

# COMMUNITY FOUNDATION SONOMA COUNTY

## INVESTMENT POLICY: LONG-TERM POOLS

### **INTRODUCTION:**

This statement of investment objectives and policies is set forth in order that:

- A. There is a clear understanding by the Board of Directors, the Investment Advisory Committee, and any appointed Investment Manager(s) or Consultants of the nature, purpose and goals of this fund.
- B. The Investment Manager(s) are given guidance regarding the execution of their duties on behalf of the fund.
- C. The Board of Directors and the Investment Advisory Committee have agreed upon a basis for evaluation of the performance of the fund's assets and any Investment Manager(s).

The intent of this statement is to establish an attitude and/or philosophy which will guide the Board of Directors, the Investment Advisory Committee, and Investment Manager(s) toward the performance desired. It is intended that the objectives be sufficiently specific to be meaningful, but flexible enough to be practical. There are other funds that fall outside the scope of this policy or have other special purposes.

### **BOARD OF DIRECTOR'S RESPONSIBILITY:**

The Board of Directors is charged with the responsibility for the investment of fund assets. The Board of Directors shall discharge their duties solely in the interest of the Community Foundation, with the care, skill, prudence and diligence under the circumstances then prevailing, that a prudent investor, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of a like character with like aims.

### **INVESTMENT ADVISORY COMMITTEES' OBJECTIVES:**

The Board of Directors may request that the Investment Advisory Committee provide recommendations on the general investment policy of the Foundation; review any special donor fund investment requests or constraints; recommend appropriate policy for the Foundation's Pooled Income Fund; select Investment Manager(s) or Consultants; and oversee the monitoring and reporting requirements necessary to measure investment performance. The Investment Advisory Committee should apply the same prudent investor standards as discussed above for the Board of Directors.

### **INVESTMENT MANAGEMENT:**

The Board of Directors is authorized and permitted by its by-laws to engage the services of one or more investment managers or consultants who possess the necessary specialized research

facilities and skilled personnel to meet these investment objectives and guidelines. The Board of Directors require any Investment Manager or Consultant so retained to be registered under the Investment Advisors Act of 1940, and to provide to the Board of Directors, annually, a copy of their form ADV, as referenced by rule 204-3 of the Act.

Finally, the Board of Directors require any Investment Manager to adhere to the "prudent investor rule" under the Uniform Management of Institutional Funds Act (UMIFA) and other such federal laws as now apply, or may in the future apply, to the investment of any trust assets subject to their control.

### **PURPOSE:**

The purpose of the Foundation is to provide money to improve the quality of life in Sonoma County through grants to nonprofit organization.

### **LONG-RANGE GOALS:**

The Board of Directors has adopted a Total Return Concept which can offer the advantage of designing long-term investment strategies as opposed to interest sensitive short-term policies and provide for a better balance between current income and capital appreciation. The total return concept allows the fund to not only utilize current income, but over time, spend a portion of capital appreciation as part of its payout rate. For example, in 2002 a 4% grant payout rate for endowment funds was applied. The grant payout is calculated by taking the average of the fair market value of a component fund on the last day of each of the 12 prior quarters and multiplying that average by 4%. The grant payout rate is reviewed annually.

### **The Board of Directors and the Investment Advisory Committee understand that total return to the fund may come from:**

- A. Payments to the fund from dividends,
- B. Interest payments from debt securities
- C. Growth in the value of the fund from capital appreciation of equity securities.

Both the Board of Directors and the Investment Advisory Committee understand that a total return concept was adopted because interest rates are not necessarily predictable, nor are they necessarily in the best interests of either the equity portion of the fund or any longer term credit market instruments in the fund.

### **INVESTMENT OBJECTIVES:**

#### **The investment objectives for Community Foundation Sonoma County's fund are three fold:**

- A. A base spending rate of 4.0% (in 2003) on the principal adjusted for additions, expressed in dollars. This rate is evaluated annually;

- B. A base operating cost rate of 1.75% (in 2003) on the principal adjusted for additions. This rate is evaluated annually; and
- C. Over time, a minimum average annual growth rate of the underlying principal (and additions) of at least the rate of growth of the Consumer Price Index, after the payment of A and B.

