

STATEMENT OF INVESTMENT POLICY
BOARD OF ADMINISTRATION
POLICE AND FIRE DEPARTMENT RETIREMENT PLAN
May 6, 2010

GENERAL ENVIRONMENT

Investments in the San Jose Police and Fire Department Retirement Plan are subject to the restrictions specified in the San Jose Municipal Code 3.36.540. Further investment management guidelines are imposed by the Board of Administration.

INVESTMENT GUIDELINES

General

The Board Shall:

- (1) Require that the Retirement System be actuarially sound to assure that all disbursement obligations will be met.
- (2) Attempt to insure that investment earnings be sufficiently high to provide a funding source, along with contributions from City employees and the City, in order to offset liabilities in perpetuity.
- (3) Strive for the highest total return on invested funds consistent with safety in accordance with accepted investment practices.
- (4) Have the authority to grant specific exceptions to any part of the Investment Policy Statement where in their judgment the exception may add value to the fund without undue risk.

Asset Allocation

The following policy has been identified by the Board of Administration as having the greatest expected investment return, and the resulting positive impact on asset values and funded status without exceeding a prudent level of risk. The Board determined this policy after evaluating the implications of increased investment return versus increased variability of return for a number of potential investment policies with varying commitments to stocks and bonds.

It shall be the policy of the Plan to invest its assets in accordance with the maximum and minimum range, valued at market, for each asset class as stated below:

Asset Allocation from October 1, 2004 – June, 30 2008.

Asset Class	Minimum	Target	Maximum
Domestic Equity	29%	34%	39%
International Equity	10%	20%	25%
Emerging Market Equity	0%	5%	8%
Domestic Fixed Income	15%	20%	25%
Long Duration Fixed Income	0%	4%	7%
Real Estate	0%	12%	17%
Private Market Equity	0%	5%	8%

Asset Allocation from July 1, 2008 to September 29, 2009.

Asset Class	Minimum	Target	Maximum
Equity	41%	49%	57%
Large Cap		22%	
Small/Mid Cap		5%	
Developed International		17%	
Emerging Markets		5%	
Fixed Income	15%	23%	31%
Core Fixed Income		18%	
Opportunistic Strategies		5%	
Alternatives		28%	
Real Estate		10%	
Private Equity		8%	
Absolute Return		5%	
Real Assets		5%	

Asset Allocation as approved by the Board on October 1, 2009

Asset Class	Minimum	Target	Maximum
Equity	30%	40%	50%
U.S. Large Cap		18%	
U.S. Small Cap		5%	
Non-U.S. Developed Mkts		12%	
Non-U.S. Emerging Mkts		5%	
Fixed Income	15%	25%	35%
Core Fixed Income		5%	
TIPS		10%	
Long Bonds		5%	
Opportunistic Credit		5%	
Alternative Assets	10%	35%	60%
Private Equity	0%	5%	10%
Real Estate	5%	10%	15%
Inflation-Linked Assets	5%	10%	15%
Absolute Return	0%	5%	10%
Opportunistic	0%	5%	10%

The Plan's asset allocation will be reviewed relative to the targets on a semi-monthly basis and action will be taken to re-balance to within the target ranges by means of asset transfers among the categories.

When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation of the Plan.

The general guideline for re-balancing the portfolio would be when the allocation to a particular asset class reaches 95-100% of the maximum or 100-105% of the minimum; the fund will be re-balanced to the within the policy range over the following 60 days.

At any point in time, it is understood that the fund managers may not be fully invested. However, managers are expected to be fully funded and cash positions in excess of 7% require the manager to notify the Board of Administration in writing. While the Plan's assets may be partially invested in cash equivalents, for asset allocation purposes these funds shall be considered invested in the asset classes of the respective managers. In turn, each manager's performance will be evaluated on the total amount of funds under its management.

The asset allocation ranges established by this investment policy represent the long-term perspective. As such, rapid unanticipated market shifts may cause the asset mix to fall outside the policy range. Any divergence should be of a short-term nature. The Board of Administration will review the asset mix of the Plan on a quarterly basis and cause the asset mix to be rebalanced to within the policy range as necessary.

Investment managers may request temporary exemptions from guideline limits by submitting written requests to the Board of Administration for prior approval. For special situations, the Board of Administration can grant special exemptions from the guidelines. In no case can a manager actively exceed guideline limits without formal prior approval by the Board.

