



Ann Arbor Area

community foundation

For **good.** For **ever.**

Ann Arbor Area Community Foundation
Investment & Spending Policy Statement

PURPOSE

In fulfilling its mission as stated in the Mission Statement and in the Articles of Incorporation of the Ann Arbor Area Community Foundation (hereafter “Foundation”), the Board of Trustees of the Foundation desires to establish these Investment and Spending Policies with the objective of preserving or enhancing the real (inflation adjusted) purchasing power of the permanent as well as quasi endowment funds of the Foundation, while producing a relatively predictable and stable payout stream that is maximized over the long run. With this objective in mind, this policy statement is set forth in order to:

1. Provide an understanding among the Board of Trustees of the Ann Arbor Area Community Foundation, the Finance Committee of the Board, the Investment Consultant employed, and any Investment Managers employed of the investment policy of the Foundation;
2. List the duties and responsibilities that the Foundation expects its Finance Committee and its Investment Managers to assume;
3. Establish the method for determining the annual spending budget for the Foundation;
4. Establish the basis for evaluation of the investment performance of the Foundation’s portfolio and of any Investment Manager(s) servicing the portfolio;
5. Give donors and grantees a clear statement of the Foundation’s investment philosophy;
6. Maintain a disciplined approach to investment management.

FINANCE COMMITTEE RESPONSIBILITIES

The Board of Trustees of the Foundation shall delegate responsibility for execution of this policy to its Finance Committee. The Committee shall be composed of a minimum of five members with a minimum of two board members identified as having an expressed interest in serving on the Committee. Additional members shall be selected from the community at large based on their recognized expertise in the financial service area. The Finance Committee shall bring suggestions for new Finance Committee members to the Trustee Committee, who, in accordance with the bylaws, will make a formal recommendation to the Board of Trustees. The Treasurer of the Foundation shall serve as a member of the Finance Committee.

Terms for Committee members shall be for three years, with a maximum of three consecutive terms of service. The starting dates for individual terms shall be staggered to provide continuity to the Committee. Vacancies occurring prior to the expiration of a member's term shall be filled on an annual basis in conjunction with the regular Committee assignment process of the Foundation.

The Finance Committee is charged with establishment of policies and direction to implement prudent investment objectives for the Foundation. The principal duties of the Committee shall be as follows:

1. To implement and periodically review Investment and Spending Policy;
2. To identify and recommend Investment Consultant and Investment Managers to be hired by the Board;
3. To recommend to the Board the allocation of funds between approved Investment Managers;
4. To monitor the performance of all such Investment Managers;
5. To manage all assets not managed by Investment Managers;
6. Recommend fiscal policies to the Board;

All actions of the Finance Committee are subject to review by the Board. The Committee will make recommendations to the Board regarding adoption of Investment Policy guidelines, the hiring of Investment Consultant and Investment Managers and the eventual disposition of all assets not managed by the Investment Managers.

SPENDING POLICY

The spending budget for the upcoming calendar year will be determined each year at the rate of up to 5 % of the fair market value (computed with a 16 quarter rolling average of the market value) of the assets of each individual fund managed as an endowment fund within the Foundation ending September 30th of the current year. It is intended that the value of the fund will be maintained over time. The spending and investment policy are governed by a total return philosophy recognizing that funds under the guidelines of these policies are managed as endowments. The distribution that may be spent, as determined in this paragraph, may be drawn from both ordinary income earned (i.e., dividends, interest, rents, royalties, etc.) and principal including appreciation, both earned and unearned.

The spending budget amount is used for both amounts available to grant from each fund as well as administrative fees charged to each fund. The administrative fee is calculated based on the Fund Fee Schedule approved by the Board of Trustees and in effect at the time the calculation is made. Amounts available to grant are calculated by subtracting the administrative fee from the total calculated spending amount. There will be no granting permitted for any fund managed as an endowment fund until it has been at the Foundation for four quarters in one calendar year. Pass through and donor advised funds do not have the one year restriction. For the purpose of this calculation, a gift that arrives at the Foundation on any day within a calendar quarter will be considered to be at the Foundation for the entire quarter. Administrative fees will be charged to funds from the date that the fund is established, as prescribed by the Fund Fee Schedule in effect at the time. The spending budget will be determined and recommended by the Finance Committee and approved by the Board of Trustees annually.

