



Andrew Junkin, CFA, CAIA
Managing Director & Principal

July 23, 2012

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

Re: Forestland Portfolio Review

Dear Mr. Jones:

You requested Wilshire's opinion with respect to the Forestland Portfolio Program Review. In addition to our duties as the General Pension Consultant to the Investment Committee, Wilshire acts as the Board's Forestland Consultant. Additionally, we are providing various observations about the current timberland markets and the drivers of supply and demand as an overall market update.

Overview and Opinion

As we noted in our letter with respect to the annual review in April of this year, Wilshire believes that 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. This mismatch has caused performance to diverge from the benchmark over the past several years, in what has been a difficult environment.

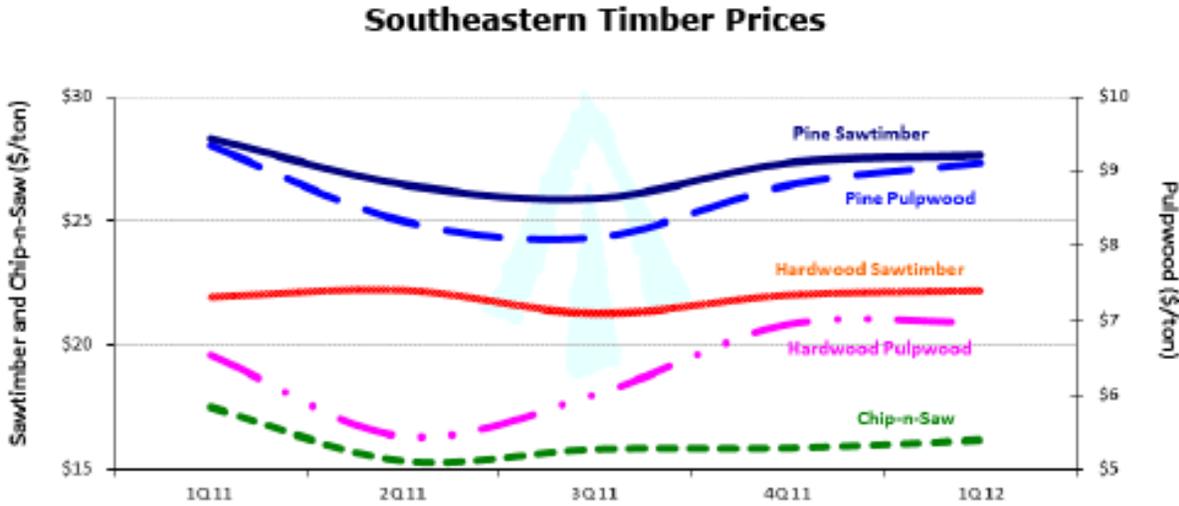
While performance continues to be challenged, we believe that the internationally diversified portfolio will provide future returns to help CalPERS meet its objectives. We continue to note the relative lack of diversification within the domestic markets and believe that, over time, the U.S. portfolio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

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 entirely 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 although prices have largely stabilized over the past year as the chart below shows¹.



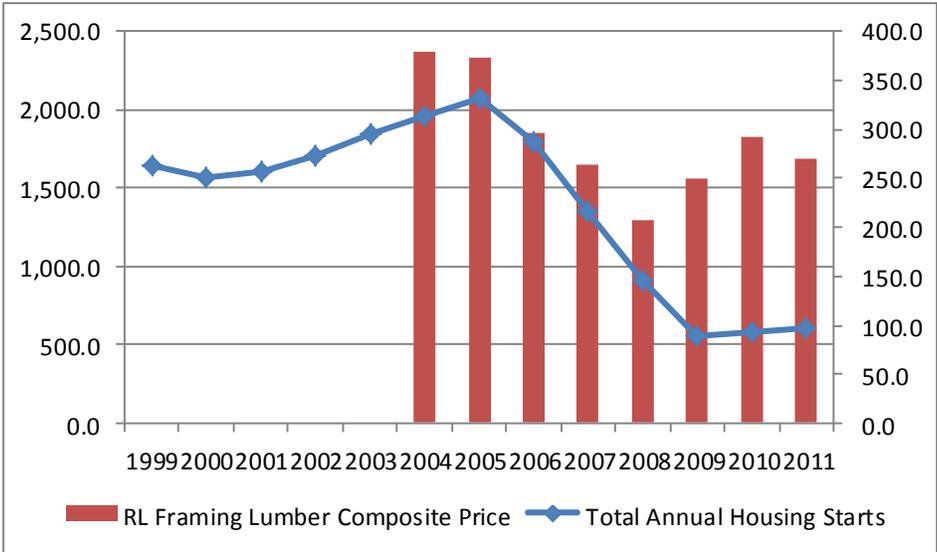
Source: Forest2Market®

Declining housing starts a few years ago (1.35 million in 2007; 609 thousand in 2011²) have contributed to falling timber prices. However, housing starts recently have stabilized and slightly improved from 2009 and 2010 levels, which may provide some level of stability to timber prices moving forward.

