



Finance and Administration Committee Agenda Item 4d

November 15, 2016

Item Name: Year-End Budget and Expenditure Report

Program: Financial Office

Item Type: Information Consent

Executive Summary

This report presents the CalPERS Year-End Budget and Expenditures for Fiscal Year (FY) 2015-16 and satisfies the 2015 Budget Act (Chapter 10, Statutes of 2015) reporting requirement to submit a final year-end report to the State Controller, the Department of Finance, the Joint Legislative Budget Committee, and fiscal committees of the Legislature; in addition, the report will be submitted to the Legislative Analyst’s Office, the Government Operations Agency, and the Office of the Legislative Counsel.

(\$ in Millions)	FY 2015-16				FY 2014-15
	Budget	Actual Expenditures	(\$ Under) Over	Percent Expended	Actual Expenditures
Administrative Operating Costs	\$444.7	\$421.5	(\$23.2)	94.8%	\$403.8
Investment Operating Costs	83.0	72.6	(10.4)	87.5%	75.3
Investment External Management Fees	930.7	794.5	(136.2)	85.4%	1,333.1
Third-Party Administrator Fees	281.4	282.6	1.2	100.4%	287.8
Subtotal: Operating Costs	\$1,739.8	\$1,571.2	(\$168.6)	90.3%	\$2,100.0
Enterprise Project Costs	37.5	32.1	(5.4)	85.6%	22.9
Headquarters Building Costs	30.3	27.7	(2.6)	91.4%	25.9
Total Budget	\$1,807.6	\$1,631.0	(\$176.6)	90.2%	\$2,148.8

Of the total FY 2015-16 CalPERS Budget of \$1.8 billion, actual expenditures were \$1.6 billion, a savings of \$176.6 million (9.8 percent). As reflected above, the Investment External Management Fees were \$136.2 million below budget primarily due to (a) renegotiation of existing relationships in the Real Assets portfolio for more favorable terms, (b) winding down of the Activist portfolio, and (c) shifting more capital to existing internal Global Equity managers while negotiating more favorable fees for external Global Equity managers. Savings in the Administrative Operating

Budget totaled \$23.2 million, primarily due to position vacancies and the continued reduction in temporary and consulting staff. Details for each of the six budget categories are presented in the Analysis section below.

Strategic Plan

CalPERS 2012-2017 Strategic Plan, Goal B supports the agenda item: to cultivate a high-performing, risk intelligent and innovative organization by actively managing business risks with an enterprise-wide view.

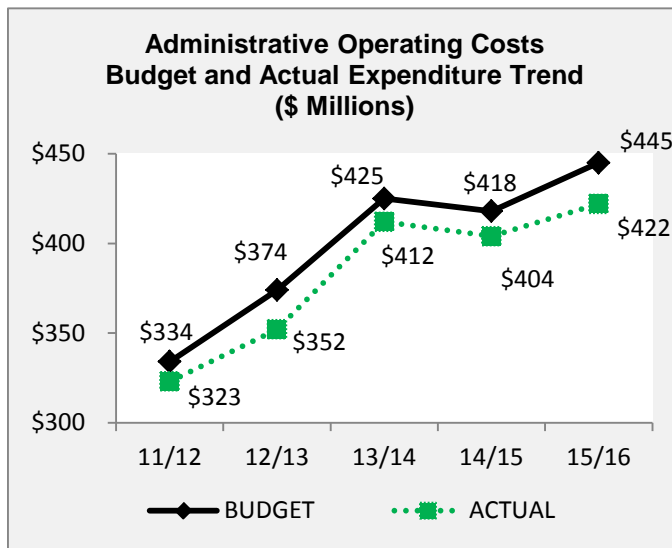
Background

The CalPERS Total Budget is comprised of six categories: Administrative Operating Costs, Investment Operating Costs, Investment External Management Fees, Third Party Administrator Fees, Enterprise Project Costs, and the Headquarters Building Costs. The CalPERS Total Budget is reviewed and approved by the CalPERS Board of Administration.

Analysis

Administrative Operating Costs

Of the total \$444.7 million Administrative Operating Costs Budget, CalPERS expended \$421.5 million, which was \$23.2 million or 5.2 percent under budget due mainly to staffing vacancies (\$11.7 million), reduced enterprise reliance on temporary staffing and consultants (\$6.6 million), and savings in travel, outside counsel services, and general operating expenses (\$4.9 million).

