



State of New Jersey

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SHOAIB KHAN
Director

April 21, 2023

MEMORANDUM TO: The State Investment Council

FROM: Shoaib Khan
Director

SUBJECT: **Private Credit Investment – HPS Investment Partners
Separately Managed Account and Co-Investment Vehicle**

The Division of Investment (the “Division”) is proposing an investment of \$350 million in a separately managed account (the “SMA”) managed by HPS Investment Partners, LLC (“HPS” or the “Firm”) and up to \$200 million in a co-investment vehicle (the “Co-Investment”). The SMA will invest in three strategies. Initially, 75% will be invested in the Specialty Direct Lending strategy (“SLF”), 15% will be invested in the Core Senior Lending (“CSL”) strategy, and 10% will be invested in the Special Situations Opportunity (“SSO”) strategy. This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

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

Market opportunity. Private credit market dislocations, lack of liquidity in the syndicated loan and in high yield bond markets, combined with banks unable to effectively de-risk their portfolios provide an opportunity to earn above-average returns over the next 3-4 years.

Sourcing and scale. HPS’s “SLF” strategy has completed over \$52 billion of loan commitments across over 300 transactions since 2010. The CSL strategy has completed over \$23.5 billion of loan commitments across over 155 investments since 2013. The average loan commitments have been ~\$358 million in SLF strategies and ~\$323 million in CSL strategies. In most cases, HPS acts as the lead agent structuring and negotiating the transaction. In SLF V, HPS has been the lead on 92% of invested capital. HPS’s ability to take on increasingly large deals should support consistent access to deal flow. The SSO strategy also benefits from HPS’s wide sourcing funnel. The large existing portfolio should create many opportunities for follow-on investments. HPS’s presence in Europe and Australia should also allow us to take advantage of opportunities in those markets.

Differentiated strategy fills a unique gap in the current private credit portfolio. The non-sponsored segment of direct lending, where HPS operates, requires special expertise and extra resources that most of HPS’s competitors do not have. Being able to provide a “one-stop” private debt solution for borrowers, especially to upper middle market companies, provides HPS with an additional edge over its competition. As a result, with this strategy HPS is able to extract premium returns. The investments with HPS will bring the core direct lending portion of the Division’s private credit portfolio closer to the desired target of 8.0%.

Dedicated and experienced workout team. HPS has a dedicated Restructuring and Value Enhancement Resources Group (the “Group”) comprised of seven investment professionals. The Group should give HPS an advantage over less-resourced peers in the event of a market downturn and credit troubles, which we expect to see in the near future.

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

Division Staff and its private credit consultant, Aksia 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 SMA has not engaged a third-party solicitor (“placement agent”) and no placement agent was engaged or paid in connection with the Pension Fund’s potential investment.

The Firm’s environmental, social, and governance (“ESG”) policy and related diligence disclosures were reviewed by the Division’s Corporate Governance team in accordance with the Council’s ESG Policy. The HPS investment team is responsible for determining internal ESG before investment approval. The Firm also utilizes the HPS ESG Forum (the “Forum”) to develop and monitor adherence to the Firm’s ESG Integration Framework. The Forum convenes quarterly to review certain new and legacy investments with respect to ESG. The Forum is comprised of investment and infrastructure professionals from across the Firm to ensure a diversity of perspectives. The Firm has an ESG policy and is a signatory to the United Nations Principles for Responsible Investing which encourages the integration of ESG factors into investment decision-making and ownership practices.

Staff 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. A preliminary Disclosure Report of Political Contributions has been obtained in accordance with the Council’s regulation governing political contributions (N.J.A.C. 17:16-4), and no political contributions have been disclosed. An updated Disclosure Report will be obtained at the time of closing.

Note that the investment is authorized pursuant to Articles 23 and 69 of the Council’s regulations. Each of the SMA and the Co-Investment is considered a private 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 IPC was held on March 22, 2023. 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 April 26, 2023 meeting.

