State of New Jersey
DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
PO BOX 290
TRENTON NJ 08625-0290

JON S. CORZINE
Governor

BRADLEY I. ABELOW
State Treasurer

June 9, 2006

MEMORANDUM TO: State Investment Council

FROM: William G. Clark
Director

SUBJECT: **Proposed Private Equity Investments in GTCR IX, DLJ Merchant Banking Partners IV, Warburg Pincus VIII, Centerbridge Capital Partners I and MHR Institutional Partners III**

This due diligence memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.12 (a) to report on five proposed private equity investments: a $75 million commitment to GTCR IX, a $50 million commitment to DLJ Merchant Banking Partners IV, the purchase of a $25 million interest in Warburg Pincus VIII, an $100 million commitment to Centerbridge Capital Partners I and a $50 million commitment to MHR Institutional Partners III.

Please note that these investments will be authorized pursuant to Articles 69 and 90 of the Council's regulations which became effective on June 20, 2005. Both investments will be considered to be "Buyout Investments" as defined under N.J.A.C. 17:16-90.2 (a).

The Alternative Investments Procedures adopted by the Council on January 20, 2005 require any potential alternative investment opportunities to be identified and initially evaluated by the Head of Alternative Investments of the Division (myself in an acting capacity) and the applicable Asset Class Consultant (Strategic Investment Solutions for private equity, or "SIS") in coordination with the DOI Investment Committee (Ike Michaels acting as Deputy Director and myself).

As a result of internal and external sourcing, the DOI Investment Committee identified these proposed investments. As a result, SIS and Division staff proceeded to undertake extensive due diligence on these five proposed investments. We completed the same due diligence process as with all the other alternative investment opportunities presented to the Council.

Based on this due diligence, the Division has determined that each of the proposed investments meets the criteria for investments set forth in the Alternative Investment Procedures.

The investments that we are proposing focus on the large and middle market buyout market (GTCR IX, DLJ Merchant Banking Partners IV and Warburg Pincus VIII) and the distressed debt market (MHR Institutional Partners III and Centerbridge Capital Partners I).

GTCR IX is a middle-market buyout fund focused on management start-ups and platform acquisitions within five sectors of the economy: consumer products and services; healthcare; outsourced business services; technology and transaction processing. The Firm will seek to add value by executing multiple strategic and synergistic follow-on acquisitions within each investment. GTCR IX has a proven track record of executing its strategy and generating top-quartile returns. The general partner will be investing a significant amount in the Fund, ensuring that the limited partners' interests are aligned with those of the general partner. The management fees are reasonable, and all the legal and economic terms associated with the partnership are fair and consistent with market standards.

DLJ Merchant Banking Partners IV (MBP IV) will focus on middle-market investments primarily in the United State and Western Europe. MBP IV will follow the same opportunistic yet disciplined investment strategy that DLJ Merchant Banking ("DLJMB") has successfully employed since its formation in 1985. This flexible approach to investing, coupled with the broad-based expertise of DLJMB's professionals and DLJMB's ability to leverage CSFB's deal flow, intellectual capital and financial resources, should allow DLJMB to capitalize on shifting industry dynamics, economic conditions, regulations and/or technology by deploying capital in industries and geographic regions that DLJMB has perceived to have the greatest return potential. The Fund intends to invest across a variety of industries, economic cycles and market conditions. The past three DLJ funds have been successful, producing returns that are top quartile for two of the three (with the third between the median and the top quartile). Again, we believe the management fees are reasonable, and all other legal and economic terms associated with the partnership are fair and consistent with market standards.

In conjunction with the above investment in MBP IV, we will also have the opportunity to purchase on a secondary basis a $25 million interest in Warburg Pincus VIII (WP VIII). You may recall that early on in the program, we made a commitment to Warburg Pincus IX. WP VIII was formed in 2001 to make special equity, venture capital and related private equity investments. Based on the analysis and due diligence performed by SIS and staff, it is our expectation that this secondary interest will be a strong performer as investments are realized through M&A and IPOs. We believe that the valuations for this fund are conservative – private investments are valued at cost as an approximation of fair value and changes in value have only been made when a significant third-party investment or financing event has occurred or there is a significant change in the financial condition or operating performance of the portfolio company. The performance of the fund since inception has been strong and we believe substantial upside remains.

