



Regular Meeting

Item Number 5 – Open Session

Subject: Chief Executive Officer Report

Presenter(s): Jack Ehnes

Item Type: Information

Date & Time: January 28, 2021 – 15 minutes

Attachment(s): None

PowerPoint(s): None

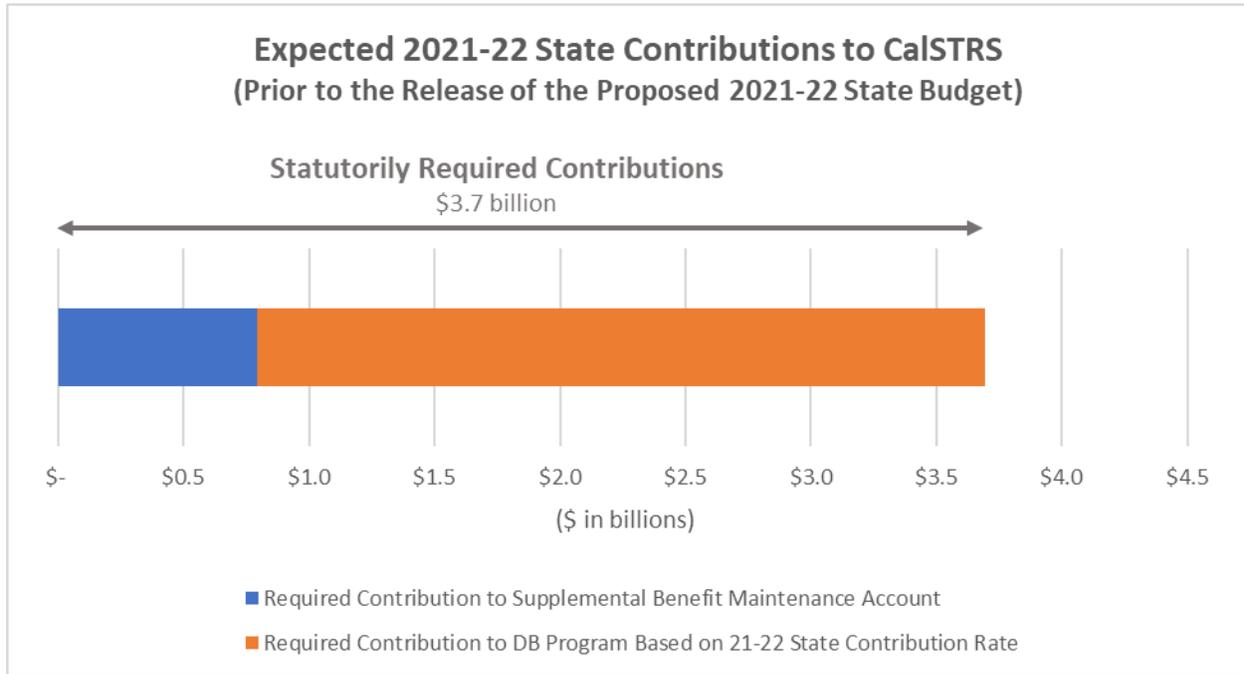
State of California Proposed 2021-22 Budget Impacts to CalSTRS Funding Plan

On January 8, 2021, Governor Newsom released his proposed budget for California for fiscal year 2021-22. It contains a proposal to provide contributions to CalSTRS above the amount that is expected based on the state contribution rate that can be set by the board under the current parameters of the CalSTRS Funding Plan.

