



# Investment Committee

## Item Number 4b – Open Session

**Subject:** Collaborative Model Savings

**Presenter(s):** April Wilcox, Shifat Hasan, and Mike Dunigan

**Item Type:** Information

**Date & Time:** November 1, 2023 – 15 minutes

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**Attachment(s):** Attachment 1 – Scope and Methodology

Attachment 2 – Savings per Asset Class

**PowerPoint(s):** 2022 Collaborative Model Savings Report

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### **Item Purpose**

To provide the Investment Committee cost savings information as of December 31, 2022, from implementing the CalSTRS Collaborative Model.

### **Executive Summary**

This report includes results from 371 investments that contributed to the reported savings. A few key notes to consider while reviewing this report:

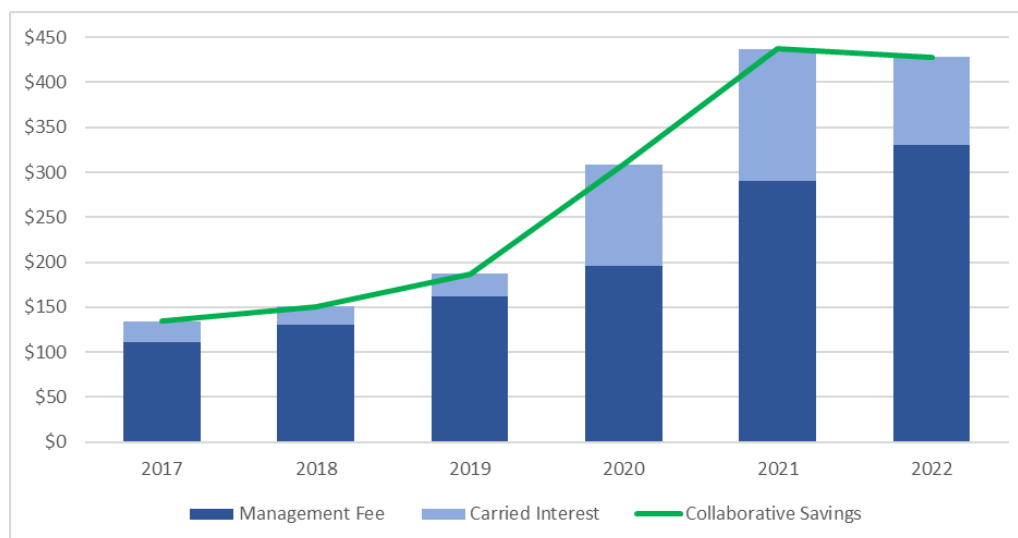
1. Results are presented annually for calendar year 2017 through 2022.
2. The report includes results from 309 collaborative private structures, 60 internally managed funds and 2 rebate agreements.
3. CalSTRS has saved over \$1.6 billion in aggregate since 2017, with an average annual savings of \$273.5 million.

### **Background**

The Collaborative Model is an internally led approach to how CalSTRS engages in the investment marketplace. It is an investment strategy to reduce costs, control risks and increase expected returns through internal management, while leveraging our external partnerships to achieve similar benefits. CalSTRS embraces partnership and collaboration with world-class investment institutions, along with building internal (or ‘direct’) investing capabilities to achieve the benefits of internally managed assets. The Collaborative Model covers a spectrum of different types of

investment strategies and investment ownership structures from simple to very complex. This report aims to quantify the savings achieved from the implementation of this strategy.

**Chart 1 – Overall Savings per Year (\$ Millions, since 2017)**



(\$ millions)	2017	2018	2019	2020	2021	2022	Total 6 Yr Savings
<b>Collaborative Savings</b>	<b>134.4</b>	<b>150.6</b>	<b>187.2</b>	<b>308.9</b>	<b>434.9</b>	<b>428.0</b>	<b>\$1.64B</b>
<b>Management Fee</b>	<b>110.8</b>	<b>130.2</b>	<b>161.4</b>	<b>195.3</b>	<b>288.9</b>	<b>330.0</b>	
<b>Carried Interest</b>	<b>23.6</b>	<b>20.3</b>	<b>25.8</b>	<b>113.5</b>	<b>146.0</b>	<b>98.0</b>	
<b>Component Count</b>	106	140	167	200	324	371	

Total cost savings in calendar year 2022 was \$428 million. The savings from management fees increased in 2022 while the savings from carried interest decreased, causing a net decrease in cost savings on a year over year basis. Even though the savings on carried interest decreased, the 2022 savings is still relatively large. Private Equity continues to see managers realize profits from the large returns during the previous 5 years. However, since private asset deal flow is decreasing and pacing for private assets are expected to slow, we expect to see these begin to taper off in 2023, leading to a more pronounced decrease in carried interest savings. The overall annual savings number will increase or decrease variably over time based on the amount of realized profits in a given year and the number of collaborative components.

