San Diego State University
Research Foundation

# Investment Policy Statement

September 2017

## INTRODUCTION

The effective management of SDSU Research Foundation (SDSURF) investments is the responsibility of the Board of Directors. In recognition of its responsibility to manage investments prudently, the Board of Directors established a Finance and Investment Committee, of which the Treasurer of the Board and the Vice President for Business and Financial Affairs of San Diego State University (SDSU) are ex-officio members.

The Finance and Investment Committee has the responsibility to maintain appropriate investment policies and guidelines and oversee the investment of assets accordingly. This authority includes, if necessary, the selection and evaluation of professional investment managers or organizations. It also includes the periodic monitoring of the investment policy and investment results. Major changes in policy or decisions that may substantially affect investment performance are forwarded to the Board of Directors for action. The Executive Director and CFO of SDSURF keep the Finance and Investment Committee informed on matters affecting the investment program and assist the Committee in carrying out its responsibilities. The Executive Director relies on the CFO and others within the Finance & Accounting Department of SDSURF for detailed monitoring, record keeping, and financial reporting. SDSURF's approach to investment management necessitates a continuous, ongoing review of asset allocations and performance results. In carrying out this review, consultants may be retained periodically to provide an independent review of investment policies, strategies and performance.

Due to the size of the investment portfolio, SDSURF retains, directly or indirectly, professional investment managers for investments in equities, bonds, real estate, including Real Estate Investment Trusts (REIT), and cash equivalents. Other cash equivalents and government securities may be directly managed by SDSURF staff.

In January 2000, SDSURF transferred all student aid funds and the majority of existing endowments to The Campanile Foundation (TCF), a new campus auxiliary organization formed to focus on fundraising for SDSU. The Campanile Foundation is the recipient of the majority of new gifts and endowments to SDSU. The only exceptions are gifts and certain endowments that directly support research at SDSU or are owned by certain self-support programs administered by SDSURF, such as KPBS, Extended Studies and the June Burnett Institute.

The following parties associated with SDSURF shall discharge their respective responsibilities in accordance with all applicable fiduciary standards as follows: (1) in the sole interest of SDSURF's contributors and beneficiaries; (2) with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and of like aims; and (3) by diversifying the investments so as to minimize the risk of large losses:

A. <u>Board of Directors:</u> The members of the Board of Directors are the fiduciaries of SDSURF and are ultimately responsible for the investments of SDSURF.

B. <u>Finance and Investment Committee and Staff:</u> The members of the Finance and Investment Committee on the authority assigned by the Board of Directors, have delegated the management of the day-to-day administrative issues associated with SDSU Research Foundation's assets to SDSURF staff. The Finance and Investment Committee has recommendatory authority to the Board of Directors with respect to the implementation of this Investment Policy Statement and shall review and present reports to the Board of Directors regarding the status of SDSURF's investments. The Finance and Investment Committee has authority to hire and fire Investment advisors.

C. <u>Retiree Medical Voluntary Employee's Beneficiary Association (VEBA) Trust Investment Advisor:</u> The investment advisor is charged with the responsibility of advising the Finance and Investment Committee on investment policy and strategic asset allocation, while having full discretion over the selection of investment managers and tactical asset allocation within the guidelines of this document. The investment advisor is also responsible for providing performance analysis and monitoring services.

D. <u>Investment Manager(s):</u> The investment manager(s) are delegated the responsibility of investing and managing SDSURF's or VEBA Trust's assets in accordance with this Investment Policy Statement, and all applicable law.

## INVESTMENT POOLS

SDSURF uses a unitized pooling concept that consolidates funds with similar investment objectives. Although monies are pooled for investment purposes, separate fund balances are recorded, thus maintaining both specific fund activity (additions and withdrawals) and allocated investment activity (income, realized and unrealized gains and losses). Through this means, investment risk is reduced and earnings potential is increased.

Two unitized investment pools with different investment objectives exist: TCF's Endowment Pool and SDSURF's Current Income Pool. SDSURF encourages the use of the established investment pools in order to enhance the overall management of endowment funds. However, unpooled endowments are maintained when necessary because of time restrictions, donor restrictions, or the uniqueness of the endowment (i.e. real estate).