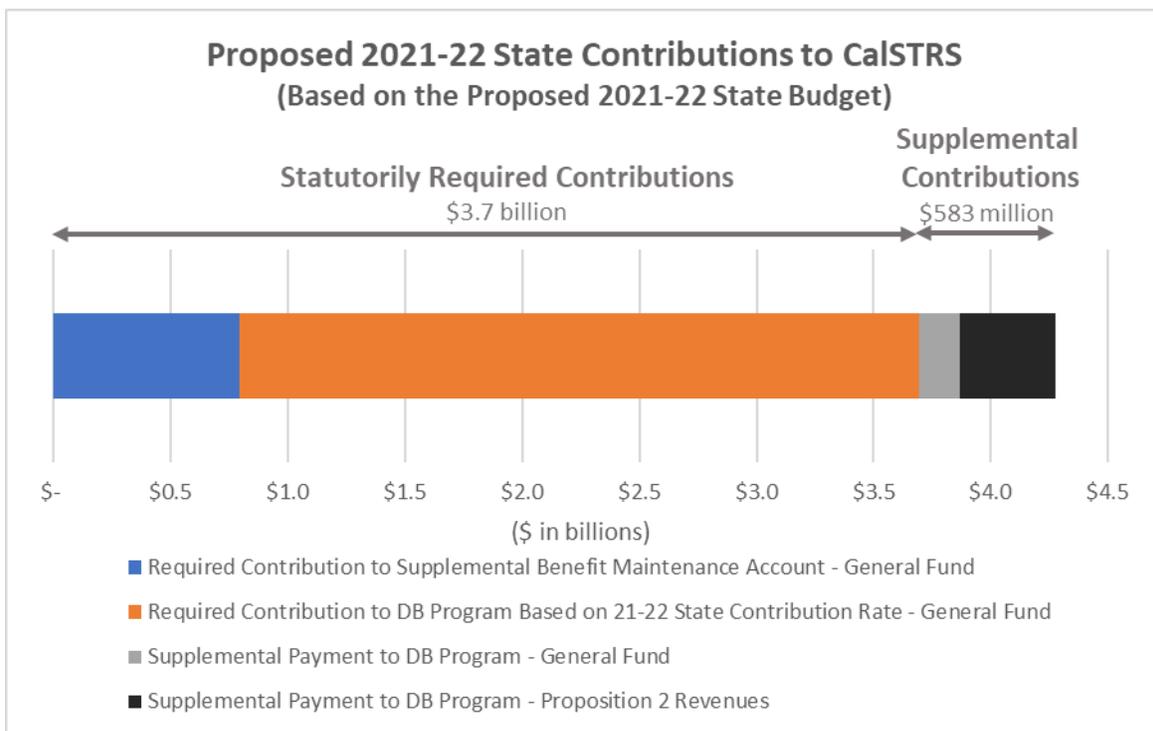
For fiscal year 2020-21, the state contribution rate for the Defined Benefit Program is 7.828% of payroll. In addition, the state is required to contribute 2.5% of payroll to the Supplemental Benefit Maintenance Account (SBMA), CalSTRS inflation protection program. The contribution rate to the Defined Benefit Program is identical to the rate that was in effect for fiscal year 2019-20. As a reminder, the 2020 Budget Act suspended the board's rate-setting authority for the state contribution rate for fiscal year 2020-21 and froze the state contribution rate at the fiscal year 2019-20 level for one year.

To ensure the state continues to make progress toward eliminating its share of CalSTRS unfunded liability by 2046, the board is anticipated to approve an increase of 0.5% of payroll for the state contribution rate at the May 2021 meeting. The 0.5% increase is the maximum allowed by the funding plan. With this increase, the state contribution rate to the Defined Benefit Program will be 8.328% for fiscal year 2021-22. Without the contribution rate freeze in the 2020 Budget Act, the state contribution rate to the Defined Benefit Program would have been set at 8.828% for fiscal year 2021-22.

As shown in the chart below, prior to the release of the proposed 2021-22 state budget, the required state contributions to CalSTRS for fiscal year 2021-22 were expected to be about \$3.7 billion. \$795 million to meet the requirement to contribute 2.5% of payroll to SBMA and about \$2.9 billion for the Defined Benefit Program based on the anticipated state contribution rate of 8.328% of payroll.



