

CALSTRS

2018-19

Annual Budget

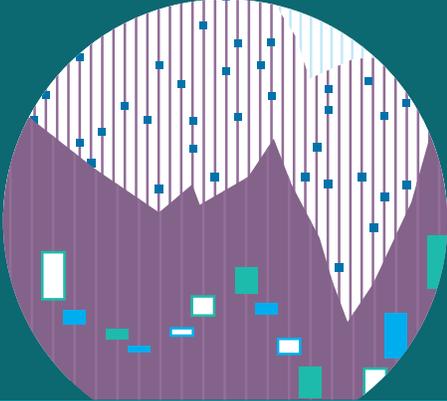
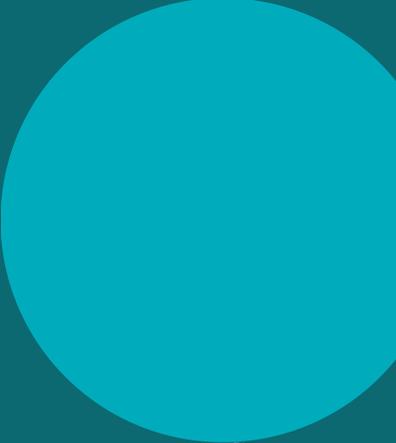
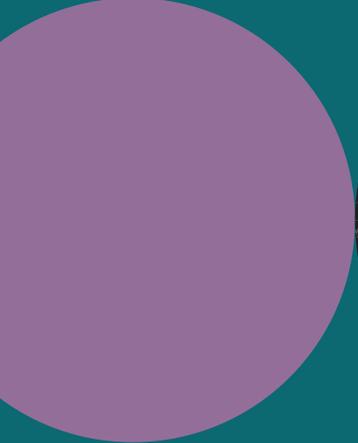
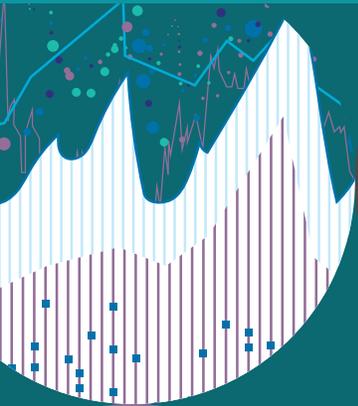




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January 25, 2018

Chief Financial Officer's Transmittal Letter

It is my pleasure to present the California State Teachers' Retirement System budget for the 2018–19 fiscal year. Guided by the CalSTRS strategic plan, enterprise risk and compliance management frameworks as well as principles of sustainability, this budget continues to advance our organizational and operational priorities through deliberate resource allocation. 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. These longer-term strategic initiatives include a fully funded and financially sound pension fund, enhanced services for members and employers, optimized business systems and processes, and continued workforce transformation.

In brief, the 2018–19 budget of \$590.9 million and 1,142 authorized positions represents an increase of approximately \$65 million, or 12 percent, and 58 positions compared to 2017–18 levels. The increased operating costs are primarily driven by external investment management fees due to increased assets under management and state-mandated salary and benefit increases. Offsetting these increases in budgeted costs, CalSTRS projects revenues of \$16.1 billion in investment income and \$12.9 billion in contributions.

Maintaining a financially sound retirement system remains the top priority for CalSTRS. Through ongoing implementation of the CalSTRS Funding Plan (Chapter 47, Statutes of 2014, Assembly Bill 1469), prudent investment policy, and efficient use of system resources, CalSTRS continues our trajectory toward full funding by approximately 2046. Moreover, CalSTRS ended the 2016–17 fiscal year with an investment return of 13.4 percent, nearly doubling the assumed investment return of 7 percent. While this exceptional investment performance is welcome news, 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 CalSTRS Funding Plan.

CalSTRS recognizes that investment costs, including external management fees, have an impact on the net investment return. In 2011, the Teachers' Retirement Board considered approaches to internal versus external management of assets and found that transitioning to internally managed assets increases control and transparency, and results in significant overall cost savings. Since then, CalSTRS has advanced the transition to internally managed assets where economically and operationally viable. Consistent with that strategy, this budget includes approximately \$15.4 million and 58 positions, deployed over a five-year period, to increase the level of internally managed assets.

Over the last decade, assets under management and annual member benefit payments both have nearly doubled to \$208.7 billion and \$13.9 billion respectively as of June 30, 2017. Similarly, contributions to the system from members, employers and the state have increased from approximately \$5.7 billion to nearly \$10.1 billion over the same time period. As the organization continues to grow in size and complexity, the need for secure, effective and adaptable technology is fundamental to delivering services to our members and employers while also producing accurate information for management and stakeholders. To address these technology challenges, CalSTRS embarked on a comprehensive solution to replace the existing pension administration system. The multiyear effort, which began in 2015, is designed to fundamentally enhance operations and the ability for CalSTRS to interact with members and employers. This budget continues CalSTRS' commitment to upgrading existing information technology infrastructure with \$18 million to support the pension administration project and enhance information security.

Consistent with CalSTRS' long-term planning horizon and commitment to organizational sustainability, this budget focuses resources on efforts to improve our financial position, enhance delivery of services to our members and employers, and safeguard our assets for many years to come.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'R Madsen', with a long horizontal line extending to the right.

Robin Madsen
Chief Financial Officer
CalSTRS



THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

MISSION

Securing the financial future and sustaining the trust of California's educators

VISION

Your Reward—
a secure retirement

Our Reward—
getting you there

BACKGROUND

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, as well as disability and survivor benefits. With a portfolio valued at \$221.7 billion as of November 30, 2017, CalSTRS is the largest educator-only pension fund in the world.

CalSTRS serves California's more than 933,000 public school educators and their beneficiaries employed in approximately 1,700 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, providing vocational or guidance counseling or are supervising people engaged in those activities.

SERVICE TO MEMBERS AND EMPLOYERS

Consistent with the CalSTRS mission, resources are allocated throughout the organization to advance the organization's ability to 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 continued investments in technology, infrastructure, business process improvements, data security, and our employees designed to enhance service delivery through improved responsiveness and cost effectiveness.

CalSTRS is committed to providing exceptional service to our members and their employers. In addition to a robust Benefits and Services Branch and various outreach activities, CalSTRS also has six service centers in California to assist members: West Sacramento (headquarters), Santa Clara, Glendale, Irvine, San Diego and Riverside. These member service centers offer educational and benefits planning services, including workshops and individual and group sessions. Every year, tens of thousands of



Photo by David Gerberding, CalSTRS

members take advantage of these services, as well as the opportunity to walk in to our member service centers and receive personal assistance.

CalSTRS monitors member satisfaction by regularly surveying our stakeholders to ensure they receive accurate, timely and thorough answers to their questions. 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.



San Diego Member Service Center

Photo by Clarissa Resultan, CalSTRS



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.

ORGANIZATION AND LEADERSHIP

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 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' monies.

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 BOARD

As of June 30, 2017



Dana Dillon
Board Chair
K-12 Classroom Teacher



Sharon Hendricks
Board Vice Chair
Community College Instructor



John Chiang
State Treasurer
Ex-Officio Member



Michael Cohen
Director of Finance
Ex-Officio Member



Joy Higa
Public Representative



Harry M. Keiley
K-12 Classroom Teacher



Paul Rosenstiel
Public Representative



Tom Torlakson
State Superintendent of
Public Instruction
Ex-Officio Member



Thomas Unterman
Public Representative



Nora E. Vargas
School Board Representative



Karen Yamamoto
Retiree Representative



Betty Yee
State Controller
Ex-Officio Member

CALSTRS EXECUTIVE STAFF

As of June 30, 2017



Jack Ehnes
Chief Executive Officer



Cassandra Lichnock
Chief Operating Officer



Christopher J. Ailman
Chief Investment Officer



Brian J. Bartow
General Counsel



Robin Madsen
Chief Financial Officer



Grant Boyken
Public Affairs Executive Officer



Ashish Jain
Chief Technology Officer



Lisa Blatnick
Chief of Administrative Services



Andrew Roth
Benefits and Services
Executive Officer



STRATEGIC PLAN AND PERFORMANCE MEASUREMENT

STRATEGIC PLAN

The CalSTRS strategic goals are developed by executive management in conjunction with the board and are presented in a three-year strategic plan. The current strategic plan covers fiscal years 2016–19, and was the culmination of a year devoted to a comprehensive environmental scan designed to gain a broad understanding of the external and internal forces affecting the future of CalSTRS. The resulting strategic plan provides overarching goals and objectives to guide CalSTRS' direction, and measures to evaluate our success.

The four goals of the 2016–19 strategic plan are at the heart of CalSTRS' operations. Each goal has supporting objectives and measures of success that are operationalized in annual business plans.

Goal 1: Financial

Ensure a financially sound retirement system.

CalSTRS' primary goal is to ensure a financially sound retirement system. Building on earlier achievements, we remain focused on achieving full funding of the CalSTRS Defined Benefit Program according to

the plan established by the California Legislature in June 2014. CalSTRS investment managers are committed to investing responsibly over the long term while continuing to add value to the portfolio. The system's actuaries assess demographic and economic assumptions used to project the plan's liabilities annually and recalculate the assumptions based on updated experience every four or five years to continually improve these funding estimates.

Goal 2: Member/Employer

Enhance services to members and employers.

CalSTRS' vision is to ensure that our members understand their retirement benefits and make smart decisions to secure their financial futures. CalSTRS also highlights our partners in this responsibility—members' employers. Accurate data and complete reporting of member information are as critical to a secure retirement as is the employer's role in educating employees about their CalSTRS benefits.

Goal 3: Business Transformation

Drive operational excellence.

CalSTRS' largest business transformation priority is to update our systems and associated business processes to better serve our members, employers and employees. The Pension Solution project addresses this priority by replacing CalSTRS' current pension administration system.

Goal 4: Workforce Transformation

Grow an engaged, highly skilled and diverse workforce.

Creating a workplace that engages employees helps to deliver optimum service and efficient performance is critically important to CalSTRS. CalSTRS knows an engaged workforce contributes to engaged members, and initial research indicates a relationship between member engagement and retirement preparedness. CalSTRS strives to hire the right individuals for the right job at the right time, and to provide a diverse and inclusive work environment.

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 step-by-step initiatives and key activities designed to advance the goals and objectives of the strategic plan.

Executives use the business plan, the current enterprise risk and compliance landscape, and sustainability principles to guide the development of the CalSTRS budget each year. The budget allocates resources according to both longer-term strategic and shorter-term business plan priorities. The priorities of the upcoming 2018–19 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, and implementing robust recruiting and retention activities to grow the CalSTRS workforce.

Executives use the business plan, the current enterprise risk and compliance landscape, and sustainability principles to guide the development of the CalSTRS budget each year.

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 operations, customer service and decision-making. The four key performance review meetings held at CalSTRS are:

- Customer service performance reviews. In these quarterly meetings, directors of member-facing operations present results for service level objectives to executives.
- Operations performance reviews. 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.
- Branch business reviews. In these quarterly meetings, directors report on a range of performance measures.

Accomplishments Report

At the end of each fiscal year, an accomplishments report is produced. This report documents the organization's ability to meet the long-term targets established in the strategic plan and evaluates progress toward advancing the shorter-term initiatives identified in the business plan. Selected achievements from the accomplishments report are presented on the next page.

