

2020-21 and 2021-22 Biennial Budget

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

Our Mission: Securing the financial future and
sustaining the trust of California's educators.



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The California State Teachers' Retirement System

Mission

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

Vision

Your reward—
A secure retirement

Our reward—
Getting you there

Core Values

The CalSTRS Core Values are a set of attitudes, beliefs and behaviors that define CalSTRS and our employees. These guiding principles are fundamental to our success and drive the work we do and how we serve our members.

Customer Service

We never compromise on quality as we strive to meet or exceed the expectations of our customers.

Accountability

We operate with transparency and accept responsibility for our actions.

Leadership

We model best practices in our industry and innovate to achieve higher standards.

Strength

We ensure the strength of our system by embracing a diversity of ideas and people.

Trust

We conduct ourselves with integrity, acting ethically in every endeavor.

Respect

We respect the needs of our members, co-workers, and others—treating everyone with fairness, honesty and courtesy.

Stewardship

We recognize our fiduciary responsibility as the foundation for all decision making.



Watch this video from Chief Financial Officer Julie Underwood regarding our biennial budget.

April 13, 2021

Chief financial officer's letter of transmittal

As trusted financial stewards of the California State Teachers' Retirement System, understanding and adapting to the changing economic environment is imperative to the success of our mission: *Securing the financial future and sustaining the trust of California's educators.*

The global COVID-19 pandemic has presented significant challenges to people and organizations around the globe, and the impact to our retirement system is no exception. As a financial services organization, this is not the first time in our over 100-year history that we have experienced times of economic volatility and disruption. We've weathered turmoil before and have recovered—as a stronger, more resilient organization.

During these unprecedented times, as part of California's response to mitigate the fiscal impact of the pandemic on the state's economy, our budget has undergone several mandatory reductions, affecting fiscal years 2020–21 and 2021–22. These fiscal challenges do not impact our strategic priorities, as we remain dedicated to our long-term vision to sustain the financial integrity of the fund for the benefit of our members. Consistent with these objectives, our 2020–21 and 2021–22 Biennial Budget provides for resources to be allocated throughout the organization to enhance our essential business functions and activities. Our total 2020–21 budget is \$621.8 million, including 1,202 authorized positions, and our 2021–22 budget is \$600.0 million, including 1,232 authorized positions. Our biennial budget largely focuses on transforming business and service delivery through technology optimization and addresses ongoing efforts to increase the level of internally managed assets and manage overall growth of our investment portfolio.

Transitioning to modern technology solutions is essential for delivering quality services to our members and employers. Therefore, the most significant addition to our 2020–21 budget is one-time funding of \$53 million for the Pension Solution Project, which supports our multiyear efforts to replace the legacy pension administration system with 21st-century functionality. The new system will increase our ability to respond to customer and business needs; gain long-term operational efficiencies; improve internal controls; and enhance services for more than 975,000 members and their beneficiaries, the school employer community and CalSTRS staff.

CalSTRS Investment Beliefs provide a foundational framework for CalSTRS staff to invest in a manner consistent with our vision to accomplish our fiduciary goal. The CalSTRS Collaborative Model helps us execute these beliefs. It's a long-term investment strategy to manage more assets internally—to reduce costs, control risks and increase expected returns—and leverage our external partnerships to achieve similar benefits. Aligned with these longer-term objectives, the 2021–22 budget includes \$40.9 million and 109 authorized positions, deployed over a five-year period, to support the growth of the Collaborative Model. The anticipated long-term cost savings and increased returns will far outweigh this resource request, which is in alignment with the state's mandate to mitigate costs.

As we continue to navigate through the current environment, we remain cognizant of the immediate and longer-term financial implications of the evolving global economic environment, and the impacts to our organization in the upcoming fiscal year and beyond. As trusted fiduciaries, we will continue to diligently monitor impacts to our members, investment portfolio and business operations. Our budget is prepared to adapt to short-term volatility, and we do not foresee any changes to the organization's longer-term strategic priorities that are currently underway as a result of recent economic events.

I am optimistic—as we prepare for, respond to and embrace change—that together we will emerge a stronger organization through discipline, perseverance and agility, ensuring the long-term strength and viability of our retirement system.

Respectfully submitted,



Julie Underwood
Chief Financial Officer
CalSTRS



The Government Finance Officers Association
of the United States and Canada

presents this

CERTIFICATE OF RECOGNITION FOR BUDGET PREPARATION

to

CALSTRS

California State Teachers' Retirement System, California



The Certificate of Recognition for Budget Preparation is presented by the Government Finance Officers Association to those individuals who have been instrumental in their government unit achieving a Distinguished Budget Presentation Award. The Distinguished Budget Presentation Award, which is the highest award in governmental budgeting, is presented to those government units whose budgets are judged to adhere to program standards.

Executive Director

Christopher P. Morill

Date **October 15, 2019**

The Government Finance Officers Association of the United States and Canada presented a Distinguished Budget Presentation Award to the California State Teachers' Retirement System for our fiscal year 2019–20 Annual Budget presentation. This is the second consecutive year we have received this prestigious award.

To receive this award, a governmental unit must publish a budget document that meets program criteria as a policy document, operations guide, financial plan and communications device. This award is valid only for fiscal year 2019–20. We believe our 2020–21 and 2021–22 Biennial Budget continues to meet these program requirements and are submitting it to the GFOA to determine its eligibility for another award.

About the California State Teachers' Retirement System

CalSTRS overview¹

The California State Teachers' Retirement System was established in 1913 to provide retirement benefits to California's public-school educators. CalSTRS administers a hybrid retirement system, consisting of traditional defined benefit, cash balance and defined contribution plans, and provides disability and survivor benefits for California full-time and part-time public school educators from prekindergarten through community college and certain other employees of the public school system. We also administer a post-employment health benefit program and a voluntary defined contribution plan.

As a global institutional investor with \$246.0 billion in investment portfolio assets as of June 30, 2020, CalSTRS is the largest educator-only pension fund in the world and the second largest pension fund in the United States. Headquartered in West Sacramento, California,

CalSTRS serves California's more than 975,000 dedicated educators and their beneficiaries, employed by 1,788 school districts, community college districts, county offices of education and other public education employers.

With eight member service centers and 34 satellite offices across California, CalSTRS provides a breadth of retirement and benefits planning services and education to our members.

CalSTRS is governed by the 12-member Teachers' Retirement Board. The board members carry fiduciary responsibility to ensure the system is sustainable over the long term in order to pay benefits and provide related services to CalSTRS members and their beneficiaries. Additional details related to the CalSTRS organization are provided in Appendix 1.

¹ All numbers in this report are rounded for presentation purposes.

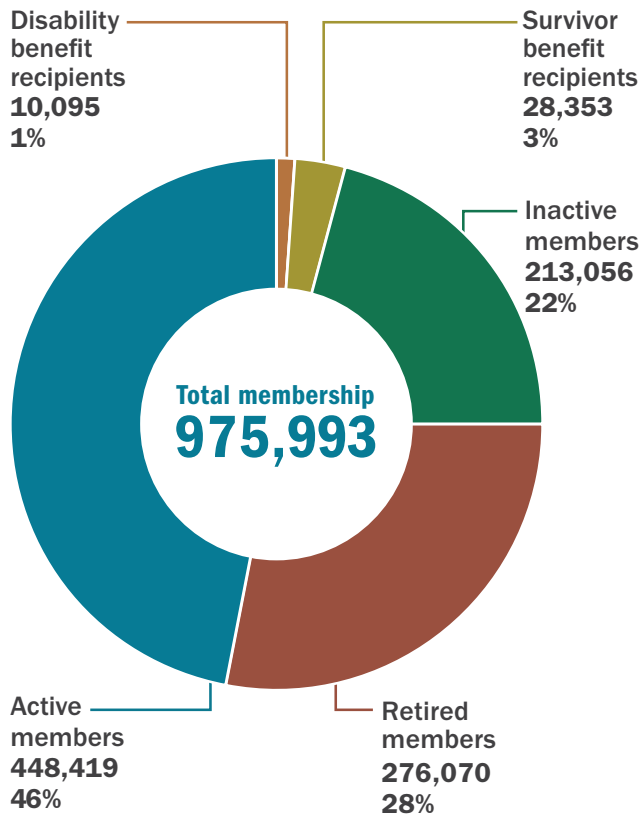
Our history

CalSTRS has been securing the financial future of California's educators for over a century. From our humble beginnings in 1913, with only 120 retired and 15,000 active members, CalSTRS now serves more than 975,000 public school educators and their beneficiaries.

- 1913** Public School Teachers' Retirement Salary Fund is established on July 1, 1913, with 120 retired members and 15,000 active members. Annual member pension is \$500.
- 1935** School districts begin contributing to CalSTRS for the first time.
- 1944** CalSTRS vesting changes from 30 years to 10 years.
- 1956** Benefits calculated based on a fixed percentage of final compensation, rather than a fixed value.
- 1958** Vesting is reduced from 10 years to its present 5-year minimum.
- 1963** First tax-sheltered annuity program is established.
- 1970** CalSTRS begins investing in real estate and equity investments.
- 1987** Internal management of the portfolio commences.
- 1991** CalSTRS begins global diversification of the portfolio.
- 2004** CalSTRS is the second-largest defined benefit pension plan in the U.S.
- 2007** Portfolio posts a 21% return, which places CalSTRS in the top 1% of all U.S. pension plans at \$175 billion.
- 2009** CalSTRS moves to its current headquarters location, which included the opening of its first California member service center, in West Sacramento.
- 2013** CalSTRS celebrates 100 years.
- 2019** CalSTRS announces the opening of its seventh and eighth California member service centers in Redding and Fresno, respectively, and commences construction of its headquarters expansion in West Sacramento.
- 2020** CalSTRS embarks on a low-carbon economy transition work plan that seeks to reduce climate-related risk and identify opportunities to invest in climate-related solutions for maximum benefit to our members.

Services to members and employers

2020 membership by the numbers



CalSTRS' vision is to ensure that our members understand their retirement benefits and make informed decisions to secure their financial futures. Consistent with the **2019-22 Strategic Plan**, CalSTRS is committed to providing exceptional service to our members and their employers. Resources are strategically allocated throughout the organization to advance CalSTRS' ability to deliver promised retirement benefits to our members.

Member service centers¹

CalSTRS operates eight member service centers throughout California, with locations in West Sacramento (headquarters), Fresno, Glendale, Irvine, Redding, Riverside, San Diego and Santa Clara. As part of advancing the organization's ability to deliver promised retirement benefits, member service centers offer financial and retirement education through webinars, workshops, benefits planning sessions, outreach and telephone and in-office assistance. Every year, tens of thousands of members take advantage of these services, as well as the opportunity to walk into our member service centers and receive personal assistance related to their retirement benefits. Members may contact a CalSTRS Contact Center agent by phone, secure online message or written correspondence. We place great emphasis on customer satisfaction and regularly survey members to ensure they receive accurate, timely and thorough answers to their questions. Seventy-six percent of members were "highly satisfied" with their Contact Center experience. We also conduct outreach through job fairs and on-campus presentations.



Watch this video tour of the San Diego Member Service Center to learn about the services offered.

¹ Although CalSTRS offices are generally open Monday through Friday, 8 a.m. to 5 p.m., office hours and services may be limited due to the COVID-19 pandemic. Please refer to our **COVID-19 resources** for current updates on how to access CalSTRS services.

Member outreach and communication

We communicate with our active and retired members through a variety of channels, including four websites—CalSTRS.com, myCalSTRS, Pension2.com and 403bCompare.com—to support member interactions and active involvement in retirement planning. In addition, we provide a balanced mix of feature-oriented,

informative and industry-focused messaging across social media platforms. By regularly posting informative content, we encourage member and stakeholder engagement on Facebook, Twitter, LinkedIn, Instagram, YouTube and Pinterest.

Connecting with members to engage and inform in 2019–20



Growth on social media platforms 2019-20



↑ **13%**
+4,409 new Facebook likes



↑ **14%**
+1,358 new Twitter followers



↑ **37%**
+1,795 new LinkedIn followers



↑ **26%**
+504 new Instagram followers

Our continued goal is to remain agile in delivering services and enhancing member education and outreach efforts. Staff conducts intensive research to understand our members' satisfaction and retirement preparedness, which helps us provide members with useful products and services. We monitor member satisfaction by regularly surveying stakeholders to ensure they receive accurate, timely and thorough answers to their questions. These surveys allow us to monitor overall trends in our programs that help us meet our members' needs.

Service to members does not stop at customer contact. We continue to address the full spectrum of retirement security by providing financial awareness and retirement planning tools, as we aim to empower our members as they embark on a well-thought-out plan and identify steps they can take to meet their future income needs. Additional details related to membership statistics are provided in Appendix 1.



Institutional investing

Investment overview

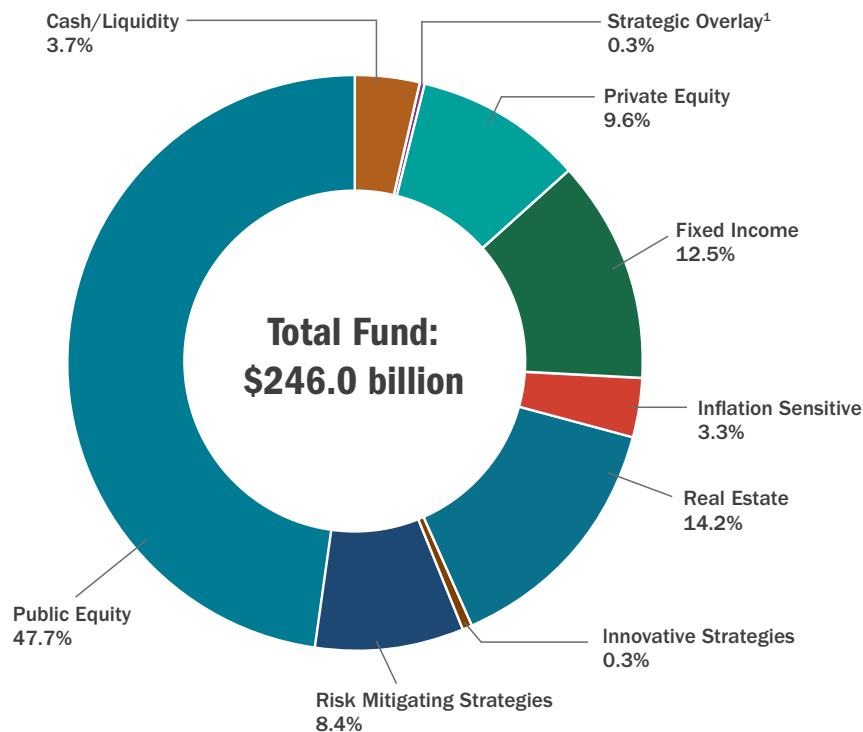
CalSTRS is a long-term investor, and ultimately, our goal is to generate returns enough to meet the plan’s liabilities for the benefit of our members and their beneficiaries. We honor this responsibility with diligence and integrity. Consistent with this vision, and as the trusted fiduciaries of the system, we must derive the most value from the investments we make to deliver promised retirement benefits.

As a global institutional investor, we take steps to balance risk with opportunity to preserve the integrity and strength of the fund. Managing an investment portfolio, with assets in excess of \$246.0 billion as of June 30, 2020, requires thoughtful diligence to monitor investment performance, analyze projections and take necessary action to ensure a stable, risk-adjusted

return profile. Our primary performance objective is to achieve the actuarially assumed rate of return of 7.0% over the long term, at a prudent level of risk, while upholding our investment philosophy in long-term patient capital, which is to buy long-term net cash flows and capital gain potential at a reasonable price.

The CalSTRS Investment Portfolio continues to be broadly diversified, holding investments ranging from publicly traded securities to privately held partnerships, spanning across both domestic and international markets. The investment portfolio follows a strategic asset allocation policy, set by the Teachers’ Retirement Board, that targets the percentage of funds invested in each asset class. The key goal of the asset allocation process is to develop an asset allocation policy that maximizes the likelihood that an investment portfolio’s assets will, overtime, fund plan benefits. Our investment portfolio allocation for the fiscal year ended June 30, 2020, is provided in the following chart.

CalSTRS asset allocation as of June 30, 2020



1. Strategic Overlay consists of the Currency Management Program and Derivative Overlay.

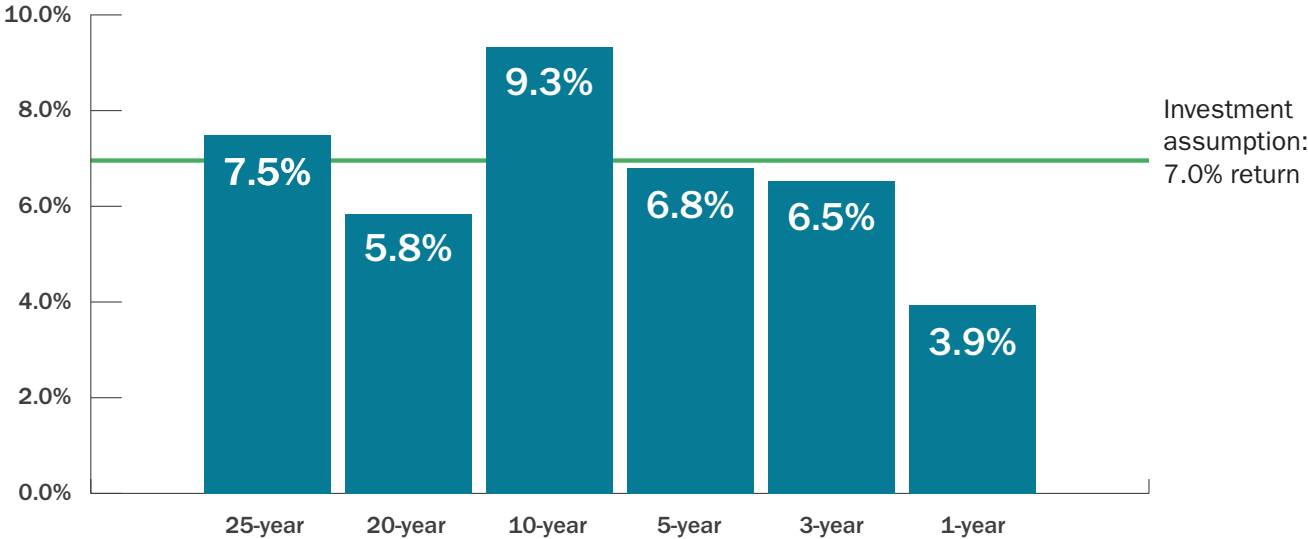
Investment performance

CalSTRS Investment Portfolio generated a 3.9% return net of fees, under the 7.0% assumed actuarial rate of return, for the fiscal year ended June 30, 2020. The portfolio increased by \$9.1 billion over the prior fiscal year and recorded its highest-ever fund value at \$246.0 billion.

CalSTRS is a long-term investor with a goal of achieving an average return of 7.0% over a

multiyear horizon to meet pension obligations for current and future retirees. Therefore, we look beyond the immediate effects of a single year's returns. The 10-year and 25-year fund performance are both above the actuarial 7.0% investment return assumption, at 9.3% and 7.5%, respectively.

CalSTRS net time-weighted returns as of June 30, 2020



Transforming business strategies through the CalSTRS Collaborative Model

In alignment with our longer-term strategic initiatives and consistent with the first goal of CalSTRS' strategic plan—to ensure a well-governed, financially sound trust fund—the organization is engaging in the continued expansion of the CalSTRS Collaborative Model. It is an investment strategy encompassing all asset classes to manage more assets internally.

The CalSTRS Collaborative Model is an internally led approach to how CalSTRS engages in the investment marketplace. We embrace partnership and collaboration with world-class investment

institutions, along with building in-house investing capabilities to maximize the benefits of internally managed assets. We have developed a strong track record of reducing costs, increasing investment returns, controlling portfolio risk and expanding investment opportunities—all for the benefit of California educators and their beneficiaries.

It is anticipated that these cost savings will be even greater as more private assets are transitioned to internal management. We have a significant opportunity to optimize costs, control risks and increase investment returns as we continue to manage and grow the portfolio of assets managed internally. Additional information on the Collaborative Model is provided in the “Budget overview” section.

CalSTRS Collaborative Model

The CalSTRS Collaborative Model is an investment strategy to manage more assets internally—to reduce costs, control risks and increase expected returns—and leverage our external partnerships to achieve similar benefits.



Reduce costs



Control portfolio risks



Increase expected returns

The CalSTRS Investment Portfolio applies this model across all asset classes with varying methods due to the distinct market forces, regulatory environments, and competitive advantages and challenges affecting each of them.



Watch this Inside CalSTRS Investments video in which CalSTRS' Chief Investment Officer Christopher J. Ailman describes a new approach to our investment strategy: The Collaborative Model.

Organizational governance and leadership structure

Teachers' Retirement Board

CalSTRS is administered by the 12-member Teachers' Retirement Board. The board sets the policies and rules for the system and is responsible for ensuring benefits are paid. Consistent with Article 16, Section 17 of the California Constitution, the board maintains plenary authority and fiduciary responsibility for the investment of monies and administration of the system.

The board is composed of 12 members:

- Five members appointed by the Governor and confirmed by the Senate for a term of four years: one school board representative, one retired CalSTRS member and three public representatives.
- Four ex officio members who serve for the duration of their term in office: the California Director of Finance (who is appointed by the Governor and confirmed by the Senate), the California State Controller, the California State Treasurer and the State Superintendent of Public Instruction.
- Three member-elected positions representing current educators who serve for a term of four years.

The board has six standing committees: Appeals, Audits and Risk Management, Benefits and Services, Board Governance, Compensation and Investment. The board appoints a chief executive officer to administer the system consistent with the board's policies and rules. The board also selects a chief investment officer to direct investments of the portfolio in accordance with board policy.

| Committee | Purpose |
|-----------------------------------|---|
| Appeals | The Appeals Committee provides a dedicated body to hear, deliberate upon and decide appeals of CalSTRS determinations pursuant to the Administrative Procedure Act. |
| Audits and Risk Management | The Audits and Risk Management Committee assists the board in fulfilling its fiduciary oversight responsibilities for financial reporting, risk management, internal control, compliance, internal audit, external audit of the financial statements and engagements with other external firms. |
| Benefits and Services | The Benefits and Services Committee develops and oversees the execution of prudent policies relating to levels of benefits and the delivery of services to CalSTRS members, retirees and beneficiaries. |
| Board Governance | The Board Governance Committee supports the board in promoting the best interests of CalSTRS, its members, retirees and beneficiaries through the implementation of sound board governance policies and practices that enhance good, fair and open decision-making. |
| Compensation | The Compensation Committee provides oversight to CalSTRS' compensation policies and plan that support the successful recruitment, development and retention of talent to meet the business objectives of CalSTRS. |
| Investment | The Investment Committee administers all matters relating to the investment of assets and investment management. The committee is charged with administering assets for the exclusive purpose of providing benefits to members and their beneficiaries and maximizing the financial stability of CalSTRS in an efficient and cost-effective manner. |

Teachers' Retirement Board¹



HARRY M. KEILEY
Board Chair
K-12 Classroom Teacher
Term: January 1, 2020 –
December 31, 2023



SHARON HENDRICKS
Board Vice Chair
Community College Instructor
Term: January 1, 2020 –
December 31, 2023



KEELY BOSLER
Director of Finance
Ex Officio Member



DENISE BRADFORD
K-12 Classroom Teacher
Term: January 1, 2020 –
December 31, 2023



JOY HIGA
Public Representative
Term: January 19, 2018 –
December 31, 2021



FIONA MA
State Treasurer
Ex Officio Member



WILLIAM PREZANT
Public Representative
Term: March 26, 2019 –
December 31, 2022



TONY THURMOND
Superintendent of Public
Instruction
Ex Officio Member



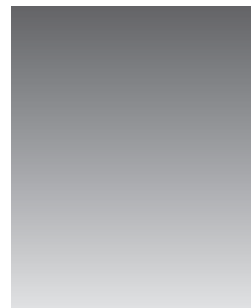
JENNIFER URDAN
Public Representative
Term: August 12, 2020 –
December 31, 2023



KAREN YAMAMOTO
Retiree Representative
Term: February 13, 2020 –
December 31, 2023



BETTY YEE
State Controller
Ex Officio Member



VACANT
School Board
Representative

¹ Board members are listed as of the date this report is issued.

Executive staff¹

Executive



JACK EHNES
Chief Executive Officer

CalSTRS executive staff is committed to implementing the direction set by the Teachers' Retirement Board and is responsible for day-to-day operations of the system.

Investments



CHRISTOPHER J. AILMAN
Chief Investment Officer



CASSANDRA LICHNOCK
Chief Operating Officer

Financial Services



JULIE UNDERWOOD
Chief Financial Officer

General Counsel



BRIAN J. BARTOW
General Counsel

Administrative Services



LISA BLATNICK
Chief of Administrative Services

Benefits and Services



WILLIAM PEREZ
Chief Benefits Officer

Public Affairs



TERESA SCHILLING
Chief Public Affairs Officer

Technology Services



ASHISH JAIN
Chief Technology Officer

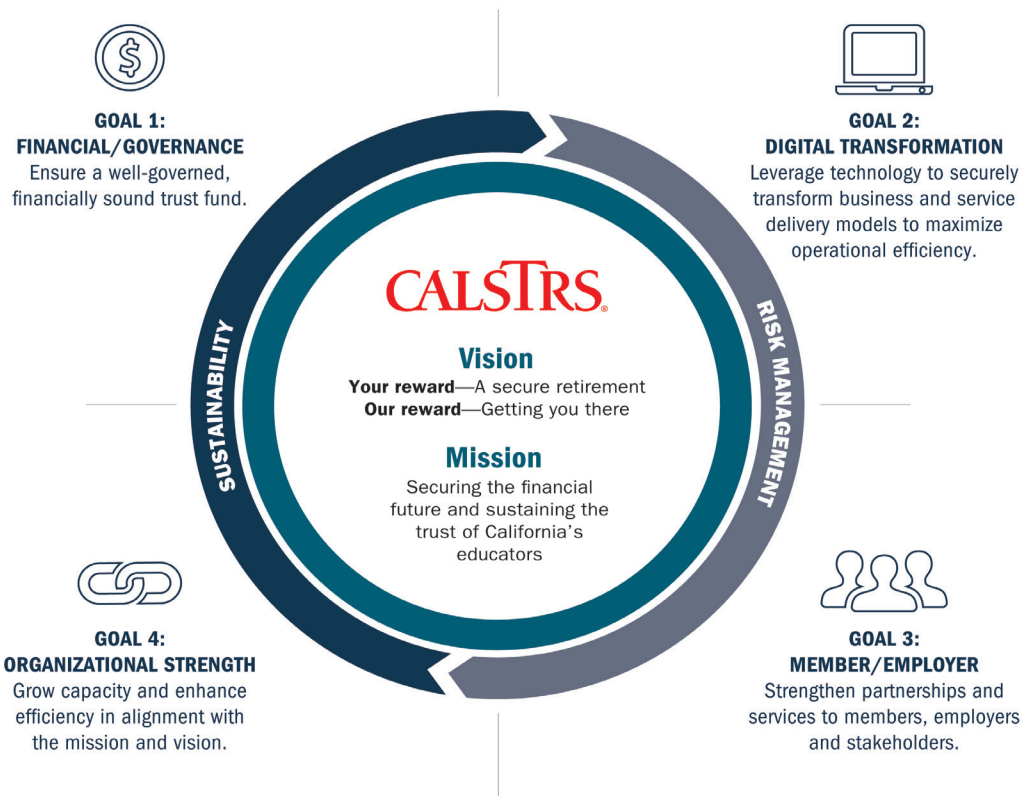
¹ Executive staff are listed as of the date this report is issued.

Strategic plan and performance measurement

2019–22 Strategic Plan

The 2019–22 Strategic Plan lays out a set of Teachers’ Retirement Board-approved goals and measurable objectives that demonstrate how our mission and vision will be advanced over the next three years. Our plan was informed by employee survey feedback, interviews and facilitated conversations with CalSTRS leadership and the board. We are proud of the discovery and wide-ranging work completed in the development of this new plan that fuels our forward momentum and guides our future direction.

This three-year plan established four overarching goals and supporting objectives to guide our collective direction and measures to evaluate our success. The strategic plan closely integrates the organization’s strategic initiatives to long-term financial management. The four goals of the strategic plan are at the heart of CalSTRS’ operations. The supporting objectives for each goal are tactically operationalized in annual business plans with initiatives and key activities.



Goal 1: Financial/Governance

Ensure a well-governed, financially sound trust fund.

CalSTRS' primary goal is to ensure a financially sound retirement system. Our steady focus on executing CalSTRS Funding Plan pursuant to **Assembly Bill 1469 (Chapter 47, Statutes of 2014)** is one aspect of ensuring a sound trust fund. Our investment and governance practices as a board and staff contribute significantly.

Objective A

Achieve full funding of the Defined Benefit Program by June 30, 2046.

Objective B

Integrate CalSTRS' sustainable investment and stewardship strategies, which support long-term value creation and educate and inform interested parties.

Objective C

Leverage investment cost information to yield long-term benefits.

Objective D

Implement CalSTRS Collaborative Model leveraging all of CalSTRS resources.

Objective E

Enhance board meeting effectiveness and efficiency.

