



## Board Report

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### 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**

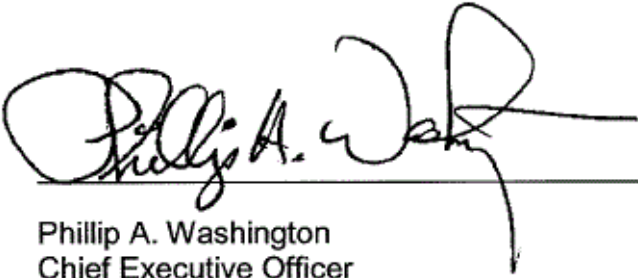
Upon Board approval, staff will execute contracts to the listed investment management firms for fixed income management services for the operating portfolio, effective January 1, 2018.

### **ATTACHMENTS**

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

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Phillip A. Washington  
Chief Executive Officer

## PROCUREMENT SUMMARY

FIXED INCOME MANAGEMENT SERVICES FOR THE OPERATING PORTFOLIO /  
PS41161A, PS41161B, PS41161C, PS41161D

1.	<b>Contract Number:</b> PS41161A; PS41161B; PS41161C; PS41161D	
2.	<b>Recommended Vendors:</b> A. Chandler Asset Management, Inc. B. LM Capital Group, LLC C. RBC-Global Asset Management (U.S.) Inc. D. US Bancorp Asset Management, Inc.	
3.	<b>Type of Procurement (check one):</b> <input type="checkbox"/> IFB <input checked="" type="checkbox"/> RFP <input type="checkbox"/> RFP-A&E <input type="checkbox"/> Non-Competitive <input type="checkbox"/> Modification <input type="checkbox"/> Task Order	
4.	<b>Procurement Dates:</b>	
	A. <b>Issued:</b> June 7, 2017	
	B. <b>Advertised/Publicized:</b> May 31, 2017	
	C. <b>Pre-Proposal Conference:</b> N/A	
	D. <b>Proposals Due:</b> July 17, 2017	
	E. <b>Pre-Qualification Completed:</b> September 25, 2017	
	F. <b>Conflict of Interest Form Submitted to Ethics:</b> September 25, 2017	
	G. <b>Protest Period End Date:</b> October 21, 2017	
5.	<b>Solicitations Picked up/Downloaded:</b> 22	<b>Bids/Proposals Received:</b> 8
6.	<b>Contract Administrator:</b> James A. Nolan	<b>Telephone Number:</b> 213-922-7312
7.	<b>Project Manager:</b> Marshall Liu	<b>Telephone Number:</b> 213-922-4285

**A. Procurement Background**

This Board Action is to approve four, five-year Contract Nos. PS41161A, PS41161B, PS41161C, and PS41161D issued to provide fixed income investment management services for Metro's Operating Fund Portfolios that are administered by the Treasury Department. The goal in the selection of firms was to maximize the value of the total operating portfolio by considering the blending of investment managers' styles to maximize strategic diversification. Board approval of contract awards are subject to resolution of any properly submitted protest.

The RFP was issued June 7, 2017, in accordance with Metro's Acquisition Policy and the contract types are Fixed Fee. A detailed Questionnaire was utilized to ascertain Proposers' qualifications and applicable experience in providing Fixed Income Investment Management Services of the type required by Metro.

No amendments were issued during the solicitation phase of this RFP.

A total of eight proposals were received on July 17, 2017, and are listed in alphabetical order as follows:

1. Chandler Asset Management, Inc.
2. Garcia Hamilton & Associates, LP

3. LM Capital Group, LLC
4. RBC Global Asset Management (U.S.) Inc.
5. Reams Asset Management (Div. of Scout Investments)
6. Standish Mellon Asset Management Company LLC
7. US Bancorp Asset Management, Inc.
8. Western Asset Management Company

**B. Evaluation of Proposals**

A Proposal Evaluation Team (PET) consisting of staff from Metro’s Treasury Department and an outside consultant was convened and conducted a comprehensive technical evaluation of the proposals received. The proposals were first evaluated according to minimum qualifications contained in the RFP. Two proposers were eliminated from further consideration because one declined to provide required reference information and the other firm did not meet the minimum qualifications regarding California government code clients.

The remaining six proposals were evaluated based on the following evaluation criteria and weights:

- |  |            |
|--|------------|
| • Organization   | 15 percent |
| • Qualifications of Firm and Key Personnel/Related Experience                                | 20 percent |
| • Investment Philosophy and Process for Managing LACMTA’s Investment Portfolio               | 25 percent |
| • Proposed Fee Structure   | 20 percent |
| • Compatibility and/or Comparability of Proposer’s Relation to the Total Operation Portfolio | 20 percent |

The evaluation criteria are appropriate and consistent with criteria developed for other, similar Treasury procurements. Several factors were considered when developing these weights, giving the greatest importance to investment philosophy and process for managing LACMTA’s investment portfolio.