Diversification

Investment diversification is consistent with the intent to minimize the risk of large losses to the Plan. Consequently, the total fund will be constructed by the individual portfolio managers to attain prudent diversification in several asset classes. To ensure adequate diversification, no manager will hold more than 5% of its portion of the total Plan assets in any single security with the exception of government backed securities and real estate equity. As a general rule, Plan assets placed with an investment manager will not represent more than 10% of that manager's total assets.

Volatility

Consistent with the desire for adequate diversification, the investment policy is based on the assumption that the volatility (the standard deviation of returns) of the portfolio will be relative to that of the market. Consequently, it is expected that the volatility of a commitment-weighted composite of the market indices, e.g., S&P 500 Index for stocks and Barclays Capital Aggregate Bond Index for bonds and U.S. T-Bills for cash, will be commensurate with the Plan's volatility.

Liquidity

Presently there is not a requirement to maintain significant liquid reserves for the payment of pension benefits. The Board has authorized the Board of Administration Secretary to review the projected cash flow requirements at least annually and indicate to investment managers the required liquidity.

Contributions are expected to be in excess of net benefit payments over the foreseeable future, resulting in a positive cash flow, which will be reinvested by the fund manager who receives the cash flow.

Commingled Funds

Investment in any of the allowed asset classes may be implemented through an investment in a pooled or commingled fund. Pooled funds and other types of commingled investment vehicles provide, under some circumstances, lower costs and better diversification than can be obtained with separately managed funds pursuing the same investment objectives. Commingled investment funds cannot customize investment policies and guidelines to the specific needs of individual clients. Whenever an investment is made through a pooled fund, the statement of investment policy of the pooled fund will override this Plan's policy. However, the Investment Manager of the pooled fund shall advise the Investment Committee, in writing, of the sections of this policy that may be violated.

Fixed Income

The Board shall require that the majority of the fixed income portfolio be invested in high quality, (investment grade) marketable bonds as provided in Section 3.36.540. Whether a global fixed income manager is employed, or separate domestic and international fixed income managers are employed, they are to invest in accordance with the following guidelines (please refer to section entitled INVESTMENT GUIDELINES, General (4) for exception policy):

- (1) Portfolio investments will be composed primarily of fixed income securities (including short-term obligations) denominated in either United States or foreign currencies. Securities may be issued by domestic or foreign governments, domestic or foreign government agencies and instrumentalities, international banks or other international organizations, corporations or other forms of business organizations.
- (2) The investment manager may also purchase securities of other categories. These investments may be used within prudent limits to manage risk, lower transaction costs, or augment returns as long as leverage is not applied. The manager will invest the assets at such times, in such amounts and in such investments as the manager shall determine in its discretion.
- (3) Deposits in banks or banking institutions, domestic or foreign, may be made. Because the fundamental objective is to enhance the rate of return calculated in U.S. dollars, and currency exchange gains and losses are included in the

calculation of total return, currency hedging shall be permitted, at the discretion of the manager, to protect the value of specific investments in U.S. dollar terms.

- (4) All bonds and notes in which the assets are invested, and which mature one year or more from the date of original issues, shall carry a rating of "BBB" or better by two of the following three rating services: Standard & Poors, Moodys Investor Services, or Fitch. In the event that ratings are provided by only two agencies and the third is non-rated, the most conservative (lowest) rating will be assigned. If only one agency assigns a rating, that rating will be used; or, if unrated, shall be of equivalent quality in the judgment of the investment manager to a similar domestic issue. Managers may, with prior written authorization, invest a maximum of 20% of their fixed income portfolio in bonds or notes that are rated B or BB.
- (5) If bonds are downgraded below the minimum credit quality allowable in the guidelines at the time of purchase, the Manager is permitted to hold up to 2% of the Plan's portfolio managed by the individual manager, using the lower of S&P, Moody's, and Fitch's rating in the event of a split-rated security. The Manager will continue to notify staff of the downgrade and confer with staff as to whether the security will continue to be held or disposed. The Manager will also provide quarterly reporting on the downgraded securities.
- (6) The fund will be valued in United States dollars on the last business day of each month and on such other "Valuation Dates" as the Board may deem appropriate. For valuation purposes, all foreign currency, foreign deposits and securities quoted in foreign currencies shall be converted into dollars pursuant to methods consistently followed and uniformly applied.
- (7) The manager may invest a portion of the assets in commingled accounts with specific mandates such as high yield trust funds with prior approval by the Board. The average credit quality of the commingled account shall be a "B" or better rating.

