

CONTRACTING WITH INVESTMENT ADVISORS & MANAGERS



ADVANTAGES AND THE RFP PROCESS

Presented by
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City of Newport Beach
and
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Portfolio Services for Government, LLC
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PRESENTATION HIGHLIGHTS


- What is an investment advisor or manager? (Terry)
- How do you know if it makes sense to hire an advisor? (Dan)
- The Newport Beach Story: If you already use an advisor, how do you go about renewing the selection process? (Dan)
- Issuing the RFP if you don't now use an advisor ... or if the current contract is near expiration (Terry)
- Q & A (Attendees, Dan & Terry)

WHAT IS AN INVESTMENT ADVISOR OR MANAGER?

ADVISOR?

MANAGER?





The terms are somewhat interchangeable but let's keep it simple.

"CLIFFS NOTES" VERSION OF DIFFERENCE

- Investment Advisors advise but are given no authority to make investment decisions.

You are MORE involved.
- Investment Managers are authorized to make investment decisions (but must abide by entity's investment policy).

You are LESS involved.

NECESSITY IS THE MOTHER OF INVENTION

- Municipal investing practices became headlines in the early 1990s
- People learned that
 - Denial is not just a river in Egypt
and
 - Citroen is not just a French car
(OK, Citron not Citroen)



USE OF ADVISORS AND MANAGERS HAD SOME HISTORY IN THE 1980S BUT REALLY

- Fairly strong use in CA, OR, WA, CO, FL
- Growing use nationally – in nearly every state
- Perhaps 10% or more municipal portfolios are advised or managed
- Most portfolios have \$20 million and up ... into the billions
- Most smaller portfolios

INVESTMENT ADVISORS

Two types of services

1. Active assistance with your operation of the investment portfolio
2. Consulting only

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ACTIVE ASSISTANCE WITH OPERATING THE INVESTMENT PORTFOLIO

- Non-discretionary
- Similar to a personal shopper, recommends but you decide
- Provide credit research, policy development, reporting
- Fees: Usually in annual basis points or flat fee. No incentive for churning the portfolio

INVESTMENT ADVISORS AS CONSULTANTS

Various levels of consulting - may include:

- Advice as to how to structure the portfolio
- Policy development
- Reporting assistance
- Periodic presentations to management and elected officials
- Fees: Usually flat fee

INVESTMENT MANAGERS

- Same service as advisors but discretionary.
- Saves time. Manager makes the decisions - based on entity's investment policy
- Works best for big portfolios and pools
- Less commonly used – most entities prefer or are required to make the investment decision, i.e. non-discretionary
- Fees: Usually in annual basis points or flat fee. No incentive for churning the portfolio

WHY USE ADVISOR OR MANAGER?

- Expertise
- Economy of scale
- National view vs. local “group-think”
- Staff supplement – not staff replacement
- Resources
- Cost-effective (usually pays for itself with improved performance)
- Increased transparency
- Superior & timely reporting
- Succession planning

EXPERTISE

- Many staff charged with portfolio got there through accounting jobs
- Really good technically (keeping track of the portfolio)
- Perhaps not so experienced with policy and the nuances of investing (instrument selection, maturities, duration, risk)
- Expertise can be developed or enhanced with advisors or managers

COST-EFFECTIVE

- Survey of Advisors:

Many advisors see client annual yield improvement of 20 to 40 basis points, gross of fees.

With fees ranging at about 10-12 or lower, even a net 8 basis point improvement is attractive

$$8\text{bps} \times \$100 \text{ million} = \$80,000$$

SUCCESSION PLANNING

- Succession planning is easier when you have experts behind the scenes who can help new investment officers get up to speed.
- Also, helps when unexpected turnover happens. The investment program keeps on ticking.



ADVISORS & MANAGERS ARE BOTH GOOD (AND OFTEN THE SAME FIRMS)

I HAVE A PREFERENCE FOR ADVISORY RELATIONSHIPS

WHY?

