

#### **404. Investment Policy and Guidelines**

##### **I. Statement of Purpose**

The purpose of this investment policy statement is to assist The Board of Trustees of The University of Alabama ("Board of Trustees") in effectively supervising and monitoring the investment activities of The University of Alabama System ("System") and to provide guidance to investment advisors employed to manage assets on its behalf. This statement represents the current investment philosophy consensus of the Board of Trustees and shall be reviewed from time-to-time to ensure that it continues to reflect the appropriate expectations, goals and objectives for the different funds managed on behalf of the Board of Trustees.

##### **II. Definition of Responsibilities**

The Board of Trustees has delegated to the Investment Committee responsibility for recommending investment objectives, broad asset allocation changes, policies and practices. The Investment Committee is responsible for overseeing investment activities and performance; for ensuring the proper control and safekeeping of the investment funds; for making changes within the broad asset allocation guidelines; and for the selection and approval of managers and custodians, and such advisors/consultants as are necessary to properly manage these funds.

##### **III. Reporting**

The System Office reports on the investments and performance of the working capital pools monthly to the Investment Committee of the Board of Trustees, the Chancellor, and the Campus Presidents. Quarterly, the advisor/consultant will make a presentation to the Investment Committee and show performance relative to benchmarks and peer institutions.

## **Investment Policy for Endowment Funds & Non-Reserve Assets**

### **I. Investment Objectives**

The purpose of the Endowment is to support the UA System campuses, hospital, related foundations, and their missions over the long-term. Accordingly, the primary investment objectives of the Endowment are to:

- A. Preserve the real purchasing power of the principal.
- B. Provide a stable source of perpetual financial support to the Endowment's beneficiaries.

In order to preserve the real purchasing power of the principal and to provide a stable source of income to the beneficiaries of the Endowment, the long-term annualized total rate of return objective for the Endowment will be targeted at inflation as defined by the Consumer Price Index (CPI) plus the Endowment spending rate plus all fees and expenses. To satisfy its long-term rate of return objective, the Endowment relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and from natural income (interest, dividends and rents). Asset allocation guidelines and the investment manager structure should be established to meet the target return while providing adequate diversification in order to minimize the volatility of investment returns.

The Endowment assets are intended to support the System in perpetuity. For investment purposes, the Endowment Portfolio is considered to have a long-term investment horizon, and performance will be reviewed over full market cycles.

### **II. Endowment Spending Policy**

The Board of Trustees shall attempt to balance the long-term objective of maintaining the purchasing power of the Endowment with the goal of providing a reasonable, predictable, stable and sustainable level of income to support current objectives. The Board has established a Spending Rate for the Pooled Endowment Fund of 4.5% of the 60-month moving average of unit market values. The Investment Committee will review the spending rate periodically.

In determining whether it is appropriate to make distributions, the System Office will comply with Section 4 of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), as adopted by the State of Alabama and codified at Code of Alabama, 19-3C-1, et seq., or any successor statute or statutes governing such distributions. UPMIFA requires, if relevant, consideration of seven factors when determining when spending is prudent: “(1) the duration and preservation of the endowment fund; (2) the purposes of the institution and the endowment fund; (3) general economic conditions; (4) the possible effect of inflation or deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the institution; (7) and the investment policy of the institution.”<sup>1</sup>

At the institutional level, campus financial and advancement officers may establish internal policies that temporarily prohibit distributions from an endowment fund that has a current market value less than its historical dollar value based on the UPMIFA guidelines. Historical value or corpus is defined as the original donor contribution plus any additional contributions, and any additions to historic dollar value as prescribed by the donor’s gift instrument. Provided however, in all instances, the donor’s intent must be met.

To prevent spending before earnings have accumulated, effective October 1, 2017, any new endowment fund shall be invested in the Pooled Endowment Fund for a consecutive period of 12 months prior to the distribution of a spending allocation of realized gains.

