

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: Annual Report on California Investments Policy,
Period Ending June 30, 2010

ITEM NUMBER: 2b

CONSENT: X

ATTACHMENT(S): 2

ACTION: _____

DATE OF MEETING: September 2, 2010

INFORMATION: X

PRESENTER(S): Michael Warmerdam

POLICY

This item is part of the Policy on California Investments, and its objective is to monitor the content of investments in California.

BOARD STRATEGIC PLAN GOAL

<p>Goal 5: Ensure a financially sound retirement system through adequate contributions and optimal investment returns.</p>

HISTORY OF THE ITEM

At the Investment Committee's request, staff has developed and presented a report on California Investments since September 5, 2001. The first report also covered information on investments in Community Reinvestment Act areas within California. The report was generated twice per year -- at the end of the calendar year December 31, and at the end of the fiscal year, June 30. The end of fiscal year report was slightly different as it was utilized to report on the Education Code Section 22362 mandate to "*give first priority to investing not less than 25 percent of all funds of the plan that become available in a fiscal year for new investments*" in California residential realty.

The semiannual report presented in September 2008 noted the focus on California investments had become intertwined into every facet of the investment branch and investment process. To improve efficiency, staff recommended and the Investment Committee approved revising the policy to only require an annual report as of June 30.

EXECUTIVE SUMMARY

This report identifies the California content of the CalSTRS Investment Portfolio (Portfolio), and the amount of investments in the underserved portions of the state.

- As of June 30, 2010, the California content of the Portfolio amounted to more than \$19.9 billion or 15.3 percent of the Portfolio.

- **In the California underserved markets, CalSTRS has invested \$5.0 billion. This represents 3.97 percent of the total Portfolio, which is almost double the original 2 percent goal.**

CONCLUSION

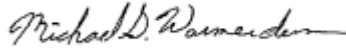
The California content of the Portfolio increased by \$3.0 billion in the last fiscal year. The portfolio content remains rich in ancillary benefits to California citizens. In attaining the goal set for investing 2 percent of total assets in the domestic underserved market, staff submits these projects with the same due diligence as any other investment consistent with their fiduciary obligation.

For the first time since setting a 2 percent goal back in 2003, CalSTRS has surpassed and almost doubled the objective. As we have always noted, setting a goal is a worthy objective but attaining it would be based on investment opportunity, not a calendar. Since this goal has been achieved for just the second time, and the size of the total fund is volatile, staff recommends keeping the goal and monitoring the exposure. The investment staff will continue to pursue urban and rural California investments as they present themselves.

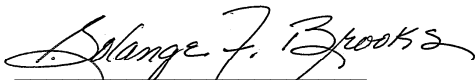
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CALSTRS

Annual Report on California Investments Policy Period Ending June 30, 2010



2009/10

ANNUAL REPORT ON CALIFORNIA INVESTMENTS POLICY

Securing the financial future
and sustaining the trust of
California's educators

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BACKGROUND

The California State Teachers' Retirement System (CalSTRS), as the defined benefit pension plan for all of California's public school teachers, represents one of the largest pools of investment capital in the state. While the primary purpose of all CalSTRS investments is to achieve the maximum return at a prudent level of risk to secure the financial future and sustain the trust of California educators, the CalSTRS Investment Committee recognizes the importance of the multi-billion dollar portfolio's investment activities within California. Many investment activities have multiple ancillary benefits, creating economic value that benefits the State and its citizens. It is with this philosophy and worldview that the California Investments Policy was originally adopted by the Board on October 10, 2001.

Furthermore, the Policy also established a goal of investing 2 percent of CalSTRS' assets in underserved markets, primarily in California. The underserved markets are described as follows:

California emerging markets investments shall focus on investment opportunities in traditionally underserved markets primarily located in California. For example, underserved markets would include urban and rural communities undergoing, or in need of, revitalization where there are assets (e.g., an available labor pool, underutilized infrastructure) conducive to business development.



The CalSTRS Investment Committee recognizes the importance of the multi-billion dollar portfolio and its investment activities within California.

