

ATTACHMENT A

INVESTMENT POLICY STATEMENT

For

**City of Valdez  
Permanent Fund**

| Approved ~~TBD, 2016~~ ~~July 6, 2015~~

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## EXECUTIVE SUMMARY

<b>Assets:</b>	\$1 <del>7</del> <sup>8</sup> 2 million (as of <del>6+2/30+1/64</del> )
<b>Planning Time Horizon:</b>	Long Term (Greater than 10 years)
<b>Risk Tolerance:</b>	Moderate, due to objective to moderately grow purchasing power of the Fund and generate earnings for annual distribution
<b>Income Needs:</b>	Distribute 1.5% of the Fund's value each year to the General Fund

### Asset Allocation:

	Lower Limit	Strategic Allocation	Upper Limit
Domestic Equity	2 <del>5</del> <sup>4</sup> %	29%	3 <del>3</del> <sup>4</sup> %
International Equity	18%	21%	24%
Fixed Income	3 <del>4</del> <sup>0</sup> %	<del>40</del> <sup>35</sup> %	4 <del>6</del> <sup>0</sup> %
<del>Treasury Inflation Protected Securities (TIPS)</del>	<del>3</del> %	<del>5</del> %	<del>7</del> %
Real Estate	7%	10%	13%
Cash Equivalents	0%	0%	10%

- The Strategic Allocation denotes acceptable ranges for asset classes except those asset classes where restrictions are placed on contributions and/or redemptions to a specific dollar amount as a specific time.*

**Performance Evaluation Benchmark:** The Fund is expected to produce a total return exceeding that of an index based upon the strategic asset allocation of the Fund and various broad asset classes. Specifically, the policy index will be a weighted index comprised of:

<u>Allocation</u>	<u>Benchmark</u>
29%	Russell 3000
21%	MSCI ACWI ex-US IMI
<del>40</del> <sup>35</sup> %	BC Aggregate
<del>5</del> %	<del>BC-US-TIPS</del>
10%	NCREIF ODCE

**Total Return Objective:** The long-term (greater than 10 years) total return objective of the Fund's investable assets net of investment management fees and prior to distributions is a ~~4.5~~% real return (CPI + ~~4.5~~%).

## **PURPOSE OF THE INVESTMENT POLICY STATEMENT**

The purpose of this Investment Policy Statement (IPS) is to assist the City Administration in effectively investing the assets of the City of Valdez Permanent Fund (the “Fund”) and in monitoring investment results and by communicating the investment objectives to the investment consultant, and external investment managers. The IPS is required by the Valdez Municipal Code Chapter 3.04.051 Section B.1. The Fund’s investment program is defined in the various sections of the IPS by:

- Stating in a written document the objectives and guidelines for the investment of Fund assets, including explicit consideration of liquidity needs and risk tolerance.
- Setting forth an investment structure for managing Fund assets. This structure includes various asset classes, asset allocation and acceptable ranges that, in total, are expected to produce an intended level of overall diversification and total investment return over the long-term.
- Providing guidelines for each investment portfolio that controls the level of overall risk and liquidity assumed in that portfolio, so that all Fund assets are managed in accordance with stated objectives.
- Establishing formal criteria to select and monitor the performance results achieved by the Fund managers on a regular basis.
- Encouraging effective communications between the City Administration, the City Council, the Investment Committee, the investment consultant, and the Fund’s managers.
- Complying with all applicable fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state and federal entities that may impact Fund assets.

## **FUND GUIDELINES**

This section describes the guidelines for the overall management of the Fund, specifically the time horizon, liquidity constraints, risk tolerance, and income distribution needs. All of these factors are incorporated in the asset allocation, which is described in this section.

### **Investment Objectives**

The investment objective of the Fund is to moderately grow the purchasing power of the Fund over time and generate earnings for annual distribution by utilizing a balanced investment approach. The Fund should be managed in a manner that is consistent with prudent levels of risk and diversification, and governed by the prudent investor rule.

### **Time Horizon**

The Fund has a very long time horizon (greater than 10 years). After the annual 1.5% distribution, the Fund's assets are held perpetually in trust for the benefit of the present and future generations of Valdez residents. Thus, the assets are to be invested with a long-term time horizon. The assumptions underlying the asset allocation analysis are based on a ten-year projection of financial markets. While the future of the Fund extends beyond the next ten years, the relevant planning horizon is consistent with the use of the assumptions. The assumptions utilized are consistent with the long run returns, risks and statistical interrelationships observed among major asset categories.