Both the Board of Directors and the Investment Advisory Committee desire that the principal value of the fund and the return generated by the fund be so managed as to at least offset any inflationary pressures on them.

It is believed that this is a relatively conservative approach and that the Board has taken appropriate measures to control risk allowing any Investment Manager(s) necessary tolerances to reasonably safeguard the assets subject to his or her control. The Board of Directors and the Investment Advisory Committee would rather set forth conservative minimum expectations than lofty goals which may force any Investment Manager(s) to take risks inconsistent with the purpose of these assets.

## **INVESTMENTS:**

In order to provide the plan's Investment Manager(s) the freedom to invest within the guidelines of this policy statement, the following security classifications are permissible and suitable investments for the purpose of managing the plan.

- A. **Equity Securities:** Publicly traded common and preferred stocks, convertible preferred stocks and convertible debentures. Equity securities may be chosen from the NYSE, Regional Exchanges, and the National Over the Counter Market. All assets must have readily ascertainable market values and be fully liquid and marketable.
- B. **Debt Instruments:** United States Government and Agency Obligations. Corporate Obligations must have an average A or better agency rating by one of the three major rating agencies. Maturity structure will be left to the discretion of the Investment Manager who will manage to an intermediate duration.
- C. **Cash and Equivalents:** Cash reserves may consist of individual fixed income securities such as Commercial Paper, U. S. Treasury Bills, and other similar instruments with less than one year to maturity and/or money market funds. Cash reserves should be free from risk and instantly liquid.

If any Investment Manager wishes to use an investment vehicle not included in the above list, a request must be submitted in writing to the Board of Directors through the Investment Advisory Committee.

## **ASSET ALLOCATION GUIDELINES:**

Asset Allocation shall remain the responsibility of The Board of Directors with the assistance of the Investment Advisory Committee. Investment Managers and Consultants will be retained to manage a portion of the assets of the fund within the management style of the individual manager. The Board of Directors will review the fund's overall asset allocation annually and will make adjustments as needed. The Investment Manager(s), Consultants, and the Investment Advisory Committee may recommend shifts in asset allocation from time to time as market conditions change.

### **ASSET ALLOCATION POLICY:**

Investment decisions shall be made within the framework of the goals stated above for optimizing the total rate of return, keeping in mind the desirability of limiting year-to-year risk of income and market value fluctuations. These goals require that the total rate of return of the portfolio be optimized, rather than maximized. The optimal portfolio mix is one that carefully equates expected rate of return with expected risk of all investment categories used in the portfolio. Addendum A, "Asset Allocation Analysis" (available upon request) illustrates the results from the optimization analysis and analytical studies. In setting the optimal mix of assets for the portfolio, the Investment Advisory Committee has adopted the following strategic (long-term) asset allocation policy which incorporates a diversified asset mix:

<u>Asset Class</u>	<u>Target Percent</u>
Domestic Large Cap Equities	40%
Domestic Small Cap Equities	15%
International Equities	15%
Fixed Income & Cash & Equivalents	30%

### **Rebalancing Policy**

The Investment Advisory Committee will manage portfolio rebalancing within the guidelines of the Investment Policy. The portfolio is to be evaluated quarterly, and if any one class or sub-class exceeds its minimum or maximum allocations, all classes and sub-classes will be rebalanced to their strategic targets as quickly as possible.

<b>Asset Class</b>	<b>Strategic Target</b>	<b>Allowable Deviation (%)</b>	<b>Percentage Range</b>	<b>Min/Max Allocation</b>
Large Cap Equity	40%	10%	+/- 4.0%	36% to 44%
Small Cap Equity	15%	15%	+/- 2.25%	12.75% to 17.25%
International Equity	15%	15%	+/- 2.25%	12.75% to 17.25%
Fixed Income	30%	16.67%	+/- 5.0%	25% to 35%

In addition, if total equities in the portfolio drop below 65% or exceed 75% of total assets, all classes and sub-classes will be rebalanced to their strategic targets as quickly as possible.

