



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

May 25, 2016

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough
Director

SUBJECT: **Proposed Investment in SONJ Private Opportunities II, L.P. Fund**

The New Jersey Division of Investment ("NJDOI" or the "Division") is proposing an additional investment of \$500 million in SONJ Private Opportunities II, L.P. ("SONJ II" or the "Fund"), which is managed by Black Rock Private Equity Partners ("BlackRock" or "PEP"). This memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9.

The Division's relationship with PEP goes back to 2006, with an initial focus on co-investments, and has since also taken advantage of venture capital funds, primary funds, and secondary opportunities. The Division's proposed \$500 million add-on will be allocated among co-investment opportunities, venture capital funds and primary fund strategies. No more than \$200 million will be allocated to venture capital and primary fund strategies, while \$300 million to \$500 million may be allocated to co-investment opportunities. The sourcing of co-investment opportunities will continue to be from other NJDOI General Partners ("GPs"), GPs with whom PEP has a relationship, and other GPs currently unaffiliated with either NJDOI or PEP. The fund opportunities will be sourced by BlackRock and will focus on top quartile venture funds and commitments to existing funds generating top quartile returns.

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

Strong Track Record: The SONJ II portfolio has delivered top-quartile performance compared to the Cambridge Associates All PE index as of September 30, 2015, generating a Net 20.5% Internal Rate of Return ("IRR") and a Net 1.72x Multiple on Invested Capital ("MOIC"). Meanwhile, realized co-investments alone have generated a gross IRR of 16.9% and a 1.82x MOIC.

Attractive Terms: The fees and structure of the SONJ II add-on have improved from the prior programs and the Division continues to retain full authority to review investments (veto rights). Some of the key negotiated terms are as follows:

- Management fee: 45bps on invested capital, down from 50 bps in prior tranche
- 10% carry on co-investments, 0% carry on fund investments

- 8% preferred return across all investments
- European style waterfall: All called capital including fees, and the preferred return, is returned to the Division before BlackRock can start receiving carry
- No-fault divorce clause
- Added: the Division's ability to pause the mandate at any time as well as turn off recycling ability if liquidity needs become apparent.

Continued Co-Investment Capability: The mandate allows for the Division to continue to lower its overall costs as typical private equity co-investments are no fee and no carry and the overall fee structure with BlackRock is well below a typical private equity fund's market terms. The account also allows for the Division to continue to be relevant with existing and prospective partners as they may need extra capital from time to time to execute certain transactions and would rather syndicate to a friendly partner than a competitor fund.

Ability to Leverage Resources: The Division's relationship with BlackRock has been extremely productive over time with the Division leveraging PEP's resources to help with underwriting or sharing notes on new investments and opportunities, providing research and training sessions for team members, providing helpful analysis when requested across the portfolio, and lending advice when appropriate. The good working relationship between the organizations is also aided by the close proximity of the groups, as PEP has a substantial amount of their team located in Princeton.

Venture Capital Exposure & Terms: The Division's venture capital portfolio within the BlackRock separate account is still young but populated with many hard to access managers with top-quartile track records over time (as of 9/30/15, over 80% of the underlying venture capital funds legacy portfolios were in the 1st or 2nd quartile on all metrics). In addition, the agreed upon terms discussed previously (0.45% management fee on invested capital, 0% carry) on fund investments are superior to other offerings not likely to be replicated, giving the Division a very cost effective way to invest in top-tier venture capital funds.

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 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 90 of the Council's regulations. SONJ Private Opportunities II, L.P. will be considered a private equity buyout 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 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: SONJ Private Opportunities fund II, L.P. - Add-on

May 25, 2016

Contact Info: Lynn Baranski, 1 University Square Drive, Princeton, NJ 08540,(609) 282-3612

Fund Details:

Firm AUM (\$bil):	\$4.6 trillion as of 12/31/2015	Key Investment Professionals: Russ Steenberg, Global Head / Managing Director: Hired by Merrill Lynch Investment Managers in 1999 to establish a private equity fund of funds and direct co-investment business. PEP was formed in July 1999 as a business unit of MLIM and was combined with BlackRock in October 2006. Prior to joining MLIM to form PEP, Mr. Steenberg was employed by AT&T Investment Management Company, where he was instrumental in building one of the earliest private capital programs in the institutional investment community. Lynn Baranski, CIO /Managing Director: Ms. Baranski has over 20 years of private equity investment experience. Prior to joining Private Equity Partners in 2001, she worked for four years as a Portfolio Manager and Research Analyst in Adviser's fixed income division in the European High Yield Group and US Bank Loan Portfolio Group, respectively. Jay Park, Managing Director: Mr. Park has over 17 years of private equity investment experience. Prior to joining Private Equity Partners in 2001, he spent four and a half years working in Merrill Lynch's Direct Investment Group.
Strategy:	Buyout and Venture Capital	
Year Founded:	1988	
Headquarters:	Princeton, NJ	
GP Commitment:	Up to \$30 million	

Investment Summary	Existing and Prior Funds			
BlackRock Private Equity Partners ("BlackRock" or "PEP") manages commitments of approximately \$21.7 billion across private equity and infrastructure, executed through primary and secondary fund investments as well as direct co-investments. PEP currently manages nine separate accounts in addition to its core comingled, co-investment and private equity growth programs. NJDOI is seeking to commit an additional \$500 million to its existing \$800 million separate account with the Firm. In regards to co-investments, BlackRock will invest opportunistically and have the flexibility to invest globally across the spectrum of private equity transactions and investment disciplines. In regards to venture capital and primary fund investments, BlackRock expects to invest across an assorted pool of 25 to 35 managers, diversified by stage, industry, and geographic focus, with commitment sizes ranging from \$1.0 million to \$15.0 million, on average.	<i>Funds</i>	<i>Vintage Year</i>	<i>Strategy</i>	<i>Returns as of 6/30/2014</i>
	SONJ I	2007	Buyout/Venture Capital	2.6% Net IRR, 1.19x Net MOIC, 0.93x DPI
	SONJ II	2008	Buyout/Venture Capital	20.5% Net IRR, 1.72x Net MOIC, 0.52x DPI
IRR = Internal Rate of Return; MOIC = Multiple on Invested Capital; DPI= Distributions to Paid-In				

Vehicle Information:

Inception:	2007	Auditor:	Deloitte & Touche, LLP
Fund Size (\$mil):	\$500 million in aggregate; up to \$500 million for coinvestments and up to \$200 million for primary venture capital fund commitments,	Legal Counsel:	Ropes & Gray, LLC
Management Fee:	0.45% on invested capital		
Carry:	10% on co-investments; no carried interest on fund commitments		
Hurdle Rate:	8%		
Offsets:	100% fee offset		

NJ AIP Program			
Recommended Allocation (\$mil):	\$500 million in aggregate	LP Advisory Board Membership:	N/A
% of Fund:	98.50%	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.