

California Public Employees' Retirement System

Fiscal Year 2020-21 Annual Budget Proposal

April 21, 2020



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Executive Summary and Highlights

CalPERS' proposed budget represents the financial resources needed by the organization to achieve strategic priorities and initiatives, meet core business needs, and further the mission of delivering retirement and health care benefits to members and their beneficiaries. The budget supports CalPERS' five strategic goals:

- Fund Sustainability
- Health Care Affordability
- Reduce Complexity
- Risk Management
- Talent Management

The total 2020-21 proposed budget is \$1.694 billion; a decrease of \$204.6 million, or 10.8 percent, compared to the 2019-20 authorized budget. Total authorized positions remain unchanged at 2,875.

2020-21 Total Budget

(in thousands)	2018-19 Actual	2019-20 Authorized Budget	2020-21 Proposed Budget	2019 to 2020 Change	
				\$ Increase / (Decrease)	% Increase / (Decrease)
Administrative Operating Costs	\$ 469,696	\$ 528,800	\$ 545,782	\$ 16,982	3.2%
Investment Operating Costs	78,782	120,436	124,856	4,420	3.7%
Enterprise Project Costs	5,641	3,116	-	(3,116)	(100.0%)
Headquarters Building Costs	23,029	24,374	24,338	(36)	(0.1%)
Total: Operating Costs	\$ 577,148	\$ 676,725	\$ 694,976	\$ 18,251	2.7%
Investment External Management Fees	759,624	899,791	685,906	(213,885)	(23.8%)
Third Party Administrator Fees	299,874	321,661	312,670	(8,991)	(2.8%)
Total: Fees	\$ 1,059,498	\$ 1,221,451	\$ 998,575	\$ (222,876)	(18.2%)
CalPERS Total Budget	\$ 1,636,645	\$ 1,898,176	\$ 1,693,551	\$ (204,625)	(10.8%)
Authorized Positions	2,875.0	2,875.0	2,875.0	-	0.0%

The major highlights of the 2020-21 proposed budget include:

- Administrative Operating Cost increases include \$15.7 million for state-negotiated salaries and benefits, and \$6.1 million for Board-approved executive and investment salaries and incentive compensation. These amounts are offset by reductions in temporary help and overtime expenses, reduced salary expenses from the position pooling process, and refined budget estimates.
- The number of Seasonal Clerks decreased 74 percent, from 85 to 22.

- OE&E increases of \$7.6 million are included to improve Disaster Recovery and Information Security capabilities, refresh network and server hardware, and augment insurance coverage.
- Investment Operating Technology Expenses increased \$5.8 million to continue implementation of the Total Fund data strategy which will modernize and enhance data, analytical, and business operations tools to support internal asset management capabilities.
- Investment External Management Fees are estimated to decrease \$213.9 million due to a reduction in external manager contracts and increased reliance on internal investment staff.
- Third Party Administrator Fees are estimated to decrease \$9.0 million based on current enrollment following the Fall 2019 Open Enrollment period.

2019-20 Current Year Update

CalPERS' 2019-20 total authorized budget is \$1.898 billion. Of this amount, \$827.7 million, or 43.6 percent, was expended as of December 31, 2019. Based on spending forecasts, CalPERS estimates that it will end the fiscal year with approximately \$44.2 million, or 2.3 percent, in unexpended funds. Until expended, all budgeted funds remain in the Public Employees' Retirement Fund (PERF) for investment. The projection is on target with the Key Performance Indicator to forecast expenses at or below 10 percent of the budget.

2019-20 Current Year Update

(in thousands)	2019-20 Authorized Budget	2019-20 Expenditures and Encumbrances thru 12-31-19	Percent Expended	Forecast	Savings
Administrative Operating Costs	\$528,800	\$246,014	46.5%	\$497,762	\$31,037
Investment Operating Costs	120,436	34,928	29.0%	120,436	-
Enterprise Projects Costs	3,116	2,420	77.7%	3,116	-
Headquarters Building Costs	24,374	9,172	37.6%	24,148	226
Total: Operating Costs	\$676,725	\$292,534	43.2%	\$645,462	\$31,263
Investment External Mgmt Fees	899,791	380,327	42.3%	899,791	-
Third Party Administrator Fees	321,661	154,884	48.2%	308,735	12,925
Total: Fees	\$1,221,451	\$535,211	43.8%	\$1,208,526	\$12,925
CalPERS Total Forecast	\$1,898,176	\$827,745	43.6%	\$1,853,988	\$44,188

Note: Admin expenses include encumbrances and affiliates rent

At mid-year, Investment Operating Costs, Investment External Management Fees, and Headquarters Building Costs are lagging below the 50 percent mark, which is typical of these expense categories. More specifically, investment-related vendor invoices and payment of external fees often trail the quarterly cycles. Similarly, Headquarters Building Costs historically lag given the timing of invoices and completion of building improvement projects begun later in the fiscal year.

There are two Enterprise Projects in 2019-20, and both are tracking above the 50 percent level at mid-year. The Actuarial Valuation System/Advanced Analytics Integration project is an ongoing effort, and funds were encumbered early in the fiscal year to continue work on the Actuarial system. The Member Electronic Payment System project began early in the fiscal year, and the new payment portal went live on March 24, 2020. The new system allows members to make benefit and health premium payments online via electronic funds transfer, debit card, or credit card.

Of the \$44.2 million forecasted savings, \$31.0 million is in Administrative Operating Costs and is largely attributable to vacancy-related salary savings driven by a 7.5 percent vacancy rate. CalPERS also estimates a \$12.9 million surplus in Third Party Administrator Fees resulting from members migrating to health plans with lower fee structures during the Fall 2019 Open Enrollment period.