Attachment

HPS/NJ Separately Managed Account

- **DOI Commitment:** up to \$550 million (including up to \$200 million in co-investment opportunities)
- **Strategy:** Private Credit – Direct Lending & Special Situations
- **Investment Focus:** Primary focus on senior secured direct lending with a small (10%) allocation to special situations. The direct lending strategies will target non-sponsored, large and upper middle market companies primarily in North America. The special situations portion will target distressed opportunities that span public and private markets, capital structures, and geographies.
- **Target Returns:** 10% net IRR
- **Investment Thesis:**
 - Macro environment provides favorable tailwinds for private credit including, reduced bank lending, higher base rates (SOFR), wider spreads, and lender-friendly deal structures.
 - Differentiated (non-sponsor) strategy fills a unique gap in the current private credit portfolio.
 - HPS's proprietary sourcing team and leading market presence provides for consistent deal flow from both sponsor and non-sponsor borrowers.
 - Dedicated and experienced workout team provides a competitive advantage over less-resourced peers, amid deteriorating economic conditions.

Fund Name: HPS-NJ SMA

April 26, 2023

Contact Info: Philip Cothren, 40 West 57th Street, 33rd Floor, New York, NY 10019

Fund Details:		
Total Firm Assets:	\$97 billion	<p>Key Investment Professionals:</p> <p>Michael Patterson (Founder & Governing Partner) – Mr. Patterson is the Portfolio Manager for the Specialty Loan Funds and Core Senior Lending Funds. Mr. Patterson joined HPS in 2007, establishing the European business before returning to the United States in 2009. Prior to joining HPS, Mr. Patterson was with Silver Point Capital in the U.S. and Europe. Mr. Patterson began his investing career in the Principal Investment Area at Goldman Sachs, where he focused on private equity and mezzanine transactions.</p> <p>Vikas Keswani (Managing Director) – Mr. Keswani is a Managing Director at HPS Investment Partners and Head of North American Specialty Lending. Prior to joining HPS in 2010, Mr. Keswani spent a majority of his career at BlackRock, where he was a part of the initial team that established, structured and capitalized BlackRock Capital Investment Corporation (NASDAQ: BKCC), a publicly traded private investment vehicle.</p> <p>Grishma Parekh (Managing Director) – Ms. Parekh is a Managing Director at HPS Investment Partners and Co-Head of North American Core Senior Lending. Prior to joining HPS in 2020, Ms. Parekh spent over twelve years as a Partner and Managing Director at The Carlyle Group. During her tenure at The Carlyle Group, Ms. Parekh was a founding member of the Direct Lending platform, served as Head of Origination for Illiquid Credit, and was a member of the Investment Committee for the Direct Lending business.</p> <p>Andersen Fisher (Managing Director) – Mr. Fisher is a Managing Director at HPS Investment Partners and Portfolio Manager of the Special Situations Opportunity Funds. Prior to joining HPS in 2018, Mr. Fisher was the Managing member of Talamod Asset Management, a distressed credit investment firm he founded in 2008. Prior to founding Talamod, Mr. Fisher was a Principal at Watershed Asset Management, a hedge fund focused on distressed debt and special situations.</p> <p>Paul Knollmeyer (Managing Director, CFO, CRO) – Mr. Knollmeyer is a Managing Director and Chief Financial Officer and Chief Risk Officer of HPS Investment Partners. Previously, Mr. Knollmeyer was Chief Financial Officer of Highbridge Capital Management and Chief Risk Officer of HPS. Prior to joining HPS in 2010, Mr. Knollmeyer was Chief Operating Officer and Member of the Investment and Business Committees for Ortelius Capital Partners, a fund of hedge funds firm focused on investing in distressed debt, special situations and long/short equity.</p> <p>Jeffrey Fitts (Managing Director) – Mr. Fitts is a Managing Director at HPS Investment Partners. Prior to joining HPS in 2014, Mr. Fitts spent six years as a Managing Director at Alvarez and Marsal (“A&M”), where he was responsible for the workout, management and ultimate liquidation of Lehman Brothers’ real estate portfolio following Lehman’s Chapter 11 filing. Prior to that, Mr. Fitts worked at GE Capital from 2000 to 2008, where he led workout, portfolio and distressed debt investing groups.</p>
Strategy:	Private Credit/Direct Lending	
Year Founded:	2007	
Headquarters:	New York, NY	
GP Commitment:	1%	