As part of his proposed 2021-22 state budget, Governor Newsom has included a payment of \$4.3 billion to CalSTRS. It includes \$3.9 billion from the General Fund, which consists of the \$3.7 billion for the statutorily required contributions of 8.328% and 2.5% for the Defined Benefit Program and SBMA, respectively, and a supplemental contribution of \$173 million, as well as an additional supplemental contribution of \$410 million using Proposition 2 revenues. In total this is \$583 million more than currently expected. The chart below breaks down the proposed contributions to CalSTRS into its source of funding and intended use.



With the proposed additional payment of \$173 million, the payment from the General Fund is equal to the amount CalSTRS would have received in 2021-22 had the board’s rate-setting authority not been suspended. As indicated in the budget summary, this is intentional to keep the CalSTRS Funding Plan on track. Looking at it another way, the proposed additional payment of \$173 million is equivalent to about 0.5% of payroll, which would bring the total General Fund contributions to the amount CalSTRS would have received in 2021-22 had the state contribution rate not been frozen for one year. The additional supplemental payment of \$410 million using Proposition 2 revenues is being proposed to reduce the state’s share of CalSTRS’ unfunded liability, generating long-term savings for the state.

When compared to the projections that were provided to the board as part of the 2020 Review of Funding Levels and Risks report, the proposed \$583 million of supplemental contributions are estimated to improve funding levels by about 0.2% over the short-term. Long-term, the state contribution rate is estimated to be about 0.14% of payroll lower, generating about \$1.6 billion in savings for the state through 2046, for total net savings of about \$1 billion. These additional contributions will also strengthen the funding plan and help reduce the risk the funding plan may not be able to react adequately to a potential recession.

The proposed budget also includes language regarding future supplemental payments to CalSTRS using Proposition 2 revenues. The current proposal, if future funds are available, is to provide CalSTRS with additional supplemental payments using Proposition 2 revenues totaling \$602 million between 2022-23 and 2024-25. These proposed supplemental contributions are an indication of the state’s commitment to eliminate its share of CalSTRS unfunded liability by 2046 and to keep the CalSTRS funding plan on track.

Significant Increase In Teacher Retirements July through December 2020

The number of service retirement benefits established for July through December 2020 demonstrated a significant increase over comparable periods in the prior 4 years. In 2020, the number of retirements (5,644) represented a 26% increase over 2019 as shown below:

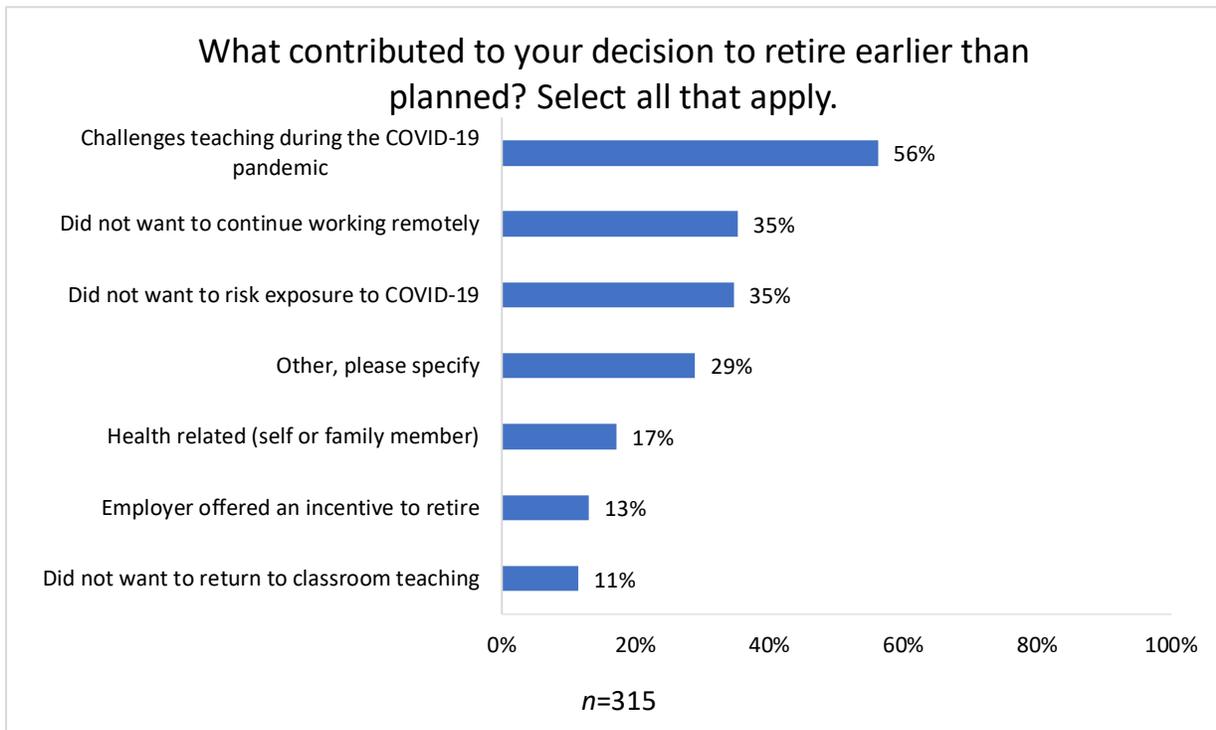
Year	2016	2017	2018	2019	2020
Total (Jul-Dec)	4,254	4,499	4,815	4,467	5,644

As a result of this significant deviation, CalSTRS surveyed most of the members who have retired to determine if they had retired earlier than planned and if so, what were the contributing factors. Two straightforward questions were posed:

- Did you decide to retire earlier than planned?
- What contributed to your decision to retire earlier than planned?

Of the 517 responses, 62% indicated they had retired earlier than planned.*

As to the reason for retiring earlier than planned, challenges related to teaching during COVID-19 are the primary contributing factors. Respondents could select as many options as applied to their situation.



CalSTRS will include these items on the service retirement survey until the situation stabilizes.

*Data as of January 7, 2021

Financial Statement Reports:

The CalSTRS Comprehensive Annual Financial Report is published annually to provide a detailed review of CalSTRS' financial, investment and actuarial related activities for the year. The CAFR for the year ended June 30, 2020 is now available online at CalSTRS.com and was submitted timely to the Government Finance Officers Association (GFOA) for the Certificate of Achievement for Excellence in Financial Reporting program.

CalSTRS also published an electronic Popular Annual Financial Report, which provides a summary of the information found in the CAFR. The PAFR for the year ended June 30, 2020 is now available online at CalSTRS.com and was submitted to the GFOA for the PAFR Award program.

CalSTRS 2021–22 Operating Budget Update

As part of the state's response to address the fiscal impact of the global COVID-19 pandemic on California's economy, the Administration enacted a permanent 5% efficiency reduction in most state operational expenditures pursuant to the [Budget Act of 2020](#), commencing in fiscal year 2021–22. On November 3, 2020, the Department of Finance (DOF) issued directives and further guidance as part of [Budget Letter 20–37](#), on achieving these budgetary reduction measures. *Budget Letter 20–37* requires departments to submit an initial expenditure reduction plan to the DOF by February 1, 2021, with DOF approval by March 30, 2021. Once approved, expenditure reductions must be implemented by July 1, 2021, to realize full savings in the 2021–22 fiscal year.