CalSTRS 16–17 Strategic Initiatives and Selected Accomplishments

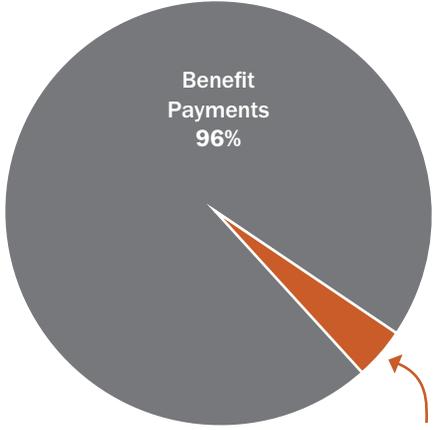
Strategic Goal	Accomplishments
Goal 1	Financial: Ensure a financially sound retirement system.
	<ul style="list-style-type: none"> • Presented a new experience study, along with an audit of the study by an independent actuarial firm. • Completed and presented the Funding Risk Report to the board in November 2016. • Developed and executed a communication and stakeholder outreach plan for the CalSTRS Experience Analysis and the actuarial valuation as of June 30, 2016. • Developed a pioneering investment cost-reporting standard for direct and indirect costs across all asset classes and investment strategies that make CalSTRS one of the frontrunners among its peers. • Created a project plan to track indirect costs that were not included in the November 2015 Annual Investment Cost Report. • Transitioned Europe, Australasia and Far East passive portfolio to internal investments and updated contracts with index providers.
Goal 2	Member/Employer: Enhance services to members and employers.
	<ul style="list-style-type: none"> • Prepared a new marketing plan in collaboration with the Pension2 program record keeper, Voya Financial. • Created and launched a comprehensively redesigned 403bCompare website in March 2017. • Developed an analytic model to evaluate monthly contributions by employer. The model comprises a series of metrics and thresholds—the combination facilitates the identification of potential variances.
Goal 3	Business Transformation: Drive operational excellence.
	<ul style="list-style-type: none"> • Identified opportunities to improve and mature CalSTRS data security in response to the fiscal year 2016–17 Phase I cybersecurity assessment. • Drafted an organizational change management plan, the Transition Management Plan. • Developed a formal change management communication plan for the Pension Solution project and hired a change management leader in March 2017. • Completed staff and leadership readiness plans; activities for both are underway. • Completed Phase I cybersecurity third-party vulnerability assessment and document/policy review. • Partnered with an outside vendor to assess our security infrastructure, identify gaps and make recommendations to remediate those gaps.
Goal 4	Workforce Transformation: Grow an engaged, highly skilled and diverse workforce.
	<ul style="list-style-type: none"> • Participated in the following Civil Service Improvement efforts: Exam and Certification Online System (ECOS) hiring, examinations and class consolidations, including generalists, attorney, actuarial and technology classifications. • Prepared Civil Service Improvement ECOS hiring best practices with recommendations provided to CalHR executive leadership for implementation statewide. • Developed, approved and presented the leadership training curriculum. • Completed pilot training for leaders and staff. • Completed the training curriculum for an organization-wide all-employee diversity and inclusion training.



BUDGET OVERVIEW

ANNUAL BUDGET OVERVIEW

This section presents the CalSTRS fiscal year 2018–19 budget. This budget funds various organizational functions and expands existing programs to include increased support for investment administration activities. The operating budget contains the budgets for pension and general administration, capital projects and internal investment administration, which are each explained in more detail in this section.

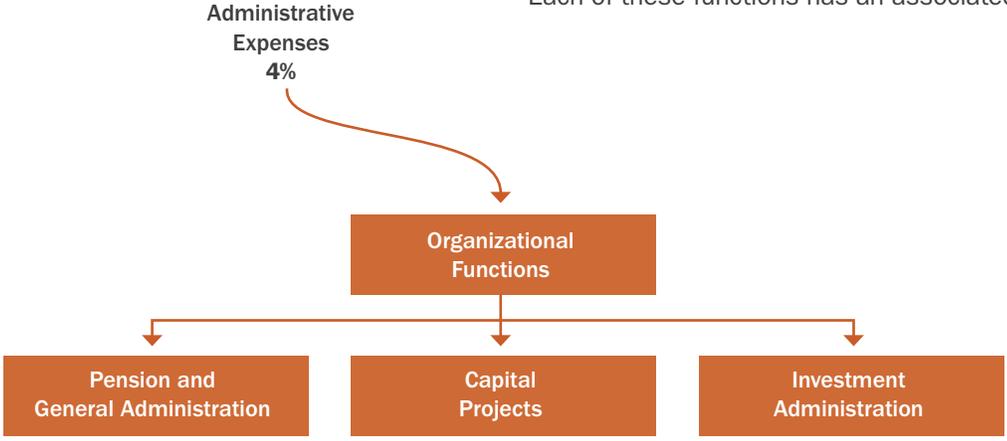


CalSTRS' expenses are primarily composed of benefit payments and the administrative costs necessary to run the organization.

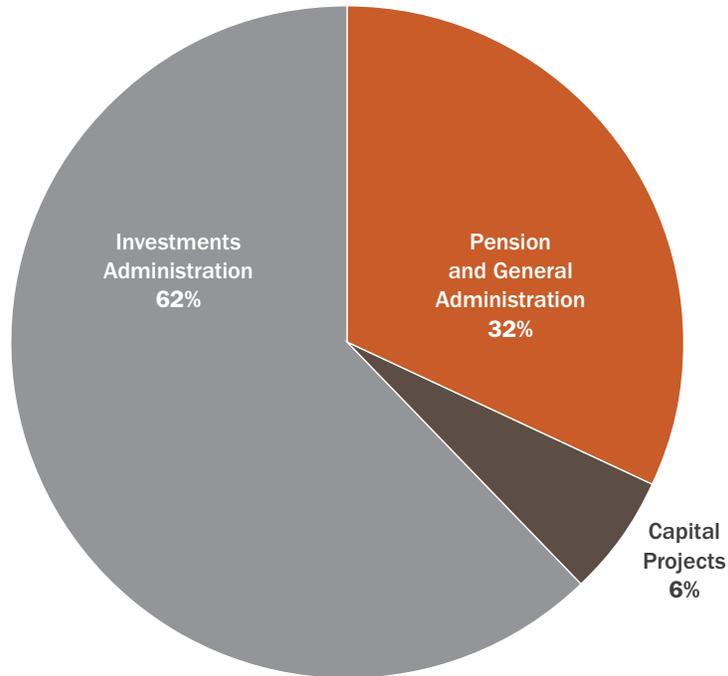
In general, administrative expenses make up a very small portion of CalSTRS' expenses. These administrative expenses fund CalSTRS' operations.

CalSTRS' operations can be divided between pension and general administration, capital projects and investment administration.

Each of these functions has an associated budget.



2018–19 PROPOSED BUDGET



The CalSTRS Budget

The budget for each administrative function for the 2016–17, 2017–18 and 2018–19 fiscal years are displayed in the table below. These figures combine both annually appropriated and continuously appropriated budgets and represent CalSTRS’ total administrative expenditures. Details for each of these budgets follow.

Budget Category	Actual ¹ 16–17	Estimated 17–18	Proposed 18–19	% Change 17–18 to 18–19
Pension and General Administration	\$152,358,200	\$178,685,246	\$186,314,127	4%
Capital Projects	37,555,632	45,481,778	36,464,439	(20)
Investment Administration ²	229,425,908	301,728,169	368,137,024	22
Totals	\$419,339,740	\$525,895,193	\$590,915,590	12%

¹These expenditures are only those against the 2016–17 budget appropriation and do not include savings from prior periods.

²Consistent with financial reporting practices, investment administration costs exclude securities lending, borrowing costs on investment-related master lines of credit, and broker commissions.

PENSION AND GENERAL ADMINISTRATION BUDGET

The Pension and General Administration budget funds CalSTRS' ongoing operations associated with managing benefit programs, enrolling members, collecting contributions, providing retirement readiness and other member contact services, establishing benefit amounts, and paying members. It also provides for general support functions such as human resources, facilities management, procurement, technology services, financial services, communications, government relations and legal services.

These activities are performed in the context of the CalSTRS Defined Benefit, Defined Benefit Supplement, Cash Balance Benefit, and Purchasing Power Protection programs, and the Replacement Benefit, Pension2 and MediCare Premium Payment programs, which CalSTRS manages.

The 2018–19 Pension and General Administration budget increased from the 2017–18 budget for several reasons. First, a salary increase was applied to most employees. This state-

Pension and General Administration Budget				
Budget Category	Actual 16–17	Estimated 17–18	Proposed 18–19	% Change 17–18 to 18–19
Salaries	\$61,722,755	\$74,034,284	\$78,392,197	6%
Benefits	29,726,471	42,087,116	43,951,444	4
Operating Expenses and Equipment	60,908,974	62,563,846	63,970,486	2
Totals	\$152,358,200	\$178,685,246	\$186,314,127	4%

Pension and General Administration Staff Counts			
	2016–17	2017–18	2018–19
Authorized Positions	889	916	919
Blanket Positions	94.5	94.5	94.5
Totals	983.5	1,010.5	1,013.5

mandated increase is the result of negotiations between the public employee unions and the state. Second, CalSTRS calculates our budget for employee benefits as a percentage of salary; therefore, benefits rose along with salaries.

Third, this budget includes a small cost increase over the 2017–18 budget for additional staff in the Office of General Counsel and the Administrative Services Branch. These additional employees will support the increased Investments Branch-related workload due to the growing portfolio.

Finally, there is an increase to the central administrative services line item due to a revised estimate this year. The central administrative services line item is an annual interagency state charge based on each agency's use of shared governmental administrative services set by the California Department of Finance (DOF), and it is contained in the Operating Expenses and Equipment category of the budget. The primary driver of this change is an increase in the cost of health benefits for retirees.

Pension and General Administration Budget Display by Fund

The Pension and General Administration budget can be separated into its component funds. In addition to the Teachers' Retirement Fund (TRF), CalSTRS manages the Teachers' Deferred Compensation Fund (TDCF) and the Teachers' Health Benefit Fund (THBF). CalSTRS also manages the Teachers' Replacement Benefit Program Fund (TRBF) and Pension2; the administrative costs of these funds are captured in the TRF and TDCF budgets, respectively. The table below breaks out budgets for the TRF, TDCF and THBF.

2018–19 Proposed Budget	Fund			Totals
	TRF	TDCF	THBF	
Budget Category	Amount	Amount	Amount	
Pension and General Administration	\$182,696,643	\$2,908,284	\$709,200	\$186,314,127

Teachers' Retirement Fund Budget

The TRF budget accounts for a majority of CalSTRS' administrative costs. As noted previously, the increase to this budget is driven primarily by salary and benefit increases. The table below shows data just for the TRF's Pension and General Administration budget.

Teachers' Retirement Fund				
Budget Category	Actual 16–17	Estimated 17–18	Proposed 18–19	% Change 17–18 to 18–19
Salaries	\$60,950,700	\$73,377,594	\$77,711,506	6%
Benefits	29,411,698	41,746,612	43,597,940	4
Operating Expenses and Equipment				
General Expense	7,982,424	15,053,009	14,117,623	(6)
Consulting and Professional Services	22,902,602	16,872,475	16,973,475	1
Facilities Operations	8,485,845	8,802,525	8,802,525	0
Central Administrative Services	9,316,680	10,458,904	11,634,906	11
Data Processing and Storage	11,351,325	9,858,668	9,858,668	0
Totals	\$150,401,274	\$176,169,787	\$182,696,643	4%

Teachers' Deferred Compensation Fund Budget

The TDCF 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 budget has increased due to salary and benefit adjustments, an updated cost allocation for general administration services, and an increase in central administrative services cost, which are assessed by the DOF.

In 2016–17, an internal cost allocation study indicated that the TDCF budget did not include an adequate percentage of CalSTRS' general administration costs. As a result, costs allocated to the TDCF budget have increased as displayed in the General Expense line item below and corresponding costs to the TRF have decreased. The central administrative services line of the operations category has also been increased to account for a trend of increasing cost over the two prior years. As previously noted, the central administrative services cost has increased to account for increased retiree healthcare costs, which are assessed by the state.

Staff monitors the cash revenue received by the TDCF to ensure it is sufficient to cover expenditures from the fund. If sufficient cash revenue is generated to support additional expansion of the program, the board may approve up to 5 percent over the baseline budget, or \$145,000, for such expenditures.

Teachers' Deferred Compensation Fund				
Budget Category	Actual 16–17	Estimated 17–18	Proposed 18–19	% Change 17–18 to 18–19
Salaries	\$534,296	\$484,408	\$501,408	4%
Benefits	229,608	235,846	244,846	4
Operating Expenses and Equipment				
General Expense	129,380	195,131	954,644	389
Consulting and Professional Services	832,988	1,103,468	1,103,468	0
Facilities Operations				
Central Administrative Services	54,000	54,624	103,918	90
Data Processing and Storage				
Totals	\$1,780,272	\$2,073,477	\$2,908,284	40%

Teachers' Health Benefit Fund Budget

The THBF is used to fund the CalSTRS Medicare Premium Payment (MPP) 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.

This budget has increased due to salary and benefit adjustments and revised cost allocation for general administration costs. As with the TDCF, a study of the allocation of CalSTRS' general administration costs indicated that the THBF budget has historically not included an adequate percentage of the organizational overhead. The budget has been increased (shown in the General Expense line below) to account for this.

