VIA Metropolitan Transit

Submission to Texas Pension Review Board for Senate Bill 322

DAHAB ASSOCIATES
New York Massachusetts Texas Pennsylvania Florida

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September 17, 2020

Board of Trustees
VIA Metropolitan Transit
800 W. Myrtle Street
San Antonio, Texas 78212

Re: Investment Practices and Performance Evaluation

Dear Members of the Board:

Thank you for giving us the opportunity to work with you to fulfill the new requirements set forth in Section 802.109 of the Texas Government Code. As the investment consulting firm providing services for the VIA Defined Benefit Plan and Other Post-Employment Benefits Plan, we are qualified to provide you with a comprehensive analysis of your Plans, which includes an evaluation of investment policies, asset allocation, fees, governance, and investment managers.

Since 1986 we have been providing investment consulting services to public and private funds. These services include but are not limited to: investment policy & guideline statement development & review, asset allocation studies & analysis, investment manager search assignments & evaluation, performance evaluation & reporting, quarterly or monthly performance reviews, Board education, research and special projects.

Our independence is without qualification. We are categorized as a private corporation under the laws of New York State. 100% of our firm's total revenue is generated from the provision of investment consulting services; we do not accept revenue from any entity other than our consulting clients. Our firm is not an affiliate of, nor a subsidiary of another company. We are not affiliated with any investment manager or broker-dealer. We are not involved in directly or indirectly managing investments of the Plans. There are no actual or potential conflicts of interest. Our entire focus is on the needs and objectives of the Plans.

We have enclosed the Investment Practices and Performance Evaluation report for your review. We are honored to have VIA Metropolitan Transit as a client and want to make this process as seamless as possible. If you have any questions or comments, please contact me at dlee@dahab.com or (631) 665-6181.

Yours,

David Lee, CFA
President

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Investment Policy

The VIA Metropolitan Transit Retirement Plan (Plan) has an established Investment Policy Statement (IPS). The current version of this IPS was finalized in December 2017. Dahab Associates was hired as the pension consultant in 1Q18. One of our first responsibilities as the new advisor was to review and suggest possible changes and/or enhancements to the IPS. Our process follows our consulting philosophy of emphasizing planning, not reacting. This philosophy encourages our clients to prepare both short and long-term investment programs based on analysis of cash flow projections. Our goal is for our clients to be prepared with the necessary information to act in an informed and timely fashion.

Our approach started with careful consideration of the Plan's specific objectives, constraints and policies. Objectives and goals are generally defined in terms of return requirements and risk tolerance. Constraints are limitations on the portfolio management process within which the Board must operate in order to achieve its goals. These constraints included liquidity, time horizon, legal and regulatory issues. Our proprietary asset allocation software allows us to customize each asset allocation study to meet the specific needs and goals of each client; we can factor in any investment objective or range constraint.

During our review, we determined that the roles and responsibilities for those entities involved with the Plan were clearly outlined. We found that the format of the IPS, broken into eight sections was easy to understand and that the document was designed to meet the needs and objectives of the Plan. The IPS has an explicit actuarial rate of return and defines the objectives needed to achieve this return. The Plan is also expected to outperform a Policy Index which is used as an objective measure of performance for the overall Plan. The Plan is also expected to meet or exceed the actuarial assumption rate over a trailing three or five year market cycle.

Regarding manager specific expectations, although a specific period is not used as a hurdle to measure performance, the IPS requires that the managers' performance be reviewed regularly and provide regular reports to VIA and to the Consultant. Additionally, managers are expected to exceed their respective benchmarks on an annualized basis and also to rank above the median in style appropriate universes (comparative groups of managers that invest similarly to the one being analyzed). We believe these are appropriate measurement techniques which provide the Board with clear, simple tests to determine the success of the manager, but also clear, simple goals for the manager to achieve. In this way, any manager could manage the portfolio and conform to the desired intentions. We continually monitor an investment manager's compliance with policies and guidelines through our quarterly performance monitoring.

Upon review of the policy's asset allocation, we determined the allocation provided for the needs and objectives of the Plan with slight modifications to the existing strategy. Our analysis determined that the Plan would likely still achieve better returns, while maintaining a similar risk profile with the elimination of the global tactical asset allocation mandate. The assets were reallocated across a few of the existing mandates in the portfolio; this resulted in the Plan being more streamlined and reduced fees. Over the past couple of years, the Plan has replaced two mandates; one for underperformance and another for behavior that led to questioning the viability of the firm's institutional presence. These adjustments to the Plan, adhered to the requirements outlined in the IPS.

