



PSERS PRIVATE INVESTMENT PROGRAM

**Recommendation for Investment in
New York Life Investment Management Mezzanine Partners II, L.P.**

Charles J. Spiller
Director of Alternative Investments

September 14, 2006

New York Life Investment Management Mezzanine Partners II, L.P.

INTRODUCTION

New York Life Investment Management Mezzanine Partners II, L.P. (the “Fund”) is seeking capital commitments of \$600 million to invest primarily in privately placed, subordinated debt with warrants and other mezzanine securities. The Fund will be the second mezzanine fund managed by NYLCAP Manager LLC (“NYLCAP” or the “Firm”), a premier investment manager of alternative investments for institutional investors. The Fund will target a gross annual internal rate of return (“IRR”) of 15% to 20% on its investment portfolio. It is anticipated that New York Life Insurance Company (“New York Life”) will make a minimum commitment of \$250 million to the Fund.

NYLCAP is managed by six senior principals (the “Managing Principals”), with over 120 years of collective investment experience and an average tenure at New York Life of 12 years. Three of the Managing Principals, John Schumacher, Adam Clemens, and Thomas Haubenstricker, have worked together at New York Life since 1991 and successfully built New York Life’s alternative investment program. Together, the Managing Principals have a long and successful track record, committing more than \$5.2 billion to alternative investments and generating strong returns across all three of NYLCAP’s product lines: mezzanine investments, equity co-investments, and limited partnership investments. From 1991 through year-end 2005, the Managing Principals invested \$640 million in 47 mezzanine investments, generating a realized IRR of 18.0%. This portfolio is comprised of: (i) \$399 million invested through New York Life Investment Management Mezzanine Partners, LP (“NYLIM Mezzanine I” or “Fund I”), the Firm’s first mezzanine fund, (ii) \$30 million invested on behalf of New York Life in mezzanine co-investments alongside Fund I (the “NYL Co-Investment Portfolio), and (iii) \$211 million invested on behalf of New York Life prior to the formation of Fund I (the “Pre-Fund Portfolio”).

NYLCAP has achieved strong investment performance primarily by leveraging New York Life’s longstanding relationships with top-performing financial sponsors. In 1991, the Managing Principals began transforming New York Life’s private equity program from a collection of small investments across many private equity funds to a focused selection of key relationships with top-performing financial sponsors. Over the past 15 years, the Managing Principals have committed approximately \$2.3 billion to more than 80 U.S. and European buyout funds and \$368 million to nine mezzanine funds. Today, the Firm has strong relationships with approximately 40 fund sponsors (the “Core Partners”) who: (i) can deliver superior investment returns, (ii) share a similar investment philosophy with NYLCAP, (iii) have a desire to expand their relationship with the Firm through significant mezzanine and equity co-investment opportunities, and (iv) provide substantive due diligence insights on the Firm’s investments.

INVESTMENT STRATEGY AND PROCESS

The Fund is seeking capital commitments of \$600 million to invest primarily in privately placed, subordinated debt with warrants and other mezzanine securities. The Fund will be managed by NYLCAP and will follow the same differentiated strategy the Managing Principals have successfully employed for more than a decade. The cornerstone of this strategy is NYLCAP’s longstanding relationships with Core Partners that share a similar investment philosophy with the Firm and provide both a source of high quality deal flow and a unique due diligence network.

Since 1991, the Managing Principals have built a portfolio of approximately 40 Core Partner relationships, including many of the most established and successful financial sponsors as well as a select group of mezzanine and emerging managers that fit the Core Partner profile. The depth of NYLCAP's Core Partner relationships is evident in (i) the longevity of the relationships, with relationships dating back to 1984 and an average relationship length of six years, (ii) the Managing Principals' involvement in approximately 85% of the Core Partners' advisory committees, and (iii) NYLCAP's extensive history of investing directly in transactions alongside the Core Partners.

