

California Public Employees' Retirement System

Fiscal Year 2021-22 Mid-Year Budget

November 16, 2021



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Executive Summary

This Mid-Year Budget reflects adjustments to the 2021-22 Annual Budget approved by the Board of Administration on April 20, 2021. The Annual Budget continued many of the permanent reductions made in the prior year, including a \$5 million reduction in Personal Services from eliminating 32 vacant positions and reducing Temporary Help and Overtime. Similarly, reductions for several OE&E costs have continued, such as reducing printing and postage by electronically distributing the PERSperspective publications. These ongoing reductions enabled CalPERS to exceed the Governor's \$5 million savings target that was established before post-pandemic contract negotiations were complete. However, mandated Covid testing and accommodating long-term teleworking has resulted in some increased expenses. As such, CalPERS continues to scrutinize its budget to identify further savings.

For the 2020-21 Mid-Year Budget, CalPERS proposes an \$8.9 million (0.5 percent) net increase. This includes an Operating Cost increase of \$10.0 million (1.5 percent), primarily driven by collectively bargained salary and benefit adjustments and unforeseen administrative expenses related to the pandemic and board elections. Within Fees, there is a \$1.1 million net decrease in External Investment Management Fees and Third Party Administrator Fees to reflect revised investment strategies and updated health plan enrollment projections, respectively. Total authorized positions remain unchanged at 2,843.

2021-22 Mid-Year Total Budget

| (\$ in thousands) | 2021-22 Authorized Annual Budget | Mid-Year Adjustments | 2021-22 Proposed Mid-Year Budget | % Change From Annual |
|-------------------------------------|--|-------------------------|--|----------------------------|
| Administrative Operating Costs | \$536,053 | \$19,224 | 555,276 | 3.6% |
| Investment Operating Costs | 130,613 | (9,220) | 121,393 | (7.1%) |
| Headquarters Building Costs | 18,450 | (35) | 18,415 | (0.2%) |
| Total: Operating Costs | \$685,115 | \$9,968 | \$695,084 | 1.5% |
| Investment External Management Fees | 899,648 | (1,151) | 898,497 | (0.1%) |
| Third Party Administrator Fees | 303,517 | 35 | 303,552 | 0.0% |
| Total: Fees | \$1,203,165 | (\$1,116) | \$1,202,049 | (0.1%) |
| CalPERS Total Budget | \$1,888,280 | \$8,853 | \$1,897,133 | 0.5% |
| Total Positions | 2,843.0 | | 2,843.0 | 0.0% |

The following pages detail the 2021-22 Mid-Year adjustments by expenditure category.

I. Administrative Operating Costs

Administrative Operating Costs include personal services expenditures (salaries, wages, and benefits for team members) and Operating Expenses and Equipment (OE&E). At mid-year, CalPERS proposes a \$19.2 million (3.6 percent) increase for these expenses. This includes a \$16.7 million increase for Personal Services, and a \$2.5 million increase for OE&E.

The Personal Services increase includes \$14.4 million for statewide compensation and benefit adjustments negotiated through collective bargaining, \$1.0 million to update salary levels for interchangeable analyst positions, \$1.2 million for Workers' Compensation costs, and \$0.1 million to fund temporary help positions to assist with implementing and monitoring new Covid testing requirements and return to office coordination.

The OE&E increase includes \$0.9 million to fund a contract to administer mandated, weekly Covid tests, \$0.5 million to fund the unforeseen public agency board member special election, \$0.4 million for new contracts to obtain death notification data, \$0.4 million for increased costs related to independent medical examinations for disability retirements, \$0.4 million for executive searches, and \$0.3 million in anticipated increases for insurance premium renewals.

