December 12, 2008 – *Revised/Final*

MEMORANDUM TO: State Investment Council

FROM: William G. Clark
Director

SUBJECT: **Proposed Private Equity Investment in TPG-TAC 2007 Fund**

This due diligence memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9 (a) to report on the following proposed private equity investment: a $30 million additional commitment to the TPG-TAC 2007 Fund.

Please note that this investment will be authorized pursuant to Articles 69 and 90 of the Council's regulations. The investment in TPG-TAC will be considered a "Debt – related Investment".

The Alternative Investments Procedures adopted by the Council on February 21, 2008 require any potential alternative investment opportunities to be identified and initially evaluated by the Head of Alternative Investments of the Division (myself in an acting capacity) and the applicable Asset Class Consultant (Strategic Investment Solutions in this case, or "SIS") in coordination with the DOI Investment Committee (Director, Deputy Director and the Senior Staff member for the applicable alternative asset class).

As a result of internal and external sourcing, the DOI Investment Committee identified this proposed investment. As a result, SIS and Division staff proceeded to undertake extensive due diligence on the proposed investment. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council. Based on this due diligence, the Division has determined that this proposed investment meet the criteria for investments set forth in the Alternative Investments Policy.

The ***TPG-TAC 2007 Fund ("TAC 2007")*** was set up to take advantage of the perceived opportunity in bank loan investments. Within the leveraged buyout market, large banks and investment banks have historically made "bridge" loans to private equity firms to help finance acquisitions. These loans typically are senior obligations in the target company's capital structure, and are secured by the company's assets. The strategy of the banks and investment banks had been to syndicate these loans to other investors, either directly or through structured credit products such as CDOs and CLOs. Given the current dislocations in the credit markets, banks and investment banks have only been able to sell off these loans at discounts to par value.

NJDOI late last year committed $100 million to TAC 2007, a fund that intended to invest in bank loans. Over many years, bank loans had generally traded near par (100). However at the onset of the current credit crisis, bank loans started trading at a 10% discount to par. TPG, given its position in the market place, had diligenced and/or was familiar with a large number of the bank loans in the market place. TAC 2007 was formed to take advantage of the temporary dislocation in the bank loan market, with committing investors benefiting from TPG's resources and knowledge of many of the credits. Given the low yields on bank loans, a function of their seniority in the capital structure, TAC 2007 obtained a leverage facility to somewhat enhance the returns of the purchased loans. It was thought the market dislocation would be temporary with the loans trading back to par in a relatively short period of time.

As you know from our discussions concerning follow-on investments in other funds that targeted the bank loan market, the volatility in the credit markets has impacted the senior loan market which has experienced a disproportionate decline in price. TPG, to protect the fund against further volatility, is proposing to raise additional capital, $300 million, in the form of preferred shares in TAC 2007. Unlike the other follow-on investments in bank loan funds that were presented to the Council in October and November, however, there are only plans to call at most 20% of the commitment at this time. The additional funds raised above this amount will serve as a contingency to reduce leverage should prices decline further on the existing credits in TAC 2007. None of these funds will be used to make new investments, and no fees will be charged on any capital that is draw down. The terms are very favorable with the preferred shares paying a specified interest rate on the capital that is called. All other investors in TPG-TAC 2007, including TPG itself, are committing their pro-rata share for the preferred shares in TAC 2007.

A formal written due diligence report for the proposed investment was sent to each member of the Investment Policy Committee of the Council on December 8, 2008, and a meeting of the Committee was held on December10, 2008. In addition to the formal written due diligence report, all other information obtained by the Division on this investment was made available to the Investment Policy Committee.

After review of the extensive due diligence, the Investment Policy Committee of the Council decided to report on the proposed investment to the full Council pursuant to Step 4 of the Alternative Investments Procedures.

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 these investments. In addition, the proposed investment must comply with the Council's "pay to play" regulation (N.J.A.C. 17:16-4). While we are confident that we will work through these issues, the potential exists that a successful resolution will not be reached with one or more of the general partners.

We look forward to discussing the proposed private equity investment at the Council's December 18, 2008 meeting.

WGC:jmm
Attachment