### **Liquidity Analysis**

Distributions from the Fund will be based on a percentage of market value of 1.5% per year as applied to the last day of the accounting year. Annual distributions will be appropriated on the first business day of the City's fiscal year. The Fund will be rebalanced as necessary to fund such distributions in excess of available dividend and interest income.

### **Risk Tolerances**

The overall risk tolerance of the Fund is heavily influenced by its objective: to moderately grow the purchasing power of the Fund and generate earnings for an annual distribution linked to a percentage of market value. Based on modern portfolio theory, the Fund must have a meaningful equity commitment to moderately grow and protect the Fund from inflation as well as generate earnings for distribution. Such an equity commitment will entail a moderate level of risk, as measured by the volatility of investment returns. The Fund has a long-term investment horizon, which allows the Fund to absorb considerable short-term volatility.

### **Asset Allocation**

The Fund's risk and liquidity exposures are, in large part, a function of asset class mix. Based on the return and risk characteristics of various asset classes, the following asset classes were deemed appropriate for the Fund:

- Domestic Equity
- International Equity
- Fixed Income
- ~~TIPS~~
- Real Estate
- Cash Equivalents

Based on the Fund's time horizon, risk tolerances, performance expectations and asset class preferences, an efficient or optimal portfolio was identified. The strategic asset allocation of the Fund is as follows:

**Strategic Asset Allocation \***

	Lower Limit	Strategic Allocation	Upper Limit
Domestic Equity	25 <del>4</del> %	29%	33 <del>4</del> %
International Equity	18%	21%	24%
Fixed Income	34 <del>0</del> %	40 <del>35</del> %	46 <del>0</del> %
<del>Treasury Inflation Protected Securities</del>	<del>3%</del>	<del>5%</del>	<del>7%</del>
Real Estate	7%	10%	13%
Cash Equivalents	0%	0%	1 <del>0</del> %

*\*The Strategic Allocation denotes acceptable ranges for asset classes except those asset classes where restrictions are placed on contributions and/or redemptions to a specific dollar amount at a specific time.*

The Domestic Equity allocation shall have the following target weights:

- 70% Large Cap
- 20% Mid Cap
- 10% Small Cap

The International Equity allocation shall have the following target weights:

- 80% Large/Mid Cap
- 20% Small Cap

The Fixed Income allocation shall have the following target weights:

- 70% Core
- 30% Global

**Rebalancing of Strategic Allocation**

The Strategic Allocation, shown in the middle column, is the target. Some variability around the target is expected and acceptable. Extreme deviation from the target is undesirable, as it alters the risk and return expectations for the Fund. Therefore, upper and lower limits are established for each asset class.

When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation. If cash flows are insufficient to bring the Fund within the strategic allocation ranges, transactions may be affected within a 12 month period to bring the allocation back within the permissible asset class ranges.

Rebalancing will be addressed at quarterly Investment Committee meetings. In the interim, any asset classes with allocations outside the policy ranges will warrant a special Investment Committee meeting to address the issue.

## INVESTMENT MANAGER GUIDELINES

The following guidelines apply to Fund assets managed in a separate account. Any mutual funds or other interests in collective and commingled funds utilized should be reviewed to determine that their governing instruments are substantially consistent with the following guidelines.

### General

- All guidelines are applicable at the time of purchase. The sale of a security is not automatically required due to a subsequent change in circumstance.
- The following transactions are not authorized:
  - Short sales or margin transactions
  - The use of leverage, except for real estate
- Each portfolio will be diversified with regard to specific issuer, industry, and economic sector, in order to reduce risk.
- Securities may be sold at a loss, if such an action is deemed to be consistent with the overall portfolio investment objectives.