Goal 2: Digital Transformation

Leverage technology to securely transform business and service delivery models to maximize operational efficiency.

Over the next three years, staff and budgetary resources are specifically assigned to replace the legacy pension administration system with contemporary 21st century functionality. As this major project is underway, we must explore new approaches, adapt our business models and be aware of changing technology solutions.

Objective A

Implement and integrate a highly adaptive pension administration system.

Objective B

Secure the confidentiality and integrity of data and member information.

Objective C

Enhance business resiliency capabilities.

Objective D

Explore advanced technology to securely gain business agility and enhance user experience.

Goal 3: Member/Employer

Strengthen partnerships and services to members, employers and stakeholders.

CalSTRS is committed to strengthening partnerships with employers and members who have a stake in our continued vitality. We seek to engage employers in recognizing the value of the defined benefit pension. We work with them to onboard new employees and to provide timely, accurate and complete data employees can use to make informed decisions. We will communicate with our members, with whom we have relationships that long outlast their working years, the long-term value of a defined benefit—an insurance investment in their financial future.

Objective A

Educate and inform CalSTRS constituent groups on strategic priorities.

Objective B

Enhance collaborative partnerships with employers to increase alignment on key initiatives and increase awareness about the value of the CalSTRS defined benefit plan.

Objective C

Increase the accuracy, completeness and timeliness of employer reporting.

Objective D

Provide educational opportunities to improve the retirement readiness of CalSTRS' members.

Objective E

Grow Pension2 participation.

Goal 4: Organizational Strength

Grow capacity and enhance efficiency in alignment with the mission and vision.

Our operational advantage lies in the competency of the Teachers' Retirement Board and CalSTRS staff to deepen capacity to wrestle with complex issues and to adapt to shifting landscapes. We actively seek opportunities to streamline processes, break down silos, avoid waste of talent and time, and operate efficiently.

Objective A

Develop board and staff competencies to respond to changing business environments.

Objective B

Improve business processes and reduce costs.

Objective C

Drive adoption of transforming business processes and technology.

Objective D

Hire, develop and retain staff to meet the needs of our changing business models and growth expectations.

CalSTRS business plan

CalSTRS creates a business plan each fiscal year to sharpen organizational focus and commit resources to the most critical priorities. This plan includes initiatives and key activities designed to advance the goals and objectives of the strategic plan.

The business plan provides essential information about the current fiscal year, including key priorities and objectives. The budget allocates resources according to both longer-term strategic and shorter-term business plan priorities. The priorities of the 2020–21 and 2021–22 Business Plan will continue to adhere to the strategic goals, with a planned focus on managing investment costs, developing technology as a catalyst for improving services to members and employers while protecting critical information from cyber threats, enhancing our member experience and engaging in opportunities to further strengthen the organization in alignment with our mission and vision.

Performance measurement

Performance reporting

Performance data is collected to determine CalSTRS' success in meeting our established targets. This data is reported and reviewed in different forums throughout the year. These forums foster collaborative dialogue and drive organizational performance and decision making. The four key performance review meetings held at CalSTRS are:

Branch business reviews

In these meetings, directors report on a range of performance measures to executives.

Customer service performance reviews

In these meetings, directors who provide direct services to members and stakeholders present results of achievements, service level agreements and overall performance objectives to executives.

Operations performance reviews

Operations reviews require directors of CalSTRS' internal operations to report to executives on the status of key performance indicators for major service responsibilities. In addition, this forum informs and assists the organization in fulfilling its oversight and fiduciary responsibilities in the achievement of the organization's strategic and operational objectives.

Quarterly performance reviews

Executives and directors report to CalSTRS leadership on organizational performance-related matters, and management shares information on division performance in the prior quarter and provide guidance for action in future quarters.

Accomplishments report

At the end of each fiscal year, progress on business plan initiatives and strategic plan measures is reported and evaluated through an accomplishments report to the Teachers' Retirement Board. This annual report assesses the organization's progress in achieving measurable objectives established by the board in the strategic plan and evaluates the continuance of initiatives identified in the business plan. In alignment with our mission, vision and strategy, status of noteworthy accomplishments in 2019–20 for the 2019–22 Strategic Plan are presented on the following pages.

CalSTRS 2019–20 Strategic Plan significant accomplishments

Goal 1 — Financial: Ensure a financially sound retirement system.

Objective A: Achieve full funding of the Defined Benefit Program by June 30, 2046.

- Concluded the Asset Liability Study reflecting a new asset allocation mix that was adopted by the board in November 2019.
- Presented the actuarial valuation for the Defined Benefit Program to the board in May 2020. The valuation provides a snapshot in time of the system's financial health and is part of the ongoing effort to monitor and assess the system's ability to meet its long-term commitments.

Objective B: Integrate CalSTRS' sustainable investment and stewardship strategies, which support long-term value creation and educate and inform interested parties.

- Implemented a more proactive messaging strategy. Staff provide timely updates that highlight CalSTRS' low-carbon transition activities and how we incorporate risk and opportunities within the investment management process.
- Created a low-carbon transition webpage and divestment perspectives landing page.

Objective C: Leverage investment cost information to yield long-term benefits.

- Presented the 2018 Annual Investment Cost Report that included newly enhanced graphs, tables and trend analysis data over a four-year period for each asset class and investment strategy to lay the groundwork and aid the discussion for the CalSTRS Collaborative Model.
- Coordinated preparations to expand the Annual Investment Cost Report to include five years of trend data and additional decomposition of investment costs.

Objective D: Implement CalSTRS Collaborative Model leveraging all of CalSTRS resources.

- Established the Pillars Project, which seeks to support the CalSTRS Collaborative Model in enabling CalSTRS to evolve from a best-in-class organization to a world-leading pension fund that captures the best investment opportunities globally.

Objective E: Enhance board meeting effectiveness and efficiency.

- Introduced a CalSTRS Stewardship Priorities Materiality Framework and Flowchart to guide board discussion on engagement priorities related to Environmental, Social and Governance issues in investments.

Goal 2 — Member/Employer: Enhance services to members and employers.

Objective A: Implement and integrate a highly adaptive pension administration system.

- Launched the Employer Support Portal successfully on CalSTRS.com.
- Conducted Soft Launch kickoff webinars with 100% of vendors and employers that required system changes.

Objective B: Secure the confidentiality and integrity of data and member information.

- Implemented a cloud-based internet gateway, which is a security solution that protects businesses by blocking online viruses and filtering dangerous websites.

Objective C: Enhance business resiliency capabilities.

- Engaged in acquiring multimodal data center services to improve the security, recoverability, availability, reliability and scalability of CalSTRS' systems and databases—enhancing business resiliency capabilities overall.

Objective D: Explore advanced technology to securely gain business agility and enhance user experience.

- Completed the Microsoft Windows 10 upgrade and personal computer refresh. These changes contributed to the ability of CalSTRS to swiftly transition staff to a work-from-home solution.
- Completed multifactor authentication for the myRemoteOffice solution. Requiring a multifactor authentication process for all remote user connectivity ensures that only authorized individuals can access CalSTRS' systems.

Goal 3 — Business Transformation: Drive operational excellence.

Objective A: Educate and inform CalSTRS constituent groups on strategic priorities.

- Engaged in communication and outreach plans that focus on major organizational initiatives and issues. The focus of fourth quarter communications to members, employers and stakeholders was centered around COVID-19 with messages of reassurance and confidence that the fund remains healthy, monthly benefits continue without delay, and member services successfully shifted to online webinars and workshops.

Objective B: Enhance collaborative partnerships with employers to increase alignment on key initiatives and increase awareness about the value of CalSTRS' defined benefit plan.

- Formulated new communications, including a COVID-19 landing page on CalSTRS.com, to keep employers informed on recent updates.

Objective C: Increase the accuracy, completeness and timeliness of employer reporting.

- Reached out to employers to reduce the risk of late employer reporting of member data. This effort supports maintaining contact to closely monitor employer contributions and delayed reporting during the COVID-19 pandemic.

Objective D: Provide educational opportunities to improve the retirement readiness of CalSTRS' members.

- Transitioned to online interactions and telephone benefits planning sessions to successfully provide member service while adhering to COVID-19 restrictions. In May 2020, staff successfully transitioned from offering in-person workshops to online webinars. More than 3,200 attendees participated in 75 webinars held in May and June 2020.

Objective E: Grow Pension2 participation.

- Adapted the “Start Saving Now with Pension2” and Financial Awareness Series workshops to webinar format due to COVID-19. Hybrid benefit specialists host webinars weekly for members.

Goal 4 — Workforce Transformation: Grow an engaged, highly skilled and diverse workforce.

Objective A: Develop board and staff competencies to respond to changing business environments.

- Converted multiple instructor-led trainings into virtual and computer-based trainings. Successfully procured additional LinkedIn Learning licenses to accommodate the increased demand of staff working and learning in a mobile environment.

Objective B: Improve business processes and reduce costs.

- Implemented the DocuSign project to make online submission easier for members. DocuSign was added to our current online system to assist members and their spouses or registered domestic partners who want to submit the following forms online: Service Retirement Application, Refund Application, Preretirement Election of an Option form and Recipient Designation form.

Objective C: Drive adoption of transforming business processes and technology.

- Developed and launched the Employer Support Portal for all employers. The portal contains FAQ, job aids, error resolution guides, file specification documents and links to the Employer Readiness Environment and the Pension Administration Learning Management System.

Objective D: Hire, develop and retain staff to meet the needs of our changing business models and growth expectations.

- Commenced foundation construction of the HQE Project in November 2019 and maintained HQE construction schedule as planned through 2019–20 with no on-site delays due to COVID-19.

Long-range financial planning

Integrated financial management

CalSTRS' primary goal is to maintain a well-governed, financially sound retirement system, which represents the cornerstone of our long-term financial planning. CalSTRS' long-range financial plan evaluates the system's overall funded status, considering impacts to total revenues and expenditures relative to legislative, economic and demographic change. The long-term financial planning process assesses current funding levels to determine whether member, employer and state contribution rates are sufficient to meet the current and future obligations of the Defined Benefit Program. The key objective is to ensure long-term sustainability of the system to pay benefits to CalSTRS members and their beneficiaries.

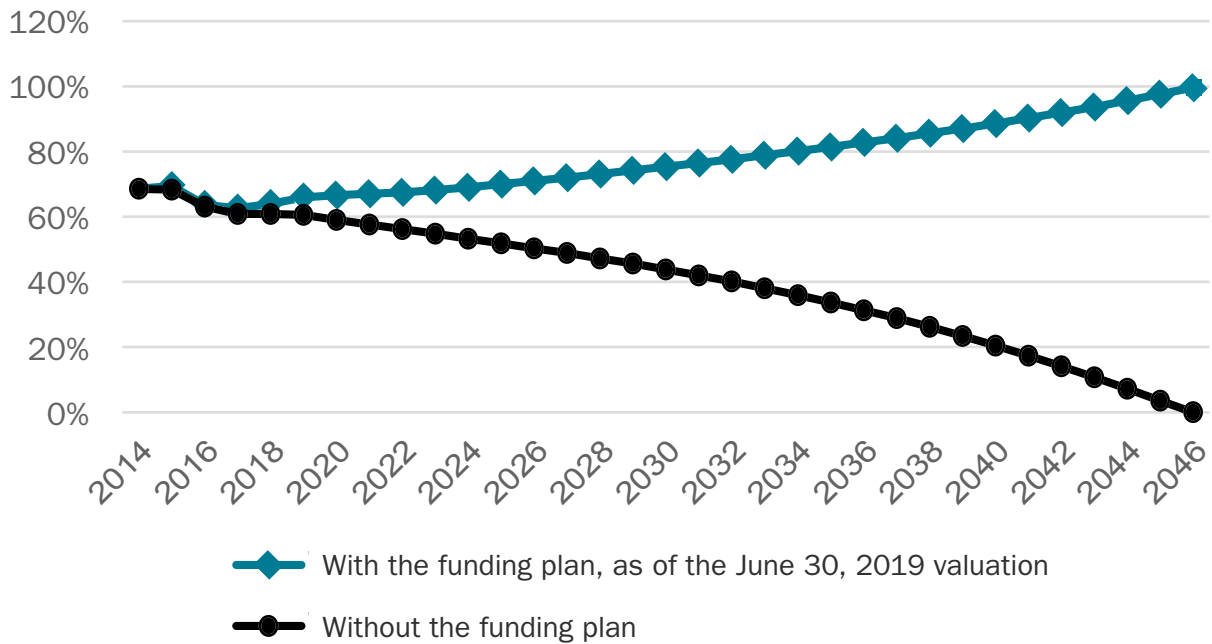
Path to full funding

Prior to the passage of the CalSTRS Funding Plan, enacted as part of the fiscal year 2014–15 budget in AB 1469 (Chapter 47, Statutes of 2014), authored by Assemblymember Rob Bonta, actuarial projections indicated long-

term system revenues were insufficient to fund future retirement obligations and that, absent any changes to contribution rates, the CalSTRS Defined Benefit Program would run out of assets within 30 years. Consistent with CalSTRS' mission, the organization was committed to promoting the development of a comprehensive strategy to address the long-term funding needs of the system.

CalSTRS Funding Plan reflects a shared commitment by members, employers and the state to incrementally adjust contributions to CalSTRS in a predictable manner to fully fund the Defined Benefit Program and ensure the long-term sustainability of the fund. The contribution rates established in the funding plan at the time it was designed in 2014 were set with the goal of achieving full funding by 2046. The funding plan provides the Teachers' Retirement Board with limited authority to increase or decrease both the state and employer contribution rates to ensure the plan remains on track and can respond, as necessary, to unexpected changes in CalSTRS' economic and demographic situation. The following graph shows the projected funded status for the Defined Benefit Program before and after the enactment of the funding plan.

Historical and projected funded status



Key highlights¹

Addressing the existing unfunded liability continues to be at the forefront of our strategic plan, as the system continues to make progress toward reducing the funding shortfall. The current long-range financial plan is based on the June 30, 2019, actuarial valuation of the Defined Benefit Program. The unfunded liability decreased from \$107.2 billion as of June 30, 2018, to \$105.7 billion as of June 30, 2019, reflecting a decrease of approximately \$1.5 billion. Over this time period, the Defined Benefit Program’s funded ratio—the amount of assets on hand to pay for obligations—improved from 64% to approximately 66%. One of the main factors contributing to the improved funding levels since the 2018 valuation results was the supplemental payments made by the state that were approved as part of the Budget Act of 2019 (**AB 74, Chapter 23, Statutes of 2019**).

The CalSTRS Defined Benefit Program continues to mature, with the ratio of retirees to active members rising. This increases the system’s sensitivity to investment volatility, especially for the state contribution rate. The largest risk facing CalSTRS’ ability to reach full funding is risk from future investment returns falling short of the assumed rate of return. Other risks include decreases in the size of the active membership or lower-than-anticipated increases in future payroll.

Long-term projections assume the current actuarial rate of return of 7.0% for investment performance and additional contribution rate adjustments pursuant to the passage of the CalSTRS Funding Plan. Relative to these assumptions, the current long-range financial plan anticipates the system’s funding ratio to gradually increase over the next 27 years, achieving a nearly fully funded status of 99.9%, by 2046.

¹ These projections are based on the valuation data presented to the Teachers’ Retirement Board Item #8, **Actuarial Valuation of the Defined Benefit Program as of June 30, 2019**, in May 2020. These projections will change based on updated valuation data, which will be presented to the board in spring 2021.

Significant changes in the past year

The current long-range financial plan represents the actuarial valuation as of June 30, 2019, and therefore, it does not reflect the fiscal impacts of the global COVID-19 pandemic on the projected funded status. Significant changes since the June 30, 2019, valuation include investment returns that were lower than the assumed investment rate of return of 7.0% for the 2019–20 fiscal year and changes to employer and state contribution rates, as part of the Budget Act of 2020 (**AB 89, Chapter 7, Statutes of 2020**).

Investment markets have been impacted by the COVID-19 pandemic. CalSTRS reported a 3.9% investment rate of return for the 2019–20 fiscal year. The return was 3.1% lower than the assumed investment return of 7.0%. Although fluctuations in the annual investment return are normal and expected based on CalSTRS' target asset allocation, investment return fluctuations can have a significant impact on projected funding levels and contribution rates, especially the state contribution rate.

Pursuant to the Budget Act of 2020 and **AB 84, (Chapter 16, Statutes of 2020)**, the state approved the redirection of supplemental payments, previously intended to provide long-term rate relief, to instead provide employers with short-term rate relief. Specifically, approximately \$1.6 billion previously recognized in fiscal year 2018–19 to reduce employers' long-term liabilities was repurposed to assist school districts with contribution relief over the next two fiscal years. As a result, employer contribution rates will be reduced by 2.95% and 2.18% for fiscal years 2020–21 and 2021–22, respectively. Member rates are unaffected. In addition, the board's rate-setting authority for the state contribution rate was suspended for 2020–21. The state contribution rate will remain at the 2019–20 level of 10.328% through the 2020–21

fiscal year. To help mitigate the impact of these rate adjustments, and to ensure CalSTRS was made whole, the State of California made a supplemental payment of \$297 million pursuant to **Senate Bill 90 (Chapter 33, Statutes of 2019)** to CalSTRS in fiscal year 2020–21 to cover the shortfall created by suspending the board's rate-setting authority.

Combined, these changes will result in slower improvements in funding levels, in the short-term. Consequently, to ensure CalSTRS remains on its path toward full funding, contribution levels will need to be higher over the long term, than those estimated in the June 30, 2019, actuarial valuation.

While not expected to affect funding levels when compared to projected funding levels under the terms of the CalSTRS Funding Plan, the changes made to contribution rates through the Budget Act of 2020 have slightly weakened the funding plan over the long term by increasing the risk it may not be able to react adequately to a potential recession. Still, with the funding plan in place, CalSTRS is better positioned today than it was 10 years ago to be able to react and absorb the impact of a recession.

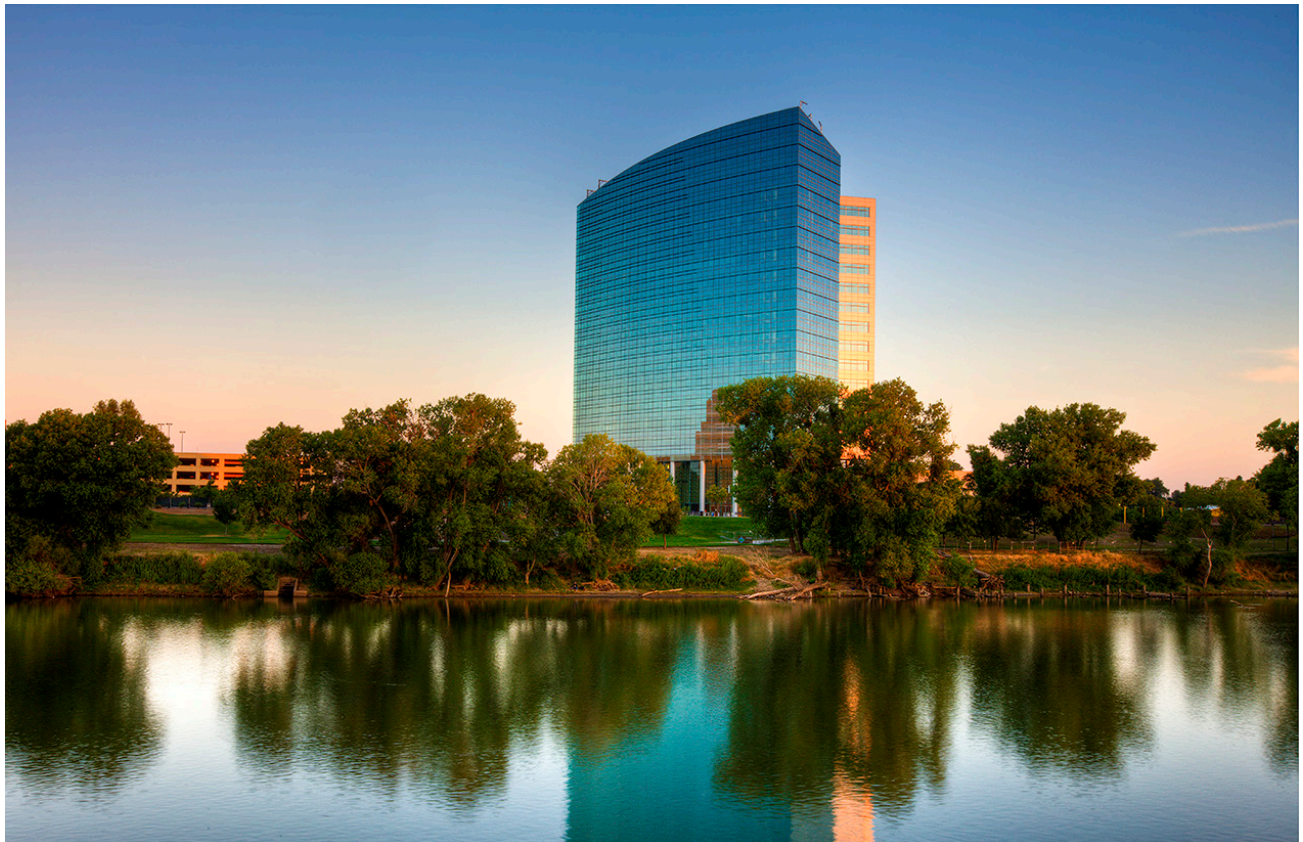
The next few years will be critical for the CalSTRS Funding Plan. The full impact of the COVID-19 pandemic on the economy, employment patterns and employers' budgets is still uncertain. The pandemic has the potential to affect investment performance, the number of teachers working in California and the longevity of CalSTRS members, the three main risks that CalSTRS has been monitoring for the last few years. We will continue to monitor the COVID-19 pandemic and how it may impact the funding of the system over the next few years, particularly how investment markets react under current recession scenarios. These impacts will be evaluated as part of the actuarial valuation as of June 30, 2020, which will be presented to the board in spring 2021.

Review of actuarial assumptions

In the 2019–20 fiscal year, CalSTRS completed a review of the actuarial assumptions used in preparing the actuarial valuation of the system. When performing actuarial valuations, actuaries rely on the use of various demographic and economic assumptions. It is important to monitor these assumptions to ensure they are reasonable, reflect the actual experience of the system and are appropriate for assessing funding levels and determining contribution levels needed to achieve full funding. CalSTRS has adopted a policy to perform a review of actuarial assumptions every four years. In January 2020, the Teachers' Retirement Board reviewed and adopted minor changes to certain demographic assumptions. The new assumptions were reflected in the June 30, 2019, actuarial valuations that was presented to the board

in May 2020. These changes did not have a material impact on the funded status nor the unfunded liability.

Even though actuarial assumptions are formally reviewed every four years, CalSTRS constantly monitors the appropriateness of the actuarial assumptions adopted by the board. If any events or changes warrant an adjustment to actuarial assumptions, the issue would be brought to the board for discussion, even if it meant such discussion would occur ahead of the normal four-year review cycle. Given the current economic downturn, it is unclear whether the COVID-19 pandemic will have long-term impacts on the actuarial assumptions. The COVID-19 pandemic could potentially affect long-term actuarial assumptions such as price inflation, wage growth, investment return and longevity.



Revenues

Contributions and investment income

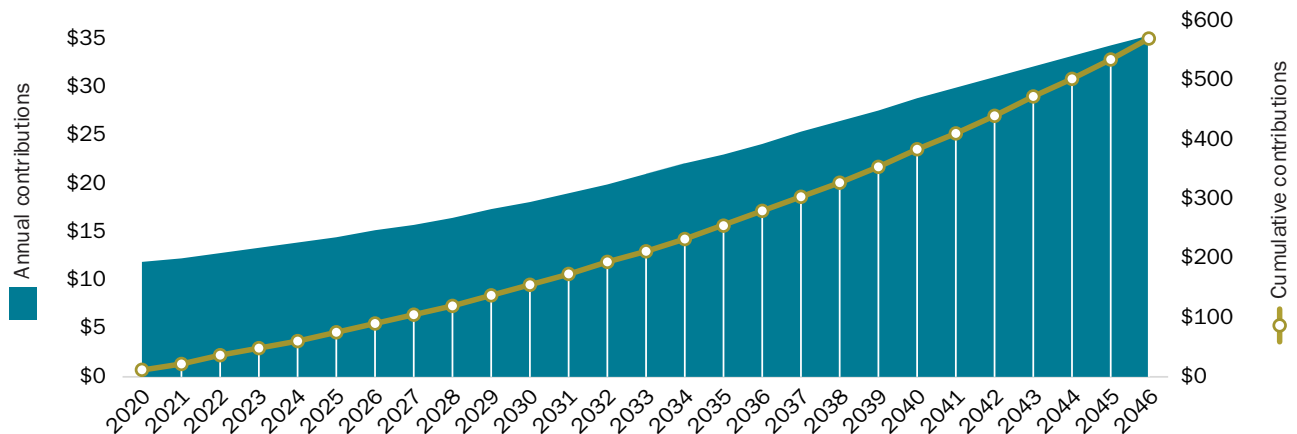
Primary revenue sources are member, employer and state contributions and investment income. Through 2046, we expect about 60% of future revenues will come from investment returns with the remainder coming from a combination of member, employer and state contributions. Contribution amounts are determined as a percentage of members' creditable compensation. Investment returns are dependent upon global market conditions. The current revenue estimates assume the fund will earn its assumed 7.0% actuarial rate of return each year into the future, the payroll will increase each year at a rate of 3.5% and that member, employer and

state contribution rates will change¹ pursuant to the funding plan.

The funding plan provides the board with limited authority to adjust the state's contribution rate by 0.5% from year to year. Current projections include the board-approved increase in the state's contribution rate of 0.5% effective July 1, 2019. To eliminate the state's share of the unfunded liability by 2046, additional increases in the state contribution rate of 0.5% were included through 2022–23.

As previously referenced, subsequent to the June 30, 2019, valuation, the board's rate-setting authority for the state contribution rate was suspended for fiscal year 2020–21. To ensure the state continues to make progress toward eliminating its share of CalSTRS' unfunded liability by 2046, the board is expected to approve a contribution rate increase of 0.5% of payroll for the state in spring 2021.

Projected contribution revenue
(dollars in billions)



1 Additional information regarding contribution rates is provided in Appendix 3.

State supplemental contributions¹

Over the last two years, the State of California made supplemental contributions to CalSTRS to provide both short- and long-term rate relief. On January 8, 2021, Governor Newsom released his proposed budget for California for fiscal year 2021–22. It contains a proposal to provide supplemental contributions to CalSTRS over the next few years. This is just a proposal and could likely be modified through the budget cycle. Future supplemental contributions would also be subject to funds being available in those years.

By proposing additional supplemental contributions for CalSTRS, the State of California is reiterating its commitment to keep the CalSTRS Funding Plan on track. If these supplemental contributions are provided to CalSTRS, they will help strengthen the funding plan and reduce the risk the funding plan may not be able to react adequately to a potential recession.

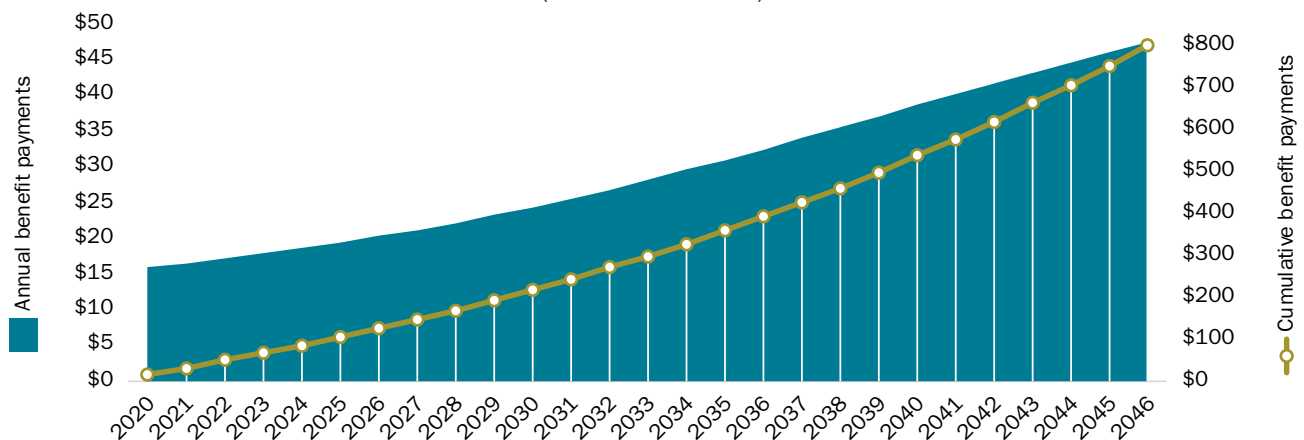
Expenses

Member benefit payments

Expenses are primarily composed of pension benefit payments and on average account for the majority of CalSTRS' total expenditures. Member benefit payments constitute the key expenditure when evaluating the system's overall unfunded liability. Changes in long-term projected benefit payments are largely driven by changes in various economic and demographic assumptions such as service retirements, mortality, credible compensation, disability and inflation.

Member benefit payments are estimated to increase at an average rate of approximately 4.3% annually through 2046. As with any mature pension system, to the extent contributions are less than current and future benefit payments, investment income is leveraged to bridge the gap.

