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A ROADMAP FOR THE ROADMAP:

creating an investment policy statement for endowments and foundations

Simon C. Krinsky, CFA
Jonathan U.R. Smith

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www.hallcapital.com

Introduction

The purpose of this white paper is to offer investment committees and staff members a guide for creating an investment policy statement (IPS) to meet their institution's specific objectives and constraints.

An IPS is intended to help an endowment or foundation:

1. Outline the purpose and goals of the investment portfolio.
2. Identify and articulate relevant constraints.
3. Set an appropriate investment structure and target asset allocation.
4. Establish guidelines to monitor performance and risk.
5. Define roles and responsibilities for the investment committee, board of directors, investment managers, consultants, custodians, chief investment officer (CIO), and/or outsourced chief investment officer (OCIO).
6. Provide continuity across changes in the board of trustees, investment committee, CIO or OCIO.

This paper is intended to cover these and other considerations, as well as provide a sample IPS for further context.

Before delving into the specifics, however, below are four general suggestions for creating an effective IPS:

1. Use vocabulary that all constituents of your institution understand. Keep the investment jargon to a minimum.
2. Review your institution's governing documents. Much of what you are looking for might already be defined in those documents.
3. Be concise. An IPS is most effective if an investment committee can digest the material and apply the key principles to constructing, managing, and reviewing a portfolio.
4. Keep it updated. Schedule an annual review of the IPS.

Objectives

Our fundamental view is that every institution is distinct. As a result, there is no single objective, set of constraints, or target asset allocation that can be applied broadly across all institutions. Instead, investment objectives and asset allocation should reflect and be designed to support the mission of each specific organization. It is impossible to cover the entire universe of organizations in this white paper, therefore we have tried to articulate a broad framework which can be applied across most institutions.

A commonly stated objective for perpetual endowments or foundations is to preserve and enhance the real purchasing power of the investment assets over time, while providing a predictable contribution to the annual operating budget. In other words, maintain or grow the portfolio after adjusting for spending, fees, and inflation, while generating reasonably predictable cash flows. This objective might fit your institution, but here are some questions to consider before reaching that conclusion:

- What percentage of the institution's operating budget does the endowment support?
- How predictable and steady are your institution's expenses and sources of income (other than transfers from the endowment)?
- Is this investment pool intended to be perpetual or spent down over a period of years?
- Might your endowment or foundation be called upon for a major capital expenditure (either planned or unplanned)?
- Is your institution's endowment cash flow positive (does the institution add more money to the endowment from gifts and/or operations than it draws each year)?
- Is your institution able to access the capital markets (e.g., by raising debt)?

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It is important to think about the actual purpose of your investment funds and to articulate that purpose clearly and succinctly. Investment committees often find that individual constraints necessitate a change to the generic objective listed earlier. For some institutions, consistent support of the operating budget supersedes long-term growth; to others, managing the investment pool to meet a social objective is the most important factor. Finally, it is worth noting that institutions may have more than one investment pool and a different IPS may be appropriate for different pools. For ease of review, this paper refers to only one endowment fund.

Constraints

Unsurprisingly, endowment and foundation constraints are more varied than their objectives, and are typically broken out between the **spending policy** and other considerations. The institution's spending policy is usually one of the most important portfolio constraints. Many organizations adopt a "total return policy" with respect to the source of funding for annual distributions from their endowment. In other words, the amount to be withdrawn to fund the operating budget is defined as a percentage of endowment capital, and the source for funding the portfolio's contribution to the annual budget can come from income, realized or unrealized gains, principal, or some combination of those. In addition, as most endowments and foundations need *reasonably* consistent cash flows from their portfolios, many adopt "smoothing" mechanisms, such as using a 3- or 5-year rolling average capital base calculation, to minimize the impact of market fluctuations on portfolio distributions. Please see Appendix C for a number of spending policy examples.

The second set of constraints revolves around governance and/or philosophical considerations, such as:

- Portfolio liquidity considerations
- Legal or regulatory restrictions
- Board and/or investment committee interpretations of their fiduciary obligation with regard to control, diversification, and transparency
- Board- or donor-designated restrictions
- Active management versus passive strategies
- Objectives for impact investing or socially responsible investing (SRI)

Some constraints are inherently rigid, such as legal- or donor-designated restrictions, while others are subject to interpretation. All constraints impact asset allocation and portfolio implementation. It is therefore advisable to fully understand and clearly articulate these constraints in the IPS.

