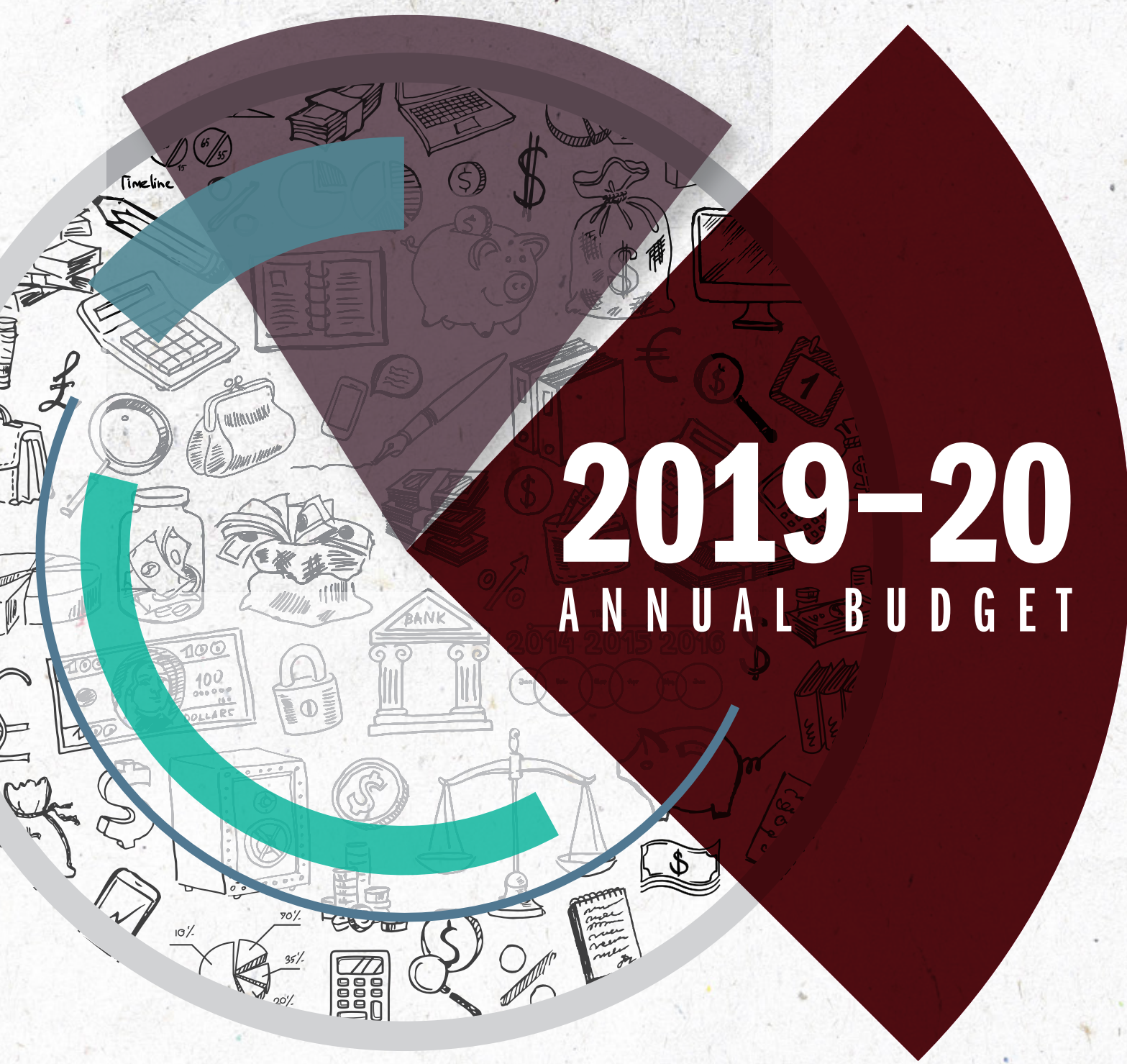


CALSTRS

2019-20

ANNUAL BUDGET





The Government Finance Officers Association
of the United States and Canada

presents this

CERTIFICATE OF RECOGNITION FOR BUDGET PREPARATION

to

**California State Teachers' Retirement System
California State Teachers' Retirement System, California**



The Certificate of Recognition of Budget Preparation is presented by the Government Finance Officers Association to those individuals and their organizations in the government and industry & distinguished Budget Presentation Award. The Distinguished Budget Presentation Award, which is the highest award in governmental budgeting, is presented to those governmental units whose budgets are judged to adhere to the program standards.

Executive Director

Christopher P. Morill

Date August 28, 2018

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 its annual budget beginning July 1, 2018. In order to receive this award, a governmental unit must publish a budget document that meets program criteria as a policy document, as an operations guide, as a financial plan and as a communications device. This award is valid only for fiscal year 2018-19. We believe our 2019-20 Annual Budget continues to conform to program requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

Graphic Design USA presented an American Graphic Design Award to the California State Teachers' Retirement System for the 2018-19 Annual Budget submission to the GFOA.

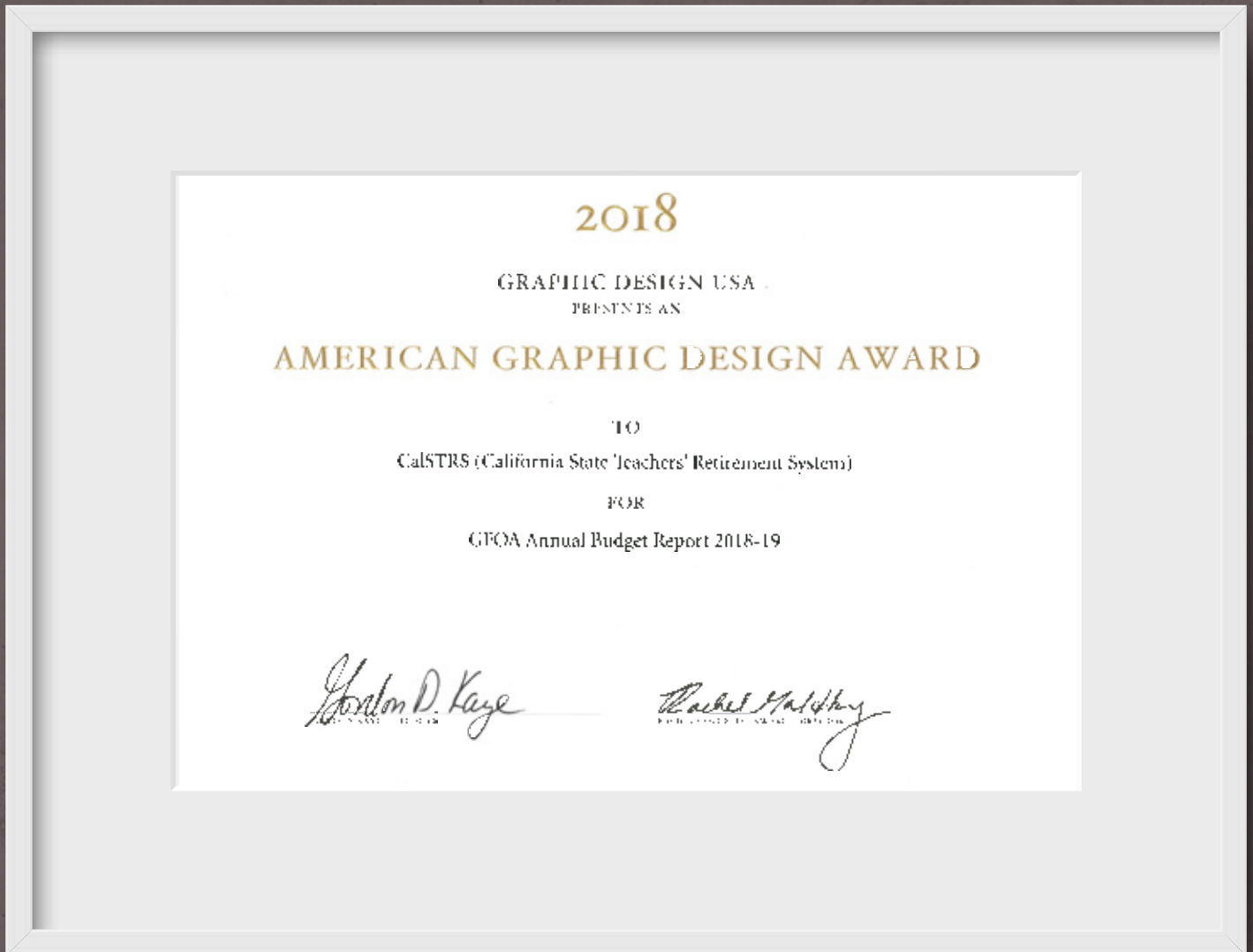




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May 21, 2019



Chief Financial Officer's Transmittal Letter

As the new Chief Financial Officer of the California State Teachers' Retirement System, it's an honor to be a part of an organization with an unrelenting commitment to its mission and core values. I am excited to contribute to long-term value creation for all of CalSTRS' stakeholders as we work diligently toward securing the financial future of California's educators through transparency, collaboration, thought leadership and trust.

I am pleased to present the 2019–20 California State Teachers' Retirement System Annual Budget. As trusted financial stewards, our annual budget is mission-driven, remaining steadfast in the face of growing internal and external complexity. Guided by our strategic plan, this budget advances our organizational priorities through effective resource allocation. Our strategic plan goals include a well-governed, financially sound fund, strong partnerships and services with members and employers, optimized information system capabilities, and operational efficiency that enhances alignment with our mission and vision. Aligned with these objectives, CalSTRS' total 2019–20 budget is \$547.2 million and includes 1,151 authorized positions.

Looking ahead, our 2019–20 budget focuses on enterprise-wide strategic and transformational initiatives, including the CalSTRS Headquarters Expansion Project, enhancing our organizational compliance framework and continued integration of the new pension administration system.

As CalSTRS continues to grow, it is imperative to the success of the organization to sustain a robust and progressive workforce. Due to increasing complexities in investment markets, the financial services sector and public pension plan administration, CalSTRS staff has increased and will continue to increase over the next two decades. As part of this growth and our broader investment management philosophy, we intend to hire additional staff in the Investments Branch to manage more assets internally, reducing reliance on external managers.

Consistent with this long-term strategy, the Teachers' Retirement Board unanimously approved the CalSTRS Headquarters Expansion Project with a budget of \$300 million using bond financing to accommodate current and future staffing needs of the organization. The new building asset is an investment for CalSTRS' future, one that we expect will meet the organization's needs for the next 30 years.

To continue adapting to an ever-changing regulatory and legislative landscape, this budget includes eight new authorized positions to mitigate risk through the establishment of an enterprise compliance function, an augmentation to the litigation team, and the establishment of a dedicated public relations staff to engage stakeholders on sensitive environmental, social and governance issues. By ensuring the organization is adequately resourced, this investment will serve to enhance existing compliance activities, further enabling us to manage operational, financial, legal and reputational risks.

Transitioning to modernized and integrated information technology systems is essential to delivering quality services to our members and employers. This budget fosters CalSTRS' commitment to upgrading its existing infrastructure capabilities to support a multi-year effort to replace the existing pension administration system. The new system, Pension Solution, is designed to improve efficiencies while optimizing services for CalSTRS members, employers and staff.

With an emphasis on transparent planning, budgeting and reporting, we are committed to meeting the needs of today's challenges while planning for the future needs of the system. Through balanced and responsible investments, prudent resource allocation, fostering business and service delivery through digital transformation and enhancing services to our members, the 2019–20 budget takes progressive steps toward long-term fiscal sustainability.

Remaining attuned to CalSTRS' long-term financing horizon helps us as an organization prepare for the future, so we can collectively contribute in more meaningful and purposeful ways. With this vision of success, we position ourselves for exemplary performance in the coming year and beyond.

Respectfully submitted,



Julie Underwood
Chief Financial Officer
CalSTRS



THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

Photo by Daniel Liu, CalSTRS

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.

CALSTRS OVERVIEW

The California State Teachers' Retirement System was established in 1913 to provide retirement benefits to California's public school teachers. CalSTRS administers a hybrid retirement system consisting of traditional defined benefit, cash balance and defined contribution plans for California's educators, prekindergarten to community college. As a global institutional investor with \$223.8 billion in portfolio assets as of June 30, 2018, 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 nearly 950,000 public school educators and their beneficiaries, employed in approximately 1,740 public school districts, community college districts, county offices of education, regional occupational centers and programs and select state agencies. Membership in the CalSTRS Defined Benefit Program includes California public school employees who teach, are involved in selecting and preparing instructional materials, provide vocational or guidance counseling or are supervising people engaged in those activities. With seven member service centers and 25 satellite offices across California, CalSTRS provides a breadth of retirement and benefits planning and education to our members.

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

As a global institutional investor with \$223.8 billion in portfolio assets as of June 30, 2018, CalSTRS is the largest educator-only pension fund in the world, and the second largest pension fund in the United States.



San Diego Member Service Center

Photo by Clarissa Resultan, CalSTRS

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 nearly 950,000 public school educators and their beneficiaries. Over the last 105 years, CalSTRS has been an important part of California's evolving history.

- **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 was \$500.
- **1929**—The Great Depression begins.
- **1935**—School districts begin contributing for the first time.
- **1937**—Golden Gate Bridge opens.
- **1944**—CalSTRS vesting changes from 30 years to 10 years.
- **1953**—Earl Warren, California's 30th governor, is appointed Supreme Court Justice.
- **1956**—Benefits begin being 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**—CalSTRS creates its first tax-sheltered annuity program.
- **1969**—Man first walks on the moon.
- **1970**—CalSTRS begins investing in real estate and equity investments.
- **1987**—Internal management of the portfolio starts.
- **1989**—World Wide Web is invented.
- **1990**—Congress passes the Clean Air Act Amendments, requiring states to demonstrate progress in improving air quality.
- **1991**—CalSTRS begins global diversification.
- **2000**—California celebrates 150th anniversary of statehood.
- **2004**—CalSTRS is the second-largest defined benefit plan in the U.S.
- **2007**—Portfolio posts a 21 percent return which places CalSTRS in the top 1 percent of all U.S. pension plans at \$175 billion.
- **2008**—Global financial markets experience turmoil.
- **2013**—CalSTRS celebrates 100 years.
- **2018**—CalSTRS reports 9.0 percent net investment return for fiscal year 2017–18, exceeding the actuarial assumed rate of return for the second consecutive year.

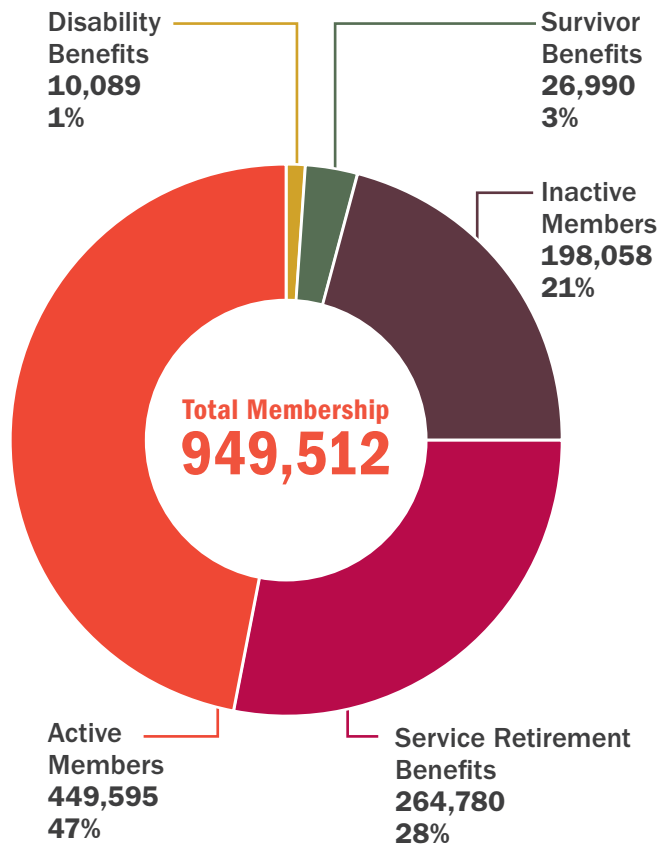
SERVICE TO MEMBERS AND EMPLOYERS

Consistent with the 2019–20 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. This budget reflects our commitment to ensuring the organization continues to deliver financial awareness education and tools to help members make informed decisions about saving for retirement over the course of their careers.

CalSTRS operates member service centers throughout the state, with locations in West Sacramento, Fresno, Glendale, Santa Clara, Irvine, San Diego and Riverside. Member service centers offer financial education services through workshops, outreach, counter assistance, telephone and in-person sessions. Every year, tens of thousands of members take advantage of these services, as well as the opportunity to walk in to our member service centers and receive personal assistance.

As a part of advancing the organization’s ability to deliver promised retirement benefits, member service centers offer multiple channels to connect with members and continue to develop and expand education products, financial literacy information and member services. These include online services, benefits planning services and workshops that explain retirement options and stress the need for early savings. With web-based information and more than 40 publications, we strive to be our members’ trusted guide to retirement. Members may reach a CalSTRS Contact Center agent by phone, secured online message or written correspondence. CalSTRS also conducts outreach through job fairs and on-campus presentations.

2018 Members by Numbers



It is CalSTRS’ continued goal to remain agile in delivering services and enhancing member education and outreach efforts. Staff evaluates the educational services provided to our membership on an ongoing basis, remaining mindful of members’ needs and resources by reviewing data and member demographics to best determine the effectiveness of, and the demand for, CalSTRS service offerings. In addition, CalSTRS monitors member satisfaction by regularly surveying stakeholders to ensure they receive accurate, timely and thorough answers to their questions. Utilization of these surveys allows us to monitor overall trends in our programs that help us to accurately budget our future ability to meet our members’ needs. Additional details related to membership statistics are provided in Appendix 1.

Connecting With Members to Engage and Inform in 2017-18



23,287

members participated in one-on-one or group benefits planning sessions



13,464

members received front counter assistance



6,518

Members attended workshops



1,239

members joined a telephone benefits planning session



Photo by Clarissa Resultan, CalSTRS

In addition, CalSTRS provides a balanced mix of feature-oriented, informative and industry-focused messaging across social media platforms. By regularly posting informative content, CalSTRS encourages member and stakeholder engagement on Facebook, Twitter, Instagram, LinkedIn, YouTube and Pinterest.

Growth on Social Media Platforms Continued to Increase in 2017-18



↑ 16%

+3,878 Facebook Page Likes



↑ 18%

+1,252 Twitter Followers



↑ 23%

+852 LinkedIn Followers



↑ 15%

+149 Instagram Followers

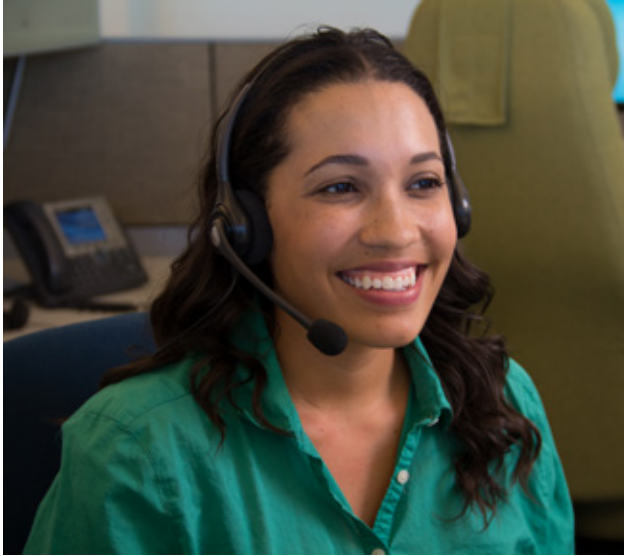


Photo by Clarissa Resultan, CalSTRS

Service to members does not stop at customer contact. CalSTRS continues to address the full spectrum of retirement security by supporting or sponsoring legislative efforts designed to protect benefits. Additionally, CalSTRS staff supports the employer reporting process through education, collaboration and continuous improvement.

By providing these financial awareness and retirement planning tools, 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.

ORGANIZATION 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. The board members carry the fiduciary responsibility to ensure that the system is sustainable over the long term.

The board includes:

- Three member-elected positions representing current educators.
- A retired CalSTRS member appointed by the Governor and confirmed by the Senate.
- Three public representatives appointed by the Governor and confirmed by the Senate.
- A school board representative appointed by the Governor and confirmed by the Senate.
- Four board members who serve in an ex-officio capacity by virtue of their California office: Director of Finance, State Controller, State Superintendent of Public Instruction and State Treasurer.

