



Regular Meeting

Item Number 3 – Open Session

Subject: Chief Executive Officer Report - Revised

Presenter(s): Cassandra Lichnock

Item Type: Information

Date & Time: January 25, 2023 – 15 minutes

Attachment(s): None

PowerPoint(s): None

CalSTRS Board Trustee Election Results Certified

CalSTRS educator elected trustees serve four-year terms and are currently expiring on December 31, 2023. The election process was initiated at the September 2022 Board meeting and the nomination period recently ended on January 10, 2023. Candidates were required to collect 250 signatures of active members or participants to qualify as a candidate. CalSTRS received only one nomination for each open board seat. Where only one candidate has been nominated, the Election Coordinator—after verification of the required signatures—cancels the remaining election procedures and designates the single candidate as the winner (per CCR section 24002).

The CalSTRS Election Coordinator validated the submitted signatures, with the results of the nominations below:

- For the PreK–12 (inclusive) seat, Harry Keiley was unopposed and has been certified as re-elected to the seat for the term January 1, 2024–December 31, 2027.
- For the PreK–12 (non-administrator) seat, Denise Bradford was unopposed and has been certified as re-elected to the seat for the term January 1, 2024–December 31, 2027.
- For the community college seat, Sharon Hendricks was unopposed and has been certified as re-elected to the seat for the term January 1, 2024–December 31, 2027.

All three candidates are currently elected CalSTRS Board members. They will begin their new terms on January 1, 2024.

CalSTRS Named one of P&I’s “Best Places to Work in Money Management”

For the eighth year, the highly regarded *Pensions & Investments* magazine has named CalSTRS one of the nation’s “Best Places to Work in Money Management.” The award-winners were chosen based on workplace policies, practices, philosophy and demographics, as well as an employee survey.

Director of Enterprise Risk Management and Compliance Services

I am pleased to announce that Lynn Bashaw is our new Director of Enterprise Risk Management and Compliance Services. Lynn previously served as the Assistant City Auditor for the City of Sacramento for over 7 years and has held other internal audit/financial analyst positions at Alaska Federal Credit Union, Golden 1 Credit Union and the California Earthquake Authority. She has a Master of Business Administration, Management degree and holds numerous certifications, including Certified Fraud Examiner, Certified Government Auditing Professional, Certified Information Systems Auditor, Certification in Risk Management Assurance and has previously held a license for the General Securities Representative (Series 7 & 63). We are excited to have Lynn join our team as we work to mature our risk and compliance programs.

Innovation Update

CalSTRS has selected Accenture as our consultant to assist us in developing our innovation capabilities. Accenture is recognized as an innovation consulting leader by industry analysts and has an extensive innovation practice. They provide services in strategy and consulting, digital experience, technology and operations in over 40 industries, including financial services and the public sector. Their innovation clients include NASA, Kaiser Permanente, Citibank and the state of California.

Accenture has a global network of over 5,000 innovators with specialized expertise. In addition, they have 165 Innovation Labs, studios, centers and hubs across 35 countries. This includes facilities in Sacramento, San Francisco and Los Angeles, which we will be able to access for our program.

Innovation was identified as a major strategic goal and a board leadership priority during development of the 2022–25 *Strategic Plan*. To realize the long-term goal of leading innovation and managing change, we determined that we must grow our capabilities and evolve our culture to support a strategic and innovation mindset.

We have finalized the details of our agreement, and we will request contract approval from the board. The services provided by Accenture will support CalSTRS as we assess our current state of innovation, define innovation for the organization, create an innovation roadmap that aligns with the 2022–25 *Strategic Plan*, build our innovation capabilities and develop a sustainable innovation program.

Accenture will guide us on this journey and assist us in integrating the innovation concepts the board and executives developed during the October offsite meeting.

