



Board Report

File #: 2017-0597, File Type: Contract

Agenda Number: 11.

FINANCE, BUDGET AND AUDIT COMMITTEE OCTOBER 18, 2017

**SUBJECT: INVESTMENT MANAGEMENT SERVICES FOR THE
OPERATING PORTFOLIO**

ACTION: AWARD CONTRACTS

RECOMMENDATION

AUTHORIZE the Chief Executive Officer to award five year, fixed rate contracts to four investment management firms; 1) LM Capital Group, 2) RBC Global Asset Management, 3) Chandler Asset Management and 4) US Bancorp Asset Management, in an amount not to exceed \$3,584,067, effective January 1, 2018, subject to resolution of protest(s), if any.

ISSUE

Our Investment Policy requires that temporarily idle funds of the agency be prudently invested to preserve capital and provide necessary liquidity, while maximizing earnings. The Los Angeles County Metropolitan Transportation Authority (Metro) hires external investment managers to invest part of our operating portfolio in longer term maturities for the benefits of superior portfolio performance, diversification, risk management and to obtain full time professional expertise in the field of fixed income at a reasonable cost. The current investment management services contracts are due to expire on December 31, 2017. We want new contracts for investment management services to be in place prior to that expiration date.

DISCUSSION

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.

Internal staff manages a separate short-term cash portfolio to meet daily liquidity requirements. The external investment managers invest the balance of our operating fund portfolio to take advantage of higher yields typically available on longer maturities.

The selection process was conducted on the "best value" basis. All proposers were evaluated on their organization, qualifications and experience of their personnel, investment style and their compatibility as investment managers in relation to the total portfolio and proposed fees.

Four investment styles, 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 times 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 portfolio sizes will be based upon the firms' total assets under management and fees charged. Subsequent account contributions and/or withdrawals will be determined by our 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 and as necessary.

The four firms recommended are our current external managers, who were selected through a competitive process in late 2012 and currently manage \$719.2 million, or 66% of the total operating fund portfolio as of June 30, 2017. As shown in Attachment C, for the contract period, the managers outperformed the benchmark and earned \$64 million in interest income during the same time period. The portfolios are managed in accordance with the guidelines in our Investment Policy approved by the Board on January 26, 2017.

DETERMINATION OF SAFETY IMPACT

Approval of this item will not impact the safety of our patrons or employees.

FINANCIAL IMPACT

Total proposed fees of \$3,584,067 over the five year contract period are based on a fixed rate applied

to estimated average assets under management of \$843.5 million, assuming growth in the portfolio over time.

Funding of \$853,000 for this service in FY18 is included in the budget under Investment Income for Government Funds and Enterprise Funds with accounting code 1102 0000 40711 00000 00000. These multi-year contracts will be managed by the Treasury department Senior Investment Manager and Assistant Treasurer; the Treasurer will be accountable for budgeting the cost in future years.

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 the risks associated with a wider range of investments. The external firms provide broader issuer coverage across permitted asset categories, professional portfolio diversification, duration and risk management.

NEXT STEPS

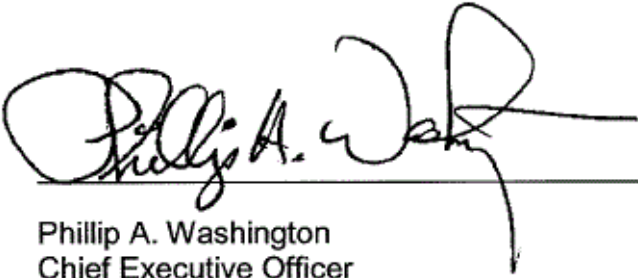
Upon Board approval, staff will execute contracts to the listed investment management firms for fixed income management services for the operating portfolio, effective January 1, 2018.

ATTACHMENTS

- Attachment A - Procurement Summary
- Attachment B - DEOD Summary
- Attachment C - External Managers Performance

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