Board members, excluding the ex-officio members, serve four-year terms.

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 in compliance with its policies and rules, and a Chief Investment Officer to direct the investment of CalSTRS' portfolio.

Executive Staff

The CalSTRS Executive staff is committed to implementing the direction set by the board and is responsible for day-to-day operations of the system.

TEACHERS' RETIREMENT BOARD¹



Dana Dillon
Board Chair
K-12 Classroom Teacher
Elected Member



Sharon Hendricks
Board Vice Chair
Community College Instructor
Elected Member



Keely Bosler
Director of Finance
Ex-Officio Member



Joy Higa
Public Representative



Harry M. Keiley
K-12 Classroom Teacher
Elected Member



Fiona Ma
State Treasurer
Ex-Officio Member



William Prezant
Public Representative



Tony Thurmond
State Superintendent of
Public Instruction
Ex-Officio Member



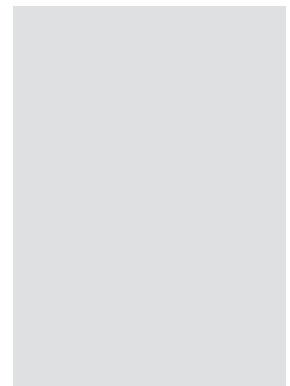
Nora E. Vargas
School Board Representative



Karen Yamamoto
Retiree Representative



Betty Yee
State Controller
Ex-Officio Member



Vacant
Public Representative

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

CALSTRS EXECUTIVE STAFF¹



Jack Ehnes
Chief Executive Officer



Cassandra Lichnock
Chief Operating Officer



Julie Underwood
Chief Financial Officer



Brian J. Bartow
General Counsel



Christopher J. Ailman
Chief Investment Officer



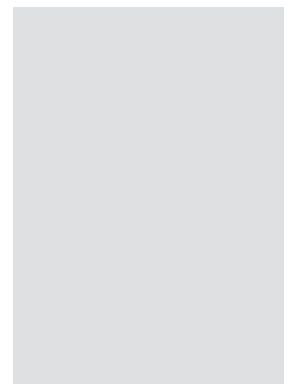
Lisa Blatnick
Chief of Administrative Services



Grant Boyken
Public Affairs Executive Officer



Ashish Jain
Chief Technology Officer



Vacant
Benefits and Services
Executive Officer

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

STRATEGIC PLAN AND PERFORMANCE MEASUREMENT

STRATEGIC PLAN

The 2019–22 Strategic Plan lays out a set of 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 Teachers' Retirement Board. We are proud of the discovery and wide-ranging work done in the development of this new plan that fuels our forward momentum and guides our future direction.

This three-year plan establishes four overarching goals, 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, Chapter 47 Statutes of 2014 (AB 1469) is one aspect of

ensuring a sound trust fund. Our investment and governance practices as a board and staff contribute significantly.

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.

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 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. As they pour into the lives of California's future, we are dedicated to preparing them to enjoy a future reward.

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 board and 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.

STRATEGY IMPLEMENTATION THROUGH FINANCIAL MANAGEMENT

Operating and Transforming the Organization

Remaining fiscally prudent, CalSTRS is consistently evaluating financial plans to deliver strategic objectives and targets, and ensuring effective utilization of the system's resources. The charts below highlight CalSTRS' budget trends for 2017–18, 2018–19 and 2019–20, classifying planned expenditures associated with operating and transforming the CalSTRS organization. This

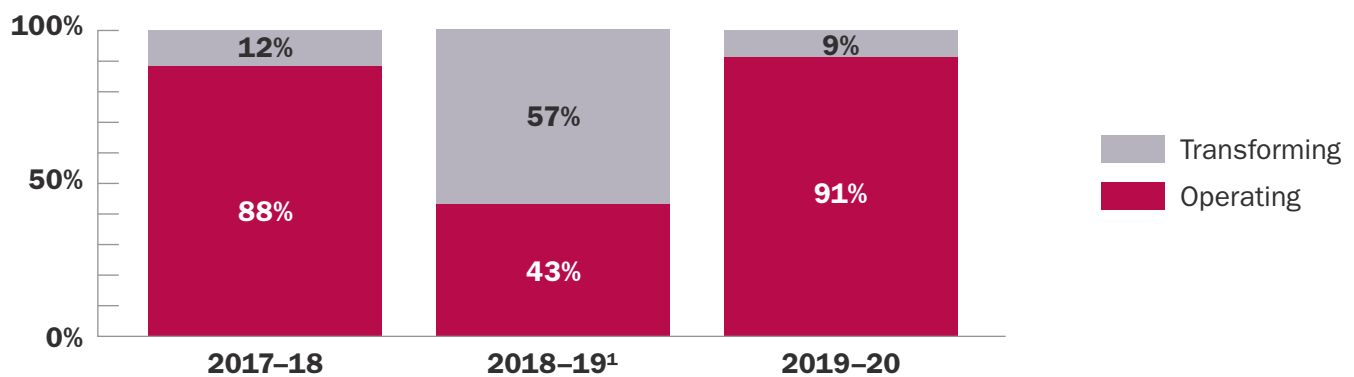
helps measure progress towards the organization's long-term vision with respect to how much is budgeted for day-to-day operations, but also to how much we are advancing in organizational transformation. This helps measure achievement of the organization's long-term direction as outlined in the strategic plan.

Operating the organization includes expenditures required to manage or operate essential and existing business functions. These include salaries and benefits for existing personnel, consulting and professional services, facilities, information technology, and other administrative and overhead expenditures associated with maintaining operations.

Transforming the organization includes costs that are the cornerstone of driving towards operational excellence. These include resource augmentation, process improvements and implementation of new business technologies, infrastructure and capabilities. Transformative costs include current budget change proposals, Pension Solution and collaborative investment strategies, including transitioning more assets to internal management and reducing reliance on external managers.

In 2019–20, the CalSTRS Operating Budget model remains steadfast, with 91 percent allocated to operating the business and 9 percent allocated to transformative activities.

Fiscal Years 2017–18 through 2019–20 Operating Budget



¹ Fiscal year 2018–19 transformative growth is largely attributable to the CalSTRS Headquarters Expansion Project, approved by the board in November 2018. Additional detail regarding the Headquarters Expansion Project is provided in the Budget Overview section.

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 on 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 upcoming 2019–20 fiscal year 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

Data Collection and 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 quarterly meetings, directors report on a range of performance measures to executives.

Customer Service Performance Reviews

In these quarterly meetings, directors of member-facing operations present results for service level objectives to executives.

Operations Performance Reviews

Quarterly operations reviews require directors of CalSTRS' internal operations to report to executives on the status of key performance indicators for major service responsibilities.







Quarterly Performance Reviews

Executives and directors report to CalSTRS leadership on organizational performance-related matters.

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 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 CalSTRS Business Plan. This is the final year of the 2016–19 Strategic Plan. Status of noteworthy accomplishments against goals and objectives of the fiscal year 2017-18 Business Plan are presented on the following page.

CalSTRS 2017–18 Business Plan Significant Accomplishments

Mission, Vision, Strategy	
Strategic Goal	Accomplishments
Goal 1	Financial: Ensure a financially sound retirement system.
	<p>Objective A: Achieve full funding of the Defined Benefit Program by June 30, 2046.</p> <ul style="list-style-type: none"> Completed and presented the 2017 Review of Funding Levels and Risks report to the board in November 2017. Established a charter school task force that provided information about charter schools and their impact on CalSTRS' long-term funding. Transitioned to long-term asset allocation outlined in the Investment Policy and Management Plan. Conducted research on future educational and demographic trends to inform long-term plan design.
	<p>Objective B: Lower the probability of downside risk to the CalSTRS Investment Portfolio.</p> <ul style="list-style-type: none"> Effective January 1, 2018, Risk Mitigation Strategies moved to a long-term range of 9 percent. Staff increased assets under management in the asset class accordingly.
	<p>Objective C: Align CalSTRS' Investment Beliefs, investment objectives and strategy implementation.</p> <ul style="list-style-type: none"> Board adopted an updated Environmental, Social and Governance Risks policy, transitioning the policy from a principle-based to a rules-based framework. The purpose of this shift was to focus on issues that pose the greatest risk to the portfolio.
	<p>Objective D: Manage costs and efficiencies and seek to influence industry best practices.</p> <ul style="list-style-type: none"> Implemented AB 2833 reporting for the first year. AB 2833 requires every California public pension or retirement system to make specific disclosures for every alternative investment vehicle investment made on or after January 1, 2017.
Goal 2	Member/Employer: Enhance services to members and employers.
	<p>Objective A: Improve the accuracy and completeness of employer reporting.</p> <ul style="list-style-type: none"> Implemented a targeted training and outreach approach to charter school employers, reaching some 80 charter schools. Updated the organization's corporate accounting system, BusinessDirect, to support the analyses of contribution accruals and variations by seasonality. This change enhanced the predictability of data and increased the detective elements for irregular reporting.
	<p>Objective B: Improve retirement readiness of CalSTRS' members.</p> <ul style="list-style-type: none"> Introduced the use of video conferencing, further expanding the suite of member education services. Executed placement of a defined contribution benefits specialists at all member services centers. CalSTRS' newly revamped 403bCompare website recognized with an Award of Innovation from <i>Pensions & Investments</i> magazine.

 On Target
  At Risk
  Accomplished

Mission, Vision, Strategy	
Strategic Goal	Accomplishments
Goal 3	Business Transformation: Drive operational excellence.
	<p>Objective A: Implement and integrate a new pension administration system.</p> <ul style="list-style-type: none"> Completed customized readiness assessments; aligning organizational expectations and structure to new business processes.
	<p>Objective B: Continuously strengthen processes and resources to secure the confidence and integrity of member data and information.</p> <ul style="list-style-type: none"> Completed the Phase II third-party vulnerability assessment and document and policy review. Implemented machine learning to perform behavioral analytics of user and network activities. Applied artificial intelligence to behavioral analytics significantly enhances CalSTRS' threat detection capabilities.
	<p>Objective C: Continuously improve the quality, cost effectiveness and efficiency of CalSTRS' business functions.</p> <ul style="list-style-type: none"> Established a new IT service management and IT asset management solution tool to assist in the improvement of IT service delivery, enhance information management and provide better visibility of historical information across the organization.
	<p>Objective D: Ensure the sustainability of critical business processes and systems through the oversight of risk and enterprise compliance.</p> <ul style="list-style-type: none"> Completed the ERM Policy. With successful implementation, the organization will be able to effectively identify, manage and report risks in meeting our business objectives.
Goal 4	Workforce Transformation: Grow an engaged, highly skilled and diverse workforce.
	<p>Objective A: Broaden recruitment and hiring practices to employ qualified individuals at CalSTRS to support our business objectives.</p> <ul style="list-style-type: none"> Implemented regulatory updates enhancing recruitment and learning and development offerings, which modernized outdated classifications specifications to reflect current or emerging technologies used within the state. Finalized a Talent Acquisition strategy document and onboarded a Talent Acquisition manager in support of the goals.
	<p>Objective B: Advance engagement strategies that retain and develop employees to meet the future business needs of CalSTRS.</p> <ul style="list-style-type: none"> Completed and released the CalSTRS Workforce Strategy Plan for Fiscal Year 2018–22. This plan is an in-depth look at the current and future needs of the CalSTRS workforce and reflects our commitment to growing an engaged, highly skilled and diverse workforce. Recognized as a progressive thought leader within California state civil service because of our early adoption of workforce planning principles and processes.
	<p>Objective C: Enhance organizational performance by strengthening strategies for leadership succession.</p> <ul style="list-style-type: none"> Created the CalSTRS Mentorship Program objectives and established a framework for the program that is aligned with CalSTRS' business and culture. Completed the CalSTRS Leadership Development and Succession Plan for Fiscal Year 2018–22. The plan focuses on human resources strategies that strengthen the CalSTRS leadership team, develop the talent pipeline and mitigate leader turnover risks.

 On Target
  At Risk
  Accomplished



LONG-RANGE FINANCIAL PLANNING

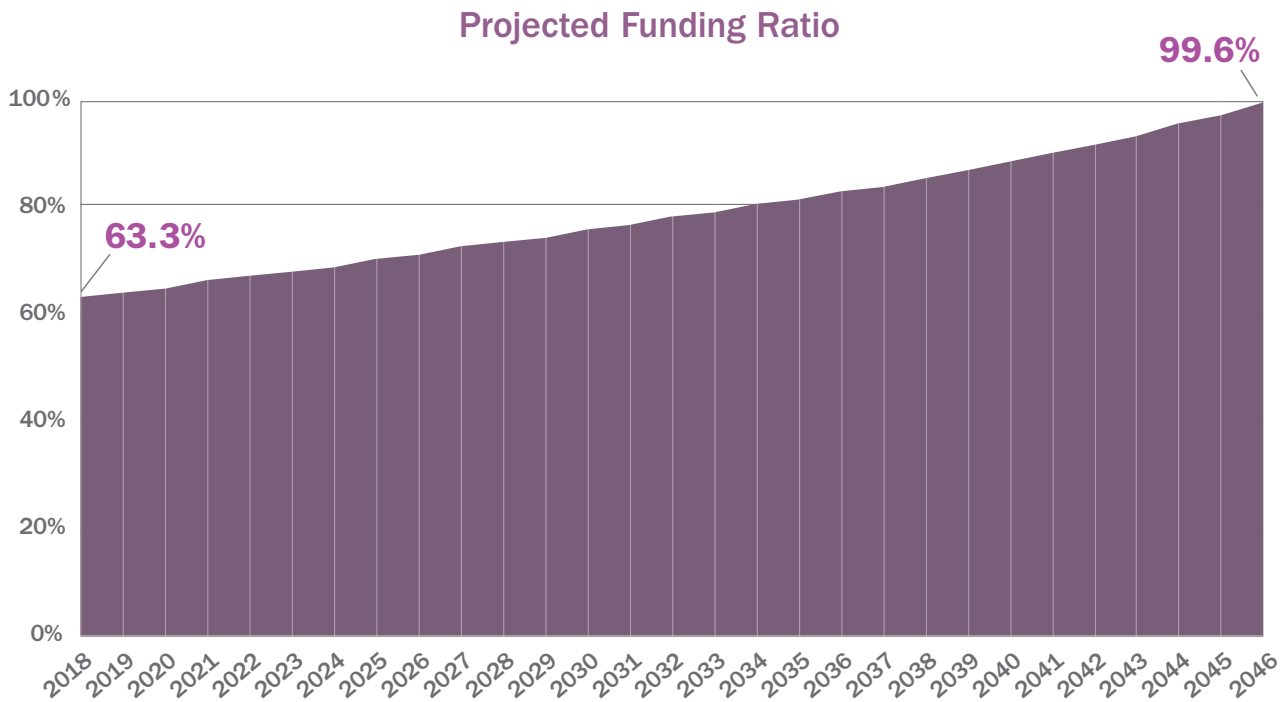
INTEGRATED FINANCIAL MANAGEMENT

The 2019–22 CalSTRS Strategic Plan lays out a set of goals and measurable objectives that demonstrate how our mission and vision will advance over the next three years. The long-range financial plan integrates the organization’s strategic initiatives and serves as the foundation of developing a detailed operational and financial forecast to deliver annual and long-term objectives and targets. Through this multidisciplinary approach, the organization strives to ensure it is responsive to the overarching goals of the organization, while maintaining fiscal prudence.

Maintaining a well-governed, financially sound retirement system is the cornerstone of the long-term financial planning. CalSTRS’ long-range financial plan evaluates the system’s overall funding status, taking into account impacts to total revenues and expenditures relative to legislative and economic change. The key objective is to ensure that the system is sustainable over the long term to pay benefits to CalSTRS members and their beneficiaries. Specifically, 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.

KEY HIGHLIGHTS¹

The graph below summarizes changes in the year-over-year projection of the funding ratio for the Defined Benefit Program through fiscal year 2046. Long-term projections assume the current estimated actuarial rate of return of 7.0 percent for investment performance and additional contribution rate increases pursuant to the passage of the CalSTRS Funding Plan. Relative to these assumptions, the current long-range financial plan anticipates the systems funding ratio to gradually increase over the next 28 years, achieving a nearly full funded status by 2046.



CALSTRS FUNDED STATUS

The cornerstone of CalSTRS’ long-range financial plan is to ensure the system has adequate assets to make promised benefit payments to our members. As underscored by our strategic plan, targeting full funding is the most financially prudent way to provide benefits to past, present and future California educators. Prior to the enactment of the CalSTRS Funding Plan, actuarial valuations at June 30, 2013, indicated

the CalSTRS Defined Benefit Program had an unfunded liability of \$73.7 billion based on lower investment returns. Absent any changes to contribution rates or liabilities, actuarial valuations indicated long-term system revenues were insufficient to fund future retirement obligations. Consistent with CalSTRS mission, the organization was committed to promote the development of a comprehensive strategy to address the long-term funding needs of the system.

¹ Projections are based on the Defined Benefit Program Actuarial Valuation as of June 30, 2018. These projections will change based on updated valuation data, which will be presented to the board this spring.

Progressive Shift Toward Full Funding

The passage of the CalSTRS Funding Plan, enacted as part of the fiscal year 2014–15 budget, set out a measured schedule of contribution rate increases for members, employers and the State of California. 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 also provided the board with limited authority to adjust rates to ensure funding of the plan remains on schedule. The graph below shows the projected funded status for the Defined Benefit Program before and after the enactment of the funding plan.

Current Funding Status

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. A snapshot of the Defined Benefit Program’s assets and liabilities as reported in the June 30, 2017, actuarial valuation

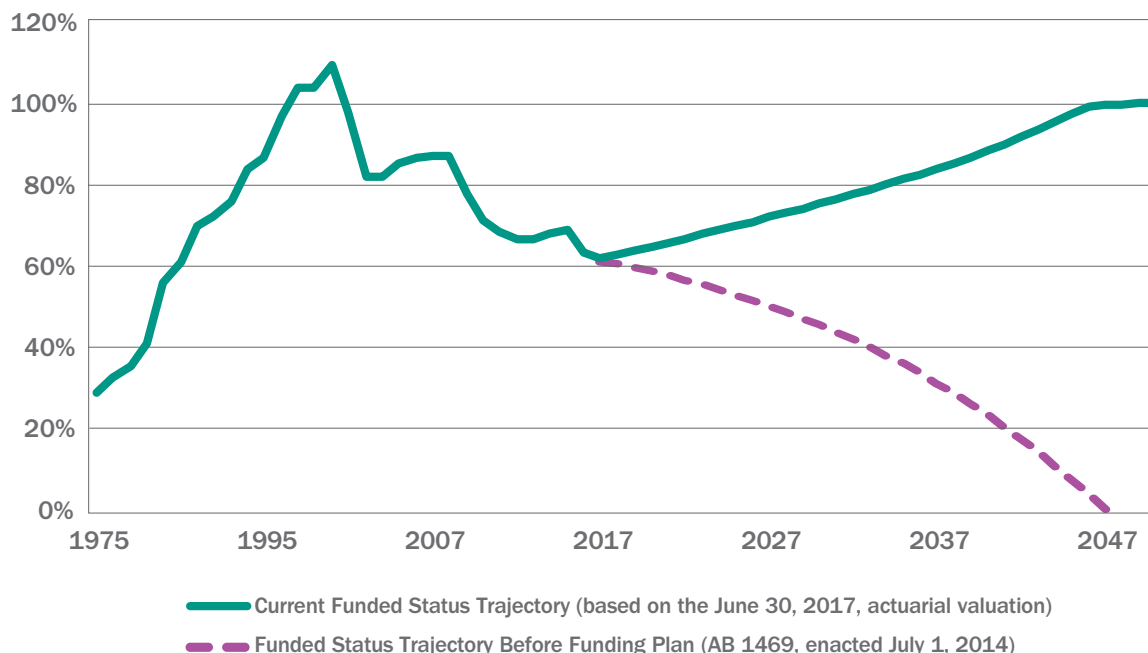
(released in May 2018) reflected an increase of \$10.6 billion in the unfunded liability, at \$107.3 billion. This increase was anticipated and occurred primarily due to the adoption of a lower investment return assumption and the increase in member life expectancies. Actuarial experts and consultants expect an upward trajectory during the coming years as progress is made on the gradual path to reach near full funding by 2046. CalSTRS remains cognizant of the risks associated with an underfunded pension system and will continue to diligently mitigate these risks through the implementation of the funding plan.

