



Board Report

File #: 2023-0054, File Type: Contract

Agenda Number: 12.

FINANCE, BUDGET, AND AUDIT COMMITTEE MARCH 15, 2023

SUBJECT: INVESTMENT MANAGEMENT SERVICES BENCH

ACTION: AWARD CONTRACTS

RECOMMENDATION

AUTHORIZE the Chief Executive Officer to award ten- (10) year bench Contract Nos. PS45150000 through PS45150007, for investment management services, to the firms listed below, for a total not-to-exceed amount of \$12,393,750 for the initial five-year base term, plus \$12,393,750 for the five-year option term, for a combined not-to-exceed amount of \$24,787,500, effective April 1, 2023, subject to resolution of protest(s), if any:

A. Discipline 1: Intermediate duration fixed income managers

- 1.1 LM Capital Group, LLC
- 1.2 RBC Global Asset Management (U.S.), Inc.
- 1.3 Chandler Asset Management, Inc.
- 1.4 US Bancorp Asset Management, Inc.
- 1.5 Payden & Rygel

B. Discipline 2: Short-term duration fixed income managers

- 2.1 CSM Advisors, LLC dba CS McKee
- 2.2 Longfellow Investment Management Co., LLC
- 2.3 US Bancorp Asset Management, Inc.
- 2.4 Loop Capital Asset Management
- 2.5 Payden & Rygel
- 2.6 RBC Global Asset Management (U.S.), Inc.

ISSUE

The Los Angeles County Metropolitan Transportation Authority's (Metro) Investment Policy requires that temporarily idle funds of the agency be prudently invested to preserve capital and provide necessary liquidity while maximizing earnings. Metro hires external investment managers to obtain full time professional expertise in the field of fixed income at a reasonable cost. The external

managers invest part of the operating portfolio in longer term maturities that increase diversification, improve risk management, and enhance performance.

BACKGROUND

Operating funds are the pool of excess working capital used to fund expenses such as salaries, capital project expenditures, fuel and supplies, contract, and professional services.

The current investment management services contracts with LM Capital, a minority owned business, RBC Global Asset Management, US Bancorp, and Chandler Asset Management, a California certified small business, are due to expire on March 31, 2023. New contracts for investment management services to be in place prior to that expiration date is preferred.

DISCUSSION

Currently, internal staff manages a separate three to six-month short-term cash portfolio to meet daily liquidity requirements. The external intermediate term portfolio managers currently invest a portion of the operating fund balance to take advantage of higher yields typically available on longer maturities. The new external short term portfolio managers will invest a portion of the operating fund balance in short to medium term maturities and provide additional liquidity when needed.

Four investment styles that are used to add value to bond portfolios: duration management, sector weighting, issuer selection and yield curve management, were selected to complement the portfolio and to reduce risk through diversification.

The investment style of duration management is a strategy which balances the trade-offs of the higher income often generated by longer maturities with the volatility/downside risk in a rising interest rate environment. Duration as it pertains to fixed income securities is the weighted average of the time until fixed cash flows are received. Shortening the duration reduces the time to receive cash flows while increasing the duration lengthens the time to receive these cash flows. In general, the shorter the duration, the lesser the portfolio is exposed to interest rate volatility.

The investment style of sector weighting is a strategy of allocating funds to asset categories (i.e., Agencies, Corporate Notes, Treasuries, Commercial Paper, etc.) poised to provide the best risk/reward profile. As market conditions change, the allocations in various sector categories are adjusted to provide the best risk/reward trade-offs.

Issuer selection is an investment style that focuses on the underlying characteristics of the fixed income security (bond issuer). This style takes into consideration the many factors (i.e., credit rating, balance sheet strength, revenue stream, etc.) and price in deciding whether the fixed income investment has potential and should be included in the portfolio.

The investment style of yield curve management strives to maximize portfolio values by utilizing the shape of the yield curve and minimizing adverse impacts to the portfolio when interest rates change.

Firms utilizing this style employ strong macro-economic research and focus on determining interest rate trends.