Domestic Common Stock

The primary emphasis of the common stock portfolio will be on high quality, readily marketable securities offering potential for above average return as protection against inflation. Common stock investments are limited to those meeting all of the following criteria (please refer to section entitled INVESTMENT GUIDELINES, General (4) for exception policy):

- (1) Investment in any corporation shall not exceed 5% of the outstanding shares of the corporation.
- (2) Not more than 5% of the total assets at market may be invested in preferred stocks.
- (3) Not more than 5% of any Investment Manager's portfolio at market shall be invested in the common stock of any corporation, except when:

- The security has a weighting greater than 5% in the manager's benchmark and
 - The manager has received prior written permission from the Director, Retirement Services. The Director will then inform the Investment Committee of any exceptions that were granted.
- (4) The manager will invest the assets at such times, in such amounts and in such investments as the manager shall determine in its discretion.
- (5) Upon the Investment Committee approval, a manager may invest in convertible securities.

International Common Stock

The following are guidelines for International Equity portfolios (please refer to section entitled INVESTMENT GUIDELINES, General (4) for exception policy):

Developed Markets

- (1) The portfolio will be invested in non-U.S. common stocks. Investment in American Depository Receipts (ADR's) is permitted but they will not be considered U.S. equities. U.S. equities are not permitted. The maximum amount of developed markets international common stock to be held is 20% of the Fund's total assets valued at market. The Board will cause the asset mix to be rebalanced to remain within the 20% restriction. A maximum of 20% of a manager's international equity portfolio may be invested in emerging markets.
- (2) Holding cash or cash equivalents, either U.S. or non-U.S., for the purpose of protecting the portfolio against perceived adverse equity market conditions abroad, will not be permitted. However, while the manager is expected to remain fully invested over time, cash and cash equivalent holdings will be permitted up to maximum of 7% of the manager's portfolio for the purpose of making country and security adjustments to the portfolio. Cash positions in excess of 7%, except for pending transactions, require the manager to notify the Board of Administration in writing.
- (3) To ensure proper diversification, the fund will be invested in a wide variety of economic sectors and countries. No one equity position will represent more than a total of 5% of the portfolio.
- (4) Upon the Investment Committee approval, a manager may invest in convertible securities.

Emerging Markets

- (1) The portfolio will be invested in non-U.S. common stocks. Investment in American Depository Receipts (ADR's) is permitted but they will not be considered U.S. equities. U.S. equities are not permitted. The maximum amount of emerging international

common stock to be held is 8% of the Fund's total assets valued at market. The Board will cause the asset mix to be rebalanced to remain within the 8% restriction

- (2) Holding cash or cash equivalents, either U.S. or non-U.S., for the purpose of protecting the portfolio against perceived adverse equity market conditions abroad, will not be permitted. However, while the manager is expected to remain fully invested over time, cash and cash equivalent holdings will be permitted up to maximum of 7% of the manager's portfolio for the purpose of making country and security adjustments to the portfolio. Cash positions in excess of 7%, except for pending transactions, require the manager to notify the Board of Administration in writing.
- (3) To ensure proper diversification, the fund will be invested in a wide variety of economic sectors and countries. No one equity position will represent more than a total of 5% of the portfolio, except when:
 - The security has a weighting greater than 5% in the manager's benchmark and the manager has received prior written permission from the Director, Retirement Services. The Director will then inform the Investment Committee of any exceptions that were granted.

