



State of New Jersey

CHRIS CHRISTIE
Governor

KIM GUADAGNO
Lt. Governor

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
P.O. BOX 290
TRENTON, NJ 08625-0290
Telephone (609) 292-5106
Facsimile (609) 984-4425

FORD M. SCUDDER
Acting State Treasurer

CHRIS MCDONOUGH
Director

July 29, 2016

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in Owl Rock Capital Corporation and related Co-Investment Account**

The New Jersey Division of Investment ("Division") is proposing an investment of up to \$400 million to Owl Rock Capital Corporation (the "Fund" or "Company"), and up to \$200 million for related overage and co-investment opportunities through one or more separate account vehicles. This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9.

Owl Rock Capital Corporation is seeking to capitalize on opportunities in the U.S. middle-market lending space caused by recent regulations restricting banks' ability to lend to middle market companies (annual EBITDA in the \$10 to \$250 million range and/or annual revenue in the \$50 million to \$2.5 billion range). The Fund will primarily target floating-rate, senior-secured, first lien positions at the top of the capital structure with call protection and financial covenants. The Fund will also invest in subordinated loans or mezzanine loans and, to a lesser extent, equity-related securities and warrants. The Fund generally will target an 8-10% coupon, upfront fees, and an Original Issue Discount of 2.5-3.5%. Various covenants and structural protections will generally be a part of the structure, such as: (i) call protection (ii) leverage, interest, or fixed charge coverage's and (iii) other covenants as appropriate for a given investment. The Fund's target credit investments will typically have maturities between three and ten years and generally range in size from \$20 million to \$250 million. The investment approach will be defensive in nature, focusing on long-term credit performance and principal protection.

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

Compelling Opportunity Set: Government regulation such as Dodd-Frank, the Volcker Rule, and Basel III have reduced banks' ability to lend to below investment grade borrowers. New rules

restrict regulated banks' ability to hold assets rated CCC or lower, assets with net debt/Earnings before Interest, Taxes, Depreciation and Amortization ("EBITDA") ratios of 6x or higher, as well as other restrictions. At the same time, demand for financing is expected to be strong as Preqin estimates there is a \$1.3 trillion overhang of private equity dry powder that could potentially be seeking debt capital. Meanwhile, Moody's estimates that speculative grade companies will need to refinance \$90 billion in 2018 (compared to only \$16 billion in 2016) and that over 40% of that \$90 billion has net debt/EBITDA ratios in excess of 6x. These supply/demand dynamics set the stage for non-traditional lenders and BDCs to grow, as they are poised to replace the lending capacity vacated by banks no longer able to lend in this space.

Experienced Investment Team: The pool of talent constructed at Owl Rock has the necessary skill sets (sourcing, underwriting, originating, structuring, retail distribution, etc.) to excel at this opportunity. Among the key team members are Doug Ostrover, previously a co-founder of GSO; Marc Lipschultz, former member of the Management Committee and Global Head of Energy & Infrastructure investments at KKR; Craig Packer, former co-head of leveraged finance for Goldman Sachs; Derek O'Leary, former president of CION Securities (CION is a non-traded BDC sub-advised by Apollo Investment Management); and Alan Kirshenbaum, former CFO of TPG's BDC, TPG Specialty Lending (NYSE: TSLX).

Differentiated Investment Strategy: The Fund's anticipated large size (inclusive of leverage) differentiates it from many competing funds by allowing it to commit to larger credits where the fund anticipates having less structuring and pricing competition. In addition, given the pedigree and experience of its founders, Owl Rock expects most of its investments will be directly originated, with the investment team responsible for underwriting, executing, and managing the assets of the Firm. The broad expertise and experience of Owl Rock's partners will allow it numerous tools to manage risk while preserving the opportunity for attractive returns as well as producing and maintaining a portfolio that will perform in a broad range of economic conditions.