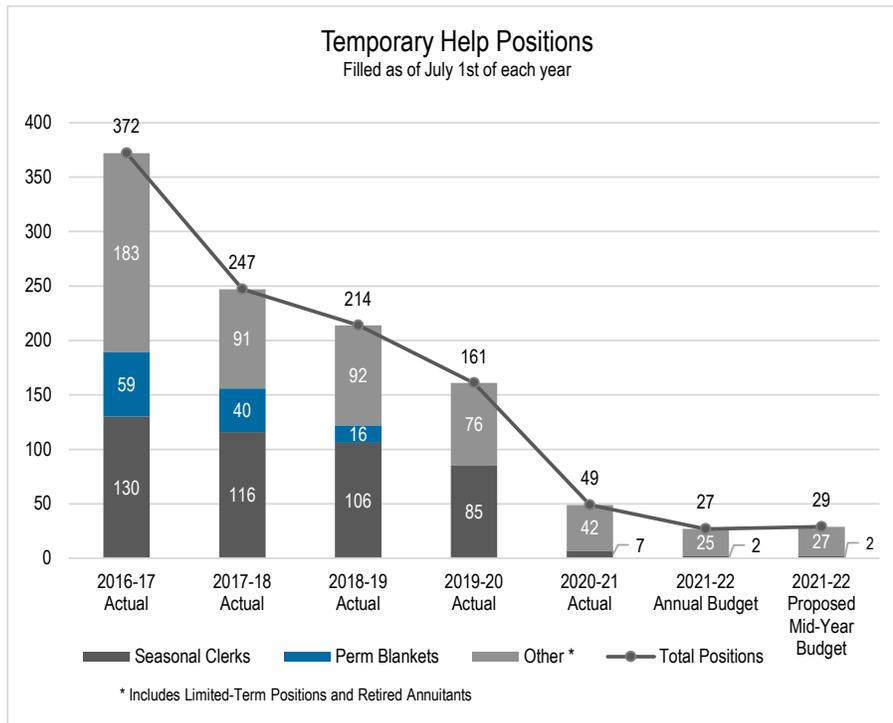
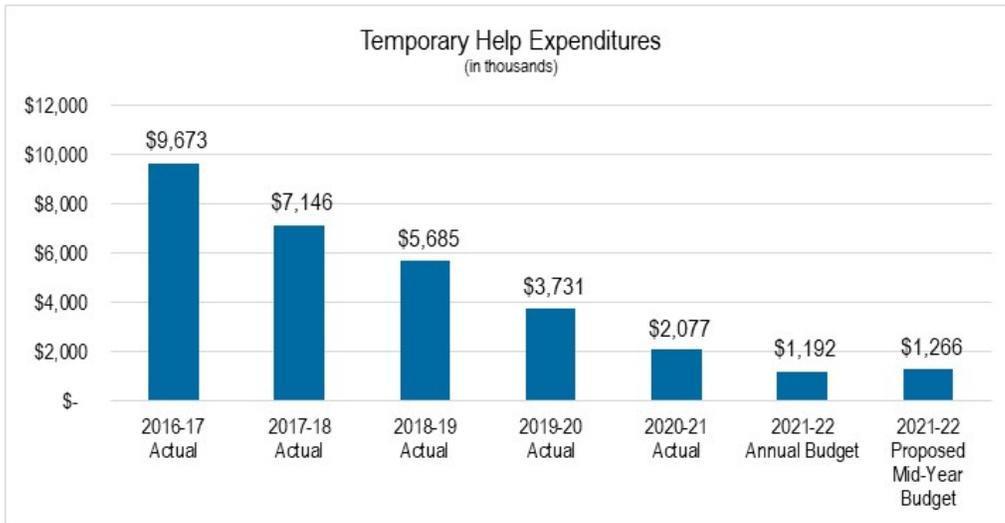
Offsetting the above are minor decreases in Overtime, Software, Printing, Travel, and Training expenses based on a review of operations and the continued impact of the pandemic and telework environment. Moreover, the reduction in Facilities Operations costs reflects the affiliate funds' share of Headquarters Building Costs, the total for which decreased as explained on pages 10 and 11.