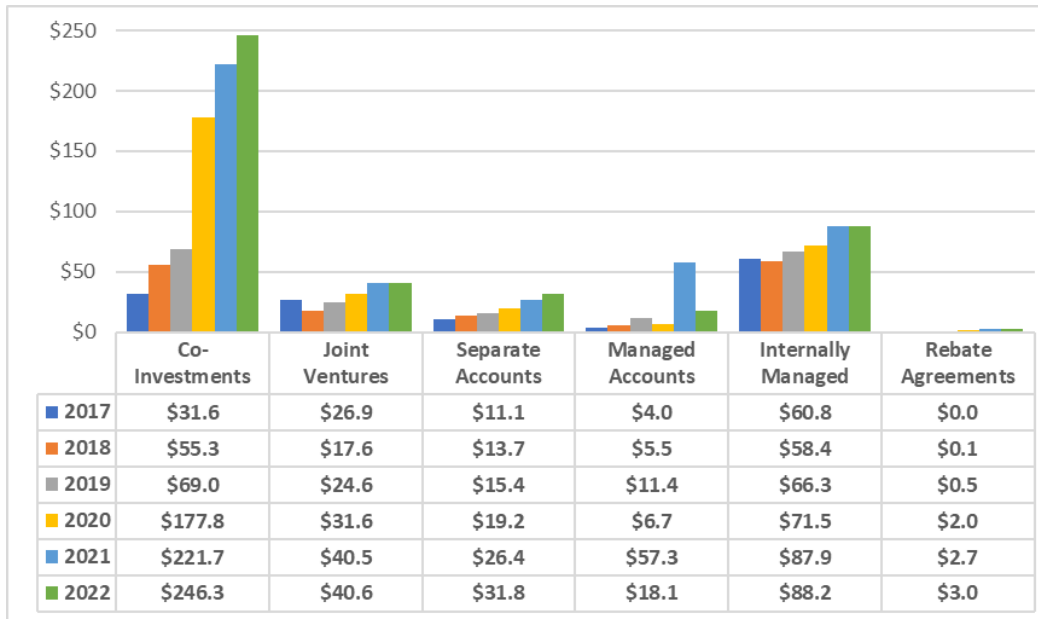
The Collaborative Savings Model tracked 371 components in 2022. The collaborative components were outlined in the model’s scope (see attachment 1). Their savings are generated from different combinations of management fees and carried interest. Joint Ventures, Separate Accounts and Managed Accounts often have reduced fee and carried interest expenses. Co-investments predominantly have zero management fees and carried interest. Internally managed public funds generate their savings from the elimination of management fees.

Of the tracked components, 244 of them generated savings in 2022 (vs. 239 in 2021). Those that didn’t generate savings include investments that are currently unfunded, investments that have entered the exit stage of their life cycle, and investments where comparable fees were not available.

Out of the tracked components, the number of investments that generated savings flattened. This slowing trend is expected to continue moving forward as the deal flow (opportunity set) has

decreased and the pacing for private asset deals has slowed. As older vintage year investments are exited, the effect on future savings estimates could be significant if the opportunity for deals with similar savings structures are not available to replace the exited investments.