Asset Allocation

Many institutions define asset classes by structure, style, and geography. Others attempt to segment the investment universe by return pattern or theoretical role in the portfolio. The examples below and on the following page reflect each approach.

Example A: (structure, style, and geography)
Cash and Equivalents
Fixed Income
Investment Grade Bonds
High-Yield Bonds
Global Bonds
US Equity
Large Value/Growth
Small-Cap Value/Growth
International Equity
Developed Countries
Emerging Markets
Alternative Investments
Hedge Funds
Private Equity
Venture Capital
Real Estate
Commodities

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Example B: (return pattern and/or portfolio role)
Liquidity
Cash and Equivalents
Fixed Income
Capital Appreciation
Global Public Equity
Distressed Credit
Hedged Equity
Global Private Equity
Inflation Sensitive
TIPS
Real Estate
Commodities
Independent Return
Market Neutral
Relative Value
Multi-Strategy

At Hall Capital Partners, we define asset classes by drivers of return and risk. At our firm, we choose to concentrate portfolios in five broadly defined asset classes: Cash/Fixed Income, Global Equities, Hedge Funds, Private Equity, and Real Assets. We also use a catch-all, Hybrid, to capture investments which do not fit neatly into one of the other asset classes. We organize balance sheets in roughly descending order of liquidity and characterize the role of each asset class in terms of return expectation, time horizon, and risk.

Investment committees should not be trapped by asset class segmentations. It is important to capture the best investment opportunities available to the institution, even if these opportunities fall between the definitions found in the IPS. So while we emphasize the importance of understanding returns and risk associated with each investment, we encourage you to think about the asset class section of the IPS as a guide, rather than a strict bucketing mechanism.

Example C: (Hall Capital Partners)
Cash/Fixed Income
Cash and Cash Equivalents
Investment Grade Bonds
Global Equities
Global
US/International
Emerging Markets
Hedge Funds
Equity Hedge
Absolute Return
Hybrid
Private Equity (Global)
Venture
Growth
Real Assets
Real Estate
Hard Assets

At Hall Capital Partners, we believe that authentic diversification requires allocating capital across different asset classes, assuming an organization can accommodate the illiquidity associated with private equity and real assets. Within each asset class, we are comfortable with a relatively small number of investment strategies, with each serving a specific purpose.

Establishing ranges around asset class exposure is strongly recommended. It is important to strike the right balance of appropriate asset class limits while maintaining the flexibility to tilt the portfolio towards the most compelling investment opportunities. Wholesale moves in or out of asset classes rarely make sense; instead, shifts within ranges and in composition of investments within asset classes can accommodate appropriate responses to changing environments.

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Framework for Rebalancing

A **rebalancing policy** is prudent for a number of reasons. First, it adds an unemotional constraint by encouraging committees to trim investments which have appreciated, and to add capital to those which have lagged. Second, it provides practical guideposts for investing new cash from donations or asset sales, recognizing that private investments pose challenges to short-term rebalancing. Rebalancing should be reviewed periodically or whenever meaningful cash flows occur.

Performance Measurement and Monitoring

Investment committees should focus on **performance** over full market cycles (seven to ten years); however, they also need to recognize that the long run is made up of a series of shorter periods of time. An effective IPS should create a framework for evaluating overall portfolio returns as well as the returns of each underlying investment manager over appropriate time periods, both long and short. In order to accomplish this, it is important that the committee develop reasonable expectations for returns and risks for each manager and for the portfolio as a whole. It is our practice to measure overall portfolios against at least two of the four benchmarks below:

- A custom benchmark of indices matching the long-term asset allocation targets (a combination of cash, bond, stock, hedge fund, private equity, and real assets indices). *This is appropriate for shorter term measurement periods (3-5 years).*
- A relevant peer universe benchmark, such as using the data provided by NACUBO for performance of comparable institutions. *This is appropriate for shorter term measurement periods (3-5 years).*
- A simple benchmark (a passive mix of stocks and bonds, such as 60% equity / 40% fixed income). *This is appropriate for the medium term (5-10 years).*
- A nominal benchmark comprised of the expected inflation rate plus the spending policy rate. *This is appropriate for the long term (10+years).*

Performance for each manager should be analyzed against an appropriate benchmark as well, both quantitatively and if possible qualitatively. Major variances – both positive and negative – should be cause for review. We acknowledge how hard it is to find meaningful benchmarks for many investments, particularly in private equity, real assets, and other potentially illiquid investments. For these investments we rely on publicly and privately available industry benchmarks, but find this data more useful over long periods of time.

