

LUBBOCK FIRE PENSION FUND

EVALUATION OF INVESTMENT POLICIES, PROCEDURES AND PRACTICES

MAY 8, 2024

JEFFREY SWANSON, PRESIDENT / SENIOR CONSULTANT
JEFF@SEADVISORY.COM, 904.233.7600

SOUTHEASTERN ADVISORY SERVICES, INC.
190 OTTLEY DR NE, STE B2A
ATLANTA, GEORGIA 30324
404.237.3156 TEL



LUBBOCK FIRE PENSION FUND
EVALUATION OF INVESTMENT POLICIES, PROCEDURES AND PRACTICES

TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
REQUIRED DISCLOSURES.....	3
I. INVESTMENT POLICY STATEMENT ANALYSIS AND COMPLIANCE	4
II. ASSET ALLOCATION REVIEW	7
A. PROCESS FOR DETERMINING TARGET ALLOCATIONS.....	7
B. EXPECTED RISK & RETURN SUMMARY	9
C. APPROPRIATENESS OF SELECTION AND VALUATION METHODOLOGIES OF ALTERNATIVE/ILLIQUID ASSETS	11
D. CONSIDERATION AND INCORPORATION OF FUTURE CASH FLOW AND LIQUIDITY NEEDS	12
III. REVIEW OF THE APPROPRIATENESS OF INVESTMENT FEES AND COMMISSIONS	14
IV. REVIEW OF GOVERNANCE PROCESSES RELATED TO INVESTMENT ACTIVITIES.....	16
A. TRANSPARENCY	16
B. INVESTMENT KNOWLEDGE/EXPERTISE	17
C. ACCOUNTABILITY	18
V. REVIEW OF INVESTMENT MANAGER SELECTION AND MONITORING PROCESS	20



EXECUTIVE SUMMARY

The Lubbock Fire Pension Fund (LFPF) has engaged Southeastern Advisory Services (SEAS) to independently evaluate the appropriateness, adequacy, and effectiveness of the Plan's investment policies, procedures, and practices. The evaluation serves to satisfy Section 802.109 of the Texas Government Code and the Texas Pension Review Board guidelines. Our report covers the following requirements:

1. An analysis of the Fund's Investment Policy and the Fund's compliance with the policy.
2. A detailed review of the Fund's investment asset allocation, including:
 - a. The process for determining target allocations.
 - b. The expected risk and expected rate of return, categorized by asset class.
 - c. The appropriateness of selection and valuation methodologies of alternative and illiquid assets
 - d. Future cash flow and liquidity needs
3. A review of the appropriateness of investment fees and commissions paid by the Fund.
4. A review of the Fund's governance process related to investment activities, including investment decision-making processes, delegation of investment authority, and Board investment expertise and education.
5. A review of the Fund's investment manager selection and monitoring process. SEAS has noted the activities completed, standards for comparison, findings, and enhancement recommendations the Plan may wish to consider for improvement.

Overview of Activities Completed:

The LFPF provided all documents requested for review by SEAS, in a timely fashion. SEAS performed several remote meetings with the administrative staff in completing this report.

Overview of Standards of Comparison:

To prepare this Evaluation Report, SEAS assembled the following reviewing team:

Jeffrey Swanson, Senior Consultant. Jeff has over 30 years of consulting experience with public Funds in Florida, Georgia, Alabama, and Texas.

Ademir Zeco, Director of Research. Ademir has over 20 years of experience in asset management diligence and related research. Ademir has extensive experience in investment policy development and review, and manager search and selection.

Kit Connick, Senior Analyst. Kit has worked with public fund clients for over 30 years.

Summer Adams, Analyst. Summer has over 4 years of experience working with defined benefit plans.

SEAS drew upon the firm's 38 years of experience serving public fund clients. We advise 35 clients, including 33 government-sponsored defined benefit retirement systems ("Public Funds"). In addition to our direct experience with similar clients, SEAS has examined other publicly available documents as an additional source of industry prevailing practices.

Overview of Findings:

SEAS finds LFPP's policies, procedures, and practices appropriate and consistent with prevailing industry comparisons.

Summary Overview of Enhancement Recommendations:

SEAS did identify some areas that LFPP may want to consider for improvement.

Investment Policy Statement

While the existing document is concise and effective in practice, it should be expanded to incorporate the recent PRB guidance. The PRB recommends the IPS include a discussion on risk, vendor review, how the Plan's liabilities may inform the asset allocation, the performance measurement process, and the use of committees in decision-making.

Fee Reporting

The reporting of investment advisory fees is now consistent with industry practice. The consultant's fee reporting could be expanded to better match the Plan's annual financial report (AFR) requirement to identify direct versus indirect fees, brokerage fees or commissions, and other investment-related expenses such as investment consulting and custody.