Today, NYLCAP's Core Partners include, among others:

ABRY Partners	Berkshire Partners	Blackstone Capital Partners
GarMark Partners	Gryphon Partners	GSC Partners
Harvest Partners	Kelso & Company	Monitor Clipper Partners
Odyssey Investment Partners	PAI	Park Square Capital
PNC	Swander Pace Capital	TCW Group
Tennenbaum Capital Partners	TPG Partners	Veronis Suhler Stevenson
Vestar Capital Partners	Wellspring Capital Partners	Welsh, Carson, Anderson & Stowe

The Managing Principals will build the Fund's portfolio by following the investment strategy they have successfully employed since 1991. This strategy has five key elements: (i) originate deal flow primarily through Core Partner relationships, (ii) minimize principal loss by leveraging a unique due diligence network, (iii) strictly adhere to established investment criteria, (iv) follow a disciplined investment process, and (v) actively monitor portfolio companies.

Originate Deal Flow Primarily Through Core Partner Relationships

Through the substantive and interactive nature of the Core Partner relationships, the Managing Principals remain informed about the Core Partner's deal pipelines, allowing NYLCAP to actively pursue those opportunities that fit both the Core Partner's expertise and the Fund's investment criteria. Continuous points of contact between NYLCAP and the Core Partners include the Managing Principals' participation on the Core Partners' advisory committees, attendance at the Core Partners' annual meetings, attendance at board meetings for portfolio companies where NYLCAP has board observer rights, and ongoing interactions regarding both existing and new mezzanine and equity co-investment activity, as well as contact through NYLCAP's pro-active marketing program. Throughout various market environments, the Core Partners have provided a consistent source of high quality deal flow.

NYLCAP anticipates this traditional deal flow may be enhanced further with opportunities to buy mezzanine securities in the secondary market from more recent entrants to the mezzanine market if there is a market dislocation. Given the aggressive structuring of second lien loans and coupon-only mezzanine transactions by recent entrants to the mezzanine market, a turn in the credit cycle may cause many of these new entrants to seek to exit their positions. Depending on the strength of the underlying portfolio company, the opportunity to purchase these secondary securities at a discount could provide the Fund with

further deal flow in issues that do not currently fit the Fund's risk/return profile. For more than a decade, NYLCAP and its predecessors have been valuable partners to sponsors looking to fulfill their financing objectives. As a relationship-oriented mezzanine provider with a differentiated approach to mezzanine investing and a willingness to align interests through participation in the equity upside of the transactions, NYLCAP provides the Core Partners with key benefits such as structuring expertise, a swift response, certainty of execution for approved transactions, and unique due diligence insights.

NYLCAP has a large, dedicated team of experienced investment professionals that can complete substantial due diligence in a timely manner. In addition, NYLCAP can simplify the Core Partner's financing execution by working with its equity co-investment funds and Madison Capital's senior debt professionals to arrange financing for multiple layers of the capital structure, where appropriate, and by partnering with other mezzanine funds that are part of NYLCAP's Core Partner network to co-underwrite large mezzanine tranches. Finally, NYLCAP can leverage its unique due diligence network to uncover and share insightful due diligence findings that are often unavailable to other potential mezzanine investors.

NYLCAP's differentiated strategy and partnership approach to investing have created relationships with the Core Partners that extend beyond the typical limited partner or financing provider/sponsor relationship. In addition to providing a consistent source of high quality deal flow, the depth of the Core Partner relationships allows for greater sharing of information between NYLCAP and the sponsors and frequently provides the Firm early access to potential transactions before they are widely marketed. This provides NYLCAP with additional time for due diligence and the ability to work alongside the sponsor through all stages of the transaction, furthering the Managing Principals' understanding of both the investment opportunity and the Core Partner's due diligence process. NYLCAP's longstanding Core Partner relationships, early involvement in transactions, and collaborative approach to due diligence often result in the Firm achieving attractive pricing relative to the market and the opportunity to combine a small equity co-investment with its mezzanine debt investment to enhance the Fund's returns.