The six responsive proposals firms are listed below ranked in descending order:

1. Chandler Asset Management, Inc.
2. LM Capital Group, LLC
3. RBC Global Asset Management (US) Inc.
4. U.S. Bancorp Asset Management, Inc.
5. Western Asset Management Company
6. Standish Mellon Asset Management Company LLC

During the week(s) of August 1, through September 11, 2017, the PET met and evaluated the firms in accordance with the applicable evaluation criteria. The PET's recommendation is to award multiple, i.e. four, contracts to the highest rated firms.

1	Firm	Average Score	Factor Weight	Weighted Average Score	Rank
2	<b>Chandler Asset Management</b>				
3	Organization	100.00	15.00%	15.00	
4	Qualifications of Firm and Key Personnel/Related Experience	96.66	20.00%	19.33	
5	Investment Philosophy and Process for Managing LACMTA's Investment Portfolio	97.33	25.00%	24.33	
6	Proposed Fee Structure	100.00	20.00%	20.00	
7	Compatibility and/or Comparability Of Proposer's Relation to the Total Operation Portfolio	96.66	20.00%	19.33	
8	<b>Total</b>		<b>100.00%</b>	<b>97.99</b>	<b>1</b>
9	<b>LM Capital Management, LLC</b>				
10	Organization	97.66	15.00%	14.65	
11	Qualifications of Firm and Key Personnel/Related Experience	96.66	20.00%	19.33	
12	Investment Philosophy and Process for Managing LACMTA's Investment Portfolio	95.66	25.00%	23.92	
13	Proposed Fee Structure	85.00	20.00%	17.00	
14	Compatibility and/or Comparability Of Proposer's Relation to the Total Operation Portfolio	96.66	20.00%	19.33	
15	<b>Total</b>		<b>100.00%</b>	<b>94.23</b>	<b>2</b>
16	<b>RBC Global Asset Management</b>				
17	Organization	97.66	15.00%	14.65	
18	Qualifications of Firm and Key Personnel/Related Experience	95.00	20.00%	19.00	
19	Investment Philosophy and Process for Managing LACMTA's Investment Portfolio	89.66	25.00%	22.41	
20	Proposed Fee Structure	95.00	20.00%	19.00	
21	Compatibility and/or Comparability Of Proposer's Relation to the Total Operation Portfolio	88.33	20.00%	17.67	
22	<b>Total</b>		<b>100.00%</b>	<b>92.73</b>	<b>3</b>
23	<b>U.S. Bancorp Asset Management, Inc.</b>				

24	Organization	95.66	15.00%	14.35	
25	Qualifications of Firm and Key Personnel/Related Experience	95.00	20.00%	19.00	
26	Investment Philosophy and Process for Managing LACMTA's Investment Portfolio	79.33	25.00%	19.83	
27	Proposed Fee Structure	90.00	20.00%	18.00	
28	Compatibility and/or Comparability Of Proposer's Relation to the Total Operation Portfolio	91.66	20.00%	18.33	
29	<b>Total</b>		<b>100.00%</b>	<b>89.51</b>	<b>4</b>
30	<b>Western Asset Management Company</b>				
31	Organization	76.66	15.00%	11.50	
32	Qualifications of Firm and Key Personnel/Related Experience	76.66	20.00%	15.33	
33	Investment Philosophy and Process for Managing LACMTA's Investment Portfolio	70.00	25.00%	17.50	
34	Proposed Fee Structure	80.00	20.00%	16.00	
35	Compatibility and/or Comparability Of Proposer's Relation to the Total Operation Portfolio	61.66	20.00%	12.33	
36	<b>Total</b>		<b>100.00%</b>	<b>72.66</b>	<b>5</b>
37	<b>Standish Mellon Asset Management Company</b>				
38	Organization	89.66	15.00%	13.45	
39	Qualifications of Firm and Key Personnel/Related Experience	68.33	20.00%	13.67	
40	Investment Philosophy and Process for Managing LACMTA's Investment Portfolio	52.66	25.00%	13.16	
41	Proposed Fee Structure	100.00	20.00%	20.00	
42	Compatibility and/or Comparability Of Proposer's Relation to the Total Operation Portfolio	56.66	20.00%	11.33	
43	<b>Total</b>		<b>100.00%</b>	<b>71.61</b>	<b>6</b>

### C. Cost/Price Analysis

The recommended price has been determined to be fair and reasonable based upon adequate price competition and price analysis. All four firms proposed a competitive fee structure. Actual fee amounts will fluctuate based on portfolio values.

## **D. Background on Recommended Contractors**

### **Chandler Asset Management**

Chandler Asset Management (Chandler), located in San Diego, California, was founded in 1988 by Catherine (Kay) Chandler. They are a 100% employee owned firm with approximately 127 public sector clients managing approximately \$10 billion in short duration fixed income or intermediate duration fixed income portfolios. The firm's investment philosophy is to select securities in sectors that are poised to outperform the market and avoid those they expect will underperform. Chandler achieves this goal with macro-economic analysis and securities research that leads to their selection of high quality issuers.

As of March 31, 2017, Chandler had 133 public clients with \$10.2 billion in Assets Under Management (AUM) and 42 private clients with \$2.8 billion in AUM.