On November 5, 2020 the board approved the 2021-22 Operating Budget in the amount of \$309.8 million and authorized staff, without further board action, to revise the budget for additional mandatory adjustments to state-wide administrative expenditures, pursuant to the *Budget Act of 2020* or as required by the Administration. After several discussions with the DOF and closely evaluating our budget for opportunities to reduce expenditures, while ensuring CalSTRS maintains sufficient funding to sustain operations and meet its strategic objectives, staff developed and submitted an initial expenditure reduction proposal in December 2020, which was approved by the DOF in January 2021, in the amount of \$2.4 million. The expenditure reduction is still pending approval as part of the overall state budget.

As a result, the 2021-22 Operating Budget will be revised from \$309.8 million to \$307.4 million. This reflects an overall reduction of \$2.4 million, or 0.8%, relative to the original board approved 2021-22 Operating Budget. The \$2.4 million reduction will be applied to various Operating Expense categories excluding expenditures for staff Salaries and Benefits. Management will regularly review operating expenditures to ensure that this reduction does not affect CalSTRS' overall operations and strategic initiatives.

CalSTRS Revised 2021–22 Operating Budget

(Dollars in Millions)

	<i>Approved</i>	<i>Revised</i>	<i>\$ Change</i>	<i>% Change</i>
Total	\$309.8	\$307.4	(\$2.4)	(0.8%)

Benefit Stabilization/Statute of Limitations – The Road Ahead

Over the past several years, CalSTRS staff along with stakeholder partners, have been discussing the issues surrounding postretirement benefit adjustments due to various factors that impact the final calculation for the determination of a member’s benefit. The impacts of these adjustments are multifaceted, and the party responsible for bearing the cost associated with overpayments (members, beneficiaries, CalSTRS and/or the employer) is dependent upon a number of factors delineated in the law, including, but not limited to, cause of the overpayment and the timeframes associated with the discovery of the error.

Regardless of their position of interest, all parties have a general agreement to take action or seek improvements to minimize (if not eliminate entirely) overpayments due to employer reporting errors. There is also an interest to reduce the impact of overpayment recovery to members and beneficiaries, if overpayment of benefits occurs through no fault of the member or beneficiary.

In December of 2020, CalSTRS staff presented a legislative proposal for the board’s consideration, which sought changes to the Teachers’ Retirement Law (TRL) that would reduce the overpayment recovery from members to a period of three years (absent circumstances delineated in the proposal). It also put a greater financial burden on employers for reporting errors, assigning overpayment and recovery responsibility beyond the three-year parameter to the employers.

Throughout the process of discussing the legislative proposal with interested stakeholder partners and in the subsequent discussion with the board at their December meeting, it was clear that the complexities associated with benefit overpayments could not be remedied to a satisfactory extent through the legislative proposal in its current state. The board asked that CalSTRS staff take the feedback provided by our stakeholders and develop a plan of action to resolve the issues not addressed in the proposal as presented. They also asked that staff look at process comparisons between our system and other system administrators to identify where improvement opportunities exist internally. Those include initial benefit audits, benefit payment timeframe requirements, employer education and guidance directives along with differences and/or parallels between the TRL and other systems’ statutes. The board asked for ongoing updates on findings and progress with a goal to consider a legislative proposal by November of 2021.

Since that meeting, CalSTRS staff has taken a proactive approach for a deep dive into all facets of the issues notated above, those that we’ve catalogued from our stakeholder partners and those that we may encounter upon our exploratory effort. The initial steps for the work will include an internal work group led by our Chief Operating Officer, working closely with our General Counsel, and will be made up of subject matter experts from our Legal Office, Member Accounts Services

(MAS), Service Retirement, Audit Services, Governmental Relations Office, Financial Services and the Ombudsman’s Office.

The group has already begun itemizing research of law and processes between our system and other system administrators. The work will include identification of issues within process, law, interpretations of law, employer education and employer guidance associated with reporting. As we work through those areas, the work group will make recommendations on improvements to address process deficiencies and educational material to guide accurate employer reporting. Staff will continue to meet with stakeholder partners to solicit their feedback on the recommendations from the work group.

