

# **PACIFIC LUTHERAN UNIVERSITY ENDOWMENT**

## **Statement of Investment Objectives and Policies**

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## Executive Summary

### References

The Pacific Lutheran University Endowment (Managed Assets) hereto will be referred to as the Endowment and Pacific Lutheran University as the Client.

### Overview

<b>Assets covered by policy</b>	
	<b>Total Portfolio</b>
<b>Investment Objectives</b>	Growth and Capital Appreciation
<b>Performance Objectives</b>	Outperform a policy index based on strategic asset allocation weights to market indices.
<b>Time Horizon</b>	Long-Term (10 years)
<b>Risk Tolerance</b>	High: possibility of loss over a 5 year time period

### Strategic Asset Allocation Targets and Performance Objectives

<b>Asset Class Represented</b>	<b>Total Portfolio</b>	<b>Allocation Ranges</b>	<b>Policy Benchmark Index</b>
Equity	60%	40-75%	MSCI ACWI
Fixed Income	30%	15-45%	Bloomberg Barclays Universal
Real Assets	10%	0-20%	1/3 Bloomberg Commodities Index 1/3 NAREIT 1/3 TIPS
Cash	0%	0-10%	Bloomberg Barclays US Treasury Bill 1-3 Months

## I. PACIFIC LUTHERAN UNIVERSITY ENDOWMENT OVERVIEW

Pacific Lutheran University's Endowment is composed primarily of investment assets owned and directly controlled by the University, but may contain assets managed entirely by and under custody of third parties. Assets held and under custody of third parties are typically held and managed by banks or brokerage firms under various arrangements made independently by University donors.

**General Investment Orientation and Goal.** The primary purpose of the Endowment is to provide returns to support the financial stability of the University.

- A. The Endowment is intended to support the mission of PLU in perpetuity, implying an objective to maintain the purchasing power of the Fund net of spending and inflation over the long term.
- B. Spending from the Endowment is also a critical source of PLU's revenue, creating an objective for stability in Endowment spending.

These two objectives are in some tension, and the Endowment's investment strategy and spending formula will be developed to balance them.

**UPMIFA.** The funds held by the Endowment, except any program-related investments, are "institutional funds" within the meaning of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), became effective in the state of Washington on July 1, 2009. The primary requirements of UPMIFA are that:

A. The Endowment shall:

- 1) consider the charitable purposes of the Endowment in investing its funds;
- 2) incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the Endowment, and the skills available to the Endowment;
- 3) make reasonable effort to verify facts relevant to the management and investment of the funds.

B. The state of Washington defines "person" as an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity. Each person responsible for investing the Endowment's funds should:

- 1) Act and make decisions in good faith and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances;
- 2) Make decisions after considering:
  - a) general economic conditions;
  - b) the possible effect of inflation or deflation ;
  - c) the expected tax consequences, if any, of investment decisions or strategies;
  - d) the role that each investment or course of action plays within the overall investment portfolio;
  - e) the expected total return from income and the appreciation of investments;
  - f) other resources of the Endowment;
  - g) the needs of the Endowment to make distributions and to preserve capital; and
  - h) an asset's special relationship or special value, if any, to the charitable purposes of the Endowment;
- 3) Make decisions about an individual asset or investment not in isolation, but rather in the context of the Endowment's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the Endowment;
- 4) Diversify the investments of the Endowment unless the Endowment has reasonably determined that, because of special circumstances, the purposes of the Endowment are better served without diversification; and similarly shall periodically make and carry out decisions to retain, dispose or rebalance the Endowment's assets to bring its funds into compliance with the provisions of UPMIFA;
- 5) Understand and agree that a person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing the Endowments' funds.

UPMIFA specifically permits the Endowment to delegate management and investment of the Endowment's funds to its committees, officers and employees; and to external agents, provided that the Endowment makes such a decision in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, in selecting the agent; establishing the scope and terms of the delegation, and periodically reviewing the agent's action to monitor the agent's performance and compliance with the terms and scope of the delegation. As further provided below, the Board of the University delegates to Investment Committee the power to decide to retain investment agents and delegate investment authority to such investment agents, provided such delegation decisions are made and implemented in a manner which complies with UPMIFA.