Projected member benefit payments
(dollars in billions)



1 Due to the timing of CalSTRS actuarial valuation and analysis, these additional payments are not reflected in the valuation as of June 30, 2019.

Administrative expenses

As with any public service organization, CalSTRS maintains focus on defraying expenses of administering the system. CalSTRS' goal is to manage resources and other administrative costs to efficiently facilitate pension and investment activities. On average, CalSTRS administrative costs account for approximately 3% of total expenditures and are composed of CalSTRS Operating Budget and External Investment Management. The Operating Budget funds CalSTRS' ongoing operations associated with managing benefit programs, enterprise projects and cost associated with internal management of the investment portfolio. The External Investment Management Budget primarily includes external investment management fees.

Administrative expenditures are reviewed on an annual basis, ensuring the organization remains fiscally prudent. Key annual changes typically include, but are not limited to, incremental baseline changes for employee compensation pursuant to collectively bargained union agreements, resource augmentations for both internal and external resources driven by new or expanded work scope, ongoing facilities maintenance and enhanced technology capabilities, project-based costs, external investment management fees, and assessments from the California Department of Finance. Additional detail on administrative expenditures is provided in the "Budget overview" section.



Budget overview

Biennial budget in brief¹

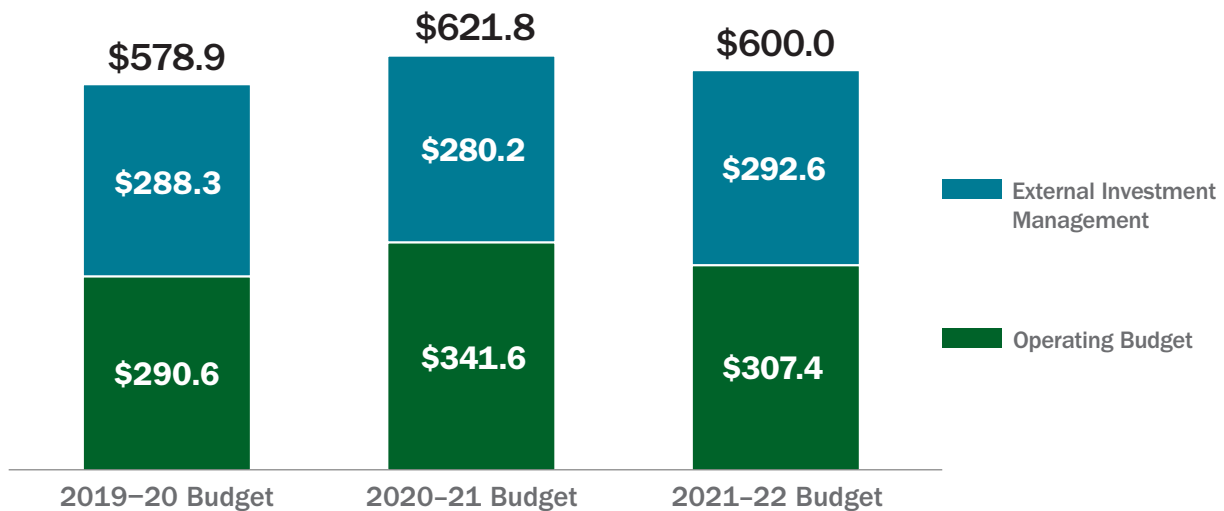
CalSTRS' 2019–22 Strategic Plan lays out a set of goals and measurable objectives that demonstrate how our mission and vision will advance through 2021–22. This task is a long-term endeavor, requiring comprehensive and sustainable solutions for today and many years to come. The CalSTRS 2020–21 and 2021–22 Biennial Budget incorporates these goals and objectives by developing a detailed operational and financial plan to deliver on annual and long-term objectives and targets.

¹ The 2020–21 and 2021–22 board-adopted operating budgets have been revised. These revisions are primarily due to mandatory reductions to statewide administrative expenditures pursuant to the Budget Act of 2020. Additional information regarding these changes subsequent to the board's adoption are provided in Appendix 6.

The 2020–21 and 2021–22 Biennial Budget fosters the replacement of our existing legacy pension administration system with modern functionality through the Pension Solution Project. In addition, it focuses on prudent organization-wide resource allocation as part of a Multi-Year Internal Investment Management Plan to successfully continue implementation of CalSTRS Collaborative Model as we transition more assets to internal management. As part of the state’s response to mitigate the fiscal impact of the global COVID-19 pandemic on California’s economy, the biennial budget also addresses state-mandated changes to employee compensation and other operational expenditures pursuant to the Budget Act of 2020.

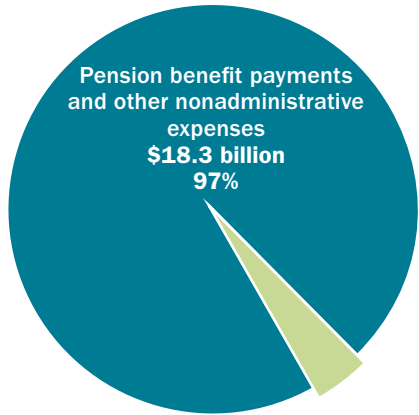
- CalSTRS total 2020–21 budget is \$621.8 million and includes 1,202 authorized positions. Of this amount, \$280.2 million is for External Investment Management,¹ and \$341.6 million represents CalSTRS’ Operating Budget. This reflects a total net Operating Budget increase of \$51.0 million, or 17.6%, relative to 2019–20.
- CalSTRS total 2021–22 budget is \$600.0 million and includes 1,232 authorized positions. Of this amount, \$292.6 million is for External Investment Management, and \$307.4 million represents CalSTRS’ Operating Budget. This reflects a total net Operating Budget decrease of \$34.2 million, or 10%, relative to 2020–21.

CalSTRS 2019–20, 2020–21 and 2021–22 budget
(dollars in millions)



¹ External Investment Management fees are largely correlated to the value of assets under management and investment returns and are continuously appropriated. Continuous appropriations represent statutory expenditure authorization that exists from year to year without further legislative or board action.

CalSTRS 2021-22 total expense breakout

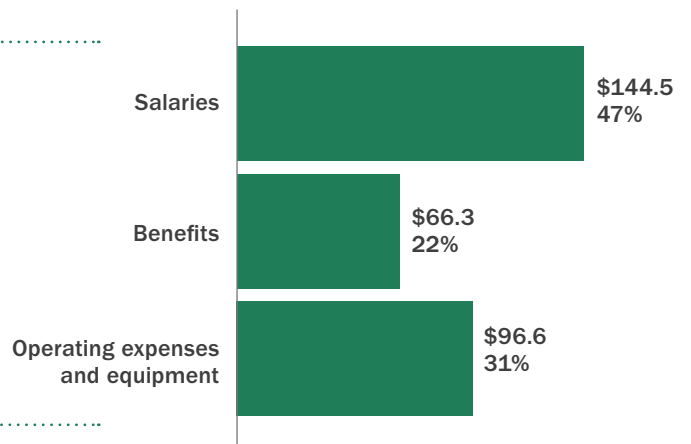
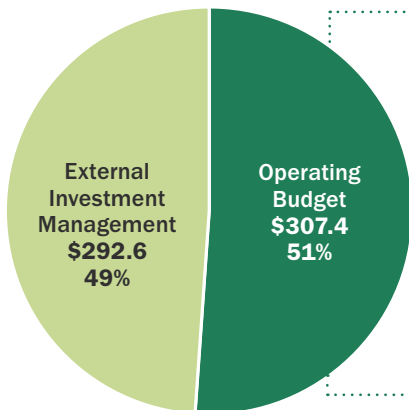


Expenses are primarily composed of pension benefit payments and the administrative expenses required to manage CalSTRS' operations.

Administrative expenses account for approximately 3% of CalSTRS' total expenses and represent CalSTRS' total budget.

Administrative expenses
\$600.0 million
3%

CalSTRS total 2021-22 budget (dollars in millions)



The following table provides a summary of CalSTRS' administrative expenditures by budget category and highlights the total Operating Budget changes for fiscal years 2020–21 and 2021–22 of \$51.0 million and \$34.2 million, respectively.

Administrative expenditures¹

(dollars in thousands)

| Budget category | Actual 2019–20 | Budget 2019–20 ² | Budget 2020–21 | Amount change | Budget 2021–22 | Amount change |
|---|-------------------|--------------------------------|-------------------|------------------|-------------------|-------------------|
| Operating Budget | | | | | | |
| Salaries | \$115,587 | \$133,011 | \$142,269 | \$9,258 | \$144,452 | \$2,183 |
| Benefits | 58,581 | 67,798 | 68,537 | 739 | 66,308 | (2,229) |
| Operating expenses and equipment | | | | | | |
| General expenses | 20,937 | 30,778 | 31,010 | 232 | 29,060 | (1,950) |
| Consulting and professional services | 26,732 | 34,523 | 74,168 | 39,645 | 39,203 | (34,965) |
| Facilities operations | 17,091 | 8,838 | 8,875 | 37 | 8,875 | - |
| Central administrative services | 11,036 | 11,036 | 12,180 | 1,144 | 14,856 | 2,676 |
| Data processing and storage | 5,170 | 4,632 | 4,628 | (4) | 4,628 | - |
| Total Operating Budget | 255,134 | 290,616 | 341,667 | 51,051 | 307,382 | (34,285) |
| External Investment Management ³ | 191,970 | 288,300 | 280,200 | (8,100) | 292,600 | 12,400 |
| Total | \$447,104 | \$578,916 | \$621,867 | \$42,951 | \$599,982 | (\$21,885) |
| Operating Budget percent change | | | | 17.6% | | (10.0%) |

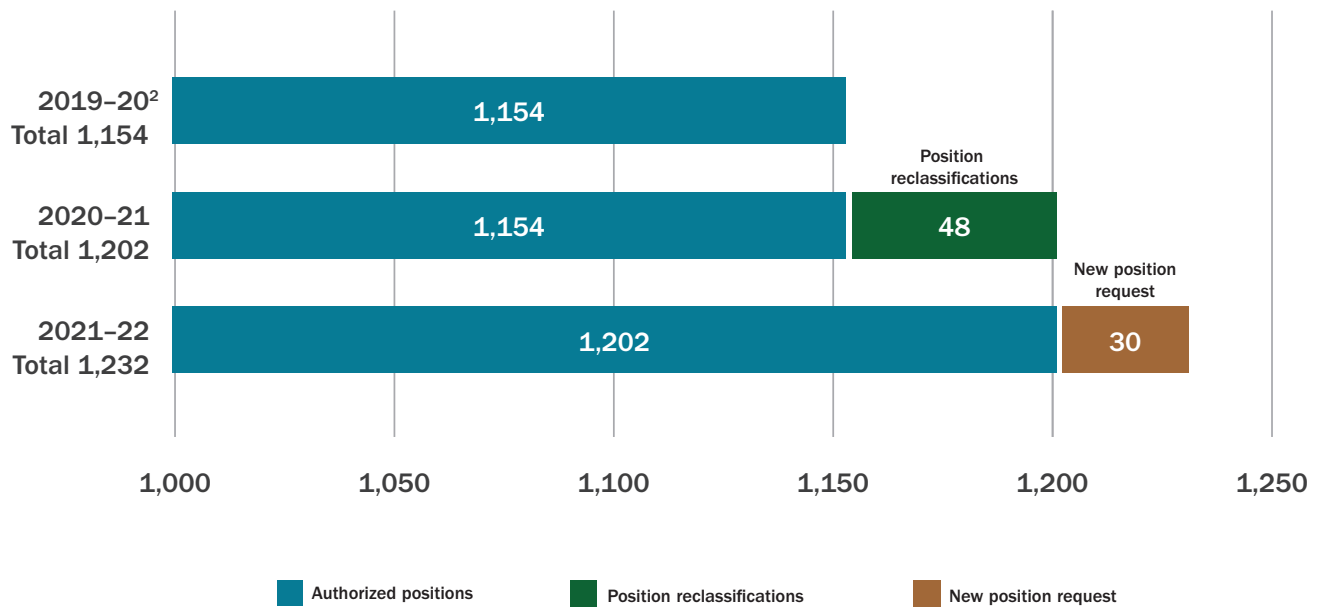
1 Three-year administrative expenditures by fund are provided in Appendix 4.

2 The 2019–20 Operating Budget is revised to include three new positions in the Sustainable Investment and Stewardship Strategies division under the Investments Branch. These positions were approved as early hires during the Teachers' Retirement Board Meeting Item #3, Adoption of Proposed 2020–21 Operating Budget.

3 Consistent with financial reporting practices, investment management costs exclude securities lending, borrowing costs on investment-related master lines of credit and broker commissions.

- The 2020–21 Operating Budget includes 1,202 total authorized positions, reflecting reclassification of 48 existing blanket¹ positions to a permanently authorized status. This reflects an increase of 4.2% to CalSTRS’ total authorized positions, relative to 2019–20.
- The 2021–22 Operating Budget includes 1,232 authorized positions, reflecting an increase of 30 new authorized positions, or 2.5%, relative to 2020–21 as part of our continued efforts to grow the Collaborative Model. A breakout of authorized positions for fiscal years 2019–20, 2020–21 and 2021–22 by branch is provided in the “Branch information” section.

2019–20, 2020–21 and 2021–22 authorized positions



1 CalSTRS workforce also includes 129 blanket positions, the majority of which are assisting with the Pension Solution Project. Blanket positions provide staffing flexibility for urgent, one-time or limited-duration operational needs. Additional information regarding blanket positions is provided in the “Glossary” section.

2 The 2019–20 Operating Budget is revised to include three new positions in the Sustainable Investment and Stewardship Strategies division under the Investments Branch. These positions were approved as early hires during the Teachers’ Retirement Board Meeting Item #3, Adoption of Proposed 2020–21 Operating Budget.

2020–21 Operating Budget changes

The 2020–21 Operating Budget is \$341.6 million and includes 1,202 authorized positions. This reflects a net increase of \$51.0 million, or 17.6%, relative to 2019–20. Key changes are largely driven by the one-time funding authority for the Pension Solution Project and State Mandates, which are composed of nondiscretionary adjustments to statewide employee compensation and address overall Capacity Management efforts to ensure the organization has adequate resources to effectively manage business priorities. Additional changes include the reclassification of 48 existing blanket positions to a permanently authorized status and have no budgetary impact. The following table displays the incremental change in budgetary expenditures of \$51.0 million by operational driver.

2020–21 Operating Budget changes

(dollars in millions)

| Operational driver | Amount change |
|--------------------------|---------------|
| Pension Solution Project | \$47.2 |
| State Mandates | 2.9 |
| Capacity Management | 0.9 |
| Total | \$51.0 |

Pension Solution Project: \$47.2 million¹

Consistent with Strategic Goal 2, Objective A, the Pension Solution Project continues to drive CalSTRS toward operational excellence through the implementation and integration of a new pension administration system.

The 2020–21 Operating Budget includes \$53 million in one-time funding authority for the Pension Solution Project. The \$53 million includes a \$34 million contract amendment with CGI Technologies and Solutions Inc., the vendor contracted to configure and implement the new pension administration system, and \$19 million associated with the 2018 schedule and scope modifications. This brings the Pension Solution Project budget to \$304.8 million. The project budget is available through June 30, 2023, to encumber and until June 30, 2025, to liquidate.

The 2020–21 Operating Budget includes a baseline reduction for the 2019–20 Pension Solution appropriation in the amount of \$5.8 million from the original spending authority. With this adjustment, the total net increase is \$47.2 million. Additional information is provided in the “Capital projects” section.

¹ Additional detail is provided in the **Pension Solution Project Budget Change Proposal**, which was submitted to the Department of Finance and approved by the Legislature as part of the 2020–21 budget cycle.

State Mandates: \$2.9 million

State Mandates include a net increase of \$2.9 million and are largely related to nondiscretionary costs, including wage escalation for existing personnel, annual pro rata assessment issued by the Department of Finance and costs associated with implementing new legislation.

Wage escalation: \$1.5 million

Wage escalation is composed of employee compensation and benefits for existing staff and accounts for the largest estimated net increase associated with nondiscretionary costs in the amount of \$1.5 million. This includes the addition of \$16.6 million for updates to CalSTRS' compensation structure for positions under the Teachers' Retirement Board's compensation-setting authority, approved during the May 2019 Compensation Committee¹ meeting, increases for merit and special salary adjustments for eligible personnel, supplemental healthcare payments for employee-paid healthcare contributions for all staff enrolled in a California Public Employees' Retirement System health plan, and the associated impact of these changes on total benefits. A component of employer-paid benefits includes changes in state-mandated prefunding contributions for other postemployment benefits. Effective July 1, 2020, CalSTRS pays an additional 1.2% for a total of 3.5% of pensionable compensation for most employees for other postemployment benefits costs.

The \$16.6 million increase is partially offset by a mandatory two-day reduction to monthly employee compensation and benefits pursuant to the Budget Act of 2020, in the amount of \$15.1 million. This reduction is administered through a Personal Leave Program and is effective for fiscal years 2020–21 and 2021–22. Additional information regarding the PLP is provided in Appendix 6.

Pro rata assessment: \$1.2 million

CalSTRS is required by the Department of Finance to contribute on a pro rata basis for the cost of providing central administrative services to CalSTRS. The pro rata assessment represents General Fund recoveries of shared statewide general administrative costs. The pro rata process apportions the costs of providing central administrative services to all state departments that benefit from shared services, such as centralized state payroll processing for CalSTRS employees.

The apportioned amount is further allocated to each state department's funding sources based on the percentage of total expenditures in each fund. Annual updates to CalSTRS' pro rata share are based on the most current assessment provided by the DOF. For 2020–21, the annual pro rata assessment is estimated to increase by \$1.2 million, largely due to higher costs for retirees' health benefits. As the number of state personnel retirees increase, the total cost associated with health benefits is also estimated to increase.

SB 964 climate-related financial risk: \$200,000

Effective January 1, 2020, and every three years thereafter, **SB 964 (Chapter 731, Statutes of 2018)**, requires CalSTRS to report on the analysis of material climate-related financial risks of public market portfolios. CalSTRS estimates an increase of \$200,000 for staff to implement the provisions of the bill and to employ an outside consultant to assess the alignment of the fund with the Paris Agreement and California Climate Policy.

¹ Additional detail is provided in the May 2019 Compensation Committee Item #4, **Report on Labor Market Benchmarking for Statutory Positions**.

Capacity Management: \$920,000

The Capacity Management component of the 2020–21 Operating Budget is largely related to requests for resource augmentation. This includes funding for both internal and external resources, including consulting services driven by new or expanded work scope in response to the organization’s strategic and operational business objectives.

Consulting services: \$550,000

The 2020–21 Operating Budget includes an increase of \$550,000 for consulting services. This includes \$380,000 for external investment audit services for CalSTRS’ investment portfolio. The growth of CalSTRS’ current investment portfolio, coupled with the complexity of underlying investment strategies, has necessitated the demand for additional external investment audit services. Service contracts also includes \$170,000 for 403bComply® services. The 403bComply service offers plan implementation guidance, ongoing plan compliance and maintenance for employers offering a 403(b) defined contribution product. Over the last two years, costs associated with these services have increased at an average rate of 4.3%. Accordingly, the additional \$170,000 is to fund increases in the 403bComply contract with TCG Services, the program’s third-party administrator, for the continued administration of the 403bComply program.

Resource augmentation: \$370,000¹

As underscored by the CalSTRS Collaborative Model,² the continued expansion and implementation of this lower-cost strategy requires additional investment resources as the organization transitions more assets from external to internal management. As the Investments Branch continues to expand as part of our longer-term cost optimization strategy, implementation of the Collaborative Model will require additional resources to support investment functions. In alignment with this longer-term initiative and consistent with the first goal of CalSTRS’ strategic plan—to ensure a well-governed, financially sound trust fund—the 2020–21 Operating Budget includes an increase of \$370,000 for three positions in the Sustainable Investment and Stewardship Strategies division, under the Investments Branch. Addressing these additional resource requirements is imperative for CalSTRS to be competitive and successful in implementing the Collaborative Model. These resources will:

- Advance the integration of environmental, social and governance factors across the CalSTRS Investment Portfolio to enhance our management of ESG risks and opportunities.
- Analyze the impacts of the low-carbon transition, both in terms of portfolio risks and investment opportunities.
- Identify new ESG sustainable investment opportunities across asset classes.

¹ These resources were approved as early hires in fiscal year 2019–20. The \$370,000 represents the incremental increase in fiscal year 2020–21.

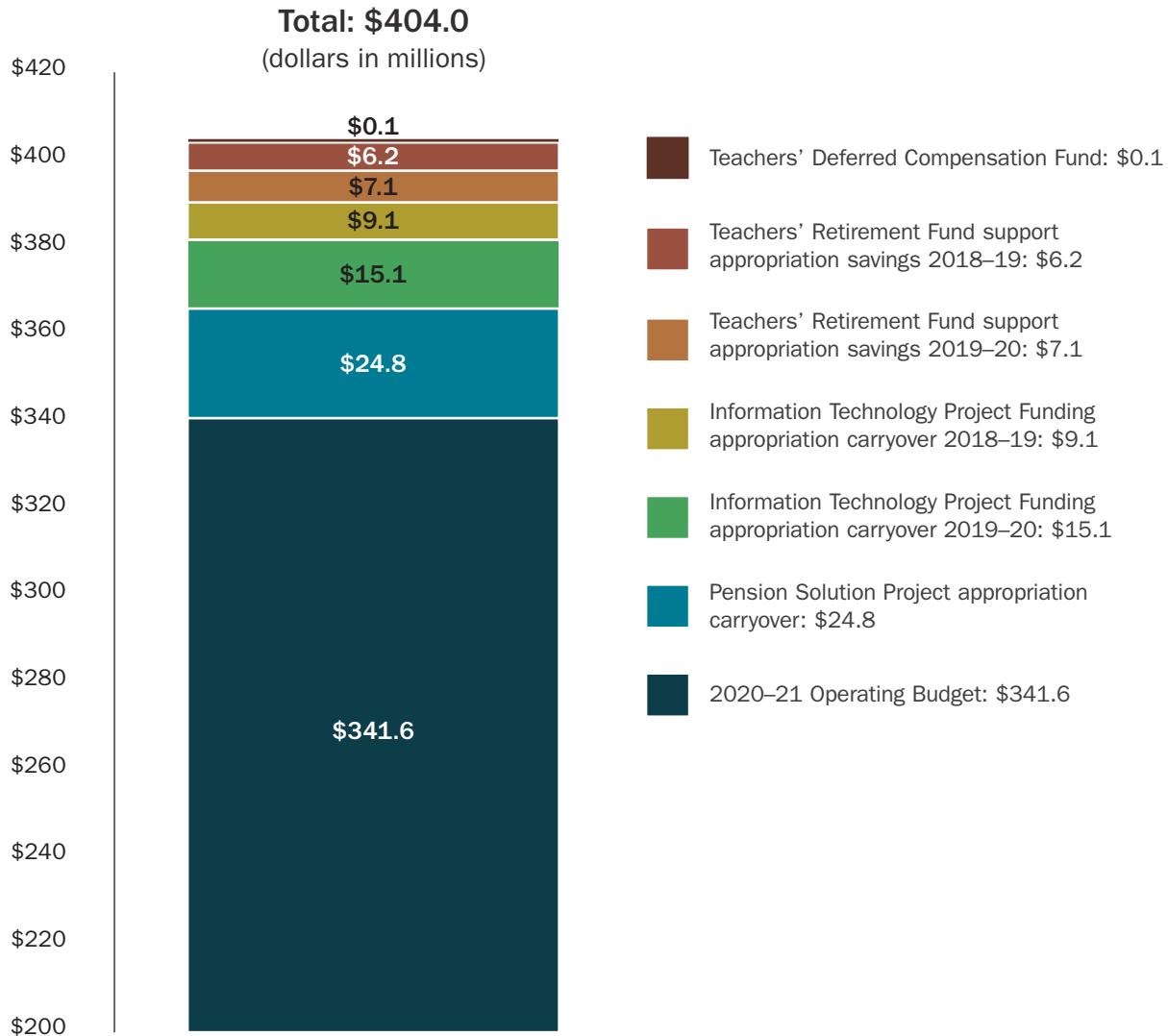
² Additional information on the CalSTRS Collaborative Model is provided in the “2021–22 Operating Budget changes” section.

Technical adjustments

The Department of Finance issued **Budget Letter 19-16** and **Budget Letter 19-25** regarding policies and processes related to position authority and the application of Control Section 31.00 of the annual Budget Act, which provides authority to administratively establish and reclassify positions within an existing appropriation authority. Pursuant to the issuance of Budget Letter 19-16 and Budget Letter 19-25 and as part of the 2020–21 budget development process to increase overall budget accuracy, transparency and accountability, CalSTRS conducted an enterprisewide analysis to determine if there were full-time tenured staff working in blanket classifications under existing appropriation authority.

Based on this analysis, CalSTRS identified 48 existing positions performing permanent ongoing work that require position reclassification. For example, CalSTRS' member service centers are all operated by full-time tenured employees; however, these employees are classified as temporary in nature pursuant to the Department of Finance classification structure. This technical adjustment will not increase CalSTRS' total staffing levels or require any additional funding authority. The positions impacted by this adjustment are funded from existing budget authority, which was previously approved by the Teachers' Retirement Board.

2020–21 total spending authority



The Operating Budget provides the authority to expend up to \$341.6 million in 2020–21. In addition, CalSTRS has additional spending authority resulting from prior board approval, available for expenditure in fiscal year 2020–21. As a result, CalSTRS can end the year with total expenditures greater than the current year Operating Budget. There are four primary sources of additional spending authority above the current year Operating Budget. These include the Teachers' Retirement Fund support appropriation savings, Pension Solution

Project appropriation carryovers, Information Technology Project Funding appropriation carryovers and additional budget authority for the Teachers' Deferred Compensation Fund.

As summarized in the chart, estimated spending authority above the 2020–21 Operating Budget is currently projected at \$62.4 million. Based on these estimates, CalSTRS can expend up to \$404.0 million in fiscal year 2020–21. Additional detail is provided on the following page.

Teachers' Retirement Fund support appropriation savings: \$13.3 million

Pursuant to section 100.B.1 of the **Teachers' Retirement Board Policy Manual**, if CalSTRS ends the year with savings in its annual Teachers' Retirement Fund support appropriation, these savings are available for expenditure for two years after the initial appropriation, upon board approval, and are limited to 3% of that appropriation. These savings would be used for the purpose of meeting unanticipated system costs and promoting better service to the system's membership. Upon board approval, \$6.2 million is available to encumber by June 30, 2021, and through June 30, 2023, to liquidate, and \$7.1 million is available to encumber by June 30, 2022, and through June 30, 2024, to liquidate.

Teachers' Deferred Compensation Fund: \$109,300

The Teachers' Deferred Compensation Fund is used to account for ancillary activities associated with deferred compensation plans and programs offered by CalSTRS to enhance the tax-deferred financial options for members and their beneficiaries. Staff monitors the cash revenues received by the fund to ensure it is sufficient to cover expenditures for the program. If sufficient cash revenue is generated to support expansion of the program, the TDCF has additional budget authority of up to 5%, or \$109,300, over the baseline TDCF budget of \$2.2 million, only as needed for unanticipated expenditures.

Information Technology Project Funding appropriation carryover: \$24.2 million

CalSTRS baseline Operating Budget includes an annual ITPF appropriation of \$18.5 million for enterprisewide projects as authorized by the Enterprise Program Investment Council (EPIC). Pursuant to the annual Budget Act, each year this amount is available to encumber for up to three years and two additional years for liquidation. Funds not encumbered in the initial fiscal year they were appropriated are carried over for up to two fiscal years and can be designated to projects authorized by EPIC. Based on current carryover projections, \$9.1 million from fiscal year 2018–19 is available to encumber by June 30, 2021, and liquidate through June 30, 2023. In addition, \$15.1 million is available from fiscal year 2019–20 to encumber by June 30, 2022, and liquidate through June 30, 2024. These funds will be utilized as projects are approved by EPIC.

Pension Solution Project appropriation carryover: \$24.8 million

Of the \$213 million original spending authority for the Pension Solution Project, \$24.8 million represents the estimated carryover amount from 2014–15 through 2019–20 appropriations. With the extended liquidation and encumbrance periods approved as part of the 2020–21 Operating Budget, the project has through June 30, 2023, to encumber and June 30, 2025, to liquidate. The project will use these carryover balances by the respective dates. Additional detail regarding the original spending authority of \$213 million for the Pension Solution Project is provided in the "Capital projects" section.

2021–22 Operating Budget changes

The 2021–22 Operating Budget is \$307.4 million and includes 1,232 authorized positions. This reflects a net decrease of \$34.2 million, or 10%, relative to 2020–21. Key changes are driven by the Multi-Year Internal Investment Management Plan to establish 109 authorized positions and funding for external investment audit services, dispersed across fiscal years 2021–22 through 2025–26. Operating Budget changes also reflect an increase to address State Mandates and a baseline reduction for the one-time 2020–21 Pension Solution Project funding authority, which was approved for the 2020–21 fiscal year. The following table displays the incremental change in budgetary expenditures of \$34.2 million by operational driver.