<https://www.prb.texas.gov/investments/investment-expense-reporting/>

Asset Allocation Studies

These studies could be expanded to include additional risk measures such as value-at-risk and maximum loss.

REQUIRED DISCLOSURES

1. A summary outlining the qualifications of the firm in evaluating institutional investment practices and performance;

Southeastern Advisory Services was founded in 1986 with the goal of serving public defined benefit pension plans in the Southeast. To our knowledge, SEAS is the longest-tenured independent institutional investment consultant headquartered in Atlanta, GA. We serve over 35 public retirement systems as general investment consultants with combined assets of over 4 billion dollars. Our firm and staff have decades of experience providing performance measurement and related investment consulting services.

2. A statement that the firm meets the experience requirements;

SEAS affirms that it meets the experience requirements.

3. A statement indicating the nature of any existing relationship between the firm and the system being evaluated;

There is no relationship between SEAS and the system being evaluated.

4. A statement acknowledging that the firm, or its related entities, is not involved in directly or indirectly managing investments of the system;

SEAS is an independent fee-only advisor. We do not directly or indirectly manage any investments for the system or any other entity. We do not have any related entities.

5. A statement identifying any potential conflict of interest or any appearance of a conflict of interest that could impact the analysis between the independent firm and the system or any current/former member of the system's governing body;

There are no potential conflicts of interest.

6. A list of the types of remuneration received by the firm from sources other than the retirement system for services provided to the system; and

None.

7. An explanation of the firm's determination regarding whether to include a recommendation for each of the evaluated matters in the report or a lack thereof.

We have included an overview of enhancement recommendations. Specific recommendations can be found within each section of the report.

I. INVESTMENT POLICY STATEMENT ANALYSIS AND COMPLIANCE

1. Does the system have a written investment policy statement (IPS)?

Yes - restated and updated regularly. Last updated on 11/15/23.

2. Are the roles and responsibilities of those involved in governance, investing, consulting, monitoring, and custody clearly outlined?

Yes. Roles and responsibilities are detailed and clearly defined.

3. Is the policy carefully designed to meet the real needs and objectives of the retirement plan? Is it integrated with any existing funding or benefit policies? (i.e. does the policy take into account the current funded status of the plan, the specific liquidity needs associated with the difference between expected short-term inflows and outflows, the underlying nature of the liabilities being supported [e.g. pay-based vs. flat \$ benefit, automatic COLAs, DROP, etc.]?)

Yes. The Plan takes a total return approach to achieving its objectives, including a clearly defined liquidity policy (IPS: Asset Allocation Strategy, page 6). The cash reserves required to meet liabilities are specifically quantified with dollar ranges. Although funding and benefit policies are not specifically articulated, this document section is evidence that liabilities and cash needs are considered and regularly measured.

4. Is the policy written so clearly and explicitly that anyone could manage a portfolio and conform to the desired intentions?

Yes. Asset manager responsibilities are clearly defined. Specific asset manager benchmarks and comparative universes are correctly identified.

5. Does the policy follow industry best practices? If not, what are the differences?

Yes. The IPS includes the following sections:

- Overview (Mission)
- Investment Objectives
- Responsibilities (Board and vendors)
- Asset Allocation Strategy (Includes liquidity / rebalancing policies)
- Investment Discretion
- Investment Manager Selection
- Manager Review Standards
- Appendix A (Includes investable assets / objectives / benchmarks / managers and their assigned benchmarks)

The IPS does not contain the following generally recommended sections:

- Risk Tolerance – At the plan level and how it is to be measured.
- Performance Evaluation and Measurement – The frequency, method of tracking performance, and fees.

6. Does the IPS contain measurable outcomes for managers? Does the IPS outline cover what time periods performance is to be considered?

Yes. Measurement periods for performance are identified as a three-to-five-year period. There is a clear process for reviewing and replacing managers based on performance.

7. Is there evidence that the system is following its IPS? Is there evidence that the system is not following its IPS?

Yes, there is clear evidence the system follows the IPS. Based on the consultant's performance report and meeting minutes, the Plan complies with all stated IPS ranges and has been rebalancing assets as required.

8. What practices are being followed that are not in, or are counter to, written investment policies and procedures?

All stated policies and procedures in the IPS appear to be followed. The Plan has a practice of reviewing the asset allocation annually. This is not articulated in the IPS.

9. Are stated investment objectives being met?

Yes. Over longer-term periods, the Fund meets its stated objectives and generally ranks above average relative to peers.

10. Will the retirement fund be able to sustain a commitment to the policies under stress test scenarios, including those based on the capital markets that have actually been experienced over the past ten, twenty, or thirty years?

Yes. The strategic asset mix appears to have been determined and updated periodically based on annual asset allocation studies. The investment consultant has reviewed the current allocation relative to alternative asset mixes. The analysis includes stress-testing and drawdowns based on historical periods from 1 to 15 years. The study includes the hypothetical drawdowns during historic periods of market dislocations.

