



Investment Committee

Item Number 6b – Open Session

Subject: Infrastructure Policy Revision – First Reading

Presenter(s): Paul Shantic & Charles Fitzpatrick

Item Type: Information

Date & Time: July 7, 2022 – 20 minutes

Attachment(s): Attachment 1 – Meketa Concurrence Memo

Attachment 2 – Infrastructure Investment Policy – Redline Version

Attachment 3 – Infrastructure Investment Policy – Clean Version

PowerPoint(s): Infrastructure Investment Policy Revisions – First Reading

POLICY

The [CalSTRS Infrastructure Policy](#) (Page L-1), which governs the management of the Infrastructure Program, seeks to ensure that a diversified portfolio of infrastructure assets is developed to meet CalSTRS’ objectives, within acceptable risk parameters.

PURPOSE

This is a first reading of these proposed Infrastructure Policy revisions.

This is an action item proposing policy changes to the Infrastructure Policy language so as to suggest and incorporate additional modifications in keeping with the evolving market conditions, practices, and opportunities available to the unit.

Staff is proposing policy changes designed to accomplish:

- Clarify “domestic investments in K-12 schools” as not allowable investments. Keep the remaining language around the uncertainty of the definition and the role of the Chief Investment Officer, with the assistance of the Director of Inflation Sensitive and staff, in seeking clarification around such investments.

- Eliminate from the infrastructure Policy the sub-classifications descriptions and details around strategy, allocation, cash yield, real return targets, and examples. This language will be moved to Infrastructure guideline documents and modified by staff as needed to reflect market trends. Shorter descriptions of core, value added, opportunistic and publicly listed portfolios are found under the **Strategic Objectives** section.
- Adjusts allocation ranges around Core and Value-Added assets to better reflect the risk/return profile around Value-Added assets. Core assets are still a valuable and desired addition to the portfolio and will be acquired based on pricing sensitivities around the asset and the risk/return profile.
- Modify the language and detail around the shifting definition of an OECD country to make it more flexible in terms of new entrants and exits. Also, separates the United States and Canada, thus making the United States its own geographic region and shifts the United States only into the new 30% to 80% range in terms of portfolio geography. This encourages continued alignment between asset acquisition, the benchmark, and opportunities available in the marketplace. Canada returns to the “OECD – ex U.S.” classification.
- Add a definition for “*Direct Investments*” as the unit converted an Account structure, along with two other institutional investors, into a direct investment in 2021. The additional definition broadly defines and categorizes the structure type into Policy.
- Under the **Risk Management/Risks** section the listing of the various risks has been shortened and broadly referred to as the application of detailed risk specifications is not always appropriate for each investment. Also, recommended by the Compliance unit for removal from the Policy as such risk descriptions are better located in unit guidelines.
- Under both the **Environmental Liability** and **Responsible Contractor Policy** sections the deleted sections and additions reflect language consistent with the 2021 Board adopted Real Estate Investment Policy revisions.
- Under the **Concentration Limits** section, the Infrastructure Manager concentration limit is moved from 20% to 25% of total targeted IPMP AUM. This slight increase in manager limits ensures consistency with the Collaborative Model and continues to aid CalSTRS’ commercial position in the infrastructure marketplace and alignment of interests with strong and consistently capable managers.
- Eliminate the **Policy Information Flow Chart and Glossary** to ensure consistency with other policy updates. Those exhibits will be incorporated into the unit’s guidelines, with

the exception of the Glossary which will be retired. In its place a centralized CalSTRS Investment Glossary has been created which includes all investment asset class definitions.

DISCUSSION/SUMMARY

The Infrastructure Policy is a dynamic document that needs to reflect the market of which it is a part. The revisions below seek to clarify, update, and amend sections of the current policy to better reflect the realities of the marketplace and ensure that CalSTRS, as one of the largest teacher based public pension funds in the United States, maintains its position as an active and innovative leader in the infrastructure market in both the United States and around the world.