ASSET ALLOCATION AND INVESTMENT OBJECTIVES

A. Investment Objective

The primary objective of the investments for the Foundation will be to provide long-term growth of principal and income, without undue exposure to risk. Investments are intended to remain in stocks, bonds, alternative investments, and a limited investment in cash.

B. Asset Allocation

To insure that negative results achieved by one asset class shall not skew the entire portfolio, assets are to be diversified. Diversification will include intentional division of investments by type, characteristic, and numbers, as well as by styles of Investment Managers.

The Board recognizes that asset allocation decisions will be the single most important determinant of portfolio risk and return. Thus, it is the Board's responsibility to set long-term asset allocation ranges and review them from time to time. Investment Consultant and/or Managers shall advise Finance Committee if the parameters provided in this policy are inappropriate to achieve the Board's investment objectives. Rebalancing of the allocation of assets shall be considered at least annually by the Finance Committee during the first quarter of each fiscal year to insure that such allocation is within policy guidelines.

Asset Allocation Guidelines

Types of Securities	Target Position	Range
<u>Equities</u>	<u>65</u>	<u>55-75 %</u>
Large Cap Index	10.5	7.5-15
Large Cap Value	8.5	5-15
Large Cap Growth	8.5	5-15
Small Cap Growth	8.75	5-15
Small Cap Value	8.75	5-15
International	10	5-20
International Small Cap	5	0-10
Emerging Markets	5	0-10
<u>Fixed Income</u>	<u>20</u>	<u>10-30</u>
Core	15	10-30
High Yield	5	0-10
<u>Alternatives</u>	<u>15</u>	<u>0- 25</u>
Hedge Funds	10	0-20
Real Estate	0	0-5
Private Equity/Venture Capital	2.5	0-7.5
Natural Resources/Commodities	2.5-	0-5
Cash	0	0

Individual managers may be hired to manage only a sub-set of these asset classes, and target positions will be developed for each manager, assuming that the overall allocation of all assets falls within the above guidelines. In the event of severe economic or market conditions that would negatively impact the Foundation, the Investment Manager(s) may deviate from the stated asset structure only upon prior communication with the Foundation’s President. Any such decision must be explained in writing to the Finance Committee immediately thereafter. Any other deviations must first be communicated to, and approved by, the Finance Committee.

A Liquidity Account will be used to provide for the preservation and stability of principal and the maximization of current income through investment in high quality and liquid investments, including, but not limited to, money market or short term bond fund. This account will be used for funds held in the Administrative Account, pass-through accounts, and other accounts that are short term in nature or awaiting more permanent investment.

C. Investment Time Horizon

Due to the inevitability of short-term market fluctuations that may cause variations in the investment performance, it is intended that the Investment Managers will achieve the following performance objectives over a moving five-year period, net of investment management fees. However, the Finance Committee does not guarantee that the Investment Manager will be given a five-year time horizon and reserves the right to evaluate and make any necessary changes regarding the Investment Managers over a shorter term using the criteria established in the “Evaluation of Investment Managers” section of this Statement.

D. Rebalancing

In maintaining these asset allocation targets, the Foundation will strive to remain within the allocation ranges with the intent of rebalancing to targets annually, more frequently if necessary. The appropriateness of this allocation will be reviewed annually.

E. Specific Performance Objectives

	Investment Benchmark	Required Return	Volatility (standard deviation)
Foundation	Primary: 8% Secondary ; The Balanced Index: 45% S&P 500 Index 20% Russell 2000 Index 10% MSCI EAFE Index 20% LB Aggregate Bond Index and 5% ML High Yield Index	= Benchmark > Benchmark	≤ 1.20 times index
	Balanced Manager Universe	>top 50% ranking	