Administrative Operating Costs by Object of Expenditure

| (in thousands) | 2021-22 Authorized Annual Budget | 2021-22 Proposed Mid-Year Budget | Change From Annual | |
|---|--|--|-----------------------------|----------------------------|
| | | | \$ Increase / (Decrease) | % Increase / (Decrease) |
| [1] PERSONAL SERVICES | | | | |
| Salaries & Wages | \$ 271,830 | \$ 282,776 | \$ 10,947 | 4.0% |
| Temporary Help | 1,192 | 1,266 | 73 | 6.1% |
| Overtime | 1,360 | 1,319 | (41) | (3.0%) |
| Benefits | 135,097 | 140,809 | 5,712 | 4.2% |
| Total Personal Services | \$ 409,479 | \$ 426,170 | \$ 16,691 | 4.1% |
| [2] OPERATING EXPENSES & EQUIPMENT | | | | |
| General Expense | \$ 8,884 | \$ 9,178 | \$ 293 | 3.3% |
| Software | 5,988 | 5,987 | (1) | (0.0%) |
| Printing | 746 | 744 | (2) | (0.3%) |
| Postage | 2,645 | 2,795 | 150 | 5.7% |
| Communications | 1,615 | 1,615 | - | 0.0% |
| Data Processing Services | 21,439 | 21,439 | - | 0.0% |
| Travel | 1,978 | 1,837 | (140) | (7.1%) |
| Training | 1,116 | 1,073 | (43) | (3.9%) |
| Medical Exam/Disability Travel | 1,250 | 1,625 | 375 | 30.0% |
| Facilities Operations | 7,713 | 7,508 | (204) | (2.6%) |
| Central Administrative Services | 30,924 | 30,924 | - | 0.0% |
| University Enterprises, Inc. | 444 | 444 | - | 0.0% |
| External Legal Counsel | 6,141 | 6,141 | - | 0.0% |
| Professional Services | 4,433 | 4,511 | 78 | 1.8% |
| Consultants | 21,076 | 23,103 | 2,027 | 9.6% |
| Audit Services | 1,607 | 1,607 | - | 0.0% |
| Federal Legislative Rep | 552 | 552 | - | 0.0% |
| Admin Hearings | 1,402 | 1,402 | - | 0.0% |
| Consolidated Data Centers | 310 | 310 | - | 0.0% |
| Equipment (Includes EDP) | 6,310 | 6,310 | - | 0.0% |
| Total Operating Expenses & Equipment | \$ 126,573 | \$ 129,106 | \$ 2,532 | 2.0% |
| Total Costs | \$ 536,053 | \$ 555,276 | \$ 19,224 | 3.6% |

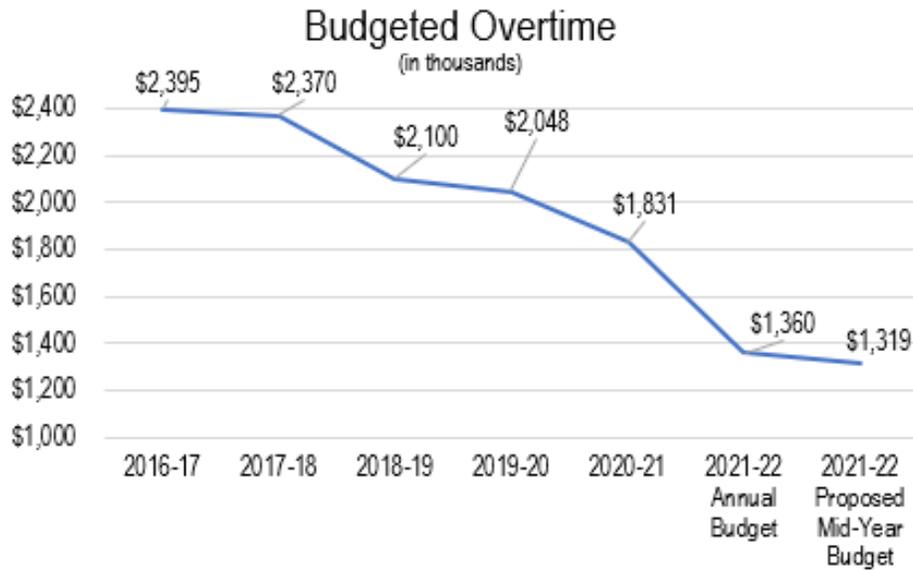
Temporary Help

Included in the Administrative Operating Costs budget is funding for temporary help positions, which includes Seasonal Clerks, Retired Annuitants, and limited-term positions. This line item also includes funding for board members' employer reimbursements. At mid-year, CalPERS proposes an increase of \$0.1 million for two additional retired annuitant positions to assist with mandated Covid testing requirements and return to office coordination. Of the total \$1.3 million proposed at mid-year, \$0.7 million is budgeted for temporary help positions, and \$0.6 million for board member reimbursements.



