

COMMUNITY FOUNDATION *for* MUSKEGON COUNTY

INVESTMENT POLICY STATEMENT

1. Purpose and Authority

This Investment Policy Statement serves as the guideline for management of the Community Foundation for Muskegon County (CFFMC) investment portfolio. The CFFMC Board of Trustees uses this policy to aid in the fulfillment of its fiduciary responsibility for the general management of the investment portfolio. Although the CFFMC delegates decisions to the Investment Committee, the Board of Trustees remains ultimately responsible for these primary responsibilities:

- Determining investment goals and objectives
- Choosing an appropriate asset allocation strategy
- Establishing an explicit, written investment policy consistent with the goals and objectives
- Approving appropriate investment advisors, money managers, mutual funds, or other “prudent experts” to implement the investment policy
- Monitoring the activities of the overall investment program for compliance with the investment policy
- Avoiding conflicts of interest and prohibited transactions

Investment Committee actions are monitored and approved through reporting at CFFMC Board of Trustees Meetings.

2. Investment Committee

CFFMC By-Laws state the Investment Committee shall act as liaison between the Board of Trustees and the fiscal agents employed, monitor investment performances and make recommendations to the Board of Trustees regarding investment performance issues.

The committee is responsible for the establishment, implementation and oversight of the Foundation’s investment program within the guidelines provided by the CFFMC Board of Trustees. The committee may delegate certain decisions to professional money managers, trustees and/or investment advisors and consultants. Even when decisions are delegated, the committee still retains the same primary responsibilities as noted above for the Board of Trustees.

See Addendum A for detailed list of Investment Committee tasks.

3. Role of CFFMC Staff

Staff is responsible for administration of this Investment Policy, recommending Investment Advisors or Consultants, recommending Custodians, and performing such duties as may from time to time be assigned by the Investment Committee. In performing these duties Staff retains the same primary responsibilities as noted above for the Board of Trustees.

See Addendum B for detailed list of Staff tasks.

4. **Spending Policy**

Spending of funds is determined primarily by the donor's stated charitable intent as to spending and preservation of principal.

The Foundation has established a spending guideline of 5% - 6%, absent specific donor intent. This spending includes; grants, administrative fees, and investment expenses. Under this spending guideline and absent direction from the donor, the Foundation will make grants of 4% from unrestricted funds.

See Addendum D for additional spending policy discussion.

5. **Investment Goal, Objectives, Time Horizon, and Asset Allocation**

The primary investment goal for the Foundation will be to provide for long-term growth of capital to fund its perpetual grantmaking role. A perpetual grant making objective should be matched with a long-term investment horizon leading to a more aggressive asset mix and higher returns. The Foundation has adopted a long-term investment horizon.

The total investment return objective is to equal or exceed the spending target plus the rate of inflation (e.g., 6.0% + 3.25% = 9.25%). Our objective is to exceed the CPI Index by 5 - 6%.

A second objective is for total investment return to exceed the CFFMC Balanced Index Benchmark, which is comprised of 55.0% Russell 3000 Index, 15% MSCI AC World Index Free ex-US, and 30.0% LB Aggregate Bond Index.

For individual managers, the objective is to achieve market benchmark returns for passive investments and to exceed market benchmark returns, on a risk-adjusted basis, for actively managed investments.

We recognize the need to accept risk associated with our long term return target, but will work to minimize it by appropriate diversification of assets. The CFFMC portfolio is expected to achieve returns commensurate with the CFFMC Balanced Index Benchmark with equal or less risk, as measured by standard deviation and beta.

Disciplined management of the asset mix among classes of investments is both a necessary and desirable responsibility. In the allocation of assets, diversification of investments among asset classes that are not similarly affected by economic, political, or social developments is expected. Consequently, the general policy shall be to diversify investments so as to provide a balance that will enhance total return, while avoiding undue risk concentrations in any single asset class or investment category. The diversification does not necessarily depend upon the number of industries or companies in a portfolio or their particular location, but rather upon the broad nature of such investments and of the factors that may influence them.