### III. Endowment Asset Allocation

To achieve its investment objectives, the Endowment shall be allocated among a number of asset classes. The primary asset classes may include: global equity, global fixed income, real assets and diversifying strategies and cash. The purpose of allocating among asset classes is to ensure the proper level of diversification within the Endowment. Further description of the asset classes are below:

Global Equity – The allocation will consist of public equity, private

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<sup>1</sup> Code of Alabama Section 19-3C-4(a)

equity, and equity-oriented hedge funds. This is expected to be the highest risk, highest return asset category of the four. The allocation will be diversified by factors including security, sector, geography, market capitalization, and manager style.

Global Fixed Income – The allocation will consist of two broad categories: high quality/rate sensitive and global and credit/distressed.

- 1) High quality/rate sensitive investments are defined as managers where the majority of the portfolio is rated investment grade by S&P and Moody's (Baa/BBB and above). These bonds provide equity risk mitigation, deflation protection and liquidity to the portfolio.
- 2) Global and credit/distressed allocation will include high yield bonds, bank loans, emerging market debt, structured or asset backed bonds, debt oriented hedge funds, and private partnerships investing in debt (mezzanine loans, distressed debt, etc.). This allocation provides investment opportunities to generate a substantial real return, but is more correlated with equity markets than high quality fixed income.

Real Assets – The allocation will consist primarily of real estate, natural resources, and infrastructure assets. Investments will include public securities, hedge funds and private partnership structures. These investments are expected to provide inflation protection as well as generate positive real rates of return.

Diversifying Strategies – The allocation will consist of investments whose primary source of risk and return is not a constant allocation to one of the three asset classes listed above. This includes, but is not limited to, hedge funds whose approach can be described as “absolute return,” multi-strategy, event driven, relative value, or global macro.

The Investment Committee shall periodically review asset allocation targets, ranges, investment objectives, policies, and make changes in investment managers to reflect changes in market conditions, as well as changes in asset class valuations or investment manager performance.

#### IV. Endowment Liquidity

Liquidity is necessary to meet the spending policy payout requirements and any extraordinary events. In many instances, investment opportunities

come with liquidity constraints. The tradeoff between opportunity and liquidity will be considered throughout the portfolio construction process. Sufficient liquidity should be maintained to fulfill the spending and operating objectives. Portfolio liquidity will be monitored using a three-tier system:

- Liquid: available within 90 days
- Semi-liquid: available in 90 days or more but less than 2 years
- Illiquid: available only in 2 years or more

New commitments will be made to illiquid/private capital investments with the intent to keep the current market value of liquid holdings above 40% of the total fund.

#### V. In-Kind Gift Policy

- A. As a general rule, securities received as gifts will be sold on receipt and the proceeds added to the pooled fund, unless the Endowment documents require separate management, in which case the proceeds will be allocated to the investment managers. In those cases where the Investment Committee decides not to sell securities received as a gift, those securities will not be commingled with the rest of the endowment but will be accounted for separately until sold.
- B. Gifts of real estate will be held at the individual campuses as separately managed assets until liquidated. Unless the real estate has strategic long term importance to the campuses or can be managed with existing land, timber, and mineral holdings for investment purposes, it should be liquidated as quickly as practical. Once the real estate is liquidated the funds will be invested in the appropriate System fund.
- C. Annually, campuses are to provide to the System Office a report on all campus managed investments.
- D. Annually, each campus will report on non-campus land and natural resources held for investment.

#### VI. Life Income and Annuity Funds Investments

The Board assigns to campus presidents the responsibility for direct

investment and administration of life income and annuity funds. Investments are to be made in accordance with payout agreements determined at the time of initiation, subject to investment criteria for Endowment funds, as described above. With the approval of The Board of Trustees, external investment advisors may be retained to manage certain life income and annuity funds. Upon the death of the respective beneficiaries, the principal becomes available to the University for the purposes described in each individual trust conveyance; investment of such funds will then be determined by applicable funds investment policy.