High Yield Bonds and Bank Loans:

The High Yield Bonds and Bank Loans portion of the plan assets shall be invested predominantly in below investment grade securities and bank loans. The investment managers employed to manage high yield and bank loan instruments will have discretion in the day-to-day management of assets under their control. The high yield and bank loan managers shall have discretion to invest in all the instruments allowed for investment by the domestic bond managers, plus the investments that meet the following criteria:

- (1) At the time of purchase at least 95% of the instruments must have a minimum rating of B- or B3, or if unrated, of a comparable quality rating as determined by the Investment Manager. Should more than 5% of a portfolio fall below this standard, the investment manager shall notify the Board of the downgrade immediately and submit a plan for returning the portfolio to the standard.
- (2) U.S. corporate bonds, including zero-coupon, step-up, convertible, toggle and pay-in-kind bonds and Non-dollar corporate bonds (which should be hedged), Private placement securities, Bank loans, participations and assignments.
- (3) U.S. dollar denominated bonds issued by entities not domiciled in the United States (Yankee bonds / euro bonds)
- (4) U.S. Treasury futures, Currency forward or futures contracts, and Credit default swaps may be used for hedging purposes.
- (5) No more than 3% of the portfolio shall be invested in obligations of a single non-governmental issuer.

- (6) The number of issues held, the sector and the industry diversification constraints shall be detailed in each manager's investment guidelines. The portfolio shall be appropriately diversified as consistent with the manager's stated investment approach.
- (7) Following is a summary of the manager's investment guidelines with the detailed guidelines attached as Appendix A:
- (a) Following the initial investment period, manager anticipates minimal turnover and the manager will be expected to hold the bonds to maturity. Sales or exchanges will only occur due to credit impaired assets or defaults.
 - (b) Following are the benchmarks to be used:
 - Bank Loans: The CSFB Leveraged Loan Index with a maximum of 20% in High Yield Corporate Bonds .
 - High Yield: Merrill Lynch High Yield BB-B Rated Index (HOA4).
 - (c) Bank loan securities should be purchased only from corporations that also issue high yield bonds and cannot exceed 20% of the portfolio (at the time of purchase).
 - (d) Diversification Requirements & Portfolio Construction

The portfolio shall be managed within the following parameters:

- Maximum 5% of its assets in the securities of any single issuer;
- Maximum 15% of its assets in a single industry, with the exception of any one industry which may have up to 20% of the portfolio's assets;
- Maximum final legal maturity of any issue of 7 years;
- Maximum average life of 4 years;
- Bank loans should be purchased only from corporations that also issue high yield bonds.

Issuer limits are set at time of funding and can and will fluctuate as the Client receives distributions from the portfolio.

In a situation in which a bond or loan has a put feature or is trading on a yield to call basis as a result of a potential corporate event that the manager views as a very high probability event (e.g., takeover, merger, asset sale, refinancing, etc.), the manager will treat the expected put date or event date as the final legal maturity.

- (e) Concentration Allocation [Maximum, except U.S. Treasury/Agency and Bank STIF's]:
 - Fixed Income Securities Maximum:
 - Per Issuer – Benchmark + 3%
 - Short-term Instruments Maximum:
 - Per Issuer – 4% of Portfolio
 - 20% maximum in Private Placement Securities without registration rights.
 - 25% maximum in any one industry (Merrill Lynch level 4).

Convertible Bonds:

The Convertible Bonds portion of the plan assets shall be invested predominantly in convertible securities. The Manager may invest in investment or non-investment grade rated U.S. and non-U.S. convertible securities, including convertible bonds; convertible preferred stock; bonds or preferred stock with warrants; and zero- and low-coupon convertibles across the entire credit quality spectrum. In addition, the investment manager can utilize convertible structured notes issued by third parties, as well as synthetic convertible securities created by the investment manager. The investment manager(s) employed to manage the convertible instruments will have discretion in the day-to-day management of assets under their control. The convertible bond manager(s) shall have discretion to invest in all the instruments allowed for investment by the domestic bond managers, plus the all investments that meet the following criteria:

- (1) At the time of purchase at least 95% of the instruments must have a minimum rating of B- or B3, or if unrated, of a comparable quality rating as determined by the Investment Manager. Should more than 5% of a portfolio fall below this standard, the investment manager shall notify the Board of the downgrade immediately and submit a plan for returning the portfolio to the standard.
- (2) U.S. Treasury's, U.S. corporate bonds, including zero-coupon, step-up, toggle and pay-in-kind bonds and Non-dollar corporate bonds (which may be hedged), Private placement securities, Bank loans, participations and assignments.
- (3) Non-dollar and U.S. dollar denominated bonds issued by entities not domiciled in the United States (Yankee bonds / euro bonds)
- (4) U.S. Treasury futures, Currency forward or futures contracts, and Credit default swaps may be used for hedging purposes only.
- (5) Equity securities obtained as a result of conversion must be liquidated within 60 trading days after conversion. This period may be extended upon approval by the Board.
- (6) No more than 5% of the portfolio shall be invested in obligations of a single non-governmental issuer at cost, and 8% at market value.
- (7) The portfolio shall be appropriately diversified by number of issues, geography and sector. In general, the portfolio will hold between 60-120 issues and be generally invested in a minimum of 5 countries. In addition, the portfolio allocation to any single sector will not exceed 1½ times the sector weight of the benchmark.
- (8) The general position of the portfolio is to be hedged from a currency perspective.

