



# Matching Investment Strategy with Portfolio Objectives

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# Questions We Will Address Today

- ▶ What types of investment providers are available?
- ▶ When should our community hire a broker-dealer or an investment advisor?
- ▶ How to align investment goals and strategies?
- ▶ How can we conduct an investment RFP?



# What is an Investment Advisor?

- ▶ As defined by the Investment Advisors Act of 1940:
  - ▶ a "person or firm that, for compensation, is engaged in the act of providing advice, making recommendations, issuing reports or furnishing analyses on securities, either directly or through publications."
- ▶ The "anti-fraud" provision of the Investment Advisors Act of 1940 imposes a fiduciary duty on Investment Advisers:
  - ▶ Unlawful for an investment adviser to engage in fraudulent, deceptive, or manipulative conduct

# What is a Broker-Dealer?

- ▶ As defined by FINRA (Financial Industry Regulatory Authority):
  - ▶ a “person or company that is in the business of buying and selling securities—stocks, bonds, mutual funds, and certain other investment products—on behalf of its customers (as broker), for its own account (as dealer), or both”
- ▶ Although many broker-dealers are “independent” firms solely involved in broker-dealer services, many others are business units or subsidiaries of:
  - ▶ Commercial banks
  - ▶ Investment banks or
  - ▶ Investment companies



# Let's Make It Simpler

- ▶ Broker-dealer: self-directed investments
  - ▶ You make all decisions
  - ▶ Sell investment products (Treasuries, Agencies, Corporates)
- ▶ Investment advisor: investment management
  - ▶ Discretionary or non-discretionary management
  - ▶ Separately managed accounts
  - ▶ Investment funds/pools

# What is a Municipal Advisor?

- ▶ The Exchange Act states: “A municipal advisor and any person associated with such municipal advisor shall be deemed to have a **fiduciary duty** to any municipal entity for whom such municipal advisor acts as a municipal advisor....”
- ▶ Advisors are required to exercise due care when advising **all clients, including state and local governments, other municipal entities** and non-municipal entities obligated to repay the bonds.
- ▶ This “duty of care” entails a responsibility to possess the requisite knowledge and conduct appropriate research to provide **informed advice** and make **suitability** determinations for recommendations to their clients.
- ▶ Further, when dealing with municipal entities, municipal advisors owe a duty of loyalty and must act with utmost good faith and put their **clients’ interests ahead of their own** under the federal fiduciary duty established by the Dodd-Frank Act.



# What is a Fiduciary Duty?

- ▶ Requires the firm to act in the best interest of their clients, putting their clients' interests ahead of their own at all times
- ▶ The firm must avoid conflicts of interest
  - ▶ A fiduciary must be sensitive to the conscious and unconscious possibility of providing less than disinterested advice

# Does a Broker-Dealer Have Fiduciary Duty?

- ▶ Only broker-dealers that are municipal advisors have a fiduciary duty and then only for certain accounts:
  - ▶ The fiduciary duty **only** applies to the **investment of bond proceeds** and not to other investment accounts such as operating funds.
- ▶ Under the **suitability rule**, brokerage firms are required to deal fairly with their customers.
  - ▶ Firms and their associated persons “must have a reasonable basis to believe” that a transaction or investment strategy involving securities that they recommend is suitable for the customer.



# Comparison of Broker-Dealers and Investment Advisors

	Broker-Dealers	Investment Advisors
Fees	▶ Transaction fee, mark-up or commission	▶ Fee based on assets under management
Transacting	▶ Self-Directed	▶ Managed Accounts
Responsibility	▶ Suitability ▶ Fiduciary Duty for Municipal Advisors on investment of bond proceeds	▶ Fiduciary Duty

