

TREASURY - GENERAL

STATE INVESTMENT COUNCIL

Real Assets

Proposed Repeals and New Rules: N.J.A.C. 17:16-71

Authorized By: State Investment Council, Peter A. Langerman, Director,
Division of Investment

Authority: N.J.S.A. 52:18A-91

Calendar Reference: See Summary below for explanation of exception to calendar
requirement.

Proposal Number: PRN 2005-69

Submit comments by April 23, 2005 to:

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The agency proposal follows:

Summary

The current rules governing real estate equity investments (N.J.A.C. 17:16-71) are repealed in their entirety. In its place, the proposed new rules establish real assets as an investable asset class for five New Jersey pension funds (Police and Firemen's Retirement System; Public Employees' Retirement System; State Police Retirement System; Teachers' Pension and Annuity Fund; and Judicial Retirement System of New Jersey) under management by the Division of Investment. Real assets, as defined in the proposed new rules, consist of investments in real estate (excluding publicly-traded real estate investment trusts), oil and gas, timber properties, royalty trusts and commodity-linked investments. These assets could be invested in any of the following types of funds: separate account (ownership is segregated and kept in the investor's name);

commingled funds (all open-end and closed-end pooled investment vehicles designed for institutional tax-exempt investors, which may be organized as a group trust, partnership, corporation, insurance company separate account, or other multiple ownership entity); co-investments (two parties – usually the limited partner and the general partner of a fund – invest alongside each other in the same company); joint ventures (contractual agreement joining two or more parties for the purpose of executing a particular undertaking); and direct investments. The pension funds' commingled shares of real assets would be held in the newly proposed Common Pension Fund E, which is the common fund to be established by N.J.A.C. 17:16-69, proposed elsewhere in this issue of the New Jersey Register.

For any of the pension and annuity group funds investing in Common Pension Fund E, certain limits will apply for each of the following subcategories – leverage within the investment vehicle is limited to a maximum of 160 percent of equity value at the time of purchase; in direct investments, co-investments and joint ventures, no more than 1.65 percent of the market value of any pension fund's assets may be invested in real estate located outside the United States, no more than two percent of the market value of any pension fund's assets may be invested in a single property type, such types being defined as office, retail, apartment/multi-family, industrial and mixed use, and no more than two percent of the market value of any pension fund's assets may be invested in any one region of the United States, such regions being defined as East, South, Midwest and West. In addition, real asset investments in oil and gas, timber, royalty trusts and commodity-linked investment vehicles are permissible provided that no more than 1.5 percent of the market value of any pension fund's assets may be invested in this subcategory.

An overall aggregate market value limitation on real asset investments is set at five percent of the market value of all assets of any of the eligible pension funds investing in Common Pension Fund E, and the Council shall be notified at a regularly scheduled meeting if the market value exceeds five percent; however, the Division may be granted a six-month grace period in which to reduce the level of participation below the five percent level, with an allowance for additional four-month extensions, as approved by the Council.

Because the Division is providing a 60-day comment period on this notice of proposal, this notice is exempt from the rulemaking calendar requirement pursuant to N.J.A.C. 1:30-3.3(a)5.

Social Impact

The proposed new rules are intended to expand the asset classes in which the State's pension funds can be invested and it is not anticipated that any actual social impact from the proposed new rules will occur.

Economic Impact

The proposed new rules will facilitate investment diversification, which based upon historical experience, should result in a reduction of total portfolio risk for the State's pension funds while offering an opportunity for improved rates of return over time. Therefore, it is not anticipated that the rules will have a negative economic impact; rather, the potential for improved returns should bode favorably for the State's taxpayers by reducing the level of State and municipal contributions over the long term.

Federal Standards Statement

A Federal standards analysis is not required because the investment policy rules of the Division of Investment are under the auspices of the State Investment Council, and are not subject to any Federal requirements or standards.

Jobs Impact

The State Investment Council and the Division of Investment do not believe that any jobs will be lost by virtue of the proposed new rules. Rather, the expectation is that there will be a creation of jobs within the Division of Investment to assist with the implementation and monitoring of this proposed investment program.

Agriculture Industry Impact

The proposed new rules shall have no impact on the agriculture industry.

Regulatory Flexibility Statement

A regulatory flexibility analysis is not required, since the proposed new rules impose no requirements on small businesses as the term is defined in N.J.S.A. 52:14B-16 et seq., but regulate only the Director of the Division of Investment.