Minimize Principal Loss by Leveraging a Unique Due Diligence Network

The Managing Principals take a judicious and selective approach to NYLCAP's mezzanine activities, approaching each investment decision first as a credit decision with a focus on preservation of capital prior to reviewing the potential for capital appreciation. The majority of the Fund's deal flow will be generated through the Core Partner relationships and pre-screened by these top-performing sponsors prior to the Firm's involvement. In addition to reviewing the due diligence findings of the Core Partners, the Managing Principals leverage NYLCAP's unique due diligence network to conduct significant independent due diligence on each opportunity.

The focus of the due diligence is on evaluating the target company's management team, the competitive dynamics of the industry, and the company's historical and projected financial results, with an emphasis on the company's ability to maintain sufficient liquidity to meet its debt service obligations and fund necessary capital expenditures in flat or low growth environments. Through this due diligence, the Managing Principals are able to select those opportunities where the credit worthiness of the target company and the attractiveness of the opportunity have been independently evaluated. The Managing Principals use their diligence insights to analyze the transaction's structure and proposed covenant levels to ensure that leverage is set at an appropriate level for the cash flow characteristics of the company and that there is a significant equity 'cushion' supporting the mezzanine debt. NYLCAP has unique due diligence capabilities due to the combination of the Managing Principals'

extensive investment experience and the Firm's access to the expertise of the Core Partners and NYLIM's investment professionals. The Managing Principals have extensive backgrounds in private finance and corporate lending.

The Managing Principals supplement their own investment expertise with the due diligence insights and industry expertise of the Core Partner network and NYLIM's 240 investment professionals. Core Partners and NYLIM analysts with substantial industry expertise can provide the Managing Principals with valuable insights into the target company's industry stability and growth prospects, as well as to what makes firms within that industry successful. The executives of portfolio companies that are customers, suppliers, or competitors of the target company can provide an understanding of the management team's strengths and weaknesses and their ability to lead the transaction to success. In addition, these executives can alert the Managing Principals to key diligence items to focus on and provide an understanding of the due diligence information only available to those in the marketplace on a daily basis. Finally, Core Partners that analyzed the transaction at an earlier stage can provide further insight into the target company's management team and company fundamentals, as well as to the appropriateness of the purchase price and the potential for capital appreciation. Through this unique due diligence network, NYLCAP often gains proprietary insights into target companies, industries and management teams that are unavailable to other potential mezzanine investors.

Strictly Adhere to Established Investment Criteria

The Fund will target opportunities where the sponsor has relevant expertise, a quantifiable history of successful investing, and a proven ability to add tangible value to the company involved in the transaction. Through the longevity and depth of the Core Partner relationships, the Managing Principals have become well acquainted with the Core Partners' investment professionals, strategies, and processes, and can use this knowledge to concentrate on those transactions that best fit within a Core Partner's expertise. The Fund will seek to align its interests with the interests of the lead sponsor through participation in the equity upside of the transaction.

The Fund will seek to invest in companies that have proven management teams, strong and sustainable cash flows, and competitive advantages in industries with barriers to entry. A high priority will be placed on companies that have relatively low exposure to cyclical downturns, a low threat of obsolescence or rapid technological change, and low customer and geographic concentrations.

The Fund will focus on transactions where the growth thesis can be validated and where the exit strategy has been clearly identified. Potential exit strategies are likely to include trade sales to strategic or private buyers, initial public offerings, and recapitalizations. The Managing Principals will analyze comparable transactions, potential purchasers, public market opportunities, and the growth plans of the company to determine the relative capital appreciation potential and an appropriate valuation. Based on their assessment of the risks and potential return of the transaction, the Managing Principals will seek to structure each investment to provide proper downside protection for the mezzanine securities and an appropriate return for the risk taken.

