



NORTHERN ARIZONA UNIVERSITY FOUNDATION

Northern Arizona University Foundation

Policies and Procedures

August 22, 2009 – Revised 2/4/12

Investment Policies

Introduction

The Northern Arizona University Foundation Investment Committee, subject to the approval of the Foundation Board of Directors, establishes the investment policies and procedures for all funds held by the Foundation. The committee is acting in a fiduciary capacity with respect to the portfolio, and is accountable to the Foundation Board of Directors for recommending the selection and evaluation of investment managers and for the establishment of goals and operating principles for investment managers. The purpose of this document is to provide the basis for the Investment Committee to properly discharge its responsibilities with respect to investment of funds for which it has been assigned management responsibility by the Foundation.

The Policies contained in this statement are intended to provide boundaries, where necessary, for ensuring that the Portfolio's investments are managed consistent with the short-term and long-term financial goals of the Fund. At the same time, they are intended to provide for sufficient investment flexibility in the face of changes in capital market conditions and in the financial circumstances of the Institution.

The investment policy will be reviewed on an annual basis.

Investment Philosophy and Objectives

The investment philosophy is based on a disciplined and consistent approach. Extreme positions and opportunistic styles are not appropriate to this philosophy. The overall investment objective is to obtain the best possible total return (income plus capital appreciation) on investments with the appropriate degree of risk and to exceed the needs of the Foundation and University over time. Over the long-term, cash disbursements should meet the objectives as determined by the Board of Directors. These objectives should also maintain the purchasing power of income and protect the real value of endowment principal.

The distribution of Fund assets will be permitted to the extent that such distributions do not exceed a level that would erode the Fund's real assets over time. The Committee will seek to

reduce the variability of annual Fund distributions by factoring past spending and Portfolio asset values into its current spending decisions. The Committee will review its spending assumptions annually for the purpose of deciding whether any changes therein necessitate amending the Fund's spending policy, its target asset allocation, or both.

Periodic cash flow, either into or out of the Portfolio, will be used to better align the investment portfolio to the target asset allocation outlined in the Asset Allocation Policy.

Strategy

The Committee believes the long-term risk of not investing in securities with higher return expectations outweighs their short-term volatility risk. As a result, the majority of assets will be invested in equity or equity-like securities. Fixed income securities will be used to lower the short-term volatility of the portfolio and to provide income stability, especially during periods of weak or negative equity markets. Cash is not a strategic asset of the portfolio, but is a residual to the investment process and used to meet short-term liquidity needs.

The Committee recognizes that the strategic allocation of Portfolio assets across broadly-defined financial asset and sub-asset categories with varying degrees of risk, return, and return correlation will be the most significant determinant of long-term investment returns and Portfolio asset value stability

The Committee expects that actual returns and return volatility may vary widely from expectations and return objectives across short periods of time. While the Committee wishes to retain flexibility with respect to making periodic changes to the Portfolio's asset allocation, it expects to do so only in the event of material changes to the Fund, to the assumptions underlying Fund spending policies, and/or to the capital markets and asset classes in which the Portfolio invests

Investment Managers

The Investment Committee will not directly manage any portion of the endowment assets except those assets that cannot be disposed of because of donor restrictions or marketability, that essentially are not liquid, or that cannot be feasibly or economically managed by external advisers. The Investment Committee will retain one or more investment managers to manage the assets.

Investment managers shall be selected from established and financially sound organizations that have a proven and demonstrated record in managing similar funds. Selection of investment managers will depend upon factors established by the Investment Committee from time to time and will be consistent with state and federal laws.

Operating Principles for Investment Managers

Investment goals and objectives shall be discussed with investment managers, and the investment managers shall be expected to recommend investment strategies that can reasonably be expected to meet the stated objectives and to structure portfolios of securities

designed to implement those strategies. A written contract with each manager will be signed to verify the terms and investment strategy.

