



# Investment Committee

## Item number 3 – Open session

**Subject:** 2023 Annual Cost & Collaborative Model Savings Report

**Presenter(s):** April Wilcox, Shifat Hasan, and Mike Dunigan

**Item type:** Information

**Date and time:** November 6, 2024 – 30 minutes

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**Attachment(s):** Attachment 1 – Cost Breakdown

Attachment 2 – Cost Breakout by Category

Attachment 3 – Capture Ratio

Attachment 4 – Peer Comparison

Attachment 5 – Collaborative Savings

**PowerPoint presentation(s):** Cost & Collaborative Model Savings Report

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### **Item purpose**

The purpose of this informational report is to provide the Committee with a complete breakdown of the costs associated with running the Total Fund for the calendar year 2023. It is important to note that information in this Cost Report is on a cash basis and at one point in time. Costs can fluctuate significantly each year depending on the life cycle of the underlying investments and/or the investment pace of the strategy. CalSTRS is a long-term investor and return and cost data is more meaningful when compared over longer time periods; as such, data over a 9-year period has been included in this report.

### **Executive summary**

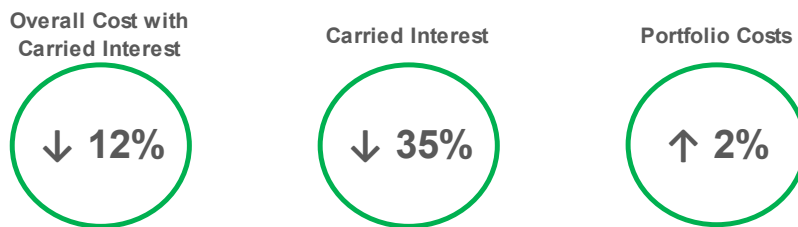
In 2023, CalSTRS paid out just over \$2 billion in costs to run the Total Fund and another \$820 million in carried interest. This was a slight increase to Total Portfolio Costs from the previous year, but a decrease overall in Total Costs with Carried Interest.

The 2023 financial markets were a complete reversal of a very challenging 2022. Despite a feared recession instigated by an aggressive rate hike cycle, Global Equities captured double-digit returns led by the technology sector. In mid-November, after seeing inflation continue to

decline toward their target, the U.S. Federal Reserve announced they would pause raising rates. This relief inspired the U.S. bond market to have one of its best months in over 40 years, helping to bring the Fixed Income annual return to 6% for the year.

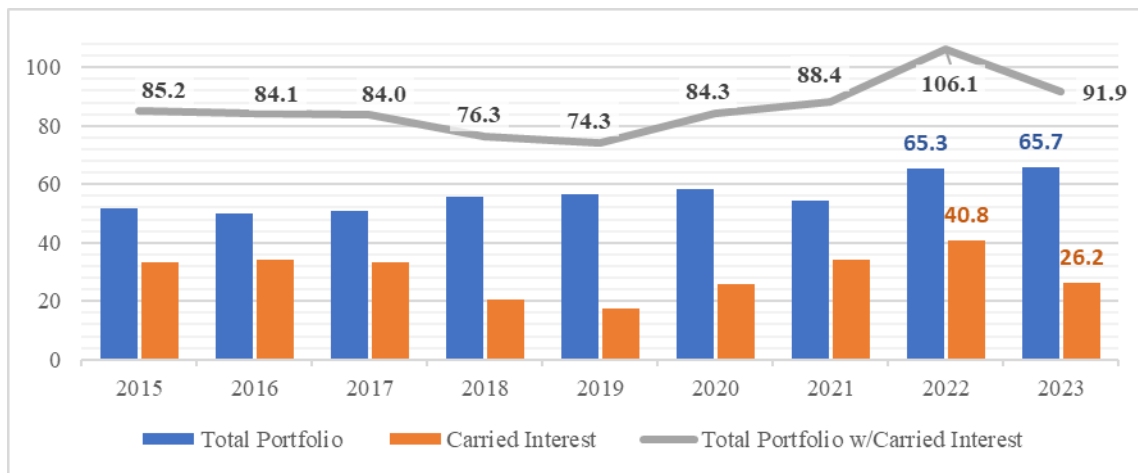
In the private markets, Real Estate declined 9%, while Private Equity and Infrastructure increased around 8% despite increasing capital costs and the regional bank crisis.