WITH ADVISORS, YOU OR YOUR STAFF:

- Have greater control (you call the shots)
- You're responsible for the portfolio quality anyway
(Can delegate but not abdicate)
- Develops stronger skills
- Can more readily explain the portfolio to higher management and elected officials

IF YOU USE AN ADVISOR, YOU ARE PROBABLY USING ONE OF THESE:

Chandler Asset Management
Government Portfolio Advisors
Insight Investments
FTN Main Street Advisors
Patterson & Associates
PFM Asset Management
Public Trust Advisors

**Most have
a
California
presence**

NOW TO DAN ...



ABOUT NEWPORT BEACH

NEWPORT BEACH, CA CITY PROFILE

- Stable, prosperous, and financially secure municipality due to its strong underlying tax base, disciplined fiscal decisions, and governance
- Mature full-service City incorporated in 1906. Operates its own fire, police and enterprise (water/wastewater) operations
- Hosts one of the largest recreational harbors in the world, accommodating 4,300 recreational and sports charter boats docked within 21-square-mile harbor
- Median household income is nearly twice that of the U.S. median household income
- Permanent population of 84,915, which typically grows to over 100,000 during summer months
- Full-time staffing of 725 in 2018, Finance Department staffing of 30 responsible for annual budget, AP, Payroll, Accounting and Revenue Services (billing, parking lots, business licenses, regulatory permits)
- One of the few cities in California with a AAA credit rating from Moody's, Standard and Poor, and Fitch
- \$300M annual budget, \$250M investment Portfolio



HOW DO YOU KNOW IF IT MAKES SENSE TO HIRE AN INVESTMENT ADVISOR?

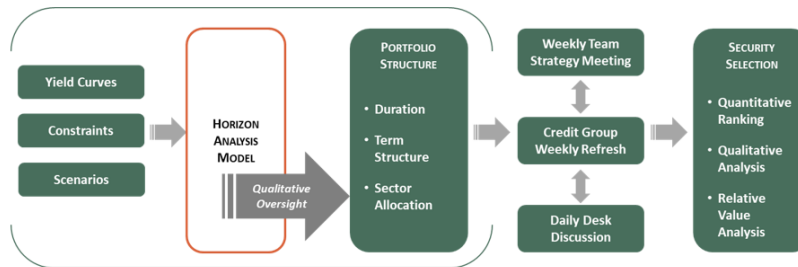


CAN YOU BENEFIT FROM THE FOLLOWING?

- **EXPERTISE AND SPECIALIZATION:** With reduced staffing and increased workloads over the years, it is increasingly clear that the City's portfolio has benefited from full time expert management by professionally managed investment firm that provides 360° view of the entire investment program.
- **NAVIGATE COMPLEX ECONOMIC ENVIRONMENTS:** During the last 8-9 years, the Fed kept interest rates historically low, and reduced the inventory of agency securities making investing idle funds and diversifying the portfolio more challenging especially to find risk adjusted value.
- **ECONOMY OF SCALE:** Contracting for investment advisory services avails the City to a full complement of investment services that would not be possible to do in-house without the economy of scale that full-time investment advisory services command.
- **GREATER SCRUTINY AND EVALUATION OF INVESTMENTS:** Our investment portfolio is invested more safely because it benefits from full-time professional attention, ongoing credit analysis and the industry tools and resources to manage public funds effectively and prudently.