For the traditional, passive component of the portfolio, the investment advisor will actively manage the asset allocation based on their determination of market valuations, but remain within an acceptable range at all times. Should any category move out of acceptable range due to market movements, the investment advisor will use prudence in rebalancing the portfolio, either immediately or over the subsequent few months.

Aggregate Strategic Asset Allocation Guidelines

Asset Class	Long-Term Target	Min	Max
Variable Return/Equities	62%	35%	85%
Fixed Income	23%	5%	35%
Real Assets /Real Estate/Absolute Return	15%	5%	20%
Cash	0%	0%	10%

See Addendum D for additional asset allocation policy discussion.

Investment Guidelines and Parameters

It is recognized that a wide range of investments should be considered and used by the CFFMC to provide appropriate diversification and risk control. Investments should be made in a variety of variable return and fixed income type of investments, both domestic and international.

CFFMC guidelines for investment managers are in Addendum E.

Many investments are made with pooled/mutual fund investment managers, where the CFFMC cannot dictate policy. It is our intent to select and retain only pooled/mutual funds with policies similar to the guidelines in Addendum E.

All types of alternative investments, including but not limited to; real assets, private equity, venture capital and limited partnerships are open to consideration. Currently, the only types of alternative investments approved in the asset allocation guideline are hedge funds. Hedge funds are utilized in the portfolio to provide an absolute return strategy, defensive protection in challenging markets and low correlation to traditional equity and fixed income managers.

Investments in hedge funds shall be made through a fund-of-funds vehicle to provide appropriate diversification by manager and strategy. Investments in hedge funds will be used to diversify the overall portfolio and enhance total return. Derivative securities may be utilized indirectly as part of a diversified hedge fund-of funds strategy. It is understood that hedge funds have limited liquidity (typically annual redemption) and are private partnerships that may experience high variability of returns. It is the Committee's intent to only retain those hedge funds that have characteristics consistent with lower volatility strategies and whose historical standard deviation of returns is in line with that of the Barclays Capital Aggregate Index. The Committee shall consider certain criteria including, but not limited to, the following in its evaluation of a fund:

- a. Tenure and track record of management as a team;
- b. Expertise in targeted areas of investment;
- c. Diversification relative to other investments;
- d. Use of leverage;
- e. Liquidity of investments;
- f. Maintain registration with the SEC

The Foundation will only invest in offshore limited partnership shares -- to avoid "Unrelated Business Taxable Income" (UBTI) -- and its investment will not comprise more than 10% of any individual partnership's assets.

6. Investment Advisor Responsibilities

An Investment Advisor is used by the CFFMC to provide professional advice and guidance in developing and monitoring the CFFMC investment strategy. The Investment Advisor is also relied on to recommend investment options. This advice and guidance shall include the relevant information needed for the Investment Committee to manage a prudent investment process.

See Addendum C for detailed list of Investment Advisor tasks.

7. Custodian Responsibilities

The Foundation may choose to utilize custodians to hold some or all of its investments. Where a custodian is utilized, the role of the custodian is to: 1) Hold securities for safekeeping; 2) Report holdings and transactions; 3) Collect interest and dividends; and 4) if required, affect trades.

Addendum A - Investment Committee Tasks

1. The Investment Committee holds regular meetings about six weeks following the end of a calendar year quarter. Standing agenda items for these regular meetings include:
 - Approval of last meeting minutes
 - Staff Reports
 - Review Investment Advisor Report & Recommendations
 - Changes in asset allocation
 - Re-balancing
 - Investment manager changes
 - Review Investment Advisor due diligence review or educational materials when approving new investment options
2. Evaluate CFFMC investment practices against benchmark information and best practices. Benchmark investment performance and spending policy information is available from Council of Foundations. Best practice fiduciary information is available in [A Handbook for Investment Fiduciaries](#), written by the Foundation for Fiduciary Studies.