The Investment Committee shall receive and review written reports in sufficient detail to allow comparison to stated objectives, major market indexes, and comparable funds. The Investment Committee shall meet with or receive reports from the investment managers at least on a semi-annual basis to review performance, investment strategies as related to current and projected economic conditions, and quality and risk factors in the portfolio.

Time Horizon

The NAUF seeks to achieve or outperform the targeted expected returns, as defined by the asset allocation decision, over a full market cycle. It is not expected that all investment objectives will be attained in each year and recognizes that over various time periods, investment managers may produce significant over or under performance relative to the broad markets. For this reason, long term investment returns will be measured over a five year moving period. The NAUF reserves the right to evaluate and make any necessary changes regarding investment managers over a shorter term using the criteria established under "Manager Evaluation" (attached).

Investment Policy and Constraints

The Investment Committee desires to give managers the flexibility their styles and strategies may need, but as fiduciaries must require a measure of conservatism consistent with prudent investment practice. A primary consideration of investment policy is to preserve the principal of the funds in the Foundation.

The Foundation operates as a component unit of Northern Arizona University and therefore complies with rules set forth by the Arizona Board of Regents regarding investments.

The following constraints are expressed for general guidance. Specific contracts with managers should contain these general guidelines and any additional guidelines the managers and the Investment Committee consider appropriate. These guidelines will be reviewed from time to time for desirability. Such a review will include the allocation of investment assets among investment managers and allocations to market segments including fixed income, general equity, and international equity securities.

Diversification

Diversification across and within asset classes is the primary means by which the Committee expects the Portfolio to avoid undue risk of large losses over long time periods. To protect the Portfolio against unfavorable outcomes within an asset class due to the assumption of large risks, the Committee will take reasonable precautions to avoid excessive investment concentrations. Specifically, the following guidelines will be in place:

- With the exception of fixed income investments explicitly guaranteed by the U.S. government, no single investment security shall represent more than 5% of total Portfolio assets.

- With the exception of passively managed investment vehicles seeking to match the returns on a broadly diversified market index, no single investment pool or investment company (mutual fund) shall comprise more than 20% of total Portfolio assets.

- With respect to fixed income investments, the minimum average credit quality of these investments shall be investment grade (Standard & Poor's BBB or Moody's Baa or higher).

Investment Portfolio Policy

Asset Allocation. The Investment Committee will oversee the allocation of the investment portfolio between fixed-income securities and common stocks in order to obtain the best possible investment return commensurate with a given level of risk relative to the portfolio's objectives. In view of the difficulty involved in successful market timing and to move large amounts of funds in and out of assets, the long term asset allocation should be moved incrementally within certain bands rather than making sudden dramatic changes.

Outlined below are the long-term strategic asset allocation guidelines, determined by the investment committee to be the most appropriate, given the Fund's long-term objectives and short-term constraints. Portfolio assets will, under normal circumstances, be allocated across broad asset and sub-asset classes in accordance with the following guidelines:

<u>Asset Class</u>	<u>Sub-Asset Class</u>	<u>Target Allocation</u>
Equity		<u>70%</u>
	U.S.	49%
	Non-U.S.	21%
<hr/>		
Fixed Income		<u>20%</u>
	Investment Grade	20%
	Below-Investment Grade	0%
Alternatives/ University Projects	Investments in University Projects	10%
Cash		<u>0%</u>

Investments in University Projects

The Foundation may at times invest in projects to further the mission of the University. These investments may include, but are not limited to: building and other facilities, equipment, capital improvement leases, intellectual property, etc. These investments may be made directly by the Foundation, or through legal subsidiaries of the Foundation established for such purposes. The purpose of these investments shall be twofold: to provide funding to further the mission of the

University, and to provide the Foundation with sufficient investment returns to meet its continuing obligations.