Real Estate

The Fund is currently moving from direct ownership of Real Estate investments to pooled funds. The transition will occur over an extended time period.

INVESTABLE INSTRUMENTS

Investment Vehicles

Real estate investments can be made through a variety of different vehicles. The following vehicles are allowed:

- **Open-end pooled funds**
- **Close-end pooled funds**
- **Separate accounts**
- **Fund of funds**
- **Real Estate Investment Trusts.**

Co-Investment and Direct Placements

Investors' rights may include opportunities for additional capital participation such as co-investment or other side-by-side direct investments opportunities. Committing capital for exercising these rights is currently prohibited. Discretionary managers may exercise the co-investment rights with pre-approval by the Board.

Private Equity

Subject to specific approval of the Investment Committee of the Board of Administration, investments may be made for the purpose of creating a diversified portfolio of private markets. Examples of such private markets investments include, but are not limited to, venture capital partnerships, leveraged buyout funds, private debt, and private placements. While it is expected that the majority of these assets will be invested within the United States, a portion can be allocated to non-US investments, with a primary focus on Europe. Investments may be made in secondary investments on an opportunistic basis (please refer to section entitled INVESTMENT GUIDELINES, General (4) for exception policy).

It is expected that these investments will typically be structured through the use of Fund of Funds managers. Therefore, it is possible that those managers would engage in direct investments or co-investments, in which the Plan would purchase majority control in individual corporate entities.

Funds that are committed, but not yet drawn down, may be invested in the Plan's small cap equity funds, as the risk/reward characteristics of these funds most closely match those of Private Equities.

The following sub-category allocations were derived to be consistent with the investable universe within private markets. The ranges reflect long-term averages, once the 5% allocation to Private Equities has been fully committed. During the initial investment period, approximately four to six years, it is expected that sub-category allocations may fall outside the approved ranges.

Sub-Category*	Minimum	Target	Maximum
Buyouts	40%	60%	70%
Venture Capital	20%	30%	50%
Debt-Related	0%	10%	20%

*International allocations and secondary investments are reflected within each sub-category

Opportunistic Strategies

Investment in any of the instruments or vehicles allowed in other section is also allowed in this section. In addition, investment in the credit market is also allowed and may be implemented through:

1. Pooled funds; Separate accounts; Limited Partnerships; or Limited Liability Company;
2. Credit linked notes;
3. Direct investment.

Direct Investment may be implemented through investments in any of the following markets and securities:

1. High Yield Bonds;
2. Leveraged Bank Loans;
3. Sovereign Emerging Market debt;
4. Distressed Debt;
5. Collateralized bond, loan or debt obligations.

Absolute Return

Absolute Return Funds, also called Hedge Funds, are private investment vehicles that are not registered with the U.S. Securities and Exchange Commission (SEC); they are offered in Limited Partnerships or Limited Liability company form.

The allowed Absolute Return Strategies are:

1. Any of the following single strategies:
 - a. Equity long/short including Absolute Return Strategies specializing in Emerging Markets, Market Capitalization, Regional, Sectoral or Global Market subsets;
 - b. Equity Market timing;
 - c. Short or dedicated short;
 - d. Distressed securities;
 - e. Merger Arbitrage;
 - f. Event driven or Risk Arbitrage;
 - g. Fixed Income Arbitrage;
 - h. Convertible Bond Arbitrage;
 - i. Equity Market Neutral;
 - j. Statistical Arbitrage;
 - k. Relative Value Arbitrage;

- l. Global Macro or Global Tactical Asset Allocation;
 - m. Managed Futures and Commodity Trading Advisors (CTA's).
2. Multi-Strategy or Fund of Funds are also allowed and combine several single Absolute Return strategies into a single portfolio. The combination provides, in some circumstances, diversification of risk in a single investment.

