



State of New Jersey

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DEPARTMENT OF THE TREASURY
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September 13, 2013

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Acting Director

SUBJECT: **Proposed Investment in Aether Real Assets III, L.P. and
Aether Real Assets III, L.P. Surplus**

The New Jersey Division of Investment ("Division") is proposing an investment of \$30 million in Aether Real Assets III, L.P. ("ARA III" or "main fund") and \$100 million in Aether Real Assets III, L.P. Surplus ("ARA Surplus" or "surplus fund"). 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:

Real Assets Expertise & Deal Sourcing: Aether (the "Firm") possesses a broad network of relationships with GPs, placement agents, investors and other members of the private markets and real assets community. In addition, Aether has a unique network of industry relationships with individuals mostly involved on the operating side, such as engineers, appraisers, geologists, bankers and attorneys. This allows the Firm to access investment opportunities with undiscovered managers that are often too small to attract large institutional capital. Aether's specific focus on private real assets has allowed them to develop a reputation in the industry for firms that are seeking institutional capital but have not built out the systems and processes to do so. Aether has provided assistance to various funds in building out their infrastructure to institutional standards. The Firm's location, in Denver, CO, is also helpful since many of the industry professionals previously mentioned are located in and around the region.

Niche Exposure: The majority of Aether's fund commitments have been in funds under \$500 million, allowing the Firm to take advantage of inefficiencies typical for this segment of the market. These opportunities include, but are not limited to, ignored or mismanaged smaller assets, smaller transactions at lower valuations that are not efficiently priced, and the fostering of better economic alignment between managers and investors. Aether also focuses on fund managers that possess operational and/or technical expertise and do not depend on leverage or technological innovation.

Successful Track Record: Aether's first fund, a 2009 vintage, is currently marked at a net Internal Rate of Return ("IRR") of 19.2% and a 1.29x multiple of invested capital. ARA II was closed in July 2012 and is currently held just above cost. Fund I's returns are considered top-quartile on an IRR basis.

Structure: The Division is proposing an investment both in ARA III and ARA Surplus, a separate account that will act as an overage account for ARA III. The ARA Surplus account will

have the ability to absorb excess capacity Aether receives, allowing the Division to increase its allocation to desirable managers at advantageous terms. This fund structure will also provide the Division access to Aether's database of information and the ability to have Aether assist in reviewing real asset investments that the Division may consider on a direct basis.

Real Assets Exposure: While the Division has just over \$2 billion invested in real assets, only \$315 million (~15%) is invested in the private markets. Given Aether's strategy and expertise, a relationship with the Firm will allow the Division to develop expertise in the asset class. This account will be an anchor to the Division's real asset portfolio and act as a tool for building the portfolio going forward.

Attractive Terms: The negotiated terms, along with the resources in which the Division will have access to, are very accretive to the portfolio. The management fee on the main fund and the surplus fund are .85% and .60%, respectively, in the first five years. Thereafter, the fees are reduced by 15% of the previous year's fee percentage. This results in a blended fee of .66% in the first five years across both funds, and an average of .41% annually over the expected life of the fund. The carry is also well below market standard with a rate of 5% on the main fund and 3.5% on the surplus fund.

A report of the Investment Policy Committee ("IPC") summarizing the details of the proposed investment is attached. Division Staff and its real asset consultant, Strategic Investment Solutions, 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 accordance with N.J.A.C. 17:16-69.9(c), given Aether's current AUM, the Division will require contractual provisions that prevent its total investments from exceeding 20% of Aether's total assets. 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 the investment is authorized pursuant to Article 69. The Aether Real Assets III, L.P. and Aether Real Assets III, L.P. Surplus will be considered real asset investments, as defined under N.J.A.C. 17:16-71.1. Since N.J.A.C. 17:16-71 does not currently explicitly provide for investments through fund-of-fund vehicles, the Division is seeking Council investment approval under N.J.A.C. 17:16-71.2(b). Once the Regulation Readoption is effective, the revised subchapter will explicitly include fund-of-funds.

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 September 5, 2013. 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 September 19, 2013 meeting.