Identifying Risk

Endowment and foundation portfolios are subject to many forms of **risk**. Volatility, which is often used to define risk, is not necessarily the most important measure in our view. Ultimately, the most critical risks are permanent loss of capital and/or the inability for an organization to fulfill its mission due to lack of access to liquidity. These three risks are related however as portfolio volatility could crystallize mark-to-market losses if asset sales are necessary to fund operations. In other words, volatility becomes more important (and dangerous) for institutions as spending rates rise. Some questions to consider when discussing risk include:

- How many years of spending for operations should be held in cash and equivalents? *(market risk, volatility risk)*
- What is the appropriate threshold percentage of unfunded commitments to private investments, relative to cash and high quality fixed income? *(liquidity risk, potential funding risk)*
- What percentage of the portfolio could be liquidated within one week, one month, six months, one year, or longer periods? *(liquidity risk)*

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- How much leverage, if any, is applied by underlying portfolio managers? *(risk of permanent capital loss)*
- What is the maximum acceptable allocation to a single manager? *(manager-specific risk: this is often defined differently across asset classes and/or geographies)*
- What are the operational risks of underlying portfolio managers? *(counterparty, custody, mark-to-market, and other risks)*
- What is the tolerance of the board of trustees, investment committee, or staff for complexity in the portfolio? *(complexity risk)*

If an IPS can properly account for the other risks outlined above, then market volatility might create opportunities that outweigh the additional risk.

Roles and Responsibilities

The IPS is the best place to define roles and responsibilities of the board of trustees, investment committee, staff, consultants (if appropriate), investment managers, custodians, and/or CIO/OCIO. Some investment policy statements achieve this in matrix form, while others use the written word. In our experience, the most important roles and responsibilities to establish or define are:

- A spending policy *(typically by the board of trustees)*
- IPS oversight and target asset allocation *(typically by the investment committee as authorized by the board of trustees)*
- A framework for selecting, sizing, and terminating investment managers *(typically by either the CIO/OCIO or the investment committee)*
- Investment performance monitoring and reporting and other portfolio analysis *(typically by the CIO/OCIO with direction from the investment committee)*

One of the most important decisions an institution needs to make is whether to select investments internally or in partnership with external investment professionals. Manager selection and portfolio performance oversight emphasize the relationship between the investment committee and a CIO/OCIO. Institutions need to determine the right balance between hiring an internal CIO and staff to manage the investment pool, seeking a fully or partially external investment solution, or managing all investment decisions as a committee. Factors to consider include: organizational culture, management capabilities and capacity, costs, investment and portfolio management skills, additional resources (administrative, accounting, or otherwise), and the ability to customize. An IPS should be clear on the desired degree of flexibility for an investment committee to transition between these models.

Conclusion

An institution's mission, objectives, constraints, and governance structure will dictate a distinctive roadmap articulated in the form of the investment policy statement. The elements outlined in this white paper are not intended to be exhaustive but are presented as guideposts to help the author of an IPS construct a governing document with purpose and clarity. Our hope is that the sample IPS that follows serves to translate the considerations presented in this paper into a cohesive framework for practical illustration purposes. Ultimately, the investment policy statement is a living, flexible document that should be reviewed annually and updated over time to reflect an institution's current posture and forward-looking aspirations.

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[Governance structures vary across institutions. This is a sample IPS assuming a Board of Trustees, Investment Committee, and a retained OCIO. For other governance structures, the roles of the OCIO could be subsumed by an Investment Committee, consultant, or other structure.]