REVENUES

Contributions and Investment Income

Primary revenue sources are member, employer and state contributions and investment income. Contribution amounts are determined as a percentage of members’ creditable compensation. Investment returns are dependent upon global

CalSTRS Funded Status (Historical and Projected)



market conditions. The current revenue estimates assume a 7.0 percent actuarial rate of return for future investment income coupled with member, employer and state contribution rate changes¹ pursuant to the funding plan.

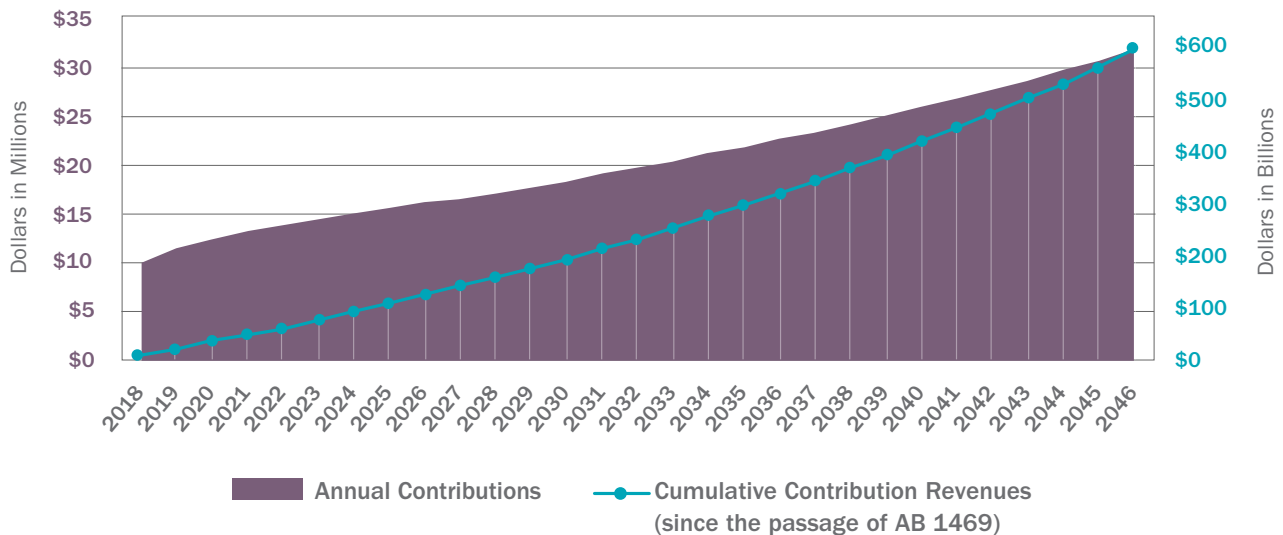
Total contributions are estimated to increase at an average rate of approximately \$783.4 million, or 4.2 percent annually through 2046, which reflects a total net increase of \$594.3 billion. Projected revenue estimates will change due to long-term variability in investment performance, as well as adjustments to required member, employer and state contribution rates. Under the funding plan, contributions are projected to eventually cover the interest on the unfunded actuarial obligation² and reduce the principal, but it will still take a number of years due to graded increases in state and employer contribution rates.

Proposed Supplemental Contribution

The Governor’s 2019–20 budget proposal includes supplemental contributions to CalSTRS to help reduce both the state’s and employers’ share of the UAO. Under this proposal, the state would contribute approximately \$3.15 billion to CalSTRS on behalf of employers. Of this amount, \$850 million would be used to pay a portion of the required employer contribution to CalSTRS and \$2.3 billion would be allocated to directly pay down the employers’ share of the UAO. In addition, \$2.9 billion would be directed to the state’s portion of the UAO.

Should the proposed supplemental contributions to CalSTRS Defined Benefit Program become law, it would further support the CalSTRS Funding Plan as enacted under AB 1469. While the funding plan is working as intended, the

Projected Contribution Revenues



¹ AB 1469 contribution rate tables are provided in Appendix 3.

² Excess of actuarial obligation over the actuarial value of assets, which represents a liability that must be funded over time.

proposed supplemental contributions would increase the speed in which the system reaches near full funding.

This is considered a proposal until the final budget is adopted by the Legislature. Due to the uncertainty in both the timing and final structure of the Governor’s proposed 2019-20 budget, these supplemental payments are not reflected in the current long-range financial plan.

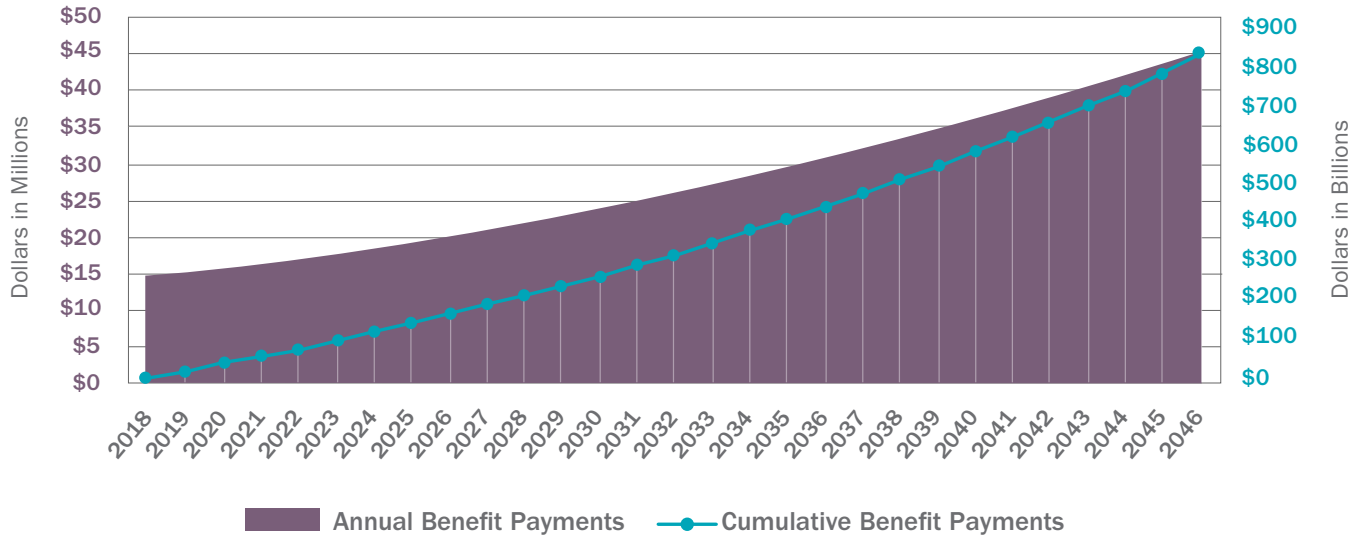
EXPENSES

Member Benefit Payments

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 increases in service retirements and inflationary adjustments. Member benefit payments are estimated to increase at an average rate of approximately \$1.1 billion, or 4.3 percent, annually through 2046, which reflects a total net increase of \$831.8 billion. Historically, investment returns have generally provided more than 62 percent of the resources necessary to fund member benefit payments, with the remainder coming from a combination of member, employer and state contributions. 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 Expenses

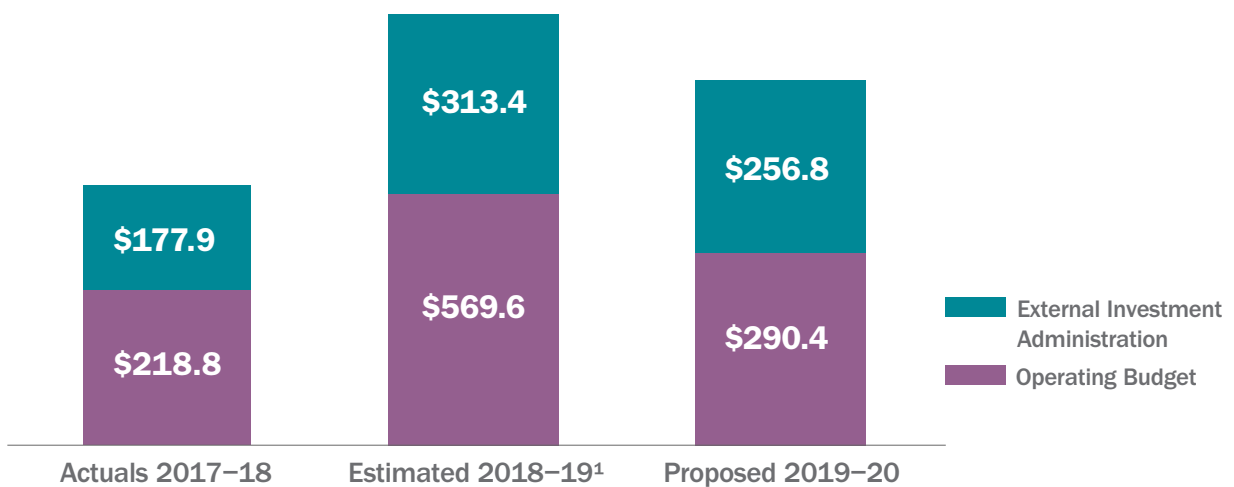


Administrative Expenses

As with any public service organization, CalSTRS maintains focus on defraying reasonable expenses of administering the system. As outlined in the Budget Overview section, expenses are primarily comprised of pension benefit payments and account for approximately 97 percent of CalSTRS' total expenditures. The remaining 3 percent¹ is directly associated with administrative costs required to manage CalSTRS operations. Administrative expenditures are reviewed on an annual basis, ensuring the organization remains fiscally prudent. Key growth drivers include but are not limited to incremental baseline changes for salaries and wages which typically experience a 3.5 percent inflationary adjustment, resource augmentation for both internal and external resources driven by new or expanded work scope, information technology, investments, project-based costs and assessments issued by the California Department of Finance. The graph below summarizes administrative expenditures for fiscal years 2017–18, 2018–19 and 2019–20.

CalSTRS' goal is to manage resources and other administrative costs to efficiently facilitate pension administration activities. From a scalability perspective, projected costs of administrative expenditures are largely a derivative of total portfolio assets, complexity of investment markets and membership growth. As the business grows, this naturally drives ancillary growth in various facets of the organization. As assets in the portfolio increase in size and complexity, the system will naturally endure increased administrative costs to accommodate that growth. Further, as the system experiences membership growth, the demand for member services also grows. This includes services such as calculation of benefits, payroll processing and member account administration. These services are manual, labor-intensive and require additional resources within various branches to maintain the same level of service for a growing population.

3-Year Administrative Expenses (Dollars in Millions)



¹ Historically, administrative expenses have averaged 3 percent of CalSTRS' total expenses. However, in 2018–19 the board approved a one-time budgetary expense of \$292 million for the CalSTRS Headquarters Expansion Project.



BUDGET OVERVIEW

2019–20 ANNUAL BUDGET OVERVIEW

This section presents CalSTRS' fiscal year 2019–20 budget, approved by the board in November 2018. The 2019–20 budget funds various organizational functions and expands existing programs.

BUDGET HIGHLIGHTS¹

Consistent with the CalSTRS mission, the proposed 2019–20 Operating Budget and resources are allocated throughout the organization to advance our ability to make sound investments and deliver promised retirement benefits to our members. This task is a long-term endeavor, requiring comprehensive and sustainable solutions for today and many years to come. This budget makes tactical investments in technology, infrastructure, business process improvements and continued workforce transformation designed to enhance service delivery through improved responsiveness.

CalSTRS Total Budget (Dollars in Thousands)					
Budget Category ²	Actual 2017-18	Estimated 2018-19 ³	Proposed 2019-20	\$ Change	% Change
Pension and General Administration	\$159,882	\$186,314	\$205,986	\$19,672	11%
Capital Projects	20,502	36,465	24,337	(12,128)	(33%)
Headquarters Expansion	—	292,000	—	(292,000)	(100%)
Internal Investment Administration	38,402	54,863	60,030	5,167	9%
CalSTRS Operating Budget	218,786	569,642	290,353	(279,289)	(49%)
External Investment Administration	177,891	313,434	256,815	(56,619)	(18%)
CalSTRS Total Budget	\$396,677	\$883,076	\$547,168	(\$335,908)	(38%)

CalSTRS total 2019–20 budget of \$547.2 million represents a decrease of approximately \$335.9 million, or 38.0 percent, compared to 2018–19. Overall, the net decrease is largely due to the CalSTRS Headquarter Expansion Project and the continued transition to internally managing portfolio assets. The CalSTRS Headquarters Expansion Project represents a one-time augmentation of budgetary authority to the 2018–19 Operating Budget. Further, CalSTRS has advanced the transition to internally managed assets where economically and operationally viable, reducing reliance on external portfolio management. The organization anticipates this transformation will result in continued annual savings to the fund. These

decreases are slightly offset by staffing levels that increased by eight authorized positions, primarily driven by the enhancement of existing compliance and risk management activities, enabling CalSTRS to strategically manage operational, financial, legal and reputational risks.

BUDGET DETAIL

The total 2019–20 budget is \$547.2 million and represents 3 percent of CalSTRS’ total expenses. Of this amount, \$290.4 million represents the proposed operating budget, which includes Pension and General Administration, Capital Projects and Internal Investment Administration. The operating budget excludes External Investment Administration, which is continuously appropriated.⁴

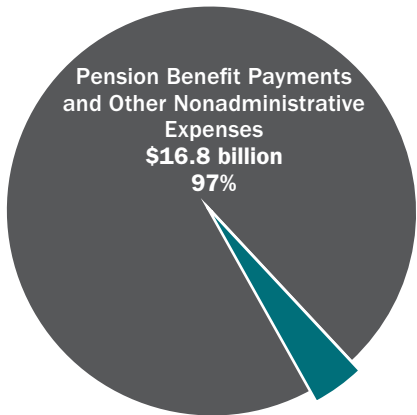
¹ All numbers are rounded for presentation purposes.

² Additional details regarding Pension and General Administration, Capital Projects and Investment Administration are included in Appendix 5.

³ The 2018–19 Operating Budget, as modified, includes one new authorized position and the CalSTRS Headquarters Expansion Project approved by the board in May 2018 and November 2018, respectively.

⁴ Constitutional or statutory expenditure authorization that is renewed each year without further legislative action.

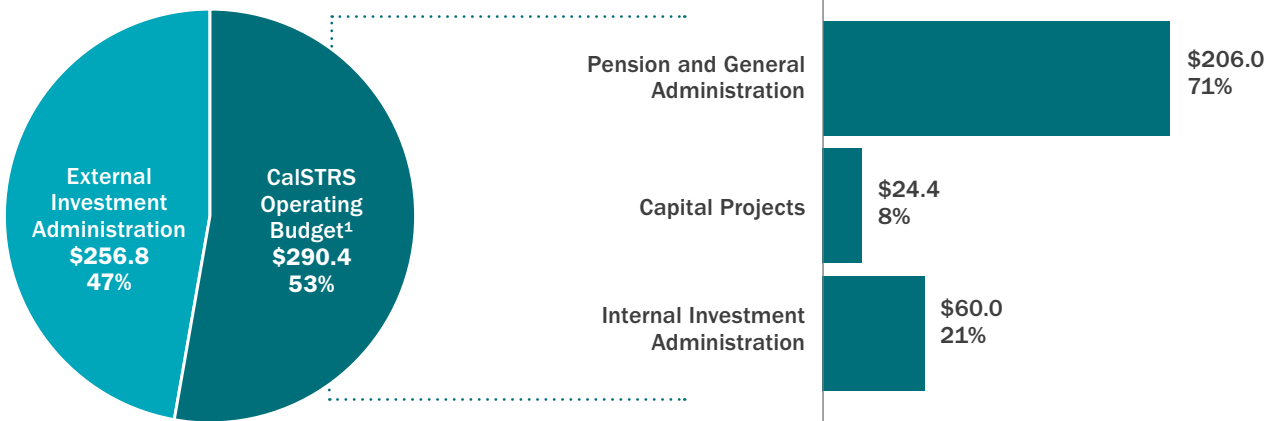
**CalSTRS 2019–20
Total Expense Breakout**



Expenses are primarily comprised of pension benefit payments and the administrative costs required to manage CalSTRS operations.

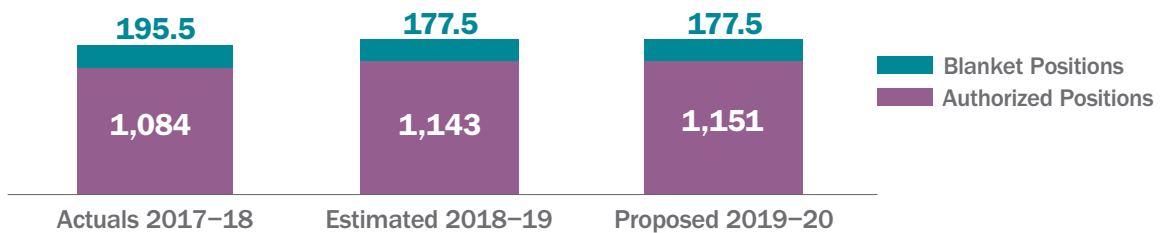
Overall, administrative expenses account for approximately 3 percent of total expenses and represent CalSTRS total budget.

**CalSTRS Total 2019–20 Budget
(Dollars in Millions)**



The proposed 2019–20 Operating Budget includes 1,151 authorized and 177.5 blanket positions. Compared to 2018–19, the operating budget represents an increase of eight new authorized positions, or approximately 1 percent.

CalSTRS Total Staff



¹ 2019–20 Operating Budget by Fund is provided in Appendix 4.

Key Budget Changes

The proposed 2019–20 Operating Budget is \$290.4 million and represents a \$279.3 million, or 49 percent, net decrease compared to the 2018–19 Operating Budget. The \$279.3 million decrease is predominantly due to five key operational drivers. These include changes in Wage Escalation, Organizational Growth, State Mandates, Pension Solution and the CalSTRS Headquarters Expansion Project. The relative change by operational driver is outlined in the table below.

2019–20 Proposed Key Budget Changes (Dollars in Millions)	
Operational Drivers	\$ Change
Wage Escalation	\$18.9
Organizational Growth	4.1
State Mandates	1.8
Pension Solution	(12.1)
Headquarters Expansion Project	(292.0)
Total Operating Budget	(\$279.3)

Wage Escalation—\$18.9 million

Wage Escalation is comprised of employee salaries and benefits and accounts for the largest budgetary increase in the proposed 2019–20

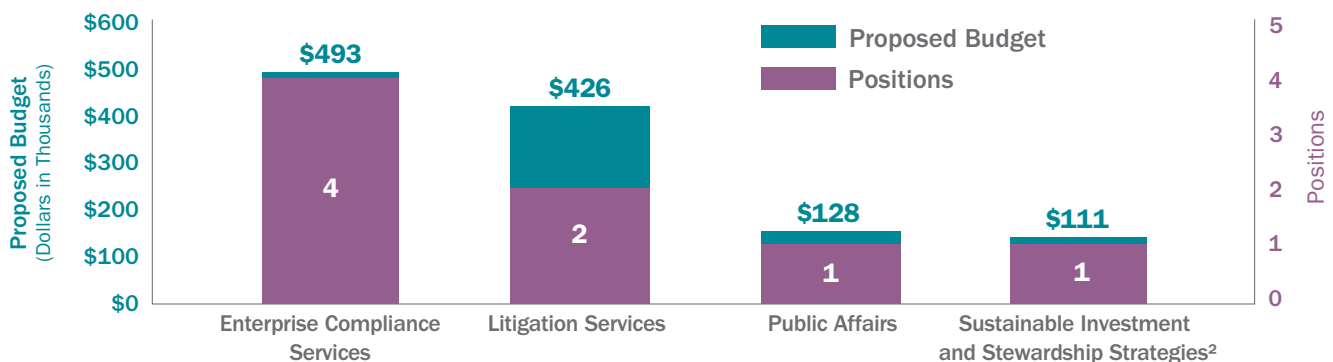
Operating Budget. For 2019–20, salaries and benefits were estimated using 1,143¹ authorized and 177.5 blanket positions. Salaries account for \$11.6 million, or 61 percent, and benefits account for \$7.3 million, or 39 percent, of the total increase. This is mostly due to salary, merit and benefit rate adjustments pursuant to collectively bargained union agreements for rank-and-file employees. Similar salary and benefit increases are extended to most managerial level employees. In addition, a component of employer-paid benefits includes prefunding contributions for Other Post-Employment Benefits. Effective July 1, 2019, CalSTRS will pay an additional 1.1 percent for a total of 2.3 percent of pensionable compensation for most employees for OPEB costs.

