

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

October 29, 2013

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

Re: Forestland Program Review

Dear Mr. Jones:

You requested Wilshire's opinion with respect to the Forestland Portfolio Program Update. 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

Wilshire continues to believe that the Forestland portfolio will help CalPERS meet its long term return goals and will provide diversification and some protection against inflation. The portfolio continues to deviate significantly from the NCREIF Timberland Index with respect to leverage and geographic exposure, which has caused performance to lag over the past several years.

As we have noted in prior reviews, Wilshire believes that having an internationally diversified portfolio is appropriate for CalPERS, although it does create a misfit when comparing the program to the NCREIF benchmark. While the U.S. portion of the portfolio remains concentrated in the southeast, we recognize that this portfolio does not lend itself well to minor adjustments and that any changes are likely to take a significant period of time to materialize.

Background

As has been the case for several years, 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. While we have no evidence to believe that any one geographic region or type of wood should outperform the others, increasing diversification as the program continues will help to reduce the risk that results from an overconcentration to any particular area or end product.

Staff notes that because the portfolio is approximately at its target weight and the relative lack of liquidity of Forestland makes modest portfolio adjustments challenging, this portfolio is largely in a “manage and monitor” state. Wilshire believes that there will be periodic occasions to buy or sell Forestland at attractive prices and that Staff should be opportunistic when those opportunities present themselves. This may result in modest over- or under-allocations to the Program but this approach aligns itself with a number of CalPERS Investment Beliefs – in particular, Belief 2: A long time horizon is a responsibility and an advantage.

Wilshire has reviewed the Policy for the Forestland Program and believe that the program is in compliance with its Policy. Wilshire notes that the Policy calls for diversification by Revenue Source, which we believe can and should be accomplished as the portfolio evolves.

Conclusion

The returns of the Forestland Program have not met its benchmark over recent periods. However, as we have noted before, we believe the strategic role of timberland is important to the CalPERS portfolio and that the diversified nature of the Portfolio will benefit CalPERS going forward. Additional regional diversification within the U.S. would be advantageous for diversification and risk reduction 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 has caused 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. ...'.