Twenty- and thirty-year time period analysis was not examined. Based on the modestly negative cash outflows of the Plan, the 1-15 year time horizon is deemed appropriate. Longer-term analysis over 20-30 year horizons are deemed most appropriate for younger plans with positive cash flows. Further, shorter period capital market assumptions have generally proven to be lower giving the studies a conservative bias.

11. Will the investment managers be able to maintain fidelity to the policy under the same scenarios?

Yes. The managers are tasked with achieving their benchmarks for their individual assignments. The Board and consultant are tasked with the asset allocation at the total fund level that would be adjusted based on the scenario modeling.

12. Will the policy achieve the stated investment objectives under the same scenarios?

Yes. The asset allocation appears appropriate. The Plan is meeting its objectives.

13. How often is the policy reviewed and/or updated? When was the most recent substantial change to the policy and why was this change made?

The policy has been reviewed and adjusted annually. The most significant change has been to adjust the absolute return target, the benchmark index, and allowable asset ranges.

Findings

The IPS document is clearly written and consistent with industry practice. The Board has regularly reviewed and updated the document.

The consultant uses “Appendix A” to express the Fund objectives, benchmarks, and manager assignments. This format streamlines the document and makes it easily understandable. The document has been updated annually, also consistent with accepted industry practices. We found the concise approach of the policy to be effective.

Enhancement Recommendations: Investment Policy Statement

- Vendor Review – We recommend that a process for vendor review be identified and included to ensure quality services and competitive costs. This could be developed as periodic or on an ad hoc basis.
- Risk Factors / Tolerances - We recommend a discussion on risk to identify the types of risk to be mitigated, to define a time horizon, and to explain a quantitative framework for measuring risk at the total fund level.
- Liabilities -The document should acknowledge the unique funding constraints and benefit payment requirements in the IPS and how this may inform the asset allocation strategy.
- Performance Evaluation—We recommend a discussion on how performance is to be measured. This should specify metrics (time-weighted/internal rate of return), cost management, and gross and net fee return calculations. Also included should be the discussion for expense reporting consistent with the Texas statutory requirements (direct and indirect fee evaluation).
- Periodic Review—For the benefit of future trustees and overall continuity, LFPF should memorialize its current practice of reviewing the IPS and asset allocation each year in the IPS document.

II. ASSET ALLOCATION REVIEW

II (A). PROCESS FOR DETERMINING TARGET ALLOCATIONS

1. Does the system have a formal and/or written policy for determining and evaluating its asset allocation? Is the system following this policy?

Yes. The asset allocation framework is correctly identified in the IPS. The system follows its policy and regularly complies with allowable ranges for each asset class.

2. If no formal policy exists, what is occurring in practice?

The IPS document has a formal policy and framework for asset allocation. The Plan has a practice of conducting asset allocation studies in each of the past three years.

3. Who is responsible for making the decisions regarding strategic asset allocation?

After reviewing the historical meeting minutes, it is clear that the Board of Trustees, with guidance from the investment consultant, is the responsible party.

4. How is the system's overall risk tolerance expressed and measured? What methodology is used to determine and evaluate the strategic asset allocation?

The Plan's assets allocation studies utilize standard deviation to evaluate risk in its scenario modeling. The performance reporting shows risk-adjusted returns relative to peer groups as well as statistical comparisons (beta/Sharpe/information ratios).

5. How often is the strategic asset allocation reviewed?

Annually.

6. Do the system's investment consultants and actuaries communicate regarding their respective future expectations?

The consultant produces annual asset allocation studies that produce output the actuary uses in their bi-annual valuations.

7. How does the current assumed rate of return used for discounting plan liabilities factor into the discussion and decision-making associated with setting the asset allocation? Is the actuarial expected return on assets a function of the asset allocation or has the asset allocation been chosen to meet the desired actuarial expected return on assets?

The asset allocation studies determine if the current assumed rate of return is achievable and reasonable given risk parameters. The consultant weighs the assumed return against the Trustees' risk tolerances to determine the most appropriate recommended assumed rate for the Plan's valuation.

The asset allocation studies evaluate three different absolute return targets (assumed rates of return) and produce optimized portfolio scenarios based on simulated historical performance. Stress testing shows total drawdowns of hypothetical portfolios during historic market dislocations.

8. Is the asset allocation approach used by the system based on a specific methodology? Is this methodology prudent, recognized as best practice, and consistently applied?

The current approach utilizes capital market assumptions for risk and returns to produce various expected returns based on simulated historical performance. We view this methodology as prudent. It has been shown to be consistently applied. This approach as common practice across other investment consultants.

9. Does the system implement a tactical asset allocation? If so, what methodology is used to determine the tactical asset allocation? Who is responsible for making decisions regarding the tactical asset allocation?