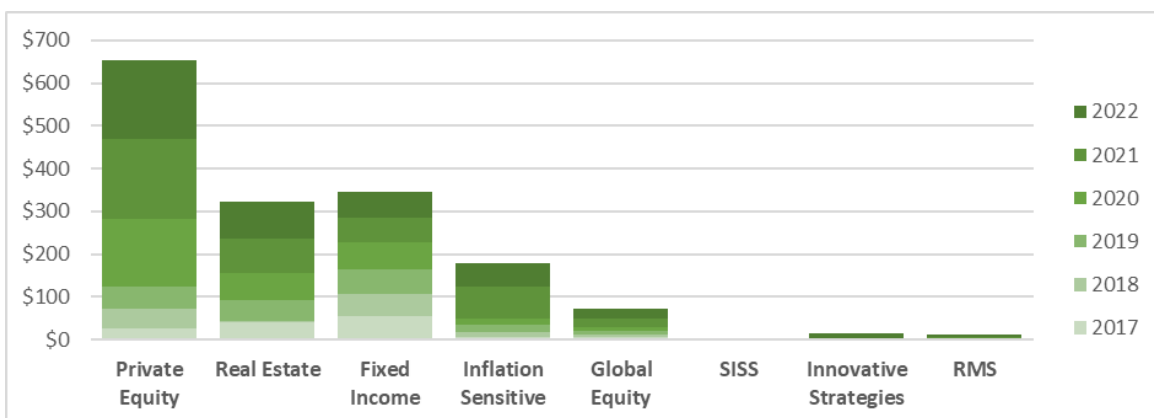
**Chart 2 – Savings per Investment Type (\$ Millions)**



Co-investments have provided the greatest amount of savings for the model. In 2022, co-investments across the private asset classes saved \$246.3 million, with \$89.6 million coming from not having to pay carried interest. Co-investments, with their aggressively reduced fee structures (often zero fees and carry), will often reflect the greatest amount of savings in periods after bull markets when profits are realized without having to share profits with a General Partner (carried interest savings).

Internally managed funds have contributed the second most to the model with savings of \$88.2 million in 2022. They are compared against public managers with low fee structures, so the savings is derived from the amount of assets managed in-house and reflected as management fee savings.

**Chart 3 – Savings per Asset Class (\$ Millions, since 2017)**



2022	PE	RE	FI	IS	GE	SISS	Inn Strat	RMS
<b>Fee</b>	\$120.8 m	\$72.8 m	\$59.4 m	\$35.6 m	\$20.8 m	\$0.4 m	\$11.6 m	\$6.0 m
<b>Carry</b>	\$64.7 m	\$14.0 m	\$0.0 m	\$18.8 m	\$0.0 m	\$0.0 m	\$0.0 m	\$0.0 m

Chart 3 reflects the contributed savings per asset class over the last six years (see Attachment 2 for a complete dollar breakdown). Over the 6-year period, Private Equity has contributed the most savings, with Fixed Income internally managed funds having contributed the second most savings over this time.

**Table 1 - Collaborative Savings Impact on 2022 Returns (\$ Millions)**

Asset Class		Net Dollars Earned	Collaborative Dollars Saved	2022 Return	Return with Savings Removed	Excess Return Added
<b>Total Portfolio</b>		<b>-\$21,899.4</b>	<b>\$428.0</b>	<b>-6.74%</b>	<b>-6.87%</b>	<b>0.13%</b>
<b>Growth</b>	Global Equity	-24,583.2	20.8	-18.06%	-18.07%	0.02%
	Private Equity	-269.2	185.5	-0.48%	-0.81%	0.33%
	SISS	-2,228.5	0.4	-19.89%	-19.89%	0.00%
<b>Real Assets</b>	Real Estate	8,945.8	86.8	20.89%	20.69%	0.20%
	Inflation Sensitive	2,197.9	54.4	6.33%	6.17%	0.16%
<b>Diversifying</b>	Fixed Income	-4,544.0	59.4	-12.59%	-12.75%	0.16%
	RMS	302.6	6.0	0.58%	0.57%	0.01%
	Innovative Strategies	225.9	11.6	7.20%	6.83%	0.37%

Table 1 estimates the impact the Collaborative Model had on each of the asset classes listed. The savings earned by reducing costs had a direct impact to the dollars earned (dollar return) over 2022. Removing this savings from the dollar return reduced each asset class return as shown in the table below.

In 2022, the Collaborative Model saved the Total Fund roughly \$428 million, adding an estimated 0.13% (13 basis points) to the 2022 net return.

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**Strategic Plan Linkage:** Goal 1 of the [Strategic Plan](#). Trusted stewards – Ensuring a well-governed, financially sound trust fund.