# Comparison of Broker-Dealers and Investment Advisors

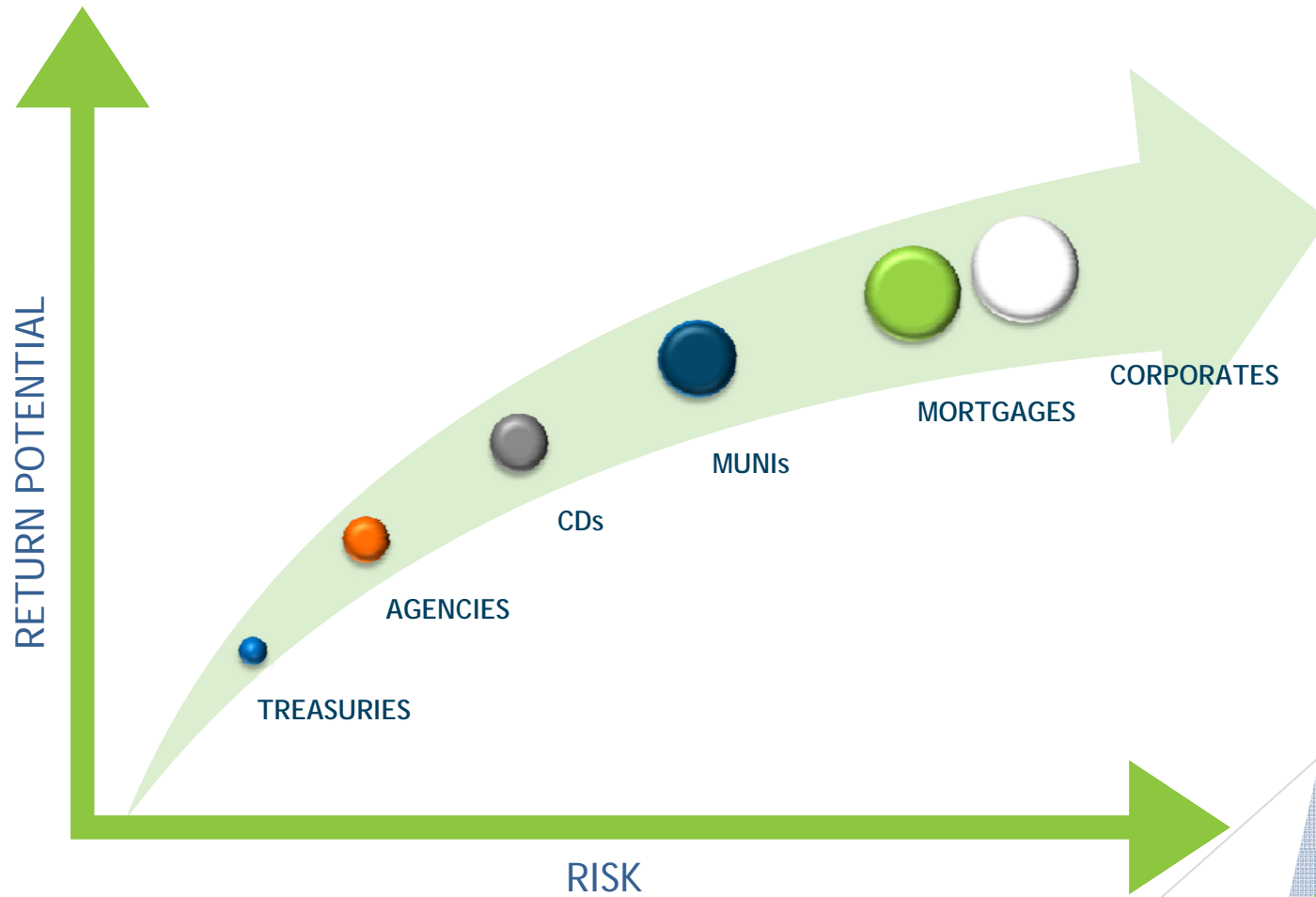
	Broker-Dealers	Investment Advisors
National Regulators	<ul style="list-style-type: none"><li>▶ SEC - Securities and Exchange Commission</li><li>▶ FINRA - Financial Industry Regulatory Authority</li><li>▶ MSRB - Municipal Securities Rulemaking Board</li></ul>	<ul style="list-style-type: none"><li>▶ SEC - Securities and Exchange Commission</li></ul>
State Regulators	<ul style="list-style-type: none"><li>▶ Applicable State Regulators</li></ul>	<ul style="list-style-type: none"><li>▶ Applicable State Regulators</li></ul>



# When Should We Hire an Investment Professional?

- ▶ what types of investment providers are available?
- ▶ when should our community hire a broker-dealer or an investment advisor?
- ▶ how to align investment goals and strategies?
- ▶ how can we conduct an investment RFP?

# Investment Types





# When to Utilize

Asset Type	LGIP	Broker/Dealer Bank Products	Investment Advisor
Highly Liquid Funds <9 Months	+	+	↔
Medium Term Funds 1-2 Years	↔	+	+
Core Funds >2 Years	↔	↔	+
Bond Proceeds (depends on use)		↔	↔
Self Insurance Assets			+
OPEB/Pension Assets			+