SAMPLE INVESTMENT POLICY STATEMENT

ABC Institute

Adopted [Insert Date]

This Investment Policy Statement ("Policy") is intended to govern the investment practices of the assets of the ABC Institute ("ABC"), so that all individuals with either direct or indirect responsibility may understand and manage ABC investment assets, hereafter referred to as the "Endowment."
This Policy addresses the following issues:

- The general goals of the Endowment
- The specific investment objectives of the Endowment
- Asset allocation and rebalancing policies
- Measurement and evaluation of investment performance
- Policies and guidelines for Investment Managers

A. Policy

Endowment assets will be managed on a total return basis while taking into account the level of liquidity required. The Investment Committee recognizes the importance of the long-term preservation of capital. The Investment Committee also adheres to the principle that varying degrees of investment risk are generally rewarded with commensurate returns over the long term. Therefore, investments with different types and degrees of risk are appropriate for the Endowment, provided that such risks are regularly identified and managed.

B. Roles and Responsibilities

The Investment Committee is authorized by the Board of Trustees ("Board") to act on its behalf subject to this Policy Statement. The Investment Committee, in turn, is authorized to delegate certain responsibilities to professional experts in various fields, including the flexibility to retain, terminate, or replace an Outsourced Chief Investment Officer ("OCIO"). This delegation of authority allows for sufficient flexibility in the management process to capture investment opportunities as they arise.

The Investment Committee is responsible for:

1. Establishing and maintaining the Investment Policy Statement and Target Asset Allocation.

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2. Monitoring the performance and risk profile of the Endowment as a whole.
3. Reviewing the OCIO's implementation of the investment program.
4. Hiring, terminating, or replacing the OCIO.
5. Reviewing and addressing all potential conflicts of interest.

The OCIO is responsible for:

1. Selecting, rebalancing, terminating, and making tactical shifts between Investment Managers.
2. Monitoring the appropriateness of each Investment Manager's strategy given ABC's overall investment strategies, philosophies, and objectives.
3. Monitoring the investment performance of each Investment Manager compared to the benchmark established for that Investment Manager.
4. Overseeing ABC investment assets and reporting on the status of the investments to the Investment Committee and/or Board of Trustees.

C. Investment Goals and Objectives

The investment objective for the Endowment is to preserve and enhance the real purchasing power of these assets over time, while providing a reasonably predictable contribution to the annual operating budget.

Return

The expected return objective for the portfolio, measured over rolling five-year and seven-year periods, is to provide an annualized total return, net of fees, of five percent (5%) over the rate of inflation (as measured by the Consumer Price Index ("CPI")). The Investment Committee has set an additional goal of outperforming, net of all investment expenses, a composite market index which best represents the target asset allocation of the Endowment's overall investment structure.

Composite Market Index (based on the asset allocation described in Section F below):

5% ML 3-month T-bills
10% Barclays Aggregate Bond Index
40% MSCI AC World Index Free
25% HFRI Fund of Funds Index
15% Cambridge Associates Private Equity Composite
5% NCREIF and Cambridge Associates Real Assets Composite

Risk

The Endowment should experience risk as measured by volatility or variability of return not materially higher than that of the composite benchmark as defined above.

The investment goals above are the objectives of the aggregate Endowment, and are not meant to be imposed on each Investment Manager.

D. Policy on Environmental, Social and Governance Considerations

The Endowment's strategic asset allocation is constructed to properly balance the need for liquidity, growth and/or preservation of purchasing power, and tolerance for risk. The primary criterion for the selection of the Endowment investments is to maximize return within defined risk parameters, which in turn, maximizes the financial support for ABC. In addition, ABC is committed to balancing the financial objectives of the Endowment with the social, environmental and governance priorities of the broader ABC community. The OCIO and Investment Committee will consider social, environmental and governance impacts when selecting Investment Managers across all asset classes.

E. Spending Policy

The Board of Trustees sets the spending policy with input from the Investment Committee. The current annual draw rate is 5% multiplied by the average of the prior twelve quarter-ending Endowment values. In addition, annual draws are subject to a "collar": the minimum draw in any particular year should be 4% applied to the most recent fiscal year-end Endowment value, and the maximum draw should be 6% applied to the most recent fiscal year-end Endowment value. The "smoothing" policy serves two purposes. First, it provides for more consistent and predictable spending for the programs supported by this Endowment. Second, it allows the Investment Committee to design an investment strategy which is more aggressive with a higher expected return than might be the case if spending were determined by annual investment performance. The application of a "collar" to the moving average has the benefit of mitigating extreme market outcomes.