Staff and the Board consultant, Meketa Investment Group (Meketa), have reviewed the Infrastructure Policy and recommend the following revisions:

1. *Page L-1 – L-12* – notes the introduction of a ministerial revision throughout the document. “P” in “Portfolio” stands for the entire CalSTRS Portfolio. The use of “p” in “portfolio” stands for the Infrastructure portfolio only.
2. *Page L-3* – the **Infrastructure Sectors** section adds the clarifying language “domestic investments in K-12 schools” as not an allowable investment. Keeps the remaining language around the need for occasional interpretation of the definition and the role of the Director and staff in working with the Chief Investment Officer in seeking clarification around any potential conflicts.
3. *Page L-3 & L-4*– the **Strategic Objectives and Infrastructure Portfolio Sub-Classifications** section eliminates from the Policy the infrastructure sub-classification descriptions and details around strategy, allocation, cash yield, real return targets and examples. Shorter descriptions of core, value added, opportunistic and publicly listed are found under Strategic Objectives. This language will be moved to guideline documents and modified from time to time by staff.
4. *Page L-5* – the **Portfolio Sub-Classifications** ranges are adjusted to better reflect the opportunity set available to Value-Added infrastructure assets and the more expensive nature of Core assets. The bottom of the Core asset range is expanded from 40% to 30%. The top of the value-added range is expanded from 50% to 60%. Core assets are still desirable additions to the portfolio but will be reviewed with an eye towards asset price sensitivities around the asset itself, market comparables, and the risk/return profile offered. This change recognizes the changing nature of the Infrastructure market and the competition for Core assets.
5. *Page L-5* – the *Portfolio Development* section strikes the language concerning the Infrastructure program being a developing program. The program has been in operational

for over five years and has been integrated into the overall CalSTRS asset allocation process and portfolio structure.

6. *Page L-6* – under the **Geographic Regions** section this language more broadly defines OECD countries without a detailed naming convention and is more flexible as OECD countries are included and excluded from the definition. Also, separates the United States and Canada, thus making the United States its own geographic region in the 30% to 80% range, a slight increase over the previous 75% upper limit. This change recognizes the importance of the United States infrastructure market, keeping alignment with the portfolio's U.S. based CPI benchmark, and the opportunity set available.
7. *Page L-8* - under **Direct Investments** this language adds and defines a direct investment. This language updates the Policy to recognize the addition of the Program's first direct investment in 2021.
8. *Page L-8 & L-9* – under the **Risk Management/Risks** section the listing of the various risks has been shortened and broadened as the application of detailed risk specifications is not always consistent and appropriate for each investment. Also, recommended by the Compliance unit for removal from the Policy as it is better located in unit guidelines and is bespoke to individual investments.
9. *Page L-9* – under the **Portfolio Leverage** section – ministerial language.
10. *Page L-10* – under the **Environmental Liability** section the proposed language is similar to language found in the recently adopted Real Estate Investment Policy approved by the Board in 2021. Removed language will be moved to infrastructure guidelines as recommended by the Compliance unit.
11. *Page L-10* – under the **Concentration Limits** section this language moves the infrastructure manager concentration limit from 20% to 25%. This action increases the limit that CalSTRS would have with any one infrastructure manager, ensures consistency with the Collaborative Model, and continues to aid CalSTRS' strong commercial presence in the infrastructure marketplace and enhances the alignment of interests with strong and consistently capable managers.
12. *Page L-11* – under the **Discretionary Authority** section this adds language that staff has discretion to approve up to \$500 million for an additional investment in a direct investment vehicle. Also, adds language that limits the amount with any manager or any one direct investment vehicle to a maximum of 25%, and ensures that no single direct asset could represent more than 5% of the entire Infrastructure portfolio. This aligns with previously adopted Infrastructure Investment Policy language around Accounts and Co-investments.
13. *Page L-11 & L-12* – under the **Responsible Contracting Policies** the additions revise the RCP language of this Policy to be consistent with the Board adopted 2021 Real Estate

Policy. All deleted sections will be incorporated into infrastructure procedures and guidelines as applicable.

14. *Page L-13* – under the **Monitoring and Reporting** section this language, rather than specifically designating FASB or GASB accounting standards, aligns the Policy with industry best practices.

Under the **Infrastructure Investment Selection** section, the entire paragraph is struck as all parts of the CalSTRS investment unit operate under the “prudent expert” standard and the development of internal procedures are common to all asset classes. It’s place in Policy is unnecessary and redundant.

Under the **Policy Monitoring and Modification** section new language has been added and updated for inclusion by CalSTRS’ Compliance unit.

15. *Pages L-15 to L-19* - the **Policy Information Flow Chart and Glossary** sections have been struck from the Policy and will be incorporated into guidelines and procedures in order to be consistent with other CalSTRS policies. This recommendation has been made at the suggestion of the Compliance unit.

RECOMMENDATION

Staff recommends and the Board consultant Meketa concur that the Investment Committee consider the proposed revisions to the Infrastructure Investment Policy. Staff will incorporate the Board’s feedback into the Policy and bring it back for a second reading, unless the Board decides to approve the recommended changes at this meeting.