Detailed analysis of the TRL and potential changes will frame a legislative proposal for the board’s consideration as we work through these steps in the next 10 months. Staff will conduct ongoing updates with the board at their regularly scheduled meetings at the board’s desire. Our next progress update is expected at the March 2021 board meeting.

CalSTRS Strategic Plan – Planning Cycle Begins in 2021

CalSTRS is halfway through our 2019-22 Strategic Plan, a document that records overarching goals, objectives to guide our collective direction, and measures to evaluate our success. This quarter, we begin drafting the final business plan to accompany the 2019-22 strategic plan while simultaneously launching activities related to establishing the 2022-25 Strategic Plan. This effort will culminate with a first reading in January 2022 and planned board adoption in March 2022. Board work plans are developed in alignment with the final adopted strategic plan.

CalSTRS embarks on a new strategic planning cycle every three years. This routine cycle includes various planning activities, such as:

- A comprehensive environmental scan to gain a broad understanding of the external and internal forces affecting the future of CalSTRS, including interviews with board members
- An Executive planning session(s) to review the current scan and determine critical themes with an eye toward the future and an informative evaluation of the past strategic plan
- A Board offsite strategy planning discussion to identify and prioritize objectives and help meld the thinking across board members and executive staff

The annual strategic management cycle begins with the 3-year CalSTRS Board Strategic Plan as its foundation. The board’s Strategic Plan lays out the goals and priorities of the organization while the annual business plan includes a step-by-step tactical plan with initiatives and key activities designed to advance the goals and objectives of the board’s Strategic Plan.

The annual business plan outlines the allocation of resources and identifies key activities scheduled for completion by the close of the fiscal year. Progress on the business plan and overarching strategic plan is reported and evaluated annually through an Accomplishments Report to the board.

The visual exhibit serves as a roadmap for the planning activities we will embark on over the coming months as we prepare for the future with a new 2022–25 Strategic Plan for board adoption in Spring 2022. Each new Strategic Plan is designed to maintain the viability of our fund. The goals and objectives of the plan are designed to position us to accomplish our mission of securing the financial future and sustaining the trust of California’s educators for decades to come.



Headquarters Expansion (HQE) Construction Update

As of November 30, 2020, the construction of the project is approximately 29% complete but due to the delay in the issuance of the Phase IV Architectural MEP/TI permit, the substantial completion date has been moved out seven weeks to August 18, 2022. Both the integrated project team and the Executive Steering Committee continue to evaluate all major project decisions at bi-weekly meetings and continue to monitor the status of the plan review with the Office of the State Fire Marshal very closely.

The detail below outlines the status of the financing, construction activities, schedule, budget and associated risks.

Status of Bond Financing

In December 2019, CalSTRS successfully secured the bond financing necessary for the Headquarters Expansion (HQE) Project with the issuance of \$340.6 million (\$272.6 million par and \$68.0 million original issue premium) in tax-exempt lease-revenue green bonds through a conduit issuer, the California Infrastructure and Economic Development Bank (IBank) ("the

bonds”). Since the issuance of the bonds over a year ago, there has been significant activities undertaken with respect to the management of the bonds, including:

- **Policy, Procedures and Framework:** Staff established the appropriate framework for managing the bonds on an ongoing basis. These efforts included the development of a policy, procedures and the operational, accounting and financial reporting framework needed to properly manage the bond activities. With the establishment of this framework, all required capitalized interest payments and invoices were paid timely and all bond activities were properly accounted for and reported within our audited financial statements for the period ended June 30, 2020.
- **Internal Audit:** Audit Services conducted an internal audit of the Headquarters Expansion Billing process and no audit findings were noted.
- **MSRB and Conduit Issuer Disclosures:** Staff submitted the required annual disclosures and certifications with the Municipal Securities Rulemaking Board and IBank.
- **Rating Assessments:** The bonds were also subject to annual rating assessments by Fitch, Moody’s, and S&P during October through December 2020. Fitch, Moody’s and S&P reaffirmed the original bond ratings of AA, A1 and A+, respectively.
- **Green Bond Certification:** The bonds were issued as green bonds, certified as Climate Bonds by the Climate Bond Initiative (CBI) Standard Board and verified by Kestrel Verifiers (Kestrel). The Climate Bonds Standard requires a post-Issuance verification report within 24 months of bond issuance. Kestrel issued their post-issuance verification report in December 2020, noting in their opinion that the uses of the bond proceeds complies with the Climate Bonds Standard requirements.
- **Award:** CalSTRS received the 2020 Green Project Bond of the Year award from Environmental Finance for the issuance of the bonds.