	Investment Benchmark	Required Return	Volatility (beta)
Equity managers			

Large Cap	Primary: Russell 1000 Style Secondary: S&P 500 Index Large Cap Universe (Broad, Value, and/or Growth)	> Benchmark Top 50% ranking	≤ 1.20 times index
Small Cap	Primary: Russell 2000 Style Secondary: Russell 2000 Index Small Cap Universe (Broad, Value, and/or Growth)	> Benchmark Top 50% ranking	≤ 1.20 times index
International Equity	Primary: MSCI EAFE Index Secondary: MSCI Style International Equity Universe (Broad, Value, and/or Growth)	> Benchmark Top 50% ranking	≤ 1.20 times index
International Small Cap	Primary: MSCI EAFE Small Cap Index Secondary: None International Small Cap Equity Universe	> Benchmark Top 50% ranking	≤ 1.20 times index
Emerging Markets	Primary: MSCI EMF Index Secondary: None Emerging Markets Universe	> Benchmark Top 50% ranking	≤ 1.20 times index
Fixed Income Managers Core	LB Aggregate Bond Index Core Fixed Income Universe	> Benchmark Top 50% ranking	$\pm 20\%$ duration
High Yield	ML 1-10 Yr BB High Yield Bond Index High Yield Universe	> Benchmark Top 50% ranking	B Avg Credit Quality
	Investment Benchmark	Required Return	Volatility (beta)
Real Estate Managers	NCREIF Real Estate Index Universe - Na	> Benchmark Top 50% ranking	< 1.20 times index
	Investment Benchmark	Required Return	Volatility
Hedge Fund Managers	Primary: HFRI Hedge Fund Index	> Benchmark	Na

	Secondary: S&P 500 Index or LB Aggregate Index		
	Universe - Na		Top 50% ranking
	Investment Benchmark	Required Return	Volatility
Private Equity/ Venture Capital Managers	Primary: Venture Economics Secondary: S&P 500 Index + 5% Universe - Na	> Benchmark Top 50% ranking	Na
	Investment Benchmark	Required Return	Volatility
Natural Resources/ Commodities	NCREIF Timberland Property Index or S&P 500 Energy Sector Index Universe - Na	➤ Benchmark Top 50% ranking	Na

In addition, all Investment Managers are expected to maintain positive risk-adjusted performance results (i.e. positive alpha).

F. Evaluation of Investment Managers

Investment Managers employed by the Foundation shall manage assets in accordance with the policies and objectives adopted by the Finance Committee. Evaluation of Investment Manager performance will be based on comparison results achieved against absolute and relative return objectives. The Finance Committee reserves the right to evaluate and make any necessary changes regarding the Investment Managers at any point prior to the stated five-year time horizon, based upon the following additional criteria:

1. Ability to exceed the performance objectives stated in this Investment Policy Statement.
2. Adherence to the philosophy and style, which were articulated to the Finance Committee at, or subsequent to, the time the Investment Manager, was retained.
3. Ability to exceed the performance of other Investment Managers who adhere to the same or similar style.
4. Continuity of personnel and practices at the firm.

INVESTMENT MANAGER GUIDELINES

The guidelines stated below apply to investments in non-mutual and non-pooled funds, where the Investment Manager is able to construct a separate, discretionary account on behalf of the Foundation. Although the Finance Committee cannot dictate policy to pooled/mutual fund Investment Managers, it is the Finance Committee's intent to select and retain only pooled/mutual funds with policies that are similar to that of the Foundation. However, all Managers (pooled/mutual or separate) are expected to achieve the performance objectives.

A. General Guidelines

Unless prior written approval is obtained from the Finance Committee to the contrary:

1. Each Investment Manager must satisfy the performance objectives.
2. Each Investment Manager shall have the full investment discretion with regard to market timing, and security selection, consistent with their philosophy as articulated when they were retained.
3. Each Investment Manager shall be evaluated on a quarterly basis and should be prepared to meet with the Finance Committee at least annually.
4. Each Investment Manager shall immediately notify the Finance Committee in writing of any material changes in its investment outlook, strategy, portfolio structure, ownership, or senior personnel.
5. Each Investment Manager is prohibited from investing in non-marketable securities. However, assets not otherwise publicly traded can be received from donors and held by the Foundation with the prior written approval of the Finance Committee. Such assets include but are not limited to shares of stock in closely held corporations and real estate, which the Foundation may sell (at its discretion) at fair market value as it shall determine.
6. Each Investment Manager shall make no purchase that would cause a position in the portfolio to exceed 5% of the issue outstanding.
7. It is the intention that Investment Managers will be fully invested at all times. However, the Committee recognizes that the portfolio may hold residual cash as part of the investment process. Therefore, the portfolios are expected to have no more than 10% of the portfolio at any time in cash equivalents.

