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President, Wilshire Consulting

July 12, 2016

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

Re: Real Asset Program Policy

Dear Mr. Jones:

You requested Wilshire's opinion with respect to the proposed revisions to the second reading of the Investment Policy for the Real Assets (RA) Program Policy (the "Policy"). Wilshire serves the Investment Committee as the General Pension Consultant and the Forestland Consultant.

Overview and Recommendation

As we noted at the first reading in June, CalPERS Staff has worked to revamp the investment policies across the organization. The project's goal has been to streamline and simplify the policies in order to make them more effective governance tools, which is in line with CalPERS' overarching goals and Investment Beliefs.

Part of the streamlining process includes removing from the Investment Committee (IC)-approved investment policies certain language that is more operational, and relocating it in to IPPGs (Investment Policies, Procedures and Guidelines), which function as internal management guidelines for Staff. Wilshire has been and will continue to be involved in vetting the transfer of language from the previous versions of IC-approved policies to new/proposed IC-approved policies and IPPGs. While not provided to the IC, Wilshire has reviewed a marked up version of the current policy that highlights which portions have been moved into the proposed policy and which are being moved into the IPPG for RA.

We note that many of the substantive changes (diversification limits, leverage limits, delegated authority limits) in the proposed RA investment policy were taken from the Strategic Plan that the Investment Committee approved in April.

As we previously noted, the current policy includes a target return of CPI plus 4% as a Strategic Objective. While vetting the proposed policy with Staff, Wilshire recommended that this be removed as one of the goals of the policy review project is to remove such "aspirational"

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language. While a net, real return of 4% is a laudable goal as part of the strategic role of the RA Program, this type of very specific target return is not contained within any other program's approved investment policy. The specificity of this return goal could come into conflict with the other strategic roles targeted by CalPERS – stable income, inflation protection, and acting as a diversifier for equity risk. Staff agreed that the language was aspirational and removed it from the proposed policy.

Wilshire also notes that the proposed RA policy does not include specific reporting requirements from the Real Estate, Infrastructure, and Forestland consultants. This seems odd when viewed in a vacuum. However, these are laid out clearly in the Total Fund Investment Policy Statement.

With respect to the Forestland-specific Staff Authority Limits, the dollar amounts have increased from the current policy. Wilshire believes the proposed amounts provide sufficient flexibility for investment actions without sacrificing IC input on major decisions. Wilshire recommends the IC approve these new higher limits.

This is the second reading of this policy. The IC has reviewed this during the June IC meeting and comments from PCA, Stepstone, and Wilshire. **Wilshire recommends that the Investment Committee approve the proposed policy.**

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,

