



## State of New Jersey

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September 23, 2016

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough  
Director

SUBJECT: **Proposed Investment in Benefit Street Partners Special Situations Fund L.P.**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$150 million in Benefit Street Partners Special Situations Fund L.P. (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 is being formed to continue the team’s prior successful track record of pursuing attractive risk-adjusted returns across stressed and distressed investments in four categories: non-market correlated opportunities, opportunistic low loan-to-value credit, opportunistic high yield debt and restructuring opportunities. With regard to geography, the focus will be North America but other regions with reliable legal systems will be considered opportunistically. At each phase of the credit market cycle, Benefit Street (the “Firm”) will aim to identify instruments that are trading below their inherent value. The Fund aims to prioritize a niche segment of its investible universe, namely focusing on issuers with sub \$1.5 billion debt capital structures. The Fund will leverage the broader Benefit Street platform, providing it access to information, bespoke investment opportunities and proprietary private debt transactions. The Fund targets net returns of 15–20%+IRR and a 2.0x – 2.5x MOIC.

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

**Distressed Market Opportunities:** Factors such as deteriorating underwriting standards, increased volatility and suppressed liquidity potentially create a unique investing platform. Leverage levels remain elevated, a trend that is typical for a market that is in the later stages of the credit cycle. Purchase price multiples are also at peak levels, running at 10.5x or higher over the past two years, above the former peak of 9.9x in 2007. Despite the high yield market rally in Q2 2016, over 11% of the market is currently trading at distressed levels (defined as spreads greater than 1,000 bps), which has doubled since 2014. Moreover, the rally in US distressed high yield in 2016 is attributed almost exclusively to a pronounced recovery in the lower-quality portions of the energy and metals

and mining sectors, which have moved higher as commodity prices, notably oil, rallied. However, these assets have held on to gains even as oil prices have declined over 10% since early June.

**Targeted Investment Universe:** Emphasis is on a niche segment of the investable universe, namely focusing on issuers with sub-\$1.5 billion debt capital structures, where an opportunity exists given a lack of liquidity. Large companies enjoy low interest rates and access to attractive financing, but middle market companies with smaller issue sizes or more complexity are often yielding double digit rates. These issuers are not as widely held or tracked by the broader investment community. Healthy premiums exist to invest in these situations, presenting a more attractive return opportunity.

**Extensive Benefit Street Platform:** The team that is managing the Special Situations Fund is a part of the larger Benefit Street platform, which consists of over 70 investment professionals, which affords the special situations team access to extensive deal flow and market intelligence from the Firm's private debt and research teams. In addition to their extensive in-house network, the Firm has access to a vast network of external attorneys, advisors, turnaround professionals and other distressed credit industry contacts. The extensive back office of the Firm allows the senior professionals of the Fund the ability to focus solely on investment-related activities.

**Highly Experienced, Cohesive Team with Expertise Across Multiple Credit Cycles:** The management of the Fund will be led by Ray Costa (Portfolio Manager of the Fund and member of Investment Committee) and Brent Buckley (Managing Director and member Investment Committee). Mr. Costa and Mr. Buckley together have over 40 years of experience with distressed credit investments. Both Mr. Costa and Mr. Buckley were hired in 2014, having previously worked at Deutsche Bank alongside other senior members of the Firm. Mr. Costa was the Head of US Distressed Products (2004-2009) and Co-Head of Credit Fixed Income in North America (2010-2013) at Deutsche Bank. Mr. Buckley was a Managing Director at Centerbridge Partners (2006-2009) and previously the Head of Research of Deutsche Bank Distressed Products (1999-2006). The Fund's investment committee is comprised of Mr. Costa, Mr. Buckley, Tom Gahan (CEO of Benefit Street) and Mike Paasche (Senior Managing Director). All four gentlemen have an extensive history of working together since Deutsche Bank and experience successfully managing capital through multiple credit cycles.

**Attractive Terms:** The Division will receive discounted terms for being a large investor and in the first close, with a management fee of 1.0%, which is charged only on invested capital, and a 13.75% incentive fee over a 6% hurdle rate, with a European-style (back-ended) waterfall.

**Immediate Performance Benefits:** Benefit Street created a \$50 million Special Purpose Vehicle at the end of 2015, which the team has used to invest in select special situations opportunities. Investors in the Fund will buy into those assets, which have appreciated approximately 51% since 6/30/2016 (inception to date gross Internal Rate of Return), at cost plus interest, thus producing an immediate Day One Net Asset Value appreciation for investors.

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

Division Staff and its private equity consultant, TorreyCove Capital Partners, 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 engaged a third-party solicitor (“placement agent”) in the fundraising of the fund, but the placement agent was not used to solicit 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 90 of the Council’s regulations. Benefit Street Partners Special Situations Fund L.P. will be considered a debt-related private equity investment, as defined under N.J.A.C. 17:16-90.1.