2021–22 Operating Budget changes

(dollars in millions)

| Operational driver | Amount change |
|--|-----------------|
| Multi-Year Internal Investment Management Plan | \$12.3 |
| State Mandates | 6.5 |
| Pension Solution Project | (53.0) |
| Total | (\$34.2) |

Multi-Year Internal Investment Management Plan: \$12.3 million

In alignment with the first goal of the CalSTRS 2019–22 Strategic Plan, to ensure a well-governed, financially sound trust fund, and the fourth goal, to grow capacity and enhance efficiency in alignment with the mission and vision, the plan includes funding and resources in the amount of \$40.9 million. This includes \$40.6 million for 109 authorized positions and \$300,000 for external investment audit services, dispersed over five years, across fiscal years 2021–22 through 2025–26. Of the 109 authorized positions, the plan includes

91 positions in the Investments Branch and 18 Investment Administrative Support positions across the organization to support investment functions. The plan is a five-year resource planning strategy to (1) continue successful implementation efforts and growth of the Collaborative Model as we transition more assets to internal management and (2) manage growth of assets under management. The primary objectives of the Collaborative Model are to reduce costs, control portfolio risk, increase investment returns and leverage our external partnerships to achieve similar benefits—all for the benefit of California educators and their beneficiaries.

The following table provides the five-year forecast for the plan and represents the scheduled funding and resources that will be added to CalSTRS baseline Operating Budget in each fiscal year.

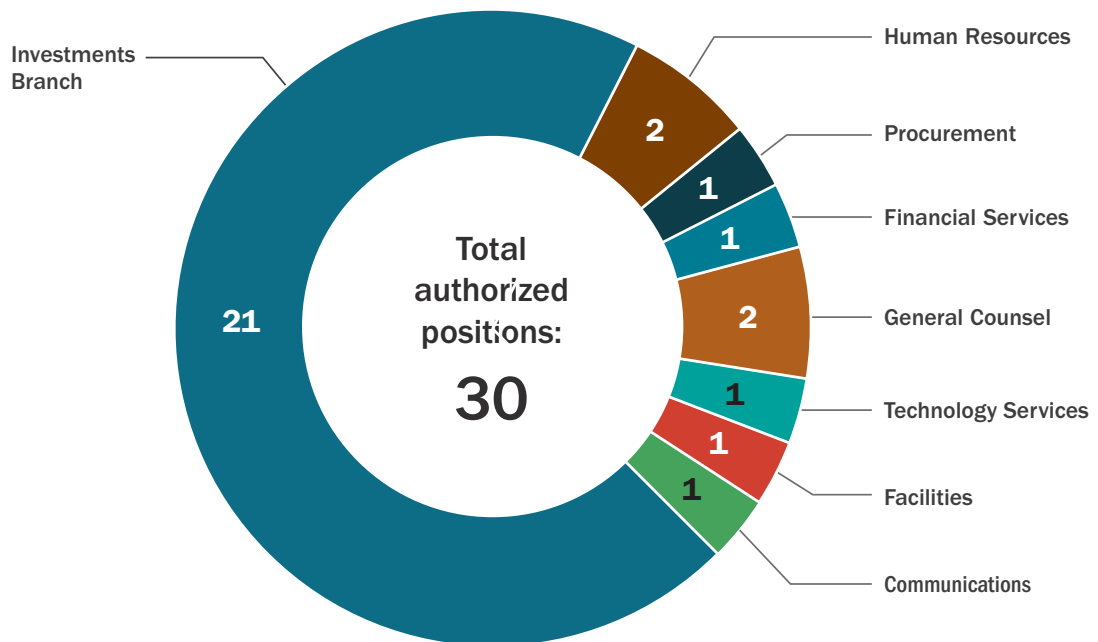
Five-year funding and resource forecast

(dollars in millions)

| | 2021-22 | 2022-23 | 2023-24 | 2024-25 | 2025-26 | Total |
|----------------------|---------|---------|---------|---------|---------|--------|
| Budget | \$12.3 | \$7.8 | \$9.9 | \$6.5 | \$4.4 | \$40.9 |
| Authorized positions | 30 | 24 | 21 | 19 | 15 | 109 |

Of the total \$40.9 million in funding for the five-year plan, the 2021-22 Operating Budget includes the first year of scheduled funding in the amount of \$12.3 million. This includes \$12.2 million for 30 authorized positions dispersed across the organization, and \$60,000 for external investment audit services. The following chart displays the 2021-22 authorized position request by business area.

Authorized position request by business area for 2021-22



Key business drivers – The Collaborative Model and AUM

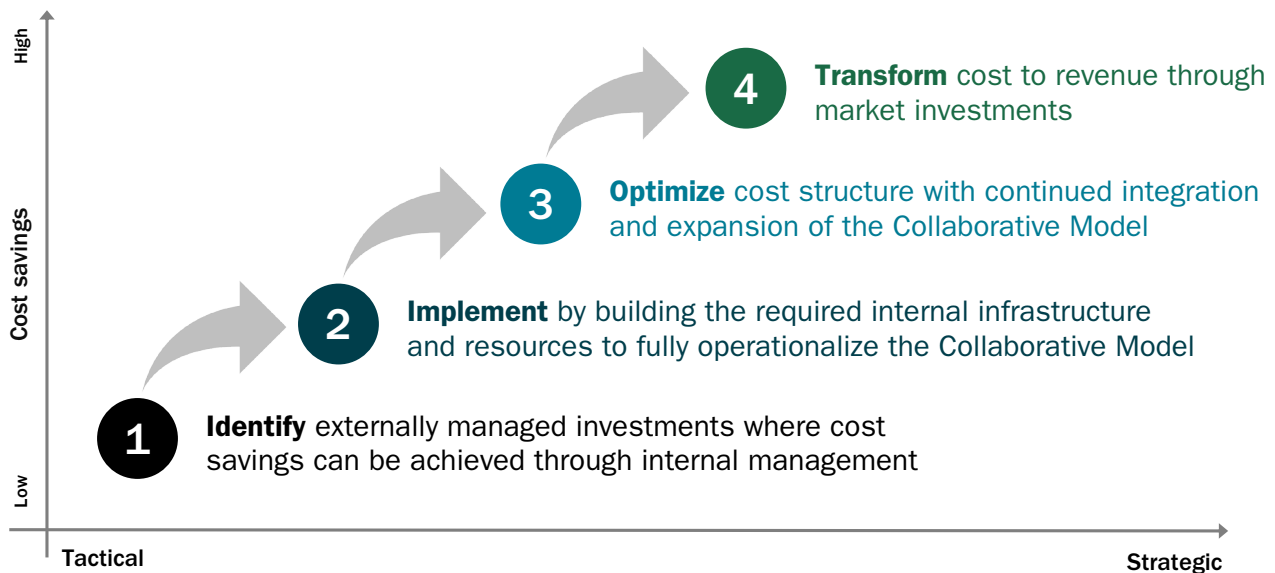
The Collaborative Model

The cornerstone of the plan is prefaced by CalSTRS’ Investment Belief 3—Managing investment costs yields long-term benefits.¹ Investment costs, if not managed appropriately, can have a significant impact on overall portfolio performance. CalSTRS, as a large-scale investor, focuses on measuring, monitoring and minimizing all relevant investment costs, and as a trusted fiduciary of the fund, it is CalSTRS’ responsibility to ensure prudent use of the system’s resources. On that basis, the plan seeks to further enhance this investment belief through the continued

implementation of the Collaborative Model as a more cost-effective approach to managing portfolio assets.

Key benefits of implementing the Collaborative Model include reducing costs and increasing expected investment returns. The diagram below illustrates the conceptual framework—seeking to transform current business practices by transitioning portfolio assets from external to internal and hybrid-private management structures by moving from a tactical to a strategic and cost-effective operating model. We expect this to reduce overall investment costs and increase expected net returns, ultimately generating more income to pay member benefits.

Nature of cost optimization through the Collaborative Model



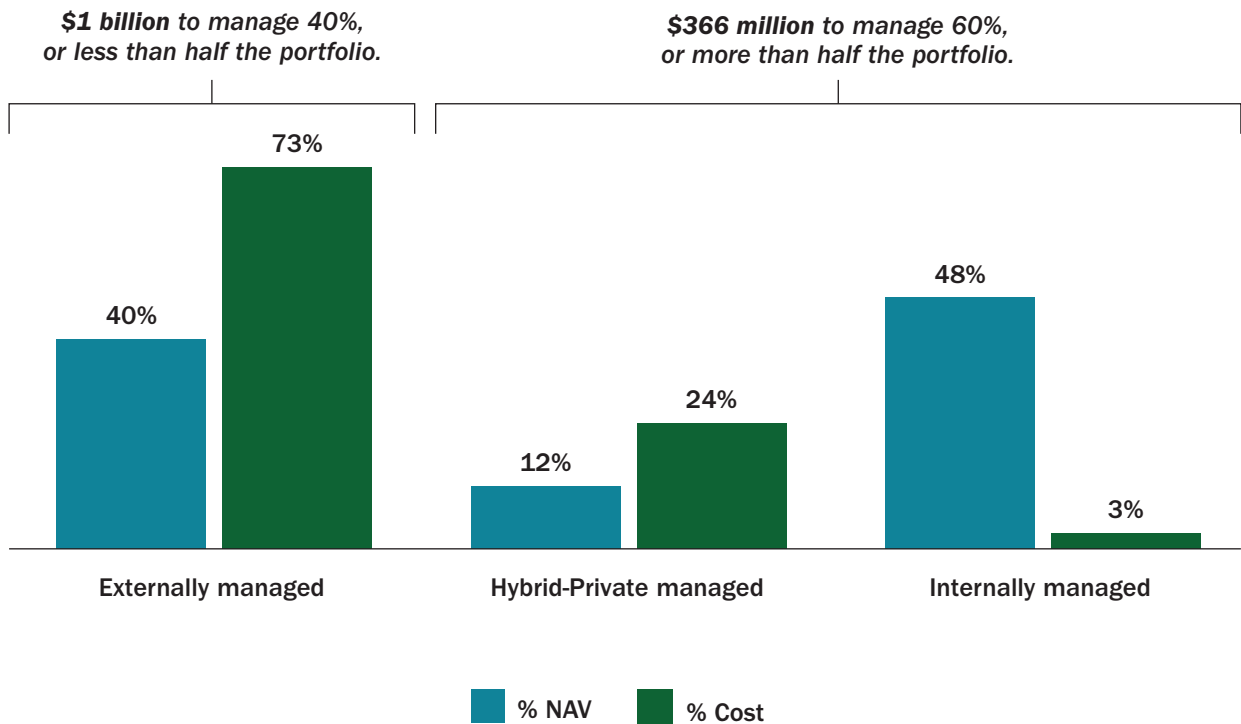
1. Additional information is provided in CalSTRS Investment Beliefs.

Reducing costs and increasing investment returns

Based on historical experience, managing public assets internally can be accomplished at approximately one-tenth of the cost as compared to externally managed public assets. Moreover, it is anticipated that further cost savings can be achieved as investment strategies are implemented across the portfolio where penetration is lower, particularly in alternative and private assets. According to CEM Benchmarking, a firm that collects metrics from pension funds worldwide, CalSTRS Investments Branch saved approximately \$222 million in 2019 over expected investment costs, as compared to peers given the same asset mix.

As part of the Collaborative Model, more externally managed private assets will be shifted to the lower-cost hybrid-private and internal management investment structure, which will result in lower costs to the system. For context, when total portfolio costs are compared to the total fund net asset value (NAV), the cost disparity relative to the investment management structure—external, hybrid-private and internal—is evident. As illustrated in the following chart, externally managed assets represented 40% of NAV and accounted for \$1 billion of total portfolio costs. In comparison, hybrid-private managed and internally managed investments represented 60% of the NAV and accounted for \$366 million of the total portfolio costs.¹

Total portfolio costs relative to NAV and investment management structure



¹ Costs are for calendar year 2019 and on a cash basis. These figures exclude carried interest. Carried interest is a performance-based fee paid to external fund managers.

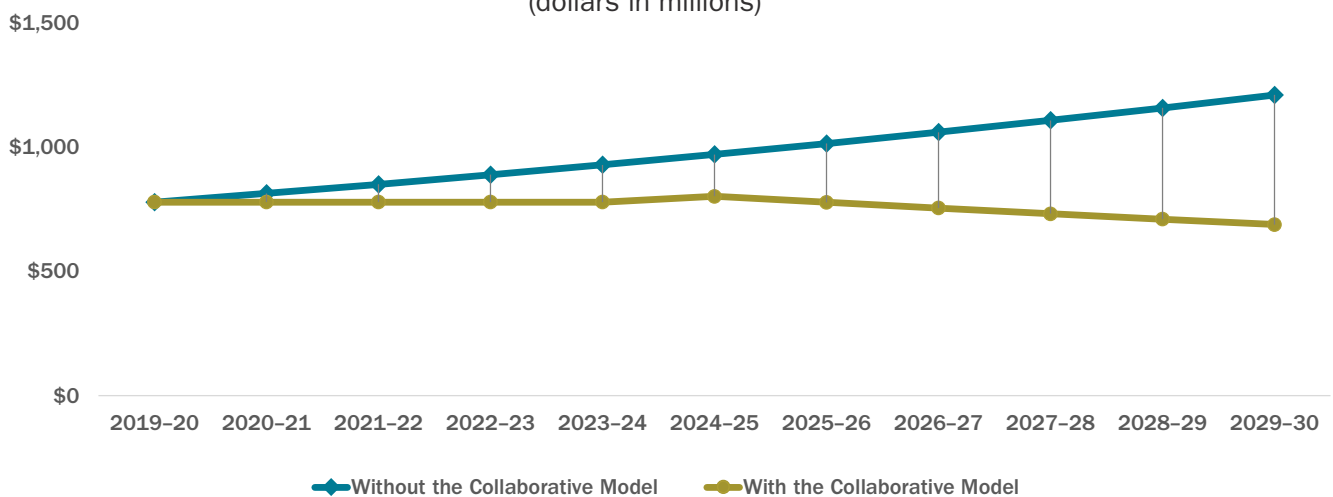
Overall, the cost savings from lower external fees and carried interest will notably outweigh increased costs associated with hiring more internal staff. From a long-range financial planning perspective, not only will managing a larger portion of assets internally result in significant annual net savings to the fund, but it also will enable the organization to invest these savings in financial markets. By investing more efficiently, CalSTRS increases the chances of achieving a 7% return over time with less volatility than other methods.

The continued implementation and growth of the Collaborative Model is estimated to save CalSTRS significant carried interest and management fees, which notably outweigh the funding requested as part of this proposal. It should be noted that external management costs can fluctuate each

year depending on the life cycle of the underlying investment, the investment pace of the asset class or investment strategy, or both. Most private assets have a life cycle of 10 to 15 years; therefore, it is more meaningful to analyze costs and savings over longer periods of time when comparing cost data. If fully implemented, the Collaborative Model may produce \$200 million to \$300 million in cost savings and increased returns annually over the next 10 to 15 years.

With regards to pure cost savings, current projections indicate the continued growth of the Collaborative Model could create enough annual savings to keep annual portfolio costs at current levels 10 years from now, as depicted in the following chart, despite a near 50% portfolio growth through 2029–30.

Projected management fees and carried interest
(dollars in millions)



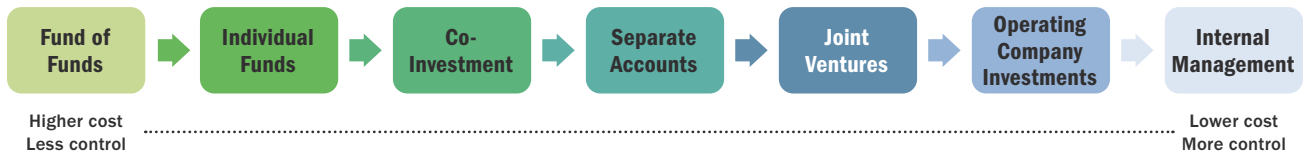
Controlling portfolio risks

The Collaborative Model is an investment strategy to both manage more assets internally and embrace partnership and collaboration with world-class investment institutions. As noted above, another primary objective is to control portfolio risk. With the use of external managers, an investor such as CalSTRS has less control over how its investments are managed (i.e., less control over what to buy, when to buy, when to sell and how to manage assets while owned). As adding new strategies internally is considered, CalSTRS will have greater control over risk associated with investment strategies. Typically, staff will control major decisions such as purchase, sale and leverage and have sole discretion over major capital commitments. In addition, staff will have greater control over when

and how assets are deployed and diversified and corporate governance issues are addressed.

CalSTRS has identified opportunities to implement investment strategies across the investment portfolio, spanning each asset class to reduce risk. These opportunities cover a range of different types of investment strategies and investment ownership structures from simple to complex. The following diagram displays the general spectrum of investment options available to institutional investors. Moving from left to right, the investor gains more control over risk through additional oversight and cost savings but has a greater need for investment discretion. This requires specialized skills in various business areas to leverage the support necessary at an enterprise level to successfully implement these strategies under the Collaborative Model.

Spectrum of investment options



It is important to highlight that there is also increased transparency into the investments being made. This is best highlighted when CalSTRS invests capital within a partnership and is one of many limited partners within the overall fund. Under this example structure, the general partner maintains significant control over the investments, while CalSTRS has limited influence to buy or sell assets. Conversely, when CalSTRS chooses to co-invest in a similar strategy, using internal resources, buy and sell decisions are made internally, and visibility into the underlying assets is more readily available.

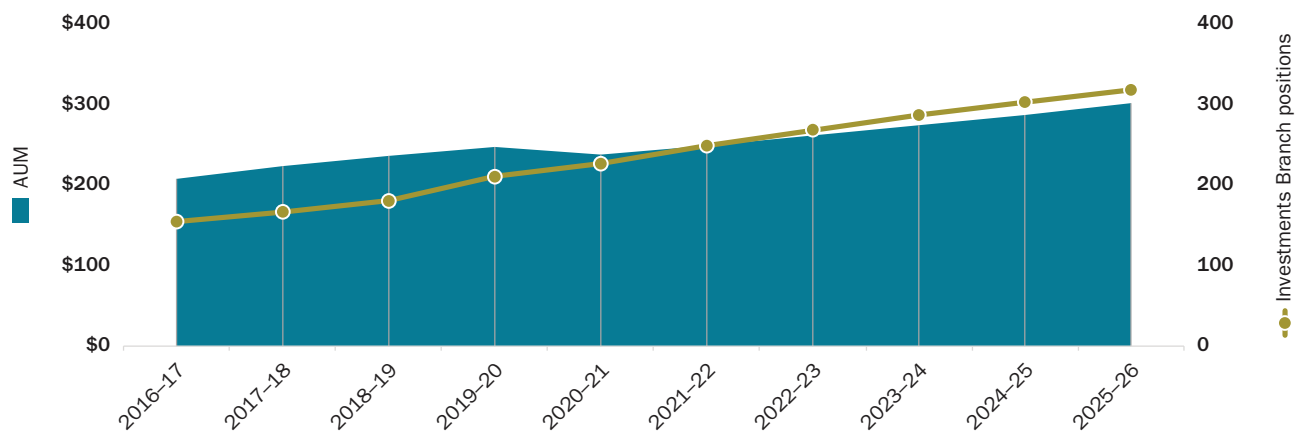
Assets under management

Another key element driving the need for additional resources is growth in AUM. CalSTRS' AUM growth is largely correlated with projected net investment returns and changes in member, employer and state contribution rates. CalSTRS ended the fiscal year with portfolio assets valued at \$246 billion as of June 30, 2020, which are projected to grow to \$302.5 billion by 2025–26. Increases in AUM have a direct impact on the number of investment staff required to manage and make prudent investment decisions and support investment activities. Overall growth

in AUM has required additional investment resources to successfully manage the size and complexity of the CalSTRS portfolio. As assets increase, the need for additional investment staff is also projected to rise.

The following chart highlights the correlation and scaling of investment resources relative to growth in AUM over a 10-year period using actual (2016–17 through 2019–20) and forecasted (2020–21 through 2025–26) data. Based on the historical actual and projected increases in AUM, additional resources requested in this proposal are in alignment with this growth trajectory.

Actual and forecasted AUM and Investments Branch positions
(dollars in billions)



State Mandates: \$6.5 million

State Mandates include a net increase of \$6.5 million and are largely related to nondiscretionary costs, including wage escalation for existing personnel, annual pro rata assessment issued by the Department of Finance and costs associated with implementing new legislation.

Wage escalation: \$6.2 million

Wage escalation is composed of employee compensation and benefits for existing staff and accounts for the largest estimated increase associated with nondiscretionary costs in the amount of \$6.2 million. Salaries and incentives account for \$4.6 million, or 74%, and benefits account for \$1.6 million, or 26%, of the total estimated increase. This is primarily due to merit salary adjustments and incentives for eligible personnel, and the associated impact of these changes on total benefits.

Pro rata assessment: \$2.7 million

CalSTRS is required by the Department of Finance to contribute on a pro rata basis for the cost of providing central administrative services to CalSTRS. The pro rata assessment represents General Fund recoveries of shared statewide general administrative costs. The pro rata process apportions the costs of providing central administrative services to all state departments that benefit from shared services, such as centralized state payroll processing for CalSTRS employees.

The apportioned amount is further allocated to each state department's funding sources based on the percentage of total expenditures in each fund. Annual updates to CalSTRS' pro rata share are based on the most current assessment provided by the DOF. For 2021–22, the annual pro rata assessment is estimated to increase by \$2.7 million, largely due to higher costs for retiree health benefits and an anticipated increase in the number of state personnel retirements. As the

number of state personnel retirees increase, the total cost associated with health benefits is also estimated to increase.

Operational efficiency reduction: (\$2.4) million

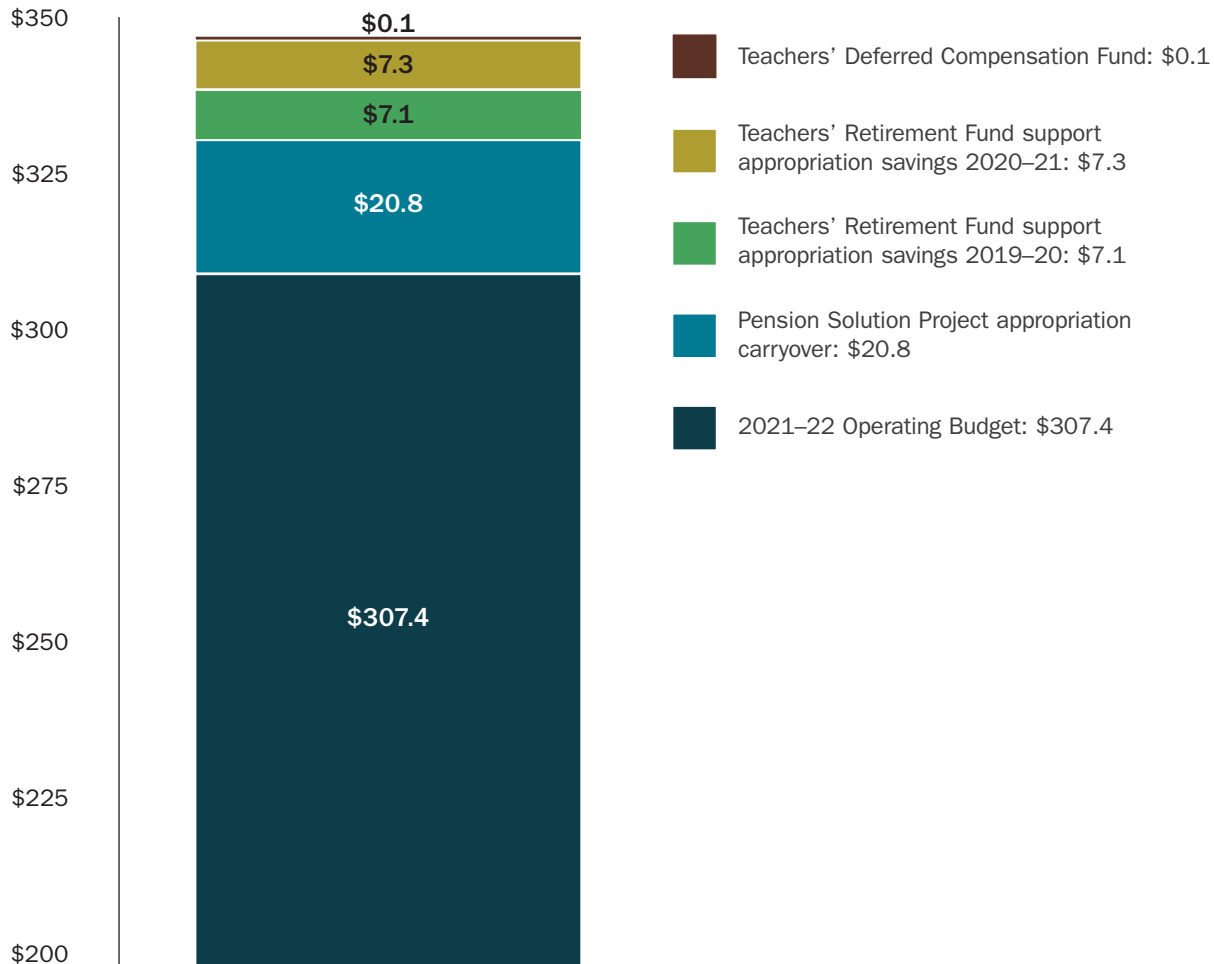
As part of the state's response to address the fiscal impact of the global COVID-19 pandemic on California's economy, the administration commenced immediate measures to mitigate the financial impact to the state. Pursuant to the Budget Act of 2020, the state enacted mandatory reductions to state-wide administrative expenditures, which included a permanent operational efficiency reduction in most state operational expenditures. Supplemental guidance on achieving these budgetary reduction measures was provided by the Department of Finance in **Budget Letter 20–37**. Specifically, these directives required all state departments to identify permanent cost savings as a result of transitioning to a more permanent and longer-term telework environment due to the cascading businesses impacts of the pandemic. As a result of these budgetary reduction measures and evaluation of the long-term impacts to our operational expenditures, the 2021–22 Operating Budget was reduced by \$2.4 million. The \$2.4 million reduction will be applied to various operating expenses, excluding expenditures for staff salaries and benefits. Additional information regarding this reduction is provided in Appendix 6.

Pension Solution Project: (\$53.0) million

The 2021–22 Operating Budget includes a baseline reduction for the one-time 2020–21 Pension Solution Project funding authority in the amount of \$53.0 million, which was approved for the 2020–21 fiscal year. It is important to note that this change is not a reduction to the overall Pension Solution Project budget, rather a baseline change from the 2020–21 to the 2021–22 Operating Budget for the one-time expenditure. Additional information regarding the total Pension Solution Project budget is provided in the "Capital projects" section.

2021–22 total spending authority

Total: \$342.7
(dollars in millions)



The Operating Budget provides the authority to expend up to \$307.4 million in 2021–22. In addition, CalSTRS has additional spending authority, resulting from prior board approval, available for expenditure in fiscal year 2021–22. As a result, CalSTRS can end the year with total expenditures greater than the current year Operating Budget. There are four primary sources of additional spending authority above the current year Operating Budget. These include the Teachers' Retirement Fund support appropriation savings, Pension Solution

Project appropriation carryovers, Information Technology Project Funding appropriation carryovers and additional budget authority for the Teachers' Deferred Compensation Fund.

As summarized in the chart, estimated spending authority above the 2021–22 Operating Budget is currently projected at \$35.3 million. Based on these estimates, CalSTRS can expend up to \$342.7 million in fiscal year 2021–22. Additional detail is provided on the following page.

Teachers' Retirement Fund support appropriation savings: \$14.4 million

Pursuant to section 100.B.1 of the **Teachers' Retirement Board Policy Manual**, if CalSTRS ends the year with savings in its annual Teachers' Retirement Fund support appropriation, these savings are available for expenditure for two years after the initial appropriation, upon board approval, and are limited to 3% of that appropriation. These savings would be used for the purpose of meeting unanticipated system costs and promoting better service to the system's membership. Upon board approval, \$7.1 million is available to encumber by June 30, 2022, and through June 30, 2024, to liquidate, and \$7.3 million is available to encumber by June 30, 2023, and through June 30, 2025, to liquidate.

Teachers' Deferred Compensation Fund: \$106,400

The Teachers' Deferred Compensation Fund is used to account for ancillary activities associated with deferred compensation plans and programs offered by CalSTRS to enhance the tax-deferred financial options for members and their beneficiaries. Staff monitors the cash revenues received by the fund to ensure it is sufficient to cover expenditures for the program. If sufficient cash revenue is generated to support expansion of the program, the TDCF has additional budget authority of up to 5%, or \$106,400, over the baseline TDCF budget of \$2.1 million, only as needed for unanticipated expenditures.

Information Technology Project Funding appropriation

CalSTRS baseline Operating Budget includes an annual ITPF appropriation of \$18.5 million for enterprisewide projects as authorized by EPIC. Pursuant to the annual Budget Act, each year this amount is available to encumber for up to three years and two additional years for liquidation. Funds not encumbered in the initial fiscal year

they were appropriated are carried over for up to two fiscal years and can be designated to projects authorized by EPIC. Over the past years, CalSTRS has significantly increased efforts to improve enterprisewide IT platforms and has used nearly all of the annual \$18.5 million ITPF appropriation. Based on our current planned project pipeline, we project full utilization of the 2019–20 and 2020–21 ITPF appropriations at this time and do not anticipate carryover balances in 2021–22.

