To: VIA Metropolitan Transit Board of Trustees

From: David Lee, CFA, President
Dahab Associates, Inc.

Date: April 5, 2024

Re: Investment Practices and Performance Evaluation

Background

Pursuant to Texas Government Code §802.109 which became effective with the adoption of Senate Bill No. 322 in 2019, public retirement systems are required to engage an independent firm to evaluate the appropriateness, adequacy, and effectiveness of investment practices and performance and to make recommendations for improving the investment program.

As the independent investment consulting firm providing services to the VIA Metropolitan Transit Retirement Plan since 2018, Dahab Associates is qualified to provide a comprehensive analysis of your Plan, which includes an evaluation of investment policies, asset allocation, fees, governance, and investment managers.

Dahab Associates' Disclosure

Dahab Associates is an independent, employee-owned investment consulting firm. 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.

We are categorized as a private corporation under the laws of New York State. 100% of our firm's revenue is generated from our investment consulting services; we do not accept payments 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 Plan. There are no actual or potential conflicts of interest. Our entire focus is on the needs and objectives of the Plan and advising the Board and staff how best to provide fiduciary oversight of the Plan's assets on behalf of the participants of the Plan.

Our only business is providing investment consulting services centered on meeting the needs and objectives of our clients. This client-centric approach is at the core of our practice, enabling us to deliver tailored solutions and insights for our clients' success.

We are pleased to present to the Board of Trustees the following Investment Practices and Performance Evaluation Report which addresses the requirements set forth in Section 802.109 of the Texas Government Code.

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

The VIA Metropolitan Transit Retirement Plan (Plan) has an established Investment Policy Statement (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.

When providing guidance for the IPS, careful consideration must be given to the Plan's specific objectives, constraints, and policies. In its body, the IPS addresses each of the following topics.

Objectives and Goals: The objectives and goals of the Plan are delineated in terms of return requirements and risk tolerance, serving as the foundation for strategic decision-making.

Constraints: Constraints represent the limitations within which the Board must operate to attain their goals. These encompass factors such as liquidity, time horizon, and legal or regulatory considerations.

Customization through Asset Allocation: The asset allocation is tailored to address the specific needs and objectives of the client, incorporating investment objectives or risk considerations.

Role of the Fiduciaries: We incorporate our understanding of fiduciary responsibility and discussions with the Board of Trustees.

Establishing Total Return Objectives: Total return objectives are established for the overall Plan, its components, and each asset class. These objectives are continuously reviewed and refined based on feedback from fiduciaries.

Investment Managers Monitoring: We rigorously enforce compliance with objectives for each asset class and manager. If a change is warranted in asset class and/or manager, alternative allocations and/or managers are formally proposed, accompanied by a rationale for the recommendation.

We reviewed the eight sections of the Investment Policy Statement (IPS) and believe that the document is easy to comprehend and closely aligned with the objectives of the Plan. It outlines the necessary objectives to achieve and defines the Policy Index as an objective performance measure. Additionally, it highlights that the Plan aims to meet or exceed the actuarial assumption rate over a trailing three or five-year period, a time frame which generally captures a full market cycle, although recent past has been less emblematic of typical market cycles.

Regarding manager expectations, although no specific period serves as a performance standard, the IPS mandates regular performance reviews and reports to VIA and the Consultant. Managers are expected to surpass their benchmarks and rank above the median in style-appropriate universes. These measurement techniques offer clear, simple tests for the Board to assess manager success and set achievable goals. As the Plan's investment consultant, we consistently monitor managers' compliance through quarterly performance reviews.

We would consider refreshing the IPS to ensure it remains aligned with current objectives and market conditions.

(2) A detailed review of the retirement system's investment asset allocation, including:

(A) the process for determining target allocations

The VIA Metropolitan Transit Retirement Plan maintains an Investment Policy Statement (IPS), which serves as a comprehensive guide supporting the Plan's needs. This IPS serves as the foundation of the Plan's investment strategy, akin to the base of a pyramid. Asset allocation and manager selection processes are built upon this foundation to execute the overall strategy effectively. The IPS undergoes continuous reevaluation, highlighting its status as a "living document" that requires regular updates. At least quarterly, the Plan's asset allocation is reviewed against the strategic asset allocation outlined in the IPS to ensure alignment and adherence to the defined strategy.