F. Asset Allocation

Diversification across asset classes is a core principle of prudent portfolio management. The Investment Committee will evaluate asset allocation targets and ranges for the Endowment and will review each annually. Certain asset classes require substantial time to adjust levels, particularly private equity and real assets, as well as multi-strategy mandates. Consequently, implementation of adjustments to targets and ranges may require several years to achieve.

Target Asset Allocation

	Minimum %	Maximum %	Target %
Cash and Equivalents	2%	10%	5%
Fixed Income	5%	25%	10%
Global Equities	30%	50%	40%
Hedge Funds	15%	35%	20%
Hybrid	0%	10%	5%
Private Equity	5%	20%	15%
Real Assets	0%	15%	5%

Liquidity is required to meet operating cash needs, additional unanticipated needs, capital calls to private equity and real assets investments, and to take advantage of unforeseen market opportunities. At least two years' of anticipated operating cash needs plus an additional two years' of expected net funding requirements for private investments should be maintained in cash and fixed income.

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Further liquidity guidelines: Investments will be made through a combination of externally managed portfolios (separately managed accounts), commingled funds, and partnerships with various liquidity terms. At all times, at least 25% of the Endowment should offer daily liquidity, and at least 50% of the Endowment should be able to be liquidated within one year. No new commitments to private investments will be made if total private investments plus unfunded commitments exceed 40% of all Endowment assets.

G. Asset Class Guidelines

1. **Cash** is intended to serve as the principal source of liquidity for operating cash flow for the Endowment. It will be invested in only the safest assets including Treasury bills, Agency notes, or very safe money market instruments that focus on Treasury bills and equivalents. The focus is on safe, highly liquid assets as opposed to generating significant yield. There are no manager-specified limits for cash.

2. The purposes of the **Fixed Income** allocation are (i) to provide current income to support operating cash flow; and (ii) to create some measure of diversification. As a result, both credit quality and preservation of principal are a core emphasis of this allocation. A current risk for cash and high-quality fixed income is the possibility of negative real returns, or returns which are less than the rate of inflation. No more than 15% of the entire portfolio should be invested with a single fixed income manager.

3. The purpose of the allocation to **Global Equities** is to provide long-term capital appreciation. Equity managers will be selected with the objective of building a portfolio that is diversified by geographic region, economic sector, industry, and market capitalization. The objective in selecting equity managers is to generate average annual compounded returns higher than those of relevant broad market indices (i.e., the S&P 500, the Russell 1000, MSCI EAFE, and MSCI World), net of fees, over full market cycles (7-10 years). However, these returns are subject to significant variability over short to medium time periods of less than five years. No more than 10% of the entire portfolio should be invested with a single equity manager.

4. The **Hedge Fund** allocation may include investments commonly characterized as “absolute return” strategies and long/short “equity hedge” strategies. Absolute return strategies typically involve event-driven, stressed and distressed credit, macro, and spread-based arbitrage investments. Absolute return strategies tend to be both flexible and opportunistic. They incorporate differentiated drivers of return compared to traditional investment strategies and, as a result, they are expected to produce returns which exhibit relatively lower correlation to broad market indices over intermediate time horizons. Equity hedge managers typically make both long and short investments and produce returns that can be expected to correlate more closely with the performance of the equity markets than would the performance of the absolute return strategies, though with lower volatility than traditional long-only equity managers. Investments in alternative assets are generally subject to an initial lock-up of 12 to 24 months or longer and thereafter investors can typically withdraw quarterly or annually with advance notice. Over time, alternative assets should generate returns comparable to long-term equity

markets but with somewhat lower volatility than equity markets. No more than 6% of the entire portfolio should be invested with a single alternative investment manager.

5. **Private Equity** investments encompass diverse strategies including: buyout, growth, venture capital, and control-oriented distressed. These illiquid investments generally have four-to six-year investment periods and approximately 10-year fund lives. Given their illiquidity, private investments are expected to generate higher returns than public market strategies. In general terms, Private Equity should generate returns of at least five percentage points above long-term equity markets. The performance of funds raised and managed by the same team following similar strategies can vary significantly from one period to the next. Thus, investment in this asset class requires diversification across not only managers, strategies, and geographies, but also vintage years. No more than 3% of the entire portfolio should be committed to a single private equity fund, and no more than 8% of the entire portfolio should be committed to a single private equity firm measured at the time of the most recent commitment.

