

City of Lubbock Fire Pension Plan  
SB 322 Evaluation Report  
As prepared by J.H. Ellwood & Associates, Inc.

## Summary

The Board of the Lubbock Fire Pension Plan engaged Ellwood Associates, Inc. (“Ellwood”) to evaluate the investment practices per the requirements of SB 322. Ellwood completed the following analysis based on the elements specified in the Code. Ellwood found that the Board has the necessary policies and procedures in place to implement the investment program for the Pension Plan. Specific items of note are:

- Overall guiding principles and responsibilities are detailed in the Plan’s Investment Policy Statement which is reviewed annually by the Board and the retained investment consultant;
- Operational procedures and guidelines are detailed in an Investment Strategy Document that details, among other elements, target allocations and allowable ranges, liquidity targets, decision-making procedures and performance evaluation metrics;
- The Board reviews transactions, performance and the investment program in general at each monthly meeting;
- Fees paid to retained investment managers are reasonable relative to industry averages;
- The Board maintains all decision-making authority. Advice is provided by an independent investment consultant and investment program changes are implemented by Plan staff. All assets are held in custody for the Plan; and
- Board members seek investment education directly through participation in educational conferences sponsored by TEXPERS and TLFFRA. Further, the investment consultant provides topical education directly to the Board.

## Evaluation

The following evaluation addresses the elements as described in SB 322.

- 1) *An analysis of any investment policy or strategic investment plan adopted by the retirement system and the retirement system’s compliance with that policy or plan;*

The Board utilizes a two document approach for investment governance. The Investment Policy Statement (“IPS”) addresses the overall policies, procedures, responsibilities and monitoring for the Plan’s investments and is long-term in nature. The Investment Strategy Document (“ISD”) specifies current goals and implementation of the longer-term IPS. Both the IPS and ISD are reviewed annually. Fewer changes are expected in the long term IPS while the ISD tends to evolve to reflect current Board thinking.

The IPS and ISD were evaluated relative to best industry practices. Key elements in comprehensive investment program governance documents include:

- Delegation of Responsibilities of Trustees, Staff, and Investment Consultant;
- Investment portfolio objectives and constraints, including return objectives, investment timeframe, liquidity needs, and risk tolerance;
- The Asset Allocation Policy;
- Asset allocation targets and ranges and rebalancing procedures;
- Investment manager guidelines and evaluation criteria;
- Parameters for returns including market indexes to be used as performance benchmarks; and
- Ongoing monitoring and controls.

The delegation of responsibilities is found in the IPS as these duties do not often change. Section III of the IPS details the Board of Trustees, Staff, Investment Managers, Consultants and Custodian responsibilities with regard to the investment program of the Plan assets. Particular attention is focused on fiduciary duties and legal requirements of each group listed above.

The IPS provides broad guidelines regarding the Plan's objectives and constraints while the ISD delves into current specifics. The objective is tied to the assumed actuarial rate of return as well as the risk level target based on the outcomes of risk tolerance surveys completed by the Board. Constraints within the ISD are designed to maintain the desired risk level for the investment program and detail procedures when allocations move outside allowable ranges. The liquidity needs are determined by the plan administrator and reviewed and approved by the Board as part of the ISD. The Trustees understand investing pension plan assets is a long term endeavor and focus on at least a five year timeframe for investment results. If an active manager underperforms two consecutive calendar years, a formal review is implemented by the investment consultant.

The asset allocation strategy is broadly defined in the IPS which discusses the desire to reflect, and be consistent with, the long-term Investment Objectives. The IPS asset class ranges are broad and reflect the long-term investment goals, the risk tolerances of the Board, the liquidity needs of the Plan and any legal or regulatory constraints on the investment program. By design the ISD includes more specific asset allocation targets and tighter constraints. Both are reviewed annually as part of the Board's governance calendar through an asset allocation analysis performed by the Plan's consultant. The ISD also includes the specific liquidity amounts as determined by the Plan Administrator, given the Plan has experienced net cash outflows for several years.

All but one of the Plan's investments are implemented through a commingled vehicle. The Board understands that invest vehicles' legal documents govern the policies and procedures for these investments and understands that by utilizing these vehicles there is not an ability

to affect the investments in the funds. The Board reviews all investments monthly. Changes to the investment program can occur whenever determined appropriate, though the focus of the investment program is long-term in nature. One investment is separately managed for the Plan. This manager has agreed upon investment guidelines as determined by the Board and Investment Manager and this manager is reviewed based on these guidelines.

The total investment program, asset classes and individual managers are compared to their appropriate benchmarks on both gross of fee and net of fee bases. Managers are also compared to the universe of similar style managers. While the performance analyses is focused on long-term results, all timeframes are reviewed at each monthly Board meeting.