The Investment in University Projects percentage will be valued quarterly based on the total portfolio balance and not subject to rebalancing with market fluctuations

Rebalancing

It is expected that the Portfolio's actual asset allocation will vary from its target asset allocation as a result of the varying periodic returns earned on its investments in different asset and sub-asset classes. The Portfolio will be re-balanced to its target normal asset allocation under the following circumstances:

- Utilize incoming cash flow (contributions) or outgoing money movements (disbursements) of the portfolio to realign the current weightings closer to the target weightings for the portfolio.
- The portfolio will be reviewed quarterly (March 31, June 30, September 30, and December 31) to determine the deviation from target weightings. During each quarterly review, the following parameters will be applied:
 - If any asset class (equity or fixed income) within the portfolio is +/-5 percentage points from its target weighting, the portfolio will be rebalanced.
 - If any fund within the portfolio has increased or decreased by greater than 20% of its target weighting, the fund will be rebalanced.
- The investment manager may provide a rebalancing recommendation at any time.
- The investment manager shall act within a reasonable period of time to evaluate deviation from these ranges.

Other Investment Policies

The committee may consider nontraditional investment strategies as related to a specific donation at the approval of the NAUF board of directors.

Unless expressly authorized by the Committee, the Portfolio and its investment managers are prohibited from:

- Purchasing securities on margin, or executing short sales.
- Pledging or hypothecating securities, except for loans of securities that are fully collateralized.
- Purchasing or selling derivative securities for speculation or leverage.
- Engaging in investment strategies that have the potential to amplify or distort the risk of loss beyond a level that is reasonably expected given the objectives of their portfolios
- Private Equity/Private Placements

Monitoring Portfolio Investments and Performance

The Committee will monitor the Portfolio's investment performance against the Portfolio's stated investment objectives. At a frequency to be decided by the Committee, it will formally assess the Portfolio and the performance of its underlying investments as follows.

The Portfolio's composite investment performance (net of fees) will be judged against the following standards:

- The Portfolio's absolute long-term real return objective
- A composite benchmark consisting of the following unmanaged market indices weighted according to the expected target asset allocations stipulated by the Portfolio's investment guidelines
 - a) U.S. Equity: MSCI US Broad Market Index or a similar broad domestic index
 - b) Non-U.S. Equity: MSCI EAFE +EM Index
 - c) Investment Grade Fixed Income: Lehman Aggregate Bond Index
 - d) Non-Investment Grade Fixed Income: Lehman High Yield Index
 - e) Cash: Citigroup 3-Month T-Bill Index
- The performance of professional investment managers hired on behalf of the Portfolio will be judged against the following standards:

A market-based index appropriately selected or tailored to the manager's agreed-upon investment objective and the normal investment characteristics of the manager's portfolio

The performance of other investment managers having similar investment objectives

Manager Evaluation

All investment returns shall be measured net of fees. Each investment manager will be reviewed on an ongoing basis and evaluated, among other things, upon the following criteria:

1. Address any regulatory actions against the firm, its principals, or employees;
2. Adherence to the guidelines and objectives of this Investment Policy Statement;
3. Avoidance of significant deviation from the style and market capitalization characteristics defined as "normal" for the manager;
4. Consistency in personnel and organizational structure;
5. Ability of active managers to exceed the return of the appropriate benchmark index and, for equity managers, produce positive alpha (risk-adjusted return); and
6. Ability of active managers to meet or exceed the median performance of a peer group of managers with similar style of investing.

Non-U.S. Dollar Currency Exposure Risk Management

The investment managers are permitted to hedge the non-U.S. dollar assets under their management up to the maximum non-U.S. dollar allocation of these guidelines so long as the methods and strategies used do not place the portfolio in a leveraged position or use investment securities purchased on margin or result in open hedge positions. Cross currency hedges will

be allowed for non-U.S. dollar positions held by the investment managers. The investment managers will report all hedging activities to the committee quarterly.

Addendum

Calculation of Investment in University Projects

6/30/11

Cash	\$2,499,161
Vanguard and SMIF	<u>88,388,814</u>
	90,887,975

Amount available for University Projects \$9,088,797

Current project balance \$3,172,167