Overtime

Over the past several years, CalPERS has significantly reduced overtime expenses. The Mid-Year Budget reduces funds for overtime by an additional \$41,000.



II. Investment Operating Costs

Investment Operating Costs include expenditures incurred to support investment activities, such as consultants to inform the board of investment initiatives or to implement investment technologies and platforms; external audit, legal, and appraisal services related to asset valuations; fund administration and custody; data and analytics software; and maintaining or implementing trading and portfolio management systems.

At mid-year, CalPERS proposes a net decrease of \$9.2 million (7.1 percent) in Investment Operating Expenses. This includes a \$0.2 million decrease in Technology Consultant expenses and a \$9.0 million decrease for Total Technology expenses. These decreases are mainly due to continued review and analysis of technology projects resulting in a decision to not pursue development of a single investment platform for public asset classes. These decreases are offset by a \$0.7 million increase for Data expenses due to new Long Term Care Fund benchmarking services and related fees.

Investment Operating Costs

| (in thousands) | 2021-22 Authorized Annual Budget | Mid-Year Adjustments | 2021-22 Proposed Mid-Year Budget | % Change |
|--|--|-------------------------|--|----------------|
| Investment Consultants | \$10,000 | \$ - | \$10,000 | 0.0% |
| Board Consultants | 5,717 | - | 5,717 | 0.0% |
| Technology Consultants | 7,775 | (220) | 7,555 | (2.8%) |
| Total Consultant Expenses | \$23,491 | (\$220) | \$23,271 | (0.9%) |
| Audits | \$705 | \$ - | \$705 | 0.0% |
| Tax Advisory Services | 1,200 | - | 1,200 | 0.0% |
| Master Custodian Fee | 12,535 | - | 12,535 | 0.0% |
| Fund Administration Services / Fees | 3,848 | - | 3,848 | 0.0% |
| External Legal | 5,800 | - | 5,800 | 0.0% |
| Appraisal Fees | 10,000 | - | 10,000 | 0.0% |
| Company Expense | 450 | - | 450 | 0.0% |
| Miscellaneous Operating Expense | 300 | - | 300 | 0.0% |
| Total Operating Expenses | \$34,837 | \$ - | \$34,837 | 0.0% |
| Data | \$7,451 | \$ 700 | \$8,151 | 9.4% |
| Analytics | 20,505 | (2,300) | 18,205 | (11.2%) |
| Trading and Portfolio Management Systems | 39,473 | (6,400) | 33,073 | (16.2%) |
| Business Operations Tool | 4,676 | (1,000) | 3,676 | (21.4%) |
| Other Technology Expense | 178 | - | 178 | 0.0% |
| Total Technology Expenses | \$72,284 | (\$9,000) | \$63,284 | (12.5%) |
| Total Investment Operating Expenses | \$130,613 | \$ (9,220) | \$121,393 | (7.1%) |

III. Headquarters Building Costs

Headquarters Building expenses include amounts necessary to operate, maintain, and improve the Lincoln Plaza Buildings and regional offices, as well as the emergency operations center, Front Street parking lot, and warehouse space.

At mid-year, CalPERS proposes a \$0.2 million decrease in Headquarters Building costs. This includes a \$0.9 million decrease in Operating Costs driven by the remote work environment, including a reduction in engineering, security, and general maintenance services, as well as lower estimated expenses for the cafe and regional offices. These decreases are offset by a \$0.3 million increase in Non-Operating Costs for plumbing modifications to mitigate and prevent water system issues within the Lincoln Plaza buildings. Further, the Headquarters Building Budget reflects a reduction in anticipated parking revenues.