This report identifies the California content of the CalSTRS Portfolio, and the amount of investments in the underserved portions of the state, consistent with the annual reporting requirements.

DISCUSSION

All the investments listed in the report were made as part of the normal course of business and received the same level of due diligence as any investment made by CalSTRS. The singular primary purpose is to receive a maximum rate of return commensurate with the given level of risk.

Education Code Section 22362

CalSTRS has met the mandates of Education Code Section 22362 for fiscal year 2009-2010. This mandate requires 25 percent of the funds available for new investments to be, directly or indirectly, invested in California residential realty. The total amount of residential real estate debt investments in fiscal year 2009-2010 was \$1.058 billion, which exceeded last year's amount by \$276 million. The net cash flow this year, however, was a negative amount at \$-675 million, thus the calculation percentage is not applicable. Please refer to Exhibit 1 for more details.

Exhibit 1
California Education Code §22362

Net Cash Flow:	(\$)
Employee and Employer Contributions	5,315,828,484
Investment Income (Net of Expense)	3,354,381,669
<u>Less Benefits Paid & Withdrawals</u>	<u>-9,345,251,747</u>
<u>Net Cash Flow</u>	<u>-675,041,594</u>
25% Priority of Net Cash Flow	-168,760,398
California Residential Real Estate Debt Investments Purchased during the Past Fiscal Year:	
Publicly Traded Mortgage Backed Securities	328,531,520
<u>Home Loan Program - Residential Home Loans</u>	<u>729,739,156</u>
<u>Total Residential Real Estate Debt</u>	<u>1,058,270,676</u>
Total Investment less 25% of Net Cash Flow:	Not Applicable

Source: CalSTRS data

California

CalSTRS has invested more than \$19.9 billion, or 15.3 percent of the total portfolio in California as of June 30, 2010. CalSTRS total assets have increased by \$10.9 billion or 9.2 percent from the previous year, while CalSTRS holdings in California saw an increase of \$3.8 billion or 23.7 percent.

Some of the large change can be attributed to changes in the manner in which real estate is reported. Specifically, as of June 2010 real estate holdings are reported to be \$5.880 billion (Please refer to Exhibit 2) versus \$2.726 billion reported June 2009. This year, 2010, the Real Estate unit has provided a list of properties held in the CalSTRS Portfolio that are located in California and each property's corresponding value as measured by its Gross Asset Value (GAV). This value measurement differs from those provided in previous years. In previous years, the values provided of the properties were expressed as Net Asset Value (NAV).

GAV is the fair market value of the property. NAV is the fair market value of the property less any debt on the property or less any debt at the fund level that is allocated to the property. Furthermore, debt, in the Real Estate unit, is predominately used as a financing tool. As a large institutional investor, CalSTRS can buy properties outright with little to no debt. It is often the case that it would make more financial sense to partially finance the purchase of a property. CalSTRS still would own the property; the property's capital structure would just be different. Thus, GAV is the proper way to show which part of a property CalSTRS owns. In terms of residential real estate, the GAV would be the value of a house and NAV would be the value of the house less the mortgage balance.

In the present commercial real estate market environment, some property values have declined drastically whereas the debt on the properties has stayed the same. This dynamic has caused some NAV's to be zero or negative. Reporting a zero or negative value would misrepresent the fact that we actually own the properties, as well as their relative size compared to other less leveraged properties.

Lastly, in 2010, Private Edge has started collecting property level holdings data from all managers: separate accounts, JV's and Funds. In previous years, we had a difficult time collecting the property level data from the funds, which are notoriously protective of their holdings information. Previous years' report data came from investment level reports from the funds where we made rough adjustments to identify the California holdings and their values. This is no longer the case; thus, the information provided by Private Edge is more complete and closer represents CalSTRS holdings in real estate.