Social Security Fee Update

Beginning in 2019-20, CalPERS began charging an annual fee to public employers who provide Social Security benefits to their employees. The purpose of the fee is to cover CalPERS' administrative costs for serving as the State's designated Social Security Administrator, and is assessed based on authority in Government Code Section 22551. The fee ranges from \$200 to \$2,500 based on the total number of persons employed by the public agency. On February 27, 2020, CalPERS released for public comment, revised draft regulations specifying the fee amounts and methodology for adjusting the fees. CalPERS did not receive any comments during the comment period, and will proceed with submitting the regulations to the Office of Administrative Law for review. CalPERS will update the Board via future Annual Budgets on any changes made to the fee structure.

CalPERS Budget Process

Each fiscal year, CalPERS engages in two formal budget processes; an annual budget proposal and a mid-year review. The annual proposal details the twelve-month budget for Board approval prior to the start of a new fiscal year on July 1st. In contrast, the purpose of the mid-year review is to address new, critical, and unforeseen resource needs not envisioned when developing the annual proposal.

When developing the annual budget, CalPERS' Financial Office reviews existing budget levels for each division and program, and considers requests for additional funds to maintain, improve, or implement services, initiatives, and projects. Financial Office staff work collaboratively with each division to understand their organizational structures and business objectives as a basis for maintaining existing funding levels, and for analyzing and approving increases.

CalPERS utilizes a formal budget request process to consider, prioritize, and approve new resource requests. Pursuant to the CalPERS Budget Policy, the main criteria used to prioritize requests include:

- Mitigating risk
- Identifying opportunities for cost efficiencies
- Aligning with the Strategic Plan and Business Plan
- Implementing CalPERS Board of Administration decisions and directives
- Complying with legal mandates

The Financial Office analyzes all formal budget requests, and senior management and executive leaders review, discuss, and make funding decisions for each.

Development of the annual budget also includes a position pooling process that redirects vacancies to where they are most critically needed within the organization. The objective of this process is to limit unnecessary staffing and related budgetary increases, and to provide staff resources to divisions with the highest needs.

2020-21 Proposed Budget

CalPERS' total 2020-21 proposed budget is \$1.694 billion; a decrease of \$204.6 million, or 10.8 percent, compared to the 2019-20 authorized budget. The major driver of the year-over-year decrease is a reduction in Investment External Management and Third Party Administrator Fees. These are amounts that CalPERS pays to external parties to manage investment portfolios and administer health program and pension services. The fees can fluctuate widely due to external influences beyond CalPERS' control, such as market conditions and member enrollments. In contrast, Operating, Project, and Building costs subject to CalPERS' control are estimated to increase 2.7 percent.

2020-21 Total Budget

(in thousands)	2018-19 Actual	2019-20 Authorized Budget	2020-21 Proposed Budget	2019 to 2020 Change	
				\$ Increase / (Decrease)	% Increase / (Decrease)
Administrative Operating Costs	\$ 469,696	\$ 528,800	\$ 545,782	\$ 16,982	3.2%
Investment Operating Costs	78,782	120,436	124,856	4,420	3.7%
Enterprise Project Costs	5,641	3,116	-	(3,116)	(100.0%)
Headquarters Building Costs	23,029	24,374	24,338	(36)	(0.1%)
Total: Operating Costs	\$ 577,148	\$ 676,725	\$ 694,976	\$ 18,251	2.7%
Investment External Management Fees	759,624	899,791	685,906	(213,885)	(23.8%)
Third Party Administrator Fees	299,874	321,661	312,670	(8,991)	(2.8%)
Total: Fees	\$ 1,059,498	\$ 1,221,451	\$ 998,575	\$ (222,876)	(18.2%)
CalPERS Total Budget	\$ 1,636,645	\$ 1,898,176	\$ 1,693,551	\$ (204,625)	(10.8%)
Authorized Positions	2,875.0	2,875.0	2,875.0	-	0.0%

Over the past five years, CalPERS' total budget increased \$226.0 million as displayed below.

Total Budget 2016-17 through 2020-21

(in thousands)	2016-17 Actual	2017-18 Actual	2018-19 Actual	2019-20 Authorized Budget	2020-21 Proposed Budget	Five-Year Change	Annual Growth (%)
Administrative Operating Costs	\$437,809	\$444,065	\$469,696	\$ 528,800	\$ 545,782	\$107,973	5.7%
Investment Operating Costs	69,486	68,425	78,782	120,436	124,856	55,370	15.8%
Enterprise Projects Costs	34,088	22,366	5,641	3,116	-	(34,088)	(100.0%)
Headquarters Building Costs	26,230	23,603	23,029	24,374	24,338	(1,892)	(1.9%)
Total: Operating Costs	\$567,613	\$558,460	\$577,148	\$676,725	\$694,976	\$127,363	5.2%
Investment External Management Fees	613,509	727,208	759,624	899,791	685,906	72,397	2.8%
Third Party Administrator Fees	286,401	288,652	299,874	321,661	312,670	26,268	2.2%
Total: Fees	\$ 899,911	\$ 1,015,859	\$ 1,059,498	\$ 1,221,451	\$ 998,575	\$ 98,665	2.6%
CalPERS Total Budget	\$ 1,467,524	\$ 1,574,319	\$ 1,636,645	\$ 1,898,176	\$ 1,693,551	\$ 226,028	3.6%

The major drivers of cost increases over the past five years include:

- State-negotiated employee compensation and benefit increases (Administrative Operating Costs).
- New technologies to implement the Total Fund data strategy and modernize and enhance data, analytics, and business operations tools to support internal asset management capabilities (Investment Operating Costs).
- Continued market performance (Investment External Management Fees).
- Expanded health plan options, increased enrollment, general pricing increases, and new Third Party Administrator contracts (Third Party Administrator Fees).