Follow a Disciplined Investment Process

Prospective investments are first screened for appropriate risk/return characteristics and discussed among all of the Managing Principals at weekly deal review meetings and through informal meetings as appropriate. If the Managing Principals determine that additional due diligence is warranted, a deal team is assembled, typically consisting of two Managing

Principals, a Vice President or an Associate, and an Analyst. Assigning two Managing Principals per deal team ensures continuity and a high level of diligence.

After initial due diligence, which typically involves one or more meetings or conference calls with both company management and the Core Partner, a promising transaction is reviewed in greater depth at a weekly deal review meeting. If the Managing Principals achieve a consensus to proceed, the deal team negotiates terms and pricing with the sponsor and, if appropriate, issues a term sheet to document the negotiations. Once general agreement is reached on terms and pricing, additional due diligence is completed, typically involving further meetings and discussions with both management and the Core Partner, independent verification of the investment premise as described above, tours of plant facilities, and review of sponsor due diligence materials. In-depth reviews of legal, labor, regulatory, environmental, accounting, and other issues are also undertaken, as appropriate.

If, after additional due diligence, the Managing Principals unanimously agree to proceed with the transaction, the deal team presents the transaction to a committee for final approval (the "Investment Committee"). The Investment Committee members include the Managing Principals, Kevin Smith, Principal, and NYLIM executives, Gary Wendlandt, CEO and Chairman, Brian Murdock, President and William Cheng, Managing Director. The Investment Committee reviews the investment size, credit risk, structure, capital appreciation potential, and risk/return profile of a proposed transaction. If approved, the deal team then negotiates final documentation prior to closing.

Actively Monitor Portfolio Companies

Active monitoring of investments is critical to the successful performance of the Fund. The deal team for any given transaction maintains frequent contact with both company management and the Core Partner, attends board meetings as appropriate, and conducts regular financial reviews. Financial performance is analyzed and tracked against the original underwriting case and disseminated among the team members in monthly monitoring reports. In addition, NYLCAP maintains a portfolio scorecard that highlights those investments that require special attention or review. These investments are then reviewed in detail at quarterly portfolio review meetings and through frequent interactions with both the company's management and the Core Partner.

Through active portfolio management, the Managing Principals are well positioned to work proactively with financial sponsors and company management to quickly identify and resolve potential issues or deteriorating situations. In times of trouble, the Managing Principals seek to find creative solutions that provide the company with the liquidity needed for success while protecting and enhancing the potential returns of the Fund's investment. The Managing Principals often also provide input on potential exit strategies and acquisition opportunities during discussions with company management and Core Partners.

MANAGEMENT

The Fund will be managed by NYLCAP Manager LLC, a registered investment advisor and premier investment manager of alternative investments for institutional investors. NYLCAP is managed by six Managing Principals with over 120 years of collective investment experience and an average tenure at New York Life of 12 years. All of the Managing Principals have extensive private market investment experience, including private equity investing, mezzanine investing and leveraged lending. The Managing Principals are supported by a dedicated staff of investment professionals, including one Principal, two Directors, one Vice President, four Associates, and four Analysts.

The Fund will also benefit from the insight and experience of senior executives of NYLIM, including Gary Wendlandt, CEO and Chairman, Brian Murdock, President, and William Cheng, Managing Director, all of whom will participate in the Fund's Investment Committee.

Biographies for the NYLCAP members of the Investment Committee are provided below:

John Schumacher, CEO

Mr. Schumacher joined New York Life in 1991 and is currently CEO of NYLCAP, responsible for overseeing all NYLCAP investment activities. Prior to co-founding NYLCAP, Mr. Schumacher was the Head of the \$14 billion Private Finance Group of New York Life. Previously, Mr. Schumacher was a Vice President in the Private Placement Department at Manufacturers Hanover Trust Company, where he began his career in 1983. Mr. Schumacher earned a BA in History in 1978 from Columbia College and an MBA in 1989 from New York University's Stern School of Business.