The targeted strategic asset allocation is designed to provide an optimal asset mix for the portfolio which emphasizes diversification in order to lower risk and maximize total return relative to risk. It has been developed by simulating portfolio expected returns over time and examining their compatibility with above investment goals and desired spending plans of the Foundation. See Addendum A, Asset Allocation Analysis (available upon request).

Since the investment time horizon of the portfolio is long term, liquidity is not a first consideration; however, it is recognized that, from time to time it may be necessary to liquidate certain portfolio holdings in order to fund the anticipated spending plan; hence, every reasonable effort will be made to provide protection for the portfolio in deteriorating markets.

The recommended strategic long-term asset allocation policy, which is based upon future expectations of the capital markets, the correlation of the recommended asset classes and projected future spending plans, is shown in the above table as the target, or midpoint between the minimum and maximum allocations. At least annually, the Investment Advisory Committee will review the long-term asset allocation policy to determine if established guidelines are appropriate.

If any Investment Manager or Consultant feels that these guidelines in any way hamper the ability to manage assets in a businesslike manner, or to meet the objectives set, that manager should communicate those concerns to the Board in writing through the Investment Advisory Committee.

#### **INVESTMENT RESTRICTIONS:**

The following investment restrictions will apply:

- A. No short selling.
- B. While no strict restrictions have been placed with regard to individual equities, Investment Managers should be sensitive to the "political problems" that certain industries may create.
- C. No investment shall be made in derivative securities except where they offer the most economic means of improving the risk/reward profile of the portfolio (i.e., always compare the cost of derivatives to the cost of constructing an equivalent position in traditional securities). Derivative securities shall not be used in any way that results in outright exposure to changes in the value of assets or indices that by themselves would not be purchased for the portfolio.

The use of derivative securities shall not increase portfolio risk above the level that could be achieved in the portfolio using only traditional investment securities. In particular (a) the use of derivative securities in any program or technique shall not cause overall portfolio interest rate sensitivity to exceed the investment guidelines, and (b) the use of derivative securities shall not violate either the letter or the spirit of the investment guidelines that limit exposure to market, sector, and security risks.

#### **INVESTMENT MANAGER(S):**

Investment Managers, Consultants, and their services will be continually evaluated. In this regard, the Board of Directors may rely on the Investment Advisory Committee to select and monitor manager(s) performance on a quarterly basis.

The objective of monitoring is not to set in opposition one Investment Manager or program against another, but rather to ensure prudent management of the funds and compliance with the Investment Objectives and Guidelines.

### **SELECTION OF INVESTMENT MANAGERS:**

The selection of Investment Manager(s) must be based on prudent due diligence procedures. A qualifying investment manager must be a registered investment advisor under the Investment Advisors Act of 1940, or a bank or insurance company. The Investment Consultant will be required to conduct and document for the Investment Advisory Committee an Investment Manager search and evaluation for each asset class adopted in the Asset Allocation Analysis. The Investment Manager Search process will provide quantitative historical performance information using reliable manager composite data to evaluate the risk adjusted returns of the manager's performance track records. In addition, the Consultant will be required to perform and report a detailed qualitative analysis of the investment manager's personnel, investment process and stability of the manager's business organization. This qualitative evaluation of investment managers selected to manage assets for the Foundation must be reviewed on an annual basis.

### **INVESTMENT CONSULTANT:**

The Investment Consultant's role is that of a non-discretionary advisor to Community Foundation Sonoma County. Investment advice concerning the investment management of assets will be offered by the Investment Consultant, and will be consistent with the investment objectives, policies, guidelines and constraints as established in this statement. Specific responsibilities of the Investment Consultant include:

1. Reviewing the financial markets and economic climate in light of the pool's investment objectives and investment activity on a timely basis.
2. Assisting in the development and periodic review of investment policy.
3. Conducting investment manager searches when requested by the Investment Advisory Committee.
4. Providing "due diligence", or research, on the Investment Manager(s).
5. Monitoring the performance of the Investment Manager(s) to provide the Investment Advisory Committee with the ability to determine the progress toward the investment objectives.