No. LFPF uses a strategic asset allocation framework.

10. How does the asset allocation compare to peer systems?

Based on the investment categorization of the consultant, we view strategic asset allocation to be consistent with peer systems.

Asset Class	Target Allocation	Current Allocation	Peer Group Median Allocation
Public Equities	50%	50.2%	
Private Equities	10%	13.9%	
Total Equities	60%	64.1%	57.4%
Fixed Rate Debt	15%	13.9%	
Floating Rate Debt	10%	8.5%	
Total Debt	25%	22.4%	23.7%
Core Private Real Estate	10%	13.1%	
Value-Added Equity Real Estate	5%	0.0%	
Total Real Estate	15%	13.1%	8.1%
Cash & Equivalents	N/A	0.4%	1.6%
Total		100.0%	

If private equity was considered within the alternative investment segment, we would also view the strategic allocation to be consistent with peer systems.

The comparative universe shown above is the Investment Metrics Public Defined Benefit Universe. This peer group comparison has a population as of December 31, 2023 of approx. 565 total Public Plan members.

Findings: Asset Allocation

The Board of Trustees has conducted an asset allocation study each year for the past three years. These studies include stress testing and are consistent with industry standards. The Board's practice of annual review is consistent with industry standards.

Enhancement Recommendations

The asset allocation analysis could be expanded to include a forward-looking Monte Carlo simulation and additional risk measurements such as maximum loss and value-at-risk.

II (B). EXPECTED RISK AND EXPECTED RATE OF RETURN

1. What are the strategic and tactical allocations?

The Plan takes a strategic allocation approach consisting of 60% equities (consisting of 10% in private equity), 25% debt (consisting of fixed rate, floating, and private credit), and 15% "alternatives" (consisting of core and value-add real estate).

There are no tactical allocations.

2. What is the expected risk and expected rate of return of each asset class?

The strategic asset allocation includes the following asset classes:

Asset Class	Expected Return	Expected Risk (Standard Deviation)
Public Equity (US)	7.2%	15.1%
Private Equity (FOF)	8.7%	15.1%
Fixed Rate Debt (US Core)	4.6%	3.9%
Floating Rate Debt	4.7%	6.0%
Private Credit	7.3%	10.0%
Private Core Real Estate	6.0%	11.0%
Private Value-Add Real Estate	8.5%	23.9%

The consultant is using the following capital market assumptions in the March 2024 asset allocation study.

U.S. ECONOMY	Return	Risk
U.S. Economic Growth (Nominal GDP)	4.2%	2.7%
U.S. Economic Growth (Real GDP)	1.9%	2.7%
U.S. Inflation (CPI)	2.3%	1.25%
EQUITY MARKETS	Return	Risk
U.S. Large-Cap Equity	7.25%	15.1%
U.S. Mid-Cap Equity	7.5%	16.8%
U.S. Small-Cap Equity	7.5%	19.6%
International Stocks-Developed Markets	6.25%	16.3%
International Stocks-Emerging Markets	7.25%	22.0%
FIXED INCOME	Return	Risk
U.S. Short-Term T-Bills (Cash)	3.4%	1.0%
U.S. Short-Term Govt/Credit	3.6%	1.5%
U.S. Intermediate-Term Govt/Credit	4.0%	3.1%
U.S. Core Fixed Income	4.6%	3.9%
U.S. Intermediate-Term Treasury Bonds	3.8%	3.1%
U.S. Long-Term Treasury Bonds	4.2%	13.7%
U.S. Investment Grade Corporate Bonds	5.0%	5.7%
U.S. Long-Term Corporate Bonds	5.0%	9.5%
U.S. High Yield Corporate Bonds	6.2%	8.5%
U.S. Municipal Bonds	3.8%	5.1%
Global Bonds	3.6%	5.7%
Treasury Inflated-Protected (TIPS)	4.2%	5.8%
Floating Rate Bonds	4.7%	6.0%
REAL ASSETS	Return	Risk
U.S. Public Real Estate	6.5%	19.9%
Core Private Real Estate	6.0%	11.0%
Private Real Estate - Opportunistic/Value-add	8.5%	23.9%
Commodities	2.6%	15.2%
Core Private Real Assets	6.5%	15.5%
OTHER ALTERNATIVES	Return	Risk
Private Equity - Fund of Funds	8.75%	15.1%
Private Equity - Direct	10.25%	18.1%
Hedged Strategies - Low Volatility	4.9%	5.0%
Hedged Strategies - Hedged Equity	6.0%	11.3%
Core Private Credit	7.3%	10.0%

3. How is this risk measured and how are the expected rates of return determined? What is the time horizon?

Risk is measured using standard deviation. The capital market assumptions listed appear to be developed internally by the consultant. The asset allocation uses periods of 7-10 years for capital market assumptions. The simulated historical performance is over a time period of 1-15 years.

