



Memo

To: Members of the Investment Committee
California Public Employees' Retirement System

From: StepStone Group

Date: June 13, 2016

Subject: Revision of Real Assets Investment Policy (First Reading)
– Infrastructure Program

In its role as Private Asset Class Board Investment Consultant for the Infrastructure Program, StepStone was asked to review the revised Real Assets Program Policy ("Policy"). The proposed Policy revisions are part of a broader initiative of aligning the investment policies of each individual program with the new framework of the Total Fund Policy. In general, StepStone is supportive of these efforts to align, streamline, and simplify investment policies. The proposed revisions to the Policy introduce three significant changes with respect to the Infrastructure Program, which we outline below.

First, the revised Policy incorporates changes to the Infrastructure Program included in the updated Real Assets Strategic Plan that was approved by the Investment Committee in April 2016, including the single portfolio hierarchy for Real Assets (integrating Real Estate, Infrastructure, and Forestland). Nevertheless, specific investment limitations and constraints with respect to Staff Authority Limits and certain Key Policy Parameters for the Infrastructure Program will be retained, including risk classifications, geography, and leverage. Further, the Key Policy Parameters pertaining to risk and geographic segments will only apply when the NAV for the Infrastructure portfolio exceeds US\$5.0 billion.

Second, the revised Policy introduces new Staff Authority Limits. In February 2016, the Investment Committee approved Policy changes that incorporated the limits and constraints in the existing Delegation Resolution as an attachment ("Attachment D") to the Policy. At that time, StepStone noted that the requirements, limitations and other terms of the Delegation as they relate to the Infrastructure portfolio remain unchanged. In the revised Policy, the Staff Authority Limits have been simplified. For example, limitations on investments and dispositions by risk classification (e.g. Defensive, Defensive Plus, and Extended) have been removed (although permitted ranges by risk classification for the Infrastructure portfolio still apply). Limitations by partnership relationship or direct investment and by new and existing investments were also amended. And, the revised Policy uses a single Net Asset Value ("NAV") limit to measure investment and disposition amounts, rather than the lesser of the Program's NAV or percentage of the Policy target. In general, the Staff Authority Limits in the revised Policy should be easier to navigate, while also providing staff with greater flexibility to pursue investments.

In addition to streamlining and simplifying the Staff Authority Limits, staff's investment and disposition authority will change. For individual transactions in the Infrastructure Portfolio, the Managing Investment Director limit will increase from US\$500 million to US\$1 billion per transaction and the Chief Investment Officer limit will increase from US\$1 billion to US\$2 billion per transaction (and from US\$500 million to US\$2 billion for "Extended" investments). For the fiscal year period, aggregate Staff Authority Limits will decrease from US\$4 billion to US\$3 billion. StepStone also notes that debt financings will no longer be included in the Staff Authority Limits.

Third, the revised Policy is more concise. Definitions and other elements in the current Policy intended to guide staff on the implementation of Policy objectives will be moved to Investment Policy Procedures and Guidelines ("IPPG"). IPPG are intended to identify what the organization must do in order to achieve desired outcomes, and are intended to be clear, measurable, and specific, with the objective of reducing operational risks and complexity. For example, the risk classification of an Infrastructure investment (Core, Value Add, or Opportunistic) will remain



both a Key Policy Parameter in the Policy and subject to permitted NAV ranges. However, the definitions of the risk classifications will be moved from the Policy to the policy procedures documents. IPPG will be subject to testing by ICOR, and any changes will require approval of the Investment Strategy Group or INVO Operating Committee and concurrence by CalPERS' General Consultant. It is StepStone's understanding that the IPPG, including definitions of terms cited in the Policy, will be completed at the time the final Policy is presented to the Investment Committee for approval. Individual steps that staff is expected to follow to achieve desired Policy outcomes will be moved to desktop procedures documents, and other language identified by staff as duplicative, editorial in nature, or otherwise not applicable will be removed from the Policy. StepStone reviewed the mark up of the current Policy and believes the changes proposed in the revised version should make the document more clear and effective.

StepStone welcomes the opportunity to answer any questions of the Investment Committee.