6. **Real Assets** investments may include private real estate, energy, timber, and commodities. Private real estate is comprised of commercial properties in various operating segments, primarily office, retail, hotel, industrial, and multi-family. Managers can execute a variety of strategies within these segments (e.g., Core/Core Plus, Value-Added, and Opportunity) that are characterized by varying degrees of development, repositioning, and leverage. Global energy, timber, and commodity investment funds commit capital to investments that develop resource opportunities or to companies that provide services to the sector, such as gas processing or contracted drilling. Across the Real Assets sectors, managers generally seek some balance between income, stability, and risk, which can drive capital appreciation. In general terms, Real Assets allocations seek to deliver long-term results that are a premium to public equity market returns and also protect long-term purchasing power. No more than 3% of the entire portfolio should be committed to a single real asset fund, and no more than 8% of the entire portfolio should be committed to a single real asset firm measured at the time of the most recent commitment.

7. **Hybrid** investments share characteristics with several classes, but are not an asset class *per se*. Examples of hybrid investments include some credit-oriented funds, concentrated public/private strategies, or highly opportunistic managers. These investments can be structured with lock-ups or as drawdown funds. There is no target allocation for this category of investments, but no more than 6% of the entire portfolio should be invested with a single hybrid manager.

H. Cash Flows and Rebalancing

Interest and dividends generated by Investment Managers will generally be re-invested according to the Investment Manager's mandate. The OCIO will be responsible for making choices about additions or withdrawals to or from different Investment Managers, as per Section B. Roles and Responsibilities.

I. Meeting Schedule

The Investment Committee and OCIO will meet in person or via conference call to review the performance and Endowment’s compliance with objectives and guidelines at least four times per year.

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J. Conflict of Interest Policy

Any situation which brings to mind the question of a possible conflict of interest should be brought to the attention of the Investment Committee; members should be sensitive to even the appearance of impropriety. Generally, a conflict of interest exists whenever litigation, a contract, or other relationship being entered into, reviewed, or modified is:

- Between ABC and the member, or the employer, business partner, or immediate family of the member; or
- Between ABC and an organization in which the member's employer, business partner, or immediate family is a director, officer, or legal representative, or has a material financial interest.

A conflict of interest does not arise simply because directors or members of their families are incidentally benefited as members of a class of persons entitled to benefit from a transaction, policy, or program consistent with purposes and accomplished in good faith. For these purposes, "family" includes parents, siblings, children, grandchildren, and their spouses.

This policy is not intended to prohibit investing with any firms or investment managers with whom a Board Member or Committee Member is affiliated; rather such relationships must be disclosed and the affiliated Board or Committee Member should recuse himself from any decisions pertaining to the affiliated firm.

K. Interpretation of Relevant Law and Accounting Standards

The Board of Trustees has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds, absent explicit donor stipulations to the contrary. As a result of this interpretation, and the accounting guidance provided by the Financial Accounting Standards Board, the Institute classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowments, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets appropriated for expenditure by the Institute in a manner consistent with the standards of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Institute considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

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. The investment policy of the institution

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L. Policy Review

This Investment Policy Statement will be reviewed annually by the Investment Committee and be either reaffirmed or amended.

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SAMPLE INVESTMENT MANAGER GUIDELINES

A. Discretion

Investment Managers shall have discretion in the management of the assets subject to the policies and guidelines set forth herein, and in manager specific investment advisory agreements or fund terms. Compliance with such policies, guidelines, agreements, and fund terms is the responsibility of each Investment Manager.

B. Performance Measurement and Evaluation

Investment performance for the overall portfolio as well as for each Investment Manager is best measured over appropriate time horizons: five plus years for the overall portfolio; seven to ten years for public equity, private equity, and real assets funds; and two to five years for hedge funds and fixed income investments. It is understood however that these longer measurement periods are comprised of a series of shorter intervals in which there will be measurable investment performance. The performance of Investment Managers and for the portfolio as a whole will be quantitatively and qualitatively analyzed after each calendar quarter in the context of these longer term objectives.