Centerbridge Capital Partners is a multi-strategy investment fund that will focus on private equity and distressed securities investments. In particular, the fund will seek to opportunistically make (i) private equity investments through the firm's expertise in a targeted range of industry verticals and (ii) distressed investments with the primary purpose of obtaining influence over or control of the restructuring of financially troubled companies. The general partner believes that this distinct approach to alterative asset investing optimizes flexibility in different market environments and mitigates market timing risk. Incorporating both strategies into a single fund creates a broader depth of investment expertise by utilizing the principals' analytical strengths and capital markets knowledge and, specifically, by enhancing the firm's deal flow and its ability to evaluate investment opportunities, management teams, and exit alternatives. The Principals have each consistently produced superior returns in both strategies across all market cycles. Again, we believe the management fees are reasonable, and all other legal and economic terms associated with the partnership are fair and consistent with market standards.

MHR Institutional Partners III (MHR III) will seek to generate private equity type returns with mitigated risk by capitalizing on the inefficiencies of the markets for distressed and undervalued middle-market companies. The Partnership will seek to preserve and create value by achieving and utilizing positions of control or influence in connection with its investments. The firm employs a rigorous, due diligence-focused investment process, capitalizing on its deep industry knowledge and analytical capabilities, to generate attractive risk-adjusted returns across various investing environments in both the debt and equity markets. Furthermore, we believe that the tight level of credit spreads, the ever increasing issuance of high yield debt and an anticipated decline in overall credit quality in the market are expected to produce significant opportunities for distressed debt investors over the coming years. The principals will be investing a significant amount in the Fund, ensuring that the limited partners' interests are aligned with those of the general partner. The management fees are reasonable, and all the legal and economic terms associated with the partnership are fair and consistent with market standards.

A formal written due diligence report for each of the proposed investments was sent to each member of the Investment Policy Committee of the Council on June 2, 2006, and a meeting of the Committee was held on June 6, 2006. In addition to the formal written due diligence reports, all other information obtained by the Division on these five investments was made available to the Investment Policy Committee.

After review of the extensive due diligence, the Investment Policy Committee of the Council decided to report on these proposed investments to the full Council pursuant to Step 4 of the Alternative Investments Procedures. Under these procedures, the Council may adopt or otherwise act on this report.

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 each investment. In addition, each proposed investment must comply with the Council's "pay to play" regulation (N.J.A.C. 17:16-4). While we are confident that we will work through these issues, the potential exists that a successful resolution will not be reached with one or the other of these general partners.

We look forward to discussing these proposed private equity investments at the Council's June 15, 2006 meeting.

WGC:cae
Attachments

*SIC Investment Committee Fund Review Memo

To:	**State Investment Council**
From:	**SIC Investment Committee**
Date:	**June 15, 2006**
Subject:	**Warburg Pincus VIII Secondary purchase recommendation**

Fund Facts

Fund Name:	Warburg Pincus VIII
Fund Type:	Large Buyout / Private Equity
Current Fund Size:	$5.34 billion - vintage 2001
Previous Fund Size/Vintage:	N/A
Final Close:	April-02
Fund Address:	466 Lexington Avenue New York, New York 10017-3147

GP Contact Info

Name:	Steven Schnieder
Telephone:	(212) 878-6238
Email:	

Summary of Terms and Investment Strategy

Investment Strategy:	Venture capital, buyouts and structured investments both domestically and internationally
Geographic Focus:	US, Europe and Asia
GP Co-Investment Amount:	$100 million
Terms:	
Commitment Period:	12 years
Term:	12 years with the ability at the discretion of the General Partner to extend for 2 consecutive one-year periods.
Management Fee:	1.5% for the first $4 billion of invested capital and 1% for the additional $1.34 billion
Offset / Other Fees:	None
Hurdle Rate:	

NJ AIP Program:

Recommended Allocation:	$25 million
% of LP Commitments:	0.91%
% of New Jersey State Pension Plan:	0.03%
% of AIP Private Equity Allocation ($3.5b):	0.71%
% of Private Equity Allocation for FY06 ($2.0b):	1.25%

LP Advisory Board Membership:	NA
Consultant Recommendation:	Yes
Compliance with SIC "Pay to Play" Reg:	Compliant

*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.