Investment Summary	Existing and Prior Funds																															
<p>The HPS-NJ SMA will have a 75% targeted allocation to the Specialty Direct Lending (“SLF”) investment strategy, which is HPS’s flagship strategy. SLF primarily lends to large (\$75-350+ million EBITDA), non-sponsored, upper middle market companies in North America, Western Europe, and Australia/New Zealand, with a primary focus on North America.</p> <p>Additionally, the SMA will aim for a 15% allocation to the Core Senior Lending (“CSL”) strategy. CSL is a sub-strategy within the Direct Lending Platform and is expected to focus on senior secured lending. HPS is targeting a 50-50 split between sponsored and non-sponsored deals for the CSL strategy. CSL will have the same geography as SLF and will utilize one turn of leverage.</p> <p>The remaining 10% will be allocated to the Special Situations Opportunity (“SSO”) strategy which targets special situations and distressed investments that span public and private markets, capital structures, and geographies. HPS expects to invest 20-50% of SSO outside of North America, primarily in Europe.</p>	<table border="1"> <thead> <tr> <th>Funds</th> <th>Vintage Year</th> <th>Strategy</th> <th>Net Returns as of 12/31/2022:</th> </tr> </thead> <tbody> <tr> <td>HPS Specialty Loan Fund V, L.P. (U)</td> <td>2020</td> <td>Direct Lending</td> <td>9.0% IRR; 1.1x TVPI, 0.2x DPI</td> </tr> <tr> <td>HPS Special Situations Opportunity Fund, L.P.</td> <td>2020</td> <td>Special Situations</td> <td>17.0% IRR; 1.3x TVPI; 0.1x DPI</td> </tr> <tr> <td>Core Senior Lending Fund, L.P.</td> <td>2018</td> <td>Direct Lending</td> <td>6.0% IRR; 1.2x TVPI; 0.3x DPI</td> </tr> <tr> <td>Specialty Loan Fund 2016, L.P. (U)</td> <td>2016</td> <td>Direct Lending</td> <td>7.0% IRR; 1.3x TVPI; 0.8x DPI</td> </tr> <tr> <td>Specialty Loan Fund III, L.P. (U)</td> <td>2012</td> <td>Direct Lending</td> <td>6.0% IRR; 1.2x TVPI; 1.2x DPI</td> </tr> <tr> <td>Senior Loan Fund II, L.P. (U)</td> <td>2010</td> <td>Direct Lending</td> <td>7.0% IRR; 1.2x TVPI; 1.2x DPI</td> </tr> </tbody> </table>	Funds	Vintage Year	Strategy	Net Returns as of 12/31/2022:	HPS Specialty Loan Fund V, L.P. (U)	2020	Direct Lending	9.0% IRR; 1.1x TVPI, 0.2x DPI	HPS Special Situations Opportunity Fund, L.P.	2020	Special Situations	17.0% IRR; 1.3x TVPI; 0.1x DPI	Core Senior Lending Fund, L.P.	2018	Direct Lending	6.0% IRR; 1.2x TVPI; 0.3x DPI	Specialty Loan Fund 2016, L.P. (U)	2016	Direct Lending	7.0% IRR; 1.3x TVPI; 0.8x DPI	Specialty Loan Fund III, L.P. (U)	2012	Direct Lending	6.0% IRR; 1.2x TVPI; 1.2x DPI	Senior Loan Fund II, L.P. (U)	2010	Direct Lending	7.0% IRR; 1.2x TVPI; 1.2x DPI			
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	Source of Returns - HPS; figures are rounded to the nearest whole number																															
	IRR = Internal Rate of Return; TVPI = Total Value to Paid-In; DPI = Distributions to Paid-In																															

Vehicle Information:			
Inception:	TBD	Auditor:	PricewaterhouseCoopers LLP
Target Fund Size:	\$350 million	Legal Counsel:	Fried Frank LLP
Investment:	HPS-NJ SMA	Co-Investment Vehicle	
Management Fee:	0.80%		
Incentive Fee:	15%		
Preferred Return	8%		
Additional Expenses:	No Management Fee Offset		Pro rata Partnership Expenses

NJ AIP Program			
Recommended Allocation (Smil.): SMA	up to \$350 million	LP Advisory Board Membership:	N/A
Recommended Allocation (Smil.): Co-Investment	up to \$200 million		
% of SMA and Co-Investment:	100%	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.