### TCF Endowment Pool

The central purpose of an endowment is to provide support to programs over an extended period of time or in perpetuity. The level of support should be stable <u>in real dollars</u>, which implies that the endowment principal must grow at a rate at least equal to the rate of inflation. To achieve a reasonable rate of return and adequate growth of principal, a balanced and diversified investment approach is best. Therefore, the investment philosophy and objectives of the TCF Endowment Pool best represent SDSURF's overall endowment investment philosophy. True endowments, by their very nature, should be invested in the TCF Endowment Pool. SDSURF utilizes the TCF

Endowment Pool in an effort to provide a combination of optimum investment results and administrative efficiency. The pool is being used as an investment vehicle, and its use does not imply fund balance ownership or a shifting of responsibility, nor does it imply that SDSURF has control over TCF's investment policy or process. However, SDSURF's Finance and Investment Committee shall monitor the performance of the TCF Endowment Pool quarterly and shall be apprised of changes to TCF's Investment Policy. TCF's Investment Policy (see Appendix 1) covers asset allocation, rebalancing, performance, etc. for the pool, and is incorporated by reference into this policy. The target asset allocation for TCF endowment is as follows:

| Asset Class | Target Allocation | Minimum | Maximum |
|---|---|---|---|
| **Growth Assets** | | | |
| Global Equity | 40% | 30% | 50% |
| Private Equity | 10% | 0% | 15% |
| **Credit** | | | |
| High Yield Bonds | 3% | 0% | 6% |
| Bank Loans | 3% | 0% | 6% |
| Emerging Markets Debt | 2% | 0% | 4% |
| **Inflation Hedges** | | | |
| Natural Resources | 3% | 0% | 6% |
| Real Estate | 7% | 0% | 10% |
| TIPS | 4% | 0% | 8% |
| **Risk Mitigation** | | | |
| Core Fixed Income | 23% | 15% | 35% |
| Hedge Funds | 5% | 0% | 10% |
| Cash | 0% | 0% | 10% |

The asset mix policy and acceptable minimum and maximum ranges established by the TCF Finance and Investment Committee represent a long-term view. Rapid and significant market movements or during times when asset allocation changes are being implemented may cause the fund's actual asset mix to temporarily fall outside the policy range. Any such divergence should be of a short-term structure.

The investment objectives for TCF will be for the asset value, exclusive of contributions or withdrawals, to grow over the long run and earn, through a combination of investment income and capital appreciation, a rate of return (time-weighted total return gross of fees) in excess of the benchmarks established for the medium term (3-5 years) and long term (5+ years).

**Current Income Pool**

The objective of the Current Income Pool is to maximize income for current use rather than to preserve the purchasing power of future generations. Thus it is not appropriate for true endowments, and should consist of quasi endowments and Board-designated reserves. Income through investment yield should be the primary investment goal, with gains resulting from changes in market values being secondary. Actively managed fixed income funds are used to generate these secondary gains. Stable investments such as bonds, government securities, internal financing backed by real estate, and certificates of deposit are the principal investment vehicles for this pool.

Internal financing related to various real estate properties can be an acceptable fixed income investment for the Current Income Pool. Approved asset mixes are as follows:

| Investment Category | Range |
|---|---|
| Stable Investments/External Notes Receivable | 0 to 50% |
| Actively Managed Investments | 20 to 80% |
| Cash and Cash Equivalents | 0 to 20% |

**Investment Pool Accounting**

Each investment pool is divided into participation units, and all units have an equal interest in their respective pool. The number of new units assigned upon transfer of assets to a pool is determined by dividing the market value of the assets transferred by the market value of a unit in the pool immediately before such transfer. The value of a unit will change as the value of the pool's assets changes.

Each investment pool is operated on a July 1 - June 30 fiscal year basis and the market value of the assets in the pool and of each participating unit is determined on September 30, December 31, March 31, and June 30. Participating units may be added or deducted from the pool at the beginning of each calendar quarter (the first day of July, October, January, and April). Capital gains or losses on the sale of investments are not distributed to the participating funds, but become part of the unit value calculation for each quarter. For the Current Income Pool, distributions consist of interest income only rather than including a percentage of unrealized gains as with TCF's Endowment Pool.

**Performance of Investment Pools**

Measuring the comparative performance of investment pools with similar characteristics, objectives, and risk levels is useful in understanding investment results achieved with respect to desired goals. The performance of the TCF Endowment Pool is compared to other similar investment pools through the use of the National Association of College and University Business Officers (NACUBO) annual survey of college and university endowment funds as well as other benchmarks. TCF's Finance and Investment Committee also monitors the ongoing performance of its asset managers.

The investment philosophy of the Current Income Pool is one of stability in underlying principal while trying to maximize current yield. Therefore, yield rather than total return is considered to be the appropriate measure of performance. Yield of the pool is compared to the yield of a bond index fund that bears the closest resemblance in asset mix and maturity dates.