Investment Managers will provide, at least quarterly, an account statement that includes the account balance, investment performance relative to benchmarks, and investment segments and exposures (including credit, geographic, and currency exposure as appropriate).

C. Use of Cash Equivalents

Cash equivalents may be held in any Investment Manager's portfolio at the Investment Manager's discretion. Investment Managers will be evaluated based upon the performance of their total fund component relative to the appropriate index benchmark, regardless of the amount of cash equivalents held during any performance measurement period.

D. Review and Evaluation by OCIO of Prospective Investment Managers

Each prospective Investment Manager will be required to provide the following information as part of an initial review and evaluation. Any material changes should be reported to the OCIO.

1. Organizational structure and process
2. Detailed description of investment strategy
3. Performance history with comparison to relevant benchmarks and peer groups
4. Policies with regard to use of leverage and derivatives
5. Diversification and concentration limitations
6. Liquidity terms and restrictions or limitations on withdrawals
7. Valuation methodology and practices
8. Compliance and ethics policies, including any material violations or exceptions
9. Fees, including any use of rebates or soft dollars
10. Any potential conflicts of interest with the ABC Institute

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E. Derivatives Policy

Individual Investment Managers may utilize derivative securities only in a manner consistent with the manager's stated investment philosophy and the manager-specific guidelines described above. It is expected that Investment Managers adopt and follow practices and procedures for measuring and controlling risk that specifically address the exposure to loss inherent in derivatives and other highly speculative investments.

F. UBTI Policy

All efforts will be taken to ensure that no investment will jeopardize ABC Institute's tax exempt status. Generation of unrelated business taxable income "UBTI" should be minimized if possible. Investments that have the potential to generate UBTI will be considered for the Endowment only if the contribution to the investment portfolio is expected to be sufficient to outweigh the negative tax and accounting implications.

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SPENDING POLICY EXAMPLES

Example 1

Under the Endowment spending policy, the payout is set as a dollar amount and increased by the rate of inflation each year within a band. The increase each year is the greater of 2% or the actual rate of inflation based on the most recent CPI, with a maximum annual increase of 5%. In addition, the annual draw from the Endowment shall be no less than 4% and no greater than 7% based on the prior year-end market value of the Portfolio.

Example 2

The Board of Trustees sets the spending policy with input from the Investment Committee. The current annual draw rate is 5% multiplied by the average of the prior twelve quarter-ending Endowment values. In addition, annual draws are subject to a “collar”: the minimum draw in any particular year should be 4% applied to the most recent fiscal year-end portfolio value, and the maximum draw should be 6% applied to the most recent fiscal year-end Endowment value. The smoothing policy serves two purposes. First, it provides for more consistent and predictable spending for the programs supported by this Endowment. Second, it allows the Investment Committee to design an investment strategy which is more "aggressive" with a higher expected return than might be the case if spending were determined by annual investment performance. The application of a “collar” to the moving average has the benefit of mitigating extreme market outcomes.

Example 3

The College employs a total return Endowment spending policy that establishes the amount of investment return made available for spending. The Board of Trustees determines and implements the spending policy based on investment returns and the needs of the College. Investment staff provides input to the Board of Trustees Finance Committee regarding expected return of the Portfolio, a critical variable in the spending policy.

Example 4

The Investment Committee will attempt to balance the Endowment’s shorter-term distributions with its goal to provide for distributions in perpetuity and therefore design a spending policy which is flexible. It is currently anticipated that contributions to the Endowment will be greater than draws from it for a number of years, and that net draws of 5% or more are not anticipated until FY 20XX, if not later. However, contributions and distributions are expected to be inconsistent, and a target of at least $[X] million should be maintained in cash equivalents in the Endowment.

Example 5

The Investment Committee will calculate annual spend by a combination of: 1) 80% of the previous year’s spending (adjusted for inflation) and 2) 20% of the target spend rate (5%) multiplied by the average endowment value of the last fiscal period. The intent is to smooth the budgeted draws over the long-term and make them less susceptible to changes in market conditions, with annual draws being no less than 4% and no more than 6%.

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