Attractive Economics: The Fund is offering an initial reduced fee structure, which will increase only upon a public listing of the Fund. In addition, the Division will receive an interest in Owl Rock Capital Holdings LLC which will allow the Division to participate in economics related to the U.S. middle-market lending business ("Revenue Share") in exchange for paying certain management expenses. The total amount of initial fees and expenses, including the expenses related to the Revenue Share, represent a significant discount from typical fund fees. The Division has also negotiated attractive terms on its co-investment vehicle, with a management fee of 0%, a performance fee of 0% and a veto right on all proposed co-investment opportunities.

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

Division Staff and its consultant, TorreyCove Capital Partners, undertook extensive due diligence on the proposed investments 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 investments.

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 investments. 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 investments are authorized pursuant to Articles 23 and 69 of the Council's regulations. The Owl Rock Capital Corporation and related investments will be considered global diversified credit investments, as defined under N.J.A.C. 17:16-23.1.

A formal written due diligence report for the proposed investments was sent to each member of the IPC and a meeting of the Committee was held on July 20, 2016. In addition to the formal written due diligence report, all other information obtained by the Division on the investments was made available to the IPC.

We look forward to discussing the proposed investments at the Council's August 3, 2016 meeting.

Attachments

Fund Name: Owl Rock Capital Corporation, Co-Investment Separate Account **August 3, 2016**

Contact Info: Alan Kirshenbaum, 245 Park Avenue, 41st floor, New York, NY 10167

Fund Details:		
Total Firm Assets:	\$3 to \$5 Billion (with leverage)	Key Investment Professionals: Douglas I. Ostrover, co-founder and the Chief Executive Officer of Owl Rock Capital Partners and Co-Chief Investment Officer of Owl Rock Capital Advisors. Prior to founding Owl Rock, Mr. Ostrover was one of the founders of GSO Capital Partners. Marc S. Lipschultz, co-founder and the President of Owl Rock Capital Partners and Co-Chief Investment Officer of Owl Rock Capital Advisors. Prior to founding Owl Rock, Mr. Lipschultz spent more than two decades at KKR, where he served on the firm's Management Committee and as the Global Head of Energy and Infrastructure. Craig Packer, co-founder of Owl Rock Capital Partners and the Chief Executive Officer of Owl Rock Capital Corporation. Prior to founding Owl Rock, Mr. Packer was co-head of Leveraged Finance in the Americas at Goldman Sachs. Alan Kirshenbaum, co-founder and the Chief Operating Officer and Chief Financial Officer of Owl Rock Capital Corporation, Owl Rock Capital Partners and Owl Rock Capital Advisors. Prior to founding Owl Rock, Mr. Kirshenbaum was Chief Financial Officer of TPG Specialty Lending, Inc. Derek O'Leary, Managing Director of Owl Rock Capital Partners and the President of Owl Rock Capital Securities. Prior to joining Owl Rock in January 2016, Mr. O'Leary served as Executive Vice President of ICON Investment Group and President of CION Securities. Alexis Maged, Managing Director of Owl Rock Capital Partners, and serves as the Head of Underwriting for Owl Rock Capital Advisors. Prior to joining Owl Rock in January 2016, Mr. Maged was Chief Financial Officer of Barkbox, Inc.
Strategy:	Middle Market Lending	
Year Founded:	2015	
Headquarters:	New York	
GP Commitment:	\$110.4 million	