Exhibit 2
CalSTRS Portfolio: Exposure in California as of June 30, 2010

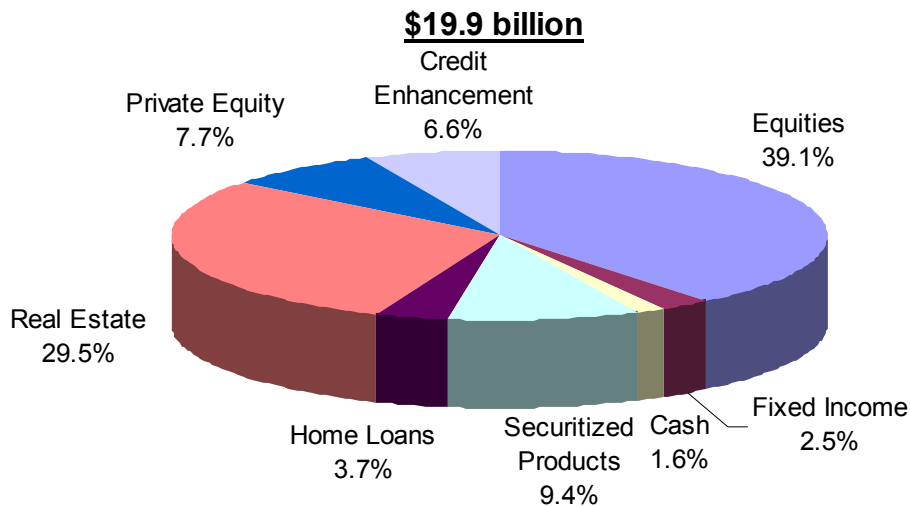
Asset Class	Market Value (in \$ millions)
Publicly Traded Equities	7,783
Corporate Fixed Income	492 ¹
Cash Investments (Estimated)	310 ¹
Fixed Income (Securitized Products)	1,877
Individual Home Loans	730
Real Estate	5,880
Private Equity	1,537
Credit Enhancement	1,305
Estimated Total Exposure in California	19,914
CalSTRS Total Portfolio	129,773
<i>Percentage of CalSTRS Total Portfolio</i>	<i>15.3%</i>

¹ The numbers only include issuers whose headquarters are located in California or who are incorporated in California.

Source: CalSTRS data

Exhibit 2 on the previous page and Exhibit 3 shown below capture CalSTRS' estimated total exposure in California. Please note the numbers in the exhibits are low estimates. The CalSTRS assets invested through the public equity and the broad fixed income portfolio, in particular, do not include many firms that have significant business exposure in California and often comprise an integral part of California communities. It is not possible to obtain the information to measure the actual exposure of these large firms in a systematic, reliable, and cost-effective manner.

Exhibit 3
CalSTRS Portfolio: Exposure in California as of June 30, 2010



Source: CalSTRS data

To provide a perspective as to the effect that the teachers' investments have on California's employment, we have listed our investments, which are more than \$3.7 billion, in some of California's largest employers. However, this is not an exhaustive list. The actual investment exposure to California companies and employers is estimated to far exceed the \$3.7 billion figure. Due to the difficulty in measuring the California content of most of CalSTRS' holdings in national and multinational corporations, an exact figure cannot be generated. Exhibit 4 on the next page lists CalSTRS' exposure to some of the largest publicly-traded employers in California. The data is based on the top 20 public companies with 10,000 or more employees and \$1 billion or more in sales revenue.

Exhibit 4**CalSTRS Portfolio: Investments in California's Largest Public-Traded Employers as of June 30, 2010**

Security	Market Value (in \$ millions)
Apple Inc.	786.8
Chevron Corporation	496.6
Wells Fargo & Company	443.7
Cisco Systems	424.4
Intel Corporation	378.4
Hewlett Packard Company	354.9
Oracle Corporation	277.7
Walt Disney Company	188.7
Northrop Grumman Corporation	77.7
Safeway Inc.	72.5
McKesson Corporation	66.3
GAP Inc.	42.7
Western Digital Corporation	37.4
Ross Stores	36.4
Jacobs Engineering Group, Inc.	21.2
URS Corporation	12.6
AECOM Technology Corporation	8.8
Sanmina-SCI Corporation	3.5
Jack in the Box	2.9
Dole Foods Co. Inc.	0.9
Estimated Total Exposure to California	3,734.2