# Aligning Investment Goals and Strategies

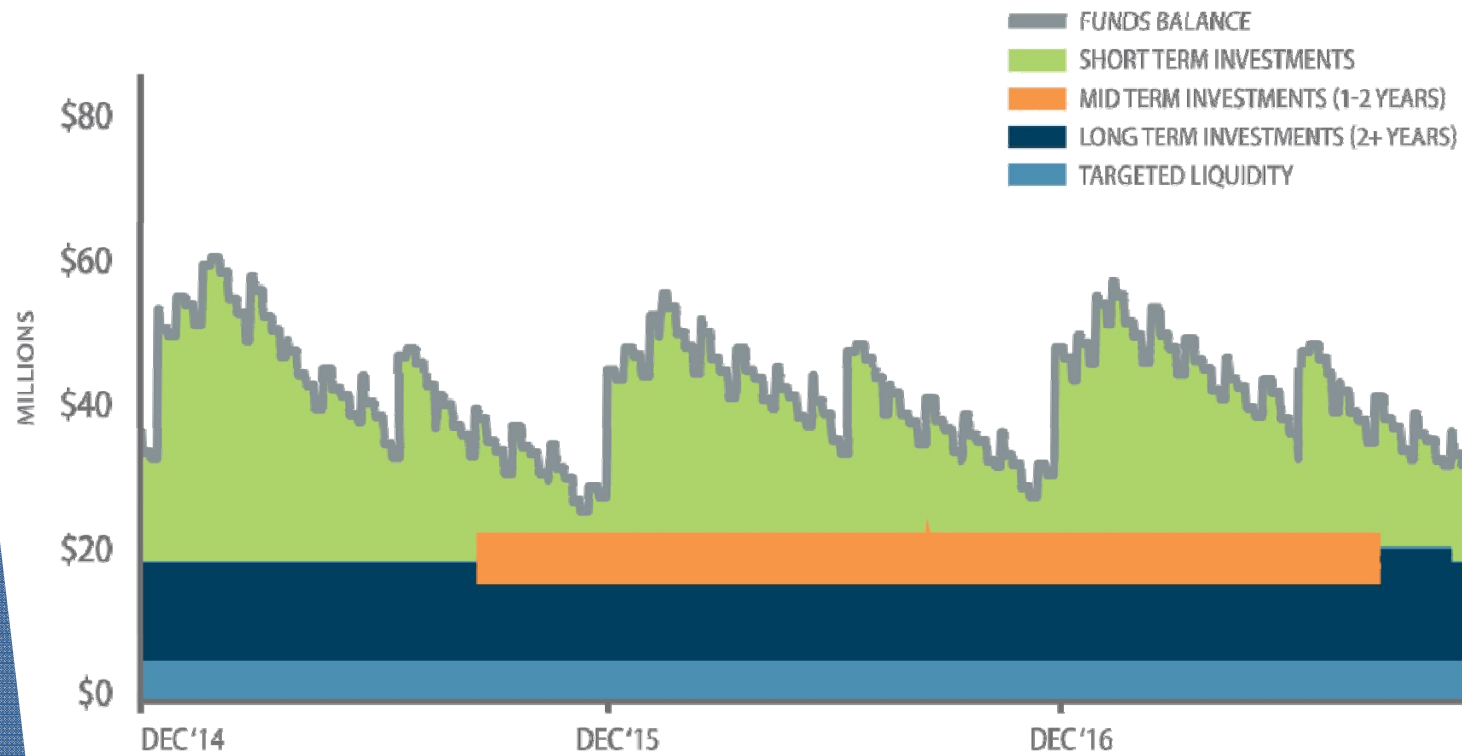




# Successful Investment Plans Align Appropriate Strategy to Purpose

- ▶ Immediate Reserves <12 months
  - ▶ T-bills/Agency Discount Notes/CD's
  - ▶ Commercial Paper
  - ▶ LGIPs
- ▶ Semi-Permanent Reserves 1-5 Years
  - ▶ Treasury Notes/Agency Notes
  - ▶ Investment Grade Corporate Bonds
  - ▶ Taxable Municipal Bonds
  - ▶ Agency Mortgage Securities
- ▶ Permanent Reserves 5+ Years
  - ▶ Investment Grade Corporate Bonds
  - ▶ Mortgage Pass Through Bonds
  - ▶ Taxable Municipal Bonds
  - ▶ Treasury Notes / Agency Notes
- ▶ Pension/OPEB Long Horizon
  - ▶ Corporate Bonds
  - ▶ Zero Coupon Treasury/Agency Bonds
  - ▶ Equities / Stocks

# Sample Cash Flow





# Opportunity Cost

- ▶ Should I wait to invest until rates rise?
- ▶ The value of time – don't try to time the market!

Invest	\$ 10,000,000	\$ 10,000,000
Yield	0.53%	0.58%
Period	365	335
Income	\$ 53,000.00	\$ 53,232.88

# Breakeven Analysis

- ▶ Should I wait to invest until rates rise?
- ▶ How much do rates need to rise?

Start Date	7/22/16
Full Term Date	7/22/17 (1 Year)
Subperiod Date	1/22/17 (6 Months)

		Income
Full Term Rate	0.53%	\$ 53,000.00
Subperiod Rate	0.42%	\$ 21,000.00
Breakeven Rate	0.64%	\$ 32,000.00
		\$ 53,000.00

➔ The 6-month rate six months forward needs to rise 22 bps to break even



# Case Study Considerations

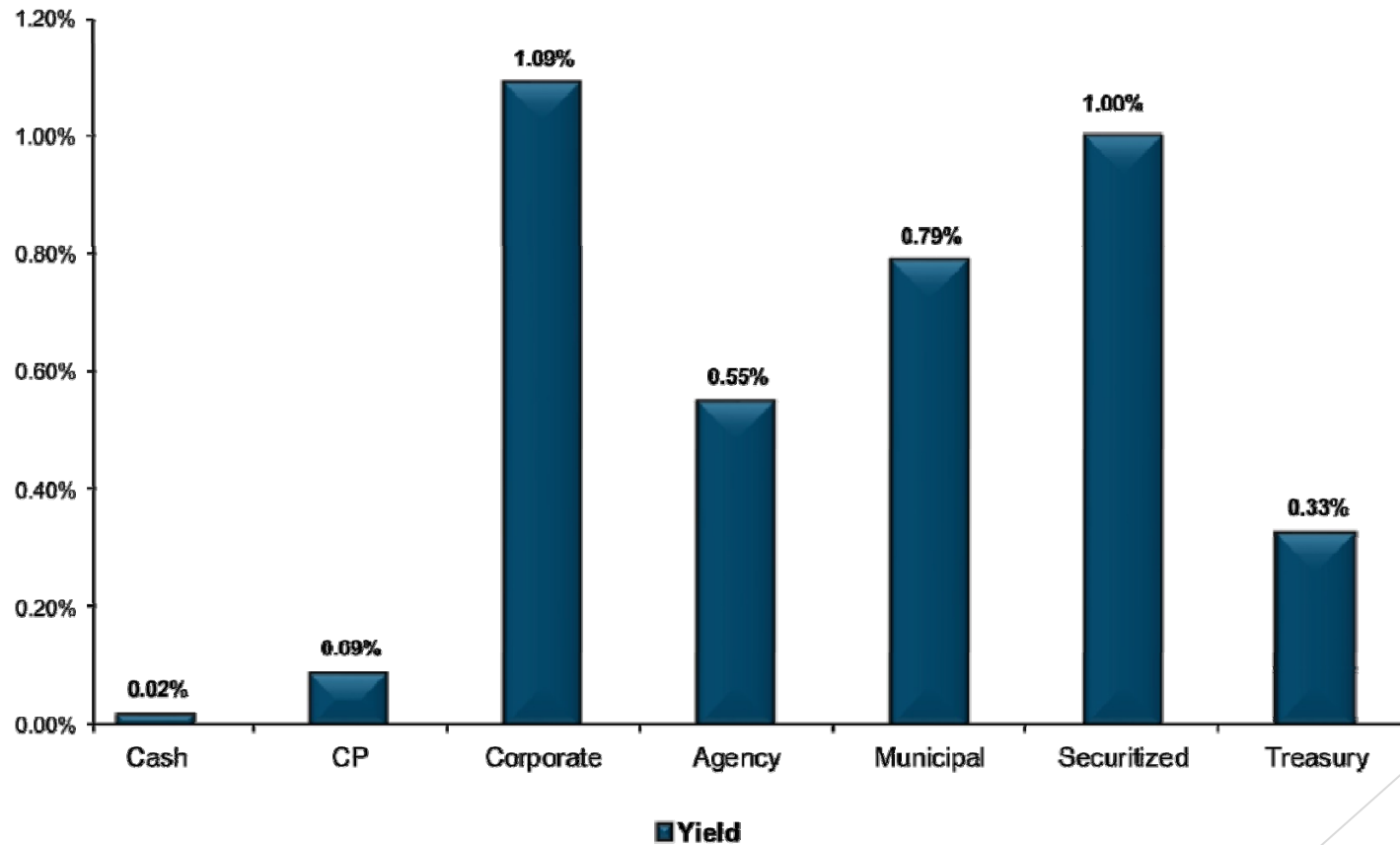
- ▶ Safety, liquidity and yield objectives
- ▶ Diversification
- ▶ Yield, income, and return across sectors
- ▶ Risk/return and price volatility

