State of New Jersey
DEPARTMENT OF THE TREASURY
DIVISION OF INVESTMENT
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September 14, 2007

MEMORANDUM TO: State Investment Council

FROM: William G. Clark
Director

SUBJECT: **Proposed Private Equity Investments in Warburg Pincus Private Equity X, L.P., Oak Hill Capital Partners III, Avenue Special Situation Fund V, Oaktree Loan Fund and TPG-TAC 2007 Fund**

This due diligence memorandum is presented to the State Investment Council (the "Council") pursuant to N.J.A.C. 17:16-69.9 (a) to report on the following proposed private equity investments: (1) a $400 million commitment to Warburg Pincus Private Equity X, L.P., (2) a $250 million commitment to Oak Hill Capital Partners III, (3) an additional $100 million commitment to Avenue Special Situation Fund V, (4) a $200 million commitment to the Oaktree Loan Fund, and (5) a $100 million commitment to the TPG-TAC 2007 Fund.

Please note that these investments will be authorized pursuant to Articles 69 and 90 of the Council's regulations. The investments in Warburg Pincus and Oak Hill will be considered "Buyout Investments" as defined under N.J.A.C. 17:16-90.2, while the investments in Avenue, Oaktree and TPG-TAC will be considered "Debt –related Investments".

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 in this case, or "SIS") in coordination with the DOI Investment Committee (Ike Michaels, Deputy Director and myself).

Based on this due diligence, the Division has determined that the proposed investments meet the criteria for investments set forth in the Council's Alternative Investment Policy.

Warburg Pincus Private Equity X, L.P. will invest in all stages of global private equity, from early-stage venture capital to growth equity to leverage buyouts and recapitalizations. Founded in 1967, Warburg Pincus is one of the pioneering firms in private equity and has raised a total of ten private equity funds prior to this current fund. Consistent with prior Warburg Pincus funds (including Warburg Pincus Private Equity IX, to which the Division committed $200 million in August 2005), Warburg Pincus' strategy is to build lasting businesses with increasing operating earnings in growing businesses. In addition, they have historically sought to avoid generating returns via excessive leverage on their investments. Both domestically and internationally, Warburg Pincus has targeted core sectors for investment. The firm's investment organization has evolved into teams focused on specific industry groups including energy, financial services, healthcare/life sciences, industrial/consumer, and TMT (technology, media and telecommunications). The general partner has a proven track record of executing its strategy and generating top-quartile returns. The general partner has substantial capital committed to the Fund thus aligning our interests 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.

Oak Hill Capital Partners III will invest primarily in "middle market" domestic companies (i.e., equity investments of $100-$400 million per company) across six industry groups: basic industries; business and financial services; consumer, retail and distribution; healthcare; media and telecommunications; and technology. In each of these industries, Oak Hill's strategy is to pro-actively influence the investment outcome by offering each portfolio company long-term strategic direction, operating insights, growth opportunities and strategic acquisition ideas. Oak Hill seeks to originate investment opportunities by capitalizing on its deep industry knowledge and extensive network of relationships. Oak Hill's track record dates back over 20 years across various economic cycles and market conditions. Please note that the Division committed $75 million to Oak Hill Capital Partners II (their previous fund) in July 2005. The firm founded by Robert Bass, and as in past funds, Mr. Bass and the other principals of Oak Hill will be making a sizable commitment to the fund. The management fees are reasonable, and all the legal and economic terms associated with the partnership are fair and consistent with market standards.

Avenue Special Situation Fund V is the current fund being managed by Avenue Capital Group to invest in distressed and undervalued credit securities (both public and private), bank loans, trade claims and private investments (both public and private). The Division initially committed $100 million to this fund in April 2007, and we are proposing to take advantage of current market conditions to make an additional commitment of $100 million. The principals of Avenue have led investments of more than $13 billion in distressed debt and securities through six prior investment funds. The senior principals each have more than 20 years of experience in this field, and have worked together since 1989. One of Avenue's key strengths is the development of long-term investment themes which engenders a high level of understanding of a specific industry that enables the principals to quickly react to opportunities as they arise. Given recent events in the credit markets, Avenue is increasing the fund size of Fund V since they have identified increased distressed opportunities and deal flow. We agree with this assessment, which explains why we are proposing this additional $100 million commitment. There is no change to the Fund terms, which we believe are reasonable and consistent with market standards.