4. What mix of assets is necessary to achieve the Plan’s investment return and risk objectives?

Based on the March 2024 asset allocation study, the Plan’s 7.5% absolute return target is not achievable based on the existing asset classes and constraints. The consultant asked the Board to consider reducing the goal return and moving to a more conservative allocation: 40% public equity (down from 50%), 10% private equity, 25% fixed rate debt (up from 15%), 5% floating rate debt, 5% private credit, 10% core real estate, and 5% value add real estate.

5. What consideration is given to active vs. passive management?

The Plan uses a mix of active and passive management for its public equity allocation. Of the 50.2% invested in public equity, 9.4% is invested passively in the Vanguard Total Stock Market Index fund, and 40.8% is invested across two actively managed equity mutual funds.



6. Is the approach used by the system to formulate asset allocation strategies sound and consistent with best practices, and does it result in a well-diversified portfolio?

Yes. The consultant's practice of conducting regular asset allocation studies reveals their understanding that most investment return comes from this process. The Board's combination of active and passive management has delivered a well-diversified and efficient portfolio.

Asset allocation study methodology also correctly uses "arithmetic" returns for capital market assumptions and model portfolio optimization. Simulated historical performance is measured over periods of up to 15 years. This approach is consistent with common industry practice.

7. How often are the strategic and tactical allocations reviewed?

The strategic asset allocation has been reviewed each of the past three years. The Board does not have a tactical asset allocation.

Findings: Expected Risk / Return

The Board of Trustees has conducted an asset allocation study each year for the past three years. These studies include stress testing and are consistent with industry standards. The Board's practice of annual asset allocation study exceeds common industry practice.

Enhancement Recommendations

The asset allocation analysis could be expanded to include a forward-looking Monte Carlo simulation and additional risk measurements such as maximum loss and value-at-risk.

II (C). APPROPRIATENESS OF SELECTION AND VALUATION METHODOLOGIES OF ALTERNATIVE/ILLIQUID ASSETS

1. How are alternative and illiquid assets selected, measured and evaluated?

Alternative investment options are selected through the consultant's various alternatives research groups. Performance for private equity and many private credit products are measured on a calendar quarter lag and are compared to appropriate illiquid indexes as well as quarter-lagged public investment indexes. Real estate investments tend not to be lagged in the reporting.

The record shows that the consultant has brought alternative asset reviews and manager candidates to the Board and the Investment Committee. After review and discussion, the Board has selected managers from those candidates sourced by the investment consultant.

The Plan's alternative/illiquid assets are correctly measured by IRR (internal rate of return) and TVPI (total value to paid-in-capital). The internal rate of return (IRR) is a common metric for evaluating the performance of private alternative investments. It measures the implied annual rate of return for an investment. Total Value to Paid-In (TVPI) is a ratio that measures the performance of a private fund. It is calculated by dividing the current value of remaining investments in a fund, plus the total value of all distributions, by the total amount of capital paid into the fund. TVPI is also known as the "Investment Multiple".

The investment consultant report contains private investment summaries. The consultant is correctly monitoring and measuring these investments by updating each asset value for capital calls, returned capital and changes in market value. This allows a complete picture of the effectiveness of each investment.

The consultant also constructs composites for each segment of private equity, private credit, and real estate. Each composite combines those respective underlying manager's individual returns. The composite performance for these segments is expressed in a time-weighted return. This allows the Board to evaluate the investment progress of each segment as a whole.

2. **Are the system's alternative investments appropriate given its size and level of investment expertise? Does the IPS outline the specific types of alternative and illiquid investments allowed, as well as the maximum allocation allowable?**

Yes. Alternative/illiquid investments are common and appropriate for a retirement system of this size. All investments are made within investment policy guidelines and allowable ranges.

3. **What valuation methodologies are used to measure alternative and illiquid assets? What alternative valuation methodologies exist and what makes the chosen method most appropriate?**

These investments are correctly valued according to the total invested contribution, distributions, and the reported market value. Statements are produced quarterly. This methodology is the industry-accepted practice for valuing and measuring private investments.

Findings: Alts / Illiquid Assets

The private investment segments are appropriate, correctly represented, and measured.

Enhancement Recommendations

None.

II (D). CONSIDERATION AND INCORPORATION OF FUTURE CASH FLOW AND LIQUIDITY NEEDS

1. **What are the Plan's anticipated future cash flow and liquidity needs? Is this based on an open or closed group projection?**

Based on the 2022 actuarial study, the Plan cash flows are not expected to change materially. The Fund has exhibited only modest cash outflows of 2% per year for the long term. Based on the actuarial valuation, this relationship appears stable.