Source: Public Reference USA Database and MyStateStreet

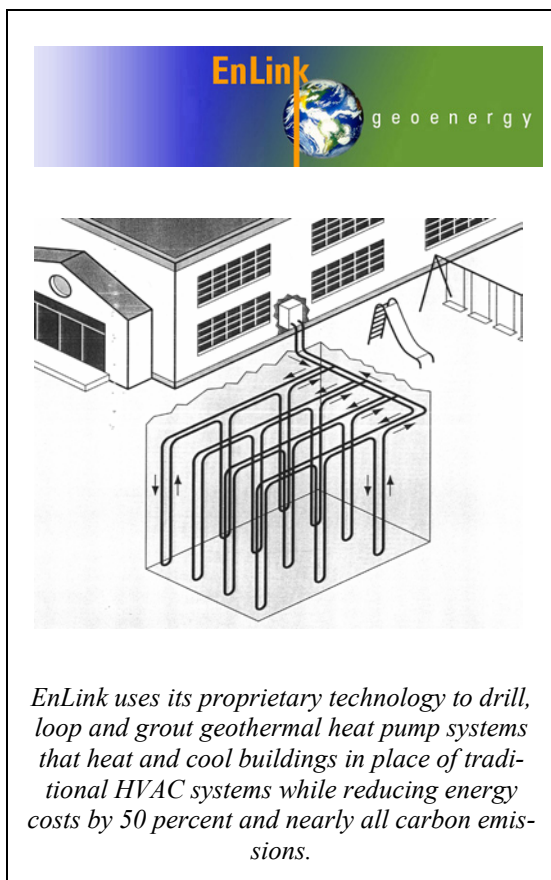
Note: Data includes companies with 10,000 or more employees and sales revenues of \$1 billion or more.

Ancillary Benefits - Proactive Portfolio

As noted by the Board in the California Investments Policy, many of the investment activities have multiple ancillary benefits. This report features examples of such investments found in the Private Equity Proactive Portfolio. The investments are, first and foremost, investments that receive the same level of due diligence as any investment made by CalSTRS. The Proactive Portfolio's primary purpose is to receive the maximum rate of return commensurate with the given level of risk; however, one can see the ancillary effects of these investments by how they benefit the lives of Californians.

Although the existing environment in the domestic emerging space remains uncertain, and the overall milieu remains challenging, there appears to be some continued momentum with regard to new deal activity in the Private Equity Proactive Portfolio. Some emerging funds opted to scale down their pace of investing in new deals due to the market meltdown in 2008; while others re-trenched and focused on anticipated problems within their existing portfolios. However, we have noticed that as the flow of capital has increased, company valuations hit lows, credit markets began to thaw and interesting investment opportunities began to emerge, particularly in California.

In this space, CalSTRS is poised for future growth. Many investments carry inherent ancillary benefits and are in line with an environmentally-conscious strategy. The following are a few examples of such California Investments found in the CalSTRS New and Next Generation Manger Program, managed by Invesco Private Capital and CalSTRS/BAML Capital Access Funds, managed by Bank of America Merrill Lynch.



EnLink Geoenergy Services, Inc. – an investment of Los Angeles-based Craton Equity Partners I:

EnLink Geoenergy Services, Inc., headquartered in Los Angeles, is a leader in providing geothermal earth-heat exchange (EHX) solutions to governments, businesses, institutions and consumers. With a successful 14 year track record and 13 unique patents, EnLink is a leader in the design and installation of earth heat exchange systems throughout the United States. EnLink's EHx systems provide an excellent solution for responding to climate change considering the advent of state and regional emission-reduction mandates and an increase in energy prices.

The principle behind a geothermal heat pump system is simple. It uses the constant temperature of the ground below the surface as a highly efficient heat sink that absorbs heat in cooling mode and as a heat source in heating mode.

EnLink has been involved in EHx projects in all types of geologic conditions from New York to California. Recently awarded projects include the City College of San Francisco Performing Arts Center and American Canyon High School in Napa, CA.