In addition to investment objectives, the IPS addresses another important duty of the managers, fiduciary responsibility. The IPS states that the assets are to be invested "with care, skill, prudence, and diligence that a prudent expert acting in a like capacity and familiar with such manners would use in the conduct of an enterprise of a like character and with like aims" and that "all transactions undertaken on behalf of the Trust must be for the sole interest of the Trust." As such, managers are expected to uphold their obligation as fiduciaries and to always act in the best interest of the Plan.

As of June 30, 2020, the Plan reported a net of fees return of 7.90% for the 3 year return and 7.70% for the 5 year return, ahead of the actuarial expected return of 7.25%. The asset allocation was within the policy statement's set target ranges. On a continuous basis, we reevaluate the assumptions and conditions of the IPS and will propose written alternatives to the formal plan including our rationale for such recommendations. We believe it is important to keep the IPS front and center as the primary document driving decisions made by the Trustees.

Investment Asset Allocation Review

(A) The Process for Determining Target Allocations

The VIA Metropolitan Transit Pension Plan has an IPS, which outlines and supports the needs of the Plan. The IPS forms the base of the pyramidal structure that represents the Plan's investment strategy. The asset allocation and manager selection all build upon this base to complete this strategy. The IPS is reevaluated on a continuous basis, emphasizing that is a "living document" that can and should be updated regularly. At least on a quarterly basis, the asset allocation of the Plan is compared to the strategic asset allocation defined in the IPS to ensure that it is being met.

As VIA's investment consultant, we work with the Board on setting and reviewing the asset allocation for the Plan. Our approach to an asset allocation begins with the construction of a mathematical model of the liability stream and simulation of the returns that various asset combinations would achieve over time. Data specific to each client including: the Plan's time horizon, liquidity needs, funding status, the appropriate level of risk, and legal or regulatory constraints are used to generate possible outcomes for various asset allocations. From the results produced by our model, we select three or four that we feel would most likely help the Plan achieve its goals. The Board then decides from amongst those recommended allocations. Additional estimates of mean return, risk, correlation, and alpha are required for each asset class included in the study.

Probabilities of each occurrence are assigned to the different scenarios and the overall expected return for each asset class is the weighted average of the forecasts within each scenario. We use the actuarial assumption rate-of-return as our target rate of return when generating the study. We take into account the liabilities provided in the actuarial report when projecting future liabilities for our asset allocation studies. While we are not actuaries, our asset allocation process is intimately related to the actuarial process. We therefore have developed a working knowledge of the actuarial process as it pertains to the cash flow projections needed to run our models.

The model and process used to perform an asset allocation study relies upon historical data to project future returns. Our allocation simulator typically analyzes hundreds of thousands of asset allocation mixes (although has the flexibility to run millions) using Monte-Carlo simulations. A "Monte Carlo" type asset simulator employs a random number generator and a series of statistical distributions and tools to create a large number of hypothetical investment experience situations. The data covers a range of pre-determined scenarios, in addition to any requested custom assumptions, and provides the return analysis, potential future cash-levels, and the efficient frontier of the market. Each situation corresponds to one possible return outcome due to fluctuating market conditions over a period of 20 years.

We establish a sound strategic asset allocation and use it as a reference point, with periodic rebalancing. We are skeptical of most tactical asset allocation strategies because we believe that market timing does not work; however, during periods of significant dislocation, we adhere to best practices and, if warranted, rebalance the portfolio closer to the target allocation.

Our asset allocation model provides strategic or long-term asset allocation. Studies have shown that asset allocation provides about 90% of the differential performance in a portfolio. We believe helping the Board to make an appropriate asset allocation – that which achieves needed return with minimal risk – is the single most important decision that is made.

Because we believe asset allocation is critical to a Plan's performance, we typically perform a comprehensive asset allocation study every two to five years. We compare the results to prior studies to see if the current allocation is still giving the Plan the highest probability of achieving the target rate of return with a reasonable amount of risk. If we find that a new allocation or asset class will give the Plan a higher probability of reaching its target with equal or less risk, we would then recommend a change to the portfolio.

Throughout the asset allocation study process, we discuss with the Board the current economic climate and asset return assumptions in order to form a model that reflects the specific needs of the Plan. Changes can be made throughout the process and multiple studies can be performed. We will have ongoing discussions on the funding status, type of workforce, and the local economic climate.

