

Commonwealth of Pennsylvania Public School Employees' Retirement System

DATE: July 27, 2011

SUBJECT: Cerberus Levered Loan Opportunities Fund I, L.P. Recommendation

TO: Members of the Board

FROM: James H. Grossman, Jr., CPA, CFA
Managing Director of External Public Markets, Risk & Compliance

At the August Finance Committee meeting, staff and Portfolio Advisors will recommend that PSERS commit \$200 million to the Cerberus Levered Loan Opportunities Fund I, L.P. (Fund), managed by Cerberus Capital Management (CCM). This fund is a limited partnership originating and issuing senior secured debt to U.S. middle market companies. Their focus will be on investments in secured debt obligations (including loans, participations in loans, and other debt instruments and obligations). The partnership intends to employ up to 1.5:1.0 leverage. We anticipate that the Fund will generate mid- to high-teens net returns over the life of the fund.

Cerberus Capital Management is a leading value-oriented private investment firm with \$23 billion of capital under management. PSERS has invested in three other Cerberus private equity funds with net IRR returns through December 31, 2010 of 27.5%, 14.3%, and 8.1%. The lending group, Cerberus Business Finance, LLC (CBF), has \$2.4 billion in assets under management currently, including \$2.3 billion in loans and bank debt assets representing 230 loans to 129 distinct borrowers. CBF has 25 investment professionals and has access to the full CCM back office for legal, reporting, and investor relations needs. CBF has established a premier specialty finance business addressing the needs of middle-market companies for flexible capital and is often viewed as a "Go To" lender, affording them access and visibility into many new lending opportunities.

Staff likes the opportunities middle-market lending over the next few years over other areas in the high yield market. Given the dislocations caused by the financial crisis in 2008, there has been a significant contraction in capital available to middle-market companies. The recommended commitment to this fund would be the third commitment to funds specializing in middle-market lending (the other two commitments are to the LBC Credit Fund II and the Sankaty Middle Market Fund). Staff likes the strength of Cerberus' organization, the investment team, the ability to obtain modest leverage, and the long history of successfully investing in middle-market companies.

Included for your review are Portfolio Advisor's recommendation, a PowerPoint presentation prepared by staff, and the resolution recommending the investment in the Cerberus Levered Loan Opportunities Fund I, L.P.

If you have any questions or comments prior to the meeting, please contact me at 717-720-4703.