### **LM Capital Group, LLC**

LM Capital Group (LM) was founded in 1989 by Luis Maizel and John Chalker. The firm is an employee owned minority business located in San Diego, CA that provides fixed income investment management services. LM has successfully managed the operating portfolio of Metro since 1990. Today, LM employs 17 investment professionals that manage approximately \$4.7 billion of assets for 22 public sector clients. Their investment style is top-down macro-economic analysis with a focus on duration management. Their economic research identifies global trends based on the worldwide flow of funds. From that analysis, they choose issuers and sectors that are primed for superior performance. Their selection is based on investment metrics such as average maturity, duration, and allocation to sectors permitted by investment policy.

As of 2016, LM Capital had 22 public clients with \$4.7 billion in AUM and 6 private clients with \$274.3 million in AUM.

### **RBC Global Asset Management (US) Inc.**

RBC Global Asset Management (US) Inc. (RBC), is the US subsidiary of the ultimate parent company Royal Bank of Canada founded in 1869 that currently employs over 80,000 full and part time employees worldwide. As of December 31, 2016, RBC has 74 public sector clients with \$9.6 billion of AUM, and 150 private sector clients with \$30.7 billion of AUM. Their investment philosophy is to employ fundamental investment processes to construct diversified, customizable portfolios of high quality fixed income securities that deliver consistent excess returns with low volatility. Their



bottom-up, fundamental process is combined with robust, top-down risk management tools designed to meet the objectives of principal preservation, liquidity and consistent excess returns over the long term. RBC's approach is to diversify portfolio income sources from high quality issuers in undervalued sectors.

**US Bancorp Asset Management, Inc.**

US Bancorp Asset Management (USBAM) is a wholly owned subsidiary of parent company US Bank National Association. USBAM was formed in 2001 with the merger of First American Asset Management and Firststar Investment Management Company. They have approximately 92 investment professionals managing \$4 billion in assets for 14 public sector clients, and \$64 billion in assets for 44 private sector clients, respectively. Their investment philosophy focuses on generating superior returns over time with active management of yield curves. They also consider duration management, sector diversification as well as security selection. This successful process is further enhanced with strong risk management and operation controls. They adapt their strategy to the best risk-adjusted return opportunities available. As of March 31,2017, US Bancorp had 14 public clients with \$4.0 billion in AUM and 44 private clients with \$63.7 billion in AUM.

All of the recommended firms are incumbents having satisfactorily provided Metro Treasury Department with these services.

DEOD SUMMARY

**FIXED INCOME MANAGEMENT SERVICES FOR THE OPERATING PORTFOLIO /  
PS41161A, PS41161B, PS41161C, and PS41161D**

**A. Small Business Participation**

The Diversity and Economic Opportunity Department (DEOD) did not recommend a small business participation goal for this procurement. As confirmed by the Project Manager, the procurement for fixed income investment management services does not offer subcontracting opportunities as the relationship between the Prime Contractors and Metro would be a fiduciary relationship.

**B. Living Wage and Service Contract Worker Retention Policy Applicability**

The Living Wage and Service Contract Worker Retention Policy is not required on these Contracts.

**C. Prevailing Wage Applicability**

Prevailing wage is not required on these Contracts.

**D. Project Labor Agreement/Construction Careers Policy**

Project Labor Agreement/Construction Careers Policy is not applicable to these Contracts.

## External Manager Performance FY13 - FY17

	6/30/2013	6/30/2014	6/30/2015	6/30/2016	6/30/2017	1/2/13 to 6/30/17	
						Returns	Benchmark
LM Capital Group *	0.51%	1.42%	0.89%	2.53%	0.13%	1.03%	0.96%
RBC Global Asset Mgmt	0.43%	1.73%	1.02%	2.88%	0.10%	1.19%	0.96%
Chandler Asset Mgmt **	-0.21%	1.20%	0.99%	2.57%	0.03%	1.01%	0.96%
US Bancorp Asset Mgmt **	-0.08%	1.03%	0.94%	2.50%	0.18%	1.01%	0.96%
External Manager Composite	0.27%	1.20%	0.94%	2.62%	0.11%	1.00%	0.96%
Benchmark - BofA ML US Govt/Corp ***	0.86%	1.25%	0.63%	2.57%	-0.17%	0.96%	
Over / (Under) performance	-0.59%	-0.05%	0.31%	0.05%	0.28%	0.04%	

\* LM Capital Group is a Minority Business Enterprise (MBE)

\*\* 6/30/13 results begins on their start date of January 2, 2013 through June 30, 2013

\*\*\* Benchmark was 1-3 year BofA ML through 1/31/15 and the 1-5 year BofA ML effective 2/1/15 and forward

Average Balance External Portfolio (in mil)	\$ 1,096	\$ 1,145	\$ 955	\$ 769	\$ 749	
Interest Income Earned (in mil)	\$ 14.7	\$ 12.7	\$ 13.0	\$ 11.6	\$ 12.4	<b>\$ 64.4</b>