## **II. PURPOSE OF STATEMENT**

This Statement of Investment Objectives and Policies (the "Statement") is intended to:

- A. Outline the investment-related responsibilities of Pacific Lutheran University's Investment Committee, Investment Staff and the providers of investment services retained to assist with the management of the Endowment's assets;
- B. Establish formal, yet flexible, investment policies and guidelines to govern the investment of the Endowment;
- C. Provide a framework for regular communication between the University Administration, Investment Committee, Investment Staff, and the Endowment's providers of investment services regarding performance and compliance;
- D. Establish prudent risk parameters, appropriate asset guidelines, and realistic return objectives;

It is expected that this Statement will be reviewed annually by the Investment Committee and amended as necessary to ensure continued relevance to current capital market conditions and the needs of the Endowment. The Board of Regents will be provided a copy of the revised policy when major changes are made to it.



### III. RESPONSIBILITIES

#### **INVESTMENT COMMITTEE**

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The primary investment-related responsibilities of the Investment Committee, with assistance from Investment Staff and the Outsourced Chief Investment Officer ("OCIO"), shall be to:

- A. Develop, review, and approve this Statement of Investment Objectives and Policies;
- B. Evaluate, engage, monitor, and remove an OCIO or develop an alternative staffing model;
- C. Develop, review and approve investment strategy and asset allocation for the Endowment's investments;
- D. Review and approve a new investment consultant or OCIO, and Custodian Banks recommended by Investment Staff; and determine the scope of investment authority delegated to each one;
- E. Monitor Investment Managers within the Endowment's investments;
- F. Evaluate, engage, monitor, and remove any other service providers for the Endowment's investments, such as Custodian Banks;
- G. Review quarterly information regarding the Endowment's investment structure and performance against established objectives and policies, including reports on the investment managers.

#### **INVESTMENT STAFF**

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The Investment Staff is responsible for the day-to-day investment-related activities of the Endowment. The Investment Staff will work closely with the OCIO to complete its responsibilities, and in many cases relies on the OCIO to supply independent advice and support for the completion of those responsibilities. The Investment Staff will also refer questions to the OCIO. The Investment Staff shall:

- A. Compile and process statements from Investment Managers used in the financial reporting for the University;
- B. Maintain files of statements and reports;

## **OUTSOURCED CHIEF INVESTMENT OFFICER - OCIO**

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The OCIO must be independent, receiving no compensation from any investment manager or service provider, in order to avoid completely conflicts with the Endowment's best investment interests. The OCIO would be responsible for:

### **A. Risk Assessment & Asset Allocation**

- 1) Assisting in the development of investment policies, objectives, and guidelines;
- 2) Incorporating into the asset allocation process an assessment of the risk tolerance of the University;
- 3) Executing asset allocation strategies including the appropriate weightings of the Endowment's investments among the major asset classes (e.g., equities, fixed income securities, real assets, multi-strategy) within allowable ranges set in this IPS;
- 4) Periodic rebalancing of asset class weightings and manager weightings, and making tactical shifts to the asset allocation, within allowable ranges set in this IPS, as capital market movements cause the actual weightings to diverge significantly from the target weightings.

### **B. Investment Managers**

- 1) Screening, identifying, evaluating, and hiring investment managers for the Endowment's investments to the Investment Committee;
- 2) Monitoring investment managers used in the Endowment's investment structure, terminating managers where appropriate, and providing reports as described below.

### **C. Reporting**

- 1) Preparing quarterly summary reports of the Endowment's investment portfolio and overall compliance with the Statement for the Investment Committee, including returns, risks, style drift, risk profile, and organizational developments;
- 2) Attending Investment Committee meetings to present evaluation reports no less than semi-annually and at other meetings as requested;
- 3) Reviewing contracts and fees for both current and potential investment managers and Custodians;
- 4) Providing research on specific issues and opportunities, and assisting the Committee in special tasks;
- 5) Identifying potential areas of risk within the investment portfolio and reporting to the Investment Committee on these risks;
- 6) Provide monthly performance reports to Investment Staff.
- 7) Periodic rebalancing of the Endowment's assets according to investment category and manager weightings as capital market movements cause the actual weights to diverge significantly from the target allocations;
- 8) Communicating investment policies and objectives to the investment managers, and monitoring their adherence to such policies and reporting all violations.

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**CUSTODIAN BANK(S)**

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Investment Staff reserves the right to engage a Custodian Bank. If hired, the Custodian Bank(s) is responsible for:

A. Safekeeping of Securities

Hold all Endowment securities in appropriately segregated accounts electronically or physically, providing highly secure storage of physical stock certificates and bonds such that there is essentially no risk of loss due to theft, fire, or accident.

B. Settlement of Trades

Arrange for timely and accurate settlement of all purchases and sales of individual securities made for the Endowment, recognized on a trade date basis.

C. Collection of Income

Provide for receipt and prompt crediting of all dividend, interest, and principal payments, monitor income receipts to ensure that income is received when due, and institute investigative process to track and correct late or insufficient payments, including reimbursement for any interest lost due to tardiness or shortfall.

