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REAL ESTATE
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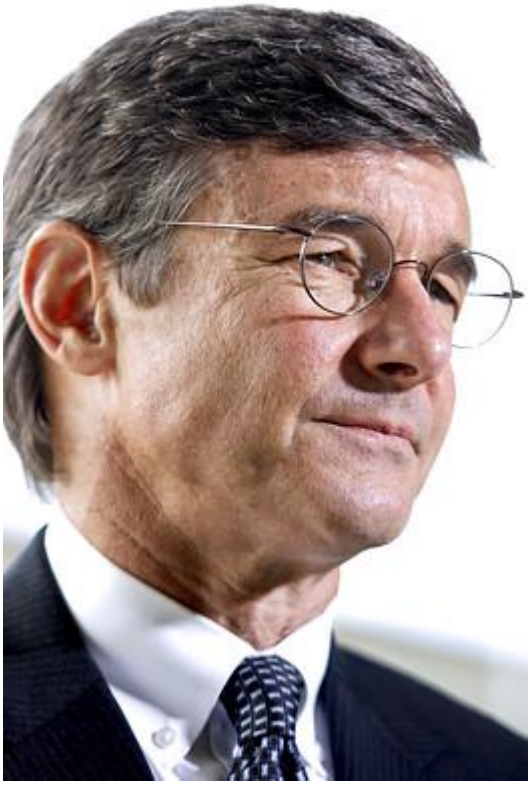
Calpers, After Losses, Plays It Safe

By ANTON TROIANOVSKI

After losing more than $10 billion on real-estate investments, Calpers, the giant California pension fund, is returning to the property market with a new strategy and fewer investment managers, seeking steady, modest gains rather than blockbuster returns.

After investing relatively small amounts in real estate during the past two years, the $226 billion California Public Employees' Retirement System is gearing up to commit as much as $2 billion to property deals in 2011, the fund said. Calpers will be making those investments with less help from some big-name managers, including BlackRock Inc., Hines Interests and Jones Lang LaSalle Inc., which it removed from overseeing parts of its portfolio in recent months.



Bloomberg News

Joseph Dear, chief investment officer for Calpers

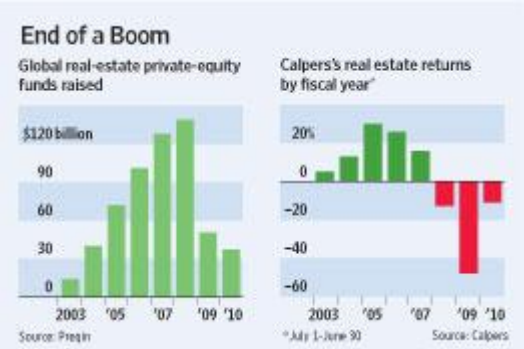
In the wake of a "searching re-examination" of its $15 billion real-estate program conducted since the financial crisis, Calpers has decided to increasingly rely on property as a source of steady income, rather than seeking to take advantage of increases in value, Chief Investment Officer Joe Dear said in an interview.

Mr. Dear said Calpers wasn't planning any significant new commitments to real-estate private-equity funds, which were popular with pension funds in the past decade because the vehicles allowed them to quickly ramp up their exposure to property around the world. Instead, Calpers will be looking to commit more capital to "separate accounts"—property portfolios managed by real-estate companies specifically on behalf of Calpers.

In a tough criticism of the real-estate funds, Mr. Dear said they "tend to be more in the asset-gathering, fee-generating businesses than they are in the capital appreciation, income-generating business."

Calpers also has culled its stable of investment managers, in recent months removing some household real-estate names as managers of portions of its portfolio and replacing them with smaller, less well-known companies such as CommonWealth Partners LLC, GI Partners and GID Investment Advisers LLC. Mr. Dear said that the investment managers who received more capital "all exercised exceptional discipline during the bubble—that is, they were selling assets rather than buying."

BlackRock and global commercial-property firm Jones Lang LaSalle had no comment. A Hines spokesman acknowledged that the Houston-based real-estate developer generated poor returns for Calpers over the past two years. But he said that annual returns as measured by Hines averaged 10.7% over the 12-year life of the Calpers joint venture and pointed out that Hines is still managing some of the pension fund's real-estate investments around the world.

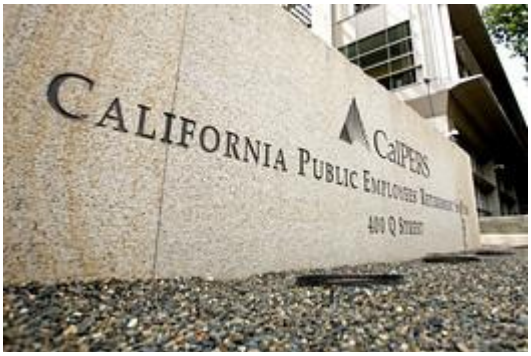


Calpers's new strategy—set to be discussed in a board meeting as early as next month—signals a broad swing toward more conservative real-estate investing among U.S. pension funds and points to continuing turmoil in a real-estate industry that in the last decade saw pensions emerge as an increasingly important source of equity capital and fees.

The more conservative strategy means borrowing less money to buy property and acquiring higher-quality, well-leased buildings. During the boom years, Calpers, like many other big investors, sought profits on risky land deals and boosted its real-estate returns with increasing amounts of debt, generating annual returns as high as 30%.

That strategy had disastrous consequences when the recession hit. Calpers's real-estate portfolio lost nearly half of its value, or more than $10 billion, from July 2008 to June 2009. Calpers's sourced investments included those made in such high-profile deals as the Stuyvesant Town and Peter Cooper Village apartment complex in Manhattan, and a venture called LandSource, which held thousands of acres of California land.

"We decided to reduce the risk in the real-estate portfolio and increase its income orientation as a risk mitigator," Mr. Dear said. "The risk in the real-estate portfolio increased steadily as the bubble expanded, and the consequence was substantial capital loss."



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Those losses finally appear to be abating. Last week, Calpers reported its smallest real-estate loss since the financial crisis: a decline of 5% in the 12 months ended Sept. 30, 2010.

Calpers's moves come as public-employee pension funds across the country grapple with how to ride the real-estate market's recovery while avoiding mistakes made during the boom. Those decisions will carry broad implications as cash-strapped pensions look for ways to make good on their promises to workers without having to ask taxpayers for more money.

Efforts by Calpers to reduce real-estate risk carry potential drawbacks of their own: Many other big investors are flocking to conservative real-estate deals, driving up prices for the best property-known as "core" real estate around the world.

Mr. Dear said that he was concerned about the widespread interest in core property and that he was prepared to bid on assets but not win them.

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