3. Items to be reviewed on an annual basis:

- Investment Policy Statement
- Investment Advisor Performance
- Investment Manager / Mutual Fund Performance
- Custodian Performance
- Investment Advisor guidance on establishing a diversified portfolio that meets the CFFMC Investment Goals and Objectives:
 - A risk level has been identified
 - An expected, model return to meet investment objectives has been identified
 - An investment time horizon has been identified
 - Selected asset classes are consistent with the identified risk, return, and time horizon
 - The number of asset classes is consistent with portfolio size
- Spending policy (relationship to Investment Goals and Objectives)
- All fee structures
- Internal Controls

Addendum B - Staff Tasks

Tasks:

- Update Investment Committee on applicable laws
- Maintain schedule of documents & records to be maintained for investment management (e.g., contracts)
- Prepare Combined Investment Fund activity report and reconcile to balance sheet
- Maintain documentation on Internal Controls for investment
- Maintain schedule of persons authorized to make investment transactions
- Maintain documentation on Donor precatory requests for handling of investments
- Monitor service vendors
 - Report to Investment Committee on an annual basis

Addendum C – Investment Advisor Tasks

CFFMC will retain an Investment Advisor to provide professional advice and guidance in developing and monitoring the CFFMC investment strategy. The Investment Advisor is also relied on to manage the portfolio and recommend alternative investment options. This advice and guidance shall include the relevant information needed for the Investment Committee to manage a prudent investment process.

Guidance on establishing a diversified portfolio that meets the CFFMC Investment Goals and Objectives will include:

- A risk level has been identified
- An expected, model return to meet investment objectives has been identified
- An investment time horizon has been identified
- Selected asset classes are consistent with the identified risk, return, and time horizon
- The number of asset classes is consistent with portfolio size

Due diligence criteria for recommending investment options will include:

- Performance relative to peer group
- Performance relative to assumed risk
- Inception date of product
- Assets under management
- Expense ratios or fees
- Stability of the organization

Guidance on monitoring of investment strategy will include:

- Quarterly reports which compare investment performance against appropriate index, peer group, and CFFMC Investment Policy Statement objectives
- Recommendations to rebalance portfolio
- Periodic reviews are made of qualitative and/or organizational changes of investment decision makers
- Control procedures are in place to periodically review policies for best execution, soft dollars and proxy voting
- Fees for investment management are consistent with agreements and the law
- “Finder Fees”, 12B-1 fees, or other forms of compensation that may have been paid for asset placement, are appropriately applied, utilized, and documented

Addendum D – Spending Policy & Asset Allocation

The Council of Foundations and DeMarche Associates worked together to create Spending Policies And Investment Planning for Foundations: A Structure for Determining a Foundation’s Asset Mix, first published in 1990. The third edition was published in 1999 and is referenced in this addendum.

The study analyzed the impact of different spending levels (e.g., all spending which includes grants, administrative fees, & investment fees). Returns were based on a “representative portfolio” from surveys of foundations from 1950 to 1998. In 1998 this representative portfolio was 60% Stocks / 10% Venture Capital & Real Estate / 30% Bonds. The portfolio had a standard deviation of 12.42 and a geometric return (annualized compounded return) of 9.45%. The analysis follows:

(000,s)	Spending Level		
	5.5%	6.5%	7.5%
1950 Asset value	1,000	1,000	1,000
1998 Nominal asset value	13,756	8,604	5,357
1998 Real (inflation-adjusted) asset value	1,982	1,239	772
1950-1998 Percentage growth (loss)	98.2%	23.9%	-22.8%
1950 Total spending	55	65	75
1998 Total spending	684	510	370
1950-1998 Total spending	9,698	8,392	7,202

One of the many observations by the authors noted: “based on the analysis of historical asset class returns used in this study, foundations cannot maintain current spending at 7.5% or above if they wish to maintain their portfolio’s purchasing power. **Foundations will require fairly aggressive asset mixes to achieve real returns that will even support 5.5% spending.**”