# Case Study Considerations

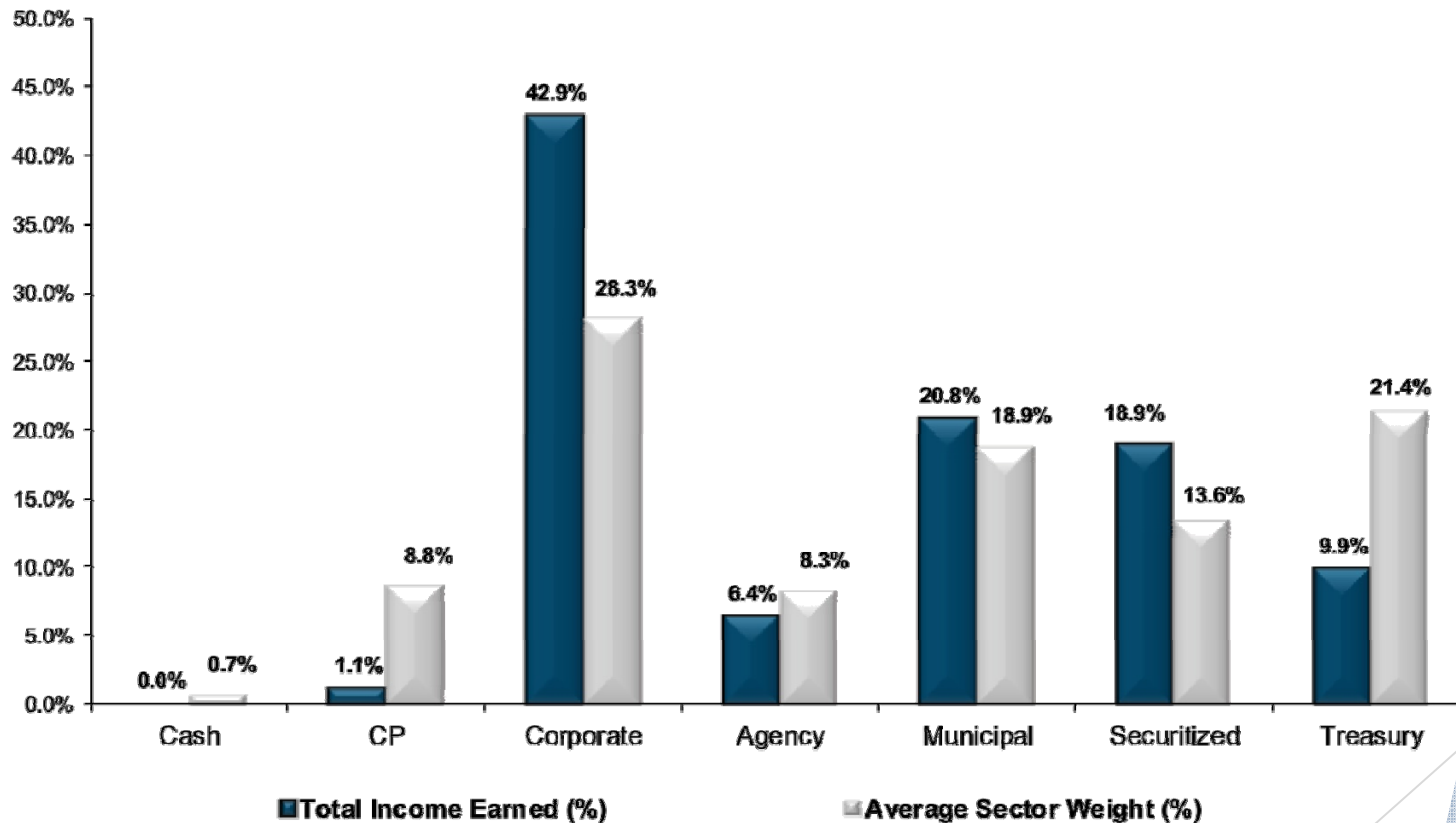
- ▶ An investment portfolio for public fund assets
- ▶ High quality emphasis; AA overall credit quality
- ▶ 5 Year final maturity (short to intermediate duration portfolio)
- ▶ 1.5 - 2 Year portfolio duration
- ▶ Eligible investments
  - ▶ U.S. Treasury Notes
  - ▶ U.S. Agency Notes and Agency Mortgage-Backed Securities
  - ▶ Municipal Securities (Rated AA/A)
  - ▶ Corporate Securities (Rated AA/A)



