



*Andrew Junkin, CFA, CAIA  
President*

March 24, 2016

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

Re: Real Asset Strategic Plan

Dear Mr. Jones:

You requested Wilshire's opinion with respect to the Strategic Plan for the Real Assets Program. In addition to our duties as the General Pension Consultant to the Investment Committee, Wilshire acts as the Investment Committee's Forestland Consultant.

### **Strategic Role and Investment Beliefs**

The strategic role of the Real Assets Program, including Real Estate, Infrastructure and Forestland is to provide stable cash flows while serving to provide long-term inflation protection and as an equity risk mitigant. The Real Asset Program is supported by a number of CalPERS' Investment Beliefs. First, Investment Belief 1 states that "Liabilities must influence the asset structure." This is evident in the Real Asset Program's strategic role. The Program requires a long-term investment horizon and thus corresponds well with Investment Belief 2, which states "A long time investment horizon is a responsibility and an advantage." The Real Assets Program also addresses Investment Belief 4 regarding multiple forms of capital – notably, in terms of how environmental practices can impact the long term returns of the Program.

Decisions regarding the strategic role of Real Assets will be important as the 2017 ALM Workshop proceeds. As the Investment Committee is aware, much of CalPERS' volatility is driven by equity risk (both public and private) and the corresponding link to global economic growth. Having Real Assets continue to serve as a diversifier to equity risk helps provide some balance to the more dominant equity risk in the portfolio.



## Investment Strategy

Staff is proposing an investment strategy that is largely unchanged from the current strategy and remains focused on high quality assets, strong cash flow, and moderate leverage. Staff is working to coordinate the classifications and terms used across the three components of the program. The revised terminology is more descriptive and should make the investment strategy more transparent for Staff, managers, and other stakeholders. Additionally, Staff is proposing adding Loan-To-Value (LTV) and Debt Service Coverage Ratio (DSCR) limits at the Program level, in addition to limits within the components.

Staff is also proposing a pilot program to apply leverage internally at the Program level, rather than on a deal-by-deal basis. There are certainly pros and cons to such an endeavor, but Wilshire believes that the portfolio is more likely to be able to sustain – and profit from – appropriate and judicious leverage at the program level. This will further align CalPERS' interests with the managers, by creating unlevered real estate mandates – managers will now simply be focused on maximizing the returns due to real estate expertise and not machinations around leverage within the portfolio. This would enable Staff to maintain significant control over the amount of leverage in the Program from a holistic perspective, rather than a manager who is simply focused on one particular sleeve of the portfolio. At this point, this is a proposed pilot program, not a major change and many details will need to be considered and approved by the ISG prior to implementation.

## Conclusion

Wilshire believes that the Real Assets Strategic Plan is appropriate as a guide for managing the Program and keeps the focus on the strategic role for the asset class. While there are no significant investment approach changes, the evolution of the Program under this Strategic Plan are likely to lead to greater transparency and commonality across the underlying components.

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. ...'.