Teachers' Health Benefit Fund				
Budget Category	Actual 16-17	Estimated 17-18	Proposed 18-19	% Change 17-18 to 18-19
Salaries	\$237,759	\$172,283	\$179,283	4%
Benefits	85,165	104,658	108,658	4
Operating Expenses and Equipment				
General Expense	(158,270) ³	108,536	365,607	237
Consulting and Professional Services		34,000	34,000	0
Facilities Operations				
Central Administrative Services	12,000	19,006	18,152	(4)
Data Processing and Storage		3,500	3,500	0
Totals	\$176,654	\$441,983	\$709,200	60%

Pension and General Administration Budget Savings

It is possible that CalSTRS can end the year with savings in our annual appropriation from the TRF. The Budget Act allows the board to authorize spending of this savings for unanticipated expenses two years after the initial appropriation, up to a certain limit. That limit is 3 percent of the initial TRF appropriation. Historically, CalSTRS' savings have exceeded this 3 percent limit.

The 3 percent limit from the annual TRF appropriations of 2016-17 and 2017-18 are shown in the table below. The amount of savings from 2016-17 was approximately \$13,500,000. These amounts are not included in the Pension and General Administration budget for fiscal year 2018-19 because they represent budget surpluses from prior years and are available only upon approval of a separate request from the board.

Projected Savings Available for 2018-19	
TRF Budget Appropriation	Amount
Fiscal year 2016-17	\$5,754,690
Fiscal year 2017-18	6,061,000
Total	\$11,815,690

³The negative amount shown in fiscal year 2016-17 is the result of an accounting accrual adjustment.

CAPITAL PROJECTS BUDGET

The Capital Projects budget plans for expenses associated with technology and other enterprise projects at CalSTRS. These costs are typically one-time, bounded costs as compared to the ongoing administrative costs captured in the Pension and General Administration budget.

From the reporting perspective of the U.S. Generally Accepted Accounting Principles (GAAP), CalSTRS capitalizes our operational assets in accordance with Governmental Accounting Standards Board (GASB) Statements No. 34 and No. 51. Specifically, all land, buildings, improvements, equipment, computer software, and all other tangible or intangible assets used in operations that have initial useful lives extending beyond one year, and have an initial cost basis of \$1 million or greater, are capitalized. Depreciation/amortization is charged to operations using the straight-line method on the estimated useful life of the related asset. CalSTRS reviews our capital assets for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. From a budgetary reporting perspective, all assets, including those with useful lives greater than one year and costing more than \$1 million are fully expensed in the year purchased.

The table below displays the budgets for CalSTRS' major projects. The significant decrease for the Pension Solution budget in 2018–19 reflects the step-down funding structure of this long-term project. Specifically, in initial years of implementation, larger amounts of capital were drawn down with lessor amounts required in later years.

Capital Projects				
Budget Category	Actual 16–17	Estimated 17–18	Proposed 18–19	% Change 17–18 to 18–19
Annual Project Appropriation	\$9,423,634	\$18,500,000	\$18,500,000	0%
Pension Solution	27,834,172	26,981,778	17,964,439	(33)
Long-Term Space Planning	297,826			
Totals	\$37,555,632	\$45,481,778	\$36,464,439	(20%)

Capital Projects Staff Counts			
	2016–17	2017–18	2018–19
Blanket Positions	101	101	101

There are two primary sources of funding for CalSTRS' projects: an annual project appropriation and the Pension Solution appropriation. The board has also approved funding from the continuous appropriation to address CalSTRS' long-term space planning needs.

CalSTRS capitalizes our operational assets in accordance with Governmental Accounting Standards Board Statements No. 34 and No. 51.

Annual Project Appropriation

The annual project appropriation is \$18.5 million. This appropriation is used for enterprise-wide projects authorized by the CalSTRS Enterprise Program Investment Council (EPIC). Each year, this amount is appropriated for three years to spend and an additional two years after the final year to pay for planned spending.

Therefore, the actual amount available for EPIC projects is typically larger than \$18.5 million because past savings are carried over for use in the current year. This budget has supported the Pension Solution project (see next page) by funding related enterprise projects such as data preparation, enterprise information management and business transformation.

The table below provides the amount of the annual project appropriation available for spending in 2017–18. Due to the appropriation time limits, any savings from the appropriations for 2014–15 and 2015–16 will not be available for use in 2018–19.

Annual Technology Project Appropriation			
Fiscal Year	Appropriated Amount	Consumed Amount	Amount Available for 2017–18
2014–15 Tech Appropriation	\$18,500,000	\$15,927,932	\$2,572,068
2015–16 Tech Appropriation	18,500,000	7,238,651	11,261,349
2016–17 Tech Appropriation	18,500,000	9,423,634	9,076,366
Totals	\$55,500,000	\$32,590,216	\$22,909,784

Pension Solution

The Pension Solution project budget is \$251,800,000. The majority of this funding (\$213,000,000) was authorized in fiscal year 2014–15, and the remaining funds are drawn from the annual technology appropriation. The table below shows how the project funding was originally planned and how much of the annual appropriation has been consumed for each year.

Pension Solution Budget			
Budget Period	Budgeted Amount	Consumed Amount	% Consumed
2014–15 Pension Solution Budget	\$61,564,071	\$58,033,029	94%
2015–16 Pension Solution Budget	63,099,167	56,533,075	90
2016–17 Pension Solution Budget	37,553,277	27,834,172	74
2017–18 Pension Solution Budget	26,981,778	5,570,523	21
2018–19 Pension Solution Budget	17,964,439		
2019–20 Pension Solution Budget	5,837,268		
Totals	\$213,000,000	\$147,970,799	69%

Past, current and projected Pension Solution budget expenditures by category are shown below. At the board's February 2018 meeting, it is anticipated that the project schedule will be discussed and potentially adjusted.

Pension Solution Budget			
Budget Category	Actual 16–17	Estimated 17–18	Proposed 18–19
Salaries	\$4,362,507	\$5,081,292	\$6,466,560
Benefits	2,085,910	2,553,732	2,521,958
Operating Expenses and Equipment	21,385,755	19,346,754	8,975,921
Totals	\$27,834,172	\$26,981,778	\$17,964,439

Long-Term Space Planning

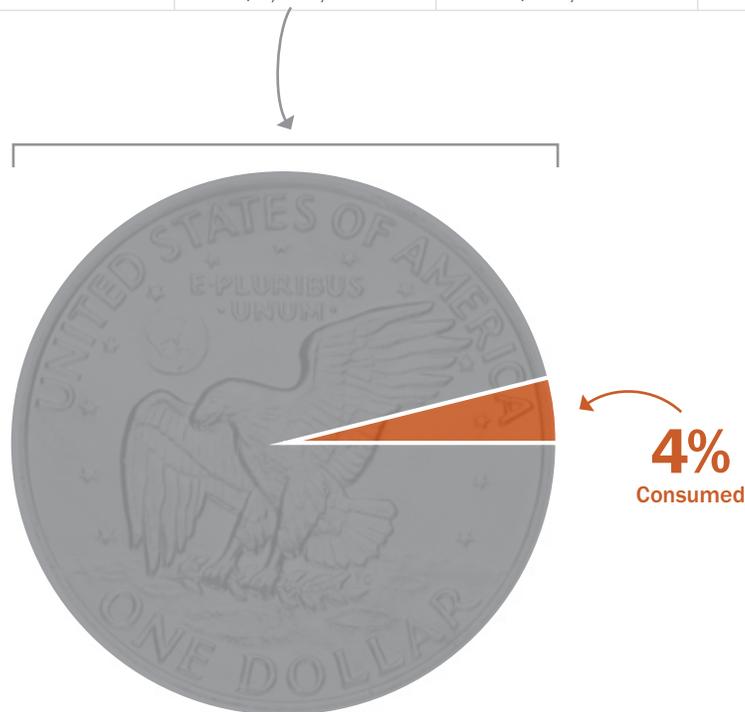
CalSTRS moved into our current headquarters building in 2009, with the assumption that the facility would accommodate the organization’s growth for approximately seven to 10 years. Entitlements for construction of an additional tower adjacent to the headquarters were included in the initial real estate transaction to be used for future organizational growth.

In 2016, the board reviewed a variety of scenarios to accommodate CalSTRS’ growth long-term, including options to construct a second building or lease office space elsewhere in the Sacramento area. The board requested a more detailed financial analysis for constructing a second building, and staff provided that analysis.

The board subsequently appropriated \$181 million to a building account for the purposes of constructing the second headquarters, but authorized

only an initial expenditure from that account of up to \$8 million. Of this amount, \$297,826 was spent in fiscal year 2016–17 and the remainder is projected to be used by the end of fiscal year 2018–19. This amount was to complete a design and provide not-to-exceed cost estimates for the construction of an additional space. Staff expects to provide updates and analysis of other long-term solutions to the board for review in 2018, at which time CalSTRS may reassess the best approach to address the organization’s long-term needs.

Long-Term Space Planning			
Budget Category	Budgeted Amount	Consumed as of 6/30/17	% Consumed
2016–17 Approved Amount	\$8,000,000	\$297,826	4%



INVESTMENT ADMINISTRATION BUDGET

The Investment Administration budget is divided broadly into two categories: internal investment administration costs and external investment management costs. Internal investment administrative costs include salaries, benefits and operating expenses and equipment for CalSTRS staff actively involved in the management of the investment portfolio. External investment management 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. Consistent with our historical reporting practices, this budget does not include costs for

securities lending or investment transactional costs because they are netted with investment gains and losses.

This budget document focuses on the internal investment administration budget. Visibility into estimated external investment management costs is provided by the annual Investments Branch business plans at the beginning of each fiscal year.

Internal administration costs will increase as the branch continues to transition assets to internal management with a larger budget for added staff. This transition will result in an overall decrease in the relative costs (in basis points) of managing the CalSTRS Investment Portfolio, as well as increased transparency and reduced risk.

The table below contains a detailed view of the total Investment Administration budget. Note that the external investment management line

accounts for fees paid for external management of the funds CalSTRS administers. These budgets are held only in the TRF. The significant year-over-year increase in the Investment Administration budget, as displayed in the chart below, is a function of increased external management fees based on projected AUM and an augmentation for internal investment resources. The augmentation authorizes approximately \$15.4 million of additional spending authority that is intended for the internal management of the investment portfolio. This authority will extend for five years, from fiscal years 2018–19 to 2022–23, and is subject to board approval before funds are disbursed. This increase is part of the long-term strategy to shift assets to internal management to capitalize on the savings realized by managing assets in house.

Investment Administration Budget				
Budget Category	Actual 16–17	Estimated 17–18	Proposed 18–19	% Change 17–18 to 18–19
Salaries	\$22,762,169	\$25,187,904	\$34,121,465	35%
Benefits	7,489,959	9,953,455	13,817,410	39
Operating Expenses and Equipment				
General Expense	2,071,714	2,685,617	6,138,751	129
Consulting and Professional Services	81,441	625,000	625,000	0
External Investment Management	197,020,625	263,276,193	313,434,398	19
Totals	\$229,425,908	\$301,728,169	\$368,137,024	22%

Investment Administration Staff Counts			
Staff Type	2016–17	2017–18	2018–19
Authorized Positions	155	168	223

BUDGET AUGMENTATION: INVESTMENTS STAFF

Initiative 1 of Objective C of the CalSTRS 2017–18 Business Plan is to “Identify appropriate opportunities to consolidate CalSTRS’ administrative authority to better serve its members.” This initiative serves Strategic Goal 3, which is to drive operational excellence at CalSTRS.

Management has concluded that increasing administrative authority for investment management would be an appropriate means to accomplish Initiative 1 and that it would result in better investment performance by reducing costs. Therefore, the 2018–19 budget focuses on increasing CalSTRS’ authority to manage investment administrative costs.

To this end, the board has approved \$15,423,020 and 58 permanent investment and directly supporting general administration positions,

The board has approved \$15,423,020 and 58 permanent investment and directly supporting general administration positions ... for the Investments Branch.

to be deployed over five years, for the Investments Branch. These resources will enable CalSTRS to rapidly respond to changes in market conditions and the increased complexities of the financial markets at lower cost through the use of internal rather than external management.

The number of Investments Branch staff needed over five years has been estimated from historical data and the board-approved Investments 10-year plan. As CalSTRS employs more internal investment staff and shifts more of the portfolio to internal management, the workload of associated business areas will also increase.

Specifically, the workload of the Office of the General Counsel and that of the Administrative Services Branch will increase in order to manage an increased number of transactions. Therefore, this year’s budget augmentation includes additional staff for those areas.

CalSTRS plans to deploy this budget as shown in the following table.