## OTHER INVESTMENT CONSIDERATIONS

### Cash Equivalents Pool

Available cash from all funds controlled by SDSURF are pooled for investment purposes in the Cash Equivalents Pool. While not a unitized pool with valuation dates and specific distributions, cash balances are combined so that higher rates of return can be earned by the General Fund knowing that all funds will not be needed on a demand basis. Funds in the pool come primarily from:

- Unpooled endowment funds, both TCF and SDSURF
- General Fund reserves and working capital
- Sponsored research funds paid in advance
- Board-designated support funds
- Self-support funds
- TCF operating and gift funds

Monies in this pool may be invested in money market accounts, certificates of deposit (within FDIC insurance limits), investment grade commercial paper, short-term government or investment grade corporate debt securities, actively managed fixed income mutual funds, and internal borrowing. Internal borrowing is utilized when real property is acquired and allows the General Fund to finance the purchase with a lower interest rate. Internal borrowing requires Board of Directors approval. Up to 50% of the funds in the Cash Equivalents Pool may be used to acquire real property. A higher percentage is allowed if a standby line of credit is in place to cover short-term cash requirements.

Investments are viewed as part of three tiers in recognition of the fact that some funds will virtually always remain on hand (core tier), some will be used within a reasonable length of time (middle tier), and some need to be available on a daily basis (demand tier). The mix of the three tiers is dependent upon the size of the pool and liquidity needs. Investment considerations are as follows:

- For the core tier, use Board approved long-term internal financing that, if necessary, could be financed by traditional methods to free up cash.
- For the core and middle tiers, minimize loss of principal due to interest rate risk by purchasing fixed income investments with fixed maturity dates that do not extend beyond five years. Fixed income mutual funds with an intermediate maturity range are also acceptable.
- For the demand tier, maintain the minimum amount of cash needed for on-going expenditure purposes and maximize yield using liquid investments (money market funds, repurchase agreements, interest bearing checking accounts, etc.).

- A standby line of credit may be utilized to alleviate temporary cash demands.

| Tier | Range |
|---|---|
| Core | up to 50% |
| Middle | up to 75% |
| Demand | up to 25% |

Given the size of SDSURF's Cash Equivalents Pool, the services of an investment manager and the use of its investment funds can be helpful with the actively managed investments. Not only can an investment manager provide investment and diversification opportunities that would not otherwise be available, it can also provide a level of monitoring of managers and a capacity to adjust that are not feasible or efficient for most individual endowments.

**Unpooled Investments**

Unpooled investments include funds with special restrictions established by donors, which make it inappropriate to pool these funds for investment purposes. The monies are sometimes invested in accordance with conditions established by the donor or fund advisor. Also included are deferred gifts that cannot be pooled with other endowments because of the existence of a current beneficiary and the fiduciary responsibilities of SDSURF. The unpooled investments are often invested in cash equivalents because of their temporary nature. These unpooled investments, as well as some General Fund reserves, earn interest at the money market rate earned by SDSURF.

**Independent Trusts**

In addition to the trusts described as deferred gifts, SDSURF may serve as trustee of other trusts called "Independent Trusts." These trusts may include revocable living trusts and irrevocable trusts for which SDSURF or SDSU are the eventual beneficiary subject to satisfaction of conditions that benefit intermediate beneficiaries. The assets of these trusts are managed and maintained separately from SDSURF assets and are not included in SDSURF's financial statements. Any income distributions are recorded as gifts at the time of receipt. Once conditions of the trust are satisfied, the trust is terminated and remaining assets transferred to SDSURF or TCF, with the principal recognized as a gift at that time.

SDSURF only serves as trustee of independent trusts in situations where SDSURF or SDSU is a major beneficiary and the arrangement is beneficial to the Trustor and SDSU. Investment policies for independent trusts are similar to those for endowment funds.

**Retiree Medical Voluntary Employees' Beneficiary Association Trust**

SDSURF has established a Voluntary Employees' Beneficiary Association (VEBA) Trust for the cost of providing medical benefits for eligible retired employees and for current employees who will be eligible in the future for similar benefits. The Trust was formed in 1996 as a separate legal entity and was initially funded with the retiree medical reserves that had been contributed by SDSURF and certain self support programs (primarily KPBS and Extended Studies). The Executive Director, CFO, and the Director of Human Resources serve as Trustees. The investment allocation is presented to the Finance and Investment Committee quarterly for review.

Annual contributions to the VEBA Trust are based upon actuarial calculations of the Other Post Employment Benefit (OPEB) liability. The VEBA Trust's investments are included in the financial statements of SDSURF's Health, Dental, Vision, Life Insurance/AD&D and Employee Assistance Program, which is audited annually by a certified public accounting firm.

Because this future obligation is long-term, a significant equity exposure is considered necessary for investment purposes. The asset mix is similar to that used for permanently restricted endowment funds, and the funds are invested separately based upon the guidance of an Outsourced Chief of Investment Officer (OCIO):

| Investment Category | Range |
|---|---|
| US Equity | 30 – 60% |
| International Equity | 5 – 20% |
| REIT's | 0 – 10% |
| Bond Funds | 15 – 35% |
| Money market | 0 – 20% |