EnLink has experience in every aspect of geothermal projects, from design to total system implementation. But its core business remains superior EHx installations. Through its exclusive and patented processes and technologies, EnLink's technology dramatically reduces the initial cost of an EHx while improving the operating efficiency of the overall system. Schools, office buildings and health care facilities across the U.S. have benefited from the Company's installation innovations. www.enlinkgeo.com

Propel Fuels – an investment of Los Angeles based Craton Equity Partners I:

Propel Fuels owns and operates a network of Clean Fuel Points – green-built, self-serve filling stations providing drivers convenient access to clean, American, low carbon fuels such as ethanol and biodiesel. The company offers drivers and fleets a cleaner fuel choice that reduces carbon emissions, creates jobs and lowers America’s dependency on foreign oil. Propel has also developed Clean-Drive™, the nation’s first integrated carbon emission reduction tracking platform. Based in Redwood City, the company operates a growing network of Clean Fuel Points in Washington and California. Each Clean Fuel Point is co-located on the property of existing gas stations to improve convenience for customers.

Propel was recently awarded \$11 million in grant funding from the Department of Energy and the California Energy Commission to help accelerate the expansion of its fueling stations. Propel plans to open more than 150 new fueling stations throughout California by 2012, creating significantly better access to ethanol (E85) and biodiesel fuels for Flex Fuel Vehicles and diesel vehicle drivers.

Propel offices and Clean Fuel Points operate carbon neutral. In addition to sustainable and efficient site design, the Company offsets the balance of their energy use with carbonfund.org to fund projects in renewable energy, energy-efficient technologies, and planting carbon-absorbing trees. Propel has been recognized for its innovation and design by the American Institute of Architects and was recently awarded the Sacramento Sustainable Business of the Year for its stations operating there.

www.propelfuels.com

Freshology, Inc. – an investment of SanFrancisco-based Pacific Community Ventures:

Another California company where CalSTRS funds have been invested is Freshology, Inc. The company is a premium, home delivered, gourmet meal service that provides clients with healthy, great tasting, and high quality handmade meals that help them reach their weight loss and wellness goals. Freshology’s programs can improve blood pressure and cholesterol levels and can be diabetic friendly.

Depending on the program, the menus rotate at least every 30 days and up to every 90 days. Daily nutrition needs are determined and calculated for each program for an effective balanced diet. The company offers fresh and frozen meal programs and all meals are prepared by a top chef at the Company’s Burbank location.



Propel fuels decrease the carbon footprint, enhance the performance of the vehicle, and displace imported oil.



Gourmet Meals
Delivered to Your Door

Over 650,000 children in the Los Angeles County face hunger. Marlee Matlin's campaign focuses on making a difference by donating 5 percent of all net profits to the LA Regional Food Bank.

taste... style... convenience... environment
FRESHOLOGY

The Company often supports community service organizations and programs. Recently, Freshology partnered with Oscar winning actress Marlee Matlin and is currently running a marketing campaign from which 5 percent of proceeds will be donated to the Los Angeles Regional Food Bank. Freshology is also committed to environmentally friendly practices and all of their packaging is bio degradable or made of recycled materials.

The Company has 55 employees of which 65 percent are classified as low-to-moderate income. Eighty-five percent of workers have access to a retirement program and all employees are eligible for stock options. The firm is proud of its diversity in its top officers, which carries throughout its organization with 85 percent of all employees being ethnic minorities and/or women.

Freshology provides substantial training opportunities for its workers and has a practice of promoting from within so there are opportunities for hourly workers to move up to supervisory roles in all departments.

www.freshology.com

Livescribe – an investment of San Francisco-based DBL Investors:

Livescribe, is a woman-owned company based in Oakland. The Pulse smartpen, a Livescribe product, is fundamentally changing the way people capture, access and share information with pen and paper.