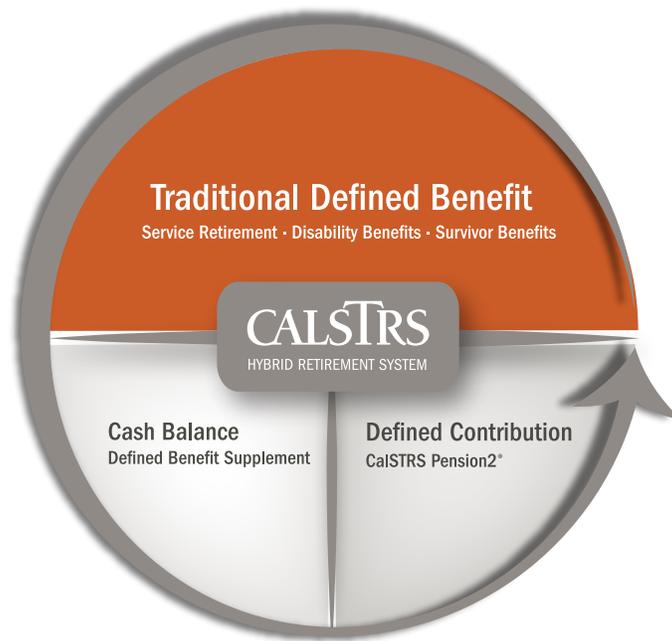
	Fiscal Year				
	2018–19	2019–20	2020–21	2021–22	2022–23
Salaries and Incentives	\$1,838,572	\$1,699,121	\$1,855,191	\$1,712,770	\$1,788,158
Benefits	804,861	736,153	813,049	742,878	780,022
Operating Expenses and Equipment	756,587	638,726	514,760	427,352	314,820
Totals	\$3,400,020	\$3,074,000	\$3,183,000	\$2,883,000	\$2,883,000
Proposed Staffing	14	12	12	10	10

OVERVIEW OF FUNDS

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

CalSTRS administers funds that are both annually and continuously appropriated. Authority to draw from an annually appropriated fund must be obtained each year through the legislative process. In contrast, a fund that is continuously appropriated has ongoing statutory authority to spend all or a portion of its assets (that is, the authority to spend does not need to be renewed in an annual appropriation from the state). The board maintains oversight and control over continuously appropriated funds through the internal budgetary controls outlined in the Internal Budget Management section.

This section describes the funds administered by CalSTRS. The budget applies to all funds, and it is divided into three functional areas: pension and general administration, investments administration, and capital projects. These areas are discussed in detail in the Annual Budget Overview section.



Teachers' Retirement Fund

The TRF 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 and Cash Balance Benefit programs.

Teachers' Replacement Benefit Fund

The TRBF 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 415 threshold for members participating within the Defined Benefit Program. The current IRC 415 threshold for the Defined Benefit Program benefits is \$220,000 for retirees between the age of 62 and 65 in the 2018 calendar year. This fund receives the amount of employer contributions necessary to fund payments to eligible beneficiaries and related administrative expenses.

CalSTRS Pension2

The Pension2® program, established by California Education code sections 24950 and 24975, provides optional 403(b) and 457(b) deferred compensation plans for CalSTRS members and employees working for CalSTRS employers. While CalSTRS is the fiduciary and ultimately responsible for the administration, oversight and investment options for Pension2, there is not an approved budget for the program. Instead, Teachers' Retirement Law calls for the provision of an annuity contract and custodial account which may be administered by a qualified third-party administrator. While the 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 TDCF.

Teachers' Deferred Compensation Fund

The TDCF was established pursuant to Chapter 655, Statutes of 2006 (SB 1466). It 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 is funded by the fee revenues received from the Pension2 participating plans,

a vendor registration program, and an employer compliance assistance program.

Teachers' Health Benefit Fund

The THBF supports the expenses of the MPP 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 25940, and it 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

Fund	Associated Programs
Teachers' Retirement Fund	Defined Benefit Defined Benefit Supplement Cash Balance Benefit Purchasing Power Protection
Teachers' Replacement Benefit Fund	Replacement Benefit
Pension2	Pension2 403(b) Pension2 457(b)
Teachers' Deferred Compensation Fund	403bCompare 403bComply
Teachers' Health Benefit Fund	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 them.

Budget Category	TRF	TRBF	Pension2	TDCF	THBF
Revenues					
Investment Income	✓		✓	✓	✓
State Contributions	✓				
Employer Contributions	✓	✓	✓		✓
Member Contributions	✓		✓		
Other Income	✓			✓	
Expenses					
Pension Benefit Payments	✓	✓	✓		
Operating Expense	✓		✓	✓	✓
Investment Management	✓		✓		
Other Postemployment Benefit Payments					✓
Other Expenses	✓	✓			



POLICIES

BOARD POLICY

CalSTRS has developed a set of policies to establish standards for the behavior of the organization. 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.

This authority provides the basis for which all polices 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.

METHOD OF ACCOUNTING AND BUDGETING

Financial Accounting and Reporting Policy

CalSTRS maintains financial accounting and reporting records on an accrual basis in accordance with the Generally 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 (CAFR), 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, postemployment benefit

liabilities, and encumbrances (commitments for expenditure).

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 California Education Code section 22002. It provides that three sources contribute to the retirement fund: members, employers and the state itself. This policy establishes guidelines for accounting for employer, member and state contributions, including penalties and interest. CalSTRS recognizes revenue for employer, member and participant 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 via an appropriation.

CalSTRS maintains financial accounting and reporting records on an accrual basis in accordance with GAAP as promulgated by the Governmental Accounting Standards Board.

- **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 switch into the Defined Benefit Program, this policy addresses the transfer of funds from the Cash Balance Benefit Program into the new 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 Accounting 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 Capital Projects section.
- **Receivable Collections and Write-offs:** CalSTRS collects all amounts due the fund to the full extent allowed by law, and records receivables for amounts due the TRF and other funds as soon as they are identified. The types of receivables CalSTRS establishes and collects are designated as “Pension Receivables,” “Administrative Receivables,” and “Investment Receivables.” With respect to write-offs, CalSTRS reports all discharged debts to the board

semiannually. Additionally, CalSTRS submits the Accounts Receivable Report annually to State Controller’s Office. The report includes all receivable activities, collections, aging, write-offs and account balances.

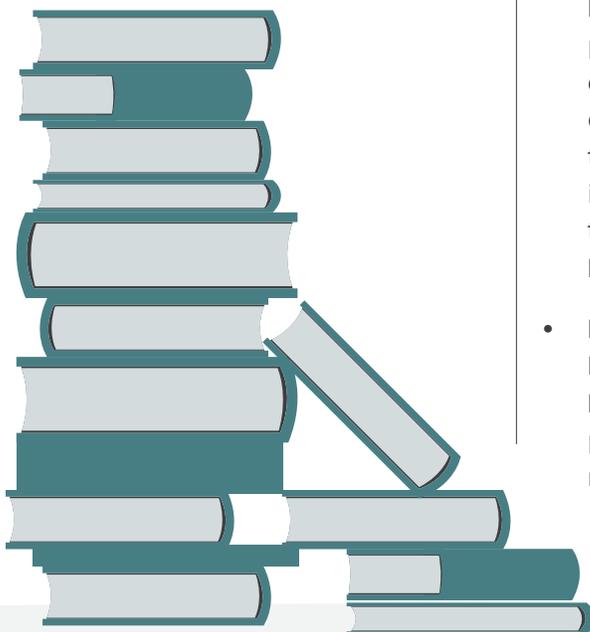
- **Allocations for Financial and Managerial Accounting:** CalSTRS has an established policy to guide the allocation of financial data for managerial and financial reporting purposes. The policy provides a framework to ensure allocations are equitable in accordance with applicable accounting standards, laws and regulations, and that they are performed consistently.

- **Actuarial Valuations for Financial Statement Presentation:** CalSTRS prepares financial statements for the State Teachers’ Retirement Plan (STRP), which is composed of the Teachers’ Retirement Fund and the Teachers’ Replacement Benefit Fund. CalSTRS prepares an actuarial valuation of these programs 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 our actuarial valuations.



- **Actuarial Valuations for Financial Statement Presentation of the Medicare Premium Payment Program:** CalSTRS prepares financial statements for the THBF, which includes the MPP Program. CalSTRS prepares biennial valuations for funding purposes and an annual 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 the MPP Program as the basis for investment return, inflation, mortality, actuarial experience and other assumptions in our actuarial valuation of the MPP Program for financial reporting.
- **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 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 alignment with the requirements of GASB Statement No. 72.

- **Financial Statement Presentation–Schedule of Investments:** It is CalSTRS’ policy to present 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 financial statements, which provides additional detail 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 MPP 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 (SOC) Reports Risk Reviews:** SOC 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.

Budget Policies

CalSTRS maintains budgetary projections 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 board and executive management in the 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 the CalSTRS budget include:

- **Blanket Positions:** 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, while the modified cash basis of accounting for our budgetary/legal reporting. The budgetary/legal basis annual report is prepared in compliance with Government Code sections 12460 and 13344.

- **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 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. The largest commitment of resources created outside the operating budget are the fees paid to external managers for services related to CalSTRS' investment portfolios.

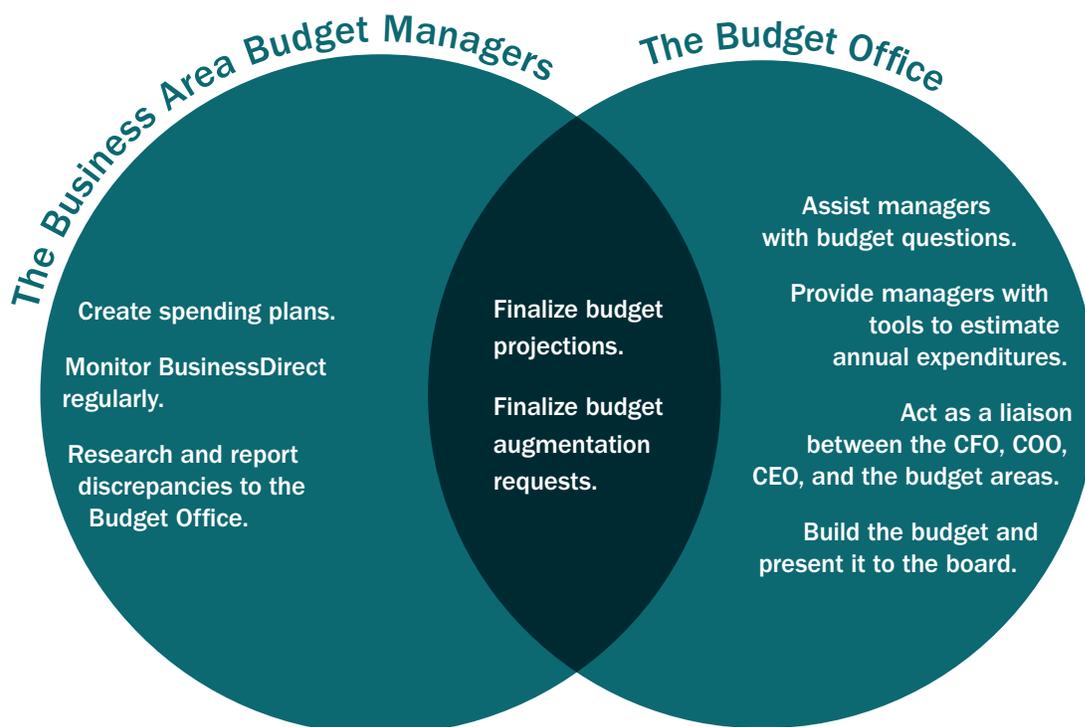
Resources are prudently allocated throughout the organization to advance the goals and objectives set forth by the board and executive management in the strategic plan.

- 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 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.

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 in the graphic 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 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 has internal controls in place to monitor our budget usage throughout the year; these are explained in the Budget Controls and Monitoring section.

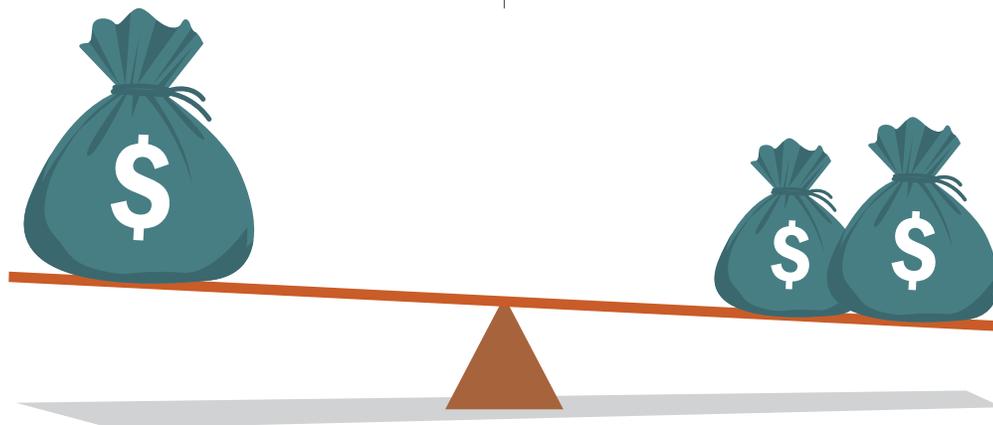
CalSTRS also monitors our pension administration and investment costs relative to peers by participating in CEM benchmarking studies. With this global perspective on pension plan administrative and investment costs, CalSTRS further analyzes operations and identifies areas where additional efficiencies can be achieved.

