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

Date: July 19, 2013

From: Pension Consulting Alliance, Inc. (PCA)

RE: Real Estate Performance through June 30, 2013

PCA received and reviewed Wilshire's Second Quarter 2013 Executive Summary of CalPERS' Investment Performance as it relates to the Real Estate Portfolio. The following items should be considered in your assessment of Real Estate's performance:

- In an illiquid asset class populated with multi-year partnerships, longer term results are more significant than those of a shorter duration.
- Performance over the one-year period continued the upward trend started in the third quarter of 2010. The positive returns were due largely to unrealized appreciation. Over the longer term, the real estate program had less favorable results with net returns of -1.6% and 3.0% during the trailing five- and ten-year periods, respectively. These returns were less than the applicable benchmark returns by 14.5% and 6.4%, respectively.

Real Estate Performance	Quarter	1 Year	3 Year	5 Year	10 Year
Real Estate Returns	7.9%	11.9%	12.6%	-10.6%	3.0%
Real Estate Policy Benchmark	2.4%	10.3%	14.2%	3.9%	9.4%
Difference	5.5%	1.6%	-1.6%	-14.5%	-6.4%

- As previously articulated, the performance of the real estate portfolio has been hindered by three primary factors: (i) significant amounts of CalPERS' capital were invested during the 2005 to 2007 period which exposed the portfolio to the risk of vintage-year concentration; (ii) the high proportion of the portfolio invested for capital appreciation (not current income) in riskier, non-stabilized properties; and (iii) high amounts of leverage employed at the peak of the cycle. These final two factors exacerbated historical underperformance to the benchmark during the economic crisis. Non-stabilized assets provide less income to insulate against valuation declines. Increased leverage magnifies positive appreciation returns in upward market cycles and negative appreciation returns in downward market cycles.
- At the February 2011 Investment Committee meeting, the proposed Real Estate Strategic Plan was approved. This plan provides for the implementation of the revised role of real estate as described in the current asset allocation study. This role is primarily to provide (i) reliable current income and (ii) diversification from public and private equity return characteristics. Therefore, as seen in this year's results, the portfolio has begun to shift in emphasis towards strategic, stabilized, domestic core

assets held for a longer term, and away from more tactical, opportunistic, appreciation-oriented investments held for a shorter term.

- In general, the global commercial real estate markets continue to display weak fundamentals insofar as occupancy demand and increases in net rental rates. This weakness is partially mitigated by below average new construction levels and historically low base rates for mortgage loans. Increases in value currently can be attributed primarily to (i) pent up demand for core property in major, primarily coastal and capital cities and (ii) relatively attractive current returns from completed properties compared to other available income-oriented investments. Until employment increases and uncertainty about economic trends and political instability is reduced, it is unlikely to expect significant increases in rent and occupancy.

Note: PCA does not believe the quarter's performance relative to the benchmark is informative since the benchmark includes properties appraised ratably throughout a twelve month period, and CalPERS' appraisal policy provides for annual appraisals. The impact of the appraisals is only incorporated into June 30 performance reporting. In other words, all else equal, compared to the portion of the benchmark relating to private real estate, PCA expects more of a year's appreciation/depreciation in values to be concentrated in the period ending June 30, and somewhat less to be recorded in CalPERS' results in the other three quarters.

PCA is available to take any questions of the Investment Committee.

Respectfully,

David Glickman

David Glickman
Managing Director