Fiduciary Training

The General Counsel has worked with the board's independent fiduciary counsel to produce fiduciary training videos to satisfy the training requirement rather than live presentations. The presentation is divided into 3 segments approximately 15 minutes in length with a few questions at the end of each session. The videos will be posted on diligent for board members to review at their convenience.

Headquarters Expansion (HOE) Construction Update

As of December 31, 2022, construction is approximately 85% complete. The Office of the State Fire Marshall (OSFM) signed off on an important milestone for the office level 3 (O3) underfloor in the final week of December, which will allow for furniture installation to begin. The State Elevator Inspector passed the freight elevator inspection, which will enable the exterior crew lift to be dismantled and the west side of the building closed in. While these actions represent significant milestones, stabilizing a project schedule continues to be the focus as the project concludes.

CalSTRS approved a revised Project Schedule with a Substantial Completion Date (SCD) of March 28, 2023 in September 2022. However, in the following months, DPR Builders – the project's contractor, continued to notify Ridge Capital – the project's construction manager, that the schedule was slipping due to complex inspection requirement processes and inability to continue work in areas until inspection passes. Although DPR and Ridge continue to look for ways to find efficiencies without compromising quality, CalSTRS was notified on January 6, 2023 that DPR was unable to meet the revised project schedule of March 28, 2023 and their new projections show a SCD of June 8, 2023. CalSTRS has expressed concerns and has requested that DPR and Ridge perform a thorough assessment of the project schedule and how they plan to address any related budget impacts (if any), before presenting a final project schedule for review. Due to the instability related to the project schedule, CalSTRS executive and Ridge will provide a verbal update on the most up-to-date project schedule status and related impacts at the regular board meeting during the CEO Report.

Construction Activities

Major activities planned for the next 30 days:

- PG&E Permanent Power
- Build-out O3, O4 and O6 IDF Rooms
- Close-up Inspection at O3 Men's and Women's Restroom Soffits & Ceilings
- Install Tile at Shower Rooms
- Sheetrock, Tape, Finish and Paint Locker Rooms and Install Lockers

Construction activities completed and ongoing since last update:

Interior Building:

- Installation of Plumbing & Electrical Trim at O3 All Gender Restrooms
- Install MEP Trim at O3 Walls, Drop ACT, Install Flooring
- Install MEP Trim at O4 Ceilings, Pull Fire Alarm Wiring, Install Light Fixtures at ACT Locations
- Trim Out MEP Devices at Atrium Ceiling, Test & Energize Lighting
- Insulate, Drywall, Tape & Paint Hard Lids and Soffits on O5
- Install ACT Grid, Boarders & Device Tiles on O5
- Install Lights at O6 and O7 Open Office Areas
- Install O6 and O7 Perimeter Jagas
- Paint Walls at O7 IDF
- Paint O7 Sprinkler Piping
- Install Raised Access Flooring at O7
- Elevator #27 - Freight Elevator: Cab and Door Operator Installation, Pit Ladder and Lights & Outlets Installation

Exterior Building:

- Install Curtainwall at Stair 21
- Install Lights and Glass at West Canopy
- MP5, Bar Grating and Louver Installation at Loading Dock
- Framing Exterior Wall, Sheeting Soffits at Stair #23
- Install MP4 at Top of South Canopy
- Painting Steel at Phase II PV Canopy and Installation of Phase I PV Equipment on P3 and P4
- Layout Paver Pedestals at O4 Terrace
- Fire Sprinkler, Fire Alarm Rough-in and Ceiling Installation at O5 Courtyard
- Frame and Sheet Parapet at North Prow and South Prow Insulation and Metal Decking
- Fireproofing Underside of Penthouse Deck and Sheet Interior Penthouse Walls

Garage Levels:

- Energize & Test P2-P4 Lighting
- Traffic Coating Installation
- Install Added Floor Drains at P5
- Chiller Room Build Out
- Parking Elevators #25 & #26: Installation of Hoistway Devices, Screening, Pit Ladder, Cab Build Out