The CalSTRS Budget Development Process

The CalSTRS budget process commences more than a year in advance of its final adoption, beginning with an assessment of resource needs to meet strategic objectives as well as address the enterprise risk and compliance landscapes and concluding with the 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 the allocation of resources, certain components of the CalSTRS budget are subject to the state’s annual Budget Act process. Authority to approve the use of continuously appropriated funds rests solely with the board, while spending from support appropriation funds requires approval via the state Budget Act.

CalSTRS receives information on changes to wages and benefit rates, as well as estimates for certain charges for state government-wide costs allocated to CalSTRS from the DOF. Simultaneously, the 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 (BCPs).

The CalSTRS budget includes a forecast of both revenues and expenses for the fiscal year (July 1–June 30).

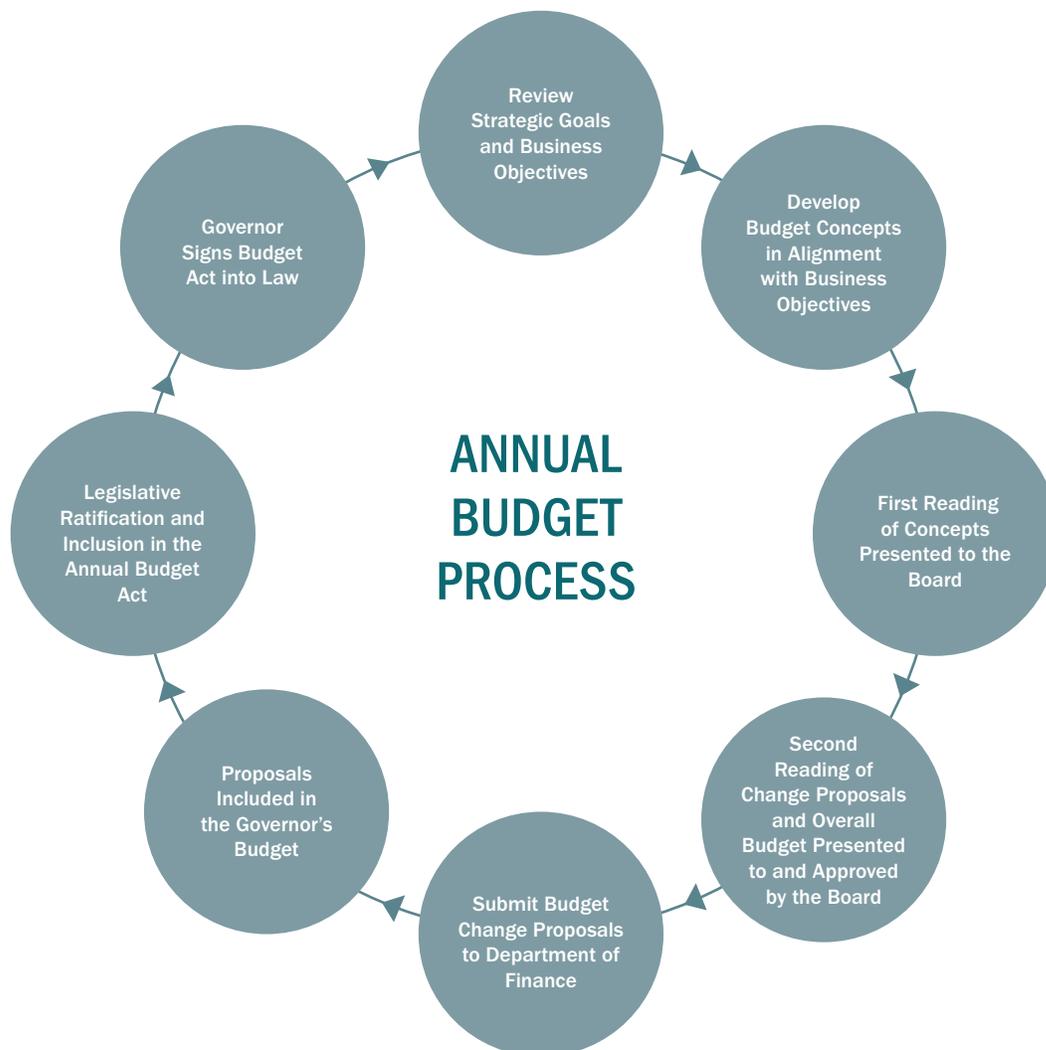


Staff presents concepts related to significant budget changes to the board at a public meeting in July (at the beginning of the fiscal year immediately preceding the budget period). Based on input from the board, staff updates the BCPs and prepares the final budget package for board review and approval at a public meeting in November. Within the final budget package, and subject to approval by the board and inclusion in the state Budget Act, is a provision allowing the board to increase the budget for the support appropriation up to a maximum of the surplus of the budget for the prior two years or 3 percent of the total value of the support appropriation budget for the prior two years, whichever is less (reappropriation authority).

Staff submits approved budget information to the DOF by the end of December and presents the board-

approved CalSTRS budget to legislative committees in the spring preceding the beginning the budget 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 may not 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 authority included in the Budget Act for appropriation savings. These augmentations must occur at appropriately noticed public board meetings. CalSTRS prepares quarterly budget to actual reports and publishes them on the 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. As stated earlier, after board approval of 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.

State budget decisions are made throughout the year by both the Legislature and the Governor.

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 "May 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. 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 on July 1. The following graphic illustrates this general timeline and CalSTRS' role in the budget approval process.

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 and signed by Governor	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 which are overseen by the DOF and the State Controller's Office. 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 the continuously appropriated budgets through various monitoring and approval processes, which are discussed in a subsequent section.

Budget Controls and Monitoring

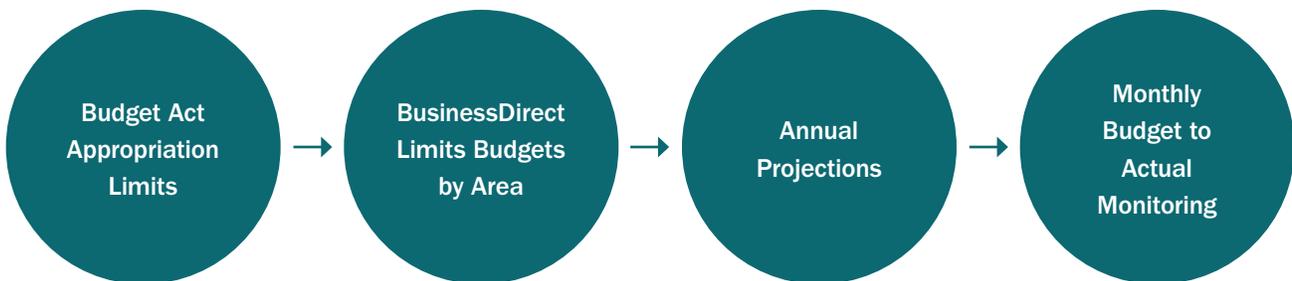
After the Governor’s budget is passed, California law requires reconciliation and monitoring of agency budgets and expenditures between the State Controller’s Office and the DOF. The State Controller submits a budgetary-legal basis report to the Governor containing a statement of the funds of the state, its revenues, and its 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 cost center and expense type. 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 that 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 also receives quarterly budget to actual reports.



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 Chief Operating Officer.



FINANCIAL SUMMARIES

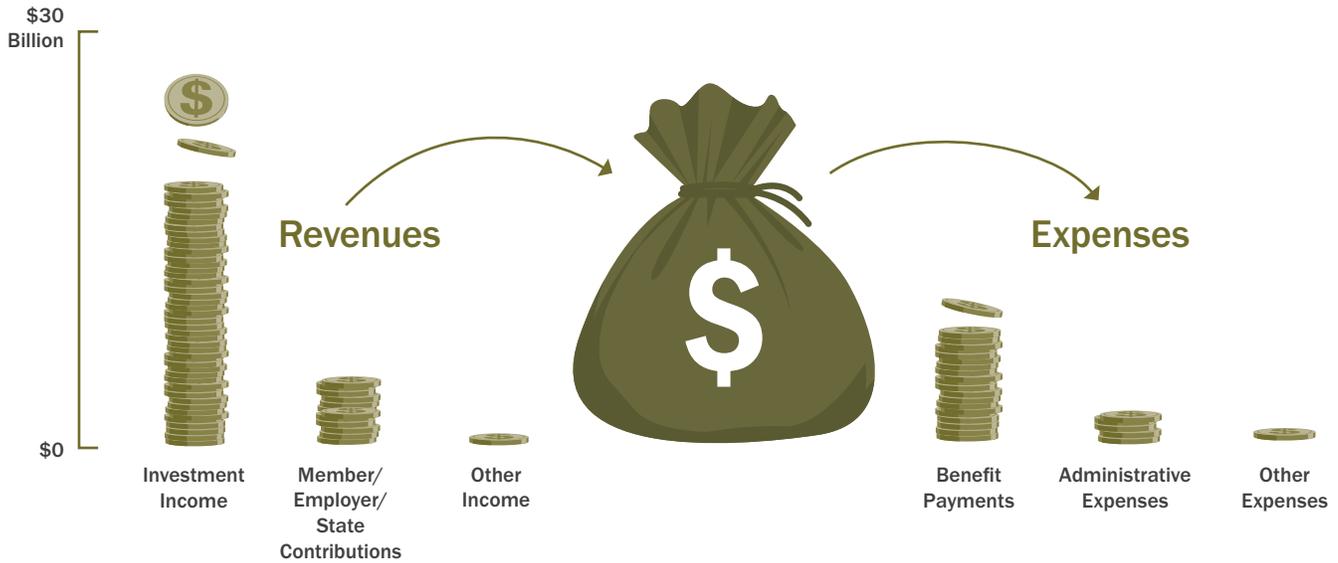
The following section describes and displays CalSTRS' revenues and expenses and includes all financial activities of the organization, both annually and continuously appropriated. This section of the budget uses a different display of financial information than what is presented in the board-approved budget and also includes slightly differing amounts due to refined forecasts, the inclusion of Pension2 activities and adjustments proposed by DOF.

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.”

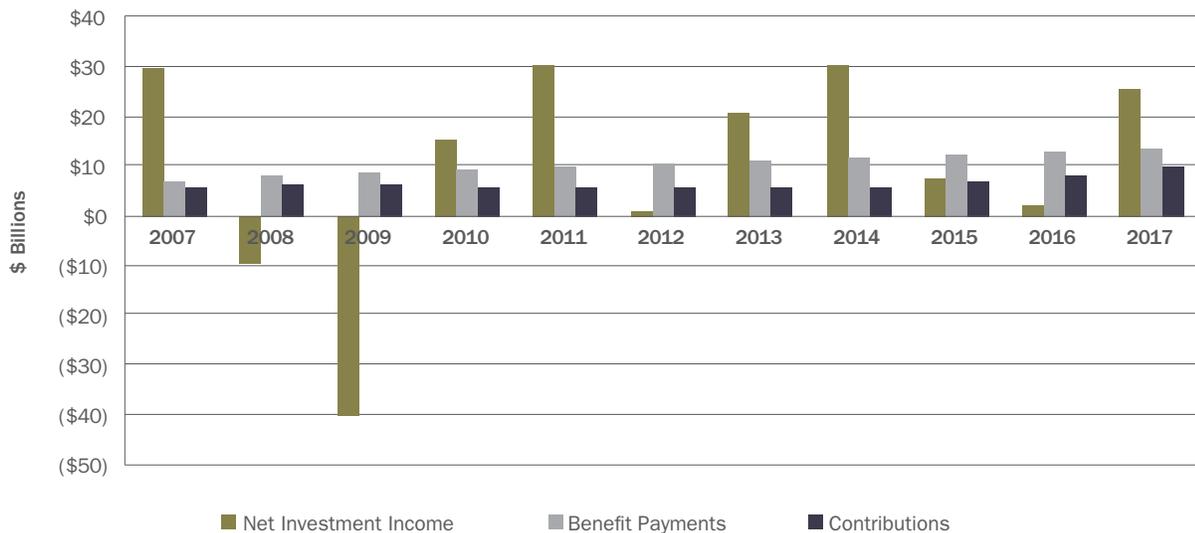
CONSOLIDATED FINANCIAL SCHEDULE

CalSTRS' largest revenues are investment income and member, employer and state contributions. The major expense categories are benefit payments and administrative expenses. Administrative expenses include investment costs. The relative sizes of each category for 2016–17 data are shown in the bar graph below.