QUANTITATIVE FOUNDATION FOR PORTFOLIO CONSTRUCTION

This example indicates the thorough research process used by our investment advisory firm to construct the portfolio
Chandler's Horizon Analysis Model

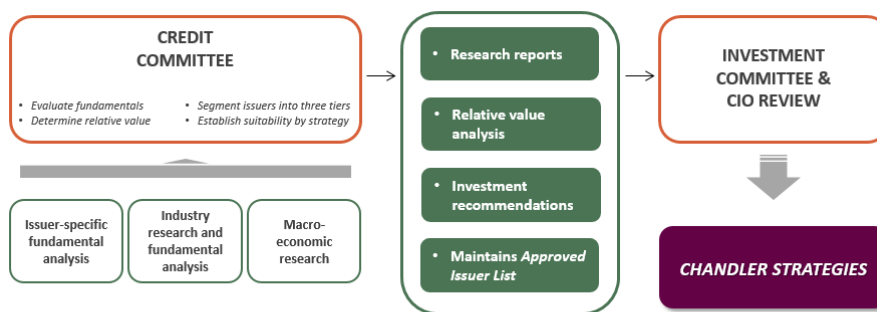


- Proprietary quantitative Horizon Analysis Model suggests target duration, sector allocation and term structure.
- The security selection process employs quantitative tools and rigorous qualitative analysis to determine relative value.

Source: Chandler Asset Management



CREDIT ANALYSIS



Source: Chandler Asset Management





THE NEWPORT BEACH STORY: IF YOU ALREADY USE AN ADVISOR, HOW DO YOU GO ABOUT RENEWING THE SELECTION PROCESS?



BACKGROUND

- The City has outsourced the management of the City's investment portfolio for more the 25 years.
- The City previously engaged five separate investment managers and five separate custodial banks to oversee and safeguard its investment portfolio.
- In 2011, the City evaluated proposals from investment advisory firms and reduced the number of service providers to three.
- In 2014, our custodian bank announced its intention to acquire the company of one of our advisors. The City terminated its contract with that advisor and transferred the assets to the remaining two.
- In 2016, as part of its due diligence, staff completed a competitive selection process for investment advisory services and ultimately reduced to one investment advisor. Reduced the incremental cost of investing new money down to 4 bps.

WHY HIRE A CONSULTANT TO ASSIST WITH RFP?

TWO OBSERVABLE MIRACLES IN PUBLIC SERVICE:

- Ordinary people become all-knowing after they are elected
- People with the title "Consultant" after their name become 10X more credible than staff

B E E S



WORKER



QUEEN



DRONE



CONSULTANT

WHY HIRE A CONSULTANT TO ASSIST WITH RFP?

- Staff has traditionally undertaken the task of planning, preparing and facilitating the RFP process for investment advisory services.
- Since the City had already engaged two excellent firms, the task to differentiate the quality of services and best fit was going to be a difficult task.
- Staff thought it was prudent to hire a consultant with (1) years of industry experience who could attract a group of highly qualified firms to respond to the RFP; (2) a demonstrated commitment to government excellence; (3) and the ability to undertake this important and detailed work during a time when staff was consumed with preparing the Fiscal Year 2016-2017 Budget and undertaking the ERP implementation.
- The City hired the firm Portfolio Services for Government, LLC (PSG) to review RFP expectations and logistics with the City, prepare the RFP documents, analyze and summarize RFP responses, and facilitate the finalist interview process.

WORKING WITH PSG TO EVALUATE PROPOSALS

- Together with PSG, the City issued a Request for Proposal (RFP) for Investment Advisory Services.
- By the proposal due date of June 17, 2016, six firms submitted proposals.
- Proposals were submitted in two parts, including a written technical proposal and a separated sealed dollar cost bid.
- Under the coordination of the Finance Director and PSG, proposals were reviewed and ranked by a three-person Selection Committee comprised of the Finance Director, the Deputy Finance Director and a staff Accountant in charge of investment accounting and reconciliation.
- The written technical proposals were reviewed and ranked by the Committee before the sealed dollar cost bids were opened and scored.

WORKING WITH PSG TO EVALUATE PROPOSALS, CONT.