# Estimated Yield by Sector



# Total % Income Earned by Sector vs. Average Sector Weight



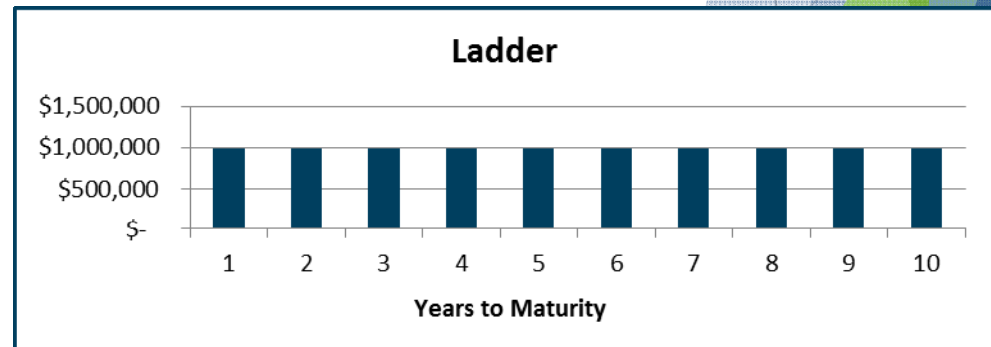
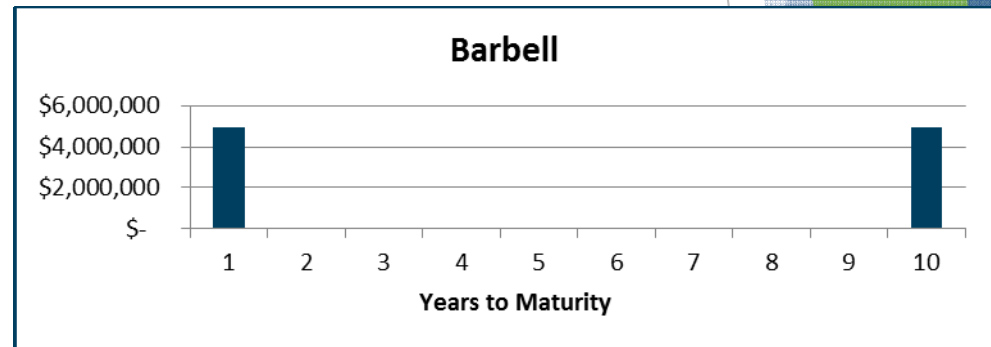
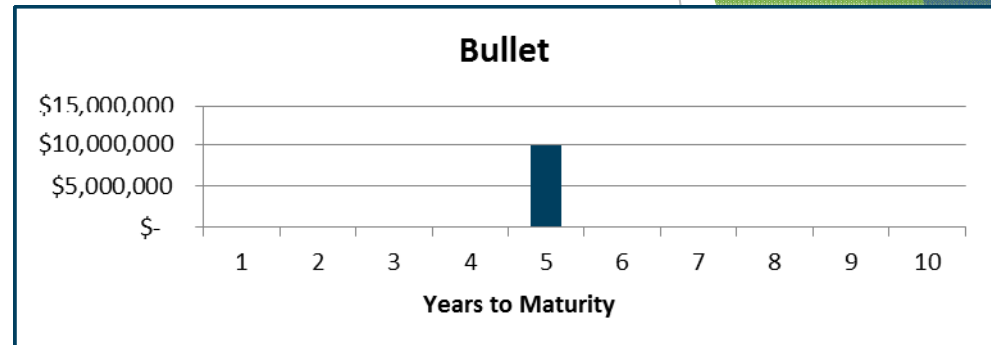
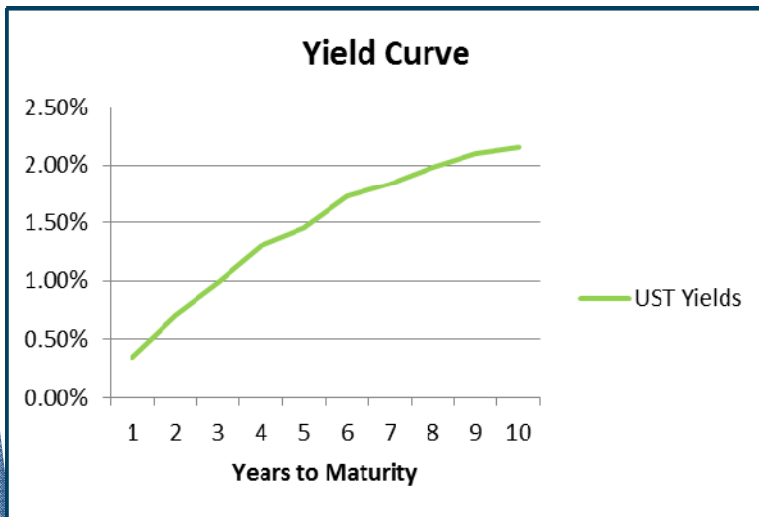