Real Assets

The following strategies are allowed:

a. **Commodities**

The strategy targets liquid investments in the commodities markets via derivatives (e.g. futures and swaps). Certain strategies may also include, to a lesser extent, investment in physicals for forward delivery. Exposure includes four major commodity market sectors: Energy Agriculture/Livestock, Industrial Metals, and Precious Metals. Expected total return is due primarily to spot price appreciation; secondarily to contract roll forward dynamics, or the differential between spot and future price (between near and longer term contracts); and thirdly to modest collateral income.

The Real Asset program may employ both passive and active commodity management. Examination of cash collateral, in particular the quality of fixed income market exposure, will be considered in risk mitigation.

b. **Energy**

The strategy targets both public and private energy-related entities. The Energy investment strategy consists of three segments: upstream, midstream, and downstream businesses. Opportunities include core diversified global conglomerates that may span across segments and specific, concentrated satellite investments that may focus on a specific Energy market segment. Investments may include both traditional (oil, natural gas, coal) & alternative (wind, solar) energy sources.

The *Upstream Investment Strategy* focuses on the production of oil and gas, and includes petroleum Exploration and Production (E&P) businesses and power generation.

The *Midstream Investment Strategy* focuses on transporting the upstream products from the source to the end user, and includes storage and processing, as well as oilfield services (the equipment and services required to produce petroleum) and electricity transmission equipment and services. Midstream assets include pipelines, gathering and storage facilities, refining, power lines, and transformer stations. Services are also considered midstream elements, such as oilfield equipment like drill bits, drill rigs, well trees, and geologic and mapping services.

The *Downstream Investment Strategy* focuses on the end users of upstream production. Power generation is an end user of petroleum products, while households and businesses are the downstream users of power generation. Downstream assets can also be local distribution centers, such as home heating oil distributors or gas stations.

Each segment of the strategy has different investment characteristics, income profiles, and risks.

c. **Metals & Mining**

Public equities in the Industrial and Precious metals-related industries. Investment opportunities include large core diversified global conglomerates and more specific, concentrated investments. Supply chain position may include upstream, midstream, and downstream companies. Expected total return is due primarily to appreciation and some income.

d. **Public Agriculture-related**

Invests primarily in Agriculture-related companies. Exposure may include both traditional agriculture and livestock investments and renewable energy sources. Supply chain position may include upstream, midstream, and downstream companies. Equity-based agriculture exposure ranges from upstream producing companies (i.e. growers) or those who are closely related to them, such as seed and agricultural chemicals companies, to downstream packaged foods producers. Opportunities include core diversified global conglomerates that may span across segments and specific, concentrated satellite investments that may focus on a specific market segment. Expected total return is due primarily to appreciation and some income.

e. **Timberland**

The strategy targets both public and private Timberland Investment Management Organizations, TIMO. The Investment strategy includes investing in entities that derive their returns from the growth and harvest of timber, a renewable and biologically growing asset. The investments may include both plantations who utilize intensive management techniques to enhance biological growth and naturally regenerating strategies. The investment strategy has varying time horizons to liquidity, shorter term for softwoods (e.g. for pulp and lumber) to longer term time horizon (e.g. hardwoods).

f. **Infrastructure**

Public and private investments in direct physical assets, or a company that operates assets that provide essential services to society. Ranges from publicly held equities to very illiquid private partnerships. Exposure includes toll-oriented projects (e.g. roads, bridges, tunnels), transport-focused (e.g. railroads, airports, seaports); regulated utilities (e.g. gas pipelines; water/sewer treatment facilities); and social services (e.g. schools, hospitals). High toll-orientation offers inflation protection. Expected total return is due primarily to current income and to a lesser extent capital appreciation. Satellite strategies typically use more leverage than core.

Typically, infrastructure assets exhibit one or more of the following qualities: monopolistic or quasi-monopolistic, high barriers to entry, long term assets, and significant regulatory or permitting constraints.

g. Emerging Sub-Strategies

Growth in these sectors is expected to outpace inflation, due in part to evolving global macroeconomic trends. Investment in these emerