

STATE INVESTMENT COUNCIL ALTERNATIVE INVESTMENTS POLICY

INTRODUCTION

The New Jersey State Investment Council (the “SIC”) hereby adopts the following policy governing the Alternative Investment Program (the “AIP”). The AIP calls for the establishment of a new common trust fund to be known as “Common Pension Fund E.” The following participating funds may invest in Common Pension Fund E: 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 (collectively, the “Pension Funds”). Common Pension Fund E shall be a fund created for the purpose of investing the Pension Funds in the “Alternative Investments” described in this AIP. The strategic objectives of the AIP are to:

- Enhance the risk-adjusted returns of the Pension Funds with a combination of return enhancement and risk reduction through diversification; and
- Generate returns net of all fees and expenses above those available in the public equity markets, as represented by a broad US equity benchmark such as the S&P 1500 Index, which shall be competitive with those of similar alternative investments programs and which shall compensate the Pension Funds for the long term and illiquid commitments associated with alternative investments. Recognizing the long-term nature of alternative investments, this relative performance will be measured over a period of multiple market cycles.

The AIP authorizes the investment of Common Pension Fund E in Alternative Investments in order to provide enhanced returns for the Pension Funds, at an acceptable level of risk. The role of the SIC is to make policy decisions with respect to Alternative Investments. The SIC shall review the AIP annually. The SIC shall receive quarterly updates from the general consultant engaged by the Division of Investment concerning compliance with the AIP and performance of the Alternative Investments. The role of the Division of Investment is to implement the AIP with the assistance of its consultants and under the overview of the SIC. The SIC, Division of Investment and the Department of the Treasury will act solely in the interests of the Pension Funds’ participants and beneficiaries and in accordance with New Jersey law when making investment decisions. It should be noted that these AIP Procedures may be amended from time to time by the SIC, which amendments may include but are not limited to, changes in allocation and sub-allocations of Asset Classes and Sub-Asset Classes.

ASSET CLASSES AND ALLOCATIONS

For purposes of the AIP, Alternative Investments can be divided into three major “Asset Classes.” Investments in these Asset Classes can be made as part of a limited partnership, as a joint venture, as a separate account, as commingled funds, as customized accounts, as fund-of-funds, as a direct investment, as a co-investment or as a secondary investment. The Asset Classes are defined as follows:

- Private Equity – investments in businesses made through means other than through publicly traded securities. Consists of buyout investments, venture capital, corporate buyouts, private placements, and debt-related investments.
- Real Assets – investments in real estate and in real assets (including oil & gas, timber, commodity linked investments and royalty trusts).
- Absolute Return Strategies or Hedge Funds – investment strategies with the goal of achieving positive returns with a degree of independence from movements in financial markets and independent of traditional performance benchmarks such as the S&P 1500 Index.

The State Investment Council may consider investing in these Assets Classes if the investment vehicles meet all appropriate standards as described below. Upon adoption of the AIP, the Division of Investment will invest in Alternative Investments. The Initial Investment Period is the anticipated length of time needed to first reach the AIP Asset Class allocation targets listed below. The Initial Investment Period is currently anticipated to be five to seven years. Targeted percentages listed below are expected to be completed within the Initial Investment Period. The total allocation in Alternative Investments is targeted to be 13% of the Pension Funds’ market value, in order to enhance the Pension Funds’ long-term results. The percentage amount of Common Pension Fund E invested in each Asset Class based on market value shall be targeted to reach an allocation as set forth in the table that follows. The total amount of the Pension Funds invested in Alternative Investments at any given time shall not exceed 13%, except as indicated below.

Asset Class	Target Ranges of Pension Fund (1)
Private Equity	5-7%
Real Assets	4-5%
Absolute Return Strategies	4-5%

- (1) Actual percentages may differ substantially from these targets during the Initial Investment Period. Additionally, because of the nature of Alternative Investments, the targeted percentage allocations may vary at any given time. However, the total amount of the Pension Funds invested in Alternative Investments shall not at any given time exceed 13% of the Pension Funds, except as indicated in Note 2 below.
- (2) Given changes in Pension Fund market values and the illiquidity of many Alternative Investments, there may be instances in which the percentages listed in the table above are exceeded. In such instances, the SIC shall be notified at its next regularly scheduled meeting. The Division of Investment may be granted a six-month period of grace to reduce the level of participation of the Asset Class below the percentage listed, except that the period of grace may be extended for additional four-month periods by the SIC.

GENERAL GUIDELINES GOVERNING ALTERNATIVE INVESTMENTS

Portfolio construction will be designed to produce a return mix including both current income and capital appreciation.