# Return Analysis

2008	2009	2010	2011	2012	2013	2014	2015
BofA Merrill Lynch 1-10 Year US Treasury & Agency Index 10.54%	BofA Merrill Lynch US Corp 1-3yr 14.69%	BofA Merrill Lynch 3-5 Year US Mortgage Backed Securities Index 7.58%	BofA Merrill Lynch 1-10 Year US Treasury & Agency Index 6.35%	BofA Merrill Lynch US Corp 1-3yr 4.49%	BofA Merrill Lynch US Corp 1-3yr 1.78%	BofA Merrill Lynch 3-5 Year US Mortgage Backed Securities Index 3.94%	BofA Merrill Lynch 1-10 Year US Treasury & Agency Index 1.24%
BofA Merrill Lynch 3-5 Year US Mortgage Backed Securities Index 6.90%	BofA Merrill Lynch 1-5 Year AAA-AA Municipal Securities Index 5.08%	BofA Merrill Lynch 1-10 Year US Treasury & Agency Index 4.94%	BofA Merrill Lynch 3-5 Year US Mortgage Backed Securities Index 5.27%	BofA Merrill Lynch 3-5 Year US Mortgage Backed Securities Index 3.01%	BofA Merrill Lynch 1-5 Year AAA-AA Municipal Securities Index 1.12%	BofA Merrill Lynch 1-10 Year US Treasury & Agency Index 2.77%	BofA Merrill Lynch 3-5 Year US Mortgage Backed Securities Index 1.12%
BofA Merrill Lynch 1-3 Year US Treasury & Agency Index 6.75%	BofA Merrill Lynch 3-5 Year US Mortgage Backed Securities Index 2.85%	BofA Merrill Lynch US Corp 1-3yr 4.86%	BofA Merrill Lynch 1-5 Year AAA-AA Municipal Securities Index 3.31%	BofA Merrill Lynch 1-10 Year US Treasury & Agency Index 1.87%	BofA Merrill Lynch 1-3 Year US Treasury & Agency Index 0.36%	BofA Merrill Lynch US Corp 1-3yr 1.19%	BofA Merrill Lynch 1-5 Year AAA-AA Municipal Securities Index 1.09%
BofA Merrill Lynch 1-5 Year AAA-AA Municipal Securities Index 5.97%	BofA Merrill Lynch 1-3 Year US Treasury & Agency Index 1.23%	BofA Merrill Lynch 1-3 Year US Treasury & Agency Index 2.34%	BofA Merrill Lynch US Corp 1-3yr 1.76%	BofA Merrill Lynch 1-5 Year AAA-AA Municipal Securities Index 1.25%	iMoneyNet Money Fund Average™ - All Taxable 0.02%	BofA Merrill Lynch 1-5 Year AAA-AA Municipal Securities Index 1.05%	BofA Merrill Lynch US Corp 1-3yr 1.01%
iMoneyNet Money Fund Average™ - All Taxable 2.05%	iMoneyNet Money Fund Average™ - All Taxable 0.19%	BofA Merrill Lynch 1-5 Year AAA-AA Municipal Securities Index 1.63%	BofA Merrill Lynch 1-3 Year US Treasury & Agency Index 1.55%	BofA Merrill Lynch 1-3 Year US Treasury & Agency Index 0.51%	BofA Merrill Lynch 3-5 Year US Mortgage Backed Securities Index (0.28%)	BofA Merrill Lynch 1-3 Year US Treasury & Agency Index 0.63%	BofA Merrill Lynch 1-3 Year US Treasury & Agency Index 0.56%
BofA Merrill Lynch US Corp 1-3yr (2.68%)	BofA Merrill Lynch 1-10 Year US Treasury & Agency Index (0.49%)	iMoneyNet Money Fund Average™ - All Taxable 0.05%	iMoneyNet Money Fund Average™ - All Taxable 0.03%	iMoneyNet Money Fund Average™ - All Taxable 0.04%	BofA Merrill Lynch 1-10 Year US Treasury & Agency Index (1.56%)	iMoneyNet Money Fund Average™ - All Taxable 0.01%	iMoneyNet Money Fund Average™ - All Taxable 0.02%

# Yield Curve Strategies

- ▶ \$10 Million Portfolio
- ▶ Average Maturity: 5 Years
- ▶ Portfolio Yield:
  - ▶ Bullet: 1.45%
  - ▶ Barbell: 1.24%
  - ▶ Ladder: 1.46%





# Investment Strategy

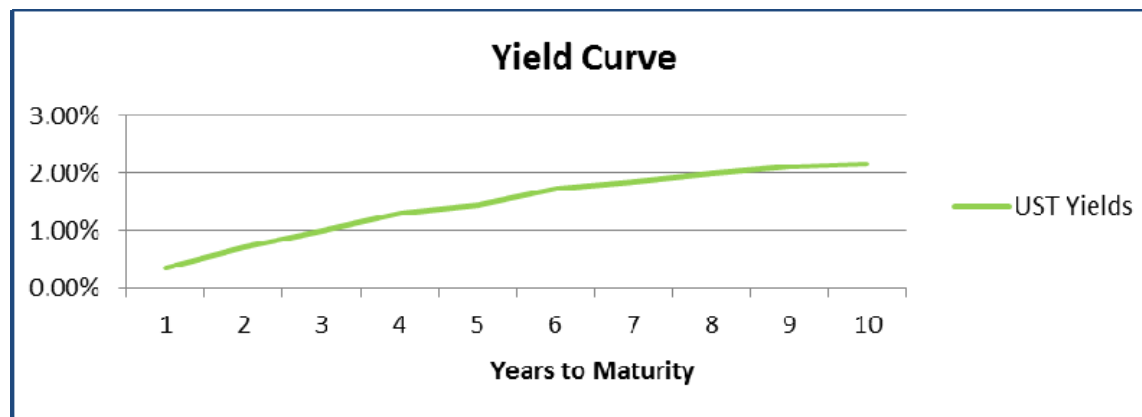
- ▶ Power of a ladder
  - ▶ Reinvest over time
  - ▶ Similar to dollar cost averaging in stocks
  - ▶ Works in all rate environments
    - ▶ Rates Fall: Locked in higher yields in longer maturities
    - ▶ Rates Stable: Longer maturities will enhance yield
    - ▶ Rates Rise: Reinvest at higher yields as bonds mature

Treasury Yields	
1 year	0.53%
2 year	0.72%
3 year	0.85%
4 year	0.95%
5 year	1.14%

← Re-invest Here

# Investment Strategy

- ▶ Rolling down the yield curve
  - ▶ In a positively sloped yield curve environment, as the bond ages it will be re-priced at a lower yield which leads to a higher price.
    - ▶ This enhances the price component of return leading to a total return greater than the purchase yield.
      - ▶ Example: 5-year UST yield 1.45% ➡ Price: 99.68
      - ▶ Next year this bond will be 4-year yielding 1.30% ➡ Price: 100.29
      - ▶ Price change: +.61 ➡ Total return: +1.98%
  - ▶ Find the steepest part of the yield curve to maximize the roll-down strategy