As the HQE project progresses, the bond proceeds remain invested in permitted, risk adverse investments, available to fund all project expenses as budgeted. Additional information on the bonds payable can be found in CalSTRS June 30, 2020, Comprehensive Annual Financial Report at CalSTRS.com.

Construction Activities

Since the November board report, construction activities continue to progress as planned. Concrete pours are complete for all parking levels and the lobby, the office level (T3) construction has just begun and the installation of irrigation and underground piping for graywater has commenced. In addition, a full- scale exterior glazing mock-up is being assembled for CalSTRS and architect approval before the exterior skin is manufactured.

Schedule Status

As mentioned, the schedule included in the GMP document projected a Substantial Completion Date of July 6, 2022 but due to permit delays, has been pushed out to August 18, 2022. There are 30 weather days included in the overall project schedule. To date, eight weather impact day notices have been issued. Below are upcoming substantial project milestones:

Project Milestones	Start Date	Completion Date
Phase IV Architectural/MEP/TI Permit/OSFM	03/31/20	<i>Est. completion date was 11/5/20- current assumption is 2/26/21</i>
P-2 Structure	05/19/20	06/24/21
P-3 Structure	06/23/20	06/24/21
P-4 Structure	07/29/20	06/15/21
P-5 Structure	08/26/20	06/30/21
Exterior Envelope	04/27/21	02/04/22
Lobby Level Interior Improvements	03/01/21	11/18/21
Roof/Skylight Construction	04/27/21	12/01/21
Bridge Construction including interiors	08/05/21	03/16/22
Office Level 03 Interior Improvements	07/07/21	01/20/22
Office level 03 Owner Furniture Installation	02/14/22	03/28/22
Office Level 04 Interior Improvements	08/04/21	02/23/22
Office Level 04 Owner furniture Installation	04/24/22	05/04/22
Office Level 05 Interior Improvements	08/30/21	03/14/22
Office Level 05 Owner Furniture Installation	03/22/22	05/02/22
Office Level 06 Interior Improvements	09/17/21	04/11/22
Office Level 06 Owner Furniture Installation	04/19/22	05/31/22
Office Level 07 Interior Improvements	10/15/21	04/27/22

Office Level 07 Owner Furniture installation	05/26/22	07/08/22
Start-Up and Commissioning	04/05/22	07/25/22
FINAL AHJ Inspections	06/08/22	08/18/22
Estimated Project Completion Date	10/21/19 start	08/18/22

Budget Status

We continue to remain within budget for the overall project. However, continued safety protocols due to COVID-19 and the delay of the tenant improvement permit, could have a significant impact on our overall budget. Although there is enough contingency funding available to cover these unexpected costs, the project contingency would be largely depleted.

The details are below:

COVID-19 costs: Due to the enhanced cleaning guidelines set forth by the Center for Disease Control (CDC) and the State of California, additional General Requirement/General Condition costs are being billed monthly, for so long as these guidelines are in place. These costs include supplies, handwashing stations, sanitizing of tools and construction trailers and staff time to pre-screen all construction crews and tradespeople.

The total monthly costs associated with COVID-19 has trended around \$55,000 for the first six-month period and increased to \$70,000 for the last two months due to more craft people on site to form and pour the large transfer girders. This cost should trend down again in January.

