



State of New Jersey

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May 25, 2016

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in Focus Healthcare Partners Fund I**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$100 million in Focus Healthcare Partners Fund I (the “Fund”). This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

The Fund will focus on the senior living industry and target properties which offer residents the ability to “age in place” across acuity levels (independent living, assisted living, and memory care). Focus (the “Firm”) is a respected owner specializing in the healthcare real estate sector and its founders are long-tenured executives of the healthcare real estate industry. The Fund is an opportunity for the Division to invest directly with a respected operating partner in order to generate attractive risk-adjusted returns with high current yields.

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

Demographics & Fundamentals: The healthcare property sector is generally decoupled from the broader economy. Aging population and increased life expectancy drive increasing demand for quality senior housing, and the sector continued to achieve positive rent growth and resilient occupancy through the depth of the recession.

Reputation & Experience of the Manager: The principals have been active in healthcare real estate since the 1990s and were directly responsible for growing multiple industry-leading platforms that owned or operated more than 50,000 senior living units and financed over \$4.5 billion in healthcare properties. Since founding Focus in 2009, the principals deployed \$151 million of equity in 15 assets representing more than 2,000 senior living units.

Single Focus & National Platform: The Firm invests only in healthcare properties and operates a national platform. The Principals have executed investments in nearly all states through their prior platforms. The Firm’s current portfolio contains investments in 11 states representing all regions of the country.

Track Record and Focus on Current Income: Focus has invested as an operating partner for various real estate private equity and separate account managers. Realized investments in the Firm's portfolio have generated 41.8% gross Internal Rate of Return and a 2.6x multiple of invested capital with an 8% current yield.

Alignment of Interest: The principals will be investing significant capital relative to their personal net worth. The Fund will also be the Firm's sole vehicle for new investments with no competing mandates, as well as investing directly for institutional investors and eliminating the double promote and fee structure that is typical with funds sponsored by real estate allocators.

Attractive Terms: Management Fee during the investment period will be 75 bps on committed capital and 150 bps on invested. After the investment period the management fee will be 100 bps on invested capital and drop down to 75 bps after three years. The preferred return is 8.0% with a 20% carry (1.40x multiple test) and no catch up. RVK estimates the negotiated structure will save the Division approximately \$18 million in management fees and incentive compensation over the life of the Fund compared with a typical allocator fund. Additionally, as a lead investor the Division will receive an enhanced economic right based on performance which will reduce the carried interest below 20% based on certain assumptions.

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. To ensure that the investment does not violate N.J.A.C. 17:16-69.9(c) given Focus Healthcare Partners' current AUM, the Division will require contractual provisions that prevent its total investments from exceeding 20% of Focus Healthcare Partners' total assets.

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. Focus Healthcare Partners Fund I 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 May 5, 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 May 25, 2016 meeting.

Attachments

Fund Name: Focus Healthcare Partners Fund I

May 25, 2016

Contact Info: Michael I. Feinstein, 200 West Madison, Suite 2650, Chicago, IL 60606

Fund Details:

Total Firm Assets (\$bil.):	\$360 million
Strategy:	Non-core
Year Founded:	2009
Headquarters:	Chicago, IL
GP Commitment:	1% with a \$2 million cap

Key Investment Professionals:

Paul Froning – Co-Founder & Co-Managing Partner, Mr. Froning is currently co-founder and co-managing partner of Focus Healthcare Partners. Mr. Froning has more than 20 years of involvement in healthcare and senior housing as an investor, operator, advisor and investment banker. Prior to founding Focus, Mr. Froning was a Managing Director of Fortress Investment Group.
Curt Schaller – Co-Founder & Co Managing Partner, Mr. Schaller is also co-founder and co-managing partner of Focus Healthcare Partners. Mr. Schaller has been involved in the healthcare real estate sector for 20 years and prior to co-founding Focus, he served in senior leadership positions with two of the leading lenders in healthcare- General Electric and Merrill Lynch Capital.
Michael Feinstein – Vice President, Mr. Feinstein is responsible for implementing the acquisition and asset management activities for Focus. Previously, Mr. Feinstein was a Vice President at Buchanan Street Partners, the real estate private equity subsidiary of the TCW Group.
Scott MacGregor – Vice President, Mr. MacGregor is responsible for asset management activities as well as underwriting, financing and closing new acquisition opportunities. Prior to joining Focus, Mr. MacGregor spent seven years as an acquisition officer for Pearlmark Real Estate Partners' dedicated multifamily fund where he was involved with over \$1 billion of transactions.

Investment Summary

Focus was founded in 2009 by Paul Froning and Curt Schaller, two recognized experts in healthcare real estate, with the belief that superior risk-adjusted returns could be achieved through rigorous asset management and alignment with select regional managers. Focus Healthcare Partners Fund I will target properties which offer residents the ability to “age in place” across acuity levels (independent living, assisted living, and memory care). The Fund will focus on private pay residents to alleviate government reimbursement risk, and will similarly avoid skilled nursing facilities which have a strong propensity toward Medicaid receivables. It will target properties and portfolios in primary and secondary markets. Acquisitions will primarily be stabilized and/or value-add assets where the owner can create attractive returns by increasing net operating income, through professional asset management. The principals have relationships with the operations community, lenders, and others that will create proprietary deal flow for the fund.

Existing and Prior Funds

<u>Venture Partners</u>	<u>Vintage Year</u>	<u>Strategy</u>	<u>Returns as of 12/31/2015</u>
Venture Partner I	2011	Non-core	51% Net IRR; 3.3x Net MOIC; 198% DPI
Venture Partner II	2013	Non-core	46% Net IRR; 2.1x Net MOIC; 4% DPI
Venture Partner III	2013	Non-core	22% Net IRR; 1.8x Net MOIC; 178% DPI
Venture Partner IV	2014	Non-core	30% Net IRR; 1.6x Net MOIC; 7% DPI

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

Vehicle Information:

Inception:	
Fund Size :	\$250 million (hard cap)
Management Fee:	During the investment period will be 75 bps on committed capital and 150 bps on invested (reduced to 125 bps if fund size reaches \$225 million). After the investment period the management fee will initially be 100 bps on invested capital and drop to 75 bps after three years
Carry:	20% with a 1.4x multiple test
Preferred Return:	8%
Offsets:	100 % fee offset

Auditor:	RSM McGladrey
Legal Counsel:	DLA Piper LLP (US)

NJ AIP Program

Recommended Allocation (\$mil.):	\$100 million	LP Advisory Board Membership:	TBD
% of Fund:	40.00%	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.