The graph below provides historical context for investment income, contributions and benefit payments for the TRF.

TRF Investment Income, Contributions and Benefit Payments



The fund summary below provides a high level view of CalSTRS' sources of revenue and expenses for the 2016–17 fiscal year. This fund summary display recognizes certain expense information crossing multiple periods and a prior period adjustment.

	Actual 16–17
Beginning Fund Balance	\$189,465,709
Revenues	
Investment Income	\$25,645,252
Employer Contributions	4,202,788
Member Contributions	3,569,344
State Contributions	2,478,230
Other Income	73,179
Total Revenues	\$35,968,793
Expenses	
Pension Benefit Payments	\$13,787,501
External Investment Expenditures	295,331
Administrative Expenditures	154,631
Contribution Refunds	115,509
Other Expenditures	90,949
Other Benefit Payments	66,020
Total Expenditures	\$14,509,941
Ending Fund Balance	\$210,924,561

\$ in thousands

CalSTRS defines an ending fund balance as the beginning fund balance net of assets over liabilities and reserves that are available for expenditure.

REVENUES

CalSTRS' primary revenue sources are retirement contributions and investment returns. Contribution amounts are determined as a percentage of members' creditable compensation. Creditable compensation is defined by California Education Code section 22119.2 and generally refers to salary and wages. Historically, investment returns have generally provided more than 50 percent of the resources necessary to fund pension benefits. Currently, the CalSTRS actuarially assumed rate of return is 7 percent; for fiscal year ending June 30, 2017, CalSTRS achieved 13.4 percent investment return. CalSTRS' 10-year investment performance is displayed in the chart below.

Year	Market Value (\$ in billions)	Time-Weighted Return Net of Fees (%)
2008	\$161.46	(4.0%)
2009	\$118.88	(25.1%)
2010	\$129.96	12.0%
2011	\$155.51	22.8%
2012	\$150.61	1.6%
2013	\$165.82	13.6%
2014	\$189.08	18.3%
2015	\$191.41	4.5%
2016	\$188.65	1.4%
2017	\$208.70	13.4%

Prior to 2014, actuarial valuations of the TRF indicated that its revenue would not support its future obligations. Pursuant to the passage the CalSTRS Funding Plan (Chapter 47, Statutes of 2014), contribution rates for members, employers and the State of California general fund increased, placing the system on a sustainable path forward to achieve full funding by approximately 2046. Under the plan, total contributions to the system will nearly double by 2020–21. For purposes of this section, the term “base rate” is 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.

Member and employer contribution rates for the Defined Benefit Program are displayed in the tables below. The rates are different depending on whether members were hired 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, 2016	10.25%	9.205%

Employer Contribution Rates	
Effective Date	Rate
July 1, 2016	12.58%
July 1, 2017	14.43%
July 1, 2018	16.28%
July 1, 2019	18.13%
July 1, 2020	19.10%
July 1, 2021 to June 30, 2046	Subject to board determination
July 1, 2046	Reverts to base rate 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 2046, depending upon the status of the unfunded actuarial obligation. The rate can be adjusted up to 0.5 percent per year.

State Contribution Rates	
Effective Date	Rate
July 1, 2016	8.828%
July 1, 2017	9.328%
July 1, 2018 to June 30, 2046	Variable
July 1, 2046 and thereafter	4.517%

The 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 their initial allowance, as long as funds are available.

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, the Replacement Benefit Program, the Medicare Premium Payment Program and the Pension2 defined contribution program.

EXPENSES

CalSTRS' operating expenses can be divided into three broad categories: pension and general administration, investment administration and project-based costs. Pension and general administration costs are primarily authorized by and composed of annual appropriations from the state Budget Act. Investment administrative expenses are primarily continuously appropriated, while project based expenditures are generally annually appropriated.

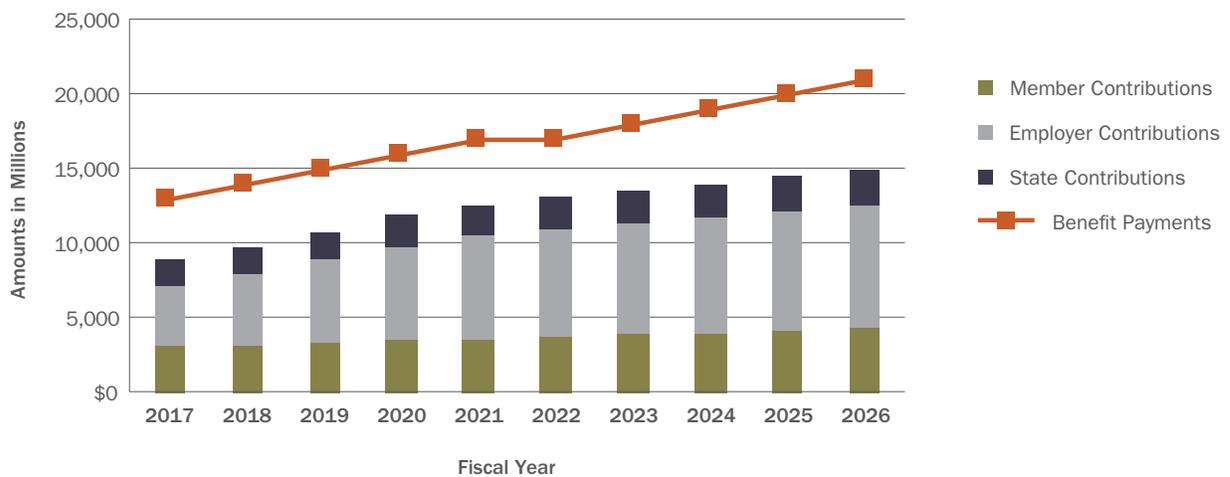
The largest CalSTRS expense is retirement benefit payments, which were approximately \$14 billion in fiscal year 2016–17. Administrative expenses include the direct costs of administering the CalSTRS pension programs, investment costs, and the costs of indirect support functions such as Human Resources, Technology Services, Facilities, Accounting and Procurement.

Administrative costs are driven primarily by salaries and benefits, information technology costs, investment costs and project-based costs. Salary and benefit costs can be forecasted because they 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 as a catalyst. Investment costs are primarily driven by the fees paid to external investment advisors to manage CalSTRS' capital.

CalSTRS accrues expenses for long-term pension and other postemployment benefit costs for our employees in accordance with Governmental Accounting Standards Board statements No. 68 and No. 75; however, these costs are not recognized for budgetary purposes.

The graph below shows projections for contributions and benefit payments over the next 10 years.

Contribution and Benefit Payment Projections



Capital and Debt

CalSTRS does not incur debt to fund administrative or operational needs. The budget is funded through existing resources that are appropriated by the board. Separately, the Investments Branch may incur debt as a leverage strategy for certain types of private assets.

As described in the Capital Projects Budget section, CalSTRS has two large capital projects underway. The first is the Pension Solution project, which has a budgeted cost of \$213 million to be expended over the course of six years during implementation. The

project is not expected to be completed until after 2019–20. In addition, CalSTRS is also exploring the development and construction of a second office tower to support the organization's future growth. The board has approved \$181 million for this effort; however, it has only authorized the expenditure of \$8 million to complete design and construction specifications. If the board ultimately approves the second facility, budgetary expenditures will be incurred throughout the construction period, which is estimated to take three to four years.

THREE-YEAR OVERVIEW AND PROJECTED FUND BALANCES

All Funds

The table below provides summaries of revenues and expenditures for prior year actual expenses, the current year estimated expenditures, and the 2018–19 proposed budget for each of CalSTRS’ major funds. Revenues and expenditures are categorized by type and function respectively. Material changes in revenues and expenditures are driven primarily by statutorily required contribution increases and external management fees based on a growing AUM.

Three-Year Overview and Projected Fund Balances: All Funds				
Budget Category	Actual 16–17	Estimated 17–18	Proposed 18–19	% Change 17–18 to 18–19
Beginning Fund Balance	\$189,465,709	\$210,924,561	\$222,919,607	6%
Revenues				
Investment Income	25,645,252	15,572,774	16,056,119	3
Employer Contributions	4,202,788	4,964,396	5,879,609	18
Member Contributions	3,569,344	3,857,609	4,130,959	7
State Contributions	2,478,230	2,790,445	2,935,000	5
Other Income	73,179	80,160	80,172	0
Total Revenues	\$35,968,793	\$27,265,384	\$29,081,859	7%
Expenses				
Pension Benefit Payments	13,787,501	14,498,760	15,152,063	5
External Investment Expenditures	295,331	263,276	313,434	19
Administrative Expenditures	154,631	263,663	277,468	5
Contribution Refunds	115,509	79,000	76,000	(4)
Other Expenditures	90,949	93,535	97,112	4
Other Benefit Payments	66,020	72,104	74,994	4
Total Expenditures	\$14,509,941	\$15,270,338	\$15,991,071	5%
Ending Fund Balance	\$210,924,561	\$222,919,607	\$236,010,395	6%

\$ in thousands

Teachers' Retirement Fund

The TRF is the largest fund that CalSTRS administers. It encompasses the Defined Benefit, Defined Benefit Supplement, Cash Balance Benefit, and Purchasing Power Protection programs. The budget projects that employer contributions and external investment expenses will increase by 19 percent. Employer contributions will continue to increase through 2021–22 consistent with enacted legislation (AB 1469) and anticipated payroll growth. External investment expenses are also forecasted to increase as a factor of AUM and investment performance.

Three-Year Overview and Projected Fund Balances: Teachers' Retirement Fund				
Budget Category	Actual 16–17	Estimated 17–18	Proposed 18–19	% Change 17–18 to 18–19
Beginning Fund Balance	\$188,790,273	\$210,083,125	\$221,910,547	6%
Revenues				
Investment Income	25,564,164	15,478,277	15,935,797	3
Employer Contributions	4,161,875	4,923,724	5,835,842	19
Member Contributions	3,440,883	3,730,043	3,994,688	7
State Contributions	2,478,230	2,790,445	2,935,000	5
Other Income	71,978	77,610	77,390	0
Total Fund Revenues	\$35,717,130	\$27,000,099	\$28,778,717	7%
Expenses				
Pension Benefit Payments	13,776,142	14,486,150	15,138,822	5
External Investment Expenditures	295,331	263,276	313,434	19
Administrative Expenditures	153,094	260,049	273,864	5
Contribution Refunds	115,509	79,000	76,000	(4)
Other Expenditures	84,202	84,202	84,202	0
Total Fund Expenditures	\$14,424,278	\$15,172,677	\$15,886,322	5%
Ending Fund Balance	\$210,083,125	\$221,910,547	\$234,802,942	6%

\$ in thousands

Teachers' Replacement Benefit Fund

The TRBF provides for the payment of benefits above the Internal Revenue Code 415 threshold. The fund serves as a flow through of benefit payments to eligible retirees of the Defined Benefit Program and does not bear operational or administrative charges.

Three Year Overview and Projected Fund Balances: Teachers' Replacement Benefit Fund				
Budget Category	Actual 16-17	Estimated 17-18	Proposed 18-19	% Change 17-18 to 18-19
Beginning Fund Balance	—	—	—	
Revenues				
Employer Contributions	11,359	12,610	13,241	5%
Total Fund Revenues	\$11,359	\$12,610	\$13,241	5%
Expenses				
Pension Benefit Payments	11,359	12,610	13,241	5%
Total Fund Expenditures	\$11,359	\$12,610	\$13,241	5%
Ending Fund Balance	—	—	—	

\$ in thousands

Pension2

The Pension2 program provides optional deferred compensation plans for CalSTRS members. There is not an operational budget associated to this fund because the program is managed by a third-party vendor. Specific activities associated with outreach and marketing of the Pension2 program are reported within the Teachers' Deferred Compensation Fund. Consistent with CalSTRS' goal of securing the financial future of our members is to encourage participation in deferred compensation programs such as Pension2. CalSTRS' marketing of the Pension2 program has significantly increased the level of contributions to the program as displayed in the adjacent table. The larger asset base is also driving larger investment returns relative to prior years. Similarly, other expenditures, which include investment management costs, are also anticipated to increase along with the growing asset base.