Over this same timeframe, CalPERS actively engaged in efforts to offset and limit operating, project, and building cost increases. This included:

- Implementing a position pooling process to redirect vacant positions to program areas with critical needs.
- Eliminating all permanent blanket positions.
- Significantly reducing the use of Seasonal Clerks.
- Delaying or phasing building improvement and enterprise projects.

The following pages detail the 2020-21 Proposed Budget by expenditure category.

I. Administrative Operating Costs

Administrative Operating Costs include Personal Services expenditures (i.e. salaries, wages, and benefits for permanent and temporary help staff) and Operating Expenses and Equipment (OE&E) for each branch within CalPERS. Administrative Operating Costs in 2020-21 are proposed at \$545.8 million. This is an increase of \$17.0 million, or 3.2 percent, compared to the 2019-20 authorized budget.

Administrative Operating Costs by Object of Expenditure

(in thousands)	2018-19 Actual	2019-20 Authorized Budget	2020-21 Proposed Budget	2019 to 2020 Change	
				\$ Increase / (Decrease)	% Increase / (Decrease)
[1] PERSONAL SERVICES					
Salaries & Wages	\$ 236,219	\$ 264,153	\$ 268,836	\$ 4,682	1.8%
Temporary Help	5,770	5,138	2,485	(2,653)	(51.6%)
Overtime	2,009	2,048	1,912	(137)	(6.7%)
Benefits	117,576	142,811	150,288	7,477	5.2%
Total Personal Services	\$ 361,574	\$ 414,151	\$ 423,521	\$ 9,370	2.3%
[2] OPERATING EXPENSES & EQUIPMENT					
General Expense	\$ 8,893	\$ 11,358	\$ 10,999	\$ (359)	(3.2%)
Software	1,701	1,842	3,158	1,316	71.4%
Printing	1,746	1,990	1,736	(254)	(12.8%)
Postage	2,559	2,843	3,363	520	18.3%
Communications	1,694	1,845	1,763	(82)	(4.4%)
Data Processing Services	14,672	15,362	20,173	4,811	31.3%
Travel	2,398	3,580	3,618	38	1.1%
Training	1,024	1,732	1,673	(59)	(3.4%)
Medical Exam/Disability Travel	1,264	1,451	1,457	6	0.4%
Facilities Operations	5,619	5,390	4,685	(705)	(13.1%)
Central Administrative Services	26,195	25,567	25,765	199	0.8%
University Enterprises, Inc.	231	521	536	15	2.8%
External Legal Counsel	5,330	5,877	6,038	161	2.7%
Professional Services	5,500	6,075	6,141	66	1.1%
Consultants	21,781	20,025	20,404	379	1.9%
Audit Services	1,123	1,969	1,687	(282)	(14.3%)
Federal Legislative Rep	598	600	600	-	0.0%
Admin Hearings	1,211	1,418	1,402	(16)	(1.1%)
Consolidated Data Centers	101	105	250	145	138.1%
Equipment (includes IT)	4,483	5,098	6,812	1,714	33.6%
Total Operating Expenses & Equipment	\$ 108,123	\$ 114,649	\$ 122,261	\$ 7,612	6.6%
Total Administrative Operating Costs	\$ 469,696	\$ 528,800	\$ 545,782	\$ 16,982	3.2%

The year-over-year increase in Administrative Operating Costs reflects a net \$9.4 million increase for Personal Services expenses, and \$7.6 million for OE&E. Consistent with prior years, the major driver of Personal Services increases is general salary and benefit increases negotiated through the State's collective bargaining process. In 2020-21, these increases are estimated at \$15.7 million. In addition, the budget includes a \$6.1 million increase for recent Board decisions related to Executive and Investment salary and incentive compensation, and to provide incentive payments to Investment Officer II positions pursuant to recent bargaining unit changes. However, reductions in temporary help expenses, reduced salary expenses from the position pooling process, and refined budget estimates offset these increases by \$12.4 million.

Within OE&E, the \$7.6 million increase provides additional funds to improve Disaster Recovery and Information Security capabilities, refresh network and server hardware, and augment insurance coverage.

Please refer to Appendix I for the allocation of Administrative Operating Costs to each branch.

Staffing Levels

The 2020-21 proposed budget holds the authorized position count at 2,875. While total positions remain unchanged from the prior year, CalPERS redirected positions between branches as displayed below.