Investment Summary	Existing and Prior Funds ⁴																												
The Division has had a long-standing relationship with one of Owl Rock's founders, Doug Ostrover, who was a co-founder at GSO, which has been a highly successful relationship for the Division. Owl Rock Capital Corporation (the "Fund") will be the first fund of Owl Rock Capital Advisors LLC (the "Adviser"), a newly-formed firm comprised of highly-respected investors and executives from prior firms such as GSO Capital Partners, KKR, Goldman Sachs, and TPG. The Adviser is a New York-based firm seeking to capitalize on opportunities in the U.S. middle-market lending space caused by recent regulations restricting banks' ability to lend to middle market companies. The Fund will invest throughout the capital structure, investing in senior secured, unsecured, subordinated or mezzanine loans, equity-related securities and warrants. The Division expects to invest up to \$400 million in the Fund, which is registered as a business development corporation ("BDC") and is aiming to raise \$3 billion to \$5 billion, inclusive of appropriate leverage. At the same time, the Division will receive an ownership interest in Owl Rock Capital Holdings LLC, the parent of the Fund's adviser. The Division also expects to invest up to \$200 million in one or more co-investment vehicles.	<table border="1"> <thead> <tr> <th><u>Prior Funds ²</u></th> <th><u>Vintage Year</u></th> <th><u>Strategy</u></th> <th><u>Returns as of 9/30/15</u></th> </tr> </thead> <tbody> <tr> <td>GSO Capital Opportunities Fund, L.P.</td> <td>2007</td> <td>Mezzanine</td> <td>17.59% Net IRR; 1.48x Net MOIC</td> </tr> <tr> <td>GSO Capital Opportunities Fund II, L.P.</td> <td>2010</td> <td>Mezzanine</td> <td>18.60% Net IRR; 1.25x Net MOIC</td> </tr> <tr> <td>GSO Energy Partners - A, L.P.</td> <td>2012</td> <td>Real Assets</td> <td>7.73% Net IRR; 1.13x Net MOIC</td> </tr> <tr> <th><u>Hedge Fund Strategies ³</u></th> <th><u>Vintage Year</u></th> <th><u>Strategy</u></th> <th><u>Returns as of 3/31/16</u></th> </tr> <tr> <td>GSO Credit Partners - A, L.P.</td> <td>2012</td> <td>Credit</td> <td>13.91% Net IRR since inception</td> </tr> <tr> <td>GSO Special Situations Fund, L.P.</td> <td>2012</td> <td>Credit</td> <td>3.82% Net IRR since inception</td> </tr> </tbody> </table> <p>3. Doug Ostrover was a former co-head of GSO and a member of the Investment Committee, which oversaw all GSO products. However, Mr. Ostrover was particularly involved in managing GSO's separately managed accounts, as well as the Firm's hedge funds.</p> <p>4. The performance listed above is the Division's performance in each of its investments with GSO, and was obtained from the Division's records.</p> <p>IRR= Internal Rate of Return; MOIC = Multiple on Invested Capital</p>	<u>Prior Funds ²</u>	<u>Vintage Year</u>	<u>Strategy</u>	<u>Returns as of 9/30/15</u>	GSO Capital Opportunities Fund, L.P.	2007	Mezzanine	17.59% Net IRR; 1.48x Net MOIC	GSO Capital Opportunities Fund II, L.P.	2010	Mezzanine	18.60% Net IRR; 1.25x Net MOIC	GSO Energy Partners - A, L.P.	2012	Real Assets	7.73% Net IRR; 1.13x Net MOIC	<u>Hedge Fund Strategies ³</u>	<u>Vintage Year</u>	<u>Strategy</u>	<u>Returns as of 3/31/16</u>	GSO Credit Partners - A, L.P.	2012	Credit	13.91% Net IRR since inception	GSO Special Situations Fund, L.P.	2012	Credit	3.82% Net IRR since inception
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Vehicle Information :		Auditor: KPMG LLP	
Inception:	2015	Legal Counsel: Goodwin Procter LLP/Sutherland Asbill & Brennan LLP	
Fund Size (\$mil.):	\$3 billion to \$5 billion		
Owl Rock Capital Corp:			
Management Fee:	0.75% ¹		
Carry:	0% ¹		
Owl Rock Capital Holdings LLC:			
Management Expenses:	1% ²		
Carry:	20% ²		
Hurdle rate:	6% ²		
Co-Investment Separate Account:			
Management Fee	0%		
Carry:	0%		

¹ Owl Rock Capital Corporation is currently a private fund, upon a listing as a public company, the fee and carry are anticipated to change to 1.75% & 20%, respectively

² Amounts are calculated on the basis of \$100 million imputed value of interest

NJ AIP Program			
Recommended Allocation:	Up to \$600 million (\$400 for the Fund, and \$200mm for related co-investment vehicles)	LP Advisory Board Membership:	Yes
% of Fund:	8% to 13%	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.