The asset allocation is reviewed as part of the quarterly evaluation presented to the Board. It remains sound; still capable of achieving the target rate of return with a reasonable amount of risk. The Plan has generated strong returns over multiple trailing periods, ranking in the 21st percentile for the trailing year (relative to a comparable Public funds universe, where the 1st percentile represents the highest rank), 44th percentile for the trailing three years, 10th percentile for the trailing five years and 4th percentile for the trailing ten years.

<u>Approach to Asset Allocation Assignment:</u> Our approach to an asset allocation assignment begins with the construction of a simple mathematical model of the liability stream and simulation of the returns that various asset combinations would achieve over time. We gather specific data from each client, including the Plan's time horizon, liquidity needs, funding status, appropriate risk level, and legal or regulatory constraints. This information is entered into the model to generate possible outcomes for different asset allocations. We then select three or four recommended allocations that we believe would best help the Plan achieve its goals. The final decision is made by the Board based on these recommendations. Additionally, we require additional estimates of mean return, risk, correlation, and alpha for each asset class included in the study.

<u>Monte Carlo Simulation and Asset Allocation Study Process:</u> The model and process used to perform an asset allocation study rely on historical data to project future returns. Our allocation simulator employs Monte Carlo simulations, analyzing hundreds of thousands of asset allocation mixes. This "Monte Carlo" type asset simulator uses a random number generator and statistical distributions to create numerous hypothetical investment experience situations. The data encompasses a range of pre-determined scenarios, along with any requested custom assumptions, providing return analysis, potential future cash levels, and the efficient frontier of the market. Each situation represents a possible return outcome over a 20-year period.

<u>Understanding Risk and Return in Asset Allocation Study:</u> The purpose of an asset allocation study is to develop a comprehensive understanding of the interaction between risk and return. It does not solely aim to identify the "optimal strategy" for the Plan. By producing probability distributions for various outcomes during a 20-year period, the Board can identify potential pitfalls and limitations associated with different allocation policies. The trade-offs between different risk/return levels become subjective decisions, taking into account governing legislation, funding options, and the burden of varying contribution rates that the Plan can sustain.

<u>Involvement of Fiduciaries and Staff in Economic Discussions:</u> We actively involve the Plan's fiduciaries and staff in discussing the economic climate and asset return assumptions that form the foundation of our asset allocation model. Through ongoing discussions, we address topics such as the funding status, type of workforce, and the local economic climate. This collaborative approach ensures that all relevant factors are considered, leading to a well-informed and comprehensive asset allocation strategy.

(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 2023:

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	11.24	8.66
Domestic Small Cap Equity	10.53	7.95
Global Equity	9.84	7.26
Long/Short Equity	3.95	1.37

Real Estate	7.89	5.31
Fixed Income	2.94	0.36

*Expected inflation rate is 2.58%

The projected rates of return are determined by averaging the historical returns of the Plan's benchmark assets across the past two decades. We assess and scrutinize key financial attributes of both individual manager portfolios and the entire Plan to identify and mitigate risk effectively. Various risk metrics, including standard deviation, Sharpe ratio, alpha, and beta are computed to provide a comprehensive risk analysis. To ensure meaningful statistics, we rely on a minimum of five years' worth of data, sourced either directly from the Plan or from third-party databases, capturing the historical performance of managers.

Our objective is to aid the Board in crafting a portfolio capable of achieving a return equal to or surpassing the target rate, typically aligned with the actuarial assumption rate, while also offering protection against downside risks in various economic conditions. We are confident that this can be achieved through the implementation of a diversified portfolio strategy. By diversifying the portfolio, we anticipate a reduction in excess volatility. Our aim is to allocate assets in a manner that maximizes the Plan's likelihood of attaining the target rate of return while maintaining a reasonable level of risk.

(C) the appropriateness of selection and valuation methodologies of alternative and illiquid assets; and

Asset classes like private real estate, farmland, timber, and private equity present appealing risk/return characteristics. Nonetheless, their restricted liquidity poses a common constraint. While they can enhance a portfolio's asset allocation, it's essential to evaluate this against the potential impact on the portfolio's cash flow. When suggesting alternative investment options, we consider factors such as the Plan's time horizon and liquidity requirements as well as the Board's familiarity and comfort level with these asset classes.

Regarding the valuation of alternative and illiquid assets, apart from employing time-weighted performance analysis, which is standard for measuring all investment managers, we utilize a net-of-fees since-inception money-weighted return approach for these assets. These returns are then benchmarked appropriately. We furnish an investor report detailing contributions, distributions, initial and remaining commitments to the fund, along with the Internal Rate of Return (IRR). The Net Asset Value (NAV) from capital account statements serves as the metric for assessing alternative and illiquid assets.