Authorized Positions by Branch

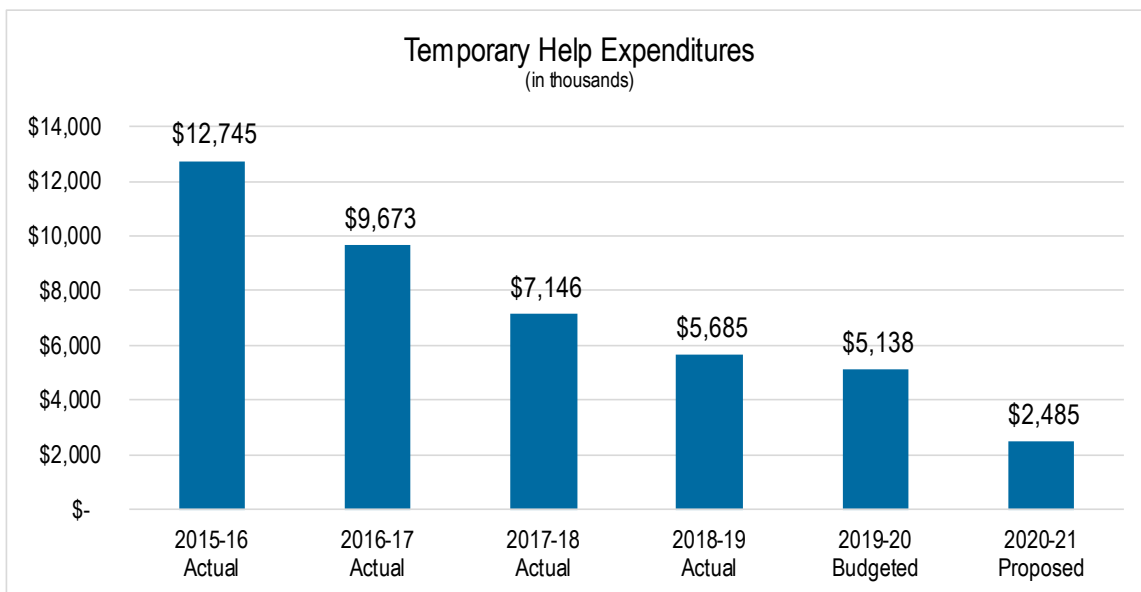
Branch	2019-20	2020-21	Change
Actuarial Office	62.0	64.0	2.0
Communications & Stakeholder Relations	80.0	79.0	(1.0)
Customer Services and Support	868.5	892.0	23.5
Enterprise Compliance	24.0	24.0	-
Executive Office	18.0	17.0	(1.0)
Financial Office	204.0	199.0	(5.0)
General Counsel	141.0	162.0	21.0
Health Policy and Benefits	210.0	211.0	1.0
Investment Office	344.0	340.0	(4.0)
Operations and Technology	911.0	885.0	(26.0)
Position Pool	12.5	2.0	(10.5)
Total Authorized Positions	2,875.0	2,875.0	-

In general, branches with position reductions assessed their workload and resource needs and determined that vacancies could be given to the position pool for redirection within the organization. The branches with the largest year-over-year changes are:

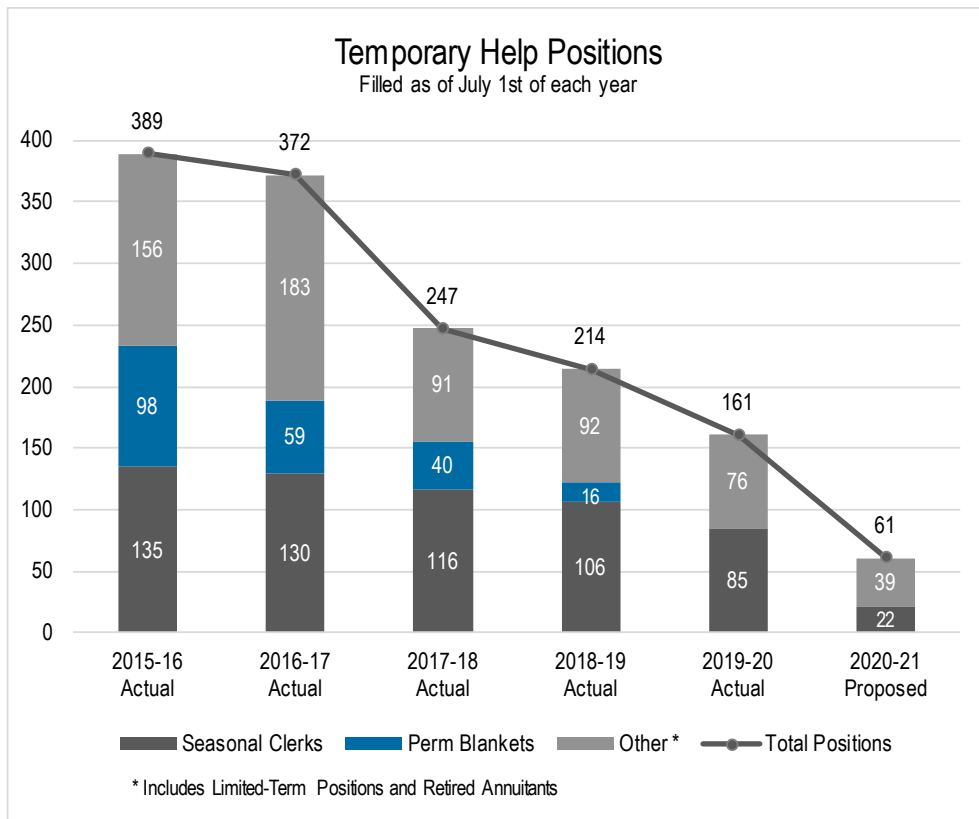
- Customer Services and Support received 23 positions from the pool to reduce its reliance on Seasonal Clerks and to assist with improving Call Center wait times.
- General Counsel positions increased due to the transfer of 23 Information Security Office positions from Operations and Technology, offset by two positions redirected to the pool.
- Operations and Technology decreased due to the transfer of 23 Information Security Office positions to General Counsel, and the redirection of three positions to the pool.

Temporary Help

Included in the Administrative Operating Costs Budget are funds for temporary help, which includes Seasonal Clerks, Retired Annuitants, and limited-term positions. As displayed below, CalPERS reduced funding for temporary help resources by \$10.3 million over the past five years.



These reductions are driven by the elimination of all permanent blanket positions, and a significant 84 percent reduction in Seasonal Clerks. The chart on the next page displays temporary help position reductions since 2015-16. By the end of 2020-21, CalPERS will implement further reductions by fully discontinuing the use of Seasonal Clerks for non-seasonal work. This will be accomplished by redirecting vacancies from the position pool as they become available, utilizing student assistants when appropriate, and reviewing and streamlining processes to achieve efficiencies.