# Investment Strategy

- ▶ Understand market realities
  - ▶ You can't "beat" the market over time
  - ▶ Extending maturity increases yield and interest rate risk
  - ▶ Match assets and liabilities to reduce risk and provide efficient investing
  - ▶ Remember, the market is efficient
- ▶ Seek best execution through competitive bids

# Investment Approach

- ▶ Invest only in allowable investments
- ▶ Tailor strategy to meet investment goals
- ▶ Invest with a disciplined investment plan
- ▶ Thoroughly understand each investment





# How Investment Professionals Can Help

# Investment Advisor–Customized to Client

## CLIENT GOALS

Partnership built from a holistic understanding of client needs, including;

- Objectives –Return and principal preservation
- Investment time horizon
- Cash flow needs
- Fit with overall portfolio structure
- Sensitivity to client fiscal concerns

## TAILORED SOLUTION

Perform analysis to develop a solution that will meet client goals:

- Expected Returns
- Scenario Analysis
- Liability Benchmarking
- Risk Analysis
- Sample Portfolio

## REGULAR MEETINGS:

- Client Feedback
- Review goals and policies
- Is this solution still meeting client needs?



# Investment Risk Factors

- ▶ Be aware of risks and do your homework
  - ▶ Credit risk
    - ▶ Will the investment be repaid by the issuer?
    - ▶ Will the investment be downgraded?
    - ▶ Are there potential administrative or headline risks?
  - ▶ Liquidity risk
    - ▶ Is there an active secondary market for the investment?
    - ▶ Could the secondary market be affected by economic or market developments?
- ▶ What other factors should be considered?
  - ▶ What is the nature of the collateral or guarantee?
  - ▶ Can I explain this investment in less than 1 minute?

# Investment Professionals Can Provide

- ▶ Investment knowledge
- ▶ Market insights
- ▶ Assistance defining investment strategy
- ▶ Best execution
- ▶ Portfolio risk management

# When Should We Hire an Investment Professional?

- ▶ Assess Your Needs
  - ▶ Determine your objectives
  - ▶ Review your Investment Policy
  - ▶ Assess your expertise
  - ▶ Consider your time





Questions?

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# Conducting an Investment RFP

Nikki Larson

Finance Director, Village of Vernon Hills



# Importance of Financial Advisers

Money management is a core responsibility of Finance Officers. Selecting the correct Financial Adviser is key in achieving that objective. The right selection will provide:

- ▶ Safety, Security, Insurance
- ▶ Access to timely information
- ▶ Advice/Expertise
- ▶ Consulting and Strategic Planning
- ▶ Training
- ▶ Facilitate custody
- ▶ Ongoing Monitoring

# Competitive Procurement of Investment Solutions

## Benefits Include:

- ▶ Requirements are specifically outlined
- ▶ Public process generates interest and larger selection pool
- ▶ Open competition promotes fairness and good decision making
  - ▶ Vendors more likely to participate
  - ▶ Quality Service at Best Price: Pricing should be lower than a direct negotiation



# Initiating Competitive Procurement

- ▶ What can generate the need for a search?
  - ▶ Investment Policy
  - ▶ State statutes
  - ▶ Local ordinance
  - ▶ Board mandates
  - ▶ Contract Expiration
  - ▶ Change in Organizational Needs or Procedures,
  - ▶ New regulation
  - ▶ Change in current relationship



# Planning Process

- ▶ Review or Establish Investment Policy\*
  - ▶ Evaluate Investment Goals
    - ▶ Rate of Return
    - ▶ Allocations - Fixed Income, Equity
  - ▶ Set Risk Tolerance
  - ▶ Ensure Safekeeping, Insurance Requirements
  - ▶ Ensure requirements are within State and Federal Regulations

*\*Attach Policy to Solicitation Document*

# Creating the Solicitation Document

- ▶ Request for Proposal - Professional Services
- ▶ Develop Criteria using Investment Policy
- ▶ Obtain Samples
  - ▶ IGFOA Knowledgebase
  - ▶ GFOA website
  - ▶ Past Documents
  - ▶ Other Municipalities/Schools
- ▶ Determine if Consultant is Needed
- ▶ Create Potential Vendor List
  - ▶ IGFOA Corporate Partners [www.igfoa.org](http://www.igfoa.org)
  - ▶ IPPFA Affiliated Vendor List [www.ippfa.org](http://www.ippfa.org)



# Components of RFP Document

- ▶ Background Information on Organization/Fund
- ▶ Terms of Engagement / Contract Length
- ▶ Scope of Services
- ▶ Timeline
  - ▶ Include any potential Meeting Dates
- ▶ Contact Information for Questions
  - ▶ Format to Ask Questions
- ▶ Evaluation Criteria
- ▶ Required Information for Response
- ▶ Procurement / Legal Requirements



# Components of RFP Document

- ▶ Define Response Format
  - ▶ Media - Paper, Electronic,
  - ▶ Define Template
  - ▶ Required Attachments
  - ▶ Number of Copies
- ▶ Highlight due date for proposals
  - ▶ How will late proposals be handled?

# Components of RFP Document

- ▶ Vendor Information
  - ▶ Senior Leadership
  - ▶ Organizational Background
  - ▶ Organizational Size
  - ▶ Types of Clients
    - ▶ Municipal? School? Pension Fund?
  - ▶ Retention of Clients
    - ▶ How many have been lost in last 5 years?
- ▶ Planned Changes in Strategy, Size, Location



# Components of RFP Document

- ▶ Vendor Information (continued)
  - ▶ Key Personnel
  - ▶ Detailed biographies of key people
- ▶ Philosophy
- ▶ Suggested Strategy
- ▶ Process & Timeline for Transition, if applicable
- ▶ Financials
  - ▶ Reporting - Customizable, Format
  - ▶ Sample Report



# Components of RFP Document

- ▶ Ancillary Items
  - ▶ Technology Platform
  - ▶ Training
- ▶ Insurance Certificate
- ▶ References
  - ▶ Specific to your Type of Fund(s)
- ▶ Pricing
  - ▶ Provide Template
  - ▶ Will this be packaged separately?