¹ Source: Forest Investment Associates
² Source: National Associate of Home Builders; housingeconomics.com

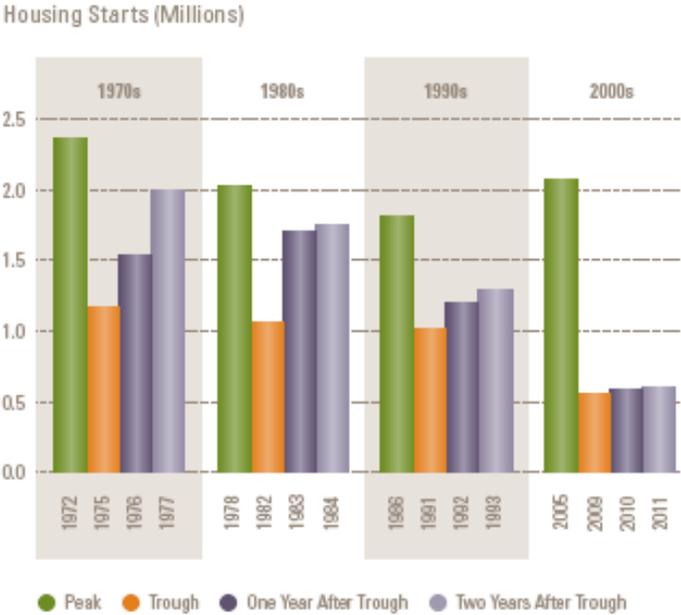


Housing Starts and Lumber Prices



Despite the stabilization of housing starts, the housing market still has far to go to return to peak rates³.

The Housing Downturn Has Been Deeper, and the Recovery Weaker, than in Any Cycle Since the 1970s



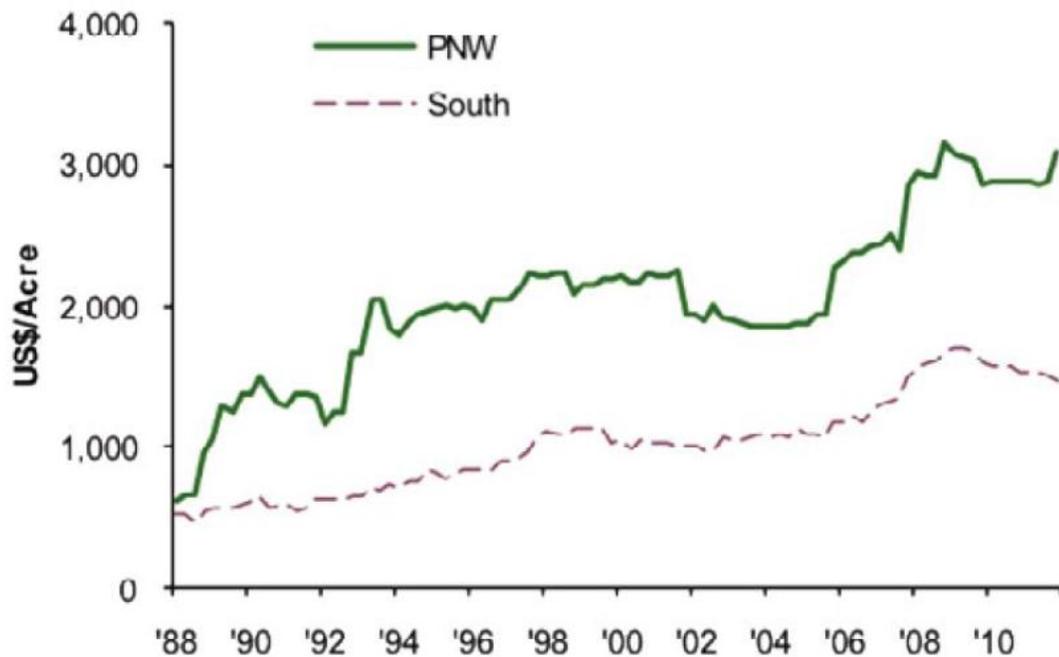
Source: JCHS tabulations of US Census Bureau, New Residential Construction Surveys.

³ Source: The State of the Nation’s Housing, The Joint Center for Housing Studies of Harvard University



As the chart below shows, prices for timberland in the Pacific Northwest have risen in recent years, while prices in the Southeast, which is 100% of CalPERS U.S. exposure, have fallen.⁴

NCREIF Timberland Value (\$ per acre)



Source: Brookfield Asset Management and NCREIF Timberlands Index.

Conclusion

As we noted in our comments on the Annual Review, 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

⁴ Source: Potlatch Corporation



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 'Ann J. ...'.