Managers usually generate valuations derived from audit values, reported at fair value and compliant with either U.S. Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS). Third-party valuations can aid in assessing the consistency and reasonableness of stated values, though valuations adhering to GAAP and IFRS standards are preferred.

The Plan's combined allocation target to real estate and long/short equity on FYE 2023 was 15%, which breaks down to 10% real estate and 5% long/short equity. The actual combined allocation was 15.8%. Real estate made up 11.2%, while long/short equity made up 4.6%.

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	11.2%	4.6%
Peer Group Median	9.0%	9.7%

(D) future cash flow and liquidity needs;

The Plan ceased accepting new participants by the end of 2012. Similar to other mature plans, it experiences negative cash flow, with benefit payments surpassing contributions. Currently, this deficit is modest, accounting for less than 2% of the Plan's total corpus, but it is anticipated to gradually grow over time. As the Plan's membership increasingly transitions to receiving benefits and fewer contributions are made, the asset allocation strategy will progressively adopt a more conservative stance. Periodically, we will conduct asset allocation assessments to monitor and adapt to this evolving condition.

(3) a review of the appropriateness of investment fees and commissions paid by the retirement system;

The IPS of the VIA Metropolitan Transit Retirement Plan outlines the oversight of both direct and indirect compensation disbursed to investment managers. While the IPS does not explicitly detail the ongoing monitoring and reporting of these fees, it is understood within the Consultant's responsibilities to the Board that such oversight is provided. We diligently track all types of compensation distributed to the managers and furnish this information to the Board.

Manager	Annual Fee Schedule
Polen	0.60% on first $10 million, 0.50% on remainder
Seizert	0.60% on first $10 million, 0.40% on remainder
Atlanta Capital Management	0.80% on first $50 million
William Blair	0.95% on first $10 million, 0.80% on next $20 million,
Vanguard Total World Stock	0.08% on all assets
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% first $10 million, 0.35% on next $10 million, 0.25% on remainder

Broker Commissions in FYE 2023 averaged $0.018 per share. The total commission was $19,725.15 on $143,089,462.42 of transactions for a percent commission to transaction amount of 0.0138%.

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

The Board strives to maintain transparency regarding the Plan's investments, with its governance structure outlined in the IPS. Monthly Board meetings are held publicly, with agendas and minutes accessible to all.

Comprising of 11 members, the Board is appointed to staggered two-year terms by various entities: five by the San Antonio City Council, three by the Bexar County Commissioners Court, and two by the Suburban Mayors. Board members fulfill their duties in accordance with Texas PRB requirements, including completing a Minimum Education Training (MET) course within their first year and subsequently retaking it every two years.

While the Board values the impartial guidance of the Investment Consultant, selected through a bidding process every five years, ultimate investment decisions rest with the Board. The Consultant's role includes updating the Board on investment progress, educating them on asset classes and market trends, and assisting with manager changes. Quarterly performance presentations and annual audits further ensure adherence to governance processes.

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

In our role as consultants to the Plan, Dahab Associates aids the Board in the vetting, retention, and recruitment of managers. We rigorously follow a selection process designed to avoid conflicts of interest. The Board can be assured that our recommendations are entirely impartial, as we maintain no affiliations with the firms we suggest; our independence is absolute. We refrain from managing funds and engaging in any other lines of business that might pose conflicts of interest. Dahab Associates is wholly owned by its employees, and our sole source of income stems from providing advisory services to our clients.

Throughout the manager search process, our focus is on aligning the client's investment objectives with the capabilities of potential investment managers, ensuring a suitable match that meets the client's specific needs. We do not limit our search to a pre-existing list of preferred investment managers. Instead, we initiate each search assignment by screening both our proprietary and purchased databases to identify candidates that align with the client's specified criteria.

Needs Assessment*:* We conduct a comprehensive assessment of the client's specific requirements, taking into account factors such as investment goals, risk tolerance, investment style preferences, asset class preferences, and any other relevant considerations.

Request for Proposal (RFP): Based on the needs assessment, we prepare or assist in the preparation of a detailed RFP document that outlines the client's requirements. The RFP includes specific questions covering various aspects such as investment philosophy, track record, team expertise, risk management processes, fees, and reporting capabilities.

Vendor Evaluation: Once the proposals are received, we carefully evaluate each investment manager's response. We outline and compare the data against benchmarks and each other. Quantitative and qualitative factors are employed to assess the responses, categorized into three groups: firm, product, and performance.