Besides performance, all managers are continuously monitored by the investment consultant for changes in organization, personnel, investment processes and other qualitative issues.

- 2) *A detailed review of the retirement system’s investment asset allocation, including;*
- a) *The process for determining target allocations;*

The asset allocation targets for the Plan’s investment program are guided by the target rate of return, the risk tolerance of the Board, and the liquidity and regulatory constraints on the investments. The Plan’s investment consultant assists by providing an annual asset allocation analysis. The analysis is based on mean-variance optimization and includes all asset classes available to the Plan and also includes appropriate limits on high volatility and/or illiquid investments.

- b) *The expected risk and expected rate of return, categorized by asset class;*

The Board utilizes the expertise of the retained investment consultant for the development of expected risk and return assumptions. These expectations from the latest asset allocation analysis dated April 12, 2019 are:

Asset Class	10-Year Expected Return	Expected Volatility	Correlation Matrix										
			Developed Equity	Emerging Markets Equity	Private Equity	Fixed Rate Debt (Intermediate)	Fixed Rate High Yield Bonds	Floating Rate Public Debt	Private Credit	Low Volatility Hedge Funds	Liquid Real Assets	Private Real Estate	
Developed Equity	7.0%	17.4%	1.00										
Emerging Markets Equity	7.9%	25.2%	0.81	1.00									
Private Equity	10.0%	22.9%	0.73	0.65	1.00								
Fixed Rate Debt (Intermediate)	3.4%	4.5%	0.05	0.17	-0.27	1.00							
Fixed Rate High Yield Bonds	6.0%	8.0%	0.74	0.73	0.54	0.25	1.00						
Floating Rate Public Debt	5.3%	5.6%	0.42	0.47	0.29	0.15	0.57	1.00					
Private Credit	6.2%	10.0%	0.58	0.56	0.46	-0.01	0.84	0.56	1.00				
Low Volatility Hedge Funds	4.9%	6.0%	0.70	0.71	0.52	0.11	0.82	0.66	0.82	1.00			
Liquid Real Assets	5.0%	10.0%	0.66	0.79	0.49	0.16	0.61	0.44	0.46	0.65	1.00		
Private Real Estate	6.9%	13.6%	0.23	0.16	0.17	0.09	0.20	0.13	0.14	0.19	0.21	1.00	

c) *The appropriateness of selection and valuation methodologies of alternative and illiquid assets; and*

As mentioned earlier in this evaluation, the majority of the Plan's investments are accessed through commingled funds. The Plan's illiquid private equity, private credit and most of the private real estate are held within commingled funds. The investment managers for each of the private commingled investments determine the valuation methodologies. Each fund is audited by an independent auditing firm annually. The Board relies on these audits for valuations.

The Plan has several real estate investments that are held directly and are managed by an investment management firm. The Board relies on the investment advisor involved with these property investments to have periodic valuations and audits of valuations performed on each property.

The following steps are followed by the Board's investment consultant when providing candidates for alternative asset class investments.

**Step 1: Fund Sourcing**

- Investment consultant's alternative research teams source ideas through industry contacts including prime brokers, fund-of-funds, databases and other funds.
- Consultant conducts conference calls/meetings to better understand the firm structure, investment team and process.

**Step 2: Onsite Meetings/Back Office Review**

- The consultant's alternative research teams conduct on-site meetings with key portfolio managers and analysts.
- Focus on manager's "edge" relative to other funds.
- Special meeting with CFO/COO to review back office procedures.

**Step 3: Qualitative Analysis**

- In-depth qualitative analysis using PerTrac performance software and other analytic tools.
- Focus on consistency of results
- Avoid funds with excessive drawdowns

**Step 4: Comprehensive Manager Packet**

- Throughout the due diligence process, consultant prepares a packet which includes a formal manager write-up, checklist, quantitative analysis, and an operational due diligence summary all of which are integral to manager selection.

**Step 5: Formal Approval**

- Candidates that meet all of consultant's requirements are presented to Alternatives Investment Committee for approval.
- Following this presentation, a vote is held among the Alternatives Investment Committee.
- Managers must be unanimously approved by consultant's Alternatives Investment Committee for client investment.

*d) Future cash flow and liquidity need;*

The Plan is currently an open plan. Net cash outflows have averaged between \$400,000 and \$500,000 per month for the last three years. The Plan Administrator monitors contribution and benefits levels to determine an appropriate liquidity target for the portfolio. The current liquidity target in the ISD is \$2 million. A minimum and maximum amount of liquid assets are set with procedures in place for adding or subtracting from liquid holdings.

Per the Board and the Plan Administrator, there are no expected large changes to the net cash flows of the Plan. The Board does not commission asset/liability studies.