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 September 14, 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 September 28, 2016 meeting.

Attachments

**Fund Name:** *Benefit Street Partners Special Situations Fund L.P.*

September 28, 2016

**Contact Info:** *David Manlowe, 9 West 57th Street, Suite 4920, New York, NY 10019*

**Fund Details:**

<b>Firm AUM:</b>	\$13.3 billion	<b>Key Investment Professionals:</b> <b>Thomas Gahan</b> , Chief Executive Officer. Prior to joining Providence and launching BSP in 2008, Mr. Gahan was global head of capital markets of Deutsche Bank Securities Inc. and head of corporate and investment banking in the Americas. He was also chairman of the principal investment committee and a member of the global banking executive committee and the global markets executive committee. <b>Michael Paasche</b> , Senior Managing Director. Prior to joining BSP in 2008, Mr. Paasche spent thirteen years at Deutsche Bank Securities Inc. with multiple positions, including global head of leveraged finance, where he was responsible for global non-investment grade loan portfolios, loan sales/trading and total return swaps in New York and London, loan and bond capital markets teams in New York, London and Australia, and leveraged finance banking teams in New York, London, Australia and Hong Kong. <b>Rav Costa</b> , Managing Director. Prior to joining BSP in 2014, Mr. Costa served as a managing director at Deutsche Bank Securities, where his responsibilities ranged from the global head of distressed debt trading to co-head of credit fixed income trading in North America. <b>Brent Buckley</b> , Managing Director. Prior to joining BSP in 2014, Mr. Buckley was a managing director of Centerbridge Partners where he was the first investment professional to join its two founding partners. Mr. Buckley was involved with establishing the distressed debt investing business which included the firm's research, analysis and investing in public and private securities.
<b>Strategy:</b>	Distressed Debt	
<b>Year Founded:</b>	2008	
<b>Headquarters:</b>	New York, NY	
<b>GP Commitment:</b>	5% of commitments not to exceed \$50 million	

**Investment Summary** **Existing and Prior Funds**<sup>1</sup>

Benefit Street Partners was established in 2008 by Thomas Gahan as a credit investing platform in partnership with Providence Equity Partners ("Providence"). Founded in 1989, Providence is an alternative asset manager with over \$47 billion in assets across private equity and credit platforms. The Fund is being formed to continue the team's prior successful track record of pursuing attractive risk-adjusted returns across stressed and distressed investments in four categories: non-market correlated opportunities, opportunistic low loan-to-value ("LTV") credit, opportunistic high yield debt and restructuring opportunities. With regard to geography, the focus will be North America but other regions with reliable legal systems will be considered opportunistically. At each phase of the credit market cycle, Benefit Street will aim to identify instruments that are trading below their inherent value. The Fund aims to prioritize a niche segment of its investible universe, namely focusing on issuers with sub \$1.5 billion debt capital structures. The Fund will leverage the broader Benefit Street platform, providing it access to information, bespoke investment opportunities and proprietary private debt transactions. The Fund targets net returns of 15-20%+IRR and a 2.0x - 2.5x MOIC.

<i>Funds</i>	<i>Vintage Year</i>	<i>Strategy</i>	<i>Returns</i> <sup>2</sup>
BSP Fund I	2008	Distressed Debt	21.9% Gross IRR, 1.35x Gross MOIC, 134.3% DPI
BSP Special Situations Fund	2016	Distressed Debt	51% Gross IRR, 43% Net IRR, 1.17x Gross MOIC, 22.3% DPI

1. Track record data is preliminary, unaudited and subject to change and is as of (i) January 31, 2016 for Fund I and (ii) June 30, 2016 for BSP Special Situations Fund.  
2. The "Fund I track record" includes only those investments made by Fund I in distressed debt investments, and excludes investments made by Fund I that are a part of the flagship private debt strategy but are not distressed debt investments  
IRR = Internal Rate of Return; MOIC = Multiple on Invested Capital; DPI = Distributions to Paid-In

**Vehicle Information:**

<b>Inception:</b>	2016	<b>Auditor:</b>	Ernst & Young LLP
<b>Fund Size (\$mil.):</b>	\$500 million	<b>Legal Counsel:</b>	Schulte Roth & Zabel LLP
<b>Management Fee:</b>	1.00%		
<b>Carry:</b>	13.75%		
<b>Hurdle Rate:</b>	6%		
<b>Additional Expenses:</b>	100% fee offset		

**NJ AIP Program**

<b>Recommended Allocation:</b>	Up to \$150 million	<b>LP Advisory Board Membership:</b>	Yes
<b>% of Fund:</b>	30.00%	<b>Consultant Recommendation:</b>	Yes
		<b>Placement Agent:</b>	No
		<b>Compliance w/ Division Placement Agent Policy:</b>	N/A
		<b>Compliance w/ SIC Political Contribution Reg:</b>	Yes

Data is as of August 31, 2016, unless otherwise indicated.

\*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.