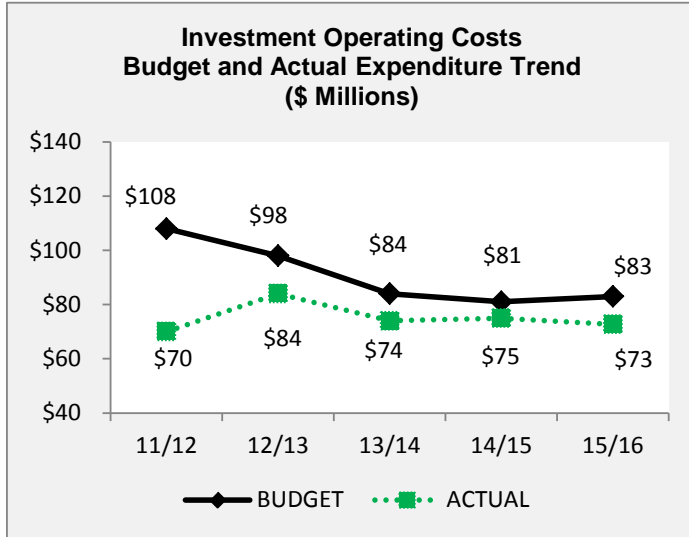


Compared to last year's 2014-15 expenses of \$403.8 million there was a net increase of \$17.7 million. Increases resulted from (a) statewide pay raises effective July 2015 and associated staff benefits of \$12.5 million, (b) 38.0 new positions approved for FY 2015-16 at a cost of \$3.5 million, (c) statewide pro rata assessment increase of \$2.9 million, and (d) increases for hardware refresh equipment purchases, software maintenance and general operating costs totaling \$4.4 million. These increases were offset by \$5.5 million reduction in temporary staffing and consulting services.

Investment Operating Costs

Of the total \$83.0 million Investment Operating Costs Budget, CalPERS expended \$72.6 million, which was \$10.4 million or 12.5 percent under budget. This is primarily due to the Investment Office's continued efforts to reduce consulting expenses and lower external legal costs. The decreases were offset by higher technology expenses due to the implementation of in-house trading and portfolio management systems, such as the Private Equity Accounting and Reporting System (PEARS) in FY 2015-16.

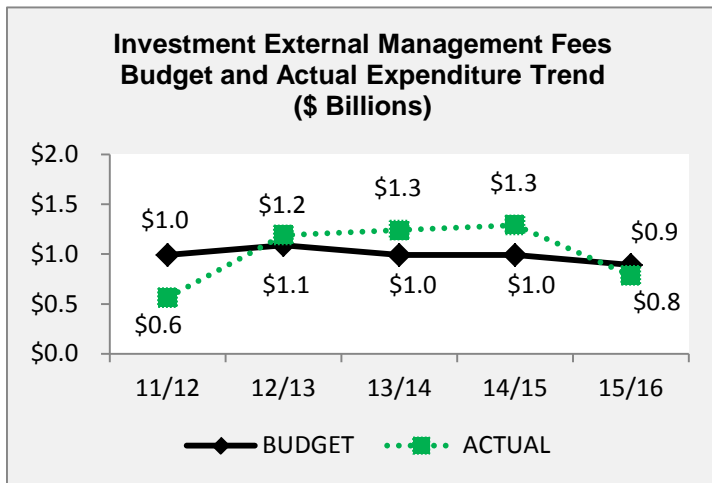




Compared to last year's 2014-15 expenses of \$75.3 million, there was a decrease of \$2.7 million due to efforts to reduce consulting expenses and less than projected legal fees offset by higher technology expenses primarily due to PEARS implementation in FY 2015-16.

Investment External Management Fees

Of the total \$930.7 million Investment External Management Fees Budget, CalPERS expended \$794.5 million, which was \$136.2 million or 14.6 percent under budget. This is due to the renegotiation of existing relationships in the Real Assets portfolio for more favorable terms, winding down of the Activist portfolio, and shifting more capital to existing internal Global Equity managers while negotiating more favorable fees for external Global Equity managers.



Compared to last year's 2014-15 expenses of \$1,333.1 million, there was a decrease of \$538.6 million mainly due to the exclusion of accrued profit sharing fees for real assets beginning in 2015-16 and the winding down of the Activist and Absolute Return Strategy portfolios.