Smart Growth Impact

The proposed new rules are not anticipated to have an impact on the achievement of smart growth and implementation of the State Development and Redevelopment Plan.

Full text of the proposed repeals may be found in the New Jersey Administrative Code at N.J.A.C 17:16-71.

Full text of the proposed new rules follows:

SUBCHAPTER 71. REAL ASSETS

17:16-71.1 Definitions

The following words and terms, as used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise:

“Co-investment” means two parties (usually the limited partner and the general partner of a fund) invest alongside each other in the same company. If a limited partner in a fund has co-investment rights, it can invest directly in a company that is also backed by a fund. The institution therefore ends up with two separate stakes in the company - one indirectly through the fund; one directly in the company.

“Commingled funds” means all open-end and closed-end pooled investment vehicles designed for institutional tax-exempt investors. A commingled fund may be organized as a group trust, partnership, corporation, insurance company separate account, or other multiple ownership entity.

“Commodity-linked investments” means investments in which all or a portion of the return is linked in the price of a particular commodity or equity security, or to an index of such prices. These include commodity-indexed deposits, loans, debt issues, and derivative products, such as forwards, options, and swaps. In these transactions, the interest, principal, or both, or payment streams in the case of swaps, are linked to the price of a commodity.

“Direct investment” means the purchase of an interest in a company or venture that has enough influence to direct the course of the investment. Direct investment usually avoids intermediaries between the buyer and the seller.

“East” means New England, New Jersey, New York, Pennsylvania, Delaware, Kentucky, Maryland, North Carolina, South Carolina, Virginia, Washington D.C. and West Virginia.

“Joint venture” means a contractual agreement joining two or more parties for the purpose of executing a particular undertaking. All parties agree to share in the profits and losses of the enterprise. Joint ventures are usually private.

“Midwest” means Illinois, Michigan, Ohio, Wisconsin, Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota and South Dakota.

“Real assets” means investments in real estate (excluding publicly traded real estate investment trusts), oil and gas, timber properties, royalty trusts and commodity-linked investments.

“Royalty trust” means equity investments that generate an income stream for investors; these primarily include natural resource assets, and pharmaceuticals and medical devices.

“Separate account” means ownership is segregated and kept in the investor’s name.

“South” means Alabama, Florida, Georgia, Mississippi, Tennessee, Arkansas, Louisiana, Oklahoma and Texas.

“West “ means Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, Wyoming, Alaska, California, Hawaii, Oregon and Washington.

17:16-71.2 Permissible investments

(a) Subject to the limitations contained in this subchapter, the Director may invest in real assets in any of the following ways:

1. Investment in real estate assets through direct investments, separate accounts, commingled funds, co-investments and joint ventures is permissible provided:
 - i. Leverage within the investment vehicle is limited to a maximum of 160 percent of equity value at the time of purchase.
 - ii. In direct investments, co-investments and joint ventures, no more than 1.65 percent of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested in real estate located outside the United States.
 - iii. No more than two percent of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested in a single property type, such types being defined as office, retail, apartment/multi-family, industrial and mixed use.

- iv. In direct investments, co-investments and joint ventures, no more than two percent of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested in any one region of the United States, such regions being defined as:
 - (1) East;
 - (2) South;
 - (3) Midwest; and
 - (4) West.
2. Investments in real assets such as oil and gas, timber, royalty trusts and commodity-linked investment vehicles are permissible provided no more than 1.5 percent of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested in this subcategory.

17:16-71.3 Applicable funds

(a) Applicable funds are as follows:

1. Police and Firemen's Retirement System;
2. Public Employees' Retirement System;
3. State Police Retirement System;
4. Teachers' Pension and Annuity Fund; and
5. Judicial Retirement System of New Jersey.

17:16-71.4 Limitations

(a) The aggregate market value of the investment of real assets under this subchapter, for any eligible pension fund, shall not exceed five percent of the market value of all assets of such pension fund.

(b) If the market value exceeds five percent, then the State Investment Council shall be notified at a regularly scheduled meeting of the Council. The Division may be granted a six-month period of grace to reduce the level of participation of the fund below the five percent level, except that the period of grace may be extended for additional four-month periods with the approval of the Council.

17:16-71.5 Legal papers

(a) Prior to any commitment to purchase obligations of the type described in this subchapter, the Director shall have obtained:

1. A prospectus or offering documentation describing the investment;
2. A purchase agreement, if applicable; and
3. Such other documents or opinions which the Attorney General may require.