- After the Director has made binding commitments aggregating an amount of two billion dollars (\$2 billion), not more than 5% of Common Pension Fund E's total allocation to Alternative Investments may be committed to any one partnership or investment, without the prior written approval of the SIC.

While specific investments may incur losses of all or part of the capital invested, it is expected that a diversified portfolio of Alternative Investments will produce a positive return significantly in excess of publicly traded equities. Alternative Investments seek to reduce overall risk in the portfolio even though some individual investments may have greater risk. Diversifiable risks associated with Alternative Investments include position in the capital structure, the timing and amounts of cash flows, the size of the individual investments, and their sensitivities to business cycles. The risks associated with Alternative Investments will be viewed within the context of the entire Pension Funds.

The Division of Investment may overweight Sub-Asset Classes within each Asset Class of Alternative Investments to improve the Pension Funds' risk/return posture when these investments are more attractive than other available opportunities.

Common Pension Fund E may take advantage of opportunities in the secondary market to gain exposure to funds that have already begun drawing capital commitments and collecting management fees. Secondary purchases would be made with the following objectives:

- To gain access to a limited partnership that was not available during its initial fund-raising period;
- To gain incremental return due to a discounted partnership interest purchase price;
- To manage the AIP's cash flow profile (the "J-curve") by avoiding part or all of the initial period of net negative cash flows and shortening the time to distributions from the partnership (net positive cash flows).

Similarly, Common Pension Fund E may take advantages of co-investment or joint venture opportunities which help achieve the following objectives:

- Allow additional funds to be put to work in attractive opportunities;
- Possibly gain access to investments made by limited partners in a fund that is otherwise closed to new investors;
- Avoid or lessen the amount of management fees and carried interest, thereby improving the returns of the AIP.

Over the long term, it is expected that new funding will be committed in each fiscal year, with deviations in amounts permitted to accommodate market opportunities and to facilitate initial entry into Alternative Investments and its Asset Classes and Sub-Asset Classes.

GUIDELINES FOR EACH ASSET CLASS

Private Equity

Buyout Investments

Description: Buyout investments typically involve the purchase of a control position (primarily majority positions, with some minority positions) in an established company with or without leverage. Investments are typically made in years one through three and returns typically occur in years three through six.

- Investment Vehicles: Mix of partnerships (large-mid market buyouts), separate accounts, fund-of-funds (small market, emerging, and NJ-based buyouts), co-investments, direct investments and joint ventures.
- Investment Constraints: Purchase of a control position (primarily majority positions with some minority positions) in established companies with or without leverage, is permissible provided no more than 3.75% of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested in this sub-category and no more than 2.45% of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested outside of the United States.
- Benchmark: 300-500 basis points above the S&P 1500 Index net of all fees and expenses over a full private equity market cycle.

Venture Capital Investments

Description: Venture capital investments are seed stage, early stage, and expansion stage investments. Investments are often made in years one through five and returns typically occur in years four through eight.

- Investment Vehicles: Primarily customized and standardized fund-of-funds, with some partnerships and co-investments.
- Investment Constraints: Purchase of an equity position in small, privately owned, high growth companies is permissible provided no more than 1.75% of the market value of the assets of any pension fund and annuity group investing in Common Fund E may be invested in this sub-category and no more than 2.45% of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested outside of the United States.

- **Benchmark:** 500 basis points above the S&P 1500 Index net of all fees and expenses over a full venture capital market cycle.

Debt-Related Investments

Description: Mezzanine investments combine a debt instrument, which provides a current yield, with an equity participation of warrants, etc. Investments are typically made in years one through three with a high level of current income that is combined with capital appreciation supplied by the warrants or other “equity kickers.” Other debt- related investments may be in distressed debt.

- **Investment Vehicles:** Primarily partnerships and co-investments.
- **Investment Constraints:** Purchase of investments which combine a debt instrument with equity participation is permissible provided no more than 1.75% of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested in this sub-category and no more than 2.45% of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested outside of the United States.
- **Benchmark:** For mezzanine debt, 300 basis points above the S&P 1500 Index net of all fees and expenses. For distressed debt, the Altman Distressed Securities Index net of all fees and expenses.

Note: There are no separate guidelines for international private equity investments. Specific guidelines for these investments are included within the sections covering buyout, venture capital, and debt -related private equity investments.

Real Assets

Real Asset investments are permissible provided:

- i. Leverage within the investment vehicle is limited to maximum of 160% for Opportunistic, 130% for Value Added and 110% for Core real estate of equity value at the time of purchase.
- ii. In direct investments, co-investments, and joint ventures, no more than 1.65% 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. In direct investments, co-investments, and joint ventures, no more than 2% 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 2% 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.