2. **When was the last time an asset-liability study was performed?**

N/A. Based on our industry experience, asset-liability studies are typically not conducted for plans below \$500M in total assets as they are considered cost-prohibitive. Alternatively, the actuary and consultant actively monitor plan demographics and cash flows in determining appropriate risk levels.

3. How are system-specific issues incorporated in the asset allocation process? What is the current funded status of the Plan, and what impact does it have? What changes should be considered when the Plan is severely underfunded, approaching full funding, or in a surplus? How does the difference between expected short-term inflows (contributions, dividends, interest, etc.) and outflows (distributions and expenses) impact the allocation? How does the underlying nature of the liabilities impact the allocation (e.g. pay-based vs. flat \$ benefit, automatic COLAs, DROP, etc.)?

The Plan is relatively well-funded (70.8% funded ratio) with responsible liability management. The sponsor has shown a willingness to contribute more than the required minimum contribution. Given this backdrop, the investment program has balanced risk with combined equity exposure (private & public combined) at 60% of assets. The allocation of assets has been responsibly implemented, given the liabilities and funded status of the Plan.

The Fund appears to have only modest net cash outflows, and based on available reports, we see nothing to indicate that this relationship may change. As the Fund becomes better funded, the Board of Trustees has the choice of reducing risk assets and/or considering improved benefits.

4. What types of stress testing are incorporated in the process?

The 2022 actuarial valuation evaluates six scenarios for possible future returns ranging from 0% to 12%. These scenarios show the impact of the amortization periods.

As witnessed by the November 19, 2019, special study, the Plan has shown a willingness and aptitude to evaluate specific liability questions that may arise over time.

Findings: Future Cash Flows and Liabilities

Evaluation of past actuarial valuations and special studies indicates that the Plan's liabilities are properly managed and funded. The Plan's demographics are clearly represented and measured, allowing the Board and consultant to develop corresponding strategies considering these factors. Our view is that the asset allocation is appropriate to meet the goal return with balanced risk.

Enhancement Recommendations

None.

III. REVIEW OF THE APPROPRIATENESS OF FEES AND COMMISSIONS

1. Do the system's policies describe the management and monitoring of direct and indirect compensation paid to investment managers and other service providers? What direct and indirect investment fees and commissions are paid by the system?

The Plan's most recent IPS, dated 11/15/23, indicates a detailed fee summary across asset managers. The investment consultant also reflects management fees, which are provided to the Board quarterly for review.

The current disclosures do not distinguish between direct and indirect fees, investment commissions are not shown, and other fees and expenses for custody and investment consulting are not measured or reported. We observe that there do not appear to be any commissions based on the use of mutual funds.

2. Who is responsible for monitoring and reporting fees to the Board? Is this responsibility clearly defined in the system's investment policies?

The investment consultant measures explicit fees in their quarterly reports.

3. Are all forms of manager compensation included in reported fees?

Yes. Management fees for managers are clearly reported, but they are not broken out into explicit and implicit fees.

4. How do these fees compare to peer group and industry averages for similar services? How are the fee benchmarks determined?

Total fees of 67 basis points are consistent with plans of similar size with alternative investment allocations. Specific fee comparisons for each portfolio segment are as follows:

- The average expense ratio for the Plan's public equity mutual funds is 47 basis points. The median corresponding Morningstar expense ratio is 44 basis points (*Investment Company Institute 2022*).
- The average expense ratio for the Plan's fixed income mutual funds is 45 basis points. The median corresponding Morningstar expense ratio is 37 basis points (*Investment Company Institute 2022 Study*).
- The average fee for the open-end real estate commingled funds is 110 basis points. Based on our industry experience, the most common management fee for these funds is 100 basis points.
- Based on our industry experience, the various fee arrangements for private equity and private credit managers are common and customary.

5. Does the system have appropriate policies and procedures in place to account for and control investment expenses and other asset management fees?

Yes. The IPS clearly states that fees are a consideration when considering asset managers. When evaluating manager candidates, the Plan has reviewed and compared fee arrangements. The Plan also has a practice of identifying and disclosing their fee arrangements both in the IPS and their periodic performance reporting.

6. What other fees are incurred by the system that are not directly related to the management of the portfolio?

Other investment-related fees that are not shown are those for custody and investment consulting.

7. How often are the fees reviewed for reasonableness?

Per the IPS, fees are evaluated whenever asset manager candidates are considered. The investment consultant provides a comprehensive fee summary in their performance reporting, which is available quarterly for Board review.

8. Is an attorney reviewing any investment fee arrangements for alternative investments?

The Board has demonstrated regular legal representation in past meeting minutes. In communication with the current attorney, he confirmed his review of all future vendor contracts.