(B) The Expected Risk and Expected Rate of Return, Categorized by Asset Class

The following are the strategic asset allocation targets for the Plan as of fiscal year-end 2019:

Investment Category	Target Allocation
Domestic Large Cap Equity	22.0%
Domestic Small Cap Equity	13.0%
Global Equity	20.0%
Long/Short Equity	5.0%
Real Estate	10.0%
Fixed Income	30.0%

The strategic asset allocation applies a corridor of generally +/-%5 for each asset class so that, if warranted, they act as a framework to assist in tactically allocating the assets.

The following is the expected nominal and real* rates of return of each asset class:

Investment Category	Nominal projection	Adjusted for Inflation
Domestic Large Cap Equity	7.91	5.71
Domestic Small Cap Equity	9.19	6.99
Global Equity	6.75	4.55
Long/Short Equity	4.09	1.89
Real Estate	9.01	6.81
Fixed Income	5.08	2.88

*Expected inflation rate is 2.2%

The expected rates of return are based on the mean returns of the Plan's benchmarks for each asset class over the last 20 years. We measure and analyze relevant financial characteristics regarding each manager's portfolio and the entire Plan in order to detect and control risk. We calculate multiple risk statistics, such as standard deviation, Sharpe ratio, alpha, beta. In order to generate the relevant statistics, we use at least five years of data; the data is either specific to the Plan or incorporated from third party databases for a manager's historical data.

Our goal is to assist the Board in designing a portfolio that will earn a return equal or greater than the target (typically the actuarial assumption rate) while providing downside protection in economic environments. We believe this can be accomplished through a diversified portfolio. By diversifying the portfolio, excess volatility should also be reduced. We want the allocation to give the Plan the highest probability of achieving the target rate of return with a reasonable amount of risk.

We believe in both active and passive management. By employing passive management for a portion of an asset category, the Plan can achieve high levels of diversification at low cost. In addition, by employing active management the Plan can add value to its portfolio. We believe passive management works best in highly efficient asset classes and active management works best in less efficient markets.

An important component of our quarterly performance report is a review of the total allocation of the Plan as well as the allocation for each manager. During this process, we will inform the Board when the allocation to any manager strays from the acceptable range as stated in the IPS.

(C) Appropriateness of Selection and Valuation Methodologies of Alternative and Illiquid Assets

Asset classes such as private real estate, farmland, timber and private equity can offer attractive risk/return profiles. However, a similar constraint for them is their limited liquidity. The added benefit they can bring to a portfolio's asset allocation need to be weighed against the potential limitation to a portfolio's cash flow. Factors we consider when recommending alternative investment options include the Board's knowledge and comfort with these asset classes and the Plan's time horizon and liquidity needs.

As for valuation of alternative and illiquid assets, in addition to the time-weighted performance analysis used to measure all investment managers, alternative and illiquid assets are measured by their net-of-fees since-inception money-weighted return. The returns are compared to the appropriate benchmark. We provide an investor report indicating contributions, distributions, initial and remaining commitment to the fund, as well as IRR. The Net Asset Value (NAV) as reported on capital account statements is used to measure alternative and illiquid assets.

The managers typically produce valuations based on audit values that are reported at fair value and in accordance with U. S. Generally Accepted Accounting Principles (GAAP) or with International Financial Reporting Standards (IFRS). Third party valuations can assist in determining the consistency and reasonableness for stated values, but the preferred valuation would adhere to GAAP and IFRS standards.

The Plan's combined allocation target to real estate and long/short equity on FYE 2019 was 15%, which breaks down to 10% real estate and 5% long/short equity. The actual combined allocation was 14.7%. Real estate made up 10.3% while long/short equity made up 4.4%.

The table below compares these allocations to the median allocation for alternative assets and real estate in a peer group of public pension plans.

	Real Estate	Alternative Investments
Target Allocation	10.0%	5.0%
Actual Allocation	10.3%	4.4%
Peer Group Median*	8.2%	9.9%

Peer group data was provided by Investment Metrics. The alternatives category does not include real estate.

(D) Future Cash Flow and Liquidity Needs

The Plan was closed to new participants as of the end of 2012. Like other mature plans, the Plan has a negative cash flow, benefit payments are greater than the contributions made into the Plan. The gap is modest presently, less than 2% of the corpus of the Plan, but will increase slowly overtime. Over time the asset allocation would migrate to a more conservative posture as the membership of the Plan shifts more to pay status and fewer contributions are made into the Plan. On a periodic basis we would conduct asset allocations to monitor this changing condition.