# Creating a Scoring Matrix

- ▶ Use RFP Evaluation Criteria
- ▶ Pick Top 5-10 Scoring Items
- ▶ Decide on Scoring Basis
  - ▶ Does Not Meet, Meets, Exceeds (1-3)
- ▶ Ensure that Evaluation Criteria is clearly explained in RFP Document

# Sample Scoring Matrix

Village of Vernon Hills Police Pension Fund													
Request for Proposals (RFP) for Investment Services													
Evaluation Matrix													
	Preliminary Review												
	Responsiveness to the RFP		Ability to Perform Required Services							Ancillary Services Proposed			
	Completeness of Response	Proposal Format	Downstate Pension Fund Experience	Online Capability	Investment Procedure and Approaches	Co-Fiduciary Capabilities & Financial Stability	Transistion Costs	Implementation Schedule	Trustee Training	Other Services	Total Score	Weighted Score	
Proposing Entity:													
											-		
											-		
											-		
											-		
											-		
											-		
											-		



# Finalizing the RFP Document

- ▶ Legal Review
  - ▶ Ensure Freedom of Information Act is Covered
  - ▶ No Costs incurred by your Agency
- ▶ Insurance Review
  - ▶ Insurance Agent or Pool Requirements
- ▶ Set Schedule
  - ▶ Issue & Due Date and Time
  - ▶ Q & A for Vendors
    - ▶ Via E-Mail (Intent to Respond Document)
    - ▶ Pre-Proposal Meeting

# Distributing the RFP Document

- ▶ Legal Notice in Local Paper
- ▶ Websites
  - ▶ Your organization (e-mail blasts)
  - ▶ Local Government News [info@localgovnews.org](mailto:info@localgovnews.org)
  - ▶ Direct Mail / E-mail to Vendor List
  - ▶ For Pension - Public Pension

# RFP Evaluation Process

- ▶ Create Evaluation Committee
  - ▶ Cross Functional / Departmental
  - ▶ If Public Board, ensure Open Meetings Act requirements are followed
- ▶ Independent Review
  - ▶ Evaluation Matrix
- ▶ Meeting
  - ▶ Discussion
  - ▶ Pricing Reveal if applicable
- ▶ Selection for Interviews



# Interviews

- ▶ Provide Structure for interviews
  - ▶ Presentations by finalists
  - ▶ Question-and-Answer format
  - ▶ Specific questions – provide beforehand
  - ▶ Time Limit on Interviews
- ▶ Evaluate firm's responsiveness to questions

# Important Evaluation Criteria

- ▶ Quality of Reports
- ▶ Willingness/ability to tailor services and reports to your organization's needs and preferences
- ▶ Experience with similar organizations/funds
- ▶ Familiarity with legal requirements
- ▶ References from current (comparable) clients
- ▶ Professionalism



# Important Evaluation Criteria

- ▶ Depth of Resources
  - ▶ Advising staff
  - ▶ Economists
  - ▶ Size of Firm / Assets
- ▶ Past Performance
- ▶ Safekeeping/Custody



# Important Evaluation Criteria

- ▶ Philosophy
- ▶ Process
- ▶ Suggested strategy for you
- ▶ Team or individual approach
- ▶ Ethics
  - ▶ How are fees structured?
  - ▶ Soft Costs?

# Finalizing the Process

- ▶ Check References
- ▶ Approval by Governing Board
- ▶ Initiate Contract Negotiations
  - ▶ GFOA Best Practices
  - ▶ Legal Review
  - ▶ Insurance Review

# Case Study:

## Investment Consulting Services RFP

- ▶ Vernon Hills Police Pension Board
  - ▶ RFP Issued May 20, 2015
- ▶ Approximately \$40 Million
- ▶ Subject to Public Pension Regulations
- ▶ Distribution:
  - ▶ Sent to 15 Vendors (included incumbent)
  - ▶ Published Online
  - ▶ Legal Notice in Paper



# Case Study:

## Investment Consulting Services RFP

- ▶ Why issued?
  - ▶ 5 - Year Requirement in Illinois
- ▶ Current Investment Policy ( Adopted 2014)
- ▶ Entire Board Elected to Evaluation Committee
- ▶ Reviewed by 2 legal teams
- ▶ Elected for an “RFP Acknowledgement Form”
  - ▶ Electronic submission of questions with deadline
  - ▶ All Vendors that submitted forms received answers

# Case Study: Investment Consulting Services RFP

## ► Timeline

- RFP Issued in May 2015
- Review of Proposals in August 2015
- Investment Presentations in November 2015
  - 15 minute time limit
  - Predetermined questions provided in advance
- Further Discussion at February 2016 and May 2016 meetings



# Case Study: Investment Consulting Services RFP

- ▶ Evaluation Process
  - ▶ Evaluation Matrix
    - ▶ Used by all members
  - ▶ Fees evaluated at same time
  - ▶ Discussion took place at Public, regularly scheduled meetings



# Case Study: Investment Consulting Services RFP

- ▶ Meanwhile....
  - ▶ Trustee was replaced in November 2015
  - ▶ Finance Director retired in January 2016
  - ▶ Complicated disability case

# Case Study: Investment Consulting Services RFP

## ▶ Lessons Learned:

- ▶ Too many Cooks Spoil the Soup
- ▶ Involve Committee early on and often
- ▶ Clear Timelines are Key
  - ▶ Set Deadlines and Expectations
- ▶ Defined Matrices / Structure is essential for a decision

## ▶ Current Status

# Questions?

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