

CALSTRS

CALIFORNIA STATE TEACHERS'
RETIREMENT SYSTEM

**POLICY ON CALIFORNIA
INVESTMENTS**

INVESTMENT BRANCH

JUNE 2014

K. Policy on California Investments

EXECUTIVE SUMMARY

The Investment Committee of the California State Teachers' Retirement Board is responsible for recommendations to that Board regarding the investment policy and overall investment strategy of the management of the Teachers' Retirement Fund. The Committee is also responsible for establishing all policies regarding the structure and objectives of the Fund. Within this authority, the Investment Committee hereby establishes a policy and guidelines for investments within the State of California. CalSTRS California Investment portfolio assets are to be invested, administered and managed in a prudent manner for the sole benefit of its participants and beneficiaries, in accordance with the California Constitution, the Teachers' Retirement Law, and other applicable statutes. No investment instrument or activity prohibited by the IPMP shall be authorized for the California Investments portfolio.

CalSTRS believes that environmental, social, and governance (ESG) issues can affect the performance of our investments. As a result, the CalSTRS 21 Risk Factors have been developed as a tool that both internal and external investment managers are expected to use to assess the impact of ESG risk when making an investment on behalf of CalSTRS.

As with other plan assets, these policies cannot be altered without explicit direction from the Board.

Laws and Statutes

All investments, including those under this policy, must be in accordance with the California Constitution Article 16, Section 17, and the California Education Code, Part 13 Teachers Retirement Law Chapter 4, Section 22250 et al, and the board approved Investment Policy and Management Plan.

Policy Objectives

As the defined benefit fund for all of California's public school teachers, and one of the largest pools of investment capital in the state, the Investment Committee recognizes the importance of the California State Teachers' Retirement System's portfolio and its investment activities within the State of California. While the exclusive purpose of any investment is to achieve the desired return, at a prudent level of risk, the Committee recognizes that many investment activities may have the ancillary benefit of creating economic value and activity that benefits the state and its citizens. Therefore, within the investment activity of each asset class, if all things are equal, especially in regards to risk, return, and diversification, CalSTRS will give preference to investments focused or based in California.

This policy delineates two objectives. The first concerns the investment priority for debt investments secured by California residential real estate under California Education Code Section 22362. The second establishes a goal for investments in underserved markets, primarily in California. The policy also describes the general investment plan to meet the goal set forth for investment in California's emerging markets.

POLICY

Education Code Section 22362

The California Legislature has established, with Education Code Section 22362, an investment priority for debt investments secured by California residential real estate. The statute sets forth an objective to invest 25 percent of the Fund's net cash flow into California residential real estate debt securities. It does not take precedence over the Board's fiduciary responsibility as set forth in both the California Constitution and Education Code. During any fiscal year in which the Board is not able to comply with this priority, the Board shall be required to submit a resolution of its findings and determinations to the Governor and Joint Legislative Audit Committee.

The annual report will demonstrate the amount of net cash flow available for investment, and the amount of residential real estate debt purchased during the year. As added information, the report should also note the level of California residential equity real estate purchased during the year.

California Emerging Markets Investments

Definition

California emerging market investments shall focus on investment opportunities in traditionally underserved markets primarily located within California. For example, underserved markets would include urban and rural communities undergoing, or in need of, revitalization where there are assets (e.g. an available labor pool, underutilized infrastructure) conducive to business development. Staff will develop internal guidelines and procedures to define underserved areas for each asset class.

Investment Goals

A. Consistent with fiduciary standards and the appropriate risk and return for each investment within each asset class, the Committee sets an aspirational goal of two percent of the total Defined Benefit plan be invested in the California emerging market. The Committee shall periodically review the goal in light of its fiduciary duty and overall risk and return experience.

B. For allocation purposes, California emerging markets investments will include, but not be limited to, existing and future investments in asset classes including public equity, fixed income, private equity, real estate, infrastructure, and in companies or investments that substantially reside in underserved areas.

Investment Approach and Parameters

A. All California emerging markets investments shall be consistent with the Committee's fiduciary obligations and approved investment policies and guidelines.

B. California emerging markets investments shall receive the same level of due diligence, as any other investment, whether conducted by staff, designated outside advisors or consultants within the CalSTRS Investment Portfolio.

C. California emerging markets investments, whether in a stand-alone portfolio or incorporated with like investments (which have no emerging market-targeted orientation), shall be priced at current market prices and shall be subject to applicable performance measurements.

D. California emerging markets investments shall be monitored by using appropriate investment benchmarks developed by staff and the general consultant and approved by the Investment Committee.

Investment Plan

This section sets forth the general plan to achieve the goal as established for investment in the California emerging markets. The plan is divided between the public markets and the private markets portions of the portfolio. The public markets are comprised of assets that are daily valued and regularly traded on open exchanges; the asset classes are U.S. and Non-U.S. equity and fixed income. The private markets arena is characterized by investments that are longer-term and illiquid in nature. While these investments can involve a higher level of risk and return, they are often investments that have a more direct impact in achieving the ancillary benefits espoused by the Policy. The private markets assets classes include real estate, private equity, credit enhancement and infrastructure.

Public Markets

Within the publically traded asset classes the Board has established a set benchmark and the objective of tight tracking error to those respective benchmarks. As a result, the ability to invest to achieve ancillary benefits is reduced. While the Fund has a considerable exposure to public companies that operate and employ people in the California emerging markets through the fixed income, U.S., and even the non-U.S. equity portfolio, these investments are primarily focused on tracking the underlying benchmark. The area of greatest opportunity is in the fixed income asset class, where mortgaged backed securities and home loans can be purchased that concentrate on these areas as long as they fulfill the primary need to match the respective benchmark.

Private Markets

Within the parameters of the Policy on California Investments, the Board has set forth the desire to invest a portion of the private equity portfolio, real estate portfolio, and if possible the infrastructure portfolio, in investments that focus on investment opportunities in traditionally underserved markets primarily located in California. Staff will maintain internal guidelines and procedures to define underserved areas for each asset class.

Responsibilities

Staff: Each June 30, fiscal year end, staff will prepare an annual report summarizing its compliance with California Education Code Section 22362. In addition, annually, staff will prepare a report identifying the California content of the investment portfolio, and particularly the amount of investments in the underserved portions of the state. Staff will also monitor the policy and recommend any enhancements or changes to the Committee.

Investment Committee: As it deems appropriate, in keeping with the investment standard, shall administer and review this policy periodically.

Originally Adopted by the Teachers' Retirement Board on October 10, 2001

Revised on July 10, 2002

Revised to annual report September 4, 2008

Revised to include ESG language and infrastructure June 6, 2014