Appropriateness of Investment Fees and Commissions Paid

VIA Metropolitan Transit's IPS describes the management and monitoring of direct and indirect compensation paid to investment managers. Although the IPS is silent on the ongoing monitoring and reporting of the fees, it is implicit in the responsibilities to the Board that the Consultant provides this oversight. We track all forms of compensation paid to the managers and provide that information to the Board.

The following table below shows the fee schedules for the Plan's investment managers as of FYE 2019.

Manager	Annual Fee Schedule
Polen	0.60% on first $10 million, 0.50% on remainder
Seizert	0.60% on first $25 million, 0.40% on remainder
William Blair	0.95% on first $10 million, 0.80% on next $20 million, 0.75% through $50 million
SSgA ACWI	0.15% on first $50 million, 0.10% on next $50 million
ABS Offshore	Base fee: 0.75% Performance fee: 5% of net increases, offset by loss carryforward
JPM Strategic Property	1% on all assets (reduced on excess cash positions)
Landmark	1% of capital commitment in first four years; 1% on assets thereafter (not to exceed 1% of commitment)
PRISA II	Effective rate: 1.20% (includes REIT level fee)
Agincourt	0.25% on first $25 million, 0.20% on next $75 million
Loomis Sayles	0.45% on all assets

Broker Commissions in FY 2019 averaged $0.0266 per share. The total commission was $35,833.63 on $85,639,251.91 of transactions for a percent commission to transaction amount of 0.0418%.

Governance Processes Related to Investments

The Board has endeavored to maintain a high level of transparency as it relates to the investments of the Plan. The governance structure of the Plan is in the IPS. The monthly Board meetings are in a public forum and agendas and minutes are available to the public.

The 11 members of the Board are appointed to staggered two-year terms by the following entities: San Antonio City Council (appoint five), Bexar County Commissioners Court (appoint three), and the Suburban Mayors (appoint two). As part of their responsibilities, Board members adhere to the requirement of the Texas PRB to pass a Minimum Education Training (MET) course. Board members are expected to pass the MET course within the first year of their tenure and retake the exam every two years thereafter.

Although the Board relies on the impartial advice of the Investment Consultant, a service provider that is bid out every five years, the Board has the final approval on investment decisions made for the Plan. It is the responsibility of the Consultant to communicate to the Board the progress of the investments in the Plan, educate the Board on asset classes and market trends and assist the Board on any manager changes. Quarterly performance presentations to the Board and annual internal and external audits assist in ensuring that governance processes are followed.

Investment Manager Selection and Monitoring

As the consultant to the Plan, Dahab Associates assists the Board in the selection, retention and hiring of managers. We adhere to a selection process that prevents conflicts of interest. From the Board's perspective, they can be assured that we have no affiliations with any of the firms recommended as we are completely independent. We do not manage money and do not have any other lines of business that can create potential conflicts of interests. We are 100% owned by employees and our only source of revenue is from advising our clients.

The manager search process conducted on behalf of the Plan is comprehensive. It begins with screening both our proprietary and purchased databases for candidates that match the criteria requested by the Plan. For those clients that require public notification, we assist them in drafting an RFP document. We also can post the RFP on our website. Managers can respond to these searches at no cost to them; this ensures that we conduct an open RFP process. A universe of potential candidates is created from the responses. As proposals are received, they are summarized so that the applicants may be analyzed and compared to benchmarks and one another. Many quantitative and qualitative factors are used to evaluate the responses. The variables are broken out into three groups: firm, product, and performance. Firm information variables include ownership, experience of key personnel, total assets and accounts, account sizes and client types, potential conflicts of interests. Product information variables include investment style, style adherence, market capitalization, buy, and sell decision-making processes, portfolio characteristics, geographic concentration, maturity, quality and sector distribution, allocation objectives and fees. The performance screening variables include rate of return, standard deviation, Sharpe ratio, tracking error, alpha, beta, and R-squared.

Manager performance is one of the more important factors in evaluating potential managers for our clients' portfolios. For both searches and performance reporting, we compare a manager's performance not only to an appropriate benchmark, but also to a universe of other actively managed portfolios of similar style.

Once a short list of finalists has been identified, we review our analysis with the Board. We provide our own comparative analysis and RFP responses for evaluation. Although we make recommendations for any hire or termination, it is the Board that ultimately makes the final decision.

After a manager is retained, they become a part of the ongoing monthly data collection and quarterly performance-monitoring program. We collect monthly custodial statements for each manager; we calculate a rate of return and compare it to the managers' statements. If there are discrepancies, we undertake a full investigation and generate a return based on complete knowledge. All portfolio holdings are reviewed and issues are raised if there is anything held which could be considered questionable or any trading practices that are considered high risk.