## **Investment Policy for System Reserves**

### **I. Investment Objectives**

The System Office, with the guidance and advice of the campuses and hospital financial officers, is charged with developing and implementing an investment strategy that is consistent with matching the duration of each campus's working capital with their projected needs. Because the reserves also serve as collateral for each institution's debt, care is taken to make sure that investment risk levels are appropriate for the financial condition of each individual campus. It is the responsibility of the Investment Office to insure that cash is available to meet the liquidity needs of the campuses and the hospital.

Reserves are to be invested in System managed pooled funds except for certain monies, which are not eligible or appropriate for inclusion in these funds, such as Endowment assets, life and annuity trusts, and proceeds from bond issues.

All System reserves are to be managed in one of the pooled funds depending on the time horizon of the reserves - aside from cash held for operating at banks:

#### **A. Short Term Liquidity Pool (STLP)**

The STLP has the goal of preserving capital with a focus of maximizing returns without undue exposure to risk. This pool will maintain sufficient cash for campuses and affiliated entities with the remainder allocated to short duration fixed income securities.

The time horizon for investments is one to three years.

B. Long Term Reserve Pool (LTRP)

The LTRP has the goal of long term growth of principal and income. This pool will be diversified across multiple asset classes with an asset allocation similar to the pooled endowment excluding private equity, private debt, and private real assets. This fund distributes a spending rate to the reserve holders in the amount of 4% of a 36-month moving average of unit market values. The time horizon for investments is three to seven years.

II. Liquidity for System Reserves

As referenced in Section 404.B.IV, liquidity will be monitored using a three-tier system. In many instances, investment opportunities come with liquidity constraints. The tradeoff between opportunity and liquidity will be considered throughout the portfolio construction process. Sufficient liquidity should be maintained to fulfill spending and operating objectives. The Short-Term Liquidity Pool will be 100% liquid, as defined in the aforementioned section. Policy guidelines for the Long-Term Reserve Pool are:

<u>Classification of Asset</u>	<u>Long-Term Reserve Pool</u>
Liquid	no less than 60%
Semi-liquid	no more than 30%
Illiquid	no more than 10%

(Investment Policy and Procedures adopted May 12, 1979 as Rule 420; amended December 14, 1979, and November 19, 1980. Investment Funds Policy adopted September 16, 1981 as Rule 420; amended February 3, 1983, and January 12, 1984. Asset Management Policy adopted September 20, 1984 as Rule 420; amended December 8, 1989. Investment Management Policy adopted April 30, 1993 as Rule 420; amended October 29, 1993, and April 21, 1995. Amended and renumbered December 5, 1997 as Rule 404; amended November 19, 1999.

Investment Committee Operations adopted November 19, 1999 as Rule 416.

Investment Management Policy, Rule 404, and Investment Committee Operations, Rule 416, amended and renumbered June 17, 2005, as Board Rule 404; amended April 7, 2006, February 2, 2007, November 14, 2008, February 6, 2009, June 15, 2012, September 19, 2014, and June 16, 2017).

## APPENDIX 1

### POOLED ENDOWMENT ASSET ALLOCATION

	<u>Long Term Target</u>	<u>Ranges</u>
Equities	40%	30-50%
Fixed Income and Cash	20%	10-30%
Real Assets	20%	10-30%
Diversifying Strategies	<u>20%</u>	10-30%
	100%	

### SHORT TERM LIQUIDITY POOL ASSET ALLOCATION

	<u>Long Term Target</u>
Fixed Income and Cash	100%

### LONG TERM RESERVE POOL ASSET ALLOCATION

	<u>Long Term Target</u>	<u>Ranges</u>
Equities	45%	35-55%
Fixed Income and Cash	20%	10-30%
Real Assets	15%	5-25%
Diversifying Strategies	<u>20%</u>	10-30%
	100%	

The advisor working with the investment staff has the responsibility of rebalancing assets periodically to stay within the current asset allocation targets.

### MANAGER DIVERSIFICATION

To ensure sufficient diversification for the Pooled Endowment and the Long-Term Reserve Pool, there will not be an allocation of more than 5% to any active manager, and 15% to a passive manager at the time of investment. The Short-Term Liquidity Pool will not allocate more than 25%, excluding cash, to any manager at the time of investment.