Findings: Fees and Commissions

Based on the Plan size and its asset allocation, including alternative strategies, the Total Plan expenses are deemed to be consistent with peers. All asset performance is shown net-of-fees. Fees are now evaluated each time a vendor is hired. Asset manager fees are expressed both in the IPS and quarterly performance reports. The asset manager fees are also being disclosed and quantified consistent with industry practice.

Enhancement Recommendations

- Fee Reporting – Expense reporting could be expanded to reflect the Texas statutory requirements for the plan's annual financial report (AFR). This would identify explicit and implicit fees, brokerage fees, commissions, and fees for other investment services such as custodial and investment consulting. [Sec. 802.103, Texas Government Code, 40 TAC, §609.105\(9\)](#)

IV. REVIEW OF THE GOVERNANCE PROCESSES RELATED TO INVESTMENT ACTIVITIES

IV (A). TRANSPARENCY

- 1. Does the system have a written governance policy statement outlining the governance structure? Is it a stand-alone document or part of the IPS?

The IPS clearly establishes governance in item 1, overview. The Plan also demonstrates governance through its policies for funding, travel, ethics, and gifts and gratuities.

- 2. Are all investment-related policy statements easily accessible by the plan members and the public (e.g. posted to system website)?

Yes. All investment-related policies and reports are posted on the Plan’s website.

- 3. How often are Board meetings? What are the primary topics of discussion? How much time, detail, and discussion are devoted to investment issues?

Monthly Board meetings are held. Meeting lengths vary based on the agenda but typically last 1-3 hours. The discussion topics are typically: Call to order, public Comment(s), Consent Agenda (varies), Benefit Applications, Changes and QDROs, Consultant report, discussion and action on consultant presentation, miscellaneous, Administrator’s report, Committee reports, and adjournment. The Board has shown a willingness to schedule special meetings for miscellaneous items that arise, such as vendor interviews. Based on the evaluation of historical meeting minutes, there appears to be ample detailed time and discussion devoted to each issue.

- 4. Are meeting agendas and minutes available to the public? How detailed are the minutes?

Yes. Meeting agendas and minutes are posted on the website. The meeting minutes are sufficiently detailed.

Findings: Governance

We find the governance processes and practices to be effective and robust.

Enhancement Recommendations

None.



IV (B). INVESTMENT KNOWLEDGE/EXPERTISE

1. What are the backgrounds of the Board members? Are there any investment-related educational requirements for Board members?

Cade Holt – Active Firefighter and Business Owner (construction)

Kevin Pounds – Active Firefighter

Jon Wheeler – Active Firefighter and Ranch Owner

Eric McDonald – Investment Advisor / Wealth Manager

Greg Taylor – Accounting

David McEndree – Accountant

Blu Kostelich – Finance Director for City

Yes. The Board has a diverse representation of expertise and backgrounds. There are no formal requirements for new Board members.

2. What training is provided and/or required of new Board members? How frequently are Board members provided investment-related education?

All Board members meet the PRB's core training requirements.

3. What are the minimum ethics, governance, and investment education requirements? Have all Board members satisfied these minimum requirements?

The Board members regularly attend training provided by TLFRA and TEXPERS. The consultant presents and attends at all meetings.

4. Does the system apply adequate policies and/or procedures to help ensure that all Board members understand their fiduciary responsibilities?

Yes. The Board has demonstrated policies and robust practices to inform the Board of their responsibilities. The Board also complies with the training requirements of the PRB and attends regular conferences covering fiduciary responsibility.

5. What is the investment management model (i.e. internal vs. external investment managers)?

The investment management model utilizes external managers.

6. Does the Board receive impartial investment advice and guidance?

Yes. The investment consultant is an independent firm.

7. How frequently is an RFP issued for investment consultant services?

The last RFP for an investment consultant was in 2017. The Board evaluates its vendors on an ad hoc basis.

Findings: Investment Knowledge/Expertise

Based on our interactions with vendors, we deem the Board of Trustees qualified and regularly trained on their responsibilities and fiduciary duty.

Enhancement Recommendations

None.

IV (C). ACCOUNTABILITY

1. How is the leadership of the Board and committee(s), if any, selected?

The Chairman assigns members to various Committees.

2. Who is responsible for making decisions regarding investments, including manager selection and asset allocation? How is authority allocated between the full Board, a portion of the Board (e.g. an investment committee), and internal staff members and/or outside consultants? Does the IPS clearly outline this information? Is the Board consistent in its use of this structure/delegation of authority?

The Board of Trustees has the authority to make investment decisions. All decisions are made by motion and voted on in the monthly Board meetings.

The Board has appointed certain members to serve on its Investment Committee. The Investment Committee often meets and reviews detailed research items with the consultant before the Board meetings. In these cases, the Investment Committee recommends investment decisions to the full Board at the subsequent Board meetings.

The IPS does not outline the responsibility or practice of using committees. The Board has shown consistency in its authority.

3. Does the system have policies in place to review the effectiveness of its investment program, including the roles of the Board, internal staff, and outside consultants?