**Board Policy Linkage:** [CalSTRS Investment Policies](#)

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## Collaborative Model Scope and Methodology

### Collaborative Model Scope

The Collaborative Savings Model consists of three components:

- 1) **Private Investments** where CalSTRS has collaborated with external industry partners.
  - *Co-Investments*: Private Equity, Real Estate, Inflation Sensitive and SISS
  - *REOCs<sup>1</sup>, Separate Accounts and Joint Ventures*: Real Estate
  - *Managed Accounts*: Inflation Sensitive
  - *Other Collaborative Structures*: to be defined at on set
- 2) **Internal Management** where CalSTRS has brought specific strategies in-house to leverage internal knowledge and achieve cost savings.
  - *Global Equity (inclusive of SISS) and Fixed Income (inclusive of RMS, Inflation Sensitive, and Currency strategies)*.
- 3) **Relationship Rebate Agreements** where CalSTRS has negotiated rebates based on the size of business across the CalSTRS plan.

### Collaborative Savings Methodology

The methodology used in the Collaborative Savings Model is intended to be consistent across components and easily repeatable. It uses standard assumptions across components and investment types with regard to areas like, term of the investment and fee stage, and is therefore an estimate of the savings to the Total Fund. The intent is to provide a conservative savings figure in the first iteration and expand over time.

The methodology focuses on identifying “comparable” investment strategies (comparable) to each of the collaborative investment components (collaborative) and calculating the difference in actual vs. expected fees. The table below provides a hierarchy of the expected fee sourcing and model assumptions. In an effort to provide a reasonable savings figure, the most conservative terms were used. As an example, this means for a public market comparable, the cheapest external manager quote was compared. Many private assets will have a tiered rate structure that lessens in future stages of the investment or a blended rate structure with different rates based on the portion of investments allocated to each strategy. In these cases, the initial fee stage and the highest strategy rate was used in the model. The following describes the variables used to calculate the savings for each of the collaborative components.

*Private Investment* fee savings are calculated by comparing management fees and carried interest associated with a collaborative investment to a comparable investment’s terms. In many cases, partnership expenses are reduced in collaborative structures, but for the purposes of this calculation they have not been included. A comparable is identified for each collaborative based on investment type. If a collaborative sells off pieces of the investment

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<sup>1</sup> Real Estate Operating Companies income to be included in future iterations of the Collaborative Savings Report

and realizes a gain, a net carried interest saved is calculated assuming hurdle rates have been met. The net difference in management fees and carried interest paid is considered the collaborative savings.

*Internally Managed Funds* fee savings are calculated by generating an average staff rate (cost per dollar) for each asset class, removing that from a comparable management fee, and applying the savings rate to the average monthly Net Asset Value (NAV) used in The Annual Cost Report. The average staff rate includes internal salaries and an estimation of additional expenses incurred by adding internal management staff related to trading & risk systems and licensing fees.

*Rebate Agreements* fee savings are calculated by obtaining the actual rebate paid to the Total Fund for a given year.

### Model Assumptions

- Collaborative investments prior to 2010 were not included unless realized gains were achieved in 2017 – 2021
- Real Estate Joint Ventures and Separate Account fees are often based on Gross Asset Value. For the savings model, State Street reported Market Values were used (which may include Net or Gross Asset Values): Net being a more conservative savings calculation.
- Where Management Fees were not calculated based on GAV or NAV, actual Management Fees incurred were used and removed from the Comparable estimate to calculate saving
- Private Investment fee stage 1 used for rate comparisons

Investment Type	Comparable Fee Source Hierarchy			Impacted Asset Classes
	1	2	3	
Co-Investments	Sponsor Fund Terms	Avg Parent Fund Terms	RCLCO for Commingled RE Funds <i>only</i>	PE, RE, Inflation Sens, SISS
	<i>Mngmt Fee = Sponsor Fee Rate - Co-Inv Fee Rate multiplied by Commitment</i> <i>Carry = Sponsor Carry Rate * any realized cap gain from Co-Invest (adjusted for carry paid by co-invest and only if hurdle rate is achieved), less any carry paid by co-invest</i>			
Joint Ventures - Core Joint Ventures - Opportunistic Joint Ventures - Value Add Separate Accounts - Value Add Separate Accounts - Core	RCLCO Estimates	Avg Parent Fund Terms	N/A	RE
	<i>Mngmt Fee = Sponsor Fee Rate - JV or SA Fee Rate multiplied by Avg NAV</i> <i>Carry = Comparable Carry Rate * any realized cap gain from investment (adjusted for carry paid by investment and only if hurdle rate is achieved), less any carry paid by investment</i>			
Managed Accounts	Meketa Estimates	N/A	N/A	Inflation Sens
	<i>Mngmt Fee = Sponsor Fee Rate - JV or SA Fee Rate multiplied by Avg NAV</i> <i>Carry = Comparable Carry Rate * any realized cap gain from investment (adjusted for carry paid by investment and only if hurdle rate is achieved), less any carry paid by investment</i>			
Internally Managed Funds	Direct Quote	eVestment	CEM Survey	GE, FI (inclusive of internal funds managed for RMS, Inflation Sens, Strat Overlay)
	<i>Quoted fee minus Staff rate</i>	<i>eVestment rate minus staff salary allocation \$</i>	<i>Basis point difference of Internal survey cost vs. External peer survey cost for similar strategies</i>	
Rebate Agreements	Annual Rebate Earned	N/A	N/A	CalSTRS