### Fixed Income

#### Core:

- Eligible investments include the following:
  - Debt instruments issued by the U.S. government, its agencies and instrumentalities
  - Debt instruments that have been issued by domestic entities, including credit, mortgage-backed and asset-backed securities
  - Dollar denominated debt issued by non-domestic entities in the U.S.
- Derivative instruments, such as futures, options, and swaps, in which the underlying security is a permissible security are permitted, provided that the use of such instruments do not introduce risks to the portfolio that are not otherwise permitted in this IPS and do not impart leverage to the portfolio.
- All securities must be rated “Baa3/BBB-/BBB-” or above.
  - When determining credit quality, the middle rating of Moody’s, Standard and Poor’s, and Fitch is used after dropping the highest and lowest available ratings. When a rating from only two agencies is available, the lower (“more conservative”) rating is used. When a rating from only one agency is available, that rating is used to determine credit quality.
  - In the event a security is downgraded below the specified minimum rating, the manager shall give written notice to the City Administration within 30 days of the downgrading; the manager shall have six months from the date of the downgrade to sell the security at the best possible price to minimize any loss to the Fund.
- The weighted average credit quality of the portfolio must be rated “Aa3/AA-/AA-” or higher.
- No security shall exceed 5% of the market value of the portfolio, with the exception of U.S. government and agency securities.
- The duration of the portfolio shall be within plus or minus 20% of the duration of the Barclays Capital Aggregate Index.

#### Global:

- No purchase shall be made which would cause the holding of any one issuer, excluding government issuers, to exceed five percent (5%) of the portfolio valued at market;
- At the time of purchase, no holding should exceed five percent (5%) of the issue outstanding;
- Global managers may hold any mix of fixed income securities and cash equivalents. However, portfolio duration shall be within plus or minus 40% of the duration of the Barclays Capital Global Aggregate Bond Index;
- The weighted average credit quality of the portfolio will not fall below “A2/A/A” or equivalent; when determining credit quality, the middle rating of Moody’s, Standard and Poor’s, and Fitch is used after dropping the highest and lowest available ratings. When a rating from only two agencies is available, the lower (“more conservative”) rating is used. When a rating from only one agency is available, that rating is used to determine credit quality;
- No more than twenty percent (20%) of the portfolio may be invested in unhedged non-dollar denominated currencies. Both long and short currency exposures are permissible. The total currency exposure will be determined by adding the net positions within currencies, and the resulting value will contribute to the portfolio’s currency exposure on an absolute basis;
- No more than twenty percent (20%) of the portfolio may be invested in securities rated below investment grade;
- No more than twenty percent (20%) of the portfolio may be invested in emerging markets.
- Global managers may use futures, and options on eligible securities, provided that such instruments do not introduce risks to the manager’s portfolio that are not otherwise permitted in this Investment Policy and do not leverage the portfolio;
- Global managers may use swaps, forwards, options on forwards, and options on swaps, provided that such instruments do not introduce risks to the manager’s portfolio that are not otherwise permitted in this Investment Policy and do not leverage the portfolio;
- Global managers may invest in private placements, providing these investments do not exceed ten percent (10%) of the portfolio. Investments in Rule 144a securities and 4(2) commercial paper are excluded from this limitation.

#### TIPS

- ~~Eligible investments include the following:~~
  - ~~— Debt instruments issued by the U.S. government, its agencies and instrumentalities~~
- ~~Derivative instruments, such as futures, options, and swaps, in which the underlying security is a permissible security are permitted, provided that the use of such instruments do not introduce risks to the portfolio that are not otherwise permitted in this IPS and do not impart leverage to the portfolio.~~
- ~~All securities must be rated BBB or Baa3 or above by Standard & Poor’s Rating Service and Moody’s, respectively.~~
  - ~~In the event a security is downgraded below the specified minimum rating by either rating agency, the manager shall give written notice to the City Administration within 30 days of the downgrading; the manager shall have six months from the date of the downgrade to sell the security at the best possible price to minimize any loss to the Fund.~~



- ~~• The weighted average credit quality of the portfolio must be rated AA or Aa3 or higher by Standard & Poor's Rating Service or Moody's, respectively.~~
- ~~• The duration of the portfolio shall be within plus or minus 20% of the duration of the Barclays Capital U.S. TIPS Index.~~