- Staff evaluated and ranked each firm's proposals based on qualifications and experience, management approach and discipline, value added services, and fees.
- Due to the lower rankings assigned to three firms, staff did not advance these three firms for further consideration.
- Staff narrowed their selection consideration to two reputable firms that have experience with meeting investment goals while providing continuity through challenging market cycles.
- These firms were then invited back to a finalist presentation and interview responding to sixteen specific questions developed by PSG that were provided to them in advance, and to respond to any other questions the Selection Committee chose to probe further into.

WORKING WITH PSG TO EVALUATE PROPOSALS, CONT.

- While the three finalists met the qualifications; the Committee picked a sole vendor based on:
 - Technical content of the proposals
 - The quality and experience of the proposed engagement staff
 - Narrow focus on fixed income investments
 - Track record on delivering on cash flow needs
 - Relatively favorable pricing

TAKEAWAYS TO CONSIDER

- Outsourcing investment advisory services will reduce your internal costs while allowing your agency to focus on its core competencies.
- Contracting for investment advisory services avails the City to a full complement of investment services that would not be possible to do in-house without the economy of scale that full-time investment advisory services command.
- Consider using a consultant to assist with the selection of investment advisor services to lend greater legitimacy to the selection process in the eyes of elected officials or boards/commissions with an oversight role.
- Selecting a vendor with industry experience and current familiarity with existing firms is also useful to navigate the complexities inherent in the RFP process.

PREPARING AND ISSUING THE RFP:

IF NOW USING AN ADVISOR OR IF THE CURRENT CONTRACT IS NEAR EXPIRATION

ISSUING THE RFP IF NOW USING ADVISOR OR IF CURRENT CONTRACT IS NEAR EXPIRATION

- First of my 3 careers was as a banker, responded to many RFPs
- Found many to be:
 - Ambiguous
 - Repetitive (and redundant 😊)
 - Contradictory wording
 - Not enough time allowed for good process – “Haste Makes Waste”
 - Allow 3 - 4 weeks for firms to provide proposals
 - Allow 2 - 4 weeks to analyze proposals (depends on how many received)
 - Conduct interviews 2+ weeks after finalists are notified

KEYS TO EFFECTIVE RFPS

- Planning
- Set scope of work
- Set minimum qualifications
- Know what questions to ask and how to interpret the answers
- Selecting the finalists for interviews
- Setting up effective interviews
- Making the right decision

PLANNING

Finance/Treasurer's Role

- Scope of Work
- Minimum Qualifications
- Developing the questions

Procurement's Role

- Providing the boilerplate
- Advertising (if required)

Joint Role

- Coordinating the calendar
- Proofing the RFP
- Coordinating with consultant, if used
- Approving the final RFP

Teamwork
!

SCOPE OF WORK

- Be specific about services required
- Be specific about whether you want a non-discretionary (advised) or discretionary (managed) relationship
- Include the scope in the contract

SET MINIMUM QUALIFICATIONS

- You want good proposals from well-qualified firms.
- You do not want proposals from “wannabes”.
(Wastes your time and theirs)

EXAMPLE OF MINIMUM QUALIFICATIONS

- Be a Registered Investment Advisor as defined and regulated by the SEC and registered in California, and whose primary business is municipal investment advisory or investment management services.
- Be familiar with all relevant state statutes regarding qualified investments for public entities.
- Be completely independent of any financial institution or securities brokerage firm, or fully disclose any such relationships relevant to the firm's relationship with the Client.
- Have at least 5 years' experience in managing municipal funds, including operating & bond funds.
- Have at least \$2 billion dollars in municipal assets under ongoing management with at least \$500 million under *non-discretionary* advisement.
- Must meet the requirements as set forth in the attached sample contract.

