



State of New Jersey

DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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January 22, 2016

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in Blackstone Real Estate Debt Strategies III, L.P.**

The New Jersey Division of Investment ("Division") is proposing an investment of \$100 million in Blackstone Real Estate Debt Strategies III, L.P. ("BREDS III" or the "Fund"). This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9.

BREDS III is being raised and managed by Blackstone Real Estate Debt Strategies ("BREDS"), a real estate debt platform within the Global Real Estate business of The Blackstone Group ("Blackstone" or the "Firm"). BREDS III is a continuation of the Firm's global debt strategy to underwrite and execute loans that capitalize on the dislocation of traditional real estate lenders from the market. The Fund will focus on providing liquidity to new borrowers, banks with legacy commercial real estate exposure, and liquid real estate debt investments.

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

Preeminent Global Real Estate Platform: One of the Firm's competitive advantages is the ability to lever the information gained through both its real estate equity and debt business. Additionally, the Firm's scale and capital availability have helped cement its position as a "first call" for sellers of large and/or complex transactions that require certainty of execution. In its acquisition of GE Capital Real Estate, the firm underwrote 612 properties in 14 countries in one month and invested \$14 billion in capital from five separate debt and equity vehicles across its real estate platform.

Strong Track Record with Current Income: The strength and tenure of Blackstone's team has driven attractive returns through multiple economic and real estate cycles. As of September 30, 2015 Blackstone Real Estate Debt Strategies L.P. was substantially realized and had generated a net 12% Internal Rate of Return ("IRR") while Blackstone Real Estate Debt Strategies II L.P. ("BREDS II") was partially realized and had generated a 10% Net IRR. The lending platform has only limited legacy issues with no realized losses. BREDS investments typically produce immediate current income and nearly 100% of the projected returns are expected to come from current income. As evidence of the focus on income, BREDS II has a current debt yield of 8.8% as of June 30, 2015.

Dislocation of Traditional Lenders: The absence of traditional real estate lenders due to regulatory constraints creates opportunities for alternate lenders to structure loans with institutional-quality sponsors on properties in resilient markets and generate attractive, risk-adjusted returns. The Firm's scale and platform give it a competitive advantage.

Complementary Real Estate Debt Exposure: The Fund provides complementary exposure to the Division's existing debt investments. The Division's current debt investments are focused on mid-market properties, and the Fund will focus on portfolio transactions and larger assets. The Division's current Debt Related Real Estate allocation is 0.55% vs. target of 0.80%.

Geographic Diversification: Tapping into Blackstone's global platform, the Fund may invest in Europe, Asia, Australia and Latin America, increasing the Division's diversification in those regions. To reduce foreign currency exposure, the Fund will generally hedge the outstanding principal balance of non-dollar denominated loans.

Deep and Experienced Team: The real estate platform is headed by Jonathan Gray who has been part of the platform since inception. Senior team members have been with Blackstone for 12 years. The firm's real estate platform is comprised of 385 professionals, of which 131 are dedicated to the debt team. The team's middle and junior level professionals are among the most experienced in the industry.

Attractive Terms: Management fee of 1.5% is based only on invested capital, and the waterfall provides for a 6% preferred return and 15% carry with 50% catch up.

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

Division Staff and its real asset consultant, RVK, Inc., 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 69 and 71 of the Council's regulations. Blackstone Real Estate Debt Strategies III, L.P. will be considered a non-core real estate investment, as defined under N.J.A.C. 17:16-71.1.

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 January 15, 2016. 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 January 27, 2016 meeting.

Attachments

Fund Name: Blackstone Real Estate Debt Strategies III, L.P.

January 27, 2016

Contact Info: Kathleen McCarthy, 345 Park Avenue, New York, NY 10154

Fund Details:

Total Firm Assets*:	\$92 billion
Strategy:	Non-core debt
Year Founded*:	1991
Headquarters:	New York
GP Commitment:	\$50M, plus up to an additional 10% of each investment based on an annual election

Key Investment Professionals:

Jonathan Gray, is the Global Head of Real Estate and a member of the Board of Directors of Blackstone and is based in New York. He also sits on the firm's Management Committee. Since joining Blackstone in 1992, Mr. Gray has helped build the largest real estate platform in the world.

Michael Nash is a Senior Managing Director of Blackstone and the Global Chairman of Blackstone Real Estate Debt Strategies. He is based in New York. Mr. Nash chairs the BREDS Investment Committee and devotes his time to evaluating investments and meeting with investors. He joined Blackstone in 2007 and previously managed the group day-to-day. Prior to joining Blackstone, Mr. Nash led Merrill Lynch's Real Estate Principal Investment Group - Americas.

Jonathan Pollack is a Senior Managing Director and Global Head of Blackstone Real Estate Debt Strategies. He is based in New York. Mr. Pollack leads the global BREDS team and manages the business day-to-day. He previously was the Chief Investment Officer of BREDS. Prior to joining Blackstone, Mr. Pollack was a Managing Director and Global Head of Commercial Real Estate, as well as Head of Risk for Structured Finance, at Deutsche Bank.

Kenneth Caplan, Mr. Caplan is a Senior Managing Director and Global Chief Investment Officer of the Real Estate group and is based in New York. Mr. Caplan is responsible for overseeing the investment strategy globally. Since joining Blackstone in 1997, Mr. Caplan played a key role in a variety of real estate acquisitions and initiatives in the United States, Europe and Asia. Before joining Blackstone, Mr. Caplan was at Lazard Frères & Co.

Timothy Johnson is a Senior Managing Director of Blackstone Real Estate Debt Strategies and the Head of U.S. Originations BREDS. He is based in New York. Mr. Johnson is involved in sourcing, underwriting, negotiating and structuring debt investments across all asset types and geographies. Before joining Blackstone in 2011, Mr. Johnson was a co-founder of BroadPeak Funding.

*Blackstone Real Estate Group

Investment Summary

The Blackstone Group (the "Firm") launched Blackstone Real Estate Debt Strategies ("BREDS") to capitalize on the unprecedented turmoil in the real estate debt market following the Global Financial Crisis and to complement Blackstone Real Estate Partners' opportunistic equity strategy. Blackstone Real Estate Debt Strategies III (the "Fund") is a continuation of the Firm's global debt strategy to underwrite and execute loans that capitalize on the dislocation of traditional real estate lenders from the market. The Fund will focus on providing liquidity to new borrowers, banks with legacy commercial real estate exposure, and liquid real estate debt investments.

Existing and Prior Funds

<u>Funds</u>	<u>Vintage Year</u>	<u>Strategy</u>	<u>Returns as of 9/30/2015</u>
BREDS I	2008	Non-core	12% Net IRR, 1.3x Net MOIC, 129% DPI
BREDS II	2013	Non-core	10% Net IRR, 1.1x Net MOIC, 45% DPI

IRR = Internal Rate of Return; MOIC= Multiple on Invested Capital; DPI = Distributions to Paid-In

Vehicle Information:

Inception:	2016
Fund Size :	\$4 billion
Management Fee:	1.50% on invested equity
Carry:	15%
Preferred Return:	6%

Auditor:	Deloitte & Touche LLP
Legal Counsel:	Simpson Thacher & Bartlett LLP

NJ AIP Program

Recommended Allocation:	\$100 million	LP Advisory Board Membership:	TBD
% of Fund:	2.5%	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.

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