### **Domestic Equity**

- Eligible investments include the following:
  - Common stock and preferred stock traded on a U.S. stock exchange or on U.S. over-the-counter markets and denominated in U.S. dollars
  - Securities that take the form of American Depositary Receipts (ADRs)
  - Securities of investment company shares, such as open-end and closed-end funds
  - Securities of unit investments trusts, such as exchange traded funds, are only permitted for the purpose of overlaying cash to generate equity exposure
- Foreign equity investments, including foreign stock listed on U.S. exchanges and ADRs, are limited to 15% of the total portfolio.
- Investment in any one company shall not exceed the greater of 5% or 1.5 times the stock's weighting in an appropriate market index. If a security is not included in the appropriate index, the limit is 5% of the market value of the portfolio.
- Investments in any one sector shall not exceed the greater of 30% or 1.5 times the sector's weighting in an appropriate market index.
- Managers shall not hold more than 5% of the portfolio in cash and cash equivalents.
- Equity futures may be employed solely for the purpose of overlaying cash to generate equity exposure; the use of other derivative instruments is prohibited without prior approval by the City Administration and Investment Committee.

### **International Equity**

- Eligible investments include the following:
  - Foreign equity securities, defined as common stock and preferred stock issued by any company that is organized or headquartered in a foreign country, or whose primary business (75% or more) is conducted outside the U.S.
  - Securities that take the form of American Depositary Receipts (ADRs), Global Depositary Receipts (GDRs), European Depositary Receipts (EDRs), or similar instruments representing securities of foreign securities
  - Securities of investment company shares, such as open-end and closed-end funds
  - Securities of unit investments trusts, such as exchange traded funds, are only permitted for the purpose of overlaying cash to generate equity exposure
- Investments in companies located in emerging markets shall not exceed 35% of the portfolio's market value.
- The manager may enter into foreign exchange contracts on currency provided that use of such contracts is limited to hedging currency exposure existing within the manager's portfolio.
- Investment in any one company shall not exceed the greater of 5% or 1.5 times the stock's weighting in an appropriate market index. If a security is not included in the appropriate index, the limit is 5% of the market value of the portfolio.

- Investments in any one sector shall not exceed the greater of 30% or 1.5 times the sector's weighting in an appropriate market index.
- Managers shall not hold more than 5% of the portfolio in cash and cash equivalents.
- Equity futures may be employed solely for the purpose of overlaying cash to generate equity exposure; the use of other derivative instruments is prohibited without prior approval by the City Administration and Investment Committee.

#### **Real Estate**

- Eligible investments include the following:
  - Real estate investments in a diversified portfolio of institutional quality, income producing properties held in a collective investment vehicle.
- The portfolio shall provide diversification both in terms of property type and geographic location.
- Leverage shall be limited to 40% of the portfolio's gross asset value.

#### **Cash Equivalents**

- Eligible investments include the following:
  - Cash and cash equivalents, which may include any security that has an effective duration under one year and/or a weighted average life under one year
  - Repurchase Agreements secured by obligations insured or guaranteed by the United States or agencies or instrumentalities of the United States.
  - Commercial paper bearing the highest rating of a nationally recognized rating agency.
  - Certificates of deposit issued by United States domestic banks which are members of the Federal Deposit Insurance Corporation for which a generally recognized secondary market exists or which are secured fully at all times as to the payment of principal and interest.
  - Money market and short-term investment funds consistent with SEC Rule 2a-7 under the Investment Company Act of 1940.
  - Deposits with mutual savings banks in Alaska which are fully secured at all times as to the payment of principal and interest.

## **SELECTION OF EXTERNAL INVESTMENT MANAGERS**

To achieve the investment objectives of the Fund, external investment managers will be employed to invest the assets. Both separate accounts and collective investment vehicles, such as mutual funds and commingled trusts, may be considered. External managers must meet the following minimum criteria:

- Be a bank, insurance company, independent investment counselor, or investment adviser as defined by the Investment Advisers Act of 1940.
- Clearly articulate the investment strategy that will be followed, provide historical performance associated with the strategy, and document that the strategy is consistent with the IPS guidelines.
- Provide detailed information on the history of the firm, key personnel, key clients, fee schedule, Form ADV, and support personnel.
- Selected firms shall have no outstanding legal judgments or past judgments, which may reflect negatively upon the firm's ability to perform.
- Demonstrate highly ethical business principles and strictly manage potential conflicts of interest.
- Offer a competitive fee structure.
- Fund assets should comprise no more than 10% of total firm assets under management.
- Acknowledge fiduciary duty in managing Fund assets.