Yes. The investment policy clearly identifies the roles and responsibilities of the critical parties involved in reviewing the investment program.

4. Is the current governance structure striking a good balance between risk and efficiency?

Yes. The Plan has employed a professional administrator who provides structure, detailed minutes, and a method of following up on action items. The separation of duties allows independent fiduciaries to hold each other accountable. This structure provides efficient governance.

5. What controls are in place to ensure policies are being followed?

Independent vendors for administration, consulting, custody, and asset management provide a structure of control to ensure policies are being followed. This structure eliminates any conflicts of interest from any one vendor.

6. How is overall portfolio performance monitored by the Board?

The investment consultant provides both quarterly and monthly flash reports. The investment consultant also attends monthly meetings, aiding the Board in monitoring the portfolios at each meeting.

7. How often are the investment governance processes reviewed for continued appropriateness?

The investment policy has been reviewed each year. The Plan has shown a practice of conducting periodic vendor RFPs. For example, both the auditor and administrative services were reviewed last year.

Findings: Accountability

The fund has demonstrated strong controls, systems, and a process of accountability.

Enhancement Recommendations

The IPS could be updated to identify the use of an Investment Committee in its decision-making.

V. INVESTMENT MANAGER SELECTION AND MONITORING PROCESS

1. Who is responsible for selecting investment managers?

The Board of Trustees with assistance from the investment consultant.

2. How are the managers identified as potential candidates?

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.

3. What are the selection criteria for including potential candidates?

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. Analysis of qualified candidates is based on quantitative characteristics, qualitative characteristics, and organizational factors.

4. What are the selection criteria when deciding between multiple candidates?

The Board will strive to hire investment managers who offer the greatest incremental benefit to the Fund, net of fees and expenses. The Board will focus on firms with products with GIPS-compliant track records of at least five years.

5. How does the selection process address ethical considerations and potential conflicts of interest between investment managers and Board members?

The investment manager search is conducted by an independent consultant who is a fiduciary to the Board of Trustees. Given this standard, the consultant should disclose any conflicts of interest or ethical considerations that may arise from an investment manager candidate.

The Ethics policy requires the Board of Trustees to disclose any personal conflict of interest and to abstain from voting whenever appropriate.

6. Who is responsible for developing and/or reviewing investment consultant and/or manager contracts?

The current Board attorney confirmed the review of all vendor contracts when hired.

7. What is the process for monitoring individual and overall fund performance?

Individual managers are monitored and evaluated by the investment consultant. This function involves assigning a benchmark and comparisons to peer groups. The investment consultant is tasked with evaluating qualitative and quantitative factors in determining opinions on the asset managers. It is within the consultant's responsibility to then make recommendations to the Board to put a manager on probation or terminate them. A manager may be removed from probation if they demonstrate satisfactorily to the Board that significant improvement or rectification of the problem has been accomplished. Active managers are expected to outperform their designated benchmarks over rolling three-to-five-year periods.

The overall fund performance is to exceed the benchmarks specified in Appendix A of the Investment Policy. The investment consultant provides a quarterly report and regularly measures the Board's progress towards meeting these requirements.

8. Who is responsible for measuring the performance?

The investment consultant.

9. What benchmarks are used to evaluate performance?

The total fund is measured relative to a custom benchmark containing passive indexes weighted to correspond with the Plan's actual asset allocation. The total fund is measured against the absolute return target of 7.5%. The Total Plan is measured relative to the median return of the peer universe performance. Investment performance is ranked against the peer universe.

10. What types of performance evaluation reports are provided to the Board? Are they provided in a digestible format accessible to trustees with differing levels of investment knowledge/expertise?

The consultant provides regular quarterly reports and monthly flash reports, which are consistent with industry standards. The information is digestible to trustees with differing levels of knowledge/expertise.

11. How frequently is net-of-fee and gross-of-fee investment manager performance reviewed? Is net-of-fee and gross-of-fee manager performance compared against benchmarks and/or peers?

All investment returns are reporting net-of-fee. The Board receives comprehensive performance reporting quarterly. The Board receives monthly FLASH performance reports.

12. What is the process for determining when an investment manager should be replaced?

Per the investment policy document, this is part of the consultant's responsibility. See Section V, answer #7 above.

13. How is individual performance evaluation integrated with other investment decisions such as asset allocation and investment risk decisions?

The investment policy document integrates periodic performance measurement and asset allocation by setting the ranges for each asset class and mandating periodic rebalancing that controls risk at the total fund level.

Findings: Manager Selection & Monitoring

The plan and consultant have a clearly defined process for evaluating and reviewing asset managers. Once the decision is made to replace a manager, the consultant is tasked with sourcing appropriate candidates based on industry-accepted criteria.

Enhancement Recommendations

None.