Organizational Growth—\$4.1 million

Organizational Growth includes all resource augmentation requests and is specific to each functional area. This includes requests for both internal and external resources driven by new or expanded work scope in response to the organization’s business objectives.

The graph below summarizes CalSTRS proposed resource augmentation for 2019–20. Additional details regarding authorized positions by functional area is provided in the Departmental Information section.

Proposed 2019–20 Authorized Positions



¹ Salaries and benefits for proposed resources are not included in Wage Escalation. These are included in Organizational Growth.

² Formerly known as Corporate Governance.

Engagement and Risk Management Budget Change Proposal—\$4.0 million

The proposed 2019–20 Operating Budget includes a budget change proposal request for \$4.0 million to establish seven authorized positions throughout the organization and our external audit services engagement, which has historically been funded from internal reserves.

This request will help improve our existing business processes, reduce costs and meet the needs of our changing business models and growth expectations. This request will serve as an enhancement of existing compliance and risk management activities, allowing CalSTRS to strategically manage operational, financial, legal and reputational risks. These activities will safeguard CalSTRS Core Values, Code of Ethics and Business Conduct and increase effectiveness of critical business processes.


Enterprise Compliance Services—\$493,000

At the February 2018 meeting, the board acknowledged the demand for resource augmentation related to compliance functions. As such, the proposed 2019–20 Operating Budget includes four positions in Audit Services under ECS to implement an enterprise-wide compliance program.

The fundamental issue CalSTRS is addressing with this proposal is to ensure the sustainability of critical business processes and systems through the oversight of risk and enterprise compliance. Implementation of an enterprise-wide compliance program is critical to managing

and enhancing CalSTRS risk profile. Moreover, CalSTRS is obligated to undertake the due diligence required to thoroughly understand risk in a central oversight capacity. In current practice, CalSTRS' compliance function is decentralized amongst all business areas, operating siloed compliance activities at the branch and unit levels. A decentralized structure creates inconsistency in monitoring, updating

and improving CalSTRS' policies and operations. Lacking congruent compliance practices across all CalSTRS business areas heightens the organization's exposure to risk, which can be detrimental from a legal, financial, business and reputational standpoint. For an institution with the size and complexity of CalSTRS, a rigorous enterprise-wide compliance program is best practice and a crucially important component of progressive risk management.



For an institution with the size and complexity of CalSTRS, a rigorous enterprise-wide compliance program is best practice and a crucially important component of progressive risk management.

ECS ensures all business areas in CalSTRS conduct business ethically and adhere to all applicable laws and regulations. Resources in ECS will help implement robust and comprehensive compliance policies and procedures and help manage and monitor business ethics and compliance to mitigate risk of potential violation of law, policies and standards. Furthermore, this staffing request will help develop measurement standards and reporting formats for a variety of policies related to each business area. Failure to manage compliance risks could lead to violation of the law and regulations, CalSTRS policies, CalSTRS Core Values, and CalSTRS' Code of Ethics and Business Conduct, leading to fines, penalties and reputational risk to the organization.

Litigation Services—\$426,000

In recent years, the number of litigation cases has notably increased. Total caseload grew from 33 cases in fiscal year 2013–14 to 86 cases in fiscal year 2017–18, or by 161 percent. Over the same time horizon, total membership grew from 879,329 to 949,512, or by 8 percent. Relative to increases in caseload and membership over this timeframe, legal resources remained relatively flat, creating heavier workload on existing personnel. The need for internal resources to handle complex and sensitive cases is evident as legal fees associated with outside counsel are costly and difficult to estimate.

This budget includes two new positions to serve as in-house subject matter experts. Hiring more in-house counsel will help develop a deeper understanding of CalSTRS and its operations, including CalSTRS membership and the Teachers' Retirement Law. Additional internal legal resources not only improves long-term quality and efficiency, but also maintains the cost effectiveness and financial efficacy of CalSTRS' business functions.

Public Affairs—\$128,000

Engagement and corporate governance are fundamental components of CalSTRS long-term success and investment strategy. The need to engage with the companies in which we invest is essential to mitigating risk, creating opportunities for improved performance and ensuring alignment with our investment policies. In addition, to effectively manage public engagement efforts, it is CalSTRS' responsibility to ensure it actively develops, manages and coordinates stakeholder communication and performs outreach and education of investment-related engagement efforts with constituents and the community. Currently, CalSTRS does not

have a dedicated resource to manage our public engagement strategy. This budget includes one permanent position in Public Affairs to engage in these efforts. The demand for a dedicated resource to manage a public communication strategy is largely driven by several factors within the environmental, social and governance space including sociopolitical issues, divestiture impacts and reputational risk.

At the May 2018 meeting, the board formally approved one position to support the public engagement strategy. As discussed during the meeting, this position was established to develop a public communication strategy to highlight areas of concern and to provide a clear and consistent message on CalSTRS' priorities, operational activities and fiduciary obligations. In addition, this position will act as a liaison, providing timely updates to our key stakeholders and the public. Expansion of this activity takes a step further to protect the CalSTRS portfolio and avoid reputational risk.

Audit Services Engagement—\$2.9 million

CalSTRS is responsible for providing financial statements in compliance with the accounting requirements set forth by the Governmental Accounting Standards Board and Generally Accepted Accounting Principles in the United States of America. Audit services provide reasonable assurance CalSTRS is in compliance with applicable financial reporting standards and that the financial statements are free of material misstatements.

Historically, all costs associated with audit services have been funded with internal reserves. Over the past few years, CalSTRS has experienced significant portfolio, membership and employee growth, which have increased both the complexity and scope of CalSTRS' financial reporting, leading



to higher engagement fees. Overall, higher fees are the result of increased scope related to new financial reporting pronouncements required by GASB, including but not limited to GASB Statement Nos. 67, 68, 72, 74 and 75, the addition of a third quarter financial review, implementation of a new Enterprise Resource Planning System, BusinessDirect, and the future implementation costs of a new pension administration system, Pension Solution. As a result, the organization can no longer fund these costs with internal reserves.

Sustainable Investment and Stewardship Strategies—\$111,000

One additional position in Sustainable Investment and Stewardship Strategies is required for additional reporting and disclosure requirements. Specifically, this position will maintain the newly implemented engagement tracking database, which is designed to track all contact between staff and portfolio companies, investors, stakeholders and fund managers. These activities will facilitate more efficient communication, analytics and reporting.

State Mandates—\$1.8 million¹

State Mandates account for a \$1.8 million increase in the proposed 2019–20 Operating Budget. This is due to new legislation and Department of Finance mandatory assessments. State Mandates include Senate Bill 84 (Chapter 50, Statutes of 2017) and the annual pro rata assessment.

Senate Bill 84 Loan Payment—\$2.8 million

SB 84, authorized a \$6 billion supplemental payment from the state’s Surplus Money Investment Fund to the California Public Employees’ Retirement System. The \$6 billion supplemental pension payment is intended 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 based on their respective pro rata share. CalSTRS’ portion of the loan payment is \$2.8 million annually through the duration of the loan period. Annual interest and principal repayments are calculated by the Department of Finance and linked to the 2-year U.S. Treasury Rate. The loan must be fully repaid by 2030.

Pro Rata Assessment—(\$720,000)

CalSTRS is required by the DOF to contribute on a pro rata basis for the cost of providing central administrative services to CalSTRS. The pro rata represents General Fund recoveries of statewide general administrative costs (indirect costs incurred by central service agencies) from special funds (California Government Code sections 11010 and 11270 through 11277). The pro rata process apportions the costs of providing central administrative services to all state departments that benefit from the services. This 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. The DOF provided a final pro rata assessment for 2019–20, which was significantly lower than originally planned and is primarily driven by lower-than-expected costs for retirees’ health benefits.

Pension Solution—(\$12.1) million

Pension Solution continues to securely transform business and service delivery models to maximize operational efficiency through the implementation of a new pension administration system.

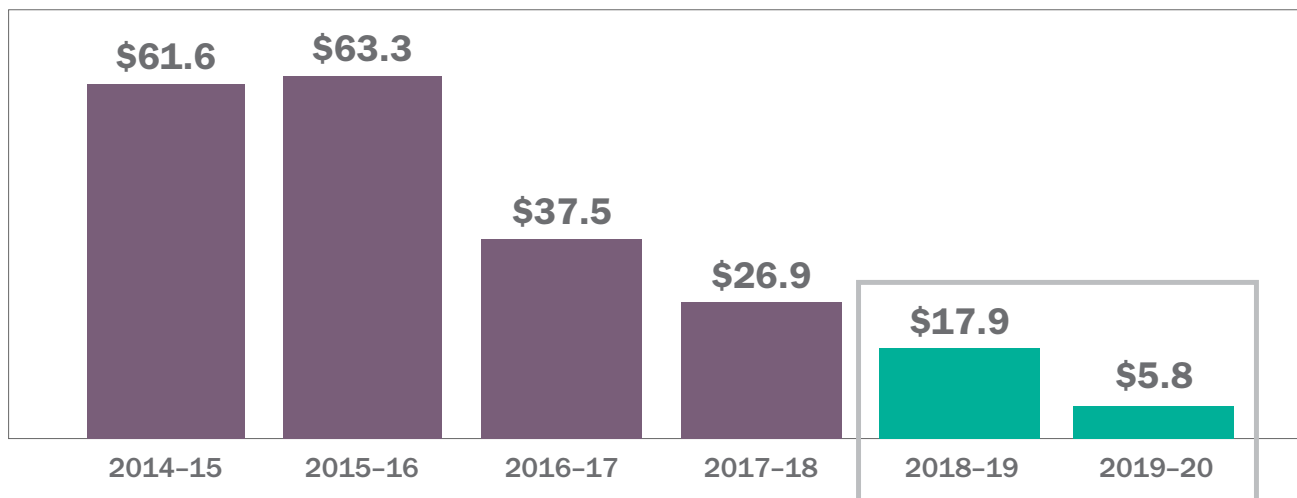
The proposed 2019–20 Operating Budget includes a funding appropriation for Pension Solution of \$5.8 million, as governed by the original spending authority. In 2018–19 the Pension Solution funding appropriation was \$17.9 million. This represents a net decrease of \$12.1 million to the proposed 2019–20

¹ State Mandates include other administrative reductions of \$343,000.

Operating Budget. It is important to note that this change is not a reduction to the overall Pension Solution budget. Rather, this represents a baseline change of \$17.9 million in 2018–19 to \$5.8 million in 2019–20. Baseline changes are necessary to ensure CalSTRS is in compliance with the original spending authority approved by the board and reported to the DOF.

The chart below outlines the Pension Solution original spending authority and the distribution across 2014–15 to 2019–20.

Pension Solution Original Spending Authority—\$213 million



As referenced above, \$213.0 million represents what was originally authorized in fiscal year 2014–15 with funding allotted annually through 2019–20. In July 2018, the board approved an interim re-baselined budget of \$285.8 million and will take action in fiscal year 2019–20 on a final budget, currently projected at \$304.8 million.

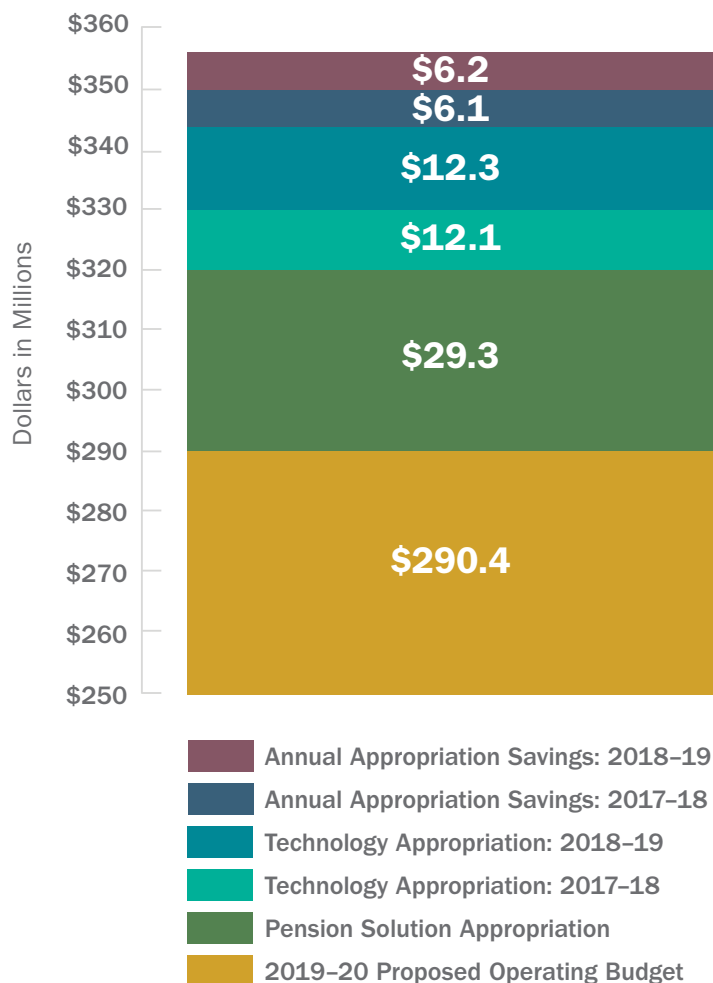
Headquarters Expansion Project—(\$292) million

The CalSTRS Headquarters Expansion Project is an investment for CalSTRS’ future, one that the board anticipates will meet the organization’s needs over the next 30 years. Due to increasing complexities in investment markets, the financial services sector and public plan administration, CalSTRS staff has increased and will continue to increase over the next two decades. This increase in staff serves as the foundation for the CalSTRS Headquarters Expansion Project.

In November 2018, the board unanimously approved the CalSTRS Headquarters Expansion Project with a total spending authority of \$300 million, using bond financing. The \$300 million spending authority includes \$8 million related to pre-construction activities which were approved as a part of the 2016–17 Operating Budget. Subsequent to the approval of the Headquarters Expansion Project, the 2018–19 Operating Budget was modified to include the remaining \$292 million for construction of the building. As such, the proposed 2019–20 Operating Budget includes a one-time baseline reduction for the cost of construction.

CARRYOVER SPENDING AUTHORITY

Estimated Spending Authority Summary—\$356.4 million



The proposed 2019–20 Operating Budget provides the authority to expend up to \$290.4 million. In addition, CalSTRS has spending authority available for expenditure in 2019–20 previously approved by the board. Accordingly, CalSTRS can end the year with total expenditures greater than the operating budget. There are three primary sources of additional spending authority. These include Annual Appropriation Savings and Technology and Pension Solution appropriation carryovers.

As summarized in the table below, the total estimated carryover for 2019–20 is \$66.0 million. As such, CalSTRS can expend up to \$356.4 million in the event the total proposed operating budget and additional spending authority is consumed. Details regarding the Annual Appropriation Savings and Technology and Pension Solution appropriation carryovers are described below.

Estimated Carryover Detail¹ (Dollars in Millions)

Category	Fiscal Year	Encumbrance Date	Liquidation Date	Amount
Annual Appropriation Savings	2018–19	6/30/21	6/30/23	\$6.2
Annual Appropriation Savings	2017–18	6/30/20	6/30/22	6.1
Technology Appropriation	2018–19	6/30/21	6/30/23	12.3
Technology Appropriation	2017–18	6/30/20	6/30/22	12.1
Pension Solution Appropriation	2014–15 to 2018–19	6/30/20	6/30/22	29.3
Total				\$66.0

¹ Estimated carryover balances for Technology and Pension Solution appropriations are based on current projections and are subject to change.

Annual Appropriation Savings— \$12.3 million

CalSTRS can end the year with savings in its annual appropriation from the Teachers' Retirement Fund. The annual Budget Act (Governor's Budget) allows the board to authorize spending of this savings for two years after the initial appropriation and is limited to 3 percent of the original TRF appropriation. These savings are available for expenditure only upon approval by the board. These savings would be used for unanticipated system costs and providing better service to the system's membership. Historically, CalSTRS' savings have exceeded this 3 percent limit. Upon board authorization, in 2019–20, \$6.1 million is available to encumber by June 30, 2020, and through June 30, 2022, to liquidate and \$6.2 million is available to encumber by June 30, 2021, and through June 30, 2023, to liquidate.

Technology Appropriation—\$24.4 million

The operating budget includes an annual technology appropriation of \$18.5 million for enterprise-wide projects as authorized by the Enterprise Program Investment Council, which is responsible for governance of all enterprise projects. Each year this amount is available to encumber for up to three years and two additional years for liquidation. This budget has supported the Pension Solution project by funding related enterprise projects such as data preparation, enterprise information management and business transformation. In 2019–20, \$12.1 million is available from the 2017–18 technology appropriation. This amount must be encumbered by June 30, 2020, and liquidated by June 30, 2022. In addition, \$12.3 million is available from the 2018-19 technology appropriation. This amount must be encumbered by June 30, 2021, and liquidated by June 30, 2023. These funds will be utilized for EPIC approved projects.

Pension Solution Appropriation— \$29.3 million

Of the \$213 million original spending authority for the Pension Solution project, \$29.3 million is the estimated carryover amount from 2014–15 through 2018–19. The project has through June 30, 2020, to encumber all residual balances from the original spending authority, and until June 30, 2022, to liquidate those expenses. The project fully anticipates utilization of these carryover balances by the respective expiration dates.

Operating Budget by Appropriation

The table below displays the proposed 2019–20 Operating Budget and the key differences compared to what will be in the annual Budget Act. The annual Budget Act is primarily comprised of the Annual Support Appropriation and Information Technology Project funding, which includes the Technology and Pension Solution appropriations of \$18.5 and \$5.8 million, respectively.

The Budget Act does not include Direct Transfers, future distributions of the multi-year Internal Investment Management BCP or Other Continuous Appropriations. Direct Transfers include the annual pro rata assessment and the SB 84 loan which are reported by the DOF for all state agencies. The multiyear Internal Investment Management BCP was approved for \$15.4 million as part of the fiscal year 2018–19 operating budget for Investments, Administrative Services and Legal Services. Of this amount, \$8.9 million represents the remaining funds for 2020–21 through 2022–23. Lastly, Other Continuous Appropriations account for additional expenditures primarily related to Sustainable Investment and Stewardship Strategies.

2019–20 Operating Budget by Appropriation (Dollars in Thousands)

Annual Support Appropriation	\$235,328
Information Technology Project Funding	24,337
Subtotal to Budget Act	259,665
Direct Transfers	13,858
Multiyear Internal Investment Management BCP (remaining balance)	8,949
Other Continuous Appropriations	7,881
Total Proposed 2019–20 Operating Budget¹	\$290,353

¹ The 2019–20 Operating Budget excludes External Investment Administration of \$256.8 million.

² The Teachers' Retirement Board will take action in fiscal year 2019–20 on the final budget, projected at \$304.8 million.

CAPITAL PROJECTS

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

While this budget represents a single year 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. These typically include but are not limited to internal and external labor, software and hardware maintenance, and other ancillary expenditures associated with maintaining the asset.

CalSTRS currently has two capital projects underway. The first is Pension Solution, with an interim budget of \$285.8 million and a final projected budget of \$304.8² million. The second is the CalSTRS Headquarters Expansion Project, which was unanimously approved by the board in November 2018 with a spending authority of \$300 million using bond financing. The CalSTRS Headquarters Expansion Project represents a one-time augmentation of budgetary authority to the 2018–19 Operating Budget.

Pension Solution

The Pension Solution project encompasses the planning, acquisition and implementation of a new pension administration system. The project will replace CalSTRS' legacy systems and modernize existing processes related to benefit administration for our membership. Broadly, the Pension Solution 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 enhance CalSTRS' ability to administer benefit plans, respond to legislative and regulatory changes, create operational efficiencies through automation, strengthen internal controls and provide self-service features to members.

In November 2013, the board approved the Pension Solution project with a total spending authority of \$213 million, allocated over six years. The total spending authority included funding for both internal and external costs. The annual appropriations were not equally distributed. This approach was designed to ensure that CalSTRS had sufficient funding.

The interim Pension Solution budget is \$285.8 million, which was approved by the board in July 2018. Of this amount, \$213 million represents what was originally authorized in fiscal year 2014–15 with funding allotted annually through 2019–20. The remaining \$72.8 million of funding is drawn from amounts that have been, and will be, reserved from the annual technology project appropriation of \$18.5 million available throughout the duration of the project. In fiscal year 2019–20, the Teachers' Retirement Board will take action on a final budget, currently projected at \$304.8 million.