## **DUTIES AND RESPONSIBILITIES**

### **Fund Managers**

The duties and responsibilities of each investment manager retained for the Fund include the following:

- Manage Fund assets under its care, custody and/or control in accordance with the IPS objectives and guidelines set forth herein.
- Exercise investment discretion with the IPS objectives and guidelines set forth herein.
- Provide monthly reports of the assets, holdings and transactions, and the total return achieved. Provide quarterly reports with additional detail on the investment strategy and outlook, and performance attribution for the prior quarter. For separate account Fund managers, monthly reports must state whether the portfolio is in compliance with the guidelines, and note the steps being taken to correct any failures to comply.
- Promptly inform the City Administration in writing regarding all significant and/or material matters and changes within the investment management firm pertaining to the investment of Fund assets, including, but not limited to:
  - Investment strategy
  - Portfolio structure
  - Ownership
  - Organizational structure
  - Financial condition
  - Professional staff
  - Recommendations for guideline changes
  - All material, legal, SEC, and other regulatory agency proceedings affecting the firm
  - Significant account losses
  - Significant growth of new business
- Promptly vote all proxies and related actions in a manner consistent with the long-term interests and objectives of the Fund set forth herein. Each manager shall keep detailed records of said voting of proxies and related actions and will comply with all regulatory obligations related thereto.
- Utilize the same care, skill, prudence and due diligence under the circumstances then prevailing that experienced, investment professionals acting in a like capacity and fully familiar with such matters would use in like activities for like investment programs with like aims in accordance and compliance with all applicable laws, rules and regulations from local, state, federal and international political entities as it pertains to fiduciary duties and responsibilities.
- Adopt a brokerage policy that ensures that all transactions effected for the Fund are subject to the best price and execution possible.
- Acknowledge and agree in writing to their fiduciary responsibility to fully comply with the entire IPS set forth herein, and as modified in the future.
- Provide on an annual basis a disclosure concerning whether the firm makes use of soft dollars. If the firm does use soft dollars, the report shall disclose how the soft dollar benefits are utilized.

### **City Administration**

Under the direction of the City Council and in consultation with the Investment Committee, the City Administration shall:

- Invest the assets of the Fund in accordance with this IPS and Section 6.7(c) of the City Charter.
- Coordinate investment manager, investment consultant and Investment Committee meetings, activities and presentations.
- Administer investment consultant, investment manager and custodian contracts.
- Annually review governing instruments of any mutual funds or other interests in collective and commingled funds to determine that such instruments are substantially consistent with the IPS guidelines set forth herein.

### **Custodian**

The Custodian shall:

- Provide safekeeping and custody of securities purchased by investment managers on behalf of the Fund.
- Provide for timely settlement of securities transactions.
- Maintain short-term investment vehicles for investment of cash not invested by investment managers.
- Check all manager accounts daily to make sure all available cash is invested.
- Collect interest, dividend and principal payments on a timely basis.
- Process corporate actions.
- Price all securities on a daily basis.
- Provide monthly, quarterly and annual reports.

### **Investment Consultant**

The Investment Consultant will provide general consulting services as required by the City in connection with the investment of Fund assets. As directed, the Consultant shall:

- Annually review the IPS to assure it is consistent with the Fund's goals and objectives.
- Annually review the Fund's asset allocation, including updated risk and return projections in order to assess the ability of the Fund to meet its goals and objectives.
- Assist with the selection of investment managers and custodian.
- Conduct a quarterly performance report of the Fund and its investment managers.
- Evaluate and monitor the Fund's investment managers on an on-going basis.
- Provide general advice, guidance, and research as required to the Investment Committee.

### **Investment Committee**

Under the direction of the City Council and in consultation with the City Administration, the Investment Committee shall:

- Provide guidance to the City Administration regarding the investment of the assets of the Fund in accordance with this IPS and Section 6.7(c) of the City Charter.
- Provide guidance on investment consultant, investment manager and custodian contracts.
- Provide insight and recommendations to the City Council on investment matters.