Headquarters Building Costs

| (in thousands) | 2021-22 Authorized Annual Budget | Mid-Year Adjustments | 2021-22 Proposed Mid-Year Budget | From Annual % Increase/(Decrease) |
|--|--|-------------------------|--|---|
| Operating: | | | | |
| Utilities | \$2,402 | \$ - | \$2,402 | 0.0% |
| Engineering Services | 3,978 | (335) | 3,643 | (8.4%) |
| Janitorial | 3,598 | - | 3,598 | 0.0% |
| Landscaping | 689 | - | 689 | 0.0% |
| General Maintenance | 1,089 | (68) | 1,020 | (6.3%) |
| Security | 2,546 | (254) | 2,291 | (10.0%) |
| Property Mgmt. & Administrative Fees | 1,360 | - | 1,360 | 0.0% |
| Café Plaza | 253 | (71) | 182 | (27.9%) |
| Offsite Expenses ¹ | 891 | (90) | 801 | (10.1%) |
| Emergency Operations Center (EOC) ² | 504 | - | 504 | 0.0% |
| Operating Other ³ | 1,881 | (90) | 1,791 | (4.8%) |
| Total Operating Expenses | \$19,190 | (\$908) | \$18,282 | (4.7%) |
| Non-Operating: | | | | |
| Owner Improvements ⁴ | 2,129 | - | 2,129 | 0.0% |
| Building Improvements ⁵ | 1,583 | 261 | 1,844 | 16.5% |
| Furniture & Fixtures | 190 | - | 190 | 0.0% |
| Building Insurance | 660 | - | 660 | 0.0% |
| Total Non-Operating Expenses | \$4,562 | \$261 | 4,824 | 5.7% |
| Subtotal Expenses | \$23,753 | (\$647) | \$23,106 | (2.7%) |
| Less: Revenue ⁶ | (867) | 408 | (459) | (47.0%) |
| Total HQ Building Expenses | \$22,886 | (\$239) | \$22,646 | (1.0%) |
| Less: Amount included in Admin. Budget | (4,435) | 204 | (4,231) | (4.6%) |
| Total Headquarters Building Budget | \$18,450 | (\$35) | \$18,415 | (0.2%) |

¹ Offsite expenses include Front Street parking, warehouse space, and regional office security and maintenance.

² EOC expenses include leasing costs, utilities, janitorial, security, landscaping, and generator maintenance.

³ Other Operating expenses includes specialized maintenance, permitting, and testing of building electrical and HVAC systems, and green building initiatives.

⁴ Owner Improvements include enhancements made to support operations and the movement of divisions, units, and/or staff within CalPERS.

⁵ Building Improvements include structural alterations and repairs and related project management.

⁶ Estimated revenue from parking and onsite leases.

IV. Investment External Management Fees

Investment External Management Fees represent amounts CalPERS pays to external investment advisors with whom it contracts to manage specific portfolios. At mid-year, CalPERS proposes a net decrease of \$1.2 million (0.1 percent) for Base Fee adjustments. This includes a \$6.9 million decrease in Global Equity related to a deployment delay for the multi-factor model, an increase of \$4.0 million in Fixed Income to reflect updated AUM assumptions, an increase of \$12.2 million in Real Assets resulting from new infrastructure investments, and a decrease of \$10.5 million in Opportunistic Strategies driven by updated market dislocation projections.

Investment External Management Fees

| (in thousands) | 2021-22 Authorized Annual Budget | Mid-Year Adjustments | 2021-22 Proposed Mid-Year Budget | % Change |
|---|--|-------------------------|--|---------------|
| Global Equity | \$43,729 | \$ (6,930) | \$36,799 | (15.8%) |
| Fixed Income | 14,925 | 4,060 | 18,985 | 27.2% |
| Real Assets | 224,088 | 12,200 | 236,288 | 5.4% |
| Absolute Return Strategy | 25 | - | 25 | 0.0% |
| Private Equity | 340,000 | - | 340,000 | 0.0% |
| Opportunistic Strategies | 48,375 | (10,480) | 37,895 | (21.7%) |
| External Mgmt - Base Fees | \$671,143 | \$ (1,151) | \$669,992 | (0.2%) |
| Global Equity | \$8,085 | \$ - | \$8,085 | 0.0% |
| Real Assets | 220,420 | - | \$220,420 | 0.0% |
| External Mgmt - Performance Fees | \$228,505 | \$ - | \$228,505 | 0.0% |
| Total External Mgmt Fees | \$899,648 | \$ (1,151) | \$898,497 | (0.1%) |

V. Third Party Administrator Fees

CalPERS contracts with Third Party Administrators to support the delivery of health and pension services. The fees cover administration, recordkeeping, and communication with participants. At mid-year, CalPERS proposes an increase of \$35,000 (0.01 percent). This includes a \$0.3 million decrease in Health Program fees based on updated enrollment projections, and a \$0.3 million increase for the Long Term Care Program to account for processing fees that were excluded from the budget in error.

