



State of New Jersey

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
P.O. BOX 290
TRENTON, NJ 08625-0290

CHRIS CHRISTIE
Governor
KIM GUADAGNO
Lt. Governor

FORD M. SCUDDER
Acting State Treasurer

November 13, 2015

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in a Blackstone TacOpps Residential Opportunities Vehicle**

The New Jersey Division of Investment ("Division") is proposing an investment of up to \$250 million in a Blackstone TacOpps Residential Opportunities Vehicle (the "Vehicle") managed by the Blackstone Tactical Opportunities ("TacOpps") group. This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9.

Blackstone's TacOpps Residential Opportunities is a vehicle to acquire and manage proprietary, new issue, non-agency residential mortgage loans and mortgage servicing rights ("MSRs"). Since the financial crisis, large banks have scaled back from the residential mortgage origination business and sharply curtailed credit availability, creating significant dislocation in the market. Consequently, the breadth of borrowers underserved by existing mortgage credit presents an attractive opportunity to own non-agency mortgage assets.

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

Attractive risk-adjusted return: The Vehicle is targeting proprietary new issue non-agency products that will lend to high credit quality borrowers, targeting an overall 8-12% gross internal rate of return ("IRR"). The Division believes these products offer better risk-adjusted returns than comparable fixed income-oriented opportunities like legacy non-performing and re-performing loan portfolios and collateralized loan obligations ("CLO") equity. Significant trading volumes have compressed return opportunities in legacy non-performing and re-performing loan portfolios. CLO equity offers exposure to corporate cash flows, however, leverage is at near-peak levels with covenant-lite packages and issuance in 2014 surpassing pre-crisis peaks.

Synergies with existing investments: Integration of proprietary origination, servicing and asset management platforms helps manage risk and potentially improves returns relative to other U.S. residential mortgage credit strategies. The experienced asset management team will design new products to help optimize borrower demand and return profiles. The Vehicle will work with high quality originators, including TacOpps' existing mortgage origination platform to originate the new products through a nation-wide loan officer network. The Vehicle's licensed originator will be able

to underwrite on a loan-by-loan basis and the integrated servicer will maintain asset-level contact to manage risk and monitor performance real-time. Few competitor vehicles have a licensed originator that can perform loan level diligence pre-origination, which is a competitive edge in being able to originate sufficient, high quality volume. The in-house financing capability will also allow the platform to scale quickly as market conditions normalize.

Off-market terms: In consideration for seeding the Vehicle, the Division has negotiated highly attractive terms of 1% on invested capital, no incentive fee and a 25% profits participation interest. To the extent other investors participate in the vehicle, the Division will receive a 25% profits participation interest on the management fees and incentive payments earned by Blackstone. In the Division's base case scenario, the profit interest translates into \$8.5 million of cash flow per year.

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

Division Staff and its consultant, TorreyCove Capital Partners, 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. We have obtained a preliminary Disclosure Report of Political Contributions in accordance with the Council's regulation governing political contributions (N.J.A.C. 17:16-4) and no political contributions have been disclosed. We will obtain an updated Disclosure Report at the time of closing.

Please note that the investment is authorized pursuant to Articles 23 and 69 of the Council's regulations. The Blackstone TacOpps Residential Opportunities Vehicle will be considered a global diversified credit investment, as defined under N.J.A.C. 17:16-23.1.

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 November 10, 2015. 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 November 18, 2015 meeting.

Attachments

Fund Name: Blackstone TacOpps Residential Opportunities Vehicle

November 13, 2015

Contact Info: Christopher James, 345 Park Avenue, New York, NY 10154

Fund Details:

Total Firm Assets (\$bil.):	\$334 billion	Key Investment Professionals: David S. Blitzer , Senior Managing Director and Global Head of the Tactical Opportunities Group. He also sits on Blackstone’s Management Committee. Mr. Blitzer is based in New York and is responsible for overseeing Blackstone’s opportunistic investment activities on a global basis. Since joining Blackstone in 1991, Mr. Blitzer has been involved in the execution of Blackstone investments across a variety of asset classes, including establishing and leading Blackstone’s European private equity business. Chad R. Pike , Senior Managing Director in the Tactical Opportunities Group and is Vice Chairman of Blackstone Europe. Mr. Pike is a member of the Investment Committee for the Tactical Opportunities funds. Prior to helping launch the Tactical Opportunities business, Mr. Pike was on the Investment Committee and was the Co-Head of the Real Estate Group where he was responsible for building and managing Blackstone’s Real Estate Group’s business outside the United States. Christopher James , Senior Managing Director and Chief Operating Officer of the Tactical Opportunities Group and is based in New York. Mr. James is a member of the Investment Committee for the Tactical Opportunities funds. Since joining Blackstone in 2006, Mr. James has been involved in a variety of strategic Blackstone business initiatives and special projects, including the firm’s initial public offering, organizing new Blackstone investment products and firm acquisitions.
Strategy:	Global Diversified Credit	
Year Founded:	1985	
Headquarters:	New York	
GP Commitment:	2%	

Investment Summary

The Division is proposing to seed Blackstone’s TacOpps Residential Opportunities, a vehicle, to acquire and manage proprietary, new issue, non-agency residential mortgage loans and mortgage servicing rights (“MSRs”). All assets will be approved by TacOpps Mortgage Investment Committee to strict standards and drawing on market insight through TacOpps mortgage origination platform, Finance of America. The TacOpps Mortgage Investment Committee controls all aspects of asset design and pricing, controlling product standards and making portfolio management decisions. The Committee will be supported by a 10-member team of experienced residential mortgage asset managers. The Vehicle will contain a licensed mortgage originator that enables it to “touch” the actual loan file, with a 20-member operations teams to conduct loan by loan quality control to ensure conformity with Investment Guidelines. As non-agency residential mortgage volumes increase, the Vehicle can convert into a publicly-listed entity, drawing on more efficient and scalable capital and delivering strong potential upside and liquidity to its anchor investors. If the Vehicle does not list, the portfolio can be placed in run-off or sold.

Existing and Prior Funds

<u>Funds</u>	<u>Vintage Year</u>	<u>Returns as of 09/30/2015</u>
US Housing Deals in Blackstone Tactical Opportunities	2012	10.6% Gross IRR; 1.2x gross TVPI

IRR= Internal Rate of Return; TVPI = Total Value to Paid-In

Vehicle Information:

Inception:	2015	Auditor:	Deloitte & Touche LLP
Fund Size:	\$255 million	Legal Counsel:	Simpson Thacher & Bartlett LLP
Management Fee:	1% on invested capital		
Carry:	0%		
Hurdle Rate:	N/A		

NJ AIP Program

Recommended Allocation:	\$250 million	LP Advisory Board Membership:	N/A
% of Fund:	98%	Consultant Recommendation:	Yes
		Placement Agent:	No
		Compliance w/ Division Placement Agent Policy:	N/A
		Compliance w/ SIC Political Contribution Reg:	Yes

*This review memorandum was prepared in accordance with the State Investment Council rules governing the Alternatives Investment Program and the policies and procedures related thereto.