Pension Solution Project appropriation: \$20.8 million

Of the total \$304.8 million total spending authority for the Pension Solution Project, \$20.8 million represents the estimated carryover amount from the 2020–21 appropriation. Carryover funds are available for encumbrance through June 30, 2023, and liquidation through June 30, 2025. Additional information is provided in the “Capital projects” section.

Capital projects

This section provides a summary of capital projects and associated financing. The Capital Projects Budget plans for expenses associated with technology, infrastructure and other enterprise projects at CalSTRS. These costs are typically one-time, bounded costs as compared to ongoing administrative costs.

CalSTRS capitalizes operational assets in accordance with Governmental Accounting Standards Board Statements No. 34 and No. 51. Specifically, all land, buildings, improvements, equipment, computer software and other tangible or intangible assets used in operations that have initial useful lives extending beyond one year and have an initial cost basis of \$1 million or greater, are capitalized. Depreciation or amortization is charged to operations using the straight-line method on the estimated useful life of the related asset. For budgetary reporting and planning, all assets, including those with useful lives greater than one year and costing more than \$1 million,

are fully expensed in the year purchased. Depending on the type of capital project or asset, funding may be authorized from either continuous or support appropriations.

CalSTRS currently has two major capital projects underway. The first is the Pension Solution Project, with a project budget of \$304.8 million. The second is the CalSTRS Headquarters Expansion Project, with a project budget of \$300 million,¹ which was financed using tax-exempt lease revenue bonds.

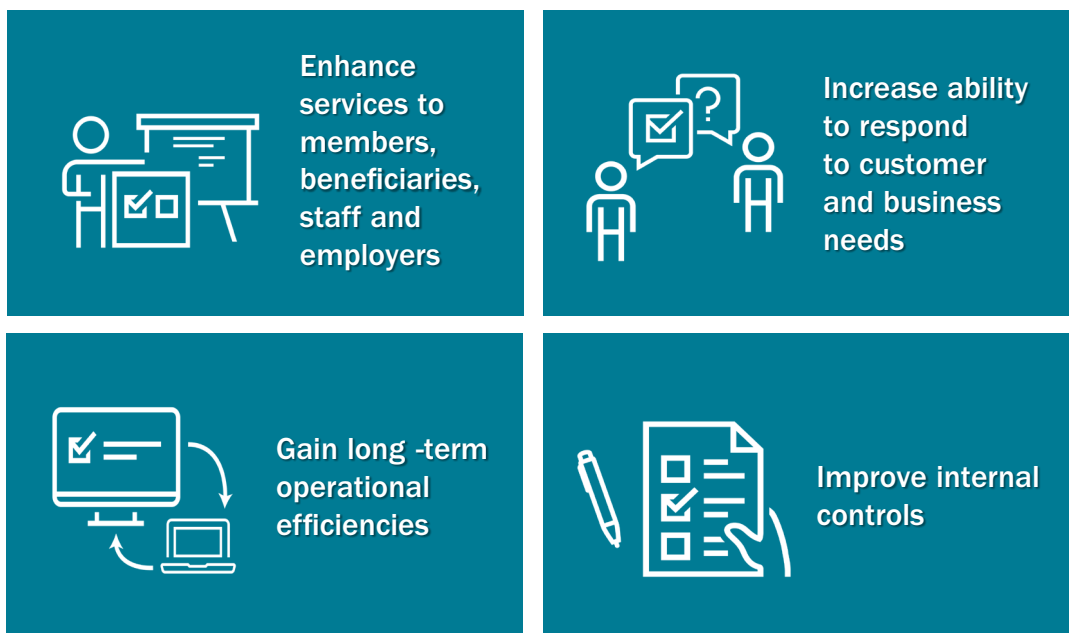
Pension Solution Project

The implementation of the new pension administration system is a major contributor to achieving CalSTRS' mission—*Securing the financial future and sustaining the trust of California's educators*—and to achieve CalSTRS' strategic plan goals and objectives. The Pension Solution Project directly affects over 975,000 members and their beneficiaries, as well as the school employer community. Members will benefit

from having a modern, robust, technologically advanced system that tracks their service credit and compensation data and generates benefit payments to eligible members and their beneficiaries.

The project encompasses the planning, acquisition and implementation of a new pension administration system, Benefit Connect, which will replace CalSTRS' legacy systems and modernize existing processes related to benefit administration for our membership. Broadly, the Pension Solution Project will administer member and beneficiary account information, employer reporting, benefit calculations and case management activities into a single integrated solution. When fully implemented, Pension Solution will deliver a state-of-the-art benefit administration system that will reduce operational risk, streamline processes and enhance services for more than 975,000 members and their beneficiaries, as well as the school employer community.

Pension Solution Project objectives

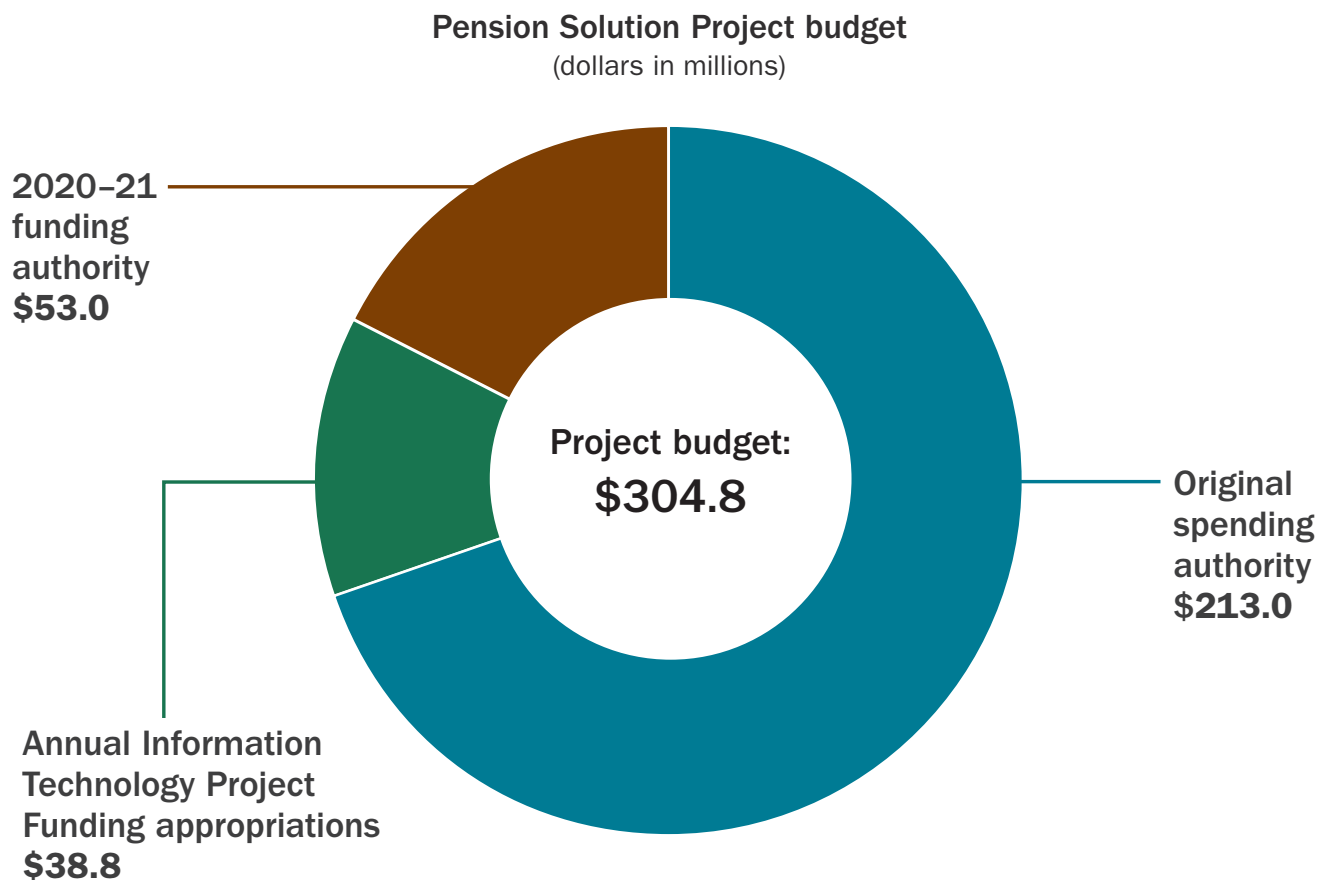


¹ Excludes the cost of financing.

Pension Solution Project budget: \$304.8 million

In July 2019, the Teachers' Retirement Board approved the Pension Solution Project budget of \$304.8 million. Of this amount, \$213 million represents the original spending authority approved in fiscal year 2014–15. As referenced previously, the 2020–21 Operating Budget includes \$53 million in one-time funding

authority, which encompasses a \$34 million contract amendment with CGI Technologies and Solutions Inc. and \$19 million for internal staff and external oversight resources. The remaining \$38.8 million is drawn from amounts reserved from the annual Information Technology Project Funding appropriations. The following chart summarizes the Pension Solution Project budget by funding source.



The following table summarizes the Pension Solution Project budget and the amounts consumed for each appropriation as of June 30, 2020.

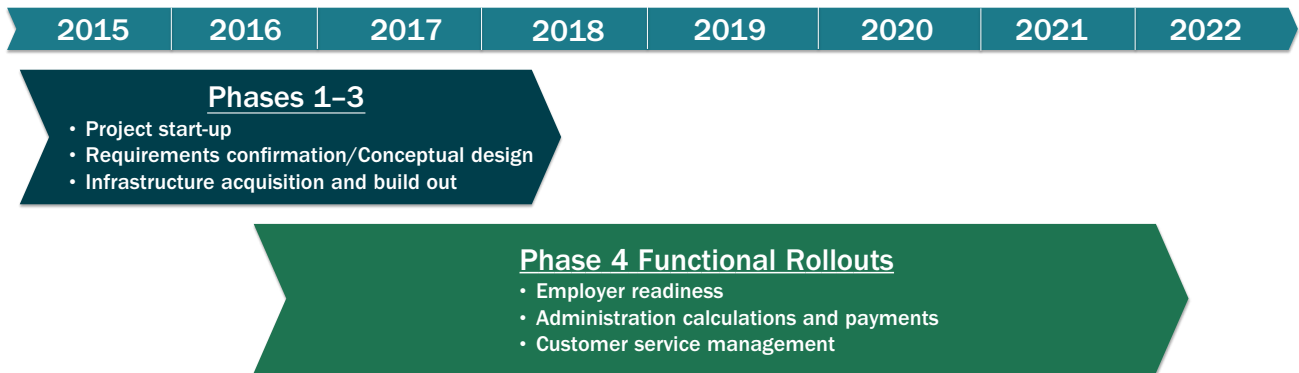
Pension Solution Project budget consumption

(dollars in thousands)

| Appropriation | Budgeted amount | Consumed amount | Remaining amount |
|--|---------------------|------------------|------------------|
| 2014–15 Pension Solution appropriation | \$61,564 | \$59,656 | \$1,908 |
| 2015–16 Pension Solution appropriation | 63,099 | 57,559 | 5,540 |
| 2016–17 Pension Solution appropriation | 37,553 | 31,267 | 6,286 |
| 2017–18 Pension Solution appropriation | 26,982 | 19,267 | 7,715 |
| 2018–19 Pension Solution appropriation | 17,965 | 15,837 | 2,128 |
| 2019–20 Pension Solution appropriation | 5,837 | 4,572 | 1,265 |
| 2020–21 Pension Solution appropriation | 53,000 | - | 53,000 |
| ITPF appropriation | 38,833 ¹ | 35,650 | 3,183 |
| Total | \$304,833 | \$223,808 | \$81,025 |

The project is anticipated to be completed by March 2022. The Pension Solution Project implementation timeline is summarized in the following diagram.

Pension Solution Project implementation timeline



¹ Funds designated to the Pension Solution Project are from various annual Information Technology Project Funding appropriations as approved by the Enterprise Program Investment Council.

CalSTRS Headquarters Expansion Project overview

In fall 2019, CalSTRS began to expand its headquarters located in West Sacramento, California. The headquarters expansion will accommodate overall organizational growth resulting from increasing complexities in the investment markets, financial sector and public plan administration. The new 10-story tower will include 260,000 square feet of additional office space and is financed through conduit tax-exempt lease revenue bonds issued by the California Infrastructure and Economic Development Bank.

CalSTRS' long-term employee growth projections forecast an increase of approximately 4.5% annually through the next decade before growth declines to approximately 2.5% per annum. The expanded headquarters space will allow the organization to grow over the long term to meet the needs of our changing business models and growth expectations. The new building is an investment for CalSTRS' future, one that we expect will meet the organization's needs for the next 30 years.

CalSTRS Headquarters Expansion Project budget: \$300 million

Prior to approving the Headquarters Expansion Project, the Teachers' Retirement Board reviewed a variety of scenarios to accommodate CalSTRS' long-term growth strategy, including developing a second structure at the current headquarters campus, acquiring an existing building or leasing office space in the region. After careful consideration of all options, on November 8, 2018, the board unanimously approved the development of a second structure using tax-exempt lease revenue bond financing with a total budget not to exceed \$300 million (excluding the cost of financing) for construction of the building. The \$300 million budget authority

includes \$8 million, which was approved as a part of the fiscal year 2016–17 Operating Budget for preconstruction activities, including design, and to provide cost estimates for various facility alternatives. The remaining \$292 million will be used for the construction and development of the building and was included as a one-time augmentation of budgetary authority in the fiscal year 2018–19 Operating Budget.¹

The long-term debt obligations used to finance the total cost of the headquarters expansion will be paid from continuous appropriations as principal and interest payments. Payments will be recognized over 30 years as described in more detail on the following page.

Tax-exempt lease revenue bond financing

In alignment with fiscal sustainability, construction of the CalSTRS Headquarters Expansion Project is financed with conduit tax-exempt lease revenue bonds, which state and local governments commonly use to finance capital improvements, such as infrastructure. Using tax-exempt lease revenue bond financing to fund the HQE Project was deemed the most efficient vehicle and held the best long-term value for the system. This alternative offers a rationale for spreading the infrastructure costs over time, as opposed to a significant and immediate one-time cash outlay of \$300 million directly from the fund. The total borrowing cost was finalized at 3.25%, leaving CalSTRS' assets invested in diversified markets at the current expected actuarial rate of return of 7%, deriving a higher expected return than the cost of bond issuance over the span of 30 years.

Green bonds

CalSTRS' vision and guiding beliefs support advancing sustainability. As such, the headquarters expansion is being designed to support sustainable green building practices,

¹ From a budgetary basis, the total cost of construction was recognized in fiscal years 2016–17 and 2018–19, when the funds were encumbered.

including green technologies, sustainable construction, energy conservation and whole-building integrated energy efficiency measures as well as employee wellness goals. These efforts qualified the tax-exempt lease revenue bonds to be classified as green bonds, which identify to investors that the bond proceeds will be used specifically for sustainable projects that will have a positive impact on the environment. CalSTRS received the 2020 Green Project Bond of the Year award from Environmental Finance for the Headquarters Expansion bond issued in December 2019.

Credit rating agencies

Credit rating is a critical component of assessing an organization's fiscal health. Rating agencies view sound fiscal health favorably, thus improving an organization's agency rating and its ability to obtain low-cost financing for important projects. CalSTRS received the following bond ratings at the time of issuance:

- **Moody's Investors Service: A1**
- **S&P Global Ratings: A+**
- **Fitch Ratings: AA**

These ratings demonstrate that CalSTRS' prudent financial management and fiscal strength are viewed most favorably by credit agencies.

Long-term debt obligations

In December 2019, the California Infrastructure and Economic Development Bank, a conduit debt issuer, issued \$340.6 million¹ in tax-exempt lease revenue bonds on behalf of CalSTRS, of which \$272.6 million represents the par value and \$68.0 million for the original issue premium. The bond proceeds will be used to fund the construction of the CalSTRS Headquarters Expansion Project and pay the cost of bond issuance and capitalized interest² during the construction period.

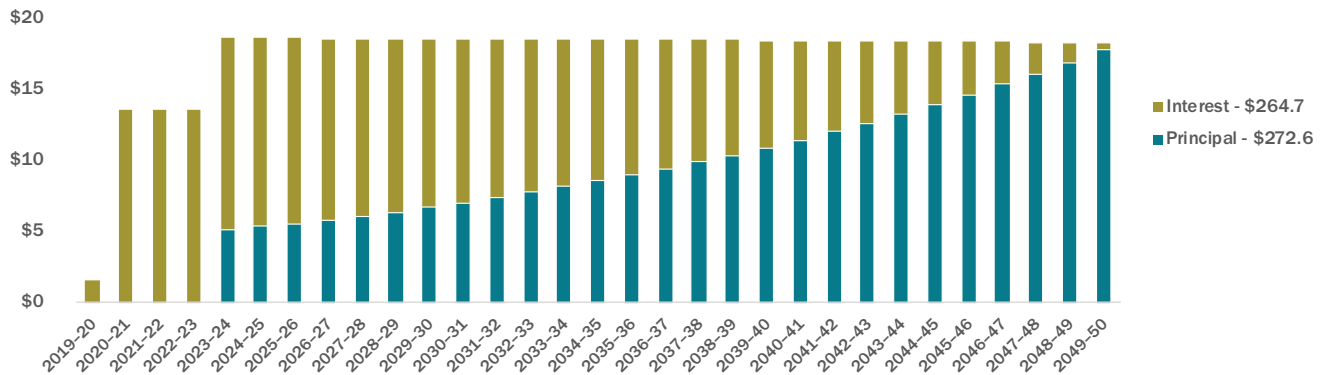
Principal and interest payments will be paid over 30 years. The first 2.5 years will consist of capitalized interest payments while the building is being constructed. Upon completion of the building, the annual principal and interest debt service payments will be made through fiscal year 2049–50.

Since construction of the building will be ongoing during fiscal year 2021–22, CalSTRS will continue to make capitalized interest payments on the debt obligations from the bond proceeds; therefore, these payments will not impact or be reflected in the biennial budget. After construction of the building is complete, principal and interest payments will be paid over 27 years in the form of lease payments. Lease payments will be presented with CalSTRS Operating Budget as an informational item beginning in fiscal year 2022–23. The amortization schedule is provided on the following diagram.

¹ Total cost of construction is \$300 million, which excludes the cost of financing.

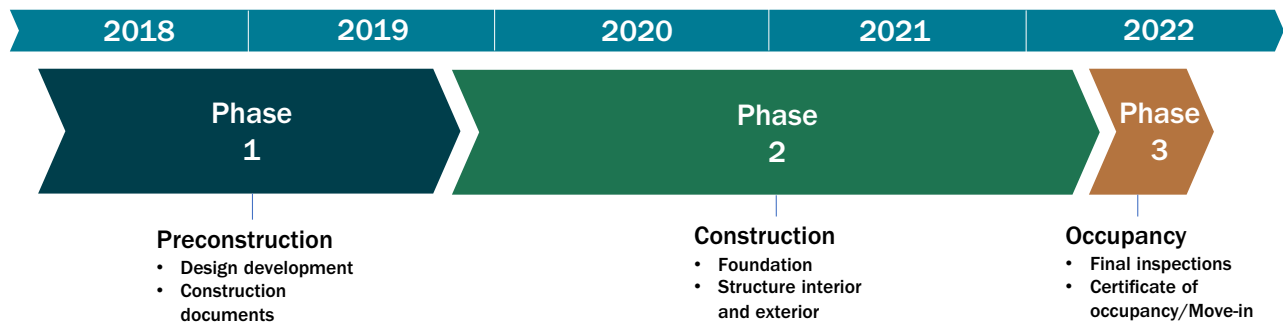
² A portion of the proceeds from a bond issue that is set aside to pay interest on the debt for the period from when the bonds are issued to when construction is expected to be completed.

Long-term debt service payments (dollars in millions)



The HQE Project is anticipated to be completed by fall 2022. The following diagram contains the high-level project milestones. As of December 31, 2020, the Headquarters Expansion Project was 30% complete.

Headquarters Expansion Project timeline



Impact of capital expenditures on the Operating Budget

While the biennial budget represents two years of planned expenditures, the major initiatives funded are generally longer term in nature and have economic impacts extending beyond the upcoming budget year. On that basis, CalSTRS evaluates the impact of current capital investments from a multiyear perspective. These expenditures encompass permanent ongoing costs associated with prior year capital investments once assets are fully functional.

Estimated operating costs associated with capital investments are evaluated each year during the annual budget cycle. During the budget planning cycle, anticipated ongoing expenditures for an asset are incorporated into the budget. These expenditures include, but are not limited to, labor, contracts and services, software and hardware maintenance, and other ancillary costs associated with maintaining the asset as an ongoing operational cost. Planning for the downstream impacts of capital projects on the Operating Budget is a critical component of business planning, ensuring the system is adequately resourced for the effective long-term financial and operations management.

Financial summaries

Overview of funds

CalSTRS administers a hybrid retirement system consisting of a defined benefit plan, cash balance and two defined contribution plans, a postemployment benefit plan and a fund used to account for ancillary activities associated with the deferred compensation plans and programs. The Teachers' Retirement Law (Education Code section 22000 et seq.), as enacted and amended by the California Legislature and the Governor, established these plans and CalSTRS as the administrator. The terms of these plans may be amended through legislation.

CalSTRS administers funds that are both annually and continuously appropriated. Authority to draw from an annually appropriated fund is obtained each year through the legislative process, as outlined in the "Budget development" section. In contrast, CalSTRS has statutory authority to spend all or a portion of assets from continuously appropriated funds. Specifically, the authority to spend does not need to be renewed in an annual appropriation from the state. The Teachers' Retirement Board maintains oversight and control over continuously appropriated funds through internal budget controls as defined in the "Policies" section.

The table below illustrates the relationship between the funds and the various programs offered by CalSTRS.

Fund program relationship

| Fund | Associated programs |
|--------------------------------------|---|
| Teachers' Retirement Fund | <ul style="list-style-type: none"> • Defined Benefit • Defined Benefit Supplement • Cash Balance Benefit • Supplemental Benefit Maintenance Account (purchasing power protection program) |
| Teachers' Replacement Benefits Fund | <ul style="list-style-type: none"> • Replacement Benefits |
| Pension2® | <ul style="list-style-type: none"> • Pension2 403(b) and Roth 403(b) • Pension2 457(b) and Roth 457(b) |
| Teachers' Deferred Compensation Fund | <ul style="list-style-type: none"> • 403bCompare • 403bComply |
| Teachers' Health Benefits Fund | <ul style="list-style-type: none"> • Medicare Premium Payment |

The table below illustrates the revenue and expense categories for each fund that CalSTRS administers.

Relationship of revenues and expenses to funds

| Budget category | TRF | TRBF | Pension2 | TDCF | THBF |
|--------------------------------|-----|------|----------|------|------|
| Revenues | | | | | |
| Investment income | ✓ | | ✓ | ✓ | ✓ |
| Employer contributions | ✓ | ✓ | ✓ | | ✓ |
| Member contributions | ✓ | | ✓ | | |
| State contributions | ✓ | | | | |
| Other income | ✓ | | ✓ | ✓ | |
| Expenses | | | | | |
| Pension benefit payments | ✓ | ✓ | | | |
| External investment management | ✓ | | | | |
| Administrative expenditures | ✓ | | | ✓ | ✓ |
| Contribution refunds | ✓ | | ✓ | | |
| Other benefit payments | ✓ | | ✓ | | ✓ |
| Other expenditures | ✓ | | ✓ | | |
| Debt service payments | ✓ | | | | |

Financial highlights

In accordance with the California Constitution, Article 16, Section 17:

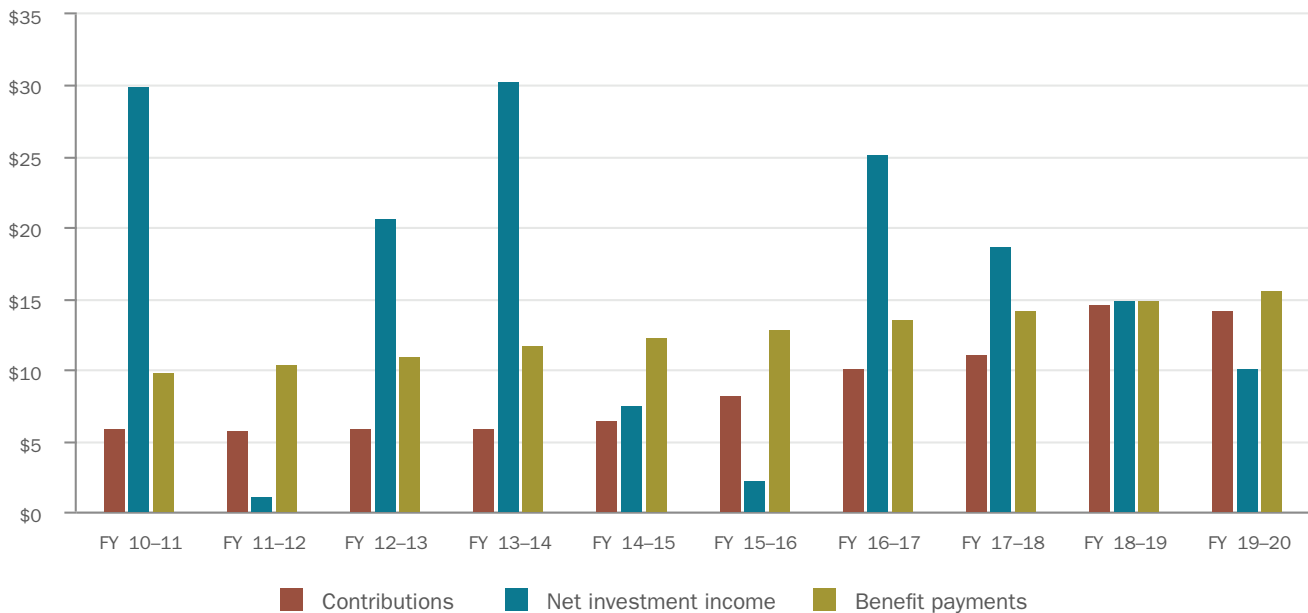
“The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.”

CalSTRS’ revenues and expenses include all financial activities of the organization. CalSTRS’

largest sources of revenue are from investment income and contributions from members, employers and the State of California. The major expense categories are benefit payments, administrative expenditures associated with maintaining operations and investment-related expenses.

The following chart provides a 10-year comparison of contributions, net investment income and benefit payments for the State Teachers’ Retirement Plan¹ for the fiscal years ended June 30.

10-year comparison of contributions, net investment income and benefit payments²
(dollars in billions)



The fund summary on the next page provides a high-level view of CalSTRS’ actual beginning fund balance for all funds and programs, sources of revenue and expenses, and ending fund balance for the 2019–20 fiscal year.

1 The State Teachers’ Retirement Plan is composed of the Defined Benefit, Defined Benefit Supplement, Cash Balance Benefit and Replacement Benefits programs.

2 Pursuant to SB 90, fiscal years 2018–19 and 2019–20 contributions include approximately \$2.2 billion and \$1.1 billion, respectively. These represent one-time supplemental contributions from the State of California.

2019–20 fiscal year fund balance: All funds¹

(dollars in thousands)

| | |
|--------------------------------|----------------------|
| Beginning fund balance | \$240,128,155 |
| Revenues | |
| Investment income | 10,810,644 |
| Employer contributions | 6,108,461 |
| Member contributions | 3,946,561 |
| State contributions | 4,446,836 |
| Other income | 103,803 |
| Total fund revenues | 25,416,305 |
| Expenses | |
| Pension benefit payments | 15,707,123 |
| External investment management | 191,970 |
| Administrative expenditures | 255,134 |
| Contribution refunds | 108,833 |
| Other benefit payments | 308,595 |
| Other expenditures | 511,689 |
| Debt service payment | 5,954 |
| Total fund expenditures | 17,089,298 |
| Ending fund balance | \$248,455,162 |

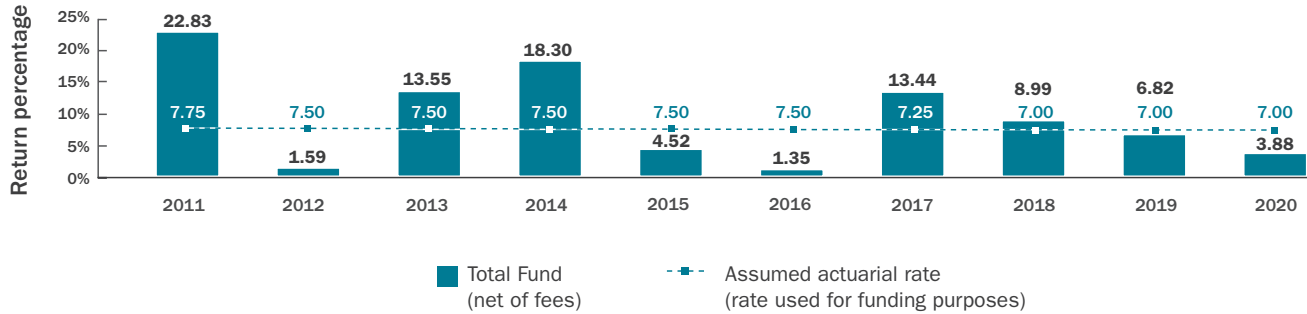
Revenues

CalSTRS' primary sources of revenue are retirement contributions and investment income, with the majority of the revenues coming from the State Teachers' Retirement Plan. Contribution amounts are determined as a percentage rate of members' creditable compensation. Creditable compensation is defined by California Education Code sections 22119.2 and 22119.3 and generally refers to member salary and wages and remuneration in addition to salary. Investment returns are generated by the CalSTRS Investment Portfolio, which earned a time-weighted investment return of 3.9% net-of-fees for the fiscal year ended June 30, 2020.