B. Equity Guidelines

1. Each Investment Manager must assure that no position of any one company shall exceed 8% of the manager's total portfolio as measured at market value or 5% as measured at cost, unless given the express consent of the Finance Committee, subsequently ratified by the Board.

2. The Equity Manager(s) shall handle the voting of proxies and tendering of shares in a manner that is in the best interest of the Foundation and consistent with the investment objectives contained herein.
3. For diversification purposes, each Manager's equity portfolio should have in excess of 20 positions unless prior authorization is given by the Finance Committee.
4. Maintain adequate diversification among economic sectors by investing no more than 40% of the portfolio in any one economic sector, as defined by the relevant benchmark.
5. With the exception of international managers, the portfolio is not to be invested in non-dollar denominated securities.
6. In the case of International Managers, maintain appropriate diversification with respect to currency and country exposure.

C. Fixed Income and Cash Equivalent Guidelines

1. Each Manager's Core Fixed Income portfolio must have an overall weighted average credit rating of "Aa" or better by Moody's or "AA" by Standard & Poors' rating services. In addition, there shall be no bond investment below investment grade (Baa/BBB). Split rated issues will be governed by the lower rating. In the event that a bond instrument is downgraded below investment grade, the Investment Manager shall notify the investment consultant and the Community Foundation as soon as possible. Additionally, the Investment Manager must be given the express consent of the Finance Committee (subsequently ratified by the Board) if the Manager wishes to continue to hold the downgraded security.
2. Each Manager's High Yield portfolio should consist of Domestic Bonds with a minimum overall weighted average credit rating of "Ba" or better by Moody's or "B" by Standard & Poors' rating services. In addition, there shall be no bond investment below "Caa" by Moody's or "CCC" Standard & Poors' rating service. Split rated issues will be governed by the lower rating. In the event that a bond instrument is downgraded below a CCC grade, the Investment Manager shall notify the Investment Consultant and the Community Foundation as soon as possible. Additionally, the Investment Manger must be given the express consent of the Finance Committee (subsequently ratified by the Board) if the Manager wishes to continue to hold the downgraded security.
3. Maintain a duration within +/- 20% of the effective duration of the benchmark index.
4. With respect to the corporate sector of the portfolio, invest no more than 25% of the portfolio in any one economic sector.
5. Each Core Fixed Income Investment Manager must assure that no position of any one issuer shall exceed 10% of the manager's total portfolio as measured at market value or 8% as measured at cost, except for securities issued by the U. S. government and its agencies.

6. Each High Yield Manager must assure that no position of any one corporate issuer shall exceed 2.5% of the manager's total portfolio at market value, except for securities issued by the U.S. government and its agencies.
7. All commercial paper must have a rating of A1/P1 and not more than 10% of an Investment Manager's portfolio, at market value, shall be invested in any one issuer.
8. Certificates of deposit shall have the highest credit quality rating from a nationally recognized rating service (e.g., Duff and Phelps, IBCA or Thompson Bank Watch).

D. Real Estate

Investments in real estate investment partnerships may be used to diversify the Foundation's total portfolio. It is understood that these funds may be long-term, illiquid, private partnerships with high variability of returns. The Committee shall consider certain criteria including, but not limited to, the following in its evaluation of a fund:

1. Tenure and track record of management as a team;
2. Expertise in targeted areas of investment;
3. Diversification relative to other real estate investments; and
4. General Partner investment, fees

Under no circumstances should the initial investment in these funds comprise more than 2.5% of the Foundation's portfolio. The Foundation will only invest in limited partnership shares and its investment will not comprise more than 5% of any individual partnership's assets.