Investment External Management Fees				
(in thousands)	FY 2015-16			FY 2014-15
	Budget	Actual Expenditures	(\$ Under) Over	Actual Expenditures
External Mgmt (Base)				
Global Equity	\$51,265	\$70,054	\$18,789	\$50,457
Fixed Income	7,915	10,206	2,291	9,354
Real Assets	206,296	178,583	(27,713)	199,279
Private Equity ¹	440,582	353,338	(87,244)	414,137
Absolute Return Strategy	2,641	6,229	3,588	40,260
Activist Funds	31,772	19,803	(11,969)	28,464
Multi Asset Class	7,650	8,115	465	-
Total External Mgmt (Base)	\$748,121	\$646,328	(\$101,793)	\$741,950
External Mgmt (Performance)				
Global Equity	\$32,096	\$50,250	\$18,154	\$69,715
Fixed Income	4,199	3,363	(836)	2,446
Real Assets	89,672	82,875	(6,797)	472,688
Absolute Return Strategy	2,938	(781)	(3,719)	46,250
Activist Funds	44,945	12,451	(32,494)	93
Multi Asset Class	8,755	-	(8,755)	-
Total External Mgmt (Performance)	\$182,605	\$148,158	(\$34,447)	\$591,192
Total External Mgmt. Fees	\$930,726	\$794,486	(\$136,240)	\$1,333,142

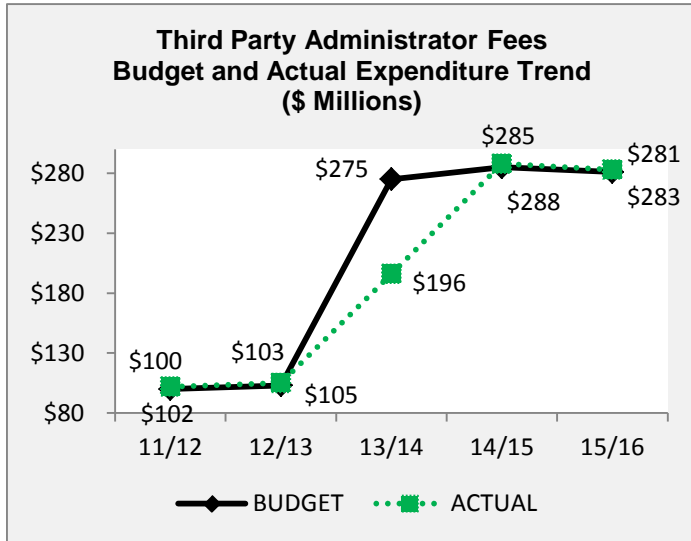
¹To be consistent with the method used to project the 2015-16 Private Equity budgeted amount of \$440.6 million, the reported figure of \$353.3 million included gross management fees, waivers, management fee offsets, and estimates of additional expenses reflected in K-1 schedules. This amount differs from the amount reflected in the 2015-16 Comprehensive Annual Financial Report (CAFR) of \$206.5 million. Going forward, the projected expense methodology will be in alignment with the annual CAFR reporting.

Third Party Administrator Fees

Of the total \$281.4 million Third Party Administrator Fees Budget, CalPERS expended \$282.6 million, which was \$1.2 million or 0.4 percent over budget. The Flex and Self-Funded Health Program cost was 1.7 percent higher than projected and was offset by a decrease in the cost of the Long Term Care Program as a higher number of participants exited the program compared to new participants joining the program.

Third Party Administrator Fees	FY 2014-15	FY 2015-16			
	Actual Expenditures	Budget	Actual Expenditures	\$(Under) Over	Percent Expended
(in millions)					
Long Term Care Program	\$20.2	\$22.8	\$19.9	(2.9)	87.1%
Flex and Self-Funded Health Program	263.8	254.7	259.0	4.3	101.7%
Supplemental Income Plan	3.8	3.9	3.7	(0.2)	94.4%
TOTAL	\$287.8	\$281.4	\$282.6	\$1.2	100.4%