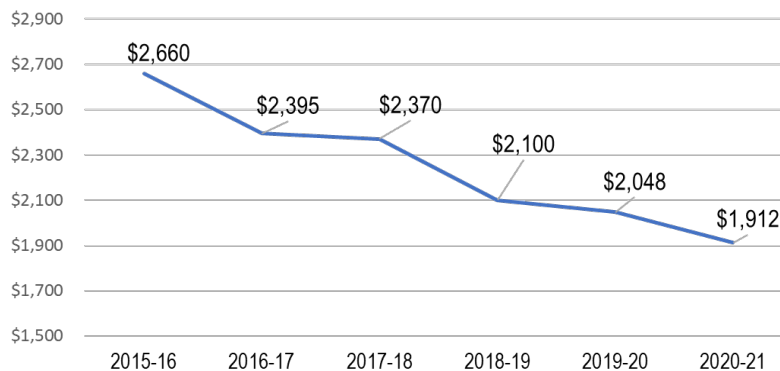


Overtime

In addition to reductions in temporary help, CalPERS has continued to decrease overtime expenditures over the past five years. Through resource and workload management, the overtime budget decreased by \$0.7 million, or 28 percent, since 2015-16.

Budgeted Overtime

(in thousands)



II. Investment Operating Costs

Investment Operating Costs include expenditures specifically incurred for investment activities, such as consultants to inform the Board of investment initiatives or to support the implementation of investment technologies and platforms; external audit, legal, and appraisal services related to asset valuations; fund administration and custody; data and analytics software and services; and maintaining or enhancing trading and portfolio management systems. Investment Operating Costs in 2020-21 are proposed at \$124.9 million. This is a \$4.4 million increase, or 3.7 percent, compared to the 2019-20 authorized budget.

Investment Operating Costs

(in thousands)	2018-19 Actual	2019-20 Authorized Budget	2020-21 Proposed Budget	2019 to 2020 Change	
				\$ Increase / (Decrease)	% Increase / (Decrease)
Investment Consultants	\$5,339	\$9,860	\$10,000	\$140	1.4%
Board Consultants	5,182	5,221	5,667	446	8.5%
Technology Consultants	3,626	7,600	8,200	600	7.9%
Total Consultant Expenses	\$14,148	\$22,681	\$23,867	\$1,186	5.2%
Audits	\$125	\$705	\$705	-	0.0%
Tax Advisory Services	821	1,200	1,200	-	0.0%
Master Custodian Fee	10,107	11,453	11,435	(19)	(0.2%)
Fund Administration Services / Fees	4,169	3,900	3,848	(52)	(1.3%)
External Legal	3,656	5,800	5,800	-	0.0%
Appraisal Fees	4,614	10,000	8,000	(2,000)	(20.0%)
Company Expense	1,141	950	450	(500)	(52.6%)
Miscellaneous Operating Expense	38	300	300	-	0.0%
Total Operating Expenses	\$24,672	\$34,308	\$31,737	(\$2,571)	(7.5%)
Data	\$6,307	\$7,500	\$7,600	\$100	1.3%
Analytics	9,421	15,000	19,581	4,581	30.5%
Trading and Portfolio Management Systems	22,869	38,769	38,136	(632)	(1.6%)
Business Operations Tool	1,362	2,000	3,757	1,757	87.9%
Other Technology Expense	5	178	178	-	0.0%
Total Technology Expenses	\$39,963	\$63,447	\$69,252	\$5,806	9.2%
Total Investment Operating Costs	\$78,782	\$120,436	\$124,856	\$4,420	3.7%

The year-over-year change includes the following:

- \$1.2 million increase for Consultant Expenses resulting from recently-negotiated, higher-cost contracts for Board consultants, as well as estimated increases for Technology Consultants to continue the Investment Office's transition to a Total Fund platform, to assess and increase private asset capabilities, and to assist with implementing the Total Fund data strategy.

- \$2.6 million decrease in Operating Expenses primarily driven by a reduction in Appraisal Fees due to changes in real estate contract cost structures.
- \$5.8 million increase in Technology Expenses to implement the Total Fund data strategy which will modernize and enhance data, analytical, and business operations tools to support internal asset management capabilities.

III. Enterprise Project Costs

Historically, CalPERS undertakes projects to improve operations, enhance services to members, and stay current with industry trends and practices. CalPERS does not propose any new projects in 2020-21.

Enterprise Project Costs

(in thousands)	2018-19 Actual	2019-20 Authorized Budget	2020-21 Proposed Budget
Actuarial Valuation System Redesign / AAI	\$4,774	\$2,942	-
Information Security Technology Solutions	365	-	-
Contact Center Applications - Migration to Cloud	502	-	-
Member Electronic Payment System	-	174	-
Total Enterprise Project Costs	\$5,641	\$3,116	\$0

IV. Headquarters Building Costs

The Headquarters Building Budget reflects expenses incurred to operate, maintain, and improve the Lincoln Plaza campus. It also includes funds for security and maintenance for regional offices, the offsite emergency operations center, the Front Street parking lot, and warehouse space. These costs are offset by rent and parking revenues. Total proposed Headquarters Building expenses in 2020-21 are \$25.8 million, which is a slight \$6,000 increase compared to the 2019-20 authorized budget.