Budget Status

The budget status for the month ended November 30, 2022, is summarized below:

Summary Period: 11/30/22			
Budget Categories	Total Project Budget	Costs to Date	Balance to Complete
Hard Costs	\$ 261,882,703	\$ 198,390,078	\$ 63,492,626
Hard Cost Contingency	\$ 3,000,472	\$ -	\$ 3,000,472
Soft Costs	\$ 50,691,286	\$ 38,215,093	\$ 12,476,193
Project Contingency	\$ 2,925,539	\$ -	\$ 2,925,539
Totals	\$ 318,500,000	\$ 236,605,171	\$ 81,894,829

CHANGE IN HARD COST CONTINGENCY SINCE LAST REPORT:

- MTA furniture relocation.....\$11,989
 - HDMI locations in XS Conf/breakout rooms.....\$10,179
 - Bridge Parapet Wall.....\$19,901
 - Contractor/Subcontractor Schedule delay through March 17, 2023 – partially funded by Hard Cost Contingency.....\$686,206
 - Firewise added consulting fees..... \$20,131
 - Curtain Wall Clip replacement and labor..... \$31,582
- Total \$779,988**

CHANGE IN PROJECT CONTINGENCY SINCE LAST REPORT:

- Construction Manager contract extension.....\$260,000
 - Inspector of Record* funding for depletion of budget line item.....\$77,428
 - Contractor/Subcontractor Schedule delay costs through March 17, 2023 – partially funded by Owner Contingency.....\$ 3,629,931
 - Allowance for Contractor/Subcontractor delay costs for March 18 through March 28, 2023.....\$770,000
- Total \$4,737,359**

* The IOR (Inspector of Record) is the Lead Project Inspector to ensure that all code-prescribed inspections and administrative duties are completed including supervision of assistant project inspectors and monitoring of special inspectors.

Risk Status

Ongoing risks associated with the project:

Project Schedule:

The revised project schedule reflects a SCD of March 28, 2023. However, with the ongoing fluctuations of proposed schedule revisions, the risk of project delays remains a very serious risk. DPR Builders and Ridge Capital continue to assess opportunities to accelerate construction activities and streamline OSFM and IOR inspections. DPR Builders and Ridge Capital are performing a thorough assessment of the project schedule and related impacts. CalSTRS Executive Steering Committee meets regularly with DPR Builders and Ridge Capital executive leaders to understand the schedule impacts and determine solutions that respond to this risk. The board will receive an update on project schedule revisions during the CEO report.

Project Budget:

Project delays remain high which may impact the project budget. The board approved a revised project budget in January 2022 for \$18.5 million, bringing the project's budget total to \$318.5 million. CalSTRS has requested that DPR Builders and Ridge Capital perform a thorough assessment of the project schedule revisions and how they plan to address any related impacts within the approved budget before submitting a final project schedule for review. The board will receive an update on potential budget risks during the CEO Report.

Project Photos:

Northwest Corner -3rd and E Streets



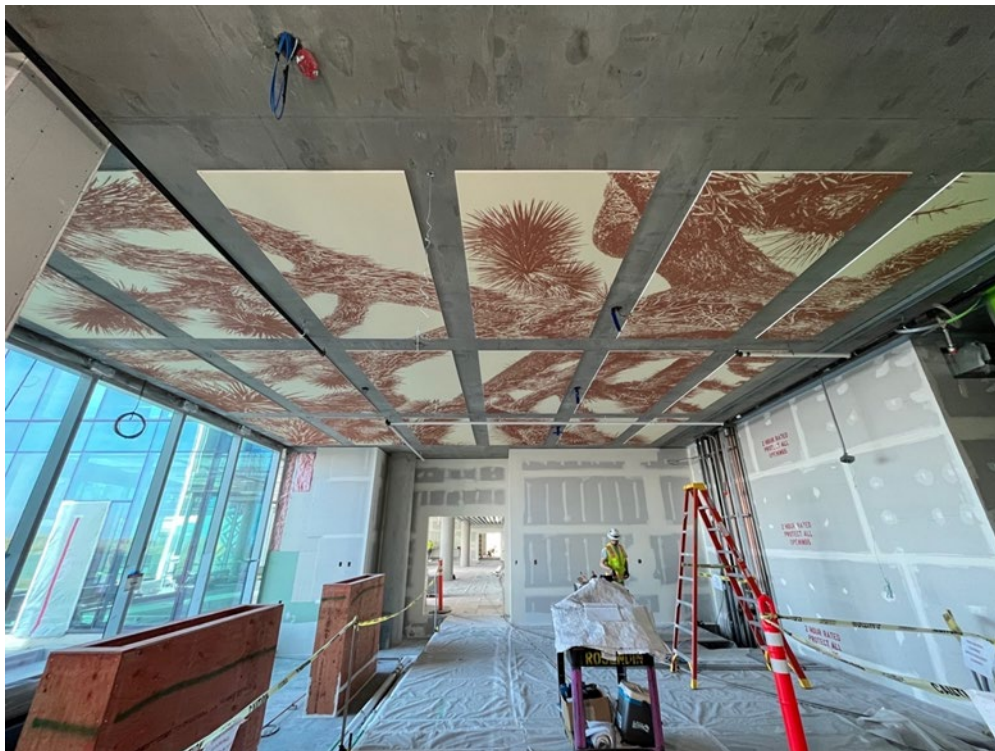
3rd Street level



P1 level: cafe progress



O3 level – break room ceiling panels



Leasing and Occupancy Update

Rising interest rates paired with ongoing economic uncertainty will continue to suppress overall real estate activity as we start the new year. The increased work-from-home policies, tenant rightsizing efforts and ongoing economic headwinds have also continued to influence the state of the office market. Throughout the four quarters of 2022, Sacramento's office market saw 850,000 square feet of negative absorption. This is the second lowest annual absorption on record – only with 2021's annual absorption of -975,000 square feet marking the lowest ever in market history.

In the 4th quarter of 2022, the CBD Downtown office market saw 44,000 square feet of negative absorption for a total of -236,000 square feet year-to-date. The CBD total office vacancy now sits at 20.7% while total market wide vacancy has reached 18.9%. This is a 2.8% rise in the last 8 quarters which equates to a loss of more than 1.8 million square feet. The State of California was the largest contributor to the regions rise in vacancy, accounting for nearly 30% of the negative absorption.

Negative absorption continues to persist, however leasing activity has shown some improvements over the course of the year. Tracked leasing activity in 2022 amounted to 2.3 million square feet. While this fell roughly 16% below last year's volume, new deal activity increased 4% year-over-year, with renewals falling over 40%. This is a positive sign that tenants are beginning to shift their focus towards long-term planning. Moreover, tenants continue to show a preference for Class A product, furthering the flight-to-quality trend that appears to be gaining momentum in the region. Class A leasing has grown 32% year-over-year while Class B leasing has fallen nearly 50%. Additionally, new deal activity in Class A product has grown by 50% since 2021.

Sublease vacancy remains in flux and well above pre-pandemic levels, ending the year at roughly 710,000 square feet. An additional 38,000 square feet was made available for sublease in Q4, however overall sublease vacancy has fallen 4.5% throughout 2022, sitting just under 710,000 square feet. Sublease asking rents have fallen roughly \$0.10 per square foot over the course of the year as sublessors attempt to capture activity.

Asking rates have remained relatively stable but Landlords are continuing to offer leasing concessions such as free rent and increased tenant improvement allowances in order to attract new Tenants. Looking ahead, we expect vacancy will continue to steadily climb as more Tenants implement hybrid real estate strategies. However, we do anticipate a stabilization as economic and market conditions become clearer by mid-2023. Presently, we are responding to a tenant interested in leasing one floor at 100 Waterfront Place. Jones Lang Lasalle continues to market headquarters site and will be hosting a broker group onsite in January.