Three Year Overview and Projected Fund Balances: Pension2				
Budget Category	Actual 16-17	Estimated 17-18	Proposed 18-19	% Change 17-18 to 18-19
Beginning Fund Balance	\$673,509	\$839,786	\$1,007,853	20%
Revenues				
Member Contributions	128,461	127,566	136,271	7%
Employer Contributions	437	551	464	(16%)
Investment Income	81,068	94,477	120,297	27%
Other Income	149	160	172	8%
Total Fund Revenues	\$210,115	\$222,754	\$257,204	15%
Expenses				
Other Benefit Payments	37,091	45,354	45,354	0%
Other Expenditures	6,747	9,333	12,910	38%
Total Fund Expenditures	\$43,838	\$54,687	\$58,264	7%
Ending Fund Balance	\$839,786	\$1,007,853	\$1,206,793	20%

\$ in thousands

Teachers' Deferred Compensation Fund

The TDCF is used to account for ancillary activities associated with deferred compensation plans. It is funded by the fee revenues received from the Pension2 participating plans, a vendor registration program, and an employer compliance assistance program.

In 2016–17, an internal cost allocation study indicated that the TDCF budget was not bearing an adequate percentage of CalSTRS' general administration costs. As a result, costs allocated to the TDCF budget have increased and corresponding costs to the TRF have decreased. This allocation activity has caused a significant decrease in the fund balance for 2018–19; however, CalSTRS anticipates the fund balance will stabilize and ultimately grow in future years to due planned increases in fee revenue.

Three-Year Overview and Projected Fund Balances: Teachers' Deferred Compensation Fund				
Budget Category	Actual 16–17	Estimated 17–18	Proposed 18–19	% Change 17–18 to 18–19
Beginning Fund Balance	\$1,356	\$1,057	\$610	(42%)
Revenues				
Investment Income	9	10	11	10
Other Income	1,052	2,390	2,610	9
Total Fund Revenues	\$1,061	\$2,400	\$2,621	9%
Expenses				
Administrative Expenditures	1,360	2,847	2,899	2
Other Benefit Payments	—	—	9	
Total Fund Expenditures	\$1,360	\$2,847	\$2,908	2%
Ending Fund Balance	\$1,057	\$610	\$323	(47%)

\$ in thousands

Teachers' Health Benefit Fund

The THBF supports the CalSTRS' MPP 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 of approximately \$600,000. Based on improved cash forecasting processes, it is anticipated that the fund balance will be further reduced in 2018–19.

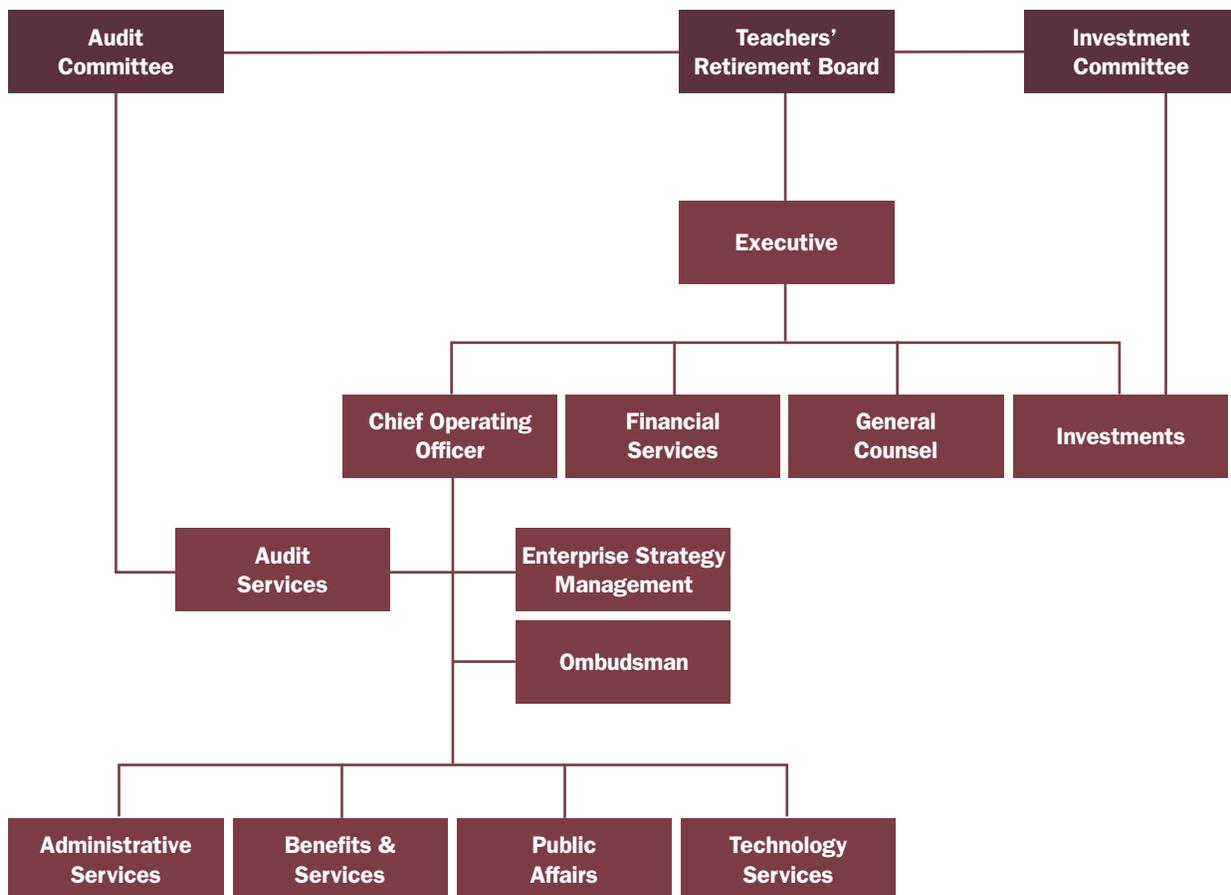
Three-Year Overview and Projected Fund Balances: Teachers' Health Benefit Fund				
Budget Category	Actual 16–17	Estimated 17–18	Proposed 18–19	% Change 17–18 to 18–19
Beginning Fund Balance	\$571	\$593	\$597	1%
Revenues				
Investment Income	11	10	14	40
Employer Contributions	29,117	27,511	30,062	9
Total Fund Revenues	\$29,128	\$27,521	\$30,076	9%
Expenses				
Administrative Expenditures	177	767	705	(8)
Other Benefit Payments	28,929	26,750	29,631	11
Total Fund Expenditures	\$29,106	\$27,517	\$30,336	10%
Ending Fund Balance	\$593	\$597	\$337	(44%)

\$ in thousands

DEPARTMENTAL INFORMATION

Art glass by Paul Housberg, 2009

THE CALSTRS ORGANIZATION



Art glass by Paul Housberg, 2009

Overall, CalSTRS' position authority will increase by 58 authorized positions, but the staff count is expected to increase by 14 positions from fiscal year 2017–18 to 2018–19. These positions will be in the Investments, Administrative Services and General Counsel branches. The table below shows the prior, current and budget year position counts. Blanket positions are temporary positions used to meet operational needs.

Summary Table of Position Counts			
Staff Type	2016–17	2017–18	2018–19
Authorized Positions	1044	1084	1142
Blanket Positions	195.5	195.5	195.5
Totals	1239.5	1279.5	1337.5

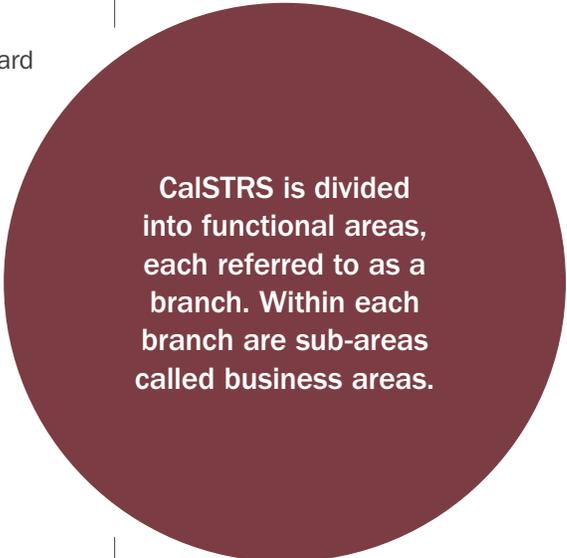
Position Control

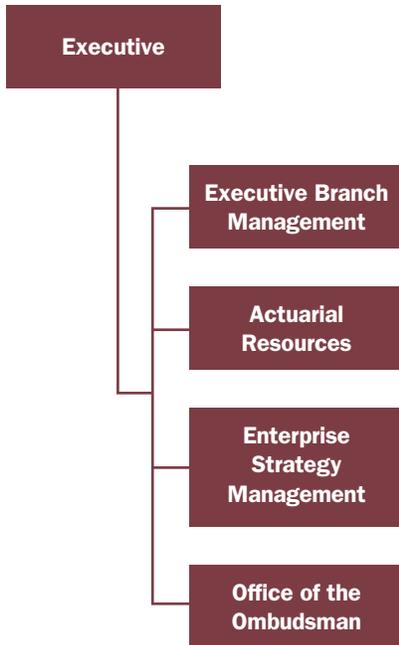
The CalSTRS workforce included 1,044 regular authorized positions as of June 30, 2017. To manage the variations in workload and/or large projects that are limited term in nature, CalSTRS maintains authority to establish additional full-time positions above the authorized limit to the extent that funding 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 state 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.

BRANCH INFORMATION

CalSTRS is divided into functional areas, each referred to as a branch. Within each branch are sub-areas called business areas. A description of each branch's activities and functions follow. Budgets and positions for each branch are shown for fiscal years 2016–17, 2017–18 and 2018–19. These totals include salaries, benefits, and operating expenses and equipment.



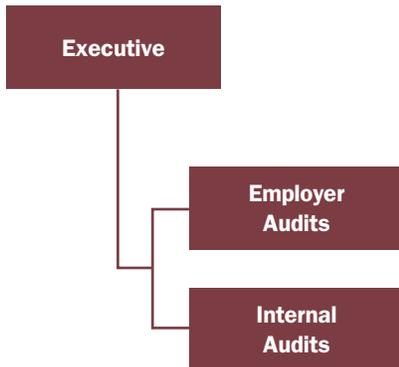


Executive

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 16-17	Estimated 17-18	Proposed 18-19
Authorized Positions	34	34	34
Budget	\$6,928,282	\$6,362,217	\$7,205,294



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 and consulting services designed to add value and improve CalSTRS’ operations. This branch assists CalSTRS in accomplishing our 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 16-17	Estimated 17-18	Proposed 18-19
Authorized Positions	33	33	33
Budget	\$6,380,246	\$5,041,147	\$5,191,664

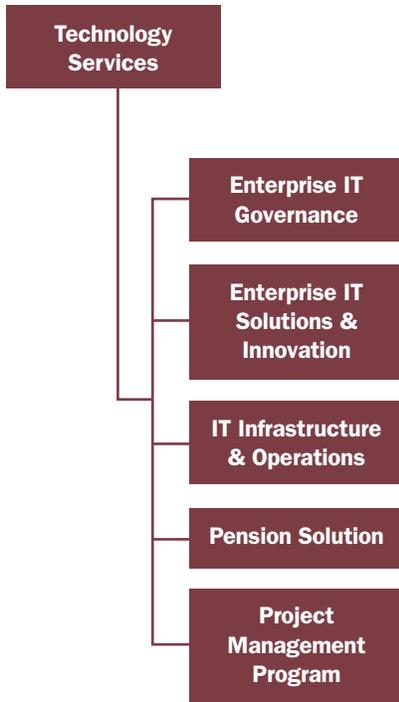


Investments

The Investments Branch oversees and manages the CalSTRS Investment Portfolio, which is valued at approximately \$221.7 billion as of November 30, 2017. The branch is composed of the Private Equity, Global Equity/Corporate Governance, Fixed Income, Real Estate, Inflation Sensitive, Risk Mitigating Strategies, Innovative Strategies, Strategic Overlay and Cash/Liquidity asset classes, and Operations and Investment Compliance units. The branch's primary performance objective is to achieve the actuarially assumed rate of return at a prudent level of risk. The Investments 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 16-17	Estimated 17-18	Proposed 18-19
Authorized Positions	155	168	223
Budget	\$32,405,283	\$38,451,976	\$54,702,626



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. It is responsible for agile delivery of quality, innovative, reliable and secure technology services in support of CalSTRS’ core operational functions and business strategy.