The initial portfolio size, account contributions, and withdrawals will be determined by Metro's liquidity needs, market conditions and the investment manager's performance relative to their benchmark. Staff reviews and discusses performance and compliance matters with the external managers during quarterly meetings, or as necessary.

Four of the five firms recommended for Discipline 1: intermediate duration fixed income managers are Metro's current external managers, who were selected through a competitive process in late 2017 and currently manage \$1.3 billion, or 42% of the total operating fund portfolio as of December 31, 2022. For the contract period, the managers outperformed the benchmark overall and earned \$81 million in interest income during the same period. The portfolios are managed in accordance with the guidelines in the Investment Policy approved by the Board on February 24, 2022.

With this procurement, Metro added Discipline 2 with the intention of creating more opportunities for small, minority owned and women-owned businesses. This short term discipline required different minimum qualifications than Discipline 1 including lower thresholds for assets under management and minimum years of experience with CA Gov't code. Six firms are recommended under this new discipline including three minority owned, women owned or employee-owned businesses.

DETERMINATION OF SAFETY IMPACT

Approval of this item will not have an impact on safety standards for Metro operations.

FINANCIAL IMPACT

Total proposed fees of \$24,787,500 over the ten-year bench contract period are based on a fixed rate applied to estimated average assets under management of \$3.9 billion, assuming growth in the portfolio over time.

Funding of \$1.8 million for this service in FY24 is included in the budget under 50316- Service Professional and Tech Services in cost center 5210 Treasury Department. The funds are divided among three projects: 4% to Project 100002, Task 30.02; 43% to Project 300076, Task 30.02; and 53% to Project 610340, Task 30.02. This multi-year will be managed by the Treasury Department Manager, Finance and DEO, Finance; the Treasurer will be accountable for budgeting the cost in future years.

EQUITY PLATFORM

Discipline 2 was added to the operating portfolio with the intention of creating more opportunities for small minority owned, and women owned businesses. This short-term discipline required different minimum qualifications than Discipline 1 including lower thresholds for assets under management and minimum years of experience with CA Gov't code. Six firms are recommended under this new discipline including three minority owned, women owned or employee-owned firms. Five firms are recommended under Discipline 1 including three small, minority owned, and minority/ woman owned

business.

Treasury staff conducted extensive outreach and thorough research through the State of California's Small Business firm listings, Los Angeles County Local Community banks, Treasury's financial advisors' database, and Metro's own certified small business enterprises (SBE) and compiled a list of 122 firms. The list includes 52 SBE firms, 32 Disadvantaged Business Enterprises (DBE), seven Minority Business Enterprises/Women-Owned Business Enterprises (MBE&WBE), and 27 Los Angeles County local community banks. RFP notifications were sent to all 122 firms.

A total of 31 proposals were received, including one non-Metro certified SBE firm and five MBE&WBE firms.

IMPLEMENTATION OF STRATEGIC PLAN GOALS

Metro's Investment Policy supports Metro's Vision 2028 Goal#5: Provide responsive, accountable, and trustworthy governance within the Metro Organization.

ALTERNATIVES CONSIDERED

The Board could elect not to select any external investment managers and rely solely upon staff to invest the operating funds. This alternative is not recommended because the depth of resources of each investment firm enables them to identify and analyze the opportunities and risks associated with a more diversified investment portfolio. The external firms provide broader issuer coverage across permitted asset categories, professional portfolio diversification, duration, and risk management.

NEXT STEPS

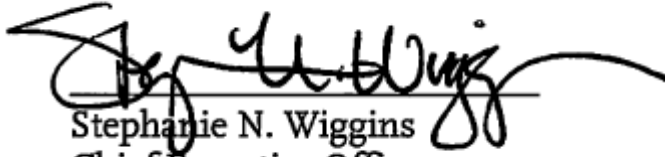
Upon Board approval, staff will execute the bench contracts for investment management services, effective April 1, 2023.

ATTACHMENTS

Attachment A - Procurement Summary
Attachment B - List of Recommended Contractors
Attachment C - DEOD Summary

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