Historically, investment income funded 60.1% of retirement benefits, with employer, state and member contributions providing 16.0%, 9.4% and 14.5% of the funding, respectively. These percentages can change over time due to fluctuations in net investment income, the adjustments to required member, employer and state contribution rates under the CalSTRS Funding Plan pursuant to AB 1469 and impacts of other legislation such as SB 90. Additional details regarding AB 1469 contribution rates are provided in Appendix 3.

¹ Fund balances are prepared on a legal basis, which combines elements of the accrual and the cash basis of accounting. These figures will differ from balances reported on CalSTRS' Comprehensive Annual Financial Report for the fiscal year ended June 30, 2020, which are prepared using Generally Accepted Accounting Principles. Refer to the "Policies" section for additional detail. Certain figures in this section have been revised from what was previously presented to the board due to refined forecasts.

10 years of time-weighted annual returns (fiscal years ended June 30)



In addition to revenues received or generated by the STRP, CalSTRS also receives a mix of investment income, contributions and other income for the Medicare Premium Payment, Pension2 and Teachers' Deferred Compensation Fund programs, as reflected in the "Relationship of revenues and expenses to funds" table earlier in this section.

Expenses

CalSTRS' major expense categories include pension benefit payments, administrative expenditures associated with maintaining operations and investment-related expenses. The largest expense for CalSTRS is retirement benefit payments for the State Teachers' Retirement Plan.¹ In the 2019–20 fiscal year, retirement benefit and supplemental purchasing power benefit payments for the STRP were approximately \$15.9 billion.

Administrative expenditures associated with maintaining operations include direct costs to administer CalSTRS' pension programs, internal investment costs, capital projects and the costs of operational support functions. Primary drivers for administrative expenditures in the 2019–20 fiscal year were staff salary and benefits,² capital projects, including Pension Solution, various

technology capabilities, including additional cost associated with transitioning to a remote telework environment, facilities maintenance and the pro rata assessed by the state's Department of Finance.

External Investment Management related expenses are continuously appropriated and include fees paid to external investment managers to manage a portion of the CalSTRS Investment Portfolio. External Investment Management fees are largely correlated to the value of the assets under management and investment returns. Portfolio related expenses are also continuously appropriated and include expenses associated with holdings or activity in the portfolio such as securities lending, interest expense and foreign taxes.

1 Additional details on member benefit payments are provided in Appendix 2.

2 Excludes long-term pension and other postemployment benefit costs accrued for financial reporting purposes for CalSTRS employees in accordance with GASB Statements No. 68 and No. 75.

Three-year overview and projected fund balances

Revenue and expense projections are based on an annual evaluation of key performance indicators and the organization's short-term and long-term goals and initiatives. This includes, but is not limited to, incorporating the current assumed actuarial rate of return for CalSTRS' Investment Portfolio; legislative impacts to member, employer and state contribution rates; and costs associated with administering the system.

The following table provides a view of revenues and expenditures by category for all of CalSTRS'

funds (Teachers' Retirement Fund, Teachers' Replacement Benefits Fund, Pension2, Teachers' Deferred Compensation Fund and the Teachers' Health Benefits Fund). Material changes in revenues are primarily driven by statutorily required and board-approved contribution rate changes pursuant to the funding plan, projected investment performance and impacts of other legislation such as SB 90 or other state-approved supplemental payment contributions. While material changes in expenditures can vary by fund, they are largely attributed to rising benefit payments driven by increasing service retirements, changes in state mandated expenditures, operational growth, one-time project funding and variations in investment-related expenses.

Three-year overview and projected fund balances: All funds^{1,2}

(dollars in thousands)

| | Actuals 2019–20 | Budget 2019–20 | Budget 2020–21 | Amount change | Budget 2021–22 | Amount change |
|--------------------------------|----------------------|----------------------|----------------------|--------------------|----------------------|---------------------|
| Beginning fund balance | \$240,128,155 | \$240,128,155 | \$248,455,162 | \$8,327,007 | \$262,403,100 | \$13,947,938 |
| Revenues | | | | | | |
| Investment income | 10,810,644 | 17,558,700 | 18,435,014 | 876,314 | 19,532,350 | 1,097,336 |
| Employer contributions | 6,108,461 | 6,162,571 | 5,933,395 | (229,176) | 5,970,426 | 37,031 |
| Member contributions | 3,946,561 | 4,012,834 | 4,030,509 | 17,675 | 4,122,418 | 91,909 |
| State contributions | 4,446,836 | 4,447,017 | 3,730,521 | (716,496) | 4,274,122 | 543,601 |
| Other income | 103,803 | 132,428 | 130,345 | (2,083) | 93,610 | (36,735) |
| Total fund revenues | 25,416,305 | 32,313,550 | 32,259,784 | (53,766) | 33,992,926 | 1,733,142 |
| Expenses | | | | | | |
| Pension benefit payments | 15,707,123 | 15,909,666 | 16,800,752 | 891,086 | 17,532,428 | 731,676 |
| External investment management | 191,970 | 288,300 | 280,200 | (8,100) | 292,600 | 12,400 |
| Administrative expenditures | 255,134 | 290,616 | 341,667 | 51,051 | 307,382 | (34,285) |
| Contribution refunds | 108,833 | 143,602 | 179,487 | 35,885 | 125,948 | (53,539) |
| Other benefit payments | 308,595 | 292,069 | 320,080 | 28,011 | 331,061 | 10,981 |
| Other expenditures | 511,689 | 550,291 | 378,485 | (171,806) | 332,984 | (45,501) |
| Debt services payments | 5,954 | 5,954 | 11,175 | 5,221 | 11,175 | - |
| Total fund expenditures | 17,089,298 | 17,480,498 | 18,311,846 | 831,348 | 18,933,578 | 621,732 |
| Ending fund balance | \$248,455,162 | \$254,961,207 | \$262,403,100 | \$7,441,893 | \$277,462,448 | \$15,059,348 |
| Percent change | | | | 2.9% | | 5.7% |

1 Fiscal years 2019–20, 2020–21 and 2021–22 include \$1.1 billion, \$297 million and \$583 million one-time, supplemental contributions from the State of California, respectively.

2 For 2020–21, the beginning fund balance represents the actual 2019–20 ending fund balance as the starting point for our budget year estimates. For 2021–22, the beginning fund balance represents the ending budgeted fund balance for 2020–21. This is done to ensure the most current information is used when preparing estimated revenues and expenditures.

Teachers' Retirement Fund

The Teachers' Retirement Fund was established by California Education Code section 22400 and is the largest fund CalSTRS administers. It is a multiple-employer, cost-sharing defined benefit plan composed of the Defined Benefit, Defined Benefit Supplement, Cash Balance Benefit, and Purchasing Power Protection programs. The fund's deposits primarily include member contributions, employer contributions, state contributions and income on investments. The majority of the fund's expenditures are from retirement benefit payments, expenses associated with the CalSTRS portfolio and the ongoing costs of funding CalSTRS' operations.

Changes in budgeted revenues are primarily associated with projected growth in investment returns, contribution rate changes pursuant to the funding plan,¹ legislative impacts on contribution rates related to AB 84 and SB 90 and additional general fund contributions² from the state, projected growth in creditable compensation and the effects of changes in interest rates on other income from loans made to CalSTRS joint ventures. The decline in state contributions in 2020–21 is due to changes in SB 90 supplemental payments.

Increases in overall budgeted expenditures are primarily driven by projected increases in pension benefit payments due to a growing retiree base and an annual non-compounding 2% benefit adjustment. Administrative expenditures are also

projected to increase in fiscal year 2020–21 before declining in fiscal year 2021–22. The overall increase in administrative expenditures in fiscal year 2020–21 is primarily driven by \$47.2 million in additional one-time funding for the Pension Solution Project and state mandated adjustments to employee compensation, benefits and pro rata assessments by the state's Department of Finance.

The subsequent decline in projected administrative expenditures in fiscal year 2021–22 is the result of a \$53 million baseline reduction for the Pension Solution Project, which is partially offset by the Multi-Year Internal Investment Management Plan, increases to employee compensation and pro rata assessments by the state's Department of Finance. Projected expenditures for contribution refunds and other benefit payments can vary significantly each year as they are based on external factors not controlled by CalSTRS such as the size and volume of member refunds requested and inflationary trends, respectively. Other expenditures are mainly composed of portfolio related expenses and are projected to have year over year declines based on declining securities lending rebates and fees and the effects of a lower interest rate environment on master line of credit interest expense. Debt service payments increased in fiscal year 2020–21 as a result of bonds being issued by CalSTRS mid-way through fiscal year 2019–20, in December of 2019, which did not reflect a full year of activity.

1 Additional information regarding contribution rates is provided in Appendix 3.

2 Pursuant to SB 90 and AB 84, the fiscal year 2018–19 state contribution of approximately \$2.2 billion made in advance on behalf of employers will be used to pay the contributions required by employers for 2019–20, 2020–21, 2021–22 fiscal years, such that employers will remit 1.030%, 2.950% and 2.180% less, respectively, than is required by the CalSTRS Funding Plan.

Teachers' Retirement Fund

(dollars in thousands)

| | Actuals 2019-20 | Budget 2019-20 | Budget 2020-21 | Amount change | Budget 2021-22 | Amount change |
|---------------------------------|----------------------|----------------------|----------------------|--------------------|----------------------|---------------------|
| Beginning fund balance | \$238,986,385 | \$238,986,385 | \$247,139,169 | \$8,152,784 | \$260,867,088 | \$13,727,919 |
| Revenues | | | | | | |
| Investment income | 10,773,340 | 17,478,000 | 18,346,000 | 868,000 | 19,440,600 | 1,094,600 |
| Employer contributions | 6,069,181 | 6,115,750 | 5,892,883 | (222,867) | 5,930,709 | 37,826 |
| Member contributions | 3,735,042 | 3,822,395 | 3,810,875 | (11,520) | 3,887,698 | 76,823 |
| State contributions | 4,446,836 | 4,447,017 | 3,730,521 | (716,496) | 4,274,122 | 543,601 |
| Other income | 101,593 | 130,320 | 127,959 | (2,361) | 91,115 | (36,844) |
| Total fund revenues | 25,125,992 | 31,993,482 | 31,908,238 | (85,244) | 33,624,244 | 1,716,006 |
| Expenses | | | | | | |
| Pension benefit payments | 15,696,244 | 15,895,763 | 16,789,152 | 893,389 | 17,521,228 | 732,076 |
| External investment management | 191,970 | 288,300 | 280,200 | (8,100) | 292,600 | 12,400 |
| Administrative expenditures | 252,945 | 287,945 | 338,681 | 50,736 | 304,509 | (34,172) |
| Contribution refunds | 102,711 | 137,000 | 172,092 | 35,092 | 116,383 | (55,709) |
| Other benefit payments | 215,026 | 162,427 | 214,318 | 51,891 | 210,000 | (4,318) |
| Other expenditures ¹ | 508,358 | 547,000 | 374,701 | (172,299) | 328,520 | (46,181) |
| Debt services payments | 5,954 | 5,954 | 11,175 | 5,221 | 11,175 | - |
| Total fund expenditures | 16,973,208 | 17,324,389 | 18,180,319 | 855,930 | 18,784,415 | 604,096 |
| Ending fund balance | \$247,139,169 | \$253,655,478 | \$260,867,088 | \$7,211,610 | \$275,706,917 | \$14,839,829 |
| Percent change | | | | 2.8% | | 5.7% |

1. Other expenditures are primarily composed of securities lending, foreign tax and interest expenses. These expenses represent indirect flow-through costs associated with investment transactions and are not accounted for as administrative expenditures.

Teachers' Replacement Benefits Fund

The Replacement Benefits Program is an excess benefits arrangement for Defined Benefit Program members that is administered as a qualified excess benefit arrangement through a separate pension program apart from the other three State Teachers' Retirement Plan programs. It was created pursuant to Education Code section 24255 and is established in accordance with IRC section 415(m). IRC section 415(b) imposes a dollar limit on the annual retirement benefits an individual may receive from a qualified defined benefit pension plan. The limit for individual CalSTRS 2% at 60 members varies based on the age at which they retire. For calendar year 2020, the federal dollar limit applicable to a CalSTRS member retiring at exactly age 65 and receiving only a single-life benefit from the DB Program was \$195,545. The federal dollar limit for other ages at retirement and other benefit types will differ.

Employer contributions that would otherwise be credited to the DB Program each month are instead credited to the RB Program to fund monthly program costs. Monthly employer contributions are received and paid to members in amounts equivalent to the benefits not paid as a result of IRC section 415(b), subject to withholding for any applicable income or employment taxes.

Actual employer contributions and pension benefit payments came in lower than projected for 2019–20 and are forecasted to remain relatively flat based on historical trends. Additionally, CalSTRS 2% at 62 members are not eligible to receive benefits from the Teachers' Replacement Benefits Program Fund and are not expected to earn benefits that would exceed the federal limit as a result of limits on creditable compensation under the California Public Employees' Pension Reform Act of 2013.

Teachers' Replacement Benefits Fund¹

(dollars in thousands)

| | Actuals 2019–20 | Budget 2019–20 | Budget 2020–21 | Amount change | Budget 2021–22 | Amount change |
|--------------------------------|--------------------|-------------------|-------------------|------------------|-------------------|------------------|
| Beginning fund balance | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Revenues | | | | | | |
| Employer contributions | 10,879 | 13,903 | 11,600 | (2,303) | 11,200 | (400) |
| Total fund revenues | 10,879 | 13,903 | 11,600 | (2,303) | 11,200 | (400) |
| Expenses | | | | | | |
| Benefit payments | 10,879 | 13,903 | 11,600 | (2,303) | 11,200 | (400) |
| Total fund expenditures | 10,879 | 13,903 | 11,600 | (2,303) | 11,200 | (400) |
| Ending fund balance | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| <i>Percent change</i> | | | | 0% | | 0% |

1 Administrative expenditures are paid by the Teachers' Retirement Fund since the TRBF is an extension of the TRF.

Pension2

The Pension2 Program is CalSTRS' voluntary defined contribution plan, established pursuant to Education Code sections 24950 and 24975, and includes two tax-deferred defined contribution plans established under IRC sections 403(b) and 457(b). Pension2 offers low-cost, flexible 403(b), Roth 403(b), 457(b) and Roth 457(b) plans for additional retirement savings. Voya Institutional Plan Services and the Teachers Insurance and Annuity Association are responsible for administrative services, including custody and recordkeeping, while CalSTRS determines the investment options that are offered to plan participants.

CalSTRS' marketing of the Pension2 Program has significantly increased member enrollments in the IRC 403(b) and 457(b) plans. The program experienced overall membership growth of 13.0% in the 2019–20 fiscal year. Given the current member growth trajectory, current forecasts

project increases in participant contributions. As assets in the plans have grown, so have outstanding member loans on plan assets. Income generated from the loans is expected to increase as reflected in other income in the table below, based on historical trends and projected growth in program assets. Even though the number of participants in the program is growing, the population of members eligible to take distributions is also increasing, resulting in additional withdrawals and account rollovers projected for fiscal years 2020–21 and 2021–22 as compared to actual outflows for 2019–20.

Other expenditures represent administrative expenses charged by third-party administrators and are also projected to grow as assets in the plans increase. Although growth in other benefit payments was lower than projected for 2019–20, they have continued to rise along with plan assets. Future forecasts were revised based on current metrics, trends and actual data.

Pension2

(dollars in thousands)

| | Actuals 2019–20 | Budget 2019–20 | Budget 2020–21 | Amount change | Budget 2021–22 | Amount change |
|--------------------------------|--------------------|--------------------|--------------------|------------------|--------------------|------------------|
| Beginning fund balance | \$1,139,894 | \$1,139,894 | \$1,313,887 | \$173,993 | \$1,534,038 | \$220,151 |
| Revenues | | | | | | |
| Investment income | 37,246 | 80,672 | 88,962 | 8,290 | 91,708 | 2,746 |
| Employer contributions | 716 | 1,146 | 1,250 | 104 | 1,179 | (71) |
| Member contributions | 211,519 | 190,439 | 219,634 | 29,195 | 234,720 | 15,086 |
| Other income | 317 | 346 | 385 | 39 | 396 | 11 |
| Total fund revenues | 249,798 | 272,603 | 310,231 | 37,628 | 328,003 | 17,772 |
| Expenses | | | | | | |
| Contribution refunds | 6,122 | 6,602 | 7,395 | 793 | 9,565 | 2,170 |
| Other benefit payments | 66,352 | 98,534 | 78,901 | (19,633) | 94,468 | 15,567 |
| Other expenditures | 3,331 | 3,291 | 3,784 | 493 | 4,464 | 680 |
| Total fund expenditures | 75,805 | 108,427 | 90,080 | (18,347) | 108,497 | 18,417 |
| Ending fund balance | \$1,313,887 | \$1,304,070 | \$1,534,038 | \$229,968 | \$1,753,544 | \$219,506 |
| Percent change | | | | 17.6% | | 14.3% |

Teachers' Deferred Compensation Fund

The Teachers' Deferred Compensation Fund was established pursuant to Education Code section 24976 and is used to account for ancillary activities associated with deferred compensation plans and programs offered by CalSTRS to enhance the tax-deferred financial options for members and their beneficiaries.

The TDCF is funded by the fee revenues received by CalSTRS from deferred compensation plans, a vendor registration program and an employer compliance assistance program. The TDCF includes 403bCompare and 403bComply services. 403bCompare is a state-sponsored website provided by CalSTRS that offers a clear and transparent way to compare investment fees, performance and services for 403(b) plans offered in California. The 403bComply service

offers plan implementation guidance, ongoing plan compliance and maintenance for qualified and nonqualified plans.

Actual investment income for 2019–20 was higher than projected but is forecasted to decrease in fiscal years 2020–21 and 2021–22 due to declining interest rates and lower interest income received on short-term investments. However, other income is projected to increase in fiscal years 2020–21 and 2021–22 due to an increase in asset based and vendor maintenance fees collected from members participating in the Pension2 Program.

Administrative expenditures are projected to increase in the 2020–21 fiscal year as a result of escalating third-party administrator costs. Administrative expenditures experienced a modest decline in 2021–22 and are largely due to state-mandated adjustments to employee compensation.

Teachers' Deferred Compensation Fund¹

(dollars in thousands)

| | Actuals 2019–20 | Budget 2019–20 | Budget 2020–21 | Amount change | Budget 2021–22 | Amount change |
|--------------------------------|--------------------|-------------------|-------------------|------------------|-------------------|------------------|
| Beginning fund balance | \$1,585 | \$1,585 | \$1,814 | \$229 | \$1,657 | (\$157) |
| Revenues | | | | | | |
| Investment income | 33 | 15 | 27 | 12 | 24 | (3) |
| Other income | 1,893 | 1,762 | 2,001 | 239 | 2,099 | 98 |
| Total fund revenues | 1,926 | 1,777 | 2,028 | 251 | 2,123 | 95 |
| Expenses | | | | | | |
| Administrative expenditures | 1,697 | 2,007 | 2,185 | 178 | 2,128 | (57) |
| Total fund expenditures | 1,697 | 2,007 | 2,185 | 178 | 2,128 | (57) |
| Ending fund balance | \$1,814 | \$1,355 | \$1,657 | \$302 | \$1,652 | (\$5) |
| Percent change | | | | 22.3% | | (0.3%) |

1 The TDCF also accounts for all operational and administrative expenditures associated with the Pension2 Program.

Teachers' Health Benefits Fund

The Teachers' Health Benefits Fund is used to administer a cost-sharing, multiple-employer other postemployment benefit plan known as the Medicare Premium Payment Program. The program was established pursuant to Education Code sections 25930 and 25940. The MPP Program pays Medicare Part A premiums and Medicare Parts A and B late enrollment surcharges for eligible members of the Defined Benefit Program who were retired or began receiving a disability allowance prior to July 1, 2012, and were not eligible for premium-free Medicare Part A. Members who retire on or after July 1, 2012, are not eligible for coverage under the MPP Program. The Teachers' Retirement Board has exclusive control of the administration of the fund. The THBF is continuously appropriated and is funded on a pay-as-you-go basis from a portion of monthly employer contributions. In accordance with

Education Code section 25930, contributions that would otherwise be credited to the DB Program each month are instead credited to the MPP Program to fund monthly program and administrative costs. Total redirections to the MPP Program are monitored to ensure that total incurred costs do not exceed the amount initially identified as the cost of the program.

Actual investment income for 2019–20 was higher than projected but is forecasted to decrease due to declining interest rates and lower interest income received on short-term investments. Employer contributions and other benefit payments in fiscal year 2019–20 were lower than forecasted and are projected to decline slightly based on historical trends of reduced membership in the program. Year-over-year changes in budgeted administrative expenditures are primarily associated with state-mandated adjustments to staff compensation and benefits and decreases in pro rata assessments by the state's Department of Finance.

Teachers' Health Benefits Fund

(dollars in thousands)

| | Actuals 2019–20 | Budget 2019–20 | Budget 2020–21 | Amount change | Budget 2021–22 | Amount change |
|--------------------------------|--------------------|-------------------|-------------------|------------------|-------------------|------------------|
| Beginning fund balance | \$291 | \$291 | \$292 | \$1 | \$317 | \$25 |
| Revenues | | | | | | |
| Investment income | 25 | 13 | 25 | 12 | 18 | (7) |
| Employer contributions | 27,685 | 31,772 | 27,662 | (4,110) | 27,338 | (324) |
| Total fund revenues | 27,710 | 31,785 | 27,687 | (4,098) | 27,356 | (331) |
| Expenses | | | | | | |
| Administrative expenditures | 492 | 664 | 801 | 137 | 745 | (56) |
| Other benefit payments | 27,217 | 31,108 | 26,861 | (4,247) | 26,593 | (268) |
| Total fund expenditures | 27,709 | 31,772 | 27,662 | (\$4,110) | 27,338 | (324) |
| Ending fund balance | \$292 | \$304 | \$317 | \$13 | \$335 | \$18 |
| Percent change | | | | 4.3% | | 5.7% |

Policies

The following policies reflect CalSTRS' overall system of principles to guide decisions and achieve balanced outcomes, ensuring the organization models integrity and ethics. Policies are reviewed annually and updated as required. Policies provide an overall framework for our

board governance and fiduciary responsibility, services to members, management and operation of the investment portfolio, and core business processes and activities, including established budget and accounting guidelines.

Board policy¹

Under the California Constitution, Article 16, Section 17, the Teachers' Retirement Board has the sole and exclusive fiduciary responsibility over the assets of the retirement system and the duty to administer the system in a manner that will assure prompt delivery of benefits and related services to the members and their beneficiaries. Therefore, the ultimate authority to manage the system is vested in the board.

Article 16, Section 17 of the California Constitution (Proposition 162)²

- (a) *The retirement board of a public pension or retirement system shall have the sole and exclusive fiduciary responsibility over the assets of the public pension or retirement system. The retirement board shall also have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system.*

This authority provides the basis for which all policies are established and affords the system a significant level of autonomy from state administration as compared to other state agencies.

1 Refer to the **Teachers' Retirement Board Policy Manual** for a comprehensive list of Teachers' Retirement Board policies.

2 Proposition 162 amended the California Constitution to give the board of each public pension system authority and fiduciary responsibility for investment of moneys and the administration of the pension system.

Benefits and Services Policy

CalSTRS desires to expand and improve, in a prudent manner, the benefits and services provided through the funds it administers as appropriate for public retirement plans.

Pursuant to Proposition 162, the Teachers' Retirement Board shall have the sole and exclusive fiduciary responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries. Consistent with this responsibility, one of the goals of the board is that the system's members be served in a prompt, accurate and efficient manner.

Investment Policy and Management Plan

The main goal for CalSTRS is to "maintain a financially sound retirement system." Within this context and in conjunction with the State Constitution and Education Code, the following general investment objectives are designed in consideration of the Investment Beliefs to establish a framework for the operation of the investment portfolio. General investment objectives related to the CalSTRS Investment Portfolio include:

Provide for present and future benefit payments:

Provide liquidity to pay benefits to its participants and their beneficiaries in the amounts and at the times called for through the investment of contributions and other fund assets, strive to meet the assumptions built into the actuarial model and strive to maintain a fully funded pension system.

Diversify the assets: Seek to diversify the assets to achieve the desired rate of return at a prudent level of risk. The asset structure must provide for diversification of risk between asset classes in order to manage the risk/return relationship through strategic asset allocation.

The reduction of CalSTRS' funding costs:

Within prudent levels of risk, the reduction of CalSTRS' funding costs shall be a consideration in the organization and structure of the investment portfolio.

Maintain the trust of the participants and

public: Manage the investment program in such a manner that will enhance the member and public's confidence in the CalSTRS Investment Program.

Establish policy and objective review process:

A formal review of the CalSTRS Investment Policy and Management Plan will be conducted annually, with an updated financial projection developed every two years.

Create reasonable pension investments

relative to other pension funds: The selection of investment vehicles and policies will be judged against other private and public pension funds. Investment performance, asset management costs, staffing and overall expenses will be compared to other public and corporate pension plans, with special emphasis on comparisons with other large public funds.

Minimize costs: Management fees, trading costs and other expenses will be aggressively monitored and controlled.

Compliance with state and federal laws:

The investment program must operate in compliance with all applicable state and federal laws and regulations concerning the investment of pension assets.

Budget Policy

CalSTRS maintains our budget and results under the modified cash basis method. Under this method, revenue is recognized when it is due, and expenses are recognized when a documented commitment to make the expenditure is established or the goods and services are received. Operational expenses are controlled primarily through budget and accounting policies. Among other controls and processes, these

policies manage position requests, the availability of appropriated funds, funding sources, methods for requesting additional funding and the development of budgets.

Specific policies related to the CalSTRS budget include but are not limited to:

Budgetary/Legal basis accounting and reporting: CalSTRS uses the accrual basis of accounting for our Comprehensive Annual Financial Report. We use the modified cash basis of accounting for our budgetary/legal-based reporting, which combines elements of the accrual basis and the cash basis. The Budgetary/Legal Basis Annual Report is prepared in compliance with Government Code sections 12460 and 13344 and in conformance with the Budget Act for each fiscal year.

Budgetary funds period of availability: CalSTRS receives legal authorizations to make expenditures from specific funds and for specific purposes. Operating Budget funds come from both annual and continuous appropriations. Generally, CalSTRS has one fiscal year to encumber and two fiscal years to liquidate funds under an annual appropriation. Other appropriations may have longer periods of availability based on the implementing legislation. Continuous appropriations do not have to be encumbered or liquidated within a specific time frame.

Commitment of budgeted funds policy: CalSTRS uses pre-encumbrances, encumbrances and earmarked funds to designate and reserve budget funds for specific purposes. The most common expenditures made under the Operating Budget are purchases of goods and services, travel expenses, training expenses, and salaries and wages.

Funding sources for budgeted expenses: CalSTRS uses standardized coding to properly identify and report expense data according to the types of commodities and services purchased/

consumed. Approval of all budgeted expenses is subject to the availability of funds within each appropriation. This policy sets in place the responsibility that the correct appropriations are charged at the time of purchase at the division and branch level, with assistance from the Budget Office as needed.

Request additional funding: Within a fiscal year, needs for additional funding authority may be identified. In most cases, funding can be obtained through redirection of available resources within CalSTRS existing budget authority or the upcoming annual budget cycle. In some cases, there may be an immediate need for resources and funding that cannot be delayed until the next budget cycle. In these limited circumstances, there is a formal process to obtain additional funding from internal reserves. This process requires executive approval.

Responsibilities using a decentralized budgeting system: CalSTRS uses a decentralized budgeting system. After the initial budget allotment each fiscal year, the funding for each business area is under the purview of its executive, director or manager. Budget transfers within each major budget category (salaries, benefits or operating expense) are allowed; however, transfers across major budget categories require approval of the Budget Office.

Financial Accounting and Reporting Policy

Specific policies related to financial accounting and reporting include but are not limited to:

Accounting for contributions: The statutory source for revenue policy regarding contributions is Education Code section 22002. It provides that three sources contribute to the retirement fund: members, employers and the state. This policy establishes guidelines for accounting for employer, member and state contributions, including penalties and interest. CalSTRS recognizes revenue for employer, member and state contributions, service credit purchases and

retirement enhancements in accordance with GAAP guidance. With limited exceptions, CalSTRS requires revenue recognition on a full accrual basis. Contributions received from governmental entities are recognized when the monies are made available to CalSTRS through appropriation.

Cash Balance administrative transfer: Members may become members in CalSTRS as part of the Cash Balance Benefit Program rather than the Defined Benefit Program. If they later become eligible for the Defined Benefit Program, there is a provision to transfer funds from the Cash Balance Benefit Program into the Defined Benefit Program.

Operational asset capitalization: Establishes the guidelines for determining what expenditures should be capitalized, how those assets are depreciated and the treatment of subsequent expenditures. These guidelines are discussed in the “Budget overview” section.