Headquarters Expansion Project

As stewards of the State Teacher’s Retirement System, we recognize that it is imperative to the success of the organization to sustain a robust and progressive workforce. It is important to maintain the trust of our members and stakeholders by ensuring CalSTRS is taking preemptive measures to ensure it has adequate staffing of resources to manage the growing size and complexity of its investment portfolio and overall administration of the fund.

As part of a transformative and strategic paradigm shift, CalSTRS anticipates continued personnel growth primarily in the Investments Branch and ancillary growth in business units that support the investment functions. From a long-range financial planning perspective, managing a larger portion of assets internally will result in significant annual savings to the fund. For context, 56 percent of assets managed externally account for 97 percent of investment costs, while 44 percent of assets managed internally account for only 3 percent of investment costs.



Image depicted is a conceptual rendering.

Prior to approving the Headquarters Expansion Project, the board reviewed a variety of scenarios to accommodate CalSTRS long-term growth strategy, including the development of a second structure at the current headquarters campus, acquisition of an existing building or lease of office space in the region. As part of this analysis, the utilization of bond financing to fund the cost of developing a second structure or acquire an existing building in the Sacramento region was evaluated as a potential financing alternative. As a public service agency, CalSTRS actively engaged with various stakeholder groups as part of a due diligence effort to assist the organization with the decision-making process. After careful deliberation, the board unanimously approved the expansion of the current headquarters building with a spending authority of \$300 million using bond financing.

The \$300 million spending authority includes \$8 million related to pre-construction activities including design, which was approved as a part of the fiscal year 2016–17 budget. The remaining \$292 million will be used for the construction and development of the building. As such, the CalSTRS Headquarters Expansion Project represents a one-time augmentation of budgetary authority of \$292 million to the 2018–19 Operating Budget. Construction is estimated to commence during the third quarter of 2019. CalSTRS expects occupancy in approximately 24 months from the start of construction. Estimated cost for construction will be expended through fiscal year 2021–22, in accordance with the anticipated construction schedule.

Expenditures associated with the headquarters expansion, including debt service payments for bond financing, will be funded directly from the TRF as prescribed by the Teacher’s Retirement Law in subdivision (a) of section 22380 and section 22307. Pursuant to this statutory authority, the headquarters expansion is an investment of the system and therefore will be funded using continuously appropriated resources at the discretion of the CalSTRS board.

Debt Financing

In alignment with fiscal sustainability, the construction of the CalSTRS Headquarters Expansion Project will be funded with bond financing, which state and local governments commonly use to finance capital improvements, such as infrastructure. Together with a team of financial experts and bond consultants, we are currently in the process of preparing the necessary analysis and disclosures to make the public offering. It is anticipated that the bonds will be sold, and proceeds will be raised sometime in early fall of 2019. In the near term, pre-construction expenditures will continue to be funded directly from the trust. Once bond proceeds are obtained, the trust will be reimbursed for costs incurred to date, and future debt service payments will be made in accordance with the terms of the bonds.

Using bond financing to fund the Headquarters Expansion 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 costs of infrastructure over time, as opposed to a significant and immediate cash outlay directly from the TRF. In addition, bond financing provides additional investment flexibility and allows CalSTRS to continue investing in diversified markets, which is assumed to have a higher yield than the cost of issuing bonds.



FINANCIAL SUMMARIES

OVERVIEW OF FUNDS

CalSTRS administers a hybrid retirement system consisting of a defined benefit plan, two cash balance plans, a postemployment benefit plan, and a fund to account for ancillary activities associated with various deferred compensation plans and activities.

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 defined in the Policies section.

Teachers' Retirement Fund

The Teachers' Retirement Fund was established by California Education Code section 22400 and is the largest fund CalSTRS administers. The fund's deposits include employee contributions, employer contributions, state contributions, income on investments, and income from fees and reimbursements. Benefit payments and the vast majority of CalSTRS' operational expenses are sourced from this fund. The TRF encompasses the Defined Benefit, Defined Benefit Supplement, Cash Balance Benefit and purchasing power protection programs.

Teachers' Replacement Benefit Fund

The Teachers' Replacement Benefit Fund was created by California Education Code section 24255 to fund the Teachers' Replacement Benefit Program. This continuously appropriated fund addresses the payment of benefits above the Internal Revenue Code section 415 threshold for members of the Defined Benefit Program. This fund receives the amount of employer contributions necessary to fund payments to eligible retirees and related administrative expenses.

Pension2

The Pension2® Program was established by California Education Code sections 24950 and 24975. The Pension2 Program is CalSTRS' voluntary defined contribution plan. Pension2 offers flexible 403(b), Roth 403(b), 457(b) and Roth 457(b) plans for additional retirement savings. While CalSTRS is the fiduciary and is ultimately responsible for the administration, oversight and investment options for Pension2, there is not an approved budget for the program. Rather, the Teachers' Retirement Law calls for the provision of an annuity contract and custodial account that may be administered by a qualified third-party administrator. While the Teachers' Retirement Board, with the advice of staff, determines the investment options

offered to Pension2 participants, the third-party administrator is contractually responsible for the custodial, recordkeeping and administrative services for the program. Specific activities associated with outreach and marketing of the Pension2 Program are reported within the Teachers' Deferred Compensation Fund.

Teachers' Deferred Compensation Fund

The Teachers' Deferred Compensation Fund was established pursuant to Chapter 655, Statutes of 2006 (SB 1466). The 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. This fund encompasses the 403bCompare and 403bComply services. 403bCompare is a state-sponsored website provided by CalSTRS that provides an easy and transparent way to compare investment fees, performance and services for 403(b) plans. It is the only comprehensive resource in the U.S. providing fee-cost comparisons by product type for 403(b) supplemental savings plans. The 403bComply service offers plan implementation guidance, ongoing plan compliance and maintenance for qualified and nonqualified plans. The TDCF is funded by the fee revenues received from the Pension2 participating members, a vendor registration program and an employer compliance assistance program.

Teachers' Health Benefit Fund

The Teachers' Health Benefit Fund supports the expenses of the CalSTRS Medicare Premium Payment Program, which pays Medicare Part A premiums and Medicare Parts A and B late enrollment surcharges for retired members of the Defined Benefit Program who meet certain eligibility requirements. The fund was created by California Education Code section 25930 and is continuously appropriated. The board has exclusive control of the administration of the fund. The THBF is funded on a pay-as-you go basis from a portion of monthly employer contributions.

Fund Program Relationship

The table below illustrates the relationship between 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 Benefit 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 Benefit Fund	<ul style="list-style-type: none"> • Medicare Premium Payment

Relationship of Revenues and Expenses to Funds

The table below illustrates the revenues contributing to the funds that CalSTRS administers and the expenses drawn from each fund.

Budget Category	TRF	TRBF	Pension2	TDCF	THBF
Revenues					
Investment Income	+		+	+	+
Employer Contributions	+	+	+		+
Member Contributions	+		+		
State Contributions	+				
Other Income	+		+	+	
Expenses					
Pension Benefit Payments	-	-			
External Investment Expenses	-				
Administrative Expenditures	-			-	-
Contribution Refunds	-				
Other Benefit Payments	-		-		-
Other Expenditures	-		-		

FINANCIAL HIGHLIGHTS

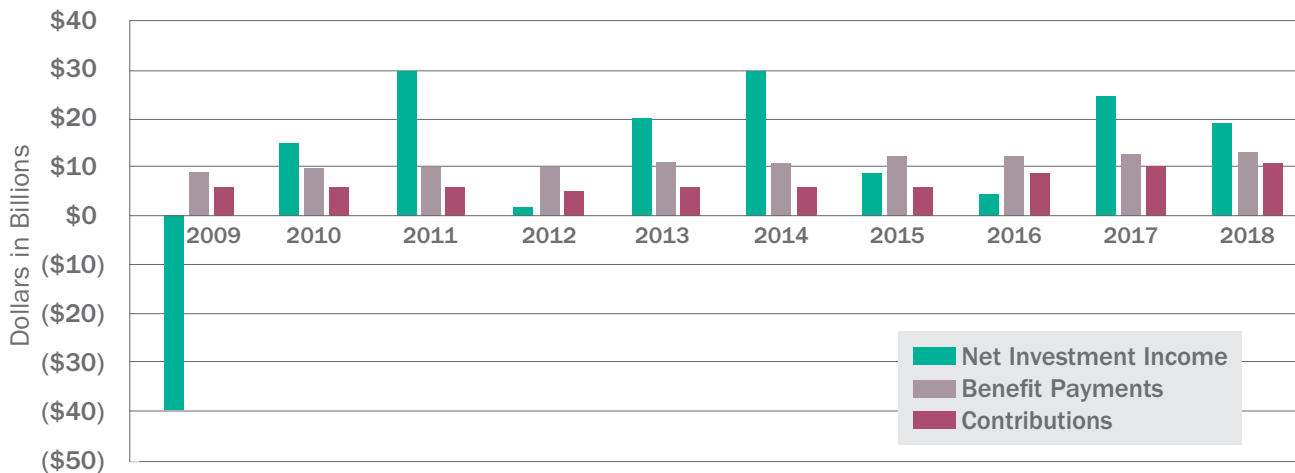
In accordance with the California Constitution, Article XVI, Section 17:

“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, composed of both annually and continuously appropriated balances. CalSTRS’ largest revenues are investment income and member, employer and state contributions. The major expense categories are benefit payments and administrative expenditures. Revenue and expense projections are based on an annual evaluation of key performance indicators. This includes but is not limited to the incorporation of the current assumed actuarial rate of return for CalSTRS’ investment portfolio and legislative impacts to member, employer and state contribution rates.

The following chart provides a 10-year comparison of investment income, contributions and benefit payments for the TRF for the fiscal years ended June 30.

10-Year Comparison of Net Investment Income, Contributions and Benefit Payments



The fund summary below provides a high level view of CalSTRS' beginning fund balance for all funds and programs, sources of revenue and expenses and ending fund balance for the most recent fiscal year 2017-18.

Actual 2017-18 Fund Balance (Dollars in Thousands)	
Beginning Fund Balance	\$210,924,561
Revenues	
Investment Income	\$19,432,465
Employer Contributions	4,895,333
Member Contributions	3,625,396
State Contributions	2,796,673
Other Income	107,150
Total Revenues	\$30,857,017
Expenses	
Pension Benefit Payments	\$14,270,951
External Investment Expenses	177,891
Administrative Expenditures	239,663
Contribution Refunds	103,886
Other Benefit Payments	239,859
Other Expenditures	462,972
Total Expenditures	\$15,495,222
Ending Fund Balance	\$226,286,356

REVENUES

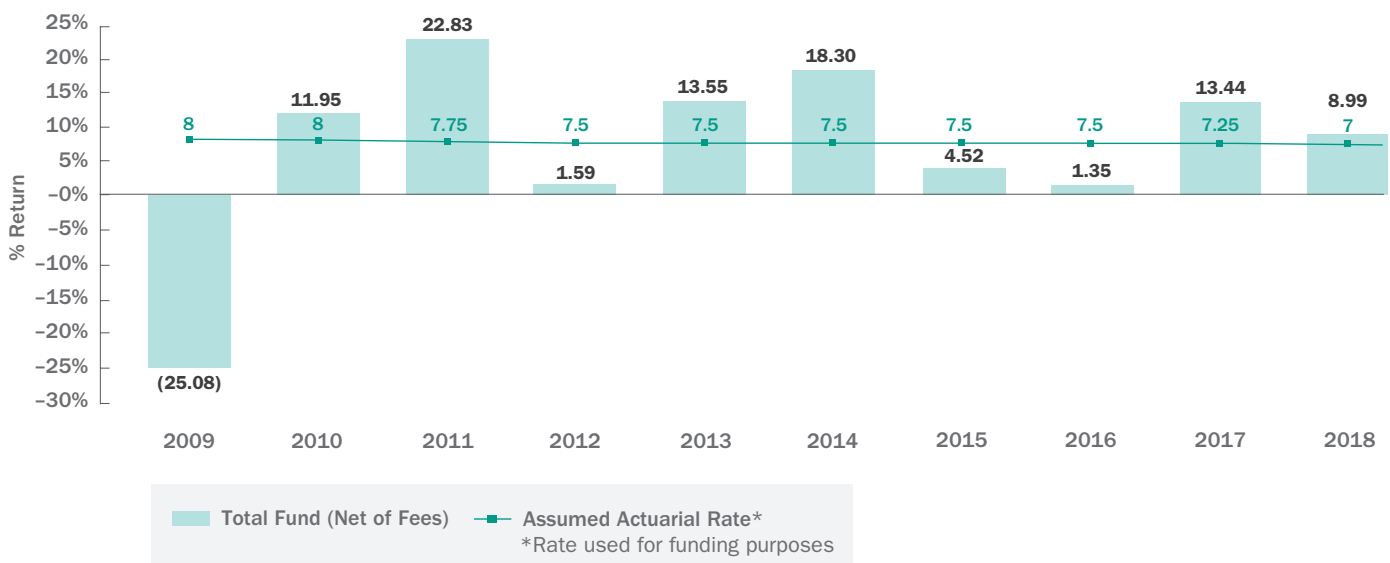
CalSTRS' primary revenue sources are retirement contributions and investment income. Contribution amounts are determined as a percentage rate of members' creditable compensation. Creditable compensation is defined by California Education Code sections 22119.2 and 22119.3 and generally refers to member salary and wages. Historically, investment returns have generally provided more than 62 percent of the resources necessary to fund pension benefits with the remainder coming from a combination of member, employer and state contributions. However, as expected, these percentages will change over time due to fluctuating net investment income, as well as the adjustments to required member, employer and state contribution rates under the CalSTRS Funding Plan pursuant to AB 1469. Additional details regarding AB 1469 contribution rates are provided in Appendix 3.

The CalSTRS Investment Portfolio is broadly diversified, holding investments ranging from publicly traded short-term bonds to privately held partnerships. The scale and breadth of investments make the management and oversight of these assets highly complex. In light of these factors, CalSTRS has been effective in using resources in a cost-efficient manner, including managing more assets internally, to reduce costs and ensure the sustainability of the system. The overall fund earned a 9.0 percent (net of fees) investment return for the fiscal year ended June 30, 2018, which exceeded the actuarial assumed rate of return of 7.0 percent used for funding purposes. CalSTRS' 10-year investment performance is displayed in the graph below.

Other Contributions

In addition to contributions made to the Defined Benefit Program, CalSTRS also receives contributions for the Defined Benefit Supplement and Cash Balance Benefit programs, Medicare Premium Payment Program and the Pension2 defined contribution programs.

10 Years of Time-Weighted Annual Returns



EXPENSES

CalSTRS' major expense categories include pension benefit payments and administrative expenses associated with maintaining operations. The largest CalSTRS expense is retirement benefit payments¹, which were approximately \$14.3 billion in fiscal year 2017–18. Administrative expenses include the direct costs of administering CalSTRS pension programs, investment costs, capital projects and the costs of indirect support functions such as Human Resources, Technology Services, Facilities, Financial Services and Procurement.

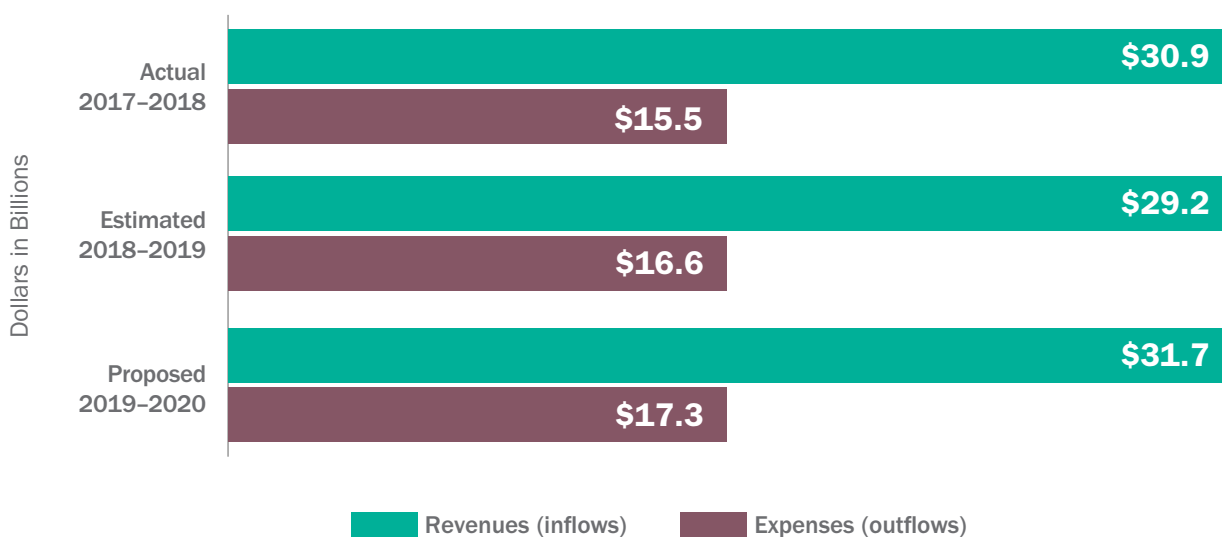
Administrative costs are primarily driven by salaries and wages, resource augmentation for both internal and external resources driven by new or expanded work scope, information technology, investments, project-based costs and assessments issued by the DOF. CalSTRS staff salary and benefit expenses are generally negotiated through long-term contracts between the state and labor organizations. Information technology costs have grown over the years primarily due to increased security and storage requirements as well as business transformation initiatives using technology. Investment costs

are primarily driven by the fees paid to external investment advisors to manage CalSTRS' capital. DOF assessments are provided to CalSTRS on an annual basis and are typically related to the cost of shared central administrative services.

For financial reporting purposes, CalSTRS accrues expenses for long-term pension and other post-employment benefit costs for its employees in accordance with GASB Statement Nos. 68 and 75; however, these costs are not recognized for budgetary purposes.

THREE-YEAR OVERVIEW AND PROJECTED BALANCES

Revenues primarily include investment income and member, employer and state contributions. The major expense categories include pension benefit payments and administrative expenses. The graph below provides a three-year overview of CalSTRS' total revenues and expenses and includes all financial activities of the organization for 2017–18, 2018–19 and 2019–20 for all funds.



¹ Additional details related to member benefit payments is provided in Appendix 2.

The table below provides a summary of revenues and expenditures for prior year actual expenses, current year estimated expenditures, and the 2019–20 proposed budget for all of CalSTRS’ funds, which includes the Teachers’ Retirement Fund, Teachers’ Replacement Benefit Fund, Pension2, Teachers’ Deferred Compensation Fund and the Teachers’ Health Benefit Fund. Revenues and expenditures are categorized by type and function, respectively.

Material changes in revenues and expenditures are primarily driven by statutorily required contribution rate increases, increases in active membership and projected investment

performance. Changes in expenditures are largely due to increased member benefit payments largely driven by increases in service retirements. The increase in Other Income relates to higher interest and fees associated with subscription lines of credit for certain designated joint venture borrowers. Conversely, external investment management fees, which are continuously appropriated and largely correlated to the value of assets under management and investment returns, are projected to decrease. This is a result of CalSTRS’ transformative shift to more internally managed assets, which increases control and transparency and results in significant overall cost savings.

Three-Year Overview and Projected Fund Balances: All Funds¹ (Dollars in Thousands)

	Actual 2017-18	Estimated 2018-19 ²	Proposed 2019-20	% Change
Beginning Fund Balance	\$210,924,561	\$226,286,356	\$238,922,334	6%
Revenues				
Investment Income	\$19,432,465	\$16,056,119	\$17,742,156	11%
Employer Contributions	4,895,333	5,879,609	6,652,048	13%
Member Contributions	3,625,396	4,130,959	4,070,265	(1%)
State Contributions	2,796,673	3,082,316	3,153,450	2%
Other Income	107,150	80,172	122,108	52%
Total Revenues	\$30,857,017	\$29,229,175	\$31,740,027	9%
Expenses				
Pension Benefit Payments	\$14,270,951	\$15,152,063	\$15,909,766	5%
External Investment Expenses	177,891	313,434	256,815	(18%)
Administrative Expenditures	239,663	277,656	290,353	5%
Contribution Refunds	103,886	76,000	82,000	8%
Other Benefit Payments	239,859	231,388	243,076	5%
Other Expenditures	462,972	542,656	549,618	1%
Total Expenditures	\$15,495,222	\$16,593,197	\$17,331,628	4%
Ending Fund Balance	\$226,286,356	\$238,992,334	\$253,330,733	6%

¹ This section is different from what was presented in the board-approved budget due to refined forecasts.

