och-Ziff and is a member of OZM's Board of Directors and Partner Management Committee.** Prior to joining Och-Ziff at its inception in 1994, Mr. Windreich was a Vice President in the Equity Derivatives Department of Goldman, Sachs & Co. He began his career at Goldman, Sachs & Co. in 1983 and became a Vice President in 1988.  
**Michael Cohen, (Executive Managing Director) Head of European Investing for Och-Ziff and is a member of Och-Ziff's Partner Management Committee.** Prior to joining Och-Ziff in 1997, Mr. Cohen was with Franklin Mutual Advisory as an Equity Research Analyst and with CS First Boston as an Investment Banking Analyst specializing in the financial services sector.  
**James Levin, (Executive Managing Director) Head of U.S. Credit for Och-Ziff.** Mr. Levin has nine years of experience, having joined Och-Ziff in 2006. His prior experience was in distressed debt and statistical arbitrage investing at Dune Capital Management and Sagamore Hill Capital Management.  
**Steven Orbuch, (Founder and the President of OZRE) Prior to forming OZRE in 2003, Mr. Orbuch was a Managing Director with Blackstone Real Estate Advisors.** Mr. Orbuch played a significant role in the investment of Blackstone's domestic real estate funds, including investments for Blackstone Real Estate Partners I, II, III and IV. Prior to joining Blackstone in 1995, Mr. Orbuch was an Associate in the Real Estate Department at Goldman Sachs.

**Investment Summary**

Och-Ziff Capital Management Group (ticker symbol "OZM") is an NYSE-listed company with a \$3.26 billion market cap as of July 18, 2012 that was founded in 1994 by Daniel S. Och and the Ziff family. The Firm has grown to be one of the largest institutional alternative asset managers in the world, with \$29.3 billion in assets under management. OZ has built an experienced investment management team consisting of 127 investment professionals working from its headquarters in New York City and in offices in London, Hong Kong, Mumbai, and Beijing.

**Performance**

<u>Account</u>	<u>Strategy</u>	<u>Performance</u>
OZSC, L.P.	Credit	Net IRR 15.43%, 1.26x MOIC
OZ Domestic Partners II, L.P.	Multi-Strategy HF	Net IRR 6.23%, 1.41x MOIC *

\* Performance reflects returns to the Division since its initial investment and do not reflect overall returns of the fund.

**Vehicle Information:**

Inception:	2012	Auditor:	Ernst & Young
Fund Size (\$mil.):	\$1.1 billion aggregate capital commitment from the Division across the 5 separate accounts, plus Och-Ziff commitment	Legal Counsel:	Schulte Roth & Zabel LLP
Management Fee:	0.75% per year of the Platform's net asset value	Accounting Firm:	Internal
Carry:	20% (aggregated across platform)	Administrator:	Citco
Hurdle Rate:	6% preferred return (aggregated across platform), subject to GP catch-up		
Management Fee Offsets:	100% management fee offset for directors', break-up, standby or commitment fees		
Term:	An initial term of five (5) years, which shall automatically be extended on five (5) year terms thereafter.		

**NJ AIP Program**

Recommended Allocation (\$mil):	\$600 million	LP Advisory Board Membership:	N/A
% of Fund:	N/A	Consultant Recommendation:	Yes
		Placement Agent:	No
		Compliance w/ Division Placement Agent Policy:	N/A
		Compliance w/ SIC Political Contribution Reg:	Yes