Core Real Estate

Description: Primarily equity real estate investments within the US and diversified geographically and by property type. Properties are generally fully-leased with returns dependent primarily on net operating income rather than price appreciation. Minimal Leverage.

- Investment Vehicles: Mix of separate accounts, commingled funds, co-investments/joint ventures, and direct investments.
- Benchmark: Annual returns 100 basis points above the NCREIF Index net of all fees and expenses over a full real estate market cycle.

Value Added Real Estate

Description: Primarily equity real estate investments within the US and diversified geographically and by property type. Investments are more speculative than Core Real Estate, with returns dependent on a mix of net operating income and price appreciation. Moderate leverage.

- Investment Vehicles: Mix of separate accounts, commingled funds, co-investments/joint ventures, and direct investments.
- Benchmark: 300 basis points above the NCREIF Index net of all fees and expenses over a full real estate market cycle.

Opportunistic Real Estate

Description: Primarily equity real estate investments within the US and diversified geographically and by property type. Investments are more speculative than Value-Added Real Estate, with returns dependent primarily on price appreciation. High leverage.

- Investment Vehicles: Mix of separate accounts, commingled funds, co-investments/joint ventures, and direct investments.
- Benchmark: 500 basis points above the NCREIF Index net of all fees and expenses over a full real estate market cycle.

Real Assets

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% 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.

Note: There are no separate guidelines for international real estate investments. Specific guidelines for these investments are included within the sections covering core, value added, and opportunistic real estate investments.

Absolute Return Strategies

Low Volatility

Description: This includes investment in arbitrage opportunities with low overall net market exposure, equity market neutral, fixed income arbitrage, convertible bond arbitrage, risk arbitrage, merger arbitrage, distressed debt and other event-driven strategies.

- Investment Vehicles: Primarily separate accounts, funds-of-funds and direct investments; a portion may be invested in individual hedge funds.
- Investment Constraints: No more than .2% of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested directly in any individual hedge fund. Participation in low volatility funds is permissible provided no more than 2% of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested in this category with appropriate consideration of acceptable levels of leverage.

- Benchmark: 300 basis points above the twelve month LIBOR over a trailing 5 year period, net of all fees and expenses.

Equity Long/Short

Description: Combination of long and short positions in publicly traded equities, with a net market exposure less than that of the overall equity market.

- Investment Vehicles: Primarily separate accounts, funds-of-funds and direct investments; a portion may be invested in individual hedge funds.
- Investment Constraints: No more than .3% of market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested directly in any individual hedge fund. Participation in equity long/short funds is permissible provided no more than 3% 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.
- Benchmark: 400 basis points above the twelve month LIBOR over a trailing 5-year period, net of all fees and expenses.

Opportunistic

Description: Investment in speculative opportunities with high net market exposure across varied markets. Includes Global Macro, Long Opportunistic, Managed Futures, and Dedicated Short Sale strategies.

- Investment Vehicles: Primarily separate accounts, funds-of-funds and direct investments; a portion may be invested in individual hedge funds.
- Investment Constraints: No more than .15% of the market value of the assets of any pension and annuity group fund investing in Common Fund E may be invested directly in any individual hedge fund. Participation in opportunistic funds is permissible provided no more than 1.5% 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.
- Benchmark: 500 basis points above the twelve month LIBOR over a trailing 5 year period, net of all fees and expenses.

RISK MANAGEMENT

The Division of Investment, with the oversight of the SIC, will monitor and endeavor to control the overall risk of the AIP by the following:

- Maintaining diversification across Sub-Asset Classes, styles, geographies, industries, and strategies.
- Understanding of the macro-economic environment.
- Conducting a thorough, comprehensive, and consistent due diligence process for all Alternative Investments, and monitoring the due diligence efforts of third-party consultants and managers.
- Monitoring portfolio investments and insuring transparency.
- Complying with the investment objectives and guidelines detailed in the AIP and the accompanying Alternative Investments Procedures.
- Identifying and resolving problem investments.

ADDITIONAL CONSIDERATIONS

The SIC encourages investment opportunities that support economic development in New Jersey, through participation in private equity and real estate investments that focus on New Jersey, in accordance with its standards for prudent investments and its guiding principles. Such investments must be: a) consistent with investment types found in approved Sub-Asset Classes as noted above; b) comply with the investment and performance standards as set forth in this Alternative Investment Policy, and c) offer competitive expected risk-adjusted returns.

Additional areas of investments may be considered for which regulations, policies and procedures will be adopted in order to incorporate any such investments.