The remaining two funds, the *Oaktree Loan Fund* and *TPG-TAC 2007 Fund* are being proposed to take advantage of a perceived opportunity in bank loan investments. Within the leveraged buyout market, large banks and investment banks have historically made "bridge" loans to private equity firms to help finance acquisitions. These loans typically are senior obligations in the target company's capital structure, and are secured by the company's assets. The strategy of the banks and investment banks has been to syndicate these loans to other investors, either directly or through structured credit products such as CDOs and CLOs. Given the current dislocations in the credit markets, we believe that the banks and investment banks will only be unable to sell off these loans at discounts to par value. To put this opportunity into perspective, we estimate that these banks are currently holding over $300 billion in such loans on their books from LBO transactions that are in various stages of completion. The remainder of this memorandum will describe the firms that will be managing these proposed investments.

The Oaktree Loan Fund will be managed by Oaktree Capital Management, which is a large alternative asset manager. Oaktree has a strong reputation for in-depth credit analysis with an emphasis on downside protection. Please note that we currently have a $50 million commitment to the OCM Mezzanine II Fund, a mezzanine debt fund also managed by Oaktree Capital Management. This new fund will managed by the high-yield team at Oaktree, but will also utilize the experience set and knowledge of the investment professionals in their distressed debt area to leverage their research efforts. While the majority of the fund will be invested in bank debt, there will be a 20% "basket" for other opportunistic investments. Given that the size of the opportunity is uncertain at this point, Oaktree has agreed to charge management fees only on invested capital rather than committed capital.

TPG-TAC 2007 is being formed by the principals of TPG Capital to utilize the expertise of the firm to purchase bank loans and related opportunities. TPGs advantage with respect to this opportunity is that they have already examined a large number of these LBO transactions as potential private equity investments for its LBO funds. Based on this experience, TPG intends to identify an initial list of target credits and to evaluate these companies using fundamental credit analysis. TPG has set up informal alliances with several other highly-respected investment firms to obtain the benefits of scale and joint analysis. As with Oaktree, TPG-TAC has agreed to charge management fees only on invested capital rather than committed capital.

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 the proposed investments. Based on this due diligence, the Division has determined that these proposed investments meet the criteria for investments set forth in the Alternative Investments Policy.

Formal written due diligence reports for the proposed investments were sent to each member of the Investment Policy Committee of the Council on September 7, 2007, and a meeting of the Committee was held on September 13, 2007. In addition to the formal written due diligence reports, all other information obtained by the Division on these 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 the proposed investments to the full Council pursuant to Step 4 of the Alternative Investments Procedures.

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 these investments. In addition, the proposed investments 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 more of the general partners.

We look forward to discussing these proposed private equity investment at the Council's September 20, 2007 meeting.

WGC:cae
Attachment

*SIC Investment Committee Fund Review Memo

To: State Investment Council
From: SIC Investment Committee
Date: September 13, 2007
Subject: Warburg Pincus Recommendation

Fund Facts

Fund Name:	Warburg Pincus X
Fund Type:	Large Buyout / Private Equity
Current Fund Size:	$15 billion
Previous Fund Size/Vintage:	$8 billion / 2005
Final Close:	January-08
Fund Address:	466 Lexington Avenue New York, New York 10017-3147

GP Contact Info

Name:	Bowman Cutter
Telephone:	212-878-9358
Email:	bcutter@warburgpincus.com

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:	$300 million / 2.5%
Terms:	
Term:	12 years
Investment period:	6 years
Management Fee:	1.5% on committed capital during investment period, 1.5% on invested capital thereafter
Other Fees:	None
Hurdle Rate:	None

NJ AIP Program:

Recommended Allocation Current:	up to $400 million
% of Fund:	2.67%
% of New Jersey State Pension Plan:	0.50%
% of AIP Private Equity Allocation ($5.0b):	8.00%
% of Buyout Commitments FY08 ($3.0b):	13.33%

LP Advisory Board Membership:	Yes
Consultant Recommendation:	Yes
*see due diligence memo	
Compliance with SIC "Pay to Play" Reg:	Side letter required

*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.