Headquarters Building Costs

(in thousands)	2018-19 Actual	2019-20 Authorized Budget	2020-21 Proposed Budget	2019 to 2020 Change	
				\$ Increase/(Decrease)	% Increase/(Decrease)
Operating:					
Utilities	\$2,222	\$2,365	\$2,403	\$38	1.6%
Engineering Services	3,263	4,038	4,168	130	3.2%
Janitorial	3,446	3,439	3,657	219	6.4%
Landscaping	801	865	890	25	2.9%
General Maintenance	1,182	1,215	1,195	(19)	(1.6%)
Security	2,601	2,911	2,881	(30)	(1.0%)
Property Mgmt. & Administrative Fees	1,829	1,512	1,593	80	5.3%
Café Plaza	213	247	249	3	1.1%
Offsite Expenses ¹	633	961	867	(94)	(9.8%)
Emergency Operations Center (EOC) ²	387	451	509	58	12.8%
Operating Other ³	1,972	2,022	2,936	914	45.2%
Total Operating Expenses	\$18,548	\$20,026	\$21,350	\$1,324	6.6%
Non-Operating:					
Owner Improvements ⁴	2,912	3,187	2,363	(824)	(25.8%)
Building Improvements ⁵	3,433	3,614	2,946	(667)	(18.5%)
Furniture & Fixtures	560	300	289	(12)	(3.8%)
Building Insurance	285	360	571	211	58.6%
Total Non-Operating Expenses	\$7,190	\$7,461	\$6,169	-\$1,292	(17.3%)
Subtotal Expenses	\$25,738	\$27,487	\$27,519	\$32	0.1%
Less: Revenue ⁶	(1,564)	(1,655)	(1,680)	(26)	1.5%
Total HQ Building Expenses	\$24,175	\$25,833	\$25,839	\$6	0.0%
Less: Amount included in Admin. Budget	(1,146)	(1,459)	(1,501)	(43)	2.9%
Total Headquarters Building Costs	\$23,029	\$24,374	\$24,338	(\$36)	(0.1%)

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 include 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, repairs and related project management.

⁶ Estimated revenue from parking and the Subway, Chocolate Fish, and Montessori Daycare leases.

Of the \$25.8 million total Headquarters Building costs, \$1.5 million is budgeted within the Administrative Operating Costs budget and represents amounts charged to affiliate funds for their share of building expenses, or rent. Therefore while total proposed building expenses are \$25.8 million, the amount included within the Headquarters Building budget is \$24.3 million.

Although the year-over-year increase in total Building Costs is minimal, there is a shift between operating and non-operating expenses due to the following:

- \$1.3 million increase in Operating Expenses driven by contract wages for engineering and janitorial staff, and to perform required electrical acceptance testing. This is a test run every five years to assess and monitor the backup system's capacity to maintain critical functions without disruption.
- \$1.3 million decrease in Non-Operating Expenses resulting from a decline in information technology-driven wiring, and a decrease in one-time building improvement projects. These decreases are offset by anticipated, market-driven insurance cost increases.

V. Investment External Management Fees

Investment External Management Fees represent amounts that CalPERS pays to external investment advisors with whom it contracts to manage specific portfolios. The Board approves Investment Advisor Contract extensions on an annual basis, and the contracts typically range from seven to twelve years. Details on investment fees paid are included in the Comprehensive Annual Financial Report (CAFR).

CalPERS estimates annual Investment External Management Fees based on market assumptions and investment diversification strategies. However, actual fees paid within a fiscal year are subject to market fluctuations. Current assumptions estimate total fees in 2020-21 at \$685.9 million. This is a decrease of \$213.9 million, or 23.8 percent, as compared to the 2019-20 authorized budget.

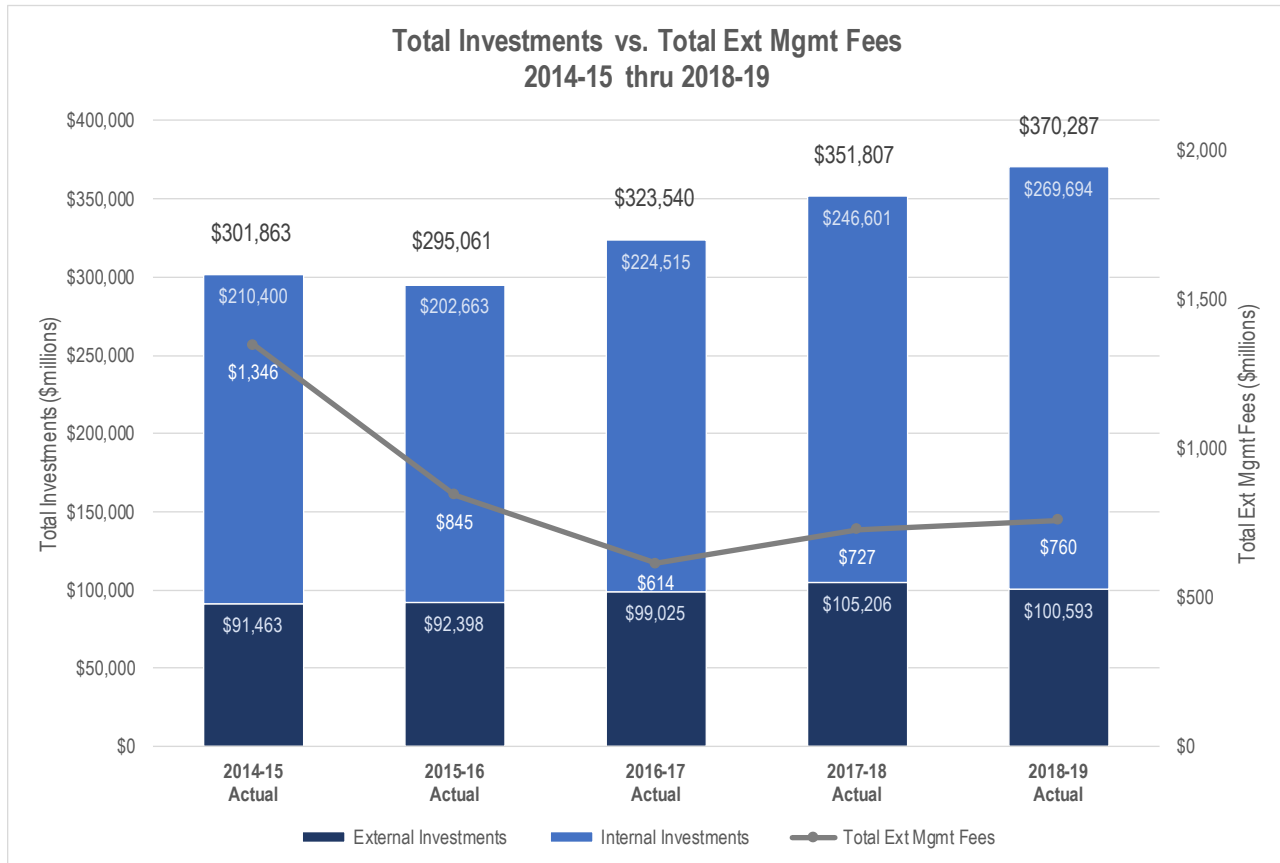
The drivers of this estimated decrease are mainly in Global Equity and Multi Asset Class investments for both base and performance fees. This is a result of investment strategy reviews that resulted in a reduction or termination of some external manager contracts, and an increased reliance on internal investment staff. The estimated increase in Real Asset base fees results from revised allocations to this asset class and projected pacing of invested capital. The decrease in Real Asset performance fees is expected given the timing and restructuring of performance payments.