*3) A review of the appropriateness of investment fees and commissions paid by the retirement system;*

Ellwood reviewed the fees of each investment firm and product in the Plan's investment program. The only separately managed account is with a fixed income manager so the plan pays no direct commissions. The following table shows the fees charged by each manager/product and the comparable median fee charged by similar managers/products.

Strategy Name	12/31/2019	% of Assets	Expense Ratio	Total Cost	Average Expense Ratio	Average Manager Cost	+/- Category Average
Total Portfolio	\$212,118,537	100%	0.58%	\$1,221,473	0.87%	\$1,839,538	(\$735,643)
Vanguard Total Stock Market Index	\$41,040,943	19.3%	0.04%	\$16,416	0.33%	\$135,435	(\$119,019)
Dodge & Cox Global Stock	\$34,689,987	16.4%	0.63%	\$218,547	1.00%	\$346,900	(\$128,353)
GQG Partners Global Equity Fund LLC	\$35,567,147	16.8%	0.72%	\$256,083	1.00%	\$355,671	(\$99,588)
Blackstone Tactical Opportunities Fund II	\$2,946,633	1.4%	1.50%	\$75,000	1.50%	\$44,199	\$0
Goldman Sachs Private Equity Partners X	\$1,483,135	0.7%	0.40%	\$20,000	1.50%	\$22,247	(\$16,314)
Greenspring Global Partners IX	\$1,826,125	0.9%	1.00%	\$50,000	1.50%	\$27,392	(\$9,131)
Tailwind Capital Partners III	\$1,427,866	0.7%	2.00%	\$105,000	1.50%	\$78,750	\$26,250
W.R. Huff Mgmt Co.	\$9,359,628	4.4%	1.00%	\$93,596	2.00%	\$100,000	(\$50,000)
Golub Capital Partners Fund XI	\$2,237,486	1.1%	1.00%	\$22,375	1.50%	\$37,500	(\$12,500)
Parametric Defensive Equity Fund	\$10,621,580	5.0%	0.35%	\$37,176	1.34%	\$142,329	(\$105,154)
Principal US Property	\$22,089,152	10.4%	0.95%	\$209,847	1.50%	\$331,337	(\$121,490)
American Strategic Value Realty Fund	\$501,426	0.2%	1.25%	\$6,268	1.50%	\$7,521	(\$1,254)
CDK Realty Advisors	\$2,314,193	1.1%	1.50%	\$34,713	1.50%	\$34,713	\$0
4223 85th Street	\$361,943	0.2%		\$0			
Garcia Hamilton	\$22,559,525	10.6%	0.25%	\$56,399	0.59%	\$133,101	(\$76,702)
Metropolitan West Total Return Bond	\$21,396,748	10.1%	0.37%	\$11,100	0.65%	\$19,500	(\$8,400)
Operating Cash	\$1,595,487	0.8%	0.16%	\$2,553	0.41%	\$6,541	(\$3,989)
Miscellaneous Cash	\$99,533	0.0%	0.16%	\$6,400	0.41%	\$16,400	(\$10,000)
	\$212,118,537	100%	0.58%	\$1,221,473	0.87%	\$1,839,538	(\$735,643)

Note: Morningstar Category Averages used as comparisons for investments in traditional asset classes. Alternative asset class fees exclude incentive fees and are compared to industry standard fees.

4) *A review of the retirement system’s governance processes related to investment activities, including investment decision-making processes, delegation of investment authority, and board investment expertise and education; and*

The Plan’s governance process is primarily described in the IPS and specifically relate to governing requirements in the Texas Civil Statutes and the Texas Government Code Title 8, Subtitle A – Provisions Generally Applicable to Public Retirement Systems.

The IPS lists governance duties, along with other duties, for the Board, Staff, Investment Consultant and other related parties. The Board does not delegate investment authority. The Board is in compliance with open records and open meetings requirements and only discusses and makes investment decisions in pre-notified open Board meetings.

The Plan has retained the services of an investment consultant to advice on investment related issues, but the consultant has no authority regarding investment selection or implementation. The Board does authorize the Staff to implement the investment decisions of the Board.

The Board follows an annual governance calendar. Formal investment evaluations are presented each calendar quarter with updates reviewed on off quarter months. Each spring, the consultant provides an asset allocation analysis to determine if the asset allocation is expected to meet the Plan’s targets or whether the allocation and/or targets may need adjustment. Two to three times each calendar year, the Board is provided educational updates on topical research from the consultant.

The Board members are active in both TEXPERS and TLFFRA which provide educational and informational seminars each year. Non-firefighter Board members have been selected based

on their relevant knowledge which can be investment, legal or pension related. All but one Board member are long-time fiduciaries of the Plan.

5) *A review of the retirement system's investment manager selection and monitoring process.*

The Board has retained the services of an investment consultant to assist in investment implementation and monitoring. The selected investment consultant is independent from any investment manager, broker/dealer, custodian or any other source of conflicts.