² 2018–19 fund balance does not reflect the \$300 million for the CalSTRS Headquarters Expansion Project as it will be recognized as an asset.

As highlighted in the table on the previous page, a component of total expenses includes Administrative Expenditures and External Investment Administration, which represent the framework of CalSTRS total budget and funds CalSTRS' operations. These include administering pension programs, investments and the costs of indirect support functions such as Human Resources, Technology Services, Facilities, Financial Services and Procurement.

Teachers' Retirement Fund

The Teachers' Retirement Fund is the largest fund that CalSTRS administers. It encompasses the Defined Benefit, Defined Benefit Supplement, Cash Balance, and purchasing power protection programs. Effective July 1, 2019, employer contribution rates will increase to a total of 18.13 percent. Employer contributions will continue to increase under the CalSTRS Funding Plan to 19.10 percent in 2020–21. External investment expenses are projected to decrease as CalSTRS continues to transition more assets under management, which results in reduced external management fees.

Teachers' Retirement Fund (Dollars in Thousands)				
	Actual 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Beginning Fund Balance	\$210,083,124	\$225,305,506	\$237,743,092	6%
Revenues				
Investment Income	\$19,364,771	\$15,935,797	\$17,598,000	10%
Employer Contributions	4,855,264	5,835,842	6,605,790	13%
Member Contributions	3,496,245	3,994,688	3,883,700	(3%)
State Contributions	2,796,673	3,082,316	3,153,450	2%
Other Income	105,221	77,390	120,000	55%
Total Fund Revenues	\$30,618,174	\$28,926,033	\$31,360,940	8%
Expenses				
Pension Benefit Payments	\$14,259,554	\$15,138,822	\$15,895,763	5%
External Investment Expenses	177,891	313,434	256,815	(18%)
Administrative Expenditures	237,765	274,038	287,682	5%
Contribution Refunds	103,886	76,000	82,000	8%
Other Benefit Payments	161,932	156,407	163,427	4%
Other Expenditures	454,764	529,746	541,000	2%
Total Fund Expenditures	\$15,395,792	\$16,488,447	\$17,226,687	4%
Ending Fund Balance	\$225,305,506	\$237,743,092	\$251,877,345	6%

Teachers' Replacement Benefit Fund

The Teachers' Replacement Benefit Fund provides for the payment of benefits above the IRC threshold. This fund serves as a pass-through of benefit payments to eligible retirees of the Defined Benefit Program and does not bear operational or administrative charges.

Teachers' Replacement Benefit Fund (Dollars in Thousands)				
	Actual 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Beginning Fund Balance	\$ —	\$ —	\$ —	—
Revenues				
Employer Contributions	11,397	13,241	14,003	6%
Total Fund Revenues	\$11,397	\$13,241	\$14,003	6%
Expenses				
Pension Benefit Payments	11,397	13,241	14,003	6%
Total Fund Expenditures	\$11,397	\$13,241	\$14,003	6%
Ending Fund Balance	\$ —	\$ —	\$ —	—

Pension2

The Pension2 program provides optional deferred compensation plans for CalSTRS members. There is not an operational budget associated for this fund; however, expenses related to specific administrative, outreach and marketing activities for Pension2 are reported within the Teachers’ Deferred Compensation Fund. CalSTRS’ marketing of the Pension2 program has significantly increased member enrollment in both the 403(b) and 457(b) plans. The program experienced overall membership growth of 15.4 percent in fiscal year 2017–18. Given the current member growth trajectory, out-year forecasts project continuous increases in participant contributions. The larger asset base is also driving larger investment returns relative to prior years. Noteworthy increases in Other Income relate to projected increases in rollover contributions from other retirement plans. Conversely, Other Expenditures, which include investment management costs and third party administration fees, are expected to decrease based on revised estimates drawn from actual experience.

Pension2 (Dollars in Thousands)				
	Actual 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Beginning Fund Balance	\$839,786	\$979,270	\$1,178,210	20%
Revenues				
Investment Income	\$67,659	\$120,297	\$144,128	20%
Employer Contributions	454	464	483	4%
Member Contributions	129,151	136,271	186,565	37%
Other Income	320	172	346	101%
Total Fund Revenues	\$197,584	\$257,204	\$331,522	29%
Expenses				
Other Benefit Payments	\$49,892	\$45,354	\$48,541	7%
Other Expenditures	8,208	12,910	8,618	(33%)
Total Fund Expenditures	\$58,100	\$58,264	\$57,159	(2%)
Ending Fund Balance	\$979,270	\$1,178,210	\$1,452,573	23%

Teachers' Deferred Compensation Fund

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. It is funded by the fee revenues received from the Pension2 participating plans, a vendor registration program and an employer compliance assistance program. In addition, the TDCF accounts for expenditures associated with outreach and marketing of the Pension2 Program. The TDCF forecasts an overall reduction primarily due to revised revenue estimates. In addition, expense estimates were updated to reflect changes in the 403(b)Compare website redesign costs.

Teachers' Deferred Compensation Fund (Dollars in Thousands)				
	Actual 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Beginning Fund Balance	\$1,057	\$1,275	\$988	(23%)
Revenues				
Investment Income	\$17	\$11	\$15	36%
Other Income	1,609	2,610	1,762	(32%)
Total Fund Revenues	\$1,626	\$2,621	\$1,777	(32%)
Expenses				
Administrative Expenditures	\$1,408	\$2,908	\$2,007	(31%)
Other Benefit Payments	—	—	—	—
Total Fund Expenditures	\$1,408	\$2,908	\$2,007	(31%)
Ending Fund Balance	\$1,275	\$988	\$758	(23%)

Teachers' Health Benefit Fund

The Teachers' Health Benefit Fund supports the CalSTRS' Medicare Premium Payment Program. It is funded on a pay-as-you-go basis from a portion of monthly employer contributions. Due to the pay-as-you-go nature of the fund, CalSTRS has historically maintained a modest fund balance. In addition, the MPPP is a closed plan. As such, activity is expected to slowly decrease over time.

Teachers' Health Benefit Fund (Dollars in Thousands)

	Actual 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Beginning Fund Balance	\$594	\$305	\$44	(86%)
Revenues				
Investment Income	\$18	\$14	\$13	(7%)
Employer Contributions	28,218	30,062	31,772	6%
Total Fund Revenues	\$28,236	\$30,076	\$31,785	6%
Expenses				
Administrative Expenditures	\$490	\$710	\$664	(6%)
Other Benefit Payments	28,035	29,627	31,108	5%
Total Fund Expenditures	\$28,525	\$30,337	\$31,772	5%
Ending Fund Balance	\$305	\$44	\$57	30%



POLICIES

BUDGET POLICY

CalSTRS maintains its budget and results under the modified cash basis method. Under this method, revenue is recognized when it is received and expenses are recognized when a documented commitment to make the expenditure is established or the goods and services are received.

Resources are prudently allocated throughout the organization to advance the goals and objectives set forth by the Teachers' Retirement Board and executive management in the 2019–22 Strategic Plan. CalSTRS' 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, the development of budgets and the management of employer contribution rates.

Specific policies related to CalSTRS budget include:

- **Blanket Positions:** Blanket Positions, formally known as Administratively Established Positions, are temporary positions designed for short-term needs. Branches may request that these be established for positions such as student assistants, seasonal clerks or when additional staff is needed for a project.
- **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:** CalSTRS uses pre-encumbrances, encumbrances and earmarked funds to designate and reserve budget funds for specific purposes. CalSTRS generally posts commitments of funding or encumbers funding for all proposed expenditures within BusinessDirect. 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, and branch executives are responsible for ensuring availability of funding at the time of purchase approval.
- **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 rare circumstances, there is a formal process to obtain additional funding from the contingency reserve fund. 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, each area's funding 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.

METHOD OF ACCOUNTING

Financial Accounting and Reporting Policy

CalSTRS maintains financial accounting and reporting records on an accrual basis in accordance with U.S. General Accepted Accounting Principles as promulgated by the Governmental Accounting Standards Board.

In addition to producing GAAP-based financial statements for the CalSTRS Comprehensive Annual Financial Report, budgetary/legal basis financial reporting is produced for consistency with the Governor's Budget and the Budget Act. Fundamental differences between GAAP data shown in the CAFR and the budgetary/legal basis data shown in this report include treatment of accrued liabilities, reimbursements, interfund transfers, capitalized assets, post-employment benefit liabilities and encumbrances, which represent commitment or contractually obligated expenditures.

CalSTRS capitalizes operational assets in accordance with Governmental Accounting Standards Board Statement Nos. 34 and 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 an initial cost basis of \$1 million or greater are capitalized. Depreciation and amortization are charged to operations using the straight-line method on the estimated useful life of the related asset. CalSTRS reviews capital assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable.

Specific policies related to financial accounting and reporting include:

- **Accounting for Gains and Losses from Investment Asset Transfers:** CalSTRS records the gains and losses from investment asset transfers between investment portfolios as unrealized gains and losses for financial reporting purposes.
- **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, retirement enhancements and state contributions 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 start 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, this policy addresses the transfer of funds from the Cash Balance Benefit Program into the Defined Benefit Program.
- **Manual Journal Entries:** Manual journal entries in BusinessDirect, the CalSTRS enterprise resource planning software, are prepared by staff, posted by a supervisor, and must be supported by documentation explaining the entry. Entries with a gross impact of \$100 million or greater must be posted by a senior manager. Manual journal entries and those posted after the books close must be approved by the Director of Financial Planning, Accounting and Reporting and the Chief Financial Officer.
- **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 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.

- **Allocations for Financial and Managerial Accounting:** CalSTRS has an established policy to guide the allocation of financial data for managerial and financial reporting purposes. The policy provides a framework to ensure allocations are equitable in accordance with applicable accounting standards, laws and regulations.
- **Actuarial Valuations for Financial Statement Presentation:** CalSTRS prepares an actuarial valuation of the State Teachers' Retirement Plan within these funds for financial statement purposes annually. As required by GASB Statement No. 67, 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.
- **Actuarial Valuations for Financial Statement Presentation of the Medicare Premium Payment Program:** CalSTRS prepares an annual actuarial valuation for financial reporting purposes as required by GASB Statement No. 74. CalSTRS uses actuarial assumptions in conformity with Actuarial Standards of Practice issued by the Actuarial Standards Board for financial reporting purposes.
- **Financial Statement Presentation—CalSTRS Fair Value Measurement Presentation:** CalSTRS values investment assets and liabilities using an exit price without adjustment for transaction costs in our principal or most advantageous market and in alignment to policies set forth by

the Teachers' Retirement Board. CalSTRS' valuation techniques include the market, cost and income approaches. CalSTRS applies these approaches to various investment assets and liabilities to maximize the use of observable inputs in line with GASB Statement No. 72.

- **Financial Statement Presentation—Schedule of Investments:** CalSTRS presents our investment portfolio within our Statement of Fiduciary Net Position summarized by the following major investment categories: Debt Securities, Equity Securities, Alternative Investments and Derivative Instruments. This presentation of investments is supported by a Schedule of Investments included in the notes to CalSTRS annual basic financial statements, which provides additional details about CalSTRS investments by identifying the primary investment types and their respective value.
- **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:** Financial Data Objects are the master elements in BusinessDirect. In order to change a Financial Data Object, this policy outlines the appropriate reviews that must occur and the necessary stakeholders that must be included.
- **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 TRF and credited to the Defined Benefit Program each month are instead deposited into the THBF and credited to the MPP Program

to fund monthly program benefits and administrative costs.

- **Monthly and Quarterly Benefit Allowance Roll Reasonableness Analysis:** CalSTRS disburses benefit payments through the allowance roll process. These amounts fluctuate as benefit recipients are added to and removed from the rolls. Review of the monthly allowance and quarterly supplemental rolls for reasonableness is intended to identify systemic errors and

reasonableness of payments by comparing the fluctuation in amounts being paid to a threshold.

- **Requirements for Service Organization Control Reports Risk Reviews:** Service Organization Control Reports are internal control reports on the services provided by a Service Organization. Service organizations provide valuable information that CalSTRS uses to identify, assess and address the risks associated with an outsourced service.

BOARD POLICY

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.

Section 17 of Article XVI of the California Constitution (Proposition 162)

- (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.*

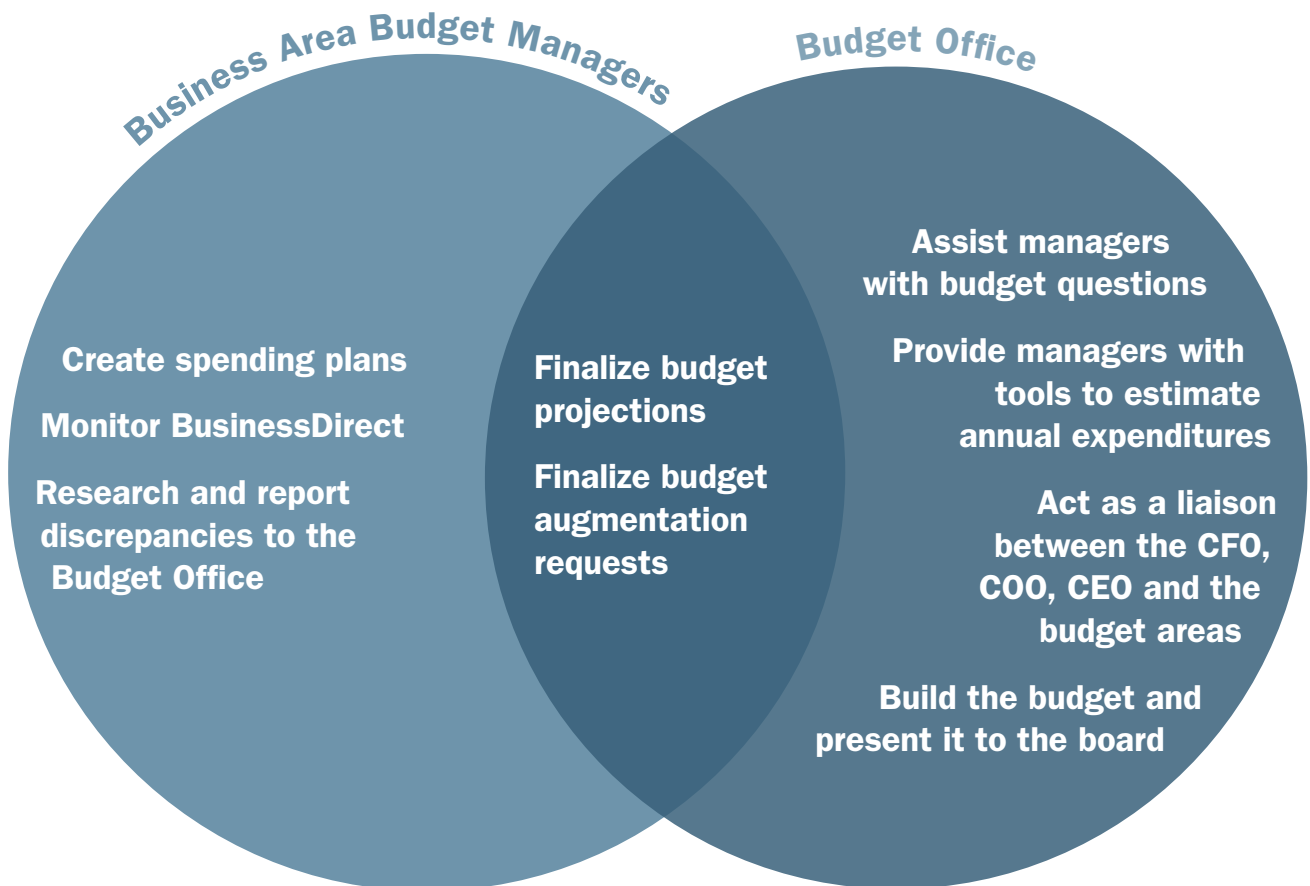
This authority provides the basis for which all policies are established and affords the system a significant level of autonomy from the state administration as compared to other state agencies. CalSTRS' policies guide activities such as development of annual budgets, procurement of goods and services, implementation and oversight of information technology projects, delegations of authority, and out-of-state and international travel.



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.

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 concludes with the Teachers' Retirement Board's final approval, the Legislature's ratification, and 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 CalSTRS 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 requires approval via the state Budget Act.

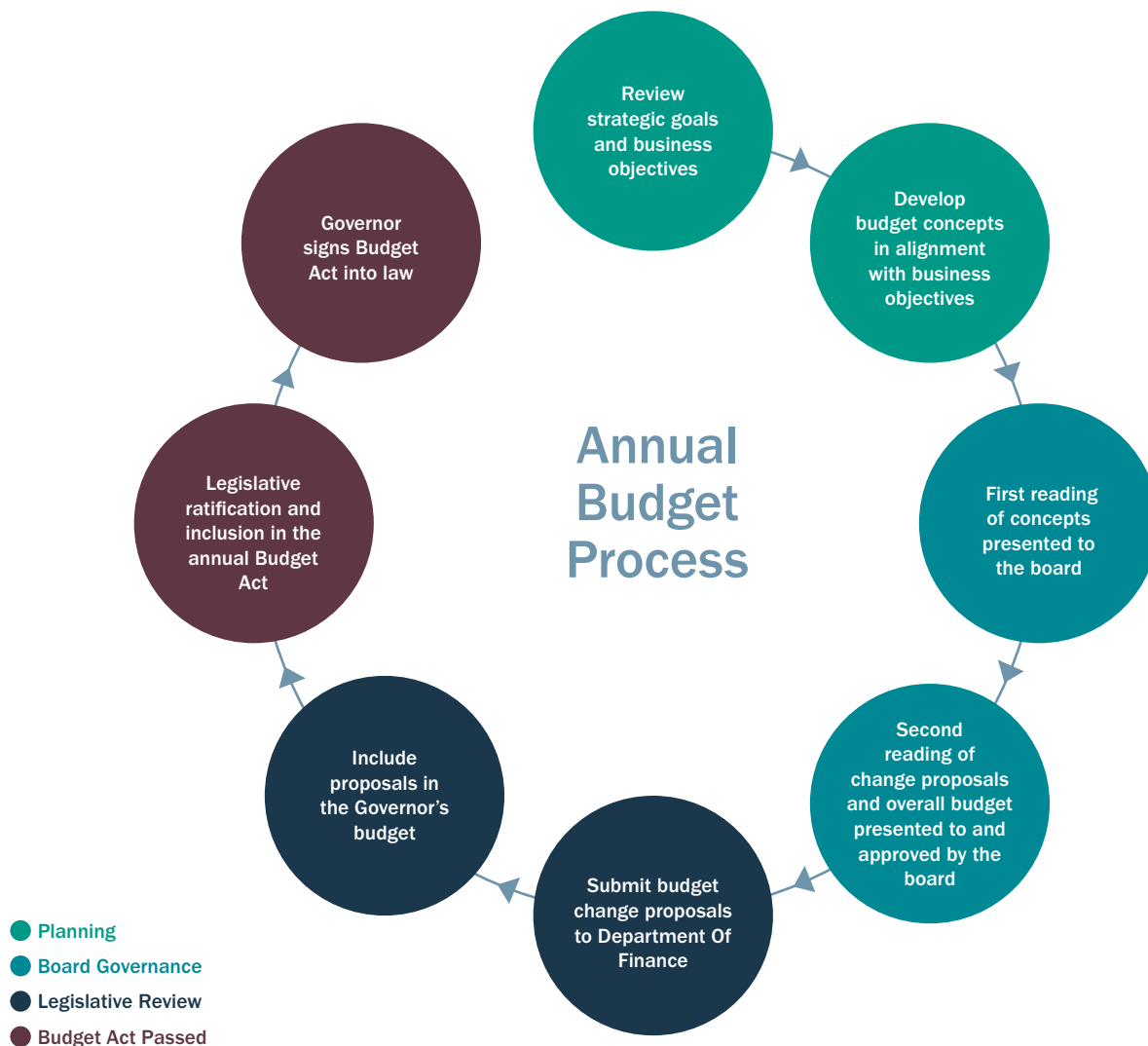
CalSTRS receives information on changes to wages and benefit rates, as well as estimates for certain costs allocated to CalSTRS from the state's DOF. Simultaneously, Budget Office staff works with business areas to prepare requests for significant changes to the baseline budget to address strategic initiatives and other enterprise priorities. Some of these resource needs are funded from current baseline budget resources through realignment. Others require augmentation to the budget and are packaged as budget change proposals.