Communicating matters of policy, manager research, and manager performance to the Investment Advisory Committee, or, upon request, to the Board of Directors.

### **MONITORING:**

Investment monitoring will be completed on annual basis evaluating the performance of the plan's assets in relation to the stated investment objectives. Quarterly reports are to be submitted for interim review by the Investment Advisory Committee. Overall Investment Manager and Consultant review will be completed after three years, and annually thereafter on a trailing three-year basis.

Relative performance measurement may be utilized to evaluate investment management in relation to the objectives, and also in relation to the capital markets and to manager(s) of similar funds with like aims.

Although the Committee may choose to schedule them more or less frequently, the Investment Managers, or a representative thereof, shall be available to meet with the Investment Advisory Committee a minimum of once a year and more often as the Committee deems appropriate.

Investment performance results will be measured by the independent consultant on a quarterly basis and compared with the objectives stated herein. The Investment Advisory Committee will review the performance of each Investment Manager regularly.

**The following indices may be used to discuss the evaluation with the Investment Committee and the Board of Trustees:**

- Consumer Price Index.
- 90 Day Treasury Bill Rates.
- Shearson Lehman Government/Corporate Intermediate Bond Index.
- Standard & Poors 500 Stock Index.
- Russell 2000 Stock Index
- EAFE International Index
- A hybrid of the above indices, or other established representative indices, so-constituted as to reasonably reflect the asset class strategy utilized by any Investment Manager(s).

The following investment goals will apply to each investment portfolio and will be evaluated over a three (3) to five (5) year time frame. If goals are not met over the time specified a formal review process will be initiated. Investment managers are further subject to separate written and signed investment guidelines.

**1. Domestic Equity Fund Objectives:**

To exceed the S&P 500 Index per annum on average over a full market cycle; or for Small Cap, to exceed the Russell 2000 Index.

To exceed the median equity fund in a nationally recognized peer universe.

To exceed the median style manager in a sub-sample of similar style managers.

**2. International Equity Fund Objectives:**

To exceed the EAFE Index per annum on average over a full market cycle.

To exceed the median International equity fund in a nationally recognized peer universe.

**3. Fixed Income Objectives**

To exceed the Lehman Brothers Intermediate Bond Index.

To exceed the median fixed income fund of similar maturity and duration in a nationally recognized peer universe.

**REVIEW MEETING:**

It is the desire of the Board of Directors that the Investment Advisory Committee meet quarterly to review investment performance and to discuss the following:

- A. Review of the ongoing investment policy and any changes thought advisable for the coming year.
- B. Develop an understanding of the asset allocation strategy and security selection tactics of any Investment Manager(s) or Consultant.
- C. Review of the current and anticipated economic environment and its effect on the fund's assets.
- D. Address any major shifts in strategy which may have taken place since the previous meeting.
- E. Review the performance of the portfolio(s) with respect to the investment objectives and policy, and
- F. Review any specific investment that may be contrary to the philosophy of the Foundation as to social or environmental issues.