Adam Clemens, President

Mr. Clemens joined New York Life in 1991 and is currently President of NYLCAP, responsible for overseeing all NYLCAP investment activities. Prior to co-founding NYLCAP, Mr. Clemens was the Head of Private Equity and Leveraged Finance within New York Life's Private Finance Group. Prior to joining New York Life, Mr. Clemens was a Vice President with Manufacturers Hanover Trust Company in the Private Placement Department, where he began his career in 1984. Mr. Clemens earned a BS in International Economics, cum laude, in 1984 from Georgetown University and an MBA in 1989 as a Beta Gamma Sigma graduate from Columbia University. Mr. Clemens is a holder of the Chartered Financial Analyst designation.

Thomas Haubenstricker, Managing Principal

Mr. Haubenstricker joined New York Life in 1991 and is currently a Managing Principal primarily responsible for mezzanine and limited partnership investing. Prior to NYLCAP, Mr. Haubenstricker was Co-Head of the Private Finance Group overseeing \$14 billion in assets. Since joining New York Life, Mr. Haubenstricker has assumed positions of increasing responsibility, including an overseas assignment when he established New York Life's London affiliate in 1994. Prior to joining New York Life, Mr. Haubenstricker worked at Prudential Financial where he focused on leveraged financings in their Private Placement Group. Mr. Haubenstricker earned a BS in Chemical Engineering, with honors, in 1982 from Michigan State University and an MBA in 1987 from the Wharton School of the University of Pennsylvania.

Steven Benevento, Managing Principal

Mr. Benevento joined New York Life in 1995 and is currently a Managing Principal primarily responsible for equity co-investments and limited partnership investing. Prior to NYLCAP, Mr. Benevento managed a portfolio of private equity, mezzanine and non-investment grade debt investments within New York Life's Private Finance Group. Previously, Mr. Benevento worked in the investment group of TIAA-CREF where he focused on debt and mezzanine investments in the private market. Mr. Benevento earned a BS in Finance, summa cum laude, in 1987 from the State University of New York at Albany and an MBA in 1991 from New York University's Stern School of Business. Mr. Benevento was a Beta Gamma Sigma honoree as both an undergraduate and graduate student. Mr. Benevento is a holder of the Chartered Financial Analyst designation.

Quint Barker, Managing Principal

Mr. Barker joined NYLCAP in 2000 and is currently a Managing Principal primarily focused on equity co-investments and limited partnership investing. Prior to NYLCAP, Mr. Barker was a Vice President in PaineWebber's Principal Transactions Group, where he co-managed a \$1 billion portfolio of alternative investments, which included the firm's, the Chairman's, and other top executives' venture capital, LBO equity, real estate, and hedge fund investments. Prior to PaineWebber, Mr. Barker worked in the Private Finance Group of New York Life, where he managed a portfolio of private equity, mezzanine, and non-investment grade debt investments. Mr. Barker earned a BS in Electrical Engineering in 1990 from Georgia Tech and an MBA in 1994 from Duke University. Mr. Barker is a holder of the Chartered Financial Analyst designation.

David Bangs, Managing Principal

Mr. Bangs joined NYLCAP in 2006 and is currently a Managing Principal primarily focused on limited partnership investing. Prior to NYLCAP, Mr. Bangs oversaw NYLIM's Private Finance and Public Investment Grade Corporate Bond Groups, which included leveraged loans and emerging market bonds. Prior to that, Mr. Bangs was the Co-Head of NYLIM's Private Finance Group. He joined New York Life in 1996 from Kemper Securities where he was responsible for all aspects of originating, structuring and placing private placements, primarily for middle market companies. Prior to that, he worked for Manufacturers Hanover Trust Company working on all aspects of their private placements business. He has over 20 years of investment experience, which includes serving on NYLCAP's Investment Committee since its inception. Mr. Bangs received a BA in Political Economy in 1983 from Johns Hopkins University and an MBA in Finance in 1989 from New York University.