Staff presents concepts related to 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 DOF in December and presents the board-approved CalSTRS budget to legislative committees 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 request the board to augment the current year budget under its authority for continuously appropriated items and by amounts under the annual appropriation savings¹, included in the Budget Act for the support appropriation. These augmentations must occur at appropriately noticed public board meetings. CalSTRS prepares quarterly reports comparing our budget-to-actual expenditures and publishes them on the

¹ Additional details regarding the annual appropriation savings are provided in the Budget Overview section.



CalSTRS external website. These reports present performance against budgeted amounts and summarize any changes to the budget.

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 BCPs to request additional funding and positions. As previously noted, after the board approves the final budget in November, CalSTRS submits our budget proposals to the DOF. Pursuant to Proposition 162 and by longstanding mutual agreement with the DOF, CalSTRS' annual

operating budget is submitted to the DOF for inclusion in the Governor's proposed budget without change. The DOF then prepares the proposed California state budget for release by January 10. Concurrently, legislative leaders develop their budget priorities for the upcoming fiscal year.

From February to early May, legislative subcommittees hold hearings to review the Governor's proposed budget and make initial decisions. 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.

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

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

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

Augmentations to Budget Act appropriations require ratification by the Legislature and approval of the Governor and include specific spending limits that are overseen by the DOF and the SCO. Separately, augmentations to continuous appropriations do not require legislative approval, and expenditures are limited only by the resources available within the funding source. CalSTRS maintains oversight and controls over continuously appropriated budgets through various monitoring and approval processes, which are discussed below.

On a monthly basis, staff reviews budget consumption to ensure that transactions are recorded accurately, and use is consistent with projections.

expenditures during the preceding fiscal year on an annual basis. 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.

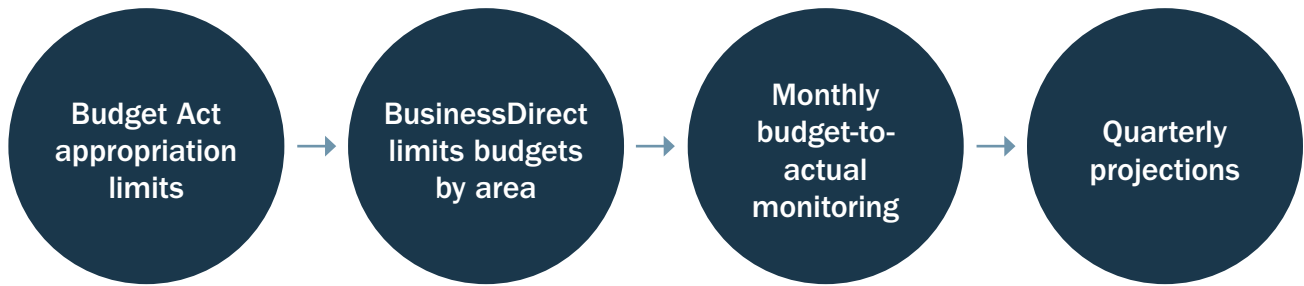
CalSTRS maintains multiple layers of control and monitoring activities throughout the organization to ensure the adopted budgets are appropriately managed. From a control perspective, the budget is recorded in the CalSTRS enterprise resource planning system, BusinessDirect, which establishes expenditure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

On a monthly basis, staff reviews budget consumption to ensure that transactions are recorded accurately and use is consistent with projections. Projections of revenues and expenditures are also forecast 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 budget-to-actual reports comparing our budget-to-actual expenditures.

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 DOF. 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

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. If the existing budget does not have sufficient funds, then available funding from other business areas within the branch is 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 contingency funds. Contingency funds are reserve funds CalSTRS maintains within the approved budget for unanticipated expenses. Use of contingency funds depends 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 DOF. Budgetary information is reconciled with the State Controller's Office on a monthly basis.

Position Control

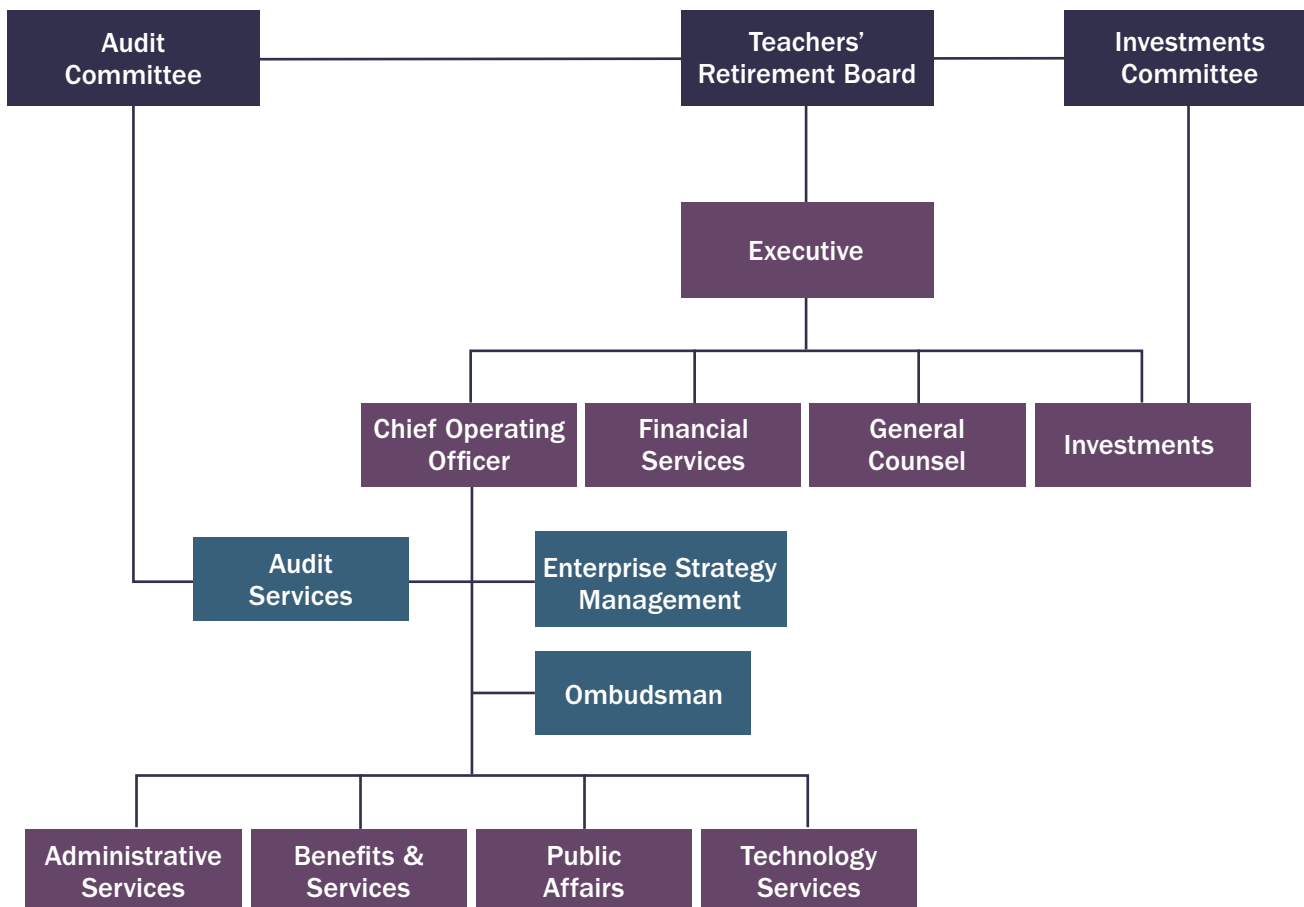
To manage the variations in workload and large projects that are limited term in nature, CalSTRS maintains authority to establish additional full-time positions above the authorized limit to the extent that funding has been approved by the board. While it varies by branch, CalSTRS generally has experienced approximately 5 to 10 percent turnover/attrition rate annually.

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 for certain executives, and other compensation is determined through collective bargaining agreements between the state and employee unions.

DEPARTMENTAL INFORMATION

Art glass by Paul Housberg, 2009

THE CALSTRS ORGANIZATION

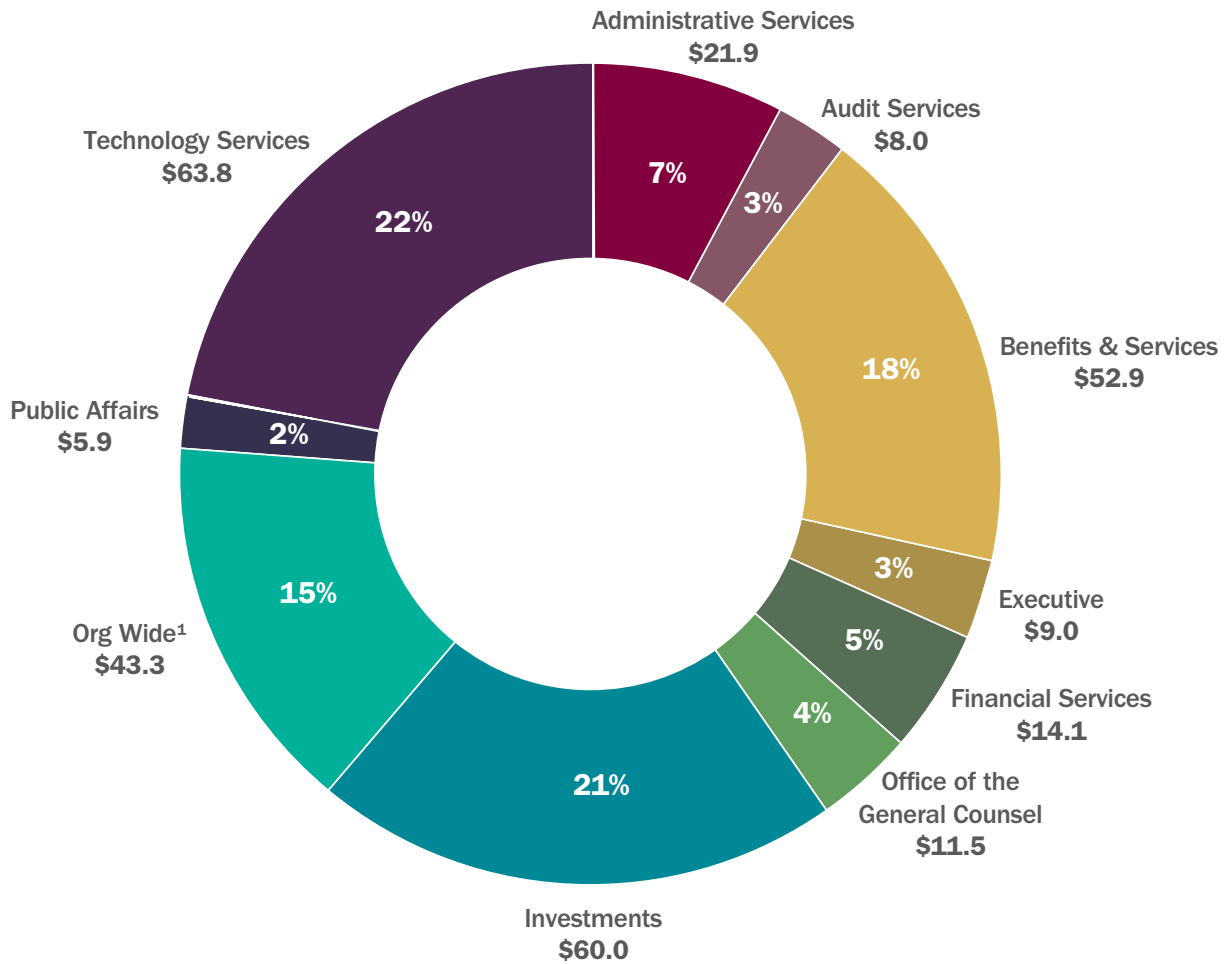


BRANCH INFORMATION

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

The following graphic displays CalSTRS' 2019–20 total functional budget by branch, which include salaries, benefits and operating expenses and equipment.

**Total 2019–20 Operating Budget by Branch—\$290.4 million
(Dollars in Millions)**

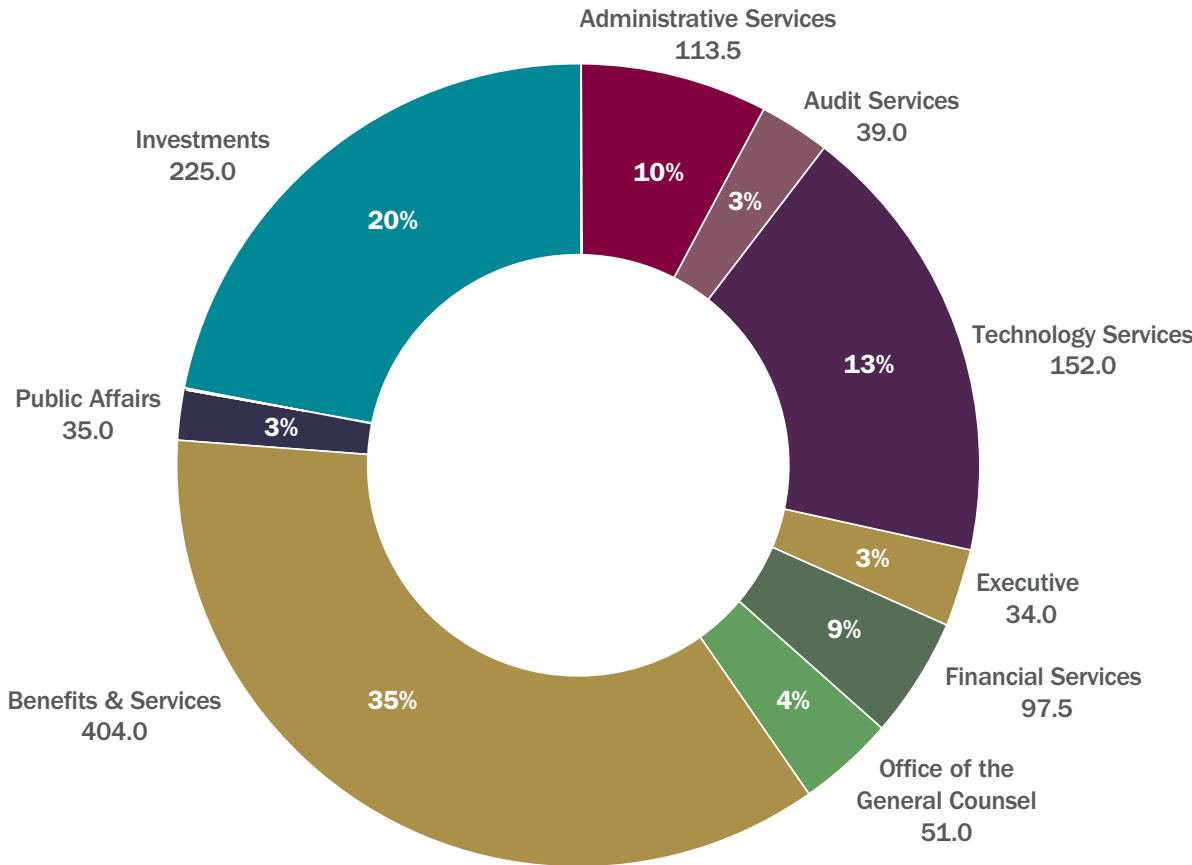


¹ Org Wide budget is for enterprise-wide expenses including specific facility costs, office supplies, contracts and internal reserves.

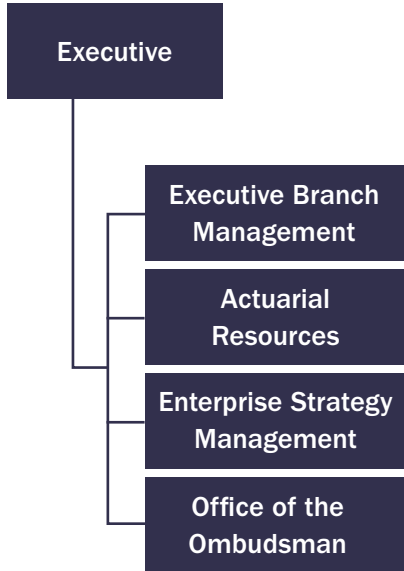
Overall, total authorized positions are expected to increase by eight, or 1 percent, compared to 2018–19. As referenced in the Budget Overview section, the request for eight new positions is included in the proposed 2019–20 authorized position counts. This includes four positions in Audit Services, two positions in the Office of General Counsel, one position in Investments and one position in Public Affairs.

The following graphic displays CalSTRS’ 2019–20 total workforce by branch.

Total 2019–20 Authorized Positions by Branch—1,151 Positions



A description of each branch and corresponding budget and position information for fiscal years 2017–18, 2018–19 and 2019–20 is provided below.

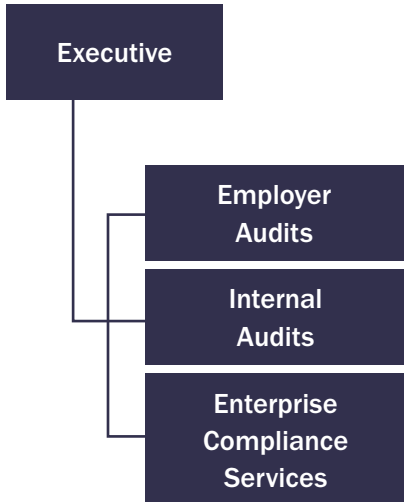


EXECUTIVE¹

The primary objective of the Executive Branch is to execute the CalSTRS mission in securing the financial future and sustaining the trust of California’s educators. The CalSTRS Executive Branch consists of the Executive Management team, Actuarial Resources, Enterprise Strategy Management and the Office of the Ombudsman. The Executive Branch shapes the organization’s policies, operations and strategies consistent with the board’s direction. Note that the Executive Branch’s reporting structure includes Audit Services. However, for budget and business planning purposes, that area is treated as its own branch.

Key Statistics			
	Fiscal Year		
	Actual 2017–18	Estimated 2018–19	Proposed 2019–20
Authorized Positions	33	34	34
Budget (Dollars in Thousands)	\$7,425	\$7,205	\$9,000

¹ Effective March 1, 2019, Actuarial Resources moved from the Executive Branch to the Financial Services Branch. Actuarial Resources and associated funding were approved as part of the 2019–20 Executive Branch budget. These resources and corresponding funding will be transferred to the Financial Services Branch budget during the 2020–21 budget cycle.



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 board and the Executive Branch. 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 its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, internal control and governance processes.

Key Statistics			
	Fiscal Year		
	Actual 2017-18	Estimated 2018-19	Proposed 2019-20
Authorized Positions	33	35	39
Budget (Dollars in Thousands)	\$7,461	\$5,192	\$8,014

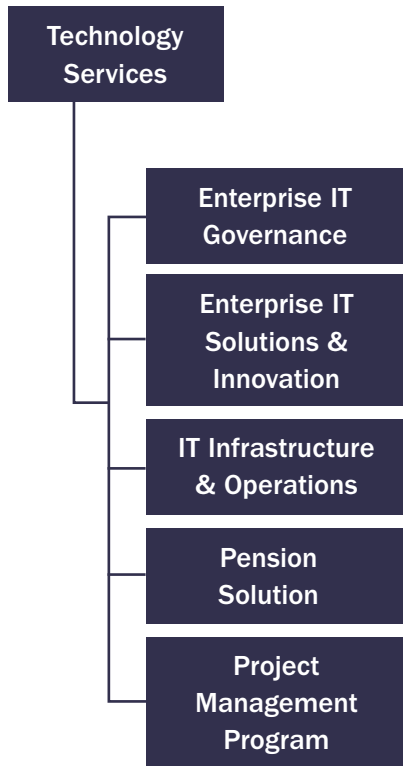


INVESTMENTS

The Investments Branch oversees and manages the CalSTRS Investment Portfolio, which is valued at approximately \$223.8 billion as of June 30, 2018. CalSTRS Investments Branch consists of Sustainable Investment and Stewardship Strategies, Fixed Income, Global Equity, Inflation Sensitive, Risk Mitigating Strategies, Innovative Strategies & Risk, Private Equity, Real Estate, Operations, Investment Performance and Compliance and Administration units. 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.