Investment performance is presented in the context of a universe with rankings to allow the Board to determine the success of the investment strategy. The comparative universes are selected to provide fair, objective measures of performance. For instance, the entire portfolio will be measured against a universe that only contains other Public funds. Additionally, each of the managers will be compared against styles and market capitalization. Style universes assist in determining style integrity and success relative to peers.

For performance measurement and peer universe rankings, we subscribe to Investment Metrics (IM). Based in Darien, CT. Investment Metrics is an independent provider of investment performance analytics for institutional investors and advisors built by institutional investment consultants.

The IM universe includes information from 35 investment consulting firms with more than $5.2 trillion in assets under advisement on behalf of over 5,416 sponsors. The universe consists of institutional custodial data submitted by the IM consulting firms. Specialty subsets include public funds, corporate funds, Taft-Hartley funds, endowments and foundations, and healthcare funds.

Performance benchmarks are chosen based on their appropriateness to a particular investment approach. This can be determined based on looking at portfolio holdings or by comparing financial characteristics of the portfolio to those of the benchmark. We typically will recommend utilizing industry standard benchmarks to clients (i.e. S&P 500 or Russell indices for domestic equities, MSCI ACWI ex US, EAFE or EM for foreign equity and Barclays for fixed income). As part of our ongoing oversight, we conduct analysis of indices to determine if changes in methodologies underlying those indices or changes in securities that comprise those indices should lead to selection of different indices against which to evaluate manager performance.

The standard reports we provide are our detailed quarterly performance reports, and when requested, monthly flash reports or ad hoc reports. Our general philosophy regarding performance evaluation is to give the Board useful information. Readable reports and understandable charts and tables are an often overlooked characteristic that can make a dramatic difference in the approachability of a service provider's message. Finance is already filled with complex terminology; our reports strive to present information so that it is understandable for people with non-financial backgrounds. They are designed to answer four questions:

1) Is the manager doing the job he/she was hired to do?
2) Is he/she doing that job well?
3) How risky is the portfolio?
4) How does this fund compare to others?

The performance evaluation report includes comprehensive capital markets analysis, absolute and relative performance comparisons, and a peer comparison and analysis. Returns are always shown on a gross of fee and net of fee basis. We use our proprietary software to produce our quarterly performance reports. Performance measurement reports are designed to highlight those factors we deem critical in reporting performance. Some key areas:

Investment Growth: Ending dollar value is established by adding or subtracting contributions/withdrawals and investment return/losses from the prior quarter beginning value. A breakdown is provided to show income and capital gains (losses). The investment growth is plotted versus the actuarial growth rate.

Executive Summary: Translates the dollar value of the fund at quarter-end into rates of return for the quarter, trailing year, and cumulative time period since inception. Rates of return (both gross and net of fees) are calculated for the total fund, equity, fixed income, etc.

Economic Environment: Quarterly performance achieved by the Plan is impacted by the overall economy. A complete discussion of the economy and capital markets activity during the quarter leads the next section on Relative Performance.

Relative Performance: States the rates of return (both gross and net-of-fees) for the composite or total fund; the component parts (equity, fixed, international, etc.) and whether it exceeded or fell short of its benchmark.

Asset Allocation: A complete breakout of the allocation of assets with asset percentages.

Analysis: Each asset class receives in-depth analysis to isolate those factors resulting in its performance. Financial statistics relevant to the benchmark are also discussed.

We are very flexible when it comes to the ability to customize our performance reports because the analysis and preparation of all client reports is performed in-house.

As outlined in the IPS, managers are continuously evaluated to see if they are meeting their obligations to the asset allocation and to the Plan overall. At times managers fall short of expectations and changes are recommended; however, we strive to avoid too much manager turnover. Manager turnover has been correlated with Plan underperformance.

The benefit of a manager termination is weighted against the need to make a change. Some reasons a manager becomes a candidate for probation are: when their firm experiences the departure of key personnel, a change in the firm's ownership, a change in the investment style of the product, failure to adhere to the IPS, failure to follow ethical and legal practices, or consistent failure to perform at or above the stated benchmark and relative to peers. We watch for changes that could lead to the failures listed above by maintaining a constant line of communication with managers. Ideally, we like to anticipate manager failure before it occurs to prevent significant damage to the client's returns. Most important among these are changes in people or process. Identifying these changes early is part of the reason we spend so much time interviewing managers.