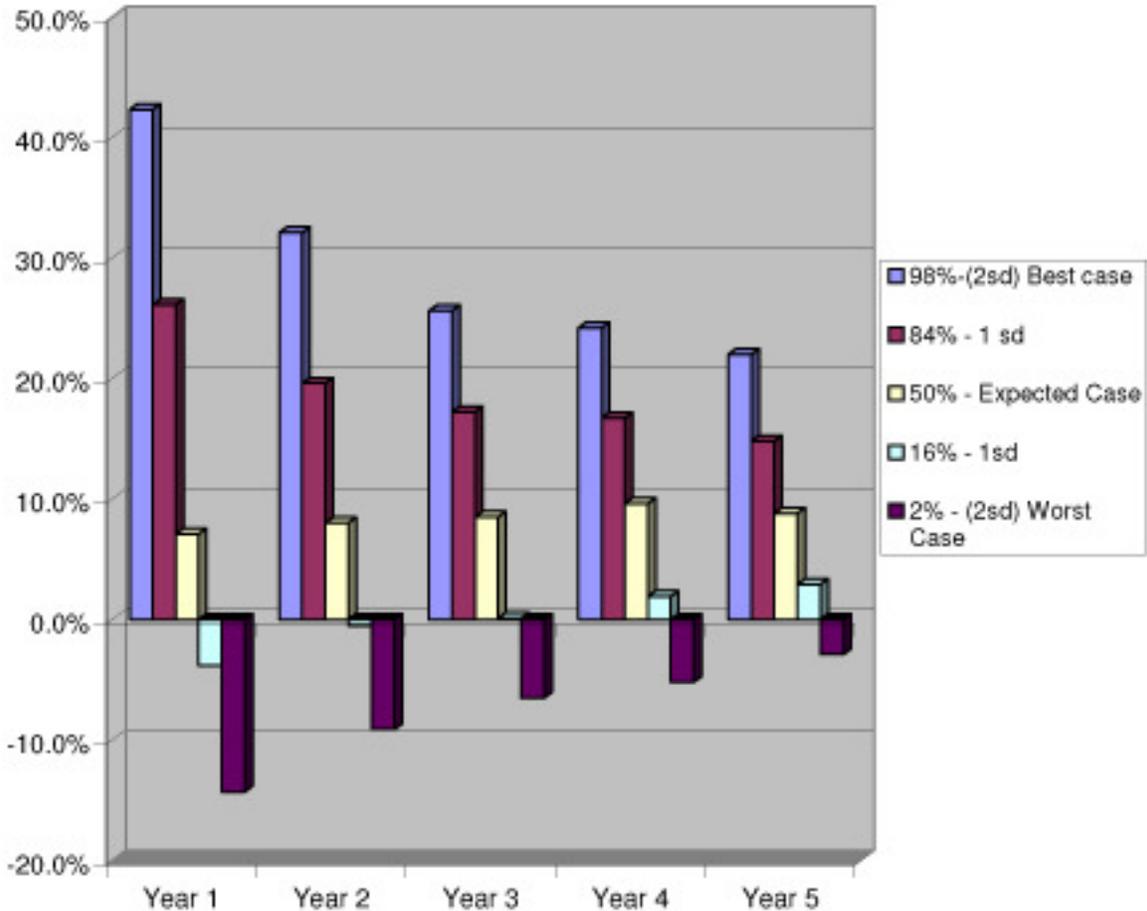
While the Board of Directors recognizes that performance for an interval as short as one year or less, is not a fair basis for the evaluation of invested assets, they do reserve the right, in the event of significantly unexpected results, to change any investment management service or program at any time.

**CONCLUSION:**

This statement of investment objectives and policy is designed to be used as a guideline to assist the Board of Directors, the Investment Advisory Committee and any Investment Manager(s) or Consultants to better understand this fund. It should not be considered a legal document or contractual obligation; rather it should be viewed as a flexible document whose purpose is to assist all parties in the management of this fund's assets.

Revised and Approved 5/22/03

**Addendum A  
Simulation Analysis-Range of Returns Long Term Pool**



	<b>Average Annual Returns</b>				
<b>Probabilities</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
98%-(2sd) Best case	42.3%	32.1%	25.6%	24.2%	22.0%
84% - 1 sd	26.1%	19.6%	17.2%	16.7%	14.8%
50% - Expected Case	7.1%	8.0%	8.5%	9.6%	8.8%
16% - 1sd	-3.8%	-0.5%	0.1%	1.9%	2.9%
2% - (2sd) Worst Case	-14.3%	-9.1%	-6.5%	-5.2%	-2.9%

Note: "sd" = standard deviation

The simulated range of average annual returns for the Composite Asset Mix are shown over the projection period. The entire range of returns covering the best case to worst case outcomes are represented. There is a 98% chance of realizing a return that is greater than the simulated worst case return. And, there is a 2% chance of exceeding the simulated best case return.