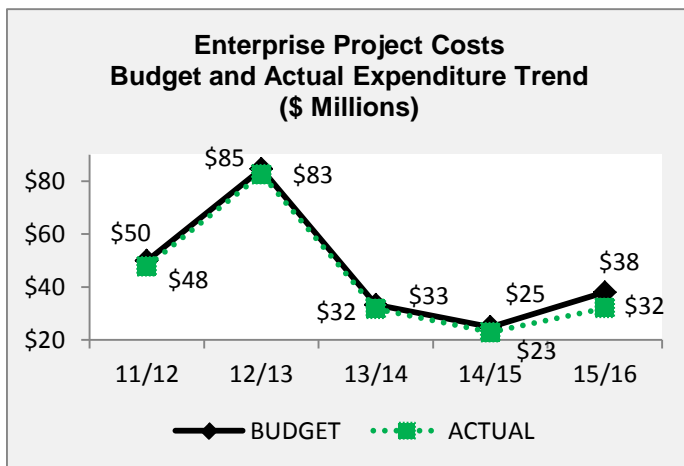




Compared to last year's 2014-15 actual expenditures of \$287.8 million, there was a decrease of \$5.2 million mainly driven by enrollment shifts in the Flex and Self-Funded Health Plans. The decrease is driven by members moving out of the Blue Shield Access+ and Blue Shield NetValue plans and into lower cost health plans including Kaiser which is the only fully funded HMO plan that does not incur Third Party Administrator costs.

Enterprise Project Costs

Of the total \$37.5 million Enterprise Project Costs Budget, CalPERS expended \$32.1 million, which was \$5.4 million or 14.4 percent under budget, due mainly to the postponement of the Information Technology Backup/Disaster Recovery project (\$4.0 million) and savings in the Security Roadmap project due to lower cost negotiated for hardware and software purchases (\$0.7 million). The Information Technology Backup/Disaster Recovery project was delayed to ensure that the new five year agreement represents CalPERS' list of refreshed mission critical services and updated recovery objectives. Savings in the Actuarial Valuation System Redesign project due to delays were reallocated to the myCalPERS Optimization Project (\$1.2 million) to implement critical health functionality changes, including Online Health Statements and the redesign of Medicare processes.

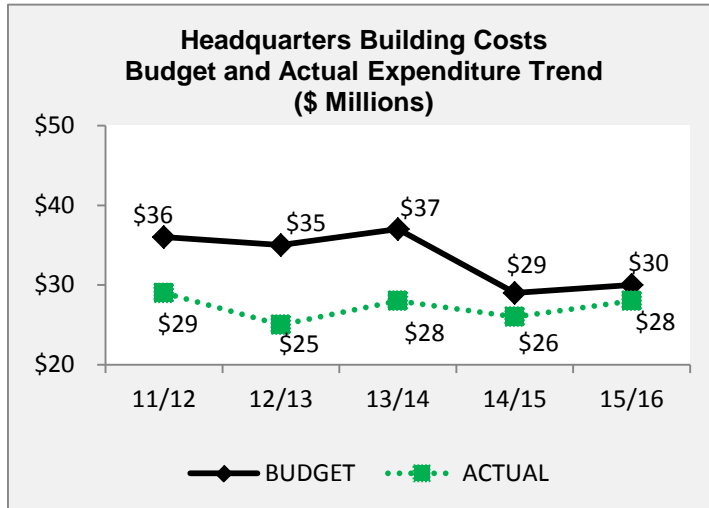


Compared to last year's 2014-15 expenses of \$22.9 million, there was a net increase of \$9.2 million. Of this total, \$8.3 million was related to continuing projects, including myCalPERS Optimization, Security Roadmap, Actuarial Valuation System Redesign, and Executive Compensation. The addition of nine new projects approved in FY 2015-16 cost \$2.9 million, which was offset by \$2.0 million in projects that were completed in FY 2014-15.



Headquarters Building Costs

Of the total \$30.3 million Headquarters Building Costs Budget, CalPERS expended \$27.7 million, which was \$2.6 million or 8.6 percent under budget due to lower maintenance, supplies, and wire plant/data costs and less staffing moves than anticipated. These decreases were offset by higher costs for the drought tolerant landscape renovation project.



Compared to last year's 2014-15 expenses of \$25.9 million, there was a net increase of \$1.8 million mainly due to higher engineering, electrical, janitorial and security services costs, as well as increased costs for the drought tolerant landscape renovation project (\$2.2 million). The increases were offset by less workstation conversions and furniture purchases (\$0.6 million).

Budget and Fiscal Impacts

There are no costs associated with this item.

Benefits and Risks

Failure to submit the year-end report to respective legislative offices could put CalPERS at risk of noncompliance with the control language in the 2015 Budget Act.

Attachment

Attachment 1 – Transmittal Letter to the Joint Legislative Budget Committee

ROSE MCAULIFFE, Chief
Financial Planning, Policy and Budgeting Division

CHERYL EASON
Chief Financial Officer