



# State of New Jersey

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September 29, 2017

MEMORANDUM TO: The State Investment Council

FROM: Christopher McDonough  
Director

SUBJECT: **Proposed Investment in Chatham Private Debt and Strategic Capital Fund**

The New Jersey Division of Investment (“Division”) is proposing an investment of up to \$200 million commitment to Chatham Private Debt and Strategic Capital Fund (the “Fund”). Funding will come from a combination of 1) rolling profits (currently \$130 million) of the Division’s existing investment in the Chatham Fund LP managed by Chatham Asset Management, LLC (“Chatham” or the “Firm”) and 2) a new capital allocation. This memorandum is presented to the State Investment Council (the “Council”) pursuant to N.J.A.C. 17:16-69.9.

Chatham Private Debt and Strategic Capital Fund will continue the Division’s successful relationship with Chatham Asset Management, LLC, which has dated back to 2013. The Fund will focus on stressed and distressed investing as well as direct lending to middle market companies.

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

**Experienced and Stable Team:** In 2003, the Firm launched successfully with professionals from the Morgan Stanley proprietary desk. The senior members of the team have worked together for over 10 years on average and have developed deep networks across various sectors. Chatham has \$2 billion in assets across the flagship product and a \$900 million liquid alternative business which has diversified their revenue streams. As a result, the Firm has the ability to retain top talent. Over its 14 year lifespan, the Firm established a disciplined and repeatable process for identifying, analyzing and executing investments.

**Successful Track Record and demonstrated downside capabilities:** Chatham’s flagship fund has generated an annualized return of 9.63% with a 4.79% standard deviation, which outperformed the HFRI ED: Distressed/Restructuring Index return of 6.69% and a 6.35% standard deviation over the same period. New Jersey’s separate account managed by Chatham Asset Management, LLC has generated an annualized net return of 14.94% with a 4.49% standard deviation resulting in a high Sharpe ratio of 3.17. During the recent credit crisis, Chatham

demonstrated its ability to navigate the volatile markets well. The flagship fund was only down -2.57% in 2008 which compares favorably to the HFRI ED: Distressed/Restructuring Index negative return of -25.20% and the ML High Yield Index return of -26.21% over the same time period.

**Disciplined Investment Manager:** The Firm returned capital to their investors when the opportunity set was unfavorable and have recently closed the flagship fund in order to stay nimble given the firm's focus on middle market companies. The Fund's flexible mandate will allow the manager to be selective and only invest in opportunities that will allow Chatham to have influence on the restructurings and the outcome and eventual exit. The team has stayed with their core competency in smaller, less trafficked middle market companies. Chatham has relatively low overlap in names across the credit portfolio holdings.

**Attractive Terms and Strong Alignment of Interests:** New Jersey has negotiated a favorable fee structure including a management fees of 50 basis points paid on invested capital, not committed capital. The Fund also has a European Waterfall which allows investors to receive full return of capital and 6% preferred return before the GP receives 15% carried interest. Chatham partners will invest at least \$30 million in the new Fund alongside the LPs.

A report of the Investment Policy Committee ("IPC") summarizing the details of the proposed investment is attached.

Division Staff and its hedge fund consultant, Cliffwater LLC, 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. Chatham Private Debt and Strategic Capital Fund will be considered a private equity debt related 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 September 20, 2017. 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 October 4, 2017 meeting.

Attachments

**Fund Name: Chatham Private Debt and Strategic Capital Fund** **September 29, 2017**

**Contact Info:** Jim Ruggerio, 26 Main St, Suite 204, Chatham, NJ 07928

<b>Fund Details:</b>		<p><b>Key Investment Professionals:</b>  <b>Anthony Melchiorre</b>, Founding Partner and Portfolio Manager with 20 years of experience in the High Yield space. Prior to forming Chatham, Mr. Melchiorre was a Managing Director and Head of Global High Yield Trading at Morgan Stanley.  <b>Kevin O'Malley</b>, Partner and Portfolio Manager: Mr. O' Malley previously worked in a variety of roles at Morgan Stanley within the Global High Yield Group.  <b>Evan Ratner</b>, Partner and Director of Research: Prior to joining Chatham, Mr. Ratner was at DLJ/Credit Suisse for 18 years in investment banking, high yield research and distressed research, most recently as a Managing Director and Head of Distressed Research.</p>
Firm AUM (\$bil.):	\$3.2 billion	
Strategy:	Debt Related Private Equity	
Year Founded:	2003	
Headquarters:	Chatham, NJ	
GP Commitment:	minimum of \$30 million	

Investment Summary	Existing and Prior Funds as of 6/30/2017		
<p>The Private Debt Fund is a drawdown vehicle seeking to take advantage of illiquidity premiums available in credit. The Fund will focus on stressed and distressed investing as well as direct lending to middle market companies. The Private Debt Fund will have a concentrated position of total 20-30 names and will have flexibility to invest across the capital structure, including subordinated debt and equity positions which will allow Chatham to be selective and opportunistic in the deals they choose to underwrite.</p>	<i>Chatham Asset Partners</i>		
	<i>High Yield Fund</i>		
	1 Year	Fund	<i>HFRI ED: Distressed/Restructuring</i>
	3 Year	18.63%	14.94%
	5 Year	12.62%	0.74%
	Inception	11.32%	5.72%
	2016	9.63%	6.69%
	2015	24.04%	15.15%
	2014	5.55%	-8.06%
	2013	5.52%	-1.39%
	2012	12.47%	14.05%
	2011	11.49%	10.12%
	2010	-5.99%	-1.79%
2009	15.50%	12.12%	
2008	34.73%	28.14%	
	-2.57%	-25.20%	

**Vehicle Information:**

Inception:	2017	Auditor:	KPMG LLP/Rothstein & Kass & Co.
Fund Size (\$mil.):	\$750 million - \$1.0 billion	Legal Counsel:	Seward & Kissel, LLP
Management Fee:	.75% per annum for Founder Class (0.50% for NJ), 1.0% per annum		
Carry:	15%		
Hurdle Rate:	6%		
Additional Expenses:	Administrative expenses approx. 29 bps		

**NJ AIP Program**

Recommended Allocation (\$mil.):	up to \$200 million	LP Advisory Board Membership:	TBD
% of Fund:	20%	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.