D. Cash Sweep

Sweep cash daily into an interest-bearing investment vehicle that has a high degree of safety of principal and liquidity.

E. Reporting

Provide monthly reports to the Endowment showing individual assets and transactions, including at least descriptive detail, units owned by the Endowment, cost basis, unit price on the report date, market value, CUSIP (when available), purchases, sales, maturations of securities, dividends, interest, deposits, withdrawals, fee payments and any other information requested by Investment Staff

F. Transfer

At the direction of the individuals specifically appointed by the Budget and Finance Committee, expeditiously transfer funds into and out of specified accounts.

G. Proxy Materials

The Custodian Bank(s) shall promptly forward all proxy materials received to the appropriate Investment Manager.

H. Class Action Lawsuits

Manage a program to track all class action lawsuits involving issuers of securities under safekeeping for the Endowment by the Custodian Bank(s), and ensure that all appropriate filings are made for the benefit of the Endowment.

#### IV. INVESTMENT OBJECTIVES

**Return Objective.** The long-term goal of the Endowment's investment program will be to develop and implement an investing strategy that will, as closely as possible, permit the Endowment to achieve, over the long term and not necessarily year-by-year, a real net rate of total return (i.e. total return less expenses) which equals or exceeds the general inflation rate plus the annual spending amount. The Endowment has a long-term investment horizon, but seeks to generate positive investment returns regularly.

**Risk Objectives.** The Endowment recognizes that it is not possible to earn consistent returns above inflation without taking some investment risks. Specific guidelines on acceptable risks for the Endowment's investments, measured in various ways, are described in a later section of this statement. These guidelines are in place to maintain a balance between Endowment spending and the protection of the real value of the Endowment principal in order to provide reasonably stable and predictable funds from the Endowment for the University's operating budget.

## V. INVESTMENT POLICIES

### INVESTMENT STRATEGY AND ASSET ALLOCATION

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#### A. Diversification

The Endowment's investments will be diversified across various types of investments known as "asset classes." The guidelines for diversification are detailed in the Risk Guidelines section below.

#### B. Broad Asset Classes

The Endowment's assets will be allocated to three main asset classes: equities, fixed income securities, and real assets. The Endowment segregates investments into these three main asset classes for purposes of monitoring Key Market Exposures within the portfolio, as described in the Risk Guidelines below. These broad asset classes each play a distinct role in the Endowment's investment structure:

- 1) Equities can include strategies such as global equities, domestic equities, international equities, and emerging markets equities through separate accounts, mutual funds, and commingled funds for long-only equities, and limited partnerships and mutual funds for long/short equities and private equity.
- 2) Fixed income can include strategies such as global bonds, domestic fixed income securities, international, and emerging markets debt instruments through separate accounts, mutual funds, and commingled funds for long-only fixed income, and limited partnerships and mutual funds for long/short fixed income and opportunistic structures. Securities can include Treasuries, U.S. government agency securities, asset-backed securities, and other sovereign bonds, as well as corporate bonds, other non-agency securities, and derivatives on any of the aforementioned securities.
- 3) Real assets refer to investments or strategies in real property, buildings and developments, timber, or commodities through public mutual funds, commingled funds, and private partnerships, all of which generally respond more directly to changes in inflation. Real Assets may also include strategies with a real return objective (e.g. "CPI + 5%"). The goal of the Endowment's allocation to real assets is to hedge against unexpected inflation, in order to maintain the real purchasing power of the Endowment's future grants.

Each of these three broad asset classes may include investments that are publicly-traded securities, private investments, long positions, and short positions, all subject to the Risk Guidelines below.

### C. Review and Establishment of Asset Allocation Targets

The Investment Committee will periodically review asset allocation, based on longer-term changes in market conditions and the relative moderate-term risks and opportunities available in different asset classes. The current asset allocation targets are found in Appendix B.

The Endowment recognizes that “market timing,” or making significant short-term deviations from this neutral position, can be a volatile and risky strategy; however, some investment managers may be used who operate in more than one of these three broad asset classes, and it is understood that prudently shifting allocations among asset classes may be a part of those Managers’ systematic investment processes, subject to the Risk Guidelines below. Those allocation shifts are deemed to have been delegated to those Investment Managers, consistent with those Managers’ absolute return objective. Any asset allocation shifts made by Managers will be closely monitored to assure continued compliance with the Endowment’s, and the Managers’, responsibilities according to this Statement. The Endowment will avoid investing in Managers with loosely defined investment mandates.