Receivable collections and write-off: CalSTRS collects all amounts due to the fund to the full extent allowed by law and records receivables for amounts due to the Teachers’ Retirement Fund and other funds as soon as they are identified. With respect to write-offs, CalSTRS reports all discharged debts to the Teachers’ Retirement Board semiannually. Additionally, CalSTRS submits the Accounts Receivable Report annually to the State Controller’s Office. The report includes all receivable activities, collections, aged receivables, write-offs and account balances, which are published on a quarterly basis on CalSTRS.com.

Allocations for financial and managerial accounting: CalSTRS establishes accounting policies and structure to accumulate and report financial information for the various programs and funds. In cases where financial data is not directly assignable to a specific program or fund, CalSTRS prepares various allocations to ensure the appropriate assets, liabilities, income and expenses for each program and fund are accounted for in accordance with

applicable accounting standards, laws and regulations and completed in a consistent and standardized manner.

Actuarial valuations for financial statement presentation: CalSTRS prepares an actuarial valuation of the State Teachers’ Retirement Plan and the Medicare Premium Payment Program for financial statement purposes annually, as required by GASB Statement No. 67 and GASB Statement No. 74, respectively. CalSTRS uses actuarial assumptions in conformity with Actuarial Standards of Practice issued by the Actuarial Standards Board as the basis for investment return, inflation, mortality, actuarial experience and other assumptions in its actuarial valuations.

Private assets fair value cut-off date for financial reporting: Establishes the financial reporting period end cut-off date for recognizing and recording adjustments to the fair value of private asset investments, which are primarily composed of investments in private equities and real estate.

Financial data objects: Establishes guidelines and requirements that must be followed to administer and manage the Financial Data Objects in BusinessDirect. Financial Data Objects are the master data elements in BusinessDirect. This policy outlines the assessment of impact of the proposed change as well as establishes the roles and responsibilities required for administering and managing FDO changes.

Funding of the Medicare Premium Payment Program: The Medicare Premium Payment Program is funded on a pay-as-you go basis from a portion of monthly employer contributions. Contributions that would otherwise be deposited into the Teachers’ Retirement Fund and credited to the Defined Benefit Program each month are instead deposited into the Teachers’ Health Benefit Fund and credited to the MPP Program to fund monthly program benefits and administrative costs.

Budget development

Budget development and management process

CalSTRS uses a decentralized budgeting system in accordance with our budget policy. The Budget Office oversees and manages the organization’s total budget through collaboration with branch and business area managers. The roles and responsibilities of this system are illustrated below.

The CalSTRS budget includes a forecast of both revenues and expenses for the fiscal year (July 1–June 30). The Budget Office staff develops projections of revenues and expenses based on current year actuals and long-term projections prepared by business areas.

Budget development and management – roles and responsibilities

Business area managers

- Create spending plans
- Monitor budget allotments
- Research and report discrepancies to the Budget Office



Budget Office

- Assist managers with budget questions
- Provide managers with tools to estimate annual expenditures
- Act as a liaison between the CFO, COO, CEO and business areas
- Build the budget and present it to the board

CalSTRS does not maintain a balanced budget in the traditional sense. Budgets are established throughout the organization by branch, programs and functions; however, due to the fluidity of certain types of revenues and expenses such as investment gains and losses, investment management and advisory fees, and benefit payments, budgets for these items may exceed their initial estimated amounts. Conversely, the majority of the operational budget is subject to the legislative process and, therefore, limited to what has been appropriated for the year. CalSTRS maintains internal controls to monitor budget usage throughout the year.

CalSTRS also monitors our pension administration and investment costs relative to peers by participating in CEM Benchmarking studies. With this global perspective on pension plan administrative and investment costs, we further analyze operations and identify where additional efficiencies can be achieved and best practices can be implemented.

CalSTRS budget development process

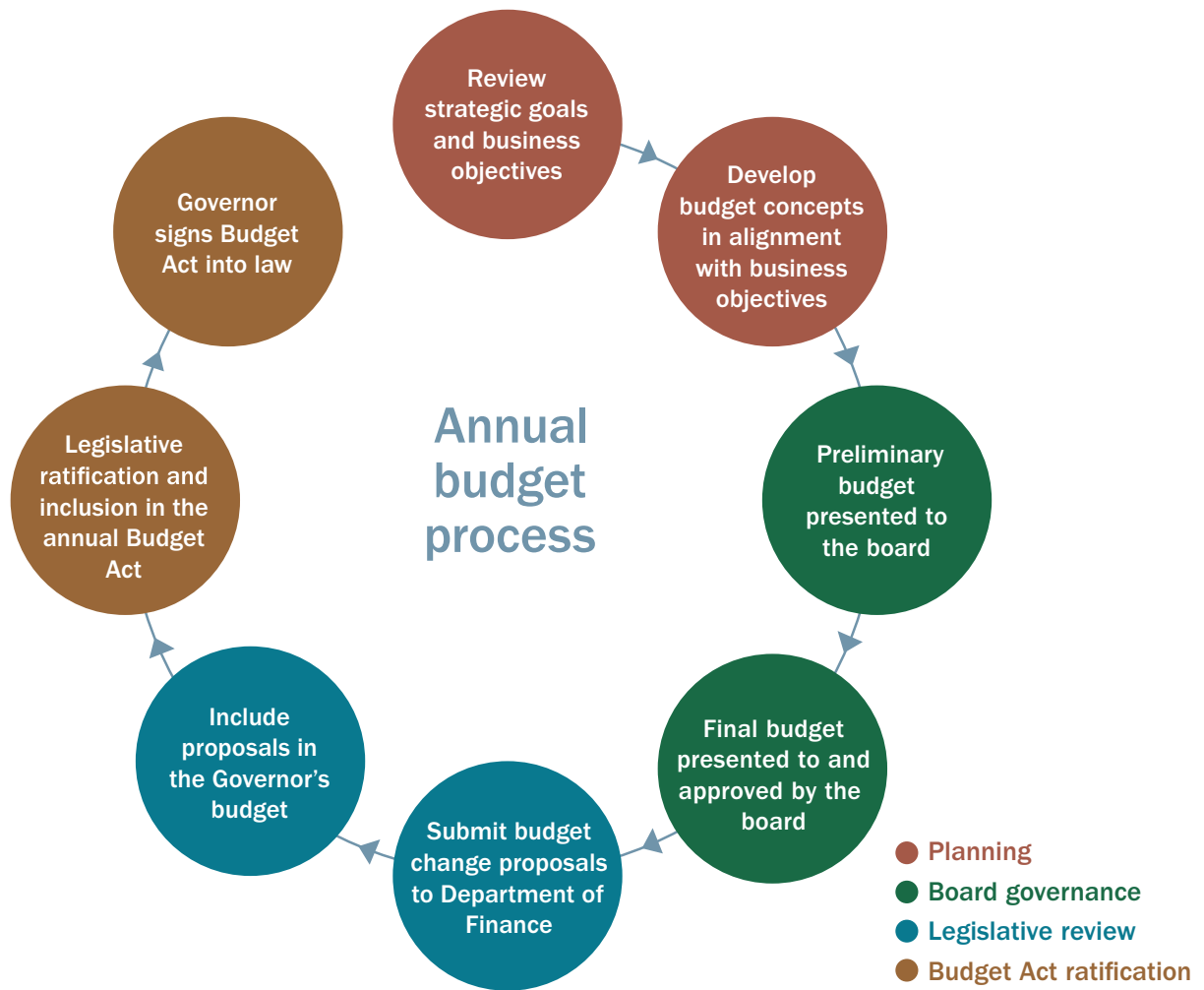
The CalSTRS budget process commences more than a year in advance of its final adoption. The process begins with an assessment of resource needs, which is important to meet strategic objectives as well as address the enterprise risk and compliance landscapes. The process advances with the Teachers' Retirement Board's final approval and the Legislature's ratification and concludes with the Governor's signature on the annual Budget Act. While the board maintains fiduciary authority over the administration of the system, which encompasses resource allocation, certain components of the budget are subject to the state's annual budget process. Authority to approve the use of continuously appropriated funds rests solely with the board, while spending from annual appropriations is subject to the State Budget Act.

CalSTRS receives information on changes to wages and benefit rates, as well as estimates for pro rata assessment by the state's Department of Finance and charged to CalSTRS. Simultaneously, the Budget Office works with business areas to prepare requests for significant changes to the baseline budget to address strategic initiatives and other enterprise priorities. Some of these resource needs are funded from current baseline budget resources through realignment. Others require augmentation to the budget through Budget Change Proposals.

Staff presents a draft of significant budget changes to the board at a public meeting in September. Based on input from the board, staff prepares the final budget package for board review and approval at a public meeting in November.

Staff submits approved budget information to the Department of Finance in December and presents the board-approved CalSTRS budget to the Legislature in the spring preceding the beginning of the fiscal year. For portions of the budget requiring only board approval, the budget is made available on July 1. For portions subject to the State Budget Act, CalSTRS cannot expend funds until the Budget Act is signed by the Governor.

CalSTRS may augment the budget under its authority for continuous and annual appropriations included in the Budget Act. Augmentations to the annual Budget Act support appropriation require ratification by the Legislature and approval of the Governor and include specific spending limits that are overseen by the Department of Finance and the State Controller's Office. Augmentations to continuous appropriations do not require legislative approval, and expenditures are limited only by the resources available within the funding source.



State budget process and timeline

State budget decisions are made throughout the year by both the Legislature and the Governor. During the summer and fall, most state agencies develop Budget Change Proposals to request additional funding and positions. As previously noted, after the Teachers’ Retirement Board approves the final budget in November, CalSTRS submits our budget proposals to the Department of Finance. Pursuant to Proposition 162 and by longstanding mutual agreement with the Department of Finance, CalSTRS’ Operating Budget is submitted for inclusion in

the Governor’s proposed budget without change. The Department of Finance then incorporates our budget into the proposed state budget for release by January 10.

From February to early May, legislative budget committees and subcommittees hold hearings to review the Governor’s proposed budget.¹ In mid-May, the Governor releases a revision of the budget. The Legislature then finalizes its version of the budget, and any differences between the Senate and Assembly versions are negotiated in a legislative conference committee.

1 Additional details regarding the Operating Budget by appropriations are provided in Appendix 5.

The general timeline and CalSTRS' role in the budget approval process is illustrated below.

| | |
|-------------------------------------|---|
| Fiscal year 1 (Prior year) | |
| March–June | CalSTRS internal budget development |
| Fiscal year 2 (Current year) | |
| July–August | CalSTRS internal budget refinement |
| September–November | Board reviews and approves budget for upcoming year |
| December | Budget submitted to Department of Finance |
| January–May | Legislative hearings on the CalSTRS budget |
| June | Budget Act passed by the Legislature and signed by the Governor |
| Fiscal year 3 (Budget year) | |
| July | Start of the fiscal year |

Lawmakers are constitutionally required to pass the budget bill by June 15. The Governor must sign the budget bill and budget-related bills as well as issue line item vetoes by the start of the fiscal year.

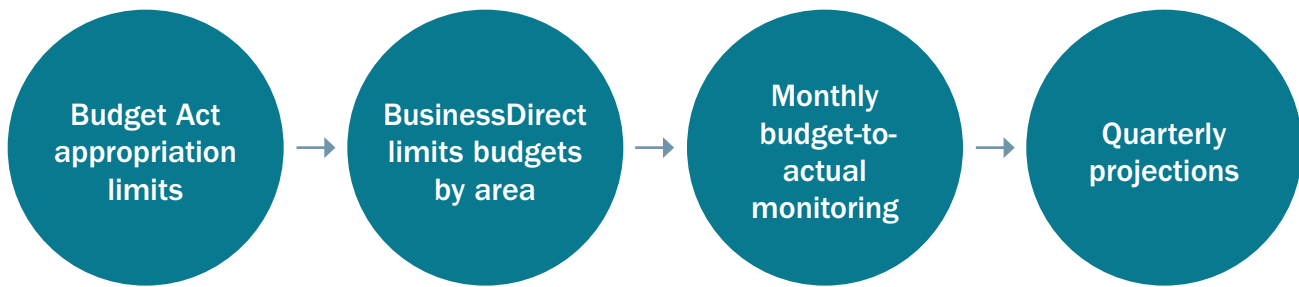
Budget controls and monitoring

After the Governor's Budget is passed, California law requires reconciliation and monitoring of agency budgets and expenditures between the State Controller's Office and the Department of Finance. On an annual basis, the State Controller submits a budgetary-legal basis report to the Governor containing a statement of the funds of the state, its revenues and its expenditures during the preceding fiscal year. This report accounts for prior year adjustments, fund balances, revenues, expenditures and other components on the same basis as that of the applicable Governor's Budget and the Budget Act. This process provides transparency on approved funding levels relative to total expenditures and assists CalSTRS in the financial planning processes.

CalSTRS maintains multiple layers of control and monitoring activities throughout the organization to ensure the adopted budgets are appropriately managed. From a control perspective, the budget is recorded in the CalSTRS enterprise resource planning system, BusinessDirect, which establishes expenditure limits by fund and branch. Additionally, the budget is recorded in both the State Controller's and Department of Finance's statewide budgeting systems, providing overlapping layers of control and reconciliation.

On a monthly basis, staff reconciles budgetary information to SCO records and reviews budget consumption to ensure that transactions are recorded accurately and use is consistent with projections. Revenues and expenditures are also forecasted and monitored monthly to prevent exceeding established resource authority. These analyses are presented to executive management on both a monthly and quarterly basis. The board then receives quarterly reports comparing our budget-to-actual expenditures, which are published on the CalSTRS external website. These reports present performance against budgeted amounts and summarize any changes to the budget.

Budget controls and monitoring



If a business area anticipates a funding shortfall during the year, there are sequential steps to address the deficit. First, the business area must look within its existing budget to evaluate whether funds can be redirected from other sources within each budget category. If the existing budget does not have sufficient funds, then available funding from other business areas within the branch are considered. If funding is not available from within the branch, the Budget Office works to identify available funding from other business areas outside of the branch. The Budget Office works with management in areas with surplus funding to redirect those funds to the business area in need.

When additional funding cannot be identified within existing budgetary allotments, the business area may request the use of internal reserves. Internal reserves are maintained within the approved budget for unanticipated expenses and/or economic uncertainties that cannot be delayed until the next budget cycle. Use of internal reserves depend on approval by both the chief financial officer and the chief operating officer.

CalSTRS prepares reports on actual spending and remaining budgetary spending authority annually and provides these to the State Controller's Office and the Department of Finance.

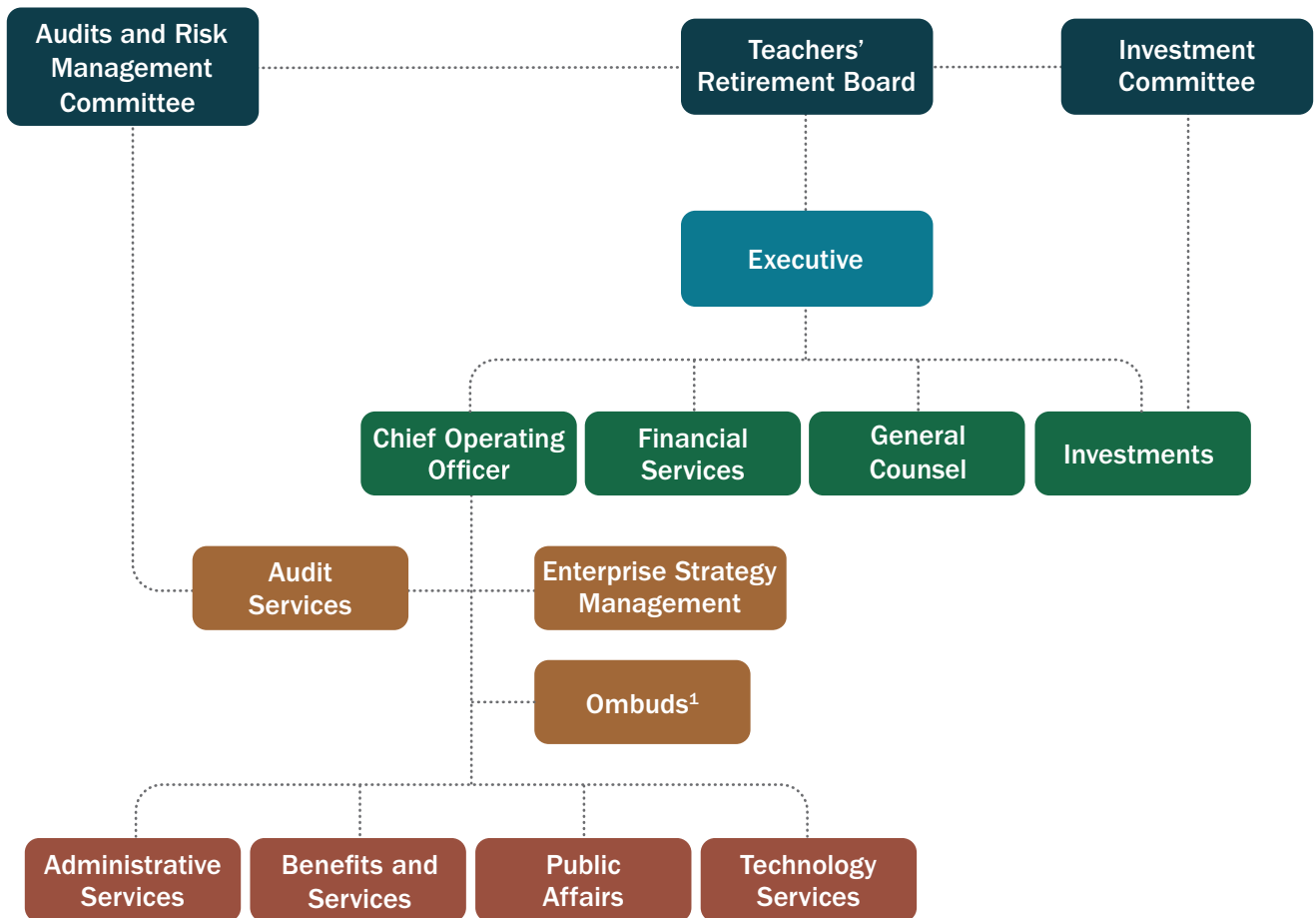
Position control

To manage the variations in workload and large projects that are limited term in nature, CalSTRS maintains authority to establish additional full-time positions above the authorized limit to the extent that funding has been approved by the Teachers' Retirement Board. While it varies by branch, CalSTRS generally has experienced approximately a 5% to 10% annual attrition rate.

Generally, augmentations to authorized positions follow the standard budget process and must be ratified by the Legislature. Once established, authorized positions are recorded into BusinessDirect and monitored monthly. Upgrades or downgrades to existing positions are documented in BusinessDirect and reconciled monthly to approved personnel change documents. Positions that are upgraded past a certain threshold require authorization from the DOF. The board sets the salary and incentive packages for certain executives and investment staff, and other compensation is determined through collective bargaining agreements between the state and employee unions.

Departmental information

The CalSTRS organization



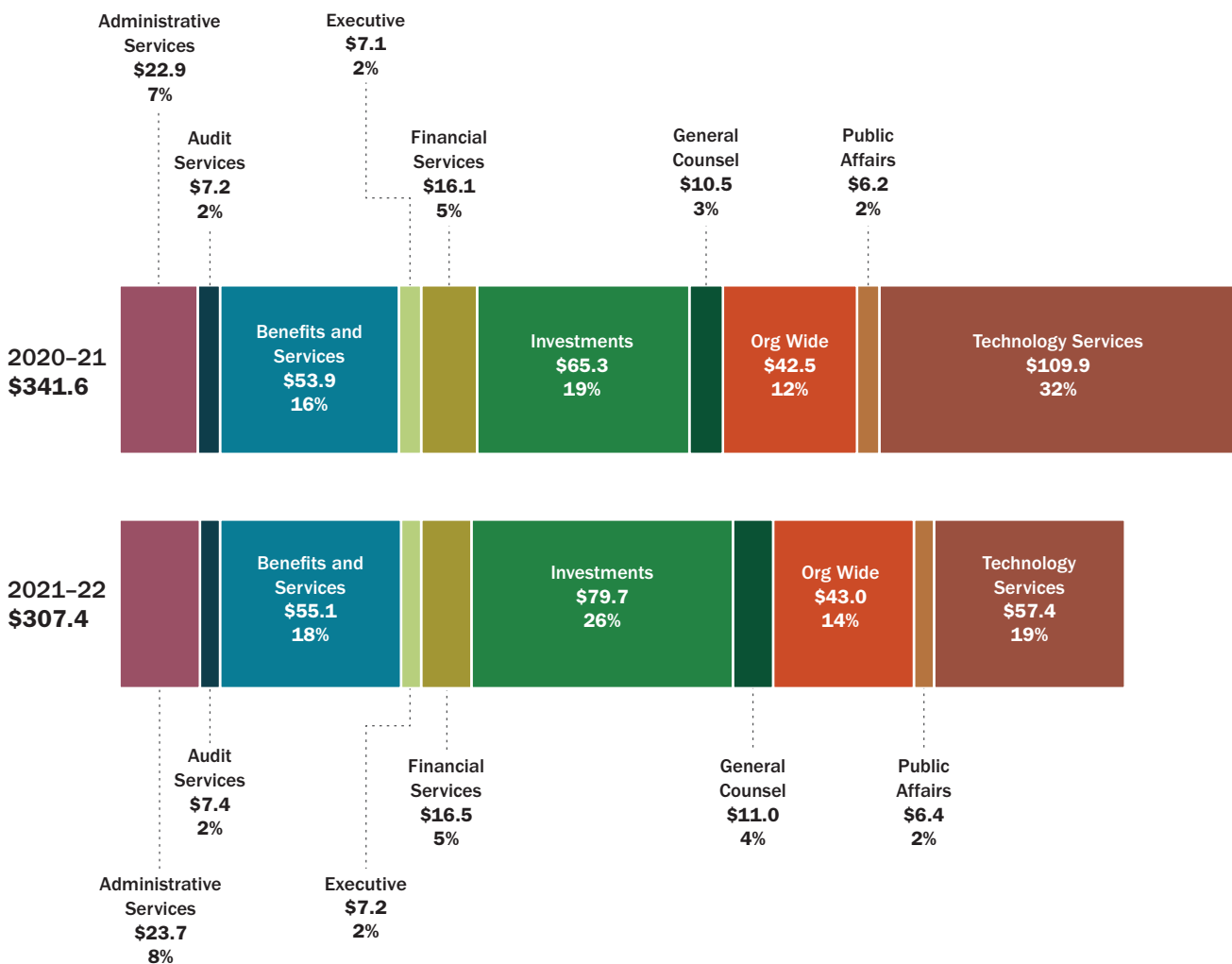
1. Formerly known as Ombudsman.

Branch information

CalSTRS is divided into functional areas, each referred to as a branch. Within each branch are business areas. Each branch has a corresponding functional budget.

The following graphic displays CalSTRS' 2020–21 and 2021–22 total functional budget by branch, which includes salaries, benefits and operating expenses and equipment.

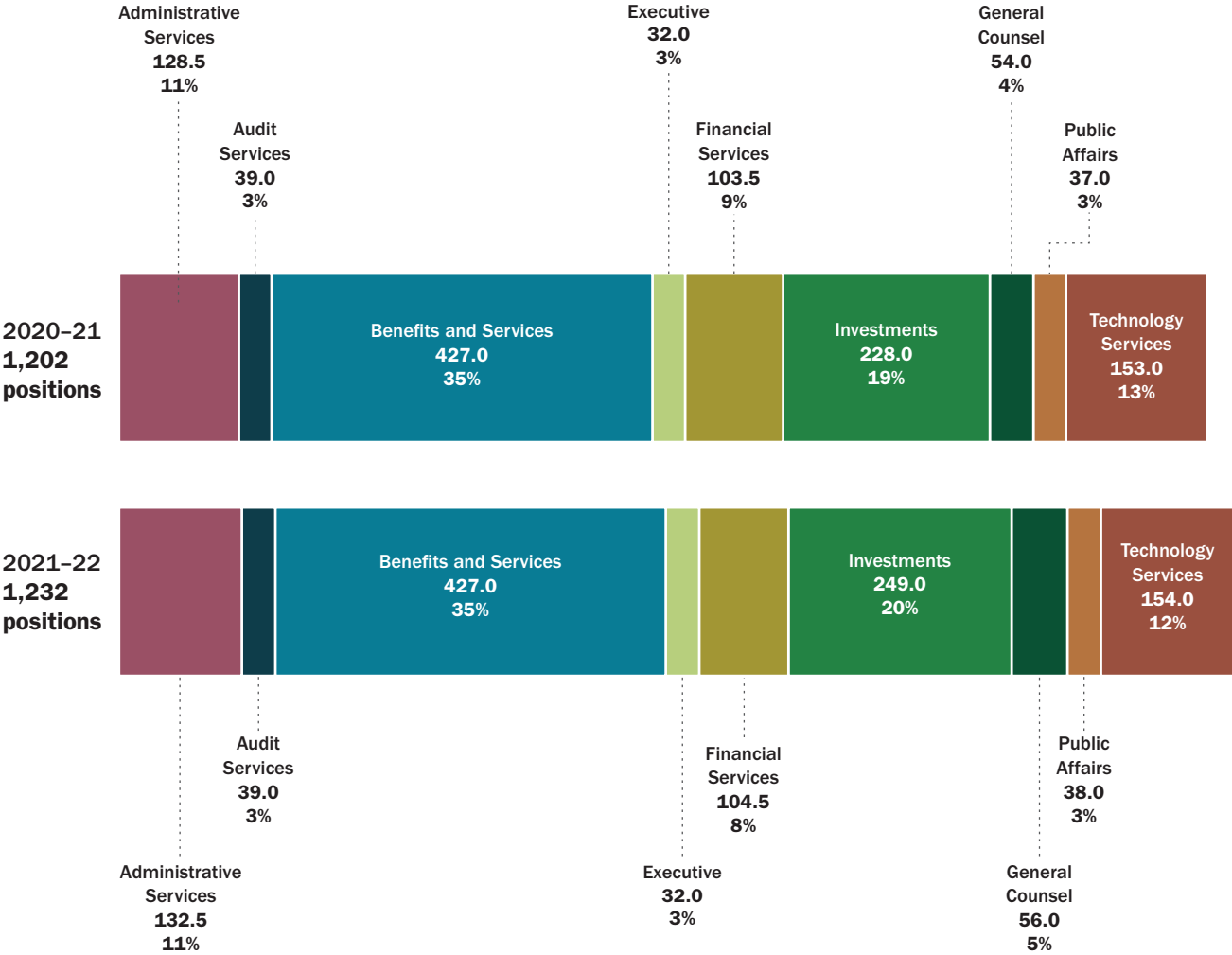
Total Operating Budget by branch¹
(dollars in millions)



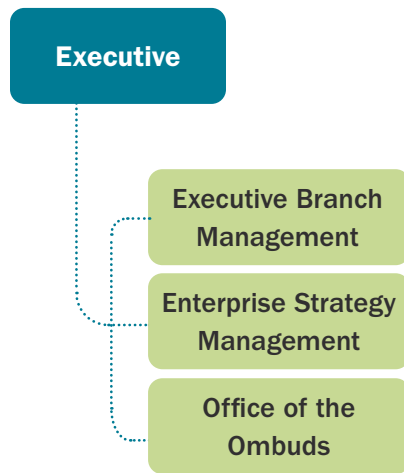
1. Org Wide budget is for enterprisewide expenses, including specific facility costs, office supplies, contracts and internal reserves.

CaSTRS' total workforce by branch is displayed in the following chart. As referenced in the "Budget overview" section, the 2020–21 and 2021–22 Operating Budget has 1,202 and 1,232 authorized positions, respectively.

Total 2020–21 and 2021–22 authorized positions by branch



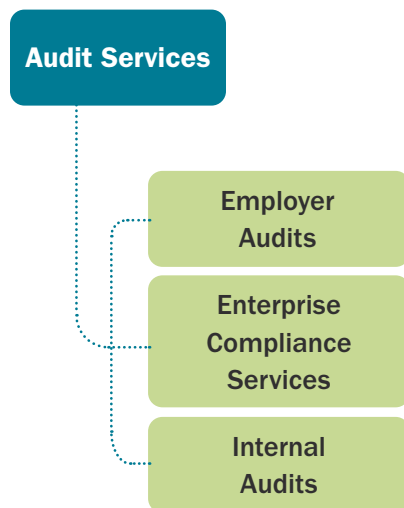
A description of each branch and corresponding budget and position information for fiscal years 2018–19, 2019–20 and 2020–21 is provided on the following pages.¹



Executive

The primary objective of the Executive Branch is to execute the CalSTRS mission of securing the financial future and sustaining the trust of California’s educators. The Executive Branch shapes the organization’s policies, operations and strategies consistent with the Teachers’ Retirement Board’s direction. The branch strives to promote a transparent, accountable, unified and high-integrity organization, whose growth is matched to the mission of paying benefits to educators.

| | Actual 2019–20 | Budget 2020–21 | Budget 2021–22 |
|-------------------------------|-------------------|-------------------|-------------------|
| Authorized positions | 25.2 | 32 | 32 |
| Budget (dollars in thousands) | \$6,597 | \$7,078 | \$7,226 |



Audit Services

From an organizational structure perspective, Audit Services is not considered a branch; however, for independence purposes, the business area has reporting lines to both the Teachers’ Retirement Board and the chief operating officer. The mission of Audit Services is to provide independent, objective assurance through audit, compliance and consulting services designed to add value and improve CalSTRS’ operations. Audit Services assists CalSTRS in accomplishing our objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, internal control and governance processes.

| | Actual 2019–20 | Budget 2020–21 | Budget 2021–22 |
|-------------------------------|-------------------|-------------------|-------------------|
| Authorized positions | 33.8 | 39 | 39 |
| Budget (dollars in thousands) | \$11,622 | \$7,205 | \$7,359 |

¹ Changes to the 2020–21 and 2021–22 Operating Budget are discussed in the “Budget overview” section.