A second observation: “Governing boards responsible for a foundation’s financial affairs typically fulfill a portion of that fiduciary responsibility by carefully selecting third-party investment professionals to manage the foundation’s portfolio of stocks, bonds, cash and other asset classes. However, responsibility for the strategic (long term) asset mix of the portfolio typically remains with the board because board members are best qualified to understand the financial circumstances and risk tolerances of their foundation. **The strategic asset allocation decision is one of the most critical financial issues board members face. It will have a much greater impact on the Foundation’s long term financial position than the relative performance of its individual investment managers. As much as 90% of a fund’s relative performance is attributable to the asset mix decision.** Yet, it is not unusual to see fiduciaries lose sight of the importance of asset allocation and become overly concerned about individual manager performance.”

Based on this analysis, CFFMC has set a spending guideline of 5% to 6%. Actual spending is influenced by donor wishes and actual investment returns.

Grant guidelines for funds at CFFMC, within our spending policy

- Donor intent is first consideration
- Target grant making in 4% to 5% range
- Unrestricted funds grant target is 4% applied to rolling 16 quarter fund balance
- Endowment fund grants are limited to accumulated earnings (i.e., principal will not be granted)

What is the appropriate level for grants from a fund?

When donors’ intend for their gift to be a permanent fund that will provide grants in perpetuity (an endowment fund), an annual amount to spend on grants must be determined.

When the donor is most concerned with current opportunities to invest in the community, it is appropriate to move to the higher end of the target grant range (e.g., 5%). When the donor is more focused on providing a growing long term source of grants, it is appropriate to move to the lower end of the target grant range (e.g., 4%).

Some donors have established funds, which are left to the discretion of the Trustees of CFFMC. Absent direction from the donor, CFFMC will focus on providing a growing long term source of grants and has set a grant target of 4%. Three thoughts drive this direction.

- First, we believe it is reflective of the intent of many of the donors of these funds (for good for ever).
- Second, a more conservative grant level increases the ability to maintain grants in difficult financial markets (often the time when community needs are the greatest). It also takes advantage of the endowment experience that less current spending creates more total spending (less is more).
- Third, current needs in our community are a good opportunity to encourage and engage donors. Ultimately the success of the foundation is dependent on matching donors with community needs.

Why use a rolling 16 quarter fund balance?

We believe this benefits the community by providing a more level amount for grants. This is especially helpful in down markets, when community needs are often at a high level.

Addendum E – Investment Manager Policy Statement

MANAGER EVALUATION

Each investment manager will be evaluated by the Investment Advisor and Investment Committee on an ongoing basis and this evaluation will include the following:

- a. Avoidance of regulatory actions against the firm, its principals, or employees.
- b. Adherence to the guidelines and parameters of this Policy Statement.
- c. Ability to exceed the return (net of fees) of the appropriate benchmark and, for equity managers, produce positive alpha (risk-adjusted return) with a beta of less than 1.20.
- d. Ability to exceed, over a complete market cycle, the median performance of a peer group of managers with similar styles of investing.

General

Each investment manager shall:

- a. Have full investment discretion with regard to security selection consistent with this Investment Policy.
- b. Immediately notify the CFFMC in writing of any material changes in the investment outlook, strategy, portfolio structure, ownership or senior personnel;
- c. Make no purchase that would cause a position in the portfolio to exceed 5% of the outstanding voting shares of the company or invest with the intent of controlling management;
- d. Not invest in non-marketable securities;

GUIDELINES AND PARAMETERS

In today's rapidly changing and complex financial world, the process by which investment strategies and decisions are developed, analyzed, adopted, implemented and monitored, and the overall manner in which investment risk is managed, will determine whether an appropriate standard of reasonableness, care and prudence has been met for the CFFMC's investments.

Equity Guidelines

Each equity investment manager shall:

- a. Assure that no position of any one company exceeds five percent of the manager's total portfolio as measured at cost and eight percent at market value;
- b. Vote proxies and share tenders in a manner that is in the best interest of the Foundation and consistent with this Investment Policy;
- c. Maintain adequate diversification among economic sectors.