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**MUTUAL, COMMINGLED, AND ALTERNATIVE FUNDS**

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The Endowment will generally give Investment Managers broad latitude to invest in a wide variety of securities and instruments, subject to each Investment Manager's particular area of expertise. This is due to the absolute return objective of the components of the Endowment's investment portfolio. The majority of the Endowment's investments will be made in pooled vehicles such as commingled funds, mutual funds, or other commingled fund structures for alternative investments. As the Endowment cannot direct the particular investment policies of these types of funds, it is understood that these funds will be governed by their own written investment guidelines and fund documents. The following do not apply to investments that are not controlled by the University.

Nevertheless, the broad guidelines outlined below will govern the selection and retention of appropriate vehicles:

A. Aggregate Assets

Investment Staff, the Investment Committee, and OCIO will determine for each Investment Manager whether the level of aggregate assets under management 1) are too low to ensure sufficient diversification, efficient trading, and economies of scale in administrative expenses and transaction costs or 2) have reached a size where they are causing the Investment Manager to deviate from the portfolio construction methods upon which the performance record was built.

B. Personnel

Investment Staff, the Investment Committee, and OCIO will monitor the organizations providing investment management services to the mutual or commingled funds, and report any changes which may negatively affect the consistency of investment method.

C. Expenses

Investment Staff, the Investment Committee, and OCIO will monitor both management fees and administrative expenses, to ensure that expense levels are appropriate and reasonable, and within normal and customary ranges.

D. Portfolio Characteristics

Investment Staff, the Investment Committee, and OCIO will establish general expectations of each fund's or pool's aggregate portfolio characteristics to create proper diversification within the Endowment's portfolio as a whole, fulfill specific needs or purposes within the portfolio, and comply with the investment strategy and asset allocation policy.

## **RISK GUIDELINES**

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### **A. Diversification**

- 1) **ACROSS DIFFERENT ASSET CLASSES:** The Endowment will be diversified across three broad asset classes: equities, fixed income securities, and real assets. No single broad asset class may be greater than 70% of the Endowment's investments.
- 2) **AMONG INVESTMENT MANAGERS:** The Endowment will be diversified across several external investment managers. No single strategy of an investment manager will represent more than 15% of the Endowment's investments, with the exception of full replication passive index funds.
- 3) **WITHIN AN INVESTMENT MANAGER'S ORGANIZATION:** The Endowment's investment with any single investment manager will not comprise more than 10% of that manager's firm-wide assets under management.
- 4) **AMONG SECURITIES (POSITIONS):** For investment managers who conduct an investment process that is intended to result in a diversified portfolio, single position sizes in excess of 10% of that investment manager's portfolio will be highlighted in the quarterly report to the Investment Committee. For investment managers who conduct an investment process that is expected to result in a concentrated portfolio, the degree of concentration must be monitored by the Consultant and included in the Consultant's quarterly report to the Investment Committee.

### **B. Transparency**

Investment managers must supply to the Investment Committee and/or the OCIO a sufficient level of position and risk transparency to allow for a thorough review of risk of the investment managers' portfolio, and to allow for integration of the manager's portfolio risk with the risk reporting conducted by the OCIO for the Investment Committee.

### **C. Leverage**

The Endowment understands that "leverage" is an attempt to quantify the exposure of an Investment Manager's portfolio, not necessarily that portfolio's risk. The Endowment recognizes that leverage can be a useful tool for investment managers, but it must be used judiciously, subject to an investment manager's experience and the overall volatility of the investment category and strategies/structures employed.

- 1) **MEASUREMENT:** For purposes of this Statement, and for ongoing monitoring of investment managers and the aggregate investments of the Endowment, "leverage" will be defined as the notional long exposure of a portfolio plus the absolute value of the notional short exposure of that portfolio, divided by net capital. For example, a "fully-invested" traditional (long-only) portfolio would have a leverage of one.
- 2) **LIMIT:** The Endowment's aggregate leverage across all investments may not exceed 1.5 times. Any leverage exceeding one must be due primarily to risk-mitigating positions such as short positions that offset long positions. The



Endowment will avoid highly levered investment strategies, and strategies that rely on leverage simply to boost performance.

D. Volatility

- 1) MEASUREMENT: For purposes of this Statement, and for ongoing monitoring of investment managers and the aggregate investments of the Endowment, "volatility" will be defined as the annualized standard deviation of total returns.
- 2) LIMIT: The Endowment's aggregate volatility is expected to be less than a blend of 60% the volatility of global equities, as measured by the MSCI ACWI IMI Index, and 40% of U.S. fixed income securities as measured by the Barclays Capital U.S. Aggregate Bond Index over any three-year period. Any one of the investment managers for the Endowment may exhibit volatility greater than this limit, but in that case the manager must provide significant diversification benefits to the aggregate Endowment investment portfolio so that the aggregate portfolio remains within this volatility risk limit.