Investment External Management Fees

(in thousands)	2019-20 Authorized Budget	2020-21 Proposed Budget	2019 to 2020 Change	
			\$ Increase / (Decrease)	% Increase / (Decrease)
Global Equity	\$126,719	\$33,438	(\$93,282)	(73.6%)
Fixed Income	13,793	13,439	(355)	(2.6%)
Real Assets	188,213	223,566	35,353	18.8%
Absolute Return Strategy	305	300	(5)	(1.6%)
Private Equity	295,000	300,000	5,000	1.7%
Multi Asset Class	40,800	1,500	(39,300)	(96.3%)
Opportunistic Strategies	1,500	5,413	3,913	100%
External Mgmt - Base Fees	\$666,331	\$577,655	(\$88,676)	(13.3%)
Global Equity	\$52,224	\$4,043	(\$48,182)	(92.3%)
Fixed Income	3,214	2,879	(336)	(10.4%)
Real Assets	176,021	101,329	(74,692)	(42.4%)
Absolute Return Strategy	-	-	-	0.0%
Multi Asset Class	2,000	-	(2,000)	100%
External Mgmt - Performance Fees	\$233,460	\$108,250	(\$125,209)	(53.6%)
Total External Management Fees	\$899,791	\$685,906	(\$213,885)	(23.8%)

D. 2020-21 Proposed Budget

As displayed below, CalPERS' total assets under management (AUM) has increased \$68.4 billion since 2014-15. While total AUM increased, the relative percentage of external AUM decreased from 30 percent in 2014-15, to 27 percent in 2018-19. Over this same time, the amount of fees paid to external investment managers significantly decreased from a high of \$1.3 billion to \$760 million. CalPERS will continue to reduce external AUM in the current and budgeted fiscal years.



VI. Third Party Administrator Fees

CalPERS contracts with Third Party Administrators to support the delivery of health and pension services with a focus on strengthening and improving long-term sustainability for members. The Board approves Third Party contracts with terms that typically extend five years and include annual fee increases. Third Party Administrators provide administration, recordkeeping, and participant communication services for the following programs:

- CalPERS Health Benefits Program
- Long Term Care Program
- Supplemental Income Plan Program
- California Employers' Retiree Benefit Trust Fund Program (CERBT)
- California Employers' Pension Prefunding Trust Program (CEPPT)

CalPERS estimates Third Party Administrator Fees based on current enrollment data, which typically fluctuates throughout the fiscal year. Based on January 2020 enrollment, the estimated Third Party Administrator Fees in 2020-21 are \$312.7 million. This is a decrease of \$9.0 million, or 2.8 percent, as compared to the 2019-20 authorized budget.

Third Party Administrator Fees

(in thousands)	2018-19 Actual	2019-20 Authorized Budget	2020-21 Proposed Budget	2019 to 2020 Change	
				\$ Increase / (Decrease)	% Increase / (Decrease)
Health Program	\$ 253,366	\$ 274,181	\$ 264,996	\$ (9,185)	(3.3%)
Pharmacy Benefit Manager	21,532	22,720	23,802	1,082	4.8%
Total, Health	\$ 274,899	\$ 296,901	\$ 288,798	\$ (8,103)	(2.7%)
Long Term Care Program	21,385	20,729	20,314	(416)	(2.0%)
Supplemental Income Plan	3,499	3,922	3,450	(472)	(12.0%)
California Employers' Retiree Benefit Trust (CERBT)	91	90	90	-	0.0%
California Employers' Pension Prefunding Trust (CEPPT)	-	18	18	-	0.0%
Total Third Party Administrator Fees	\$299,874	\$321,661	\$312,670	(\$8,991)	(2.8%)

The year-over-year decrease in Third Party Administrator Fees is primarily driven by Health program related fees, and reflects a reduction in higher fee health plan enrollment following the Fall 2019 Open Enrollment period. There is also a slight decrease in fees for the Long Term Care Program due to an enrollment decline, and for the Supplemental Income Plan due to revised contract terms with more favorable fee structures.

I. Administrative Operating Costs by Branch

Following is the allocation of proposed Administrative Operating Costs to CalPERS branches. In addition to statewide salary and benefit increases, position pooling redirections and the transfer of Information Security Office positions from Operations and Technology to General Counsel drove allocation changes. Further, OE&E increases also impacted allocation amounts. In 2020-21, OE&E increases primarily impacted General Counsel (information security enhancements) and Operations and Technology (disaster recovery and hardware refresh). The slight decrease to the Health Policy and Benefits Branch reflects a redirection of consultant funds to the Actuarial Office to fund two health actuary positions to support health plan rate development and negotiations.