Additionally, over the first half of 2023, per the board-approved strategic asset allocation, CalSTRS decreased its Public Equity allocation by 1%, increased the allocation to Private Equity by the same amount, and continued to allocate more funds toward private credit. The overall Net Asset Value (NAV) and the allocation to private assets tend to be the biggest drivers of cost. This year, Portfolio Costs stayed relatively in alignment with NAV growth, even as the allocation to private assets grew. Below are the year-over-year percentage changes to key cost factors.



**Background**

**Chart / Table 1 – Overall Costs in Basis Points and Absolute Dollars**



(\$ in Millions)	2019	2020	2021	2022	2023	2023 Δ
NAV	242,190	261,992	338,296	308,309	312,963	2%
Total Portfolio Costs	1,374	1,527	1,840	2,014	2,056	2%
Carried Interest Paid	426	681	1,150	1,257	820	-35%
Total w/Carried Interest	1,800	2,209	2,990	3,271	2,876	-12%

Overall costs decreased by 12% in 2023 primarily due to a significant drop in the amount of carried interest paid out by private investments during the year. Carried interest is a profit-

sharing agreement between the general partners and CalSTRS and is only paid out upon exiting a profitable investment. The agreements are tied to profits realized over a period of years rather than a single year, and as a result, this number will fluctuate. CalSTRS carried interest paid had increased over the prior few years after the private equity market saw double digit returns in 2020 and 2021. However, in 2023, carried interest decreased by 35%, after a flat performance year in 2022.

Total Portfolio Costs increased by 2% over the year. They include management fees, internal operating expense, and partnership costs (other expense). These costs are impacted the most by changes in the NAV, the allocation to private assets, and the split between internal and external management. The impact of these drivers is shown in Table 2 below.

**Table 2 – Portfolio Cost Drivers**

Driver	Impact	Details
Asset Growth	+ 1.5%	Management fees increased relative to the overall NAV increase
Private Asset Allocation	+ 1.5%	Allocation shift to private equity and private credit impacted management fees and operating costs
Internal Management	- 1%	Partnership cost and management fee decrease
<b>2%</b>		

Table 3 breaks down the splits between internal and external management costs across public and private assets. In 2023, internally managed assets increased 1% on par with internally managed cost. The allocation to private assets grew, while the total percentage of private costs stayed flat. This shows that the increased allocation to privates was primarily used for internal management, which had less of an impact on cost.

**Table 3 – Total Portfolio Costs as a Percentage of Net Asset Value (in Millions)**

	NAV	%	Cost	%	Avg Cost in Basis Points	
<b>Externally Managed</b>	<b>115,751</b>	<b>37%</b>	<b>1,412</b>	<b>69%</b>	<b>Private</b>	
Private	80,103	26%	1,230	60%	External	Internal
Public	35,648	11%	182	9%	154	102
<b>Internally Managed</b>	<b>197,212</b>	<b>63%</b>	<b>644</b>	<b>31%</b>	<b>Public</b>	
Private	56,907	18%	579	28%	External	Internal
Public	140,305	45%	65	3%	51	5
<b>Total</b>	<b>312,963</b>	<b>100%</b>	<b>2,056</b>	<b>100%</b>		

The 2023 calendar year saw the CalSTRS Total Fund return over 9%, Total Costs with Carried Interest declined by 12%, and the Collaborative Model saved the plan \$363 million. The

additional total portfolio costs created from the increase in NAV and an allocation shift toward private assets, were partially offset by an increase in internal management. Costs declined overall as less carried interest was paid out – a combination of managers not taking profits after a flat 2022 and increased internal private management over the years.

The capture ratio showed slight improvement for this same reason, up 20 basis points (bps) from 2022. CalSTRS captured 91.9% of its gross profits over the last 9 years (see attachment 3). In addition, CalSTRS continued to operate as a low-cost fund relative to its peers, as measured by CEM Benchmarking, Inc. The 2023 investment cost of 54.4 bps was lower than our expected cost resulting in a savings of \$162 million in 2023 as shown in Attachment 4.

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Strategic Plan linkage: **Trusted stewards:** Ensure a well-governed, financially sound trust fund.

Board Policy linkage: N/A

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**Optional reference material:**

[Annual Investment Cost Report - CalSTRS](#) – for historical Annual Cost & Collaborative Model Savings Reports.

[Investment terms glossary - CalSTRS](#) – for a full listing of glossary terms and definitions.