It is anticipated that the CDC requirements for COVID-19 will continue until the vaccine is widely available. These costs have been forecasted at \$1.33M for the coming year.

Schedule Delay Costs: Currently there is a recognized schedule delay caused by the extended OSFM plan review timeline. The updated project schedule assumes that the phase IV permit will be issued by February 26, 2021. If this approval takes longer, the schedule will slip on a day-for-day basis. The team is working through alternate ways of reducing the impact once the permit is issued.

However, based upon the estimated/current schedule delay, the associated hard and soft costs to be paid from the project contingency have been forecasted at \$2.73M.

The budget status for the month ending November 2020 is summarized below:

Budget Categories	Total Project Budget	Costs to Date	Balance to Complete
Hard Costs	\$ 244,208,843	\$ 72,376,530	\$ 171,832,314
Hard Cost Contingency	\$ 6,074,596	\$	\$ 6,074,596
Soft Costs	\$ 44,640,594	\$ 19,067,157	\$ 25,573,437
Project Contingency	\$ 5,075,967		\$ 5,075,967
Totals	\$ 300,000,000	\$ 91,443,687	\$ 208,556,314

The hard cost contingency was reduced this month by \$118,847 due to costs associated with the cement shortage, insurance deductible for an architectural wall failure, and costs associated with wildfires and smoke (ash removal and N95 masks for tradespeople).

The project contingency was reduced this month by \$247,319 due to monthly costs for COVID-19 safety protocols, re-work of architectural wall failure (although an insurance reimbursement is expected), and twelve touchless door openers for restrooms in the HQE tower.

Risk Status

On-going risks associated with the project are:

- 1) Public Agency Plan review timeframes: Staffing availability and complexity of the project continues to influence plan submittal review timelines. As a reminder, Phase IV Plans were submitted to the Office of the State Fire Marshal (OSFM) on March 31, 2020. The OSFM sent back only partial written plan check comments, which resulted in a meeting to discuss issues that were previously thought to be resolved and approved in prior permit packages. These issues included the use of the bridge and building exiting, and questions related to occupancy loads and the intended use of the first-floor meeting spaces. Solutions and responses to these issues were sent back to the OSFM in August. The wildfire activity across the state impacted their ability to review our response package in a timely manner and the Alternate Means and Method Request was not approved until October 20, 2020. The revised Phase I plans were re-submitted by CalSTRS for final review on October 23, 2020, with no response from the OSFM. Then, just last month, the original Deputy Chief overseeing this project was replaced by the Deputy Chief in charge of the Plan Review division for Yolo County. With this change, the new Deputy Chief brought into question the calculated occupancy load of the building and associated issues once again. A meeting was held in December, and most of the issues related to the occupancy loads were cleared with minor design changes. Since it is not anticipated that all of the issues associated with the first three permits will be cleared and our fourth permit approved by December 30, 2020, our substantial completion date has been pushed out seven

weeks to February 26, 2021. We are hopeful that the relationship with the new Deputy Chief, and continued communication and resolution of potential questions, will clear the way for approval of the tenant improvement permit by the February date.

- 2) COVID-19: Although there have been additional costs related to COVID-19 due to health and safety, we have more than nine months of known related costs and are not seeing any loss in productivity due to site outbreaks. In addition, the risk of supply chains unable to supply construction materials when needed is diminishing as manufacturers resume production. The current risk level associated with COVID-19 remains low.
- 3) Timely delivery of utilities from PG&E: The permanent power connection date has been set for March 13, 2021. The current risk level associated with PG&E remains low but will continue to be tracked until permanent power is delivered.
- 4) Cement Shortage: DPR's concrete supplier is no longer being rationed for cement and has committed to the transfer level pour dates and quantities. This has stabilized the pour schedule for the foreseeable future. The cement shortage is no longer a risk and will be removed from the risk log in January 2021.