MEKETA INVESTMENT GROUP

BOSTON MIAMI SAN DIEGO

October 29, 2013

Mr. Henry Jones
Chairman of the Investment Committee
California Public Employees' Retirement System
400 P Street, Suite 3492
Sacramento, CA 95814

RE: PROPOSED REVISIONS TO THE INFRASTRUCTURE INVESTMENT POLICY

Dear Mr. Jones:

In our role as the Board's Infrastructure consultant, Meketa Investment Group has reviewed several revisions to the Statement of Investment Policy for Real Assets – Infrastructure, proposed by Staff. According to Staff, the proposed revisions are intended to provide the Program with greater flexibility when pursuing investments within its mandate. The key revisions include changes to (1) permitted leverage on investments; (2) diversification limits related to CalPERS' exposure to individual vehicles, general partners, or managers; and (3) language with respect to terms used in the Policy.

Summary Opinion

With respect to leverage, we find the proposed changes to be reasonable, since they will not result in a change to the maximum allowable leverage of the Program. With respect to diversification limits, Staff's proposed revisions are also reasonable. Finally, the clarifying language is generally acceptable.

Revisions to Policy on Permitted Leverage

Staff's proposed revisions will not lead to an increase in the maximum allowable leverage of the Program, which remains unchanged at 65% of the market value of assets held within the Program. Currently, the Policy requires prior Board approval for commitments to commingled funds with leverage over 65% and direct investments with leverage over 50%. Staff has proposed the removal of a leverage limit on commingled funds and an increase in the limit on direct investments to 65%. Staff has also proposed the removal of a credit rating requirement for direct debt investments.

The objective of the proposed revisions to permitted leverage is to increase Staff's ability to pursue investments that are consistent with Defensive, lower-risk investments. Depending on the specific investment, an infrastructure asset may be capable of incurring leverage above 50% without creating excessive risk for equity investors. Cash flow stability and predictability are key characteristics of lower-risk infrastructure investments, and are commonly associated with mature, operational assets; large or growing rate bases; long-term revenue contracts with highly rated private or public counterparties; or availability payment contracts. Depending on the investment, the stable cash-flow profile of an asset may enable the use of fixed rate and lower-cost debt that is sustainable by the business. The debt may also have a longer term, which would reduce an investor's exposure to refinancing risk. Therefore, with respect to direct investments, we feel that it is reasonable for Staff to target investments that meet the Program mandate, so long as the leverage level on individual investments does not exceed 65%.

We also recognize certain practical limitations related to compliance with the current requirement that Staff obtain a credit rating for a debt investment meeting the Program's Defensive or Defensive Plus risk classification; project debt is often unrated and it may be impractical to obtain an outside rating in certain bidding situations.

With respect to commingled funds, limits on leverage used by managers may be difficult for Staff to enforce, so the removal of this limit is reasonable.

Revisions to Diversification Criteria

The revisions proposed by Staff relate to the current diversification requirements with respect to managers and managed vehicles, and consist of two changes. First, Staff proposes adding clarification to an existing limit on the percent of the total Program allocation that may be committed to a single manager to include any type of managed vehicle (commingled fund, separate account). This revision does not change the 30% concentration limit. Second, Staff instituted a new limit of 20% of the total Program allocation that an investment in a single managed vehicle may represent.

As part of its review of the existing Policy, Staff gave consideration to proposing the removal of the current Policy provision that limits ownership of a single committed fund to 25%. The intention of removing this constraint was to provide the Program with greater flexibility in partnering with managers. We will continue to engage in dialogue with Staff on the potential benefits and risks associated with this change to Policy.

Other Clarifying Language

The key change here is the replacement of "Custom Accounts" with "Separate Accounts" as a type of investment structure. The intent here is to more accurately define one type of managed vehicle that Staff intends to use in the future. Such accounts may take different forms, but in each, they require an external manager who undertakes a fiduciary duty to perform its responsibilities solely in the interest of CalPERS. While it is expected that such accounts will consist of multiple individual investments, it is possible that an account may hold a single investment.

Please do not hesitate to contact us if you have questions or require additional information.

Sincerely,

Stephen P. McCourt, CFA	David Altshuler
Managing Principal	Senior Vice President

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