Specifically, the Pulse smartpen from Livescribe is a computer within a pen that captures handwriting and simultaneously records audio and synchronizes it to the writing. Users can simply tap on their notes to replay what was recorded from the exact moment they were writing, so they never miss a word they hear, write, or speak. In addition, the smartpen synchs with your computer where all audio and handwriting is stored so everything is reviewable from your screen.

Livescribe's smartpens provide students with unlimited access to teacher instruction—anytime, anywhere. Educators can create customized instruction, monitor student progress and build a collaborative environment that drives achievement for all students. Administrators can extend staff training and knowledge sharing. Among the product's exciting applications are teaching English as a Second Language to helping children with learning disabilities learn more effectively. Further, the company continues to lower its price to make the product accessible to more low income people.

Since its education launch in March 2009, Livescribe has won multiple education awards, including the 2009 Tech & Learning Award of Excellence, 2009 SIIA Most Innovative Educational technology, 2010 AEP Golden Lamp and the 2010 AEP Distinguished Achievement Award. The company and employees are committed to having a positive impact in our local community through leveraging the power of the Livescribe smartpens for education. A program is currently being designed with a local Oakland school to innovate curriculum with the smartpens. The company will be donating pens, and employees will volunteer to help teachers and students unleash the power and creativity of learning with smart pens. Livescribe is located in an enterprise zone in Oakland, CA, and employs 78 people.

www.livescribe.com/en-us/

Underserved / Emerging California Markets

In the underserved and emerging markets of California, CalSTRS has invested \$5.0 billion as of June 30, 2010. This translates to an increase of \$2.96 billion, or 144.5 percent, over the period ending on June 30, 2009.

Due partly to the change in the reporting methodology of its portfolio, as reported earlier, the underserved portion of real estate holdings in California has grown to \$3.9 billion or a 275.2 percent increase. The Private Equity Portfolio has decreased by \$3 million, or -1.1 percent from last year.

Although the absolute number is relatively small compared to other asset classes, the market value of the Home Loan Program (HLP) Portfolio has seen tremendous gains. The HLP funded \$155 million in mortgages in underserved areas of California for the fiscal year 2009-2010, placing the program well ahead of last year's pace. Given the tightening lending requirements in the mortgage market, CalSTRS programs, especially the down payment assistance program, have been favored by many teachers.

It should be noted that public equities are excluded from the list in Exhibit 5 due to a difficulty capturing reliable data of investments made by public companies in underserved California markets. The actual investments in underserved regions would be much higher, as the figures below do not capture investments made outside of California. Please refer to Exhibits 6 and 7 which depict the historical trends of CalSTRS investments in underserved California.



While writing, the smartpen is remembering-linking everything heard to everything written. Later, simply tap on the notes to replay the recording.



Exhibit 5**CalSTRS Portfolio: Investments in Underserved California as of June 30, 2010**

Asset Class	Market Value (in \$ millions)
Fixed Income (Securitized Products)	269
Individual Home Loans	155
Real Estate	3,927
Private Equity	258
Credit Enhancement	395
Estimated Exposure in Underserved California	5,002
CalSTRS Total Portfolio	129,773
<i>Percentage of CalSTRS Total Portfolio</i>	3.9%

Note: Public Equities are excluded from figures above.