Key Statistics

	Fiscal Year		
	Actual 2017-18	Estimated 2018-19	Proposed 2019-20
Authorized Positions	167	224	225
Budget (Dollars in Thousands)	\$36,124	\$54,863	\$60,030



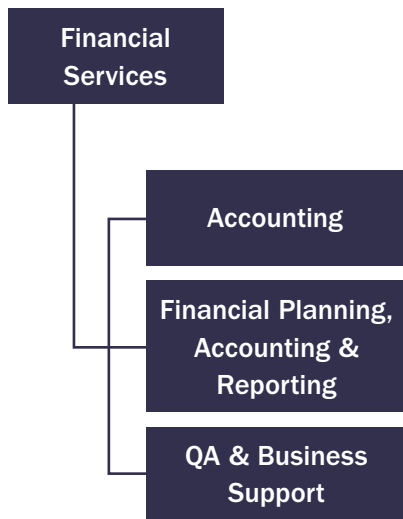
TECHNOLOGY SERVICES

Technology Services realizes CalSTRS’ business goals through technology transformation and information technology operations with quality solutions, excellence in service, strategic partnership and strong collaboration with internal and external stakeholders. The branch is responsible for agile delivery of quality, innovative, reliable and secure technology services in support of CalSTRS’ core operational functions and business strategy.

Furthermore, the branch 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 continual improvement.

Key Statistics

	Fiscal Year		
	Actual 2017–18	Estimated 2018–19	Proposed 2019–20
Authorized Positions	156	152	152
Budget (Dollars in Thousands)	\$56,115	\$75,663	\$63,772



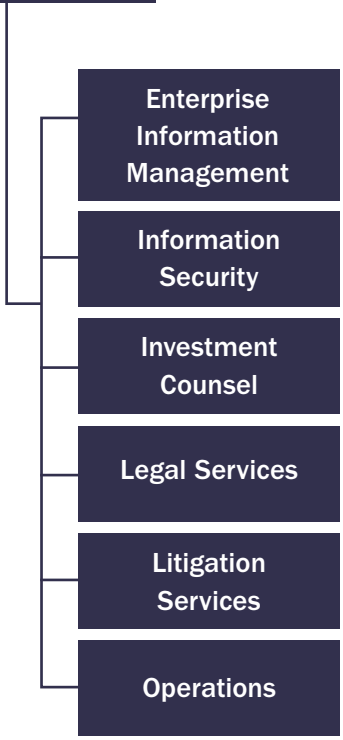
FINANCIAL SERVICES

The Financial Services Branch provides financial and business process planning; financial, cost and operational accounting; and budget, performance and operational financial reporting. The branch is composed of three core business areas supporting CalSTRS, which include Accounting; Financial Planning, Accounting and Reporting; and Quality Assurance and Business Support. The branch plays a key role in enhancing financial reporting and budgeting operations, addressing audit issues related to financial reporting and internal control and advising CalSTRS executives on all fiscal-related matters impacting the organization.

Key Statistics

	Fiscal Year		
	Actual 2017–18	Estimated 2018–19	Proposed 2019–20
Authorized Positions	97.5	97.5	97.5
Budget (Dollars in Thousands)	\$12,264	\$11,580	\$14,111

**Office of the
General Counsel**

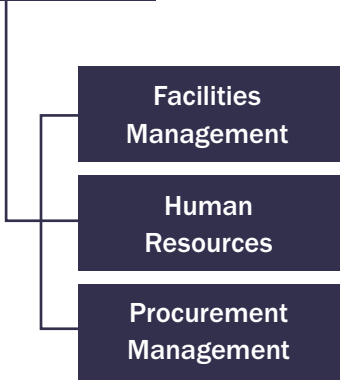


OFFICE OF THE GENERAL COUNSEL

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. The branch consists of the following business areas: Enterprise Information Management, Information Security, Investment Counsel, Legal Services, Litigation Services and Operations.

Key Statistics			
	Fiscal Year		
	Actual 2017-18	Estimated 2018-19	Proposed 2019-20
Authorized Positions	48	49	51
Budget (Dollars in Thousands)	\$8,604	\$8,318	\$11,559

**Administrative
Services**

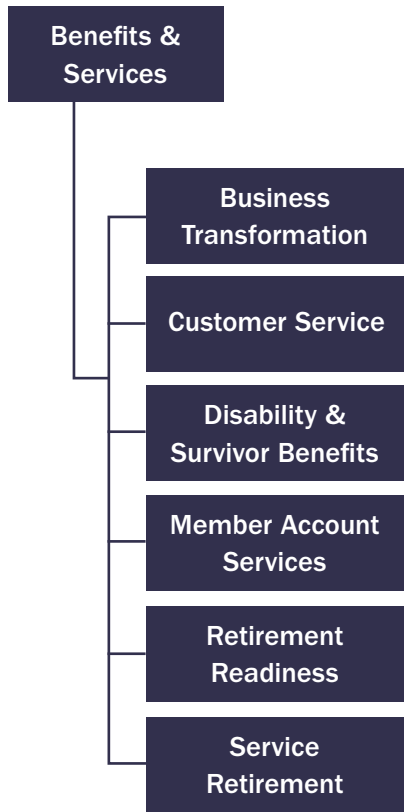


ADMINISTRATIVE SERVICES

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.

Key Statistics			
	Fiscal Year		
	Actual 2017-18	Estimated ¹ 2018-19	Proposed 2019-20
Authorized Positions	112.5	113.5	113.5
Budget (Dollars in Thousands)	\$19,949	\$311,863	\$21,850

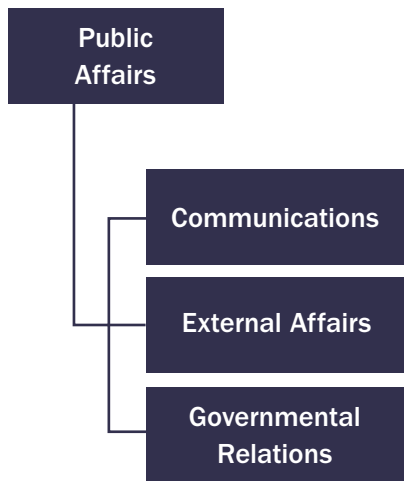
¹ The 2018-19 Operating Budget, as modified, includes the CalSTRS Headquarters Expansion Project, which was approved by the board in November 2018.



BENEFITS AND SERVICES

The Benefits and Services Branch is the largest business area in the CalSTRS organization. The branch’s six lines of business include: Business Transformation, Customer Service, Disability and Survivor Benefits, Member Account Services, Retirement Readiness and Service Retirement. 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, 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.

Key Statistics			
	Fiscal Year		
	Actual 2017–18	Estimated 2018–19	Proposed 2019–20
Authorized Positions	403	404	404
Budget (Dollars in Thousands)	\$45,673	\$47,281	\$52,868



PUBLIC AFFAIRS

The Public Affairs Branch manages CalSTRS’ relationships with the state, CalSTRS members and the public. As part of this effort, the branch serves as the primary liaison between CalSTRS and key stakeholders 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. The branch is composed of three business areas: Communications, External Affairs and Governmental Relations.

Key Statistics			
	Fiscal Year		
	Actual 2017–18	Estimated 2018–19	Proposed 2019–20
Authorized Positions	34	34	35
Budget (Dollars in Thousands)	\$4,862	\$5,278	\$5,909

APPENDIX 1 CALSTRS 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 CalSTRS current position on membership, investments and funding is below.

ANNUAL RETIREMENT STATISTICS

July 1, 2017–June 30, 2018



62.9

Median age of retirement



25.0

Median years of service credit



\$14.3 billion

Total benefit payments for the year, which includes service retirement, disability and survivor benefits



\$4,512

Median monthly Member-Only Benefit



12,778

Number of defined benefit retirements

APPENDIX 2

CALSTRS RETIREMENT BENEFITS FUEL LOCAL ECONOMIES

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. We paid an estimated \$11.5 billion in benefits to 225,541 retirees living in California during fiscal year 2017–18. The following map and chart show the number of retired members living in each county and a range of the amount of benefits paid to those members, as well as the locations of the CalSTRS Member Service Centers.

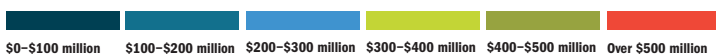
Defined Benefit Program

Retirees Who Live in California—Characteristics by County



County	Number of Retirees	Estimated Benefits Paid in FY 2017-18
Alameda	7,567	\$387,199,504
Alpine	14	418,344
Amador	438	18,311,316
Butte	2,378	103,895,797
Calaveras	578	25,613,808
Colusa	124	5,610,194
Contra Costa	7,564	362,516,938
Del Norte	242	10,363,608
El Dorado	2,164	104,366,994
Fresno	6,269	306,834,670
Glenn	134	6,106,793
Humboldt	1,380	53,144,850
Imperial	788	44,641,734
Inyo	162	6,585,515
Kern	4,285	220,612,423
Kings	596	30,399,051
Lake	482	19,999,504
Lassen	223	9,772,612
Los Angeles	43,084	2,317,697,916
Madera	1,323	61,122,724
Marin	2,310	103,706,995
Mariposa	273	11,402,660
Mendocino	1,136	46,989,846
Merced	1,498	78,688,862
Modoc	88	3,213,424
Mono	178	8,078,262
Monterey	3,074	151,367,288
Napa	1,420	66,111,624
Nevada	1,608	70,611,341
Orange	21,109	1,235,475,222
Placer	4,247	209,271,670
Plumas	325	13,170,684
Riverside	12,457	634,226,250
Sacramento	8,982	418,979,135
San Benito	311	16,277,910
San Bernardino	9,284	479,144,803
San Diego	21,046	1,067,867,484
San Francisco	2,910	136,877,783
San Joaquin	3,938	198,151,859
San Luis Obispo	4,194	196,506,289
San Mateo	3,746	202,195,932
Santa Barbara	2,946	139,422,915
Santa Clara	9,341	511,428,740
Santa Cruz	2,774	129,470,718
Shasta	1,662	72,180,076
Sierra	74	3,199,384
Siskiyou	603	23,967,738
Solano	2,988	141,647,687
Sonoma	4,488	206,851,475
Stanislaus	3,159	168,102,592
Sutter	744	37,677,869
Tehama	705	31,261,854
Trinity	146	5,742,695
Tulare	3,054	156,017,081
Tuolumne	678	30,960,236
Ventura	6,799	352,990,106
Yolo	1,104	49,024,305
Yuba	347	15,417,660
Total	225,541	\$11,518,892,749

Benefit payments by amount



APPENDIX 3

CALSTRS' LEGISLATIVE ACTIVITIES

The Teachers' Retirement Board's legislative policies are driven by an overall goal of preventing and removing obstacles that impair the ability of CalSTRS members to achieve financial security. CalSTRS actively engages in the legislative process to educate and inform stakeholders of bills that impact the pension system. As part of this engagement, CalSTRS monitors state and federal legislation that affect areas of the organization. Legislation that materially impacts the system is presented to the board for consideration so board members may formally take an opposing, supporting or neutral position.

The legislative landscape continues to be challenging in the area of forced divestment. Over the last year, various bills have been introduced that would prohibit or severely limit CalSTRS' ability to invest in specific countries, projects, companies and sectors. CalSTRS continues to advocate for engagement rather than divestment because it advances the system's ability to drive positive change for environmental, social and governance issues.

Contribution Rates

Member and employer contribution rates for the Defined Benefit Program are displayed in the following tables. For members, the rates differ depending on whether they were first hired to perform service that could be creditable to CalSTRS before or after January 1, 2013. 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	2% at 60 Members	2% at 62 Members
July 1, 2014	8.15%	8.15%
July 1, 2015	9.20%	8.56%
July 1, 2016	10.25%	9.205%
July 1, 2017	10.25%	9.205%
July 1, 2018	10.25%	10.205%

Employer Contribution Rates	
Effective Date	Rate
July 1, 2014	8.88%
July 1, 2015	10.73%
July 01, 2016	12.58%
July 01, 2017	14.43%
July 01, 2018	16.28%
July 01, 2019	18.13%
July 01, 2020	19.10%
July 01, 2021 to June 30, 2046	Subject to board determination
July 01, 2046	Revert to base rate ¹ of 8.25 percent

For the period from July 1, 2021, to June 30, 2046, the board cannot adjust the employer rate by more than 1 percent in a fiscal year, and the contribution rate cannot exceed a maximum of 20.25 percent. In July of 2046, the employer contribution rates return to the statutory values established prior to the implementation of the CalSTRS Funding Plan.

State contribution rates are also determined as a percentage of the member creditable compensation. The board also has limited authority to adjust state contribution rates from July 1, 2017, through June 30, 2046, depending upon the status of the unfunded actuarial obligation. The rate can be adjusted up to 0.5 percent per year. As of July 1, 2018, the state's contribution rate is 9.828 percent.

State Contribution Rates	
Effective Date	Rate
July 01, 2016	8.828%
July 01, 2017	9.328%
July 01, 2018	9.828%
July 01, 2019 to June 30, 2046	Variable
July 01, 2046 and thereafter	Revert to base rate of 4.517%

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

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

¹ The rate as a percentage of teacher payroll that employers and the state were statutorily required to pay prior to the implementation of the CalSTRS Funding Plan.

APPENDIX 4

OPERATING BUDGET BY FUND

The proposed 2019–20 Pension and General Administration, Capital Projects and Investment Administration budgets (functional budgets) include the Teachers’ Retirement Fund, Teacher’s Deferred Compensation Fund and the Teachers’ Health Benefit Fund as presented below.

Total Operating Budget by Fund (Dollars in Thousands)				
Budget Category	TRF	TDCF	THBF	Totals
Pension and General Administration	\$203,315	\$2,007	\$664	\$205,986
Capital Projects	24,337	—	—	24,337
Internal Investment Administration	60,030	—	—	60,030
Totals	\$287,682	\$2,007	\$664	\$290,353

Teachers’ Retirement Fund Budget

The Teachers’ Retirement Fund is the largest fund that CalSTRS administers and includes 1,142 authorized positions. The fund encompasses the Defined Benefit, Defined Benefit Supplement, Cash Balance Benefit and purchasing power protection programs. The 2018–19 Operating Budget, as modified, includes \$292 million for the CalSTRS Headquarters Expansion Project.

Teachers’ Retirement Fund (Dollars in Thousands)				
Budget Category	Actuals 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Salaries	\$96,488	\$118,391	\$123,016	4%
Benefits	44,553	59,984	68,671	14%
Operating Expenses and Equipment				
General Expenses	19,283	20,638	18,000	(13%)
Consulting and Professional Services	33,782	336,713	48,259	(86%)
Facilities Operations	9,400	8,803	9,065	3%
Central Administrative Services	10,492	11,635	10,819	(7%)
Data Processing and Storage	2,794	9,860	9,852	0%
Totals	\$216,792	\$566,024	\$287,682	(49%)

Teachers' Deferred Compensation Fund Budget

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. The TDCF includes six authorized positions.

Teachers' Deferred Compensation Fund (Dollars in Thousands)				
Budget Category	Actuals 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Salaries	\$376	\$501	\$662	32%
Benefits	163	245	290	18%
Operating Expenses and Equipment				
General Expense	196	955	136	(86%)
Consulting and Professional Services	621	1,103	751	(32%)
Central Administrative Services	53	104	168	62%
Totals	\$1,409	\$2,908	\$2,007	(31%)

Teachers' Health Benefit Fund Budget

The Teachers' Health Benefit Fund is used to fund the CalSTRS Medicare Premium Payment Program, which pays Medicare Part A hospital insurance premiums and any associated surcharges for Medicare Part A and Part B for certain eligible retired members. The THBF includes three authorized positions.

Teachers' Health Benefit Fund (Dollars in Thousands)				
Budget Category	Actuals 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Salaries	\$287	\$179	\$436	144%
Benefits	117	109	124	14%
Operating Expenses and Equipment				
General Expense	170	366	21	(94%)
Consulting and Professional Services	—	34	30	(12%)
Central Administrative Services	11	18	49	172%
Data Processing and Storage	—	4	4	0%
Totals	\$585	\$710	\$664	(6%)

APPENDIX 5

OPERATING BUDGET BY ADMINISTRATIVE FUNCTION

Pension and General Administration Budget

The pension and general administration budget funds CalSTRS' ongoing operations associated with managing benefit programs. These programs include enrolling members, collecting contributions, providing retirement readiness, establishing benefit amounts and paying members. In addition, this budget funds general support, including Human Resources, Facilities Management, Procurement, Technology Services, Financial Services, Communications, Governmental Relations and Legal Services. Further, this budget supports salaries, benefits and operating expenses and equipment associated with these activities for the Defined Benefit, Defined Benefit Supplement, Cash Balance, Replacement Benefit, Pension2 and Medicare Premium Payment programs.

Pension and General Administration Budget (Dollars in Thousands)

Budget Category	Actuals 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Salaries	\$66,696	\$78,392	\$84,667	8%
Benefits	33,724	43,952	53,009	21%
Operating Expenses and Equipment	59,462	63,970	68,310	7%
Totals	\$159,882	\$186,314	\$205,986	11%

Pension and General Administration Staff

Staff Type	Actuals 2017-18	Estimated 2018-19	Proposed 2019-20
Authorized Positions	917	919	926
Blanket Positions	94.5	72.5	75.5
Totals	1,011.5	991.5	1,001.5

Capital Projects Budget

The capital projects budget plans for expenses associated with enterprise projects at CalSTRS. These costs are typically one-time costs as compared to the ongoing administrative costs captured in the pension and general administration budget. Currently, there are three primary sources of funding for CalSTRS projects, the annual technology appropriation, Pension Solution and CalSTRS Headquarters Expansion Project.

Capital Projects Budget (Dollars in Thousands)				
Budget Category	Actuals 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Technology Appropriation	\$4,207	\$18,500	\$18,500	0%
Pension Solution	16,295	17,965	5,837 ¹	(68%)
Headquarters Expansion	—	292,000 ²	—	(100%)
Totals	\$20,502	\$328,465	\$24,337	(93%)

Capital Projects Staff			
Staff Type	Actuals 2017-18	Estimated 2018-19	Proposed 2019-20
Blanket Positions	101	101	98

¹ The total change in Pension Solution is largely due to baseline budget adjustments for Pension Solution appropriations. Any unencumbered appropriations can carryover through June 30, 2020.

² The 2018-19 Operating Budget, as modified, includes \$292 million for the CalSTRS Headquarters Expansion Project.

Investment Administration Budget

The investment administration budget is divided broadly into two categories: internal investment administration costs and external investment administration costs. Internal investment administration costs include salaries, benefits, and operating expenses and equipment for CalSTRS staff actively involved in the management of the investment portfolio. External investment administration costs include management fees, advisor and consultant costs, external legal services for investment activities, master custodial costs, research and rating services, and risk management and trading system costs associated with managing the portfolio.

The tables below contain a detailed view of the total investment administration budget and staff. The external investment administration line accounts for fees paid for external management of CalSTRS' investments.

Investment Administration Budget (Dollars in Thousands)				
Budget Category	Actuals 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Internal Investment Administration	\$38,402	\$54,863 ¹	\$60,030	9%
External Investment Administration	177,891	313,434	256,815	(18%)
Totals	\$216,293	\$368,297	\$316,845	(14%)

Investment Administration Staff			
Staff Type	Actuals 2017-18	Estimated 2018-19	Proposed 2019-20
Authorized Positions	167	224	225
Blanket Positions	0	4	4
Totals	167	228	229

¹ Increase in Internal Investment Administration in 2018-19 compared to 2017-18 is primarily due to the multi-year Internal Investment Management BCP as part of the transition of assets to internal management.

Investment Administration Budget by Category (Dollars in Thousands)

Budget Category	Actuals 2017-18	Estimated 2018-19	Proposed 2019-20	% Change
Internal Investment Administration				
Salaries	\$25,374	\$34,213	\$39,447	15%
Benefits	8,593	13,864	16,076	16%
Operating Expenses and Equipment				
General Expense	2,552	6,161	3,882	(37%)
Consulting and Professional Services	550	625	625	0%
Central Administrative Services	1,333	—	—	—
External Investment Administration				
Consulting and Professional Services	177,891	313,434	256,815	(18%)
Totals	\$216,293	\$368,297	\$316,845	(14%)

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 a specific 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. 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

A budgetary tool that provides staffing flexibility to meet operational needs and allows departments to hire above total authorized positions to the extent that additional costs can be absorbed within existing authority.

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 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 California state government, the fiscal year begins July 1 and ends the following June 30.

Fund

A legal budgeting and accounting entity 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.

General Fund

A primary source of contribution revenue to CalSTRS is derived from the state's General Fund. For legal basis accounting and budgeting purposes, the General Fund is the predominant fund for financing state government programs and used to account for revenues that are not specifically designated to be accounted for by any other fund. The primary sources of General Fund revenue are personal income tax, sales and use tax, and corporation taxes.

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 percent 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.

CALSTRS[®]
HOW WILL YOU SPEND YOUR FUTURE?