CERTIFICATIONS & OTHER DOCUMENTATION

- Investment Policy Certification
- Financial Statements (indicative of capacity)
- SEC ADV Parts 1 and 2 see: www.adviserinfo.sec.gov/IAPD/IAPDSearch.aspx
- 5 - 10 year GIPS supporting documentation(Global Investment Reporting Standards)
see: www.gipsstandards.org

Firms only report on managed (discretionary) portfolios but can give a good idea of how advised (non-discretionary) portfolios have performed

DEVELOP DETAILED QUESTIONNAIRE

- Each minimum qualification met – provide supporting evidence
- Information about the firm (includes history, business volumes, client references)
- Computer/software requirements
- Reporting capabilities and samples
- Investment training offered
- Other services offered
- Disaster recovery/Business continuity
- Any objections to parts of sample contract
- Cost proposal

SELECTING THE FINALISTS FOR INTERVIEWS

- Up to 3 finalists about right
- Develop a side-by-side comparison of questionnaire answers in a table format
 - Look for minimum qualifications being met
 - Are answers comprehensive or vague?
 - Are there areas of extra strength or potential problems
- Check or spot-check references

SETTING UP EFFECTIVE INTERVIEWS

- Develop an interview discussion guide and send to finalists in advance
 - Keep same 15 – 20 questions for each firm
 - OK to ask follow-up questions where appropriate
 - Have the presenters move through the questions without your intoning them.

You want to hear what they have to say – not prove that you can read
 - Presenters are responsible for ending on time
 - Be firm about allowing the same amount of time for each interview

90 minutes works well – this is important stuff so don't be miserly with time!

EFFECTIVE INTERVIEWS

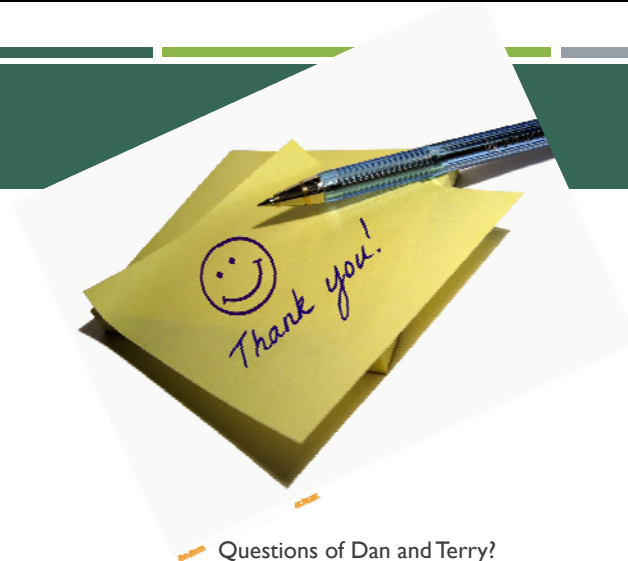
- Have finalists document their answers to questions posed in the guide
 - Provides you a written record of the interviews
 - Saves you from taking so many notes so you can concentrate on the discussion
- Discourage overhead presentations
 - Focus on the presenters – not a screen



MAKING THE RIGHT DECISION

- Often will get very good interviews – hard to decide
- There can be more than one right decision - a nice problem to have
- When a toss-up, consider:
 - Large firm versus small firm – which is right for you?
 - Are the differences in cost substantive enough to matter?
 - How do you feel about the proposed portfolio manager?

That may be the most important aspect of a good relationship



Questions of Dan and Terry?

ABOUT THE SPEAKERS

- **Dan Matusiewicz, CCMT, CFIP** is the Finance Director and Treasurer for the City of Newport Beach, CA and the current President Elect of CMTA. He started his career in public accounting but since joining the City of Newport Beach 1992, he has been involved in many disciplines including accounting and financial reporting, treasury, public finance, financial planning and analysis, long-range financial planning, public pensions and more. danm@newportbeachca.gov
- **Terry McCall** is principal of Portfolio Services for Government, specializing in RFPs for investment advisors and managers, policy review, and RFPs for banking services. When he was CFO for the City of Gresham, Oregon, he was president of the Oregon GFOA, and later was an advisor to GFOA's Treasury & Investment Management Committee.
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