Furthermore, Technology Services contributes to responsible management of CalSTRS’ IT assets through enforcing sensible IT governance, implementing information security, promoting quality management, performing proactive and preventive maintenance as well as continual improvement.

Key Statistics

	Fiscal Year		
	Actual 16-17	Estimated 17-18	Proposed 18-19
Authorized Positions	158	158	158
Budget	\$72,337,913	\$83,812,436	\$75,662,637

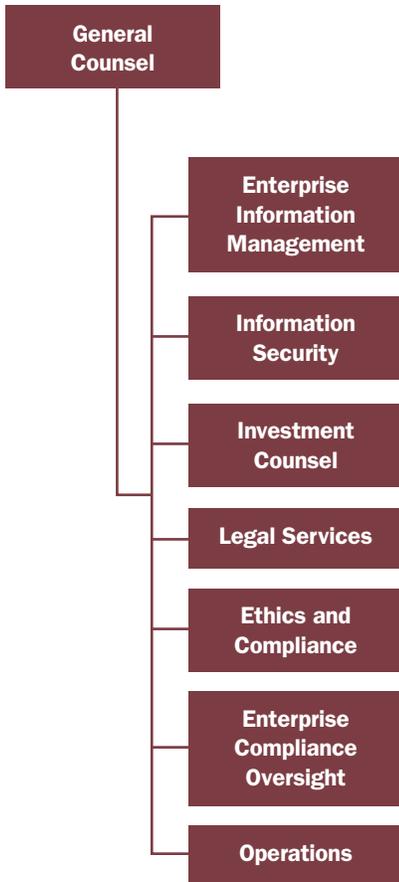


Financial Services

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. Financial Services 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 16-17	Estimated 17-18	Proposed 18-19
Authorized Positions	92.5	97.5	97.5
Budget	\$11,268,822	\$11,005,890	\$11,580,411

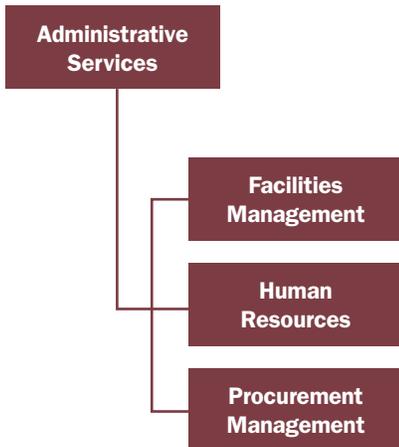


General Counsel

The General Counsel Branch provides legal advice and support to CalSTRS programs, executive management and the 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, Ethics and Compliance, Enterprise Compliance Oversight and Operations.

Key Statistics

	Fiscal Year		
	Actual 16-17	Estimated 17-18	Proposed 18-19
Authorized Positions	42	48	50
Budget	\$8,568,887	\$7,584,870	\$8,318,023

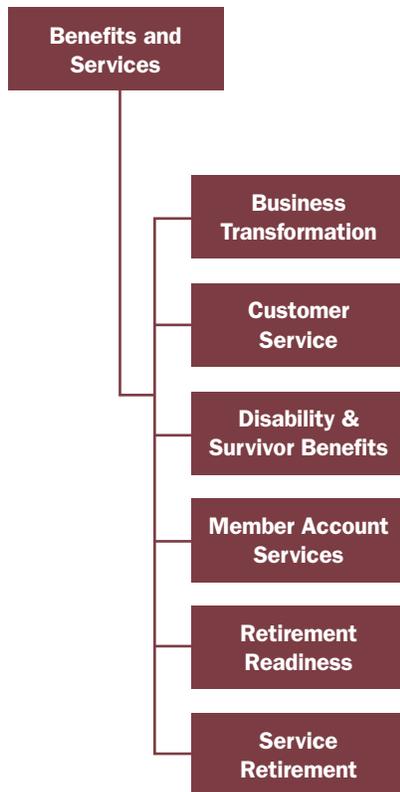


Administrative Services

The Administrative Services Branch provides Facility Management, Human Resources 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 16-17	Estimated 17-18	Proposed 18-19
Authorized Positions	107.5	110.5	111.5
Budget	\$17,945,985	\$19,216,083	\$19,863,079

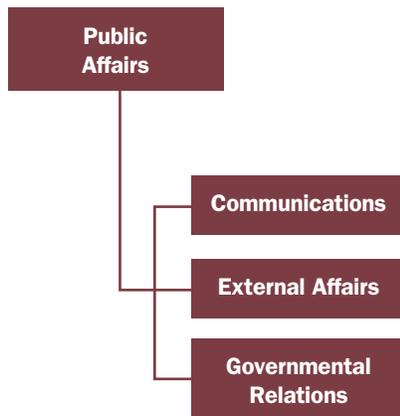


Benefits and Services

The Benefits and Services Branch is the largest business area in the CalSTRS organization. The branch's six lines of business include: Customer Service, Disability and Survivor Benefits, Member Account Services, Retirement Readiness, Service Retirement and Business Transformation. The branch's primary goal is to deliver excellent service and secure the financial future for 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. That goal further includes the delivery of appropriate retirement or disability benefits, delivering effective education to members, and the extension of benefits to survivors. Of the amount for resources displayed below, \$6.9 million and 35 positions are for the satellite member service centers located throughout California.

Key Statistics

	Fiscal Year		
	Actual 16-17	Estimated 17-18	Proposed 18-19
Authorized Positions	390	403	403
Budget	\$41,579,562	\$45,564,100	\$47,280,602



Public Affairs

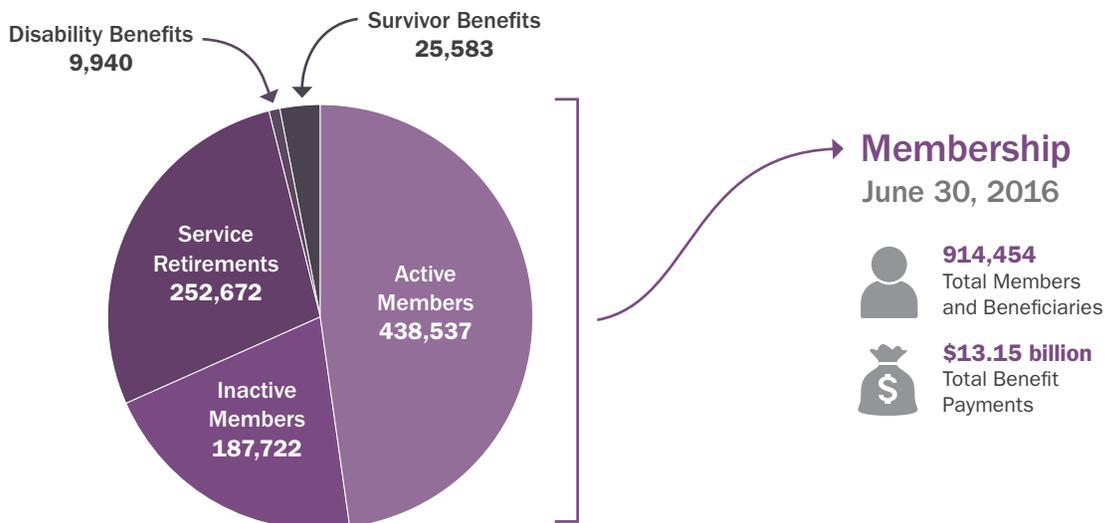
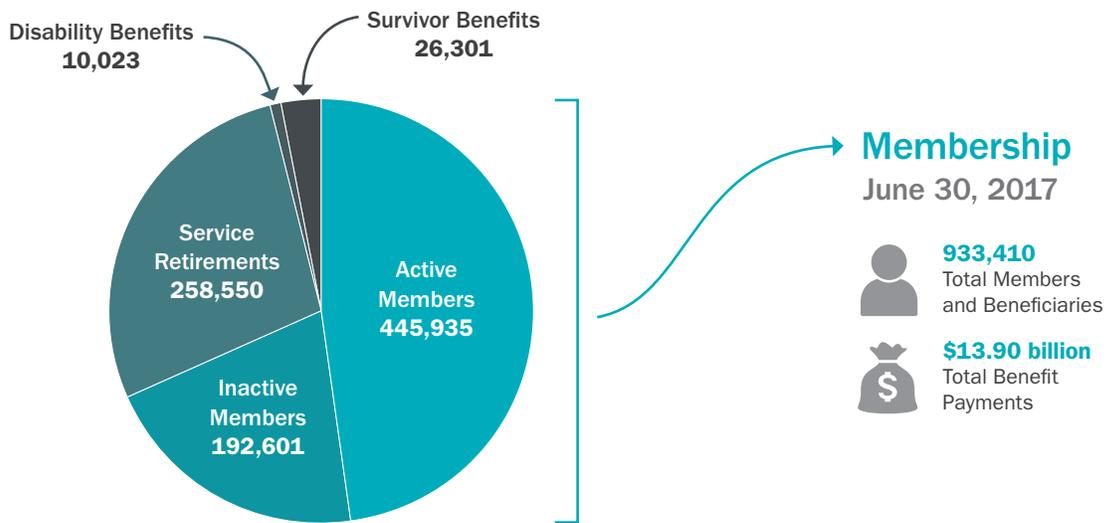
The Public Affairs Branch manages CalSTRS' relationships with the state, CalSTRS members and the public. As part of this effort, the branch serves as the primary liaison between CalSTRS and key stakeholders to provide a clear and consistent message regarding CalSTRS' priorities, operational activities 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 16-17	Estimated 17-18	Proposed 18-19
Authorized Positions	32	32	32
Budget	\$5,008,094	\$5,148,546	\$5,278,239

APPENDIX

STATISTICAL AND SUPPLEMENTAL DATA



ANNUAL RETIREMENT STATISTICS

July 1, 2016–June 30, 2017



62.9

Median age
of retirement



\$13.8 billion

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



\$4,266

Median monthly
Member-Only
Benefit



25.6

Median years of
service credit



56

Percent of
members
selecting the
Member-Only
Benefit



12,247

Number of
defined
benefit
retirements

CALSTRS RETIREMENT BENEFITS FUEL LOCAL ECONOMIES

CalSTRS paid an estimated \$11 billion in benefits to 221,052 retirees living in California during fiscal year 2016–17. This map indicates the number of retired members living in each county and the amount of benefits paid to those members, as well as the locations of the CalSTRS member service centers.

County	Retirees
Alameda	7,514
Alpine	12
Amador	439
Butte	2,340
Calaveras	590
Colusa	122
Contra Costa	7,464
Del Norte	235
El Dorado	2,098
Fresno	6,165
Glenn	179
Humboldt	1,345
Imperial	762
Inyo	156
Kern	4,169
Kings	590
Lake	474
Lassen	218
Los Angeles	42,304
Madera	1,308
Marin	2,134
Mariposa	265
Mendocino	1,132
Merced	1,479
Modoc	89
Mono	176
Monterey	2,988
Napa	1,432
Nevada	1,587
Orange	20,416
Placer	4,112
Plumas	325
Riverside	12,118
Sacramento	8,812
San Benito	306
San Bernardino	8,986
San Diego	20,571
San Francisco	2,878
San Joaquin	3,845
San Luis Obispo	4,046
San Mateo	3,722
Santa Barbara	2,891
Santa Clara	9,352
Santa Cruz	2,710
Shasta	1,641
Sierra	76
Siskiyou	604
Solano	2,931
Sonoma	4,610
Stanislaus	3,082
Sutter	748
Tehama	648
Trinity	146
Tulare	3,006
Tuolumne	678
Ventura	6,615
Yolo	1,072
Yuba	339
Total	221,052



CALSTRS' LEGISLATIVE ACTIVITIES

The board's legislative policies are driven by an overall goal to prevent and remove 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 retirement-related bills that impact the pension system. As part of this engagement, CalSTRS monitors state and federal legislation that impact areas of the organization, including investments, actuarial services and benefits. 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.



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/ services are received).

Appropriation

Legal 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 their total authorized positions to the extent that additional costs can be absorbed within their 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 or "carryforward."

Central Administrative Services

The amount of state administrative costs that are chargeable to and recovered from special funds as determined by the DOF.

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 for which other fiscal transactions are recognized. In 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.

Prior-Year Adjustment

In the Governor's budget, an adjustment for the difference between previously estimated accruals used in the development of the last Governor's budget and actual expenditures or revenues. The adjustment amount is generally included to realign the beginning fund balance to ensure accurate fund balances.

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