E. Hedge Funds

Investments in hedge funds may be used to diversify the Foundation's total portfolio and to enhance return and/or reduce volatility. It is understood that hedge funds have limited liquidity (typically annual redemption) and are private partnerships with high variability of returns. The Committee shall consider certain criteria including, but not limited to, the following in its evaluation of a fund:

1. Tenure and track record of management as a team;
2. Expertise in targeted areas of investment;
3. Diversification relative to other hedge fund investments;
4. Use of leverage;
5. Liquidity of investments; and
6. General Partner investment, fees, and potential conflicts of interest.

Under no circumstances should the initial investment in these funds comprise more than 10% of the Foundation's portfolio. The Foundation will only invest in limited partnership shares and its investment will not comprise more than 5% of any individual partnership's assets.

F. Private Equity / Venture Capital

Investments in private equity or venture capital partnerships may be used to enhance the expected return of the portfolio. It is understood that these funds are long-term, illiquid, private partnerships with high variability of returns. The Committee shall consider certain criteria including, but not limited to, the following in its evaluation of a fund:

1. Tenure and track record of management as a team;
2. Expertise in targeted areas of investment; and
3. Diversification relative to other private equity or venture capital investments;
4. General Partner investment, fees

Under no circumstances should the initial commitment to these funds comprise more than 2.5% of the Foundation's portfolio. The Foundation will only invest in limited partnership shares and its investment will not comprise more than 5% of any individual partnership's assets.

G. Natural Resources / Commodities

Investments in natural resources or commodities partnerships may be used to diversify the Foundation's total portfolio and provide an inflation hedge. It is understood that these funds may be long-term, illiquid, private partnerships with high variability of returns. The Committee shall consider certain criteria including, but not limited to, the following in its evaluation of a fund:

1. Tenure and track record of management as a team;
2. Expertise in targeted areas of investment;
3. Diversification relative to other real estate investments; and
4. General Partner investment, fees

Under no circumstances should the initial investment in these funds comprise more than 2.5% of the Foundation's portfolio. The Foundation will only invest in limited partnership shares and its investment will not comprise more than 5% of any individual partnership's assets.

H. Derivative Guidelines

For definition purposes, derivative securities include, but not limited to, Structured Notes*, lower class tranches of collateralized mortgage obligations (CMO's), principal only (PO) or interest only (IO) strips, inverse floating rate securities, futures contracts, options, short sales, and margin trading.

Under no circumstances shall the Investment Managers utilize derivative securities without the express written consent of the Committee. This consent shall include the type of allowable derivatives and approved uses of the instrument. No consent will be given for any derivative security used for the purpose of leveraging the portfolio's investments. (If the Finance Committee specifically approves options and futures, such positions must be offset in their entirety by corresponding cash or securities.)

The Committee shall consider certain criteria including, but not limited to, the following in its evaluation of a derivative strategy:

1. Manager's proven expertise in such category.
2. Value added by engaging in derivatives.
3. Liquidity of instruments.
4. Actively traded by major exchanges (or for over-the-counter positions, executed with major dealers).
5. Managers internal procedures to evaluate derivatives, such as scenario and volatility analysis and duration constraints.

*Investment in "conservative" structured notes that are principal guaranteed, unlevered, and of short-to-intermediate maturity is permitted.

I. Securities Lending

The Committee must approve any securities lending. If allowed, securities lending must be fully secured (collateralized) by obligations authorized under this policy statement. A third party will hold collateral. All agreements will be in compliance with Federal Reserve guidelines.

J. Acknowledgement

The Board of Trustees, Finance Committee, Investment Managers, and the Investment Consultant, each recognize the importance of adhering to the mission and strategies detailed in this document and agree to work to fulfill the objectives stated herein, within the guidelines and restrictions, to the best of their ability. It is acknowledged that open communications are essential to fulfilling this mission and if at any time it is necessary to discuss improvements to this document, they are welcome and should be referred through the Foundation or its consultant.

President of the AAACF

Date

Investment Manager

Date

Investment Manager

Date

Consultant – Fund Evaluation Group®

Date

as adopted by the Board of Trustees
11/19/97

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