

***Andrew Junkin, CFA, CAIA
Managing Director & Principal***

April 20, 2012

Mr. Henry Jones
Chair of the Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Forestland Portfolio Annual Review

Dear Mr. Jones:

You requested Wilshire's opinion with respect to the Forestland Portfolio Annual Program Review. In addition to our duties as the General Pension Consultant to the Investment Committee, Wilshire acts as the Board's Forestland Consultant.

Overview and Opinion

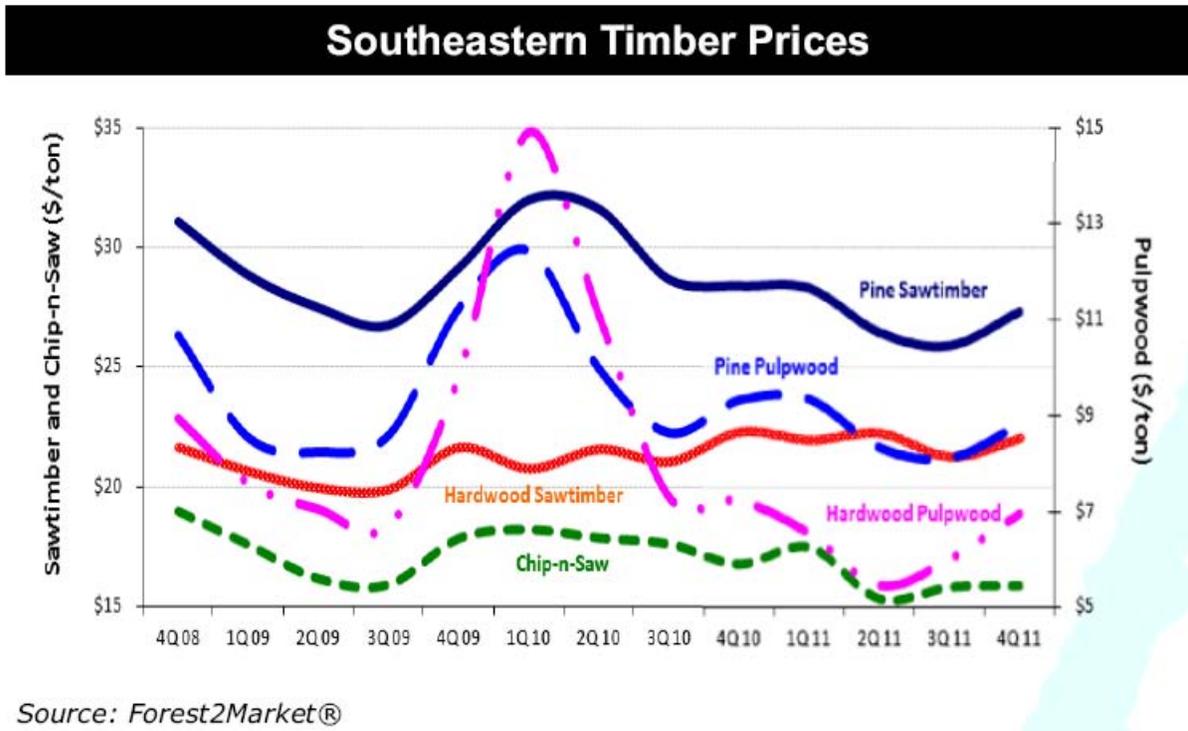
The Forestland Portfolio is appropriately managed to meet its long term goals as a partial inflation hedge and diversifier to the rest of the PERS portfolio. However, the portfolio's characteristics are not well matched with the benchmark in two material ways, as we will discuss below. This mismatch has caused performance to diverge from the benchmark over the past several years, in what has been a difficult environment,

While performance has been challenged, we believe that the internationally diversified portfolio will provide future returns to help CalPERS meet its objectives. We note the relative lack of diversification within the domestic markets and believe that, over time, the U.S. portfolio should be managed to include exposure to other regions.

Background

The Forestland Portfolio consists of only two assets. However, because the assets hold multiple parcels of forestland, the total portfolio is diversified across the U.S., Latin America and Asia Pacific markets. Within the U.S., the portfolio is largely concentrated in the Southern markets with no exposure to the Northeast or Pacific Northwest.

Southern U.S. timber prices have been volatile and have moved largely lower over the past three years, as the chart below shows¹. Declining housing starts over the past several years (1.35 million in 2007; 609 thousand in 2011²) have contributed to falling timber prices. Housing starts have stabilized and slightly improved from 2009 and 2010 levels, which should provide some level of stability to timber prices moving forward.



The performance of the Forestland Portfolio has been impacted relative to the NCREIF Timberland Index by two significant factors: 1) regional diversification, and 2) leverage. First, as noted, the Forestland Portfolio has no exposure to the Northeast or Pacific Northwest markets in the U.S., causing a relative underweight. Additionally, the Portfolio’s non-U.S. exposure (which we believe provides meaningful diversification) is not included in the NCREIF benchmark. As the Program evolves, we recommend additional geographic diversification within the U.S., so that the Portfolio might include exposure to the Northeast and Pacific Northwest regions. As the graph³ below notes, the Northeast and Pacific Northwest markets represent approximately 35% of the U.S. timber market.

¹ Source: Forest Investment Associates

² Source: National Associate of Home Builders

³ Source: Forest Investment Associates



Source: US Forest Service

Second, the NCREIF Timberland Index reports returns on an unlevered basis. However, the CalPERS portfolio is levered. In challenging markets, such as 2008-2011 where returns fall below the cost of leverage, leverage acts as a drag on returns.

	2008	2009	2010	2011
NCREIF Timberland Index	2.7%	-4.6%	-0.8%	0.5%

Conclusion

As discussed, the returns of the Forestland Program have not met its benchmark. However, we believe the strategic role of timberland is important to the CalPERS portfolio and that the diversified nature of the Portfolio will provide a benefit to CalPERS going forward. Additional regional diversification within the U.S. would be beneficial as the program evolves over time. However, Wilshire recognizes that the timber market is fragmented and significant parcels are sought after by many investors. Thus, pricing cannot be ignored in the continued management of this portfolio and this may cause the portfolio to evolve rather slowly.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,

A handwritten signature in black ink, appearing to read 'Alan J. ...'.