Kevin Smith, Principal

Mr. Smith joined NYLCAP in 2004 and is currently a Principal primarily focused on mezzanine and limited partnership investing. Prior to joining NYLCAP, Mr. Smith was a Vice President at J.H. Whitney & Co., a \$4 billion private investment firm, where he had direct responsibility for originating, structuring and executing mezzanine and private equity investments. Prior to joining J.H. Whitney, Mr. Smith spent 6 years in the High Yield Capital Markets Department of Wachovia Securities. Mr. Smith earned a BS in Finance in 1989 from the University of Maryland and an MBA in 1994 from the University of North Carolina-Chapel Hill.

Biographies for the NYLIM members of the Investment Committee are provided below:

Gary Wendlandt, Chairman and CEO – NYLIM

Mr. Wendlandt joined NYLIM in 1999 and is currently Chairman and Chief Executive Officer of NYLIM, overseeing all aspects of the business. In addition, Mr. Wendlandt is an Executive Vice President of NYLIM's parent, New York Life Insurance Company, and serves on the Executive Management Committee. Prior to joining NYLIM, Mr. Wendlandt served as Executive Vice president and Chief Investment Officer of Massachusetts Mutual Life Insurance Company ("MassMutual"), which he joined as an actuarial student in 1972. Mr. Wendlandt was responsible for all of MassMutual's asset management operations, including Oppenheimer Funds, David L. Babson and Company, Cornerstone Real Estate Advisors, and Antares Capital Corp. From 1983 until 1999, Mr. Wendlandt was President and/or Chairman of MassMutual Corporate Investors, a closed-end fund focused on private middle market mezzanine transactions. Mr. Wendlandt earned a BS in Applied Mathematics and Computer Science in 1972 from Washington University.

Brian Murdock, President – NYLIM

Mr. Murdock joined NYLIM as President in May 2004. He oversees several of NYLIM's business support units and has oversight of several investment management groups, including NYLCAP. As part of his responsibilities, Mr. Murdock also serves on the board of NYLIM. Prior to joining NYLIM, Mr. Murdock was the Chief Operating Officer for Merrill Lynch Investment Managers ("MLIM"), responsible for the P&L of the U.S. business with over \$300 billion in client assets. Before returning to the U.S., Mr. Murdock was based in London as Chief Investment Officer for Europe and Asia. Prior to moving to London, he was based in Tokyo as President of MLIM Japan and Chairman of MLIM's Pacific Region, which covered Asia, Japan, and Australia. Mr. Murdock worked at Merrill Lynch for 25 years, first as a securities and commodities broker, and then for 12 years as an equity portfolio manager specializing in U.S. and global equities. He was also Senior Vice President and CIO of Merrill's high net worth private accounts business. Mr. Murdock received a BS in Economics in 1978 from Cornell University.

William Cheng, Managing Director – NYLIM

Mr. Cheng joined New York Life in 1981 as an Investment Analyst and has over 21 years of investment experience. Currently, Mr. Cheng oversees all workout areas and is responsible for the overall credit management of NYLIM's portfolios. Prior to his current responsibilities, Mr. Cheng was the Head of NYLIM's Private Finance and Corporate Bond Research Group. Mr. Cheng received a BA in Chemistry in 1977 from Columbia College and an MBA in 1981 from New York University.

CONCLUSION/RECOMMENDATION

Based upon the successful track record, prior relationship, and experience of the principals and the recommendation of PSERS' consultant, Portfolio Advisors, staff recommends that the Board invest an amount equal to 25 percent of the committed capital, but not to exceed \$150 million plus reasonable normal investment expenses, in New York Life Investment Management Mezzanine Partners II, L.P. The final terms and conditions of the investment must be satisfactory to the Investment Office, the Office of Chief Counsel, and the Executive Director.