Administrative Operating Costs by Branch

(in thousands)	2018-19 Actual	2019-20 Authorized Budget	2020-21 Proposed Budget	2019 to 2020 Change	
				\$ Increase / (Decrease)	% Increase / (Decrease)
Actuarial Office	\$ 11,128	\$ 12,421	\$ 13,488	\$ 1,066	8.6%
Communications and Stakeholder Relations	15,258	17,006	17,298	292	1.7%
Customer Services and Support	93,968	106,887	109,248	2,361	2.2%
Enterprise Compliance Office	2,951	3,346	3,470	123	3.7%
Executive Office	9,097	7,693	8,379	686	8.9%
Financial Office ¹	24,859	37,051	37,530	480	1.3%
General Counsel	28,121	34,830	39,361	4,532	13.0%
Health Policy and Benefits Branch	29,137	33,811	33,716	(95)	(0.3%)
Investment Office	74,361	90,739	94,972	4,233	4.7%
Operations and Technology	154,620	159,450	162,554	3,105	1.9%
Pro-Rata Assessment	26,195	25,567	25,765	199	0.8%
Total Administrative Operating Costs	\$ 469,696	\$ 528,800	\$ 545,782	\$ 16,982	3.2%

¹ Includes unallocated expenses such as Executive incentive payments, a reserve for retirement payouts, and pooled positions and related funding.

II. Administrative Operating Costs by Trust Fund

Following is the allocation of proposed Administrative Operating Costs to each trust fund based on a combined direct and indirect methodology. In general, direct expenses specifically attributable to or benefiting a particular fund are allocated to that fund, and indirect expenses are allocated based on the funds' percent of direct costs.

Administrative Operating Costs by Fund

(\$ in thousands)	2018-19 Actual	2019-20 Authorized Budget	2020-21 Proposed Budget	2019 to 2020 Change	
				\$ Increase / (Decrease)	% Increase / (Decrease)
Administrative Operating Costs					
Public Employees' Retirement Fund (PERF)	\$ 376,323	\$ 423,234	\$ 436,705	\$ 13,471	3.2%
Public Employees' Contingency Reserve Fund (CRF) ¹	29,837	33,319	34,199	880	2.6%
Public Employees' Health Care Fund (HCF) ¹	42,961	48,369	49,193	824	1.7%
Long-Term Care Fund (LTCF)	5,650	7,573	8,994	1,421	18.8%
Annuitants' Health Care Coverage Fund (AHCCF)	4,470	5,477	6,341	865	15.8%
Deferred Compensation Fund (IRC 457)	1,829	1,760	1,870	111	6.3%
Supplemental Contributions Program Fund (SCP)	136	122	117	(6)	(4.5%)
Judges' Retirement Fund (JRF)	2,445	1,979	1,926	(53)	(2.7%)
Judges' Retirement Fund II (JRF II)	2,730	2,260	2,203	(57)	(2.5%)
Legislators' Retirement Fund (LRF)	555	505	497	(8)	(1.7%)
Replacement Benefit Custodial Fund (RBF)	450	536	633	97	18.1%
California Employers' Pension Prefunding Trust Fund (CEPPT) ²	-	422	5	(416)	(98.8%)
Old-Age & Survivors Insurance Fund (OASI) ¹	-	1,024	1,054	30	2.9%
Reimbursements ³	2,310	2,219	2,044	(175)	(7.9%)
Total Administrative Operating Costs	\$ 469,696	\$ 528,800	\$ 545,782	\$ 16,982	3.2%
Statewide Pro-Rata Assessment	\$ 26,195	\$ 25,567	\$ 25,765	\$ 199	0.8%
CalPERS Administrative Costs	\$ 443,501	\$ 503,233	\$ 520,016	\$ 16,784	3.3%

¹ Amounts identified for 2020-21 include estimates for statewide employee compensation subject to State Budget Act control sections.

² In 2019-20, program startup funding provided by a General Fund appropriation authorized by SB 1413, Chapter 665, Statutes of 2018. In 2020-21, administrative costs are allocated to the CEPPT fund based on a revised cost allocation methodology.

³ Reimbursements include specialized actuarial valuations prepared for public agencies, cost of photocopies/postage related to the Public Records Act requests, annual employer conferences, and administrative assessments for employers' delinquent payroll.

III. 2021-22 Projection

Each year as part of the annual budget process, CalPERS proposes and analyzes new resource requests that may impact future expenditures. Based on current information and known factors, CalPERS projects a net increase of \$1.2 million in its Operating Costs in 2021-22 due to the following:

- \$5.8 million increase in Administrative Operating Costs estimated for the 2 percent collectively-bargained salary increase planned for July 1, 2021.
- \$3.0 million decrease in Investment Operating Costs following the implementation phase of Total Fund data strategy initiatives which drove increases in 2019-20 and 2020-21.
- \$1.6 million decrease in Headquarters Building Costs driven by a reduction in one-time improvement projects.

2021-22 Projection

(in thousands)	2020-21 Proposed Budget	2021-22 Projected Budget	2020 to 2021 Change	
			\$ Increase / (Decrease)	% Increase / (Decrease)
Administrative Operating Costs	\$ 545,782	\$551,577	\$5,795	1.1%
Investment Operating Costs	124,856	121,875	(2,981)	(2.4%)
Enterprise Projects Costs	-	-	-	0.0%
Headquarters Building Costs	24,338	22,744	(1,593)	(6.5%)
Total Projection	\$694,976	\$696,197	\$1,221	0.2%
Authorized Positions	2,875.0	2,875.0	-	0.0%