Third Party Administrator Fees

| (\$ in thousands) | 2021-22 Authorized Annual Budget | Mid-Year Adjustments | 2021-22 Proposed Mid-Year Budget | From Annual % Increase/(Decrease) |
|--|--|-------------------------|--|---|
| Health Program | \$ 264,216 | \$ (258) | \$ 263,958 | (0.1%) |
| Pharmacy Benefit Manager | 17,102 | - | 17,102 | 0.0% |
| Total, Health | 281,318 | (258) | 281,060 | (0.1%) |
| | | | | |
| Long Term Care Program | 18,691 | 293 | 18,985 | 1.6% |
| | | | | |
| Supplemental Income Plan | 3,400 | - | 3,400 | 0.0% |
| | | | | |
| California Employers' Retiree Benefit Trust (CERBT) | 90 | - | 90 | 0.0% |
| | | | | |
| California Employers' Pension Prefunding Trust (CEPPT) | 18 | - | 18 | 0.0% |
| | | | | |
| Total Third Party Administrator Fees | \$303,517 | \$35 | \$303,552 | 0.01% |

I. Administrative Operating Costs by Branch

The following chart details Administrative Operating Costs by branch. In addition to statewide compensation and benefit adjustments affecting the entire organization, additional increases are a result of the adjustments discussed on page 4, as follows:

- Customer Services and Support: increase due to independent medical examination costs and contracts to obtain death notification data.
- Enterprise Compliance: increase for anticipated insurance premium renewals.
- Operations and Technology: increase related to board elections, Covid testing, Workers' Compensation, and executive searches.

Administrative Operating Costs by Branch

| (\$ in thousands) | 2021-22 Authorized Annual Budget | Mid-Year Adjustments | 2021-22 Proposed Mid-Year Budget | From Annual % Increase/(Decrease) |
|---|--|-------------------------|--|---|
| Actuarial Office | \$ 12,504 | \$ 445 | \$ 12,949 | 3.6% |
| Communications and Stakeholder Relations | 12,775 | 409 | 13,183 | 3.2% |
| Customer Services and Support | 105,044 | 4,919 | 109,963 | 4.7% |
| Enterprise Compliance Office | 5,606 | 184 | 5,791 | 3.3% |
| Executive Office | 8,725 | 50 | 8,775 | 0.6% |
| Financial Office | 34,221 | 1,171 | 35,392 | 3.4% |
| General Counsel | 36,957 | 1,209 | 38,166 | 3.3% |
| Health Policy and Benefits Branch | 31,109 | 1,339 | 32,448 | 4.3% |
| Investment Office | 92,517 | 1,250 | 93,767 | 1.4% |
| Operations and Technology | 165,671 | 8,247 | 173,918 | 5.0% |
| Pro-Rata Assessment | 30,924 | - | 30,924 | 0.0% |
| Total Administrative Operating Costs | \$ 536,053 | \$ 19,224 | \$ 555,276 | 3.6% |

II. Administrative Operating Costs by Fund

Funds for Administrative Operating costs are appropriated annually and available for encumbrance or expenditure for one fiscal year. In contrast, funds for Investment Operating Costs, Headquarters Building Costs, Investment External Manager Fees, and Third Party Administrator Fees are continuously appropriated pursuant to Board of Administration authority set by the Government Code. While the board has authority to set the budget and expenditures from most trusts and funds, appropriations from the Public Employees' Contingency Reserve Fund (CRF), Public Employees' Health Care Fund (HCF), and Old-Age & Survivors Insurance (OASI) Fund are authorized by the Legislature. The culmination of each annual and mid-year budget cycle is the distribution, or allocation, of administrative costs to the trusts and state funds. This is done through a process designed to match expenses to the funds that receive the related benefit. Allocations to the CRF, HCF, and OASI are limited to the amounts appropriated by the Legislature. The following allocation establishes the funding authority for Administrative Operating Costs, and will be provided to the State Controller's Office to effectuate the transfer and payment of funds for these expenses in fiscal year 2021-22.