Administrative Services

Facilities Management

Human Resources

Procurement Management

Administrative Services

The Administrative Services Branch provides Human Resources, Facility Management and Procurement Management services to internal and external business partners. The branch focuses on streamlining the organization’s internal operations and providing administrative support to optimize accountability, effectiveness and performance. The branch strives to continuously improve the quality, cost effectiveness and efficiency of CalSTRS’ business functions.

| | Actual 2019–20 | Budget 2020–21 | Budget 2021–22 |
|-------------------------------|-------------------|-------------------|-------------------|
| Authorized positions | 100.4 | 128.5 | 132.5 |
| Budget (dollars in thousands) | \$30,534 | \$22,915 | \$23,718 |

Benefits and Services

Customer Service

Disability and Survivor Benefits

Member Account Services

Retirement Readiness

Service Retirement

Benefits and Services

The Benefits and Services Branch is the largest business area in the CalSTRS organization. The branch’s primary goal is to deliver excellent service and secure the financial future of CalSTRS members. Benefits and Services business areas mirror the member lifecycle, starting with the establishment and maintenance of member accounts supported by accurate data reported from employers followed by ongoing communication through multiple channels. This further includes the delivery of appropriate retirement or disability benefits, the provision of effective education to members and the extension of benefits to survivors.

| | Actual 2019–20 | Budget 2020–21 | Budget 2021–22 |
|-------------------------------|-------------------|-------------------|-------------------|
| Authorized positions | 368 | 427 | 427 |
| Budget (dollars in thousands) | \$50,987 | \$53,895 | \$55,114 |

Public Affairs

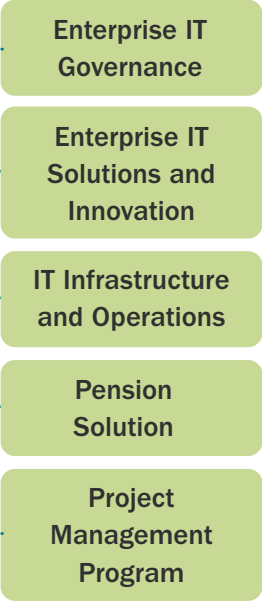


Public Affairs

The Public Affairs Branch manages CalSTRS’ relationships with the state, CalSTRS stakeholders, including members and employers, and the public. As part of this effort, the branch serves as the primary liaison between CalSTRS and key stakeholder groups to provide a clear and consistent message regarding CalSTRS’ priorities, operational activities and fiduciary obligations. In addition, the branch actively engages in the legislative process to shape statutory and regulatory issues impacting the organization.

| | Actual 2019–20 | Budget 2020–21 | Budget 2021–22 |
|-------------------------------|---------------------------|---------------------------|---------------------------|
| Authorized positions | 32.9 | 37 | 38 |
| Budget (dollars in thousands) | \$5,923 | \$6,170 | \$6,367 |

Technology Services



Technology Services

Technology Services realizes CalSTRS’ business goals through technology transformation and information technology operations with quality solutions, excellence in service, strategic partnerships and strong collaboration with internal and external stakeholders. Technology Services contributes to responsible management of CalSTRS’ IT assets through enforcing sensible IT governance, implementing information security, promoting quality management and performing proactive and preventive maintenance as well as continuous improvement.

| | Actual 2019–20 | Budget 2020–21 | Budget 2021–22 |
|-------------------------------|---------------------------|---------------------------|---------------------------|
| Authorized positions | 139.6 | 153 | 154 |
| Budget (dollars in thousands) | \$51,683 | \$109,858 | \$57,439 |

Financial Services

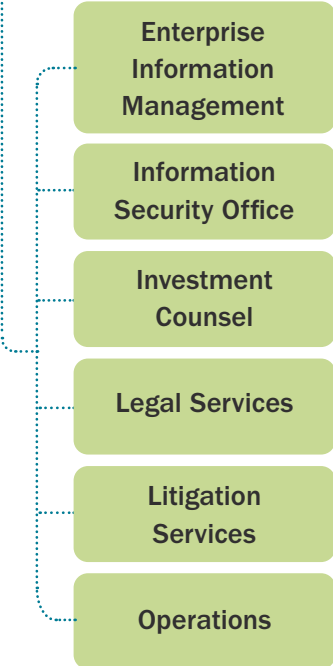


Financial Services

The Financial Services Branch provides financial and business process planning; financial, cost and operational accounting; actuarial services; enterprisewide risk management; and budget, performance and operational financial reporting. The Financial Services Branch plays a key role in preparing actuarial valuations, financial reports and operational budgets, addressing audit issues related to financial reporting and internal control, and advising CalSTRS executives on all fiscal-related matters impacting the organization.

| | Actual 2019-20 | Budget 2020-21 | Budget 2021-22 |
|-------------------------------|-------------------|-------------------|-------------------|
| Authorized positions | 91.6 | 103.5 | 104.5 |
| Budget (dollars in thousands) | \$16,598 | \$16,060 | \$16,524 |

General Counsel

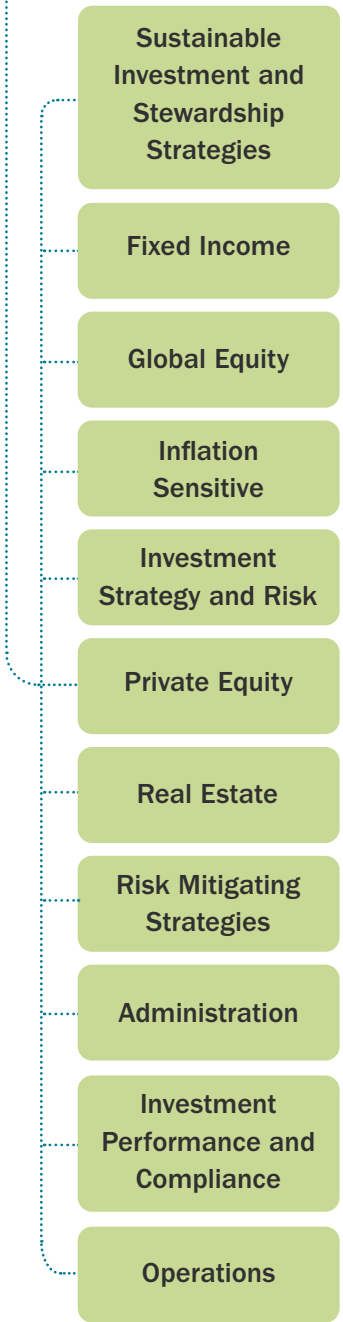


General Counsel

The General Counsel Branch provides legal advice and support to CalSTRS programs, executive management and the Teachers' Retirement Board. In addition, the branch provides independent and objective assurance that CalSTRS' assets are safeguarded, operating efficiency is enhanced, and compliance is maintained with prescribed laws and board and management policies.

| | Actual 2019-20 | Budget 2020-21 | Budget 2021-22 |
|-------------------------------|-------------------|-------------------|-------------------|
| Authorized positions | 48.4 | 54 | 56 |
| Budget (dollars in thousands) | \$10,789 | \$10,744 | \$11,016 |

Investments



Investments

The Investments Branch oversees and manages the CalSTRS Investment Portfolio, which was valued at approximately \$246.0 billion as of June 30, 2020. The Investments Branch's primary performance objective is to achieve the actuarially assumed rate of return at a prudent level of risk. The branch continues to uphold its investment philosophy in long-term patient capital, which is to buy long-term net cash flows and capital gain potential at a reasonable price.

| | Actual 2019-20 | Budget 2020-21 | Budget 2021-22 |
|-------------------------------|-------------------|-------------------|-------------------|
| Authorized positions | 172.5 | 228 | 249 |
| Budget (dollars in thousands) | \$47,627 | \$65,333 | \$79,670 |

Appendix

Appendix 1

Members and beneficiaries at a glance

Today, CalSTRS is the largest educator-only pension fund in the world and the second largest pension fund in the United States. A summary of key statistics about our members and retirees for the Defined Benefit Program is provided below.

Members and beneficiaries

975,993

Total members and beneficiaries

448,419

Active members

213,056

Inactive members

314,518

Retirees and benefit recipients

Annual retirement statistics

July 1, 2019–June 30, 2020



\$15.4 billion

Benefit payments, which include service retirement benefits, disability benefits, survivor benefits and purchasing power supplemental payments

63.3

Average member age at retirement



24.3

Average years of member service credit



58%



Percentage of members selecting the Member-Only Benefit



11,706

Number of service retirements during the fiscal year

\$4,614

Average monthly Member-Only Benefit



Appendix 2

CalSTRS retirement benefits fuel local economies

Defined Benefit Program

Retirees who live in California—Characteristics by county

CalSTRS contributes to California’s economy through the benefits it pays to its members, who may then spend that money in the communities in which they live. CalSTRS paid an estimated \$12.6 billion in benefits to 233,161 retirees living in California during fiscal year 2019–20. The following map shows a range of the amount of benefits paid by county, as well as the locations of the CalSTRS member service centers.



| County | Number of retirees | Estimated benefits paid in FY 2019–20 ¹ |
|-----------------|--------------------|--|
| Alameda | 7,732 | \$418,548,624 |
| Alpine | 13 | 459,108 |
| Amador | 439 | 19,791,876 |
| Butte | 2,205 | 103,088,160 |
| Calaveras | 593 | 27,510,456 |
| Colusa | 121 | 5,638,116 |
| Contra Costa | 7,729 | 395,477,472 |
| Del Norte | 256 | 11,470,848 |
| El Dorado | 2,316 | 116,976,528 |
| Fresno | 6,556 | 339,784,368 |
| Glenn | 141 | 6,644,484 |
| Humboldt | 1,415 | 57,664,080 |
| Imperial | 861 | 51,639,336 |
| Inyo | 164 | 6,886,032 |
| Kern | 4,449 | 241,847,640 |
| Kings | 617 | 32,473,944 |
| Lake | 502 | 22,083,984 |
| Lassen | 230 | 10,670,160 |
| Los Angeles | 44,220 | 2,508,865,920 |
| Madera | 1,397 | 68,631,816 |
| Marin | 2,381 | 113,773,704 |
| Mariposa | 271 | 11,798,256 |
| Mendocino | 1,124 | 49,379,568 |
| Merced | 1,574 | 87,054,792 |
| Modoc | 91 | 3,377,556 |
| Mono | 192 | 9,211,392 |
| Monterey | 3,217 | 168,120,420 |
| Napa | 1,446 | 71,958,744 |
| Nevada | 1,646 | 76,143,960 |
| Orange | 21,698 | 1,339,634,520 |
| Placer | 4,469 | 233,013,660 |
| Plumas | 328 | 14,083,008 |
| Riverside | 13,391 | 726,488,532 |
| Sacramento | 9,418 | 465,060,840 |
| San Benito | 324 | 17,970,336 |
| San Bernardino | 9,833 | 538,415,748 |
| San Diego | 21,646 | 1,160,312,184 |
| San Francisco | 2,935 | 147,219,600 |
| San Joaquin | 4,101 | 218,993,400 |
| San Luis Obispo | 4,399 | 217,328,196 |
| San Mateo | 3,779 | 216,718,092 |
| Santa Barbara | 3,061 | 153,723,420 |
| Santa Clara | 9,431 | 545,941,728 |
| Santa Cruz | 2,946 | 145,933,056 |
| Shasta | 1,664 | 75,758,592 |
| Sierra | 69 | 3,076,020 |
| Siskiyou | 630 | 26,278,560 |
| Solano | 3,126 | 155,899,872 |
| Sonoma | 4,616 | 225,777,792 |
| Stanislaus | 3,266 | 182,438,760 |
| Sutter | 766 | 41,235,312 |
| Tehama | 753 | 35,412,084 |
| Trinity | 135 | 5,606,820 |
| Tulare | 3,164 | 171,577,392 |
| Tuolumne | 680 | 32,493,120 |
| Ventura | 7,093 | 388,554,540 |
| Yolo | 1,192 | 55,785,600 |
| Yuba | 350 | 16,329,600 |
| Total | 233,161 | \$12,594,031,728 |

1 The annualized benefits based on the June 2020 monthly benefits, which also include SBMA payments from the Supplemental Benefit Maintenance Account.

Appendix 3

Contributions

The enactment of AB 1469, the CalSTRS Funding Plan, established a predictable schedule of contribution rate increases shared between members, employers and the state to bring CalSTRS toward full funding by 2046.

Member and employer contribution rates for the Defined Benefit Program are displayed in the following tables. For members, the rates differ depending on when they were first hired to perform service that could be creditable to CalSTRS. If hired before January 1, 2013, members are eligible for full retirement at age 60, whereas those hired on or after this date are eligible at age 62.

Member contribution rates

| Effective date | CalSTRS 2% at 60 members ¹ | CalSTRS 2% at 62 members |
|----------------|---------------------------------------|--------------------------|
| July 1, 2019 | 10.250% | 10.205% |
| July 1, 2020 | 10.250% | 10.205% ² |

Starting in the 2021–22 fiscal year, the funding plan provides the Teachers' Retirement Board limited authority to adjust the employer contribution rate. Those adjustments are limited to 1% of creditable compensation annually, but not higher than 20.25% total and no lower than 8.25%. In July of 2046, the employer contribution rates return to the statutory values established prior to the implementation of the CalSTRS Funding Plan.

Employer contribution rates

| Effective date | Rate ³ |
|--------------------------------|---|
| July 1, 2019 | 18.13% |
| July 1, 2020 | 19.10% |
| July 1, 2021, to June 30, 2046 | Subject to board determination |
| July 1, 2046, and thereafter | Revert to base rate ⁴ of 8.25% |

1 The contribution rate for CalSTRS 2% at 60 members is set in statute at 10.250%.

2 The contribution rate for CalSTRS 2% at 62 members is adjusted if the normal cost increases or decreases by more than 1% since the last time the member contribution rate was set. Based on the June 30, 2019, valuation adopted by the board in May 2020, the increase in normal cost was less than 1%. Therefore, the contribution rate for CalSTRS 2% at 62 members will not change effective July 1, 2020. Since the contribution rate for CalSTRS 2% at 62 members is based, in part, on the normal cost of benefits, the rate may increase or decrease in future years.

3 Pursuant to SB 90 and AB 84, the fiscal year 2018–19 state contribution of approximately \$2.2 billion made in advance on behalf of employers will be used to pay the contributions required by employers for the 2019–20, 2020–21 and 2021–22 fiscal years, such that employers will remit 1.030%, 2.950% and 2.180% less, respectively, than is required by the CalSTRS Funding Plan.

4 The rate as a percentage of teacher payroll that employers were statutorily required to pay prior to the implementation of the CalSTRS Funding Plan.

State contribution rates are calculated as a percentage of the member creditable compensation from two fiscal years prior. The board also has limited authority to adjust state contribution rates from July 1, 2017, through June 30, 2046. The rate can be adjusted up to 0.5% per year. As of July 1, 2020, the state’s contribution rate is 10.328%.

State contribution rates

| Effective date | Rate |
|---------------------------------|----------------------------------|
| July 1, 2019 | 10.328% ¹ |
| July 1, 2020 | 10.328% ² |
| July 01, 2021, to June 30, 2046 | Subject to board determination |
| July 01, 2046, and thereafter | Revert to base rate ³ |

The state contribution rates above include 2.5% for the Supplemental Benefit Maintenance Account. This account was established by Education Code section 22400 to separately manage the annual supplemental payments disbursed in quarterly installments to all benefit recipients whose purchasing power has fallen below 85% of the purchasing power of the initial allowance, as long as funds are available.

The CalSTRS Funding Plan sets the Defined Benefit Program on a sustainable course and ensures a secure retirement for future generations of CalSTRS members. The funding plan offers a reasonable and responsible framework needed to uphold the state’s promise to California’s educators.

1 This rate does not include the impacts of supplemental state contributions pursuant to SB 90.

2 This rate does not include the impacts of supplemental state contributions pursuant to SB 90. In May 2020, the board exercised its limited authority to increase the state contribution rate by 0.5% of the creditable compensation effective July 1, 2020. However, pursuant to AB 84, the state suspended the board’s rate-setting authority for state contributions for fiscal year 2020–21, thereby negating the board’s rate increase of 0.5%.

3 From July 1, 2046, and thereafter, the rates in effect prior to July 1, 2014, are reinstated, if necessary, to address any remaining 1990 unfunded liability.

Appendix 4

Operating Budget by fund

CalSTRS administers a hybrid retirement system consisting of a defined benefit pension plan, cash balance and two defined contribution plans, a postemployment benefit plan and a fund to account for ancillary activities associated with various deferred compensation plans and programs. The Teachers' Retirement Law (California Education Code section 22000 et seq.), as enacted and amended by the California Legislature and the Governor, established these plans and CalSTRS as the administrator. Accordingly, the proposed 2021–22 Operating Budget is administered through the TRF, TDCF and the THBF.

Teachers' Retirement Fund

(dollars in thousands)

| Budget category | Actuals 2019–20 | Budget 2019–20 | Budget 2020–21 | Amount change | Budget 2021–22 | Amount change |
|-----------------|------------------|------------------|------------------|-----------------|------------------|-------------------|
| Salaries | \$114,961 | \$132,161 | \$141,406 | \$9,245 | \$143,535 | \$2,129 |
| Benefits | 58,177 | 67,325 | 67,967 | 642 | 65,751 | (2,216) |
| OE&E | 79,807 | 88,459 | 129,308 | 40,849 | 95,223 | (34,085) |
| Total | \$252,945 | \$287,945 | \$338,681 | \$50,736 | \$304,509 | (\$34,172) |

Teachers' Deferred Compensation Fund

(dollars in thousands)

| Budget category | Actuals 2019–20 | Budget 2019–20 | Budget 2020–21 | Amount change | Budget 2021–22 | Amount change |
|-----------------|-----------------|----------------|----------------|---------------|----------------|---------------|
| Salaries | \$412 | \$575 | \$553 | (\$22) | \$582 | \$29 |
| Benefits | 272 | 287 | 346 | 59 | 376 | 30 |
| OE&E | 1,013 | 1,145 | 1,286 | 141 | 1,170 | (116) |
| Total | \$1,697 | \$2,007 | \$2,185 | \$178 | \$2,128 | (\$57) |

Teachers' Health Benefit Fund

(dollars in thousands)

| Budget category | Actuals 2019–20 | Budget 2019–20 | Budget 2020–21 | Amount change | Budget 2021–22 | Amount change |
|-----------------|-----------------|----------------|----------------|---------------|----------------|---------------|
| Salaries | \$214 | \$275 | \$310 | \$35 | \$335 | \$25 |
| Benefits | 132 | 186 | 224 | 38 | 181 | (43) |
| OE&E | 146 | 203 | 267 | 64 | 229 | (38) |
| Total | \$492 | \$664 | \$801 | \$137 | \$745 | (\$56) |

Appendix 5

Operating Budget by appropriation

The following table displays the 2020–21 and 2021–22 Operating Budgets and key differences compared to the annual Budget Act.¹ The annual Budget Act is primarily composed of the annual Teachers' Retirement Fund appropriation and the annual Information Technology Project Funding, which includes the Pension Solution Project appropriation in 2020–21.

The Budget Act does not include direct transfers, other continuous appropriations, the Teachers' Deferred Compensation Fund or the Teachers' Health Benefits Fund. Direct transfers include the annual pro rata assessment and the SB 84 (Chapter 50, Statutes of 2017)² loan payment, which are assessed by the Department of Finance for all state agencies. Other continuous appropriations are primarily composed of budget for fiduciary insurance, investment audits and the Sustainable Investment and Stewardship Strategies division.

Operating Budget by appropriation

(dollars in thousands)

| | 2020–21 | 2021–22 |
|--|------------------|------------------|
| Teachers' Retirement Fund support appropriation | \$244,566 | \$259,477 |
| Information Technology Project Funding appropriation | 71,500 | 18,500 |
| Subtotal to Budget Act | 316,066 | 277,977 |
| Direct transfers | 14,757 | 17,565 |
| Other continuous appropriations | 7,858 | 8,967 |
| Subtotal to Teachers' Retirement Fund | 338,681 | 304,509 |
| Teachers' Deferred Compensation Fund | 2,185 | 2,128 |
| Teachers' Health Benefits Fund | 801 | 745 |
| Total Operating Budget | \$341,667 | \$307,382 |

1 Additional information regarding the annual **Budget Act** can be found on the Department of Finance's website.

2 SB 84 authorized a \$6 billion supplemental payment from the state's Surplus Money Investment Fund to the California Public Employees' Retirement System to reduce long-term retirement contribution rates for all state agencies. Effective 2018–19, all state agencies are required to begin repayment of the loan.

Appendix 6

Impact of California’s economic challenges on CalSTRS’ biennial budget

In 2020–21, as part of the state’s response to address the fiscal impact of the global COVID-19 pandemic on California’s economy, the administration commenced immediate measures to mitigate the financial impact to the state. This included directives for all departments to reevaluate proposed budget augmentations and enacted mandatory reductions to state-wide administrative expenditures, including changes to employee compensation and a permanent operational efficiency reduction in most state operational expenditures, pursuant to the Budget Act of 2020. As a result of these budgetary reduction measures, the 2020–21 and 2021–22 board-approved Operating Budgets were reduced in the amount of \$23.0 million and \$2.4 million, respectively. We will continue evaluating impacts to the biennial budget in the event there are additional mandatory adjustments to state-wide administrative expenditures as required by the Administration.

2020–21 Operating Budget revisions: (\$23.0) million

The 2020–21 board-approved Operating Budget was revised from \$364.6 million and 1,229 authorized positions to \$341.6 million and 1,202 authorized positions. This reflects an overall net reduction of approximately \$23.0 million, or 6%, relative to the original board-approved Operating Budget. This reduction results from the voluntary withdrawal of the 2020–21 **Organizational Growth Budget Change Proposal**, in the amount of \$8.7 million. This proposal included \$3.9 million for 27 permanently authorized positions and \$4.8 million for new contract expenditures related to building maintenance and various technology capabilities. Additional 2020–21 revisions were composed of net reductions to employee compensation in the amount of \$14.3 million, pursuant to the **Side Letter of Agreement** between the Service Employees International Union, Local 1000, and the State of California. Notable changes to employee compensation include, but are not limited to: a mandatory two-day, or 16 hours a month, reduction in pay equating to approximately 9.23%, administered through a Personal Leave Program for fiscal years 2020–21 and 2021–22; suspension of a 2.5% General Salary Increase that would have been effective on July 1, 2020, until July 1, 2022; and the associated impact of these reductions on benefits.

CalSTRS revised 2020–21 Operating Budget

(dollars in millions)

| | Approved 2020–21 | BCP withdrawal | Employee compensation | Revised 2020–21 | Amount change | Percent change |
|--------------|---------------------|-------------------|--------------------------|--------------------|------------------|-------------------|
| Total | \$364.6 | (\$8.7) | (\$14.3) | \$341.6 | (\$23.0) | (6%) |

2021–22 Operating Budget revisions: (\$2.4) million

The 2021–22 board-approved Operating Budget was revised from \$309.8 million to \$307.4 million. This reflects a permanent reduction of \$2.4 million, or 0.8%, relative to the original board-approved 2021–22 Operating Budget. This reduction represents a permanent operational efficiency reduction, pursuant to the supplemental guidance on achieving these budgetary reduction measures provided by the Department of Finance in Budget Letter 20–37. This directive required all state departments to identify permanent cost savings as a result of transitioning to a longer-term telework environment due to the cascading businesses impacts of the pandemic. The \$2.4 million reduction will be applied to various operating expenses, excluding expenditures for staff salaries and benefits. This expenditure reduction is still pending approval as part of the overall state budget process, which is anticipated to be finalized in June 2021.

CalSTRS revised 2021–22 Operating Budget

(dollars in millions)

| | Approved 2021–22 | Revised 2021–22 | Amount change | Percent change |
|--------------|-----------------------------|----------------------------|--------------------------|---------------------------|
| Total | \$309.8 | \$307.4 | (\$2.4) | (0.8%) |

Glossary

Accrual basis of accounting

The basis of accounting in which transactions are recognized in the fiscal year when they occur, regardless of when cash is received or disbursed. Revenue is recognized in the fiscal year when earned, and expenditures are recognized in the fiscal year when obligations are created, generally when goods and services are received.

Appropriation

Authorization for an agency to make expenditures or create obligations from a specific fund for a specific purpose. It is usually limited in amount and period of time during which the expenditure is to be recognized.

Augmentation

An increase to a previously authorized appropriation. This increase can be authorized by Budget Act provisional language, control sections or other legislation. In addition, increases can also be authorized by the Teachers' Retirement Board for items funded from continuous appropriations. Generally, a budget revision or an executive order is processed to implement the increase.

Authorized positions

Represents the number of full-time equivalent staff authorized for an organization. Authorized positions are reported to, and reconciled with, the State Controller's Office.

Blanket positions

Blanket positions are established to the extent they can be funded within existing appropriation authority; serve as a budgetary policy that provides staffing flexibility for urgent, one-time or limited-duration operational needs; and allow departments to temporarily hire above total authorized positions. Blanket positions do not require formal authorization by the board, Department of Finance or the Legislature.

Branch

A functional business area within the organization.

Business area

Subunit of a branch.

Budget

A plan of operation expressed in terms of financial or other resource requirements for a specific period of time.

Budget Act

Legislation authorizing state programs to expend appropriated funds for the purposes stated in the Governor's budget and amended by the Legislature.

Budget year

The upcoming fiscal year, beginning July 1 and ending June 30, for which the Governor's budget is submitted.

Budgetary savings

The unencumbered balance of an appropriation that continues to be available for expenditure in years subsequent to the year of enactment. Also known as a carryover.

Continuous appropriation

Constitutional or statutory expenditure authorization that is automatically renewed each year without further legislative action.

Department of Finance

A fiscal control agency representing the Governor's administration within the State of California.

Encumbrance

The commitment of all or part of an appropriation. Encumbrances represent valid obligations related to unfilled purchase orders or unfulfilled contracts. Outstanding encumbrances are recognized as budgetary expenditures in budget documents and annual financial reports.

Fiscal year

A 12-month period during which revenue is earned and received, obligations are incurred, encumbrances are made, appropriations are expended and other fiscal transactions are recognized. For CalSTRS and the state of California, the fiscal year begins July 1 and ends the following June 30.

Fund

A legal budgeting and accounting mechanism that provides for the segregation of monies or other resources in the state treasury for obligations

in accordance with specific restrictions or limitations. A separate set of accounts must be maintained for each fund to show its assets, liabilities, reserves and balance, as well as its revenue and expenditures.

Fund balance

The excess of resources over uses. For budgeting purposes, the balance available in a fund condition is the carry-in balance, net of any prior year adjustments, plus revenues and transfers, less expenditures. For accounting purposes, the balance available in a fund is the net of assets over liabilities and reserves that are available for expenditure.

Generally Accepted Accounting Principles

Generally Accepted Accounting Principles refers to the standard framework of guidelines for financial accounting. They are the common set of accounting principles, standards and procedures that companies must follow when they compile their financial statements and are the commonly accepted ways of recording and reporting accounting information.

Governmental Accounting Standards Board

The Governmental Accounting Standards Board establishes accounting and financial reporting standards for state and local governments in the United States that follow Generally Accepted Accounting Principles.

Governor's Budget

The recommendations and estimates for the state's financial operations for the budget year that the Governor presents to the Legislature by January 10 of each year. This document also displays the actual revenues and expenditures of the state for the immediate past year, updates estimates for the current year revenues and expenditures, and projects revenues and expenditures for the upcoming budget year.

Liquidation

Issuance of a payment for an obligation.

Merit salary adjustment

CalSTRS generally augments organizational budgets to account for periodic increases to staff salaries. Pursuant to collectively bargained employment contracts and the California Department of Human Resources, personnel generally receive a salary increase of 5% per year up to the upper salary limit of the classification.

Operating expenses and equipment

A category of an appropriation that includes expenditures such as general expenses, printing, communication, travel, data processing, equipment and accessories for the equipment.

Other postemployment benefits

Other postemployment benefits are benefits (other than pensions) that state and local governments in the United States provide to their retired employees.

These benefits principally involve healthcare benefits, but also may include life insurance, disability benefits and legal and other services.

State Controller's Office

A fiscal control agency responsible for the accountability and disbursement of the state's financial resources.

Unfunded liability

The unfunded liability refers to the amount of additional actuarial assets needed on the valuation date to meet the expected liabilities of the plan incurred from members' past service. The term "shortfall" is also used to describe an unfunded liability, which is also known as a funding gap.



CALSTRS
HOW WILL YOU SPEND YOUR FUTURE?