Attachments

Fund Name: Aether Real Assets III, L.P. & Aether Real Assets III, L.P. Surplus

September 19, 2013

Contact Info: Sean Goodrich, 1900 Sixteenth Street, Suite 825, Denver, CO 80202

Fund Details:

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| Total Firm Assets (\$bil.): | \$430 mil | Key Investment Professionals: Sean Goodrich , Co-founder and Portfolio Manager. Immediately prior to forming Aether Investment Partners, Mr. Goodrich served as the Director of Alternative Investments at Jeffrey Slocum & Associates. During his tenure at Jeffrey Slocum & Associates, Mr. Goodrich led the firm’s private capital and real assets research activities. Troy Schell , Co-founder and Portfolio Manager. Immediately prior to forming Aether Investment Partners, Mr. Schell served as a Director and portfolio manager for BlackRock Alternative Advisors (“BAA”) following the acquisition of Quellos Group’s fund of funds business by BlackRock in October, 2007. David Rhoades , Chief Operating Officer. In this capacity, Mr. Rhoades is responsible for general business management, marketing and client relations. Immediately prior to joining Aether Investment Partners, Mr. Rhoades served as a Vice President at Blue River Asset Management, a manager of municipal bond arbitrage hedge funds. |
| Strategy: | Real Asset- Fund of Funds | |
| Year Founded: | 2008 | |
| Headquarters: | Denver, CO | |
| GP Commitment: | ARA III 1% ; ARA Surplus 0.5% | |

Investment Summary Existing and Prior Funds

The Division is proposing an investment of \$30 million to Aether Real Assets III, L.P. (“ARA III”) and \$100 million to Aether Real Assets III, L.P. Surplus (“ARA Surplus”). Aether (the “Firm”) is an investment management firm dedicated to investing in real assets managers and related sectors. The funds will focus on three sectors: Oil and Natural Gas, Metals and Minerals, and Agriculture and Timber, and will opportunistically consider Energy Assets, Infrastructure, Capital Assets, and Water. Aether Investment Partners serves as the GP and focuses exclusively on real asset investments with a particular focus on upstream natural resources. Aether purposefully maintains a smaller fund structure in order to continue to access smaller niche funds where they can be a meaningful limited partner but not outgrow the commitments made available to Aether. For the Division this provides access to smaller funds in the real asset space and a partnership with Aether to share research and due diligence information.

| Funds | Strategy | Vintage Year | Returns as of 3/31/2013 |
|--------|-------------|--------------|---------------------------------|
| ARA I | Real Assets | 2009 | 19.20% Net IRR ; 1.29x Net MOIC |
| ARA II | Real Assets | 2011 | N/M ; 1.07x MOIC |

IRR = Internal Rate of Return
MOIC = Multiple of Invested Capital

Vehicle Information:

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|-----------------------------|--|-----------------------|-------------------------------------|
| Inception: | 2013 | Auditor: | Ernst & Young LLP |
| Fund Size (\$mil.): | ARA III \$300 mil ; ARA Surplus \$100 mil | Legal Counsel: | Purrington Moody Weil LLP |
| Management Fee: | ARA III 0.85% of commitments annually for first 5 years; Reduced by 15% each year thereafter ARA Surplus 0.60% of commitments annually for first 5 years; Reduced by 15% each year thereafter | Administrator: | Stone Pine Accounting Services, LLC |
| Carry: | ARA III 5%, with a 50% catch-up ; ARA Surplus 3.5% with a 50% catch-up | | |
| Hurdle Rate: | 7% | | |
| Additional Expenses: | ARA III Organizational Expenses up to \$500,000; ARA Surplus Organizational Expenses up to \$100,000 | | |

NJ AIP Program

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| Recommended Allocation (\$mil. % of Fund): | ARA III \$30 mil ; ARA Surplus \$100 mil ARA III 10% ; ARA Surplus 99.5% | LP Advisory Board Membership: | TBD |
| | | Consultant Recommendation: | Yes |
| | | Placement Agent: | No |
| | | Compliance w/ Division Placement Agent Policy: | N/A |
| | | Compliance w/ SIC Political Contribution Reg: | Yes |