Source: CalSTRS data

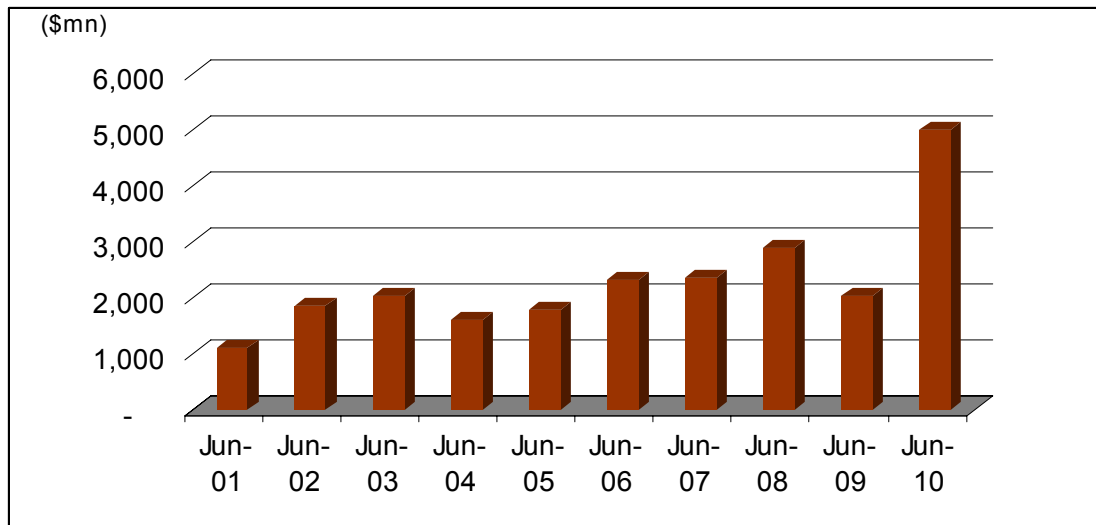
Exhibit 6**CalSTRS Portfolio: Historical Investments in Underserved California as of June 30, 2010**

Reporting Year	Market Value (in \$ millions)	% of Total CalSTRS Portfolio
2001	1,094	1.1%
2002	1,861	1.9%
2003	2,044	2.0%
2004	1,617	1.4%
2005	1,798	1.4%
2006	2,306	1.6%
2007	2,361	1.4%
2008	2,892	1.8%
2009	2,046	1.7%
2010	5,002	3.9%

Source: CalSTRS data

Exhibit 7

CalSTRS Portfolio: Historical Trend of Investments in Underserved California as of June 30, 2010



Source: CalSTRS data

Conclusion

As of June 30, 2010, the California content of the Portfolio amounts to more than \$19.9 billion or 15.3 percent of the Portfolio. In the California underserved markets, CalSTRS has invested \$5.0 billion, which represents 3.9 percent of the total Portfolio exceeding the 2 percent goal established for investments in underserved areas while submitting these projects to the same due diligence as any other investment consistent with their fiduciary obligation.

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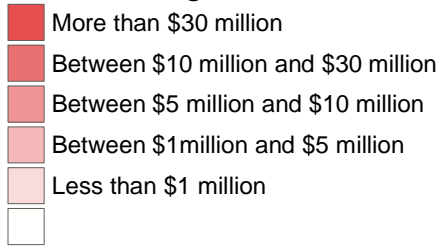
916-414-7406
www.CalSTRS.com

California Maps

Home Loan Program:	\$729.7 million
Private Equity:	\$1.5 billion
Credit Enhancement:	\$1.3 billion
Real Estate:	\$5.9 billion

CalSTRS Home Loan Program Portfolio in California as of June 30, 2010 - \$729.7 Million

Home Loan Program Portfolio



INV34

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CalSTRS Private Equity Portfolio in California as of June 30, 2010 - \$1.5 Billion

Private Equity Portfolio

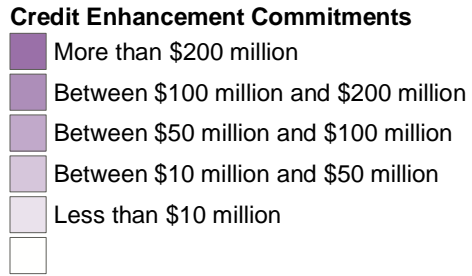
- More than \$100 million
- Between \$50 million and \$100 million
- Between \$1 million and \$50 million
- Less than \$1 million



INV35

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Credit Enhancement Commitments as of June 30, 2010 - \$1.3 Billion



INV36

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CalSTRS Real Estate Portfolio in California as of June 30, 2010 - \$5.9 Billion

Real Estate Portfolio

- More than \$1 billion
- Between \$500 million and \$1 billion
- Between \$100 million and \$500 million
- Between \$50 million and \$100 million
- Between \$10 million and \$50 million
- Less than \$10 million



Note: Investments through real estate funds are not reflected on this map.

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