## PERFORMANCE MONITORING

### Monitoring of Total Fund

The Fund is expected to produce a total return exceeding that of an index based upon the strategic asset allocation of the Fund and various broad asset classes. Specifically, the policy index will be a weighted index comprised of:

<u>Allocation</u>	<u>Benchmark</u>
29%	Russell 3000
21%	MSCI ACWI ex-US IMI
<del>40.35%</del>	BC Aggregate
<del>5%</del>	<del>BC TIPS</del>
10%	NCREIF ODCE

The long-term (greater than 10 years) total return objective of the Fund's investable assets net of investment management fees and prior to distributions is a ~~4.5%~~ real return (CPI + ~~4.5%~~).

### Monitoring of Fund Managers

Quarterly performance will be evaluated to test progress toward the attainment of long-term investment objectives. The following will be reviewed on a quarterly basis:

- Manager's adherence to the guidelines and the duties and responsibilities of investment managers, as prescribed above;
- Material changes in the manager's organization, investment philosophy and/or personnel; and
- Comparisons of the manager's results to appropriate indices and peer groups, specifically:

<i>Asset Category</i>	<i>Index</i>	<i>Peer Group Universe</i>
Large Cap	S&P 500	Large Cap Core
Mid Cap	S&P 400	Mid Cap Broad
Small Cap	Russell 2000	Small Cap Broad
Large/Mid Cap Int'l	MSCI ACWI ex-US	Non-US Equity
Small Cap Int'l	MSCI ACWI ex-US SC	Int'l SC
Core Fixed Income	BC Aggregate	Core Bond
Global Fixed Income	BC Global Agg Hedged	Global Fixed Income
<del>TIPS</del>	<del>BC TIPS</del>	<del>TIPS</del>
Real Estate	NCREIF ODCE	Open End Real Estate

Long-term performance standards should measure an investment manager's performance from inception and on a rolling 10-year return basis in relation to an appropriate market index. If an investment manager fails to generate a return premium in excess of the agreed-upon index, then, upon completion of appropriate due diligence or such other steps as the Committee determines, the Committee may decide to place on Watch List or recommend to City Council to terminate the contract with the investment manager.

Short-term performance standards should measure an investment manager's performance on a rolling 3-year return basis (or since inception if less than 3 years) in relation to an appropriate peer group. Each investment manager is to be measured against the median return of a previously agreed-upon peer group of investment managers with similar investment styles.

Notwithstanding any other provision of this IPS, the City Council, on the recommendation of the Investment Committee, retains the right to terminate the contract with, and the services provided to the City of Valdez by an investment manager at any time. The City Council will make the decision to retain or terminate an investment manager based on the Committee's reasoned judgment and its confidence in the investment manager's ability to perform in the future.

### **Watch List**

A number of factors may contribute to a manager's over- or under-performance at any given time: market dynamics, investment skill, and/or pure chance. Given this uncertainty, it is unwise to mandate termination purely for lagging performance at any specific point. A Watch List will be utilized to identify managers whose performance and/or organization changes are cause for concern.

At the discretion of the Investment Committee, a manager may be included on the Watch List based on both qualitative and quantitative criteria detailed above. Once a manager is placed on a Watch List, the manager will be notified and performance will be closely monitored and scrutinized. An update on the manager as well as recommendation from the Investment Consultant to terminate or retain the manager must be made to the Investment Committee at each subsequent meeting after inclusion on the Watch List. Organizational issues that have been resolved in a satisfactory manner and improved performance relative to an index and/or peer group will be used as an indicator to remove a given manager from the Watch List.

### **Review of Investment Objectives and IPS**

The Investment Committee will review annually the achievement of the Fund's investment objectives and monitor performance on a quarterly basis, based on the evaluation criteria set forth in this IPS. The annual review will focus on the continuing feasibility of achieving the investment objectives and the continued appropriateness of the IPS. It is not expected that the IPS will change frequently; in particular, short-term changes in the financial markets generally should not require an adjustment in the IPS.

The IPS will be reviewed annually by the Investment Committee. However, specific policy issues may be visited whenever the Investment Committee deems it necessary. Specific occurrences which might suggest to the Committee an earlier review are:

- Changes in the distribution policy.
- The availability of acceptable new asset classes, or the improvement of data on previously known but inadequately understood asset classes to the point where the asset class might reasonably be considered.
- The availability of new technology, the application of which the Investment Committee believes will improve the IPS.
- The passage of relevant new legislation or regulations.