E. Key Market Exposure

- 1) MEASUREMENT: For purposes of this Statement, and for ongoing monitoring of Investment Managers and the aggregate investments of the Endowment, Key Market Exposure is the primary measure of the portfolio's risk within an asset class. By no means are the guidelines below the sole way to measure risk within an asset class portfolio; however, the OCIO will monitor and report quarterly on the Endowment's exposure to at least the following specific Key Market Exposures:
  - a) For Equity: "Net Market Exposure", defined as the notional market value of long positions, minus the notional market value of short positions.
  - b) For Fixed Income: "Duration", defined as effective interest rate duration.
  - c) For Real Asset: "Net Market Exposure", defined as the notional market value of long positions, minus the notional market value of short positions.
- 2) LIMITS:
  - a) For Equity: "Net Market Exposure" of the aggregate of the Endowment's equity managers may not exceed 1.5 times capital.
  - b) For Fixed Income: "Duration" of the aggregate of the Endowment's fixed income managers may not exceed the 1.5 times the duration of the Barclays Capital Global Aggregate Bond Index (or whatever benchmark is deemed most appropriate for the Endowment's liabilities, as may be determined from time to time).
  - c) For Real Asset: "Net Market Exposure" of the aggregate of the Endowment's real asset managers may not exceed 1.5 times capital.

F. Ethical Standards and Conflicts of Interest

Investment decisions shall be based on professional integrity and competence, financial merit and benefit to the Endowment, and, if required or prudent, on a competitive basis. Decisions shall not be based on any family or personal relationships.

**PERFORMANCE STANDARDS**

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Performance standards, or benchmarks, are primarily used by the Investment Committee to measure and evaluate the success of the portfolio relative to the Endowment's long-term investment objectives. Benchmarks are also used to assess the effectiveness of the Investment Committee, the OCIO, and Investment Managers. These multiple goals necessitate the use of multiple benchmarks.

1. Long-Term Objective: Maintain Intergenerational Equity  
The total return of the investment portfolio should maintain purchasing power (inflation) and offset draws (spending). Therefore, the total return should exceed inflation plus 5% annually.
2. Allocation Index  
Over a market cycle, the total return of PLU's managed investments, excluding externally controlled investments, should exceed the rate of return of an Allocation Index. The Allocation Index is the return earned by applying the actual managed pool weights to the policy benchmarks defined below.

<u>Broad Asset Class</u>	<u>Market Benchmark Index</u>
Equity	MSCI All Country World IMI
Fixed Income	Barclays U.S. Aggregate Index
Real Assets	Real Assets Composite Index: 1/3 Bloomberg Commodity Index 1/3 FTSE/NAREIT Global Index 1/3 U.S. TIPS 1-10 Year Index

**REBALANCING**

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Investment Staff and the Investment Committee, in consultation with the OCIO, will periodically review the balances invested in the asset classes and compare them with the target asset allocation. This review will be conducted at least quarterly. As

necessary, the Investment Committee, with the assistance of the OCIO, will have the authority to rebalance investments across managers and asset classes, approved by the Investment Committee, to keep the Endowment's investments reasonably close to the Endowment's asset class targets, subject to available liquidity. A report of the Endowment's actual asset class allocations will be provided to the Investment Committee at least quarterly.

### **ENDOWMENT CASH**

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The endowment cash is commingled with University operating cash for the purpose of investment and will conform to the University operating cash investment policy.

### **UNIVERSITY REAL ESTATE**

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The endowment may include real estate properties either given to the University, or acquired by the University due to their location within the University's strategic footprint. While part of the Endowment's real asset allocation for asset allocation purposes, these assets have a separate investment policy and oversight for these investments is the joint responsibility of the Real Property Committee and the Investment Committee.



### **Current Spending Rate**

The Endowment's Spending Rate is **4.50%** per annum and shall be applied on a 12 quarter average market value.

Spending distributions on new endowment funds will be delayed for a minimum of one year from receipt of the donation in order to build a reserve for future spending distributions.



**Current Asset Allocation Targets**

<b>Asset Class</b>	<b>Target</b>	<b>Minimum</b>	<b>Maximum</b>
Equities	<b>60%</b>	40%	75%
Fixed Income / Cash	<b>30%</b>	15%	45%
Real Assets	<b>10%</b>	0%	20%
Cash	<b>0%</b>	0%	10%
<b>Total</b>	<b>100%</b>		