The investment consultant assists the Board in the development of the investment structure based on the targeted asset allocation selected. Once the Board has made an educated decision on structure, the investment consultant identifies candidate firms/products to utilize. Each investment search includes those firms and products that have been fully vetted in the investment consultant's research process. Any candidates that the Board wishes, will be included in this independent analysis. The Board is presented the candidates and selects the most appropriate choice based on firm stability, personnel expertise, investment process, historic success, relative fees, and fit into the Plan's portfolio. The full process is outlined below. As described above, alternative and illiquid investment searches include an extensive Operational Due Diligence review along with the Investment Due Diligence process.

The Board does not use a rigid "scoring method" to evaluate investment managers. These methods tend to place higher importance on factors that can be easily quantified. Board members objectively evaluate both the quantitative factors and qualitative factors with equal rigor when evaluating investment managers.

**Step 1: Screening**

- The investment consultant's research teams use screening tools and perform introductory calls/meetings.
- Top candidates are identified to continue in the research process.

**Step 2: Initial Meetings/Due Diligence:**

- The consultant conducts conference calls/meetings to better understand the firm structure, investment team and process.
- Comprehensive holdings-based, returns-based analysis is performed.

**Step 3: Onsite Meeting/Detailed Analysis**

- The consultant schedules onsite meetings with key investment personnel.
- Following this meeting, the investment consultant's team leader reports back to the Director of Manager Research.

#### **Step 4: Comprehensive Manager Packet and Formal Approval**

- The consultant team leader completes a Due Diligence Questionnaire (DDQ) on the investment process.
- The DDQ is reviewed by Ellwood's Manager Research Committee.
- The head of the respective manager research team presents the DDQ to the Manager Research Committee.

Following this presentation and any debate, a vote is held. If the manager is approved by the Committee, the investment firm is approved for use by the Plan.

The IPS has the following description on the Board's Investment Manager Selection procedure.

1. When, in consultation with the Consultant, the Board determines that a manager search is warranted, the Board will direct the Consultant to institute, coordinate and summarize the findings of the search. Identification of candidates will come from the manager search database maintained by the Consultant and such other sources as determined by the Board. The Board will strive to hire investment managers that offer the greatest incremental benefit to the Fund, net of fees and expenses. The Board will focus on firms that have products with GIPS compliant track records of a minimum of five years.
2. The Consultant, working with the Board, will establish certain consistently applied minimum criteria for a money manager to be considered to participate in the search.
3. Analysis of qualified candidates will be based on:
  - a. Quantitative characteristics, such as Global Investment Performance Standards (GIPS), compliant composite return data, risk-adjusted rates of return, fees, and relevant portfolio characteristics,
  - b. Qualitative characteristics, such as key personnel, investment philosophy, investment strategy, research orientation, decision making process, and risk controls, and
  - c. Organizational factors such as type and size of firm, ownership structure, client servicing capabilities, ability to obtain and retain clients and fees.
4. The Board may interview finalist candidates or may select money managers without formal interviews.



The investment program is continually monitored by the investment consultant. Full quarterly evaluations are presented to the Board quarterly and manager performance update is provided monthly. Qualitative issues are vetted as they arise, which may or may not lead to changes in investment managers or products. The following is the IPS language regarding Review Standards of the Board.

#### Performance Benchmarks

The Board intends to select active Managers that will outperform, on a net-of-fee basis, the designated passive index, and rank above median within a peer universe of active Investment managers. Passive products are expected to produce returns that exhibit minimal tracking error to their target index returns.

#### Time Horizon

Active Managers are expected to outperform their designated benchmark over rolling three- to five-year periods. A three- to five-year period is used to allow Managers the opportunity to meet their performance benchmarks, given shorter-term fluctuations due to style considerations. Managers who fail to meet the performance benchmarks over these time periods may be terminated. Underperformance for two consecutive years may be cause for a formal review of the Manager's organization, process and performance.

#### Compliance with Policies and Guidelines

Each retained Manager's portfolio will be monitored for compliance with the Policies and Guidelines found in this and other documents. If a portfolio is determined to be out of compliance, the retained Manager will be contacted to develop a mutually agreed upon solution to bring the portfolio back into compliance with this IPS. If retained Manager fails to move the portfolio into compliance, termination of the retained Manager will be considered.

#### Other Standards

Any significant changes in investment philosophy and process, organizational structure, investment staff, or other non-performance reasons may be cause for termination, regardless of the status of their investment performance relative to their designated benchmarks. The Board retains the right to terminate a Manager for any reason subject to the terms of the agreement between the two parties.

This SB 322 Evaluation Report approved and accepted by action of the Retirement Board of the Lubbock Fire Pension Plan.

DATE: April 8, 2020

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