Bond Financing Update Series 2022 Bonds

The Financing Team successfully secured the additional bond financing necessary for the completion of the Headquarters Expansion (HQE) Project. Below are the significant activities that have taken place since our last update at the November 2022 board meeting:

Bond Sale and Closing

During the weeks leading up to the bond sale on December 7, there was a concerted effort to finalize the official statement, supplement to the trust agreement, facility lease amendment, along with various other bond documents. Once the Preliminary Official Statement posted on November 22, Montague DeRose and Associates, LLC, (MDA) and the State Treasurer’s Office (STO) began an outreach effort to gauge and build interest in the bonds. In addition, with the assistance of MDA, we developed an understanding of the prevailing market conditions, evaluated key economic and financial indicators, and assessed how these indicators would affect the timing and outcome of the sale.

As a result of a well-developed and executed finance plan, the bond sale on December 7 went extremely well. The bond sale was conducted through a competitive sale process that required all bidders to purchase the entire lot of bonds, with the bonds awarded to the firm who submitted the lowest True Interest Cost (TIC). The STO, as our agent for sale, conducted the sale and we received a tremendous amount of interest. We received 26 bids, which is the most participation the STO has seen on a long-term competitive bond offering in at least 20 years. The winning bidder was Citigroup Global Markets, Inc. with a TIC of 3.86% (excluding cost of issuance), which is significantly lower than the not-to-exceed TIC of 5.75% the board authorized in the November 2022 meeting. As a result, the annual average debt service payment of \$960 thousand is well below the \$1.4 million not-to-exceed annual debt service amount the board authorized. When combined with the annual average debt service on the Series 2019 Bonds of \$18.596 million, the annual total will average \$19.556 million. On December 14th the Official Statement was posted. We closed the transaction on December 21st and received \$16,237,424.30 in bond proceeds. Below is a chart detailing the sources and uses of the bond proceeds.

Sources:	
Bond Proceeds:	
Par Amount	\$15,640,000.00
Net Premium	\$597,424.30
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	\$16,237,424.30
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Uses:	
Project Fund Deposits:	
Project Fund	\$15,800,000.00
Delivery Date Expenses:	
Costs of Issuance	\$347,494.30
Underwriter's Discount	\$89,930.00
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	\$437,424.30
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	\$16,237,424.30
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The financing generated \$15.8 million in proceeds to partially cover the additional \$18.5 million in costs needed to complete the HQE project. The remaining \$2.7 million in additional costs will be offset by excess investment earnings from the Series 2019 Bonds. This is a slight improvement over the \$2 million of excess investment earnings we initially projected and presented to the board at the January 2022 board meeting. The net present value savings of the financing, as opposed to “taking a loan” from the trust fund at 7%, is \$4.01 million. This is a slight improvement over the projected NPV savings of \$3.20 million presented to the board in the November meeting, based on a December 2022 sale, as well as \$3.77 million of projected NPV savings had the bonds been issued in April 2022.

Like the Series 2019 Bonds, over the duration the Series 2022 Bonds are outstanding, we will have several on-going reporting responsibilities we will need to perform to maintain compliance with SEC regulations and Federal Tax law. We have established processes in place to perform these additional ongoing reporting responsibilities.

Deposit of Debt Service Payments

As authorized by the board in the November 2022 meeting, to address the shortfall in capitalized interest, facilitate the successful sale of the Series 2022 Bonds, and provide assurances to bondholders that the August 1, 2023, debt service payments on the Series 2019 and 2022 Bonds will be made as scheduled (regardless of substantial completion of the HQE project), CalSTRS deposited \$12,459,698.59 with the bond trustee at the time of issuance of the Series 2022 Bonds. This deposit was invested in State and Local Government Series Securities by the bond trustee and will earn interest of 4.77% until August 1, 2023, at which time the amount deposited, along with interest earned, will be used to pay the \$12,822,808.33 combined debt service payments due on the Series 2019 and 2022 Bonds.