Firm-related variables encompass ownership, experience of key personnel, total assets and accounts, account sizes and client types, as well as potential conflicts of interests. *Product-related variables* include investment style, adherence to style, market capitalization, decision-making processes for buying and selling, portfolio characteristics, geographic concentration, maturity, quality and sector distribution, allocation objectives, and fees. *Performance screening variables* encompass rate of return, standard deviation, Sharpe ratio, tracking error, alpha, beta, and R-squared.

Manager performance stands as a crucial aspect in evaluating potential managers for our clients' portfolios. In both searches and performance reporting, we compare a manager's performance not only against a suitable benchmark but also against a universe of other actively managed portfolios of similar style.

Final Selection: Based on the evaluation and due diligence process, we provide the client with a comprehensive analysis of the investment manager candidates (usually three), highlighting their strengths, weaknesses, and suitability. We assist the client in making an informed decision by providing recommendations and facilitating discussions with the finalists, if necessary.

Implementation: Once the client has made their selection, we work closely with both parties to ensure a smooth transition and implementation process. This involves coordinating legal and operational documentation, facilitating communication, and providing ongoing support during the onboarding phase. Once a manager is retained, they are integrated into the continuous monthly data collection and quarterly performance monitoring program.

Performance Monitoring Program: We gather monthly custodial statements from each manager, calculating a rate of return and cross-referencing it with the managers' statements. If any inconsistencies arise, we conduct a thorough investigation and generate a return based on comprehensive data. Furthermore, we review all portfolio holdings, flagging any questionable assets or trading practices deemed high risk.

Investment performance is contextualized within a universe with rankings, enabling the Board to assess the efficacy of the investment strategy. These comparative universes are selected to offer fair and objective benchmarks. For example, the entire portfolio is evaluated against a universe comprising solely other public funds. Additionally, each manager is compared against specific styles and market capitalizations. Style universes aid in assessing style integrity and performance relative to peers.

For performance measurement and peer universe rankings, we utilize Investment Metrics (IM), an independent provider of investment performance analytics for institutional investors and advisors headquartered in Darien, CT.

The IM universe includes information from approximately 5,000 institutional plans covering more than $4.0 trillion in assets under advisement. 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.

Performance Reports: Our standard reporting includes detailed quarterly performance reports, and upon request, monthly flash reports or ad hoc reports. Our principal philosophy regarding performance evaluation prioritizes providing the Board with practical insights. We recognize the significance of readability in reports, employing understandable charts and tables to enhance accessibility, especially for individuals without a financial background. Our reports aim to address four key questions:

1) Is the manager fulfilling their assigned responsibilities effectively?
2) How well is the manager performing in these duties?
3) What level of risk is associated with the portfolio?
4) How does the fund compare to its peers?

Our performance evaluation reports feature comprehensive capital markets analysis, absolute and relative performance comparisons, and peer benchmarking. Returns are consistently presented on both a gross and net of fee basis. Leveraging our proprietary software, we meticulously craft quarterly performance reports tailored to highlight critical performance factors.

Key areas covered in our reports include:

- **Investment Growth:** Tracking the fund's value over time, accounting for contributions, withdrawals, and investment returns.

- **Executive Summary:** Converting quarter-end fund values into rates of return for various time periods.

- **Economic Environment:** Discussing the broader economic context and its impact on the Plan's performance.

- **Relative Performance:** Comparing the fund's performance against benchmarks and component parts.

- **Asset Allocation:** Providing a breakdown of asset allocation percentages.

- **Analysis:** Conducting in-depth analysis of each asset class's performance and relevant financial statistics.

We offer flexibility in customizing our performance reports, as all analysis and report preparation are conducted in-house.

Manager Turnover: As stipulated in the Investment Policy Statement (IPS), managers undergo continuous evaluation to ensure they fulfill their responsibilities regarding asset allocation and overall Plan objectives. 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 decision to terminate a manager is carefully weighed against the necessity for change. Instances where a manager may be considered for probation include significant personnel departures within their firm, changes in ownership, shifts in investment style, non-compliance with the IPS, ethical or legal breaches, or consistent failure to meet benchmarks compared to peers. We actively monitor for indicators of potential failure by maintaining open communication channels with managers. Ideally, we aim to anticipate such failures in advance to safeguard client returns, with particular emphasis on identifying early signs of changes in personnel or processes. This proactive approach underscores the importance of our extensive manager interviewing process.

In conclusion, Dahab Associates' evaluation finds the VIA Defined Benefit Plan's investment policies, procedures, and practices to be compliant and appropriate when compared to industry norms.