Administrative Operating Costs by Fund

| (\$ in thousands) | 2021-22 Authorized Annual Budget | 2021-22 Proposed Mid-Year Budget | Change from Annual | |
|--|--|--|-----------------------------|----------------------------|
| | | | \$ Increase / (Decrease) | % Increase / (Decrease) |
| Administrative Operating Costs | | | | |
| Public Employees' Retirement Fund (PERF) | \$ 423,324 | \$ 443,169 | \$ 19,844 | 4.7% |
| Public Employees' Contingency Reserve Fund (CRF) | 34,262 | 35,241 | 979 | 2.9% |
| Public Employees' Health Care Fund (HCF) | 49,356 | 50,762 | 1,406 | 2.8% |
| Long-Term Care Fund (LTCF) | 11,592 | 7,468 | (4,124) | (35.6%) |
| Annuitants' Health Care Coverage Fund (AHCCF) | 6,839 | 7,285 | 446 | 6.5% |
| Deferred Compensation Fund (IRC 457) | 1,728 | 1,837 | 109 | 6.3% |
| Supplemental Contributions Program Fund (SCP) | 103 | 109 | 6 | 5.4% |
| Judges' Retirement Fund (JRF) | 2,028 | 2,138 | 110 | 5.4% |
| Judges' Retirement Fund II (JRF II) | 2,444 | 2,641 | 197 | 8.1% |
| Legislators' Retirement Fund (LRF) | 533 | 561 | 28 | 5.3% |
| Replacement Benefit Custodial Fund (RBF) | 593 | 623 | 30 | 5.0% |
| California Employers' Pension Prefunding Trust (CEPPT) | 36 | 39 | 3 | 7.1% |
| Old-Age & Survivors Insurance Fund (OASI) | 1,115 | 1,145 | 30 | 2.7% |
| Reimbursements | 2,100 | 2,259 | 159 | 7.6% |
| Total Administrative Operating Costs | \$ 536,052 | \$ 555,276 | \$ 19,224 | 3.6% |
| <i>Statewide Pro-Rata Assessment</i> | \$ 30,924 | \$ 30,924 | \$ - | 0.0% |
| <i>CalPERS Administrative Costs</i> | \$ 505,128 | \$ 524,352 | \$ 19,224 | 3.8% |

III. 2022-23 Operating Costs Projection

As part of its budget process, CalPERS monitors the out-year impact of fiscal decisions to estimate future operating cost expenses. For Administrative Operating Costs, CalPERS estimates a net \$4.1 million increase in 2022-23. This includes \$9.1 million for salary increases negotiated through collective bargaining, offset by \$5.0 million in reductions for various one-time increases in the current year, such as board elections, Workers' Compensation, and equipment purchases.

Within Investment Operating Costs, CalPERS estimates a \$0.5 million increase driven by data technology expenses to support asset liability management, environmental social governance, portfolio implementation, and asset allocation activities. Additional various adjustments are anticipated for consultant and fund administration-related contractual fee increases, as well as declining project-driven analytics technology costs.

Headquarters Building Expenses are anticipated to increase by \$3 million for operating costs as CalPERS team members return to the office, and to fund security enhancements.

During the development of the 2022-23 Annual Budget, CalPERS will analyze all operating cost budgets and make budget recommendations based on updated data, assumptions, and priorities.

2022-23 Projection

| (in thousands) | 2021-22 Proposed Mid-Year Budget | 2022-23 Projected Budget | 2021 to 2022 Change | |
|--------------------------------|--|--------------------------------|-----------------------------|----------------------------|
| | | | \$ Increase / (Decrease) | % Increase / (Decrease) |
| Administrative Operating Costs | \$ 555,276 | \$559,412 | \$4,136 | 0.7% |
| Investment Operating Costs | 121,393 | 121,897 | \$504 | 0.4% |
| Headquarters Building Costs | 18,415 | 21,384 | \$2,969 | 16.1% |
| Total Projection | \$695,084 | \$702,693 | \$7,609 | 1.1% |
| Authorized Positions | 2,843.0 | 2,843.0 | - | 0.0% |