Rating Agency

In early November, CalSTRS completed the rating agency assessments, that included meeting with two rating agencies. We are pleased to announce that CalSTRS received the following ratings for the Series 2022 bonds, which are the same ratings we received from the two rating agencies on the Series 2019 bonds:

S&P Global Ratings: A+

Fitch Ratings: AA

Green Bond Certification

Working with Kestrel Verifiers, the necessary documents and forms were prepared and submitted to the Climate Bonds Initiative to consider the Series 2022 bonds for Climate Bond Certification, which is a form of Green Bond. We are pleased to announce that on November 14th, we received notification from the Climate Bonds Initiative that CalSTRS Series 2022 Bonds met the criteria for certification by the Climate Bonds Standard Board.

Financial Statement Reports:

The CalSTRS Annual Comprehensive Financial Report is published annually to provide a detailed review of CalSTRS' financial, investment and actuarial related activities for a given fiscal year. The ACFR for the year ended June 30, 2022, is now available online at [CalSTRS.com](https://www.calstrs.com) and was submitted timely to the Government Finance Officers Association for the Certificate of Achievement for Excellence in Financial Reporting program.

CalSTRS also published an electronic Popular Annual Financial Report, which provides a summary of the information found in the Annual Comprehensive Financial Report. The PAFR for the year ended June 30, 2022, is now available online at [CalSTRS.com](https://www.calstrs.com) and was submitted to the Government Finance Officers Association for the PAFR Award program.

Emerging and Existential Risks Update

At the September 2022 board meeting, the Enterprise Risk Management (ERM) team presented trustees with the semi-annual emerging and existential risk universe map. See [here](#) to view the board item. The November CEO report on emerging and existential risks reported no changes since the September report.

For this report, the universe map has been updated to include staff's current recognized emerging and existential risks. To better summarize the related risks associated with staffing resources for, Endemic COVID-19, Blended Workforce Challenges, and Post Pandemic Talent, these emerging risks were combined into a single emerging risk called Human Capital. In addition, staff added Ungoverned Software as a Service, and ESG Backlash as new emerging risks. New Ransomware Attack was removed from the emerging risk list as this is now considered a current risk and the Information Security Office has operationalized mitigating this risk.

To summarize, the emerging and existential risks that management are actively monitoring are grouped into the two categories below:

- **Evaluate:** Requires additional investigation to determine if any further risk mitigations are needed.
- **Monitor:** Understand significant changes that may occur that would require a shift in risk approach beyond the significant activity or risk mitigations that are already in place.

Evaluate	
Emerging Risks	Fraud Risk Vulnerability
	Human Capital (Updated)
	Change Fatigue
	Cost of Computing Spike
Existential Risks	Shift to Alternate Education
	Artificial Intelligence

Monitor	
Emerging Risks	Ungoverned Software as a Service (SaaS) (New)
	Evolving Sociopolitical Expectations
	ESG Backlash (New)
	Geopolitical Disruptions
	Inflationary Pressures
	Commercial Real Estate Surplus
	Cyber Insurance Availability
Existential Risks	Comprehensive Pension Reform
	Cybersecurity Event
	Demographic Shift
	Hyperinflation
	Shift in Pension Fund Investment Management

The Enterprise Risk Management team continues to regularly evaluate emerging and existential risks to determine whether these risks require active mitigations, revision to existing mitigations, active monitoring for future consideration or no action needed until the next identification cycle. As events continue to unfold and our understanding of these emerging risks continue to evolve, staff will modify the map accordingly. An updated emerging and existential risk universe map will be provided at the next semi-annual ERM risk report in March 2023.