## 5 Year Collaborative Model Savings per Asset class and Investment Type *(\$ in millions)*

(\$ Millions)	2022		2021		2020		2019		2018	
	Management Fee	Carried Interest	Management Fee	Carried Interest	Management Fee	Carried Interest	Management Fee	Carried Interest	Management Fee	Carried Interest
<b>Private Equity</b>	\$120.8	\$64.7	\$97.8	\$90.5	\$62.3	\$95.6	\$43.6	\$7.2	\$28.3	\$18.9
Co-Investments	\$120.8	\$64.7	\$97.8	\$90.5	\$62.3	\$95.6	\$43.6	\$7.2	\$28.3	\$18.9
<b>Real Estate</b>	\$72.8	\$14.0	\$62.3	\$17.9	\$46.4	\$17.7	\$39.2	\$10.4	\$33.3	\$1.5
Co-Investments	\$8.2	\$6.2	\$9.9	\$3.4	\$6.2	\$7.1	\$5.3	\$4.3	\$3.3	\$0.2
Joint Ventures	\$32.8	\$7.8	\$28.9	\$11.6	\$21.0	\$10.6	\$18.6	\$6.0	\$16.3	\$1.3
Separate Accounts	\$31.8	\$0.0	\$23.5	\$2.9	\$19.2	\$0.0	\$15.4	\$0.0	\$13.7	\$0.0
<b>Inflation Sensitive</b>	\$35.6	\$18.8	\$36.6	\$37.5	\$13.1	\$0.0	\$11.5	\$8.2	\$9.9	\$0.0
Co-Investments	\$15.6	\$18.7	\$15.6	\$0.0	\$6.3	\$0.0	\$4.8	\$3.5	\$4.4	\$0.0
Internally Managed	\$1.9	\$0.0	\$1.3	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Managed Accounts	\$18.0	\$0.1	\$19.8	\$37.5	\$6.7	\$0.0	\$6.7	\$4.7	\$5.5	\$0.0
<b>SISS</b>	\$0.4	\$0.0	\$0.3	\$0.0	\$0.3	\$0.0	\$0.3	\$0.0	\$0.3	\$0.0
Co-Investments	\$0.4	\$0.0	\$0.3	\$0.0	\$0.3	\$0.0	\$0.3	\$0.0	\$0.3	\$0.0
<b>Fixed Income</b>	\$59.4	\$0.0	\$59.4	\$0.0	\$62.3	\$0.0	\$56.9	\$0.0	\$52.8	\$0.0
Internally Managed	\$59.4	\$0.0	\$59.4	\$0.0	\$62.3	\$0.0	\$56.9	\$0.0	\$52.8	\$0.0
<b>Global Equity</b>	\$20.8	\$0.0	\$21.0	\$0.0	\$9.2	\$0.0	\$9.4	\$0.0	\$5.5	\$0.0
Internally Managed	\$20.8	\$0.0	\$21.0	\$0.0	\$9.2	\$0.0	\$9.4	\$0.0	\$5.5	\$0.0
<b>Innovative Strategies</b>	\$11.6	\$0.0	\$4.2	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Co-Investments	\$11.6	\$0.0	\$4.2	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
<b>RMS</b>	\$6.0	\$0.0	\$6.3	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Internally Managed	\$6.0	\$0.0	\$6.3	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
<b>Rebate Agreements</b>	\$2.5	\$0.5	\$2.7	\$0.5	\$1.8	\$0.2	\$0.5	\$0.0	\$0.1	\$0.0
<b>Total Savings</b>	\$330.0	\$98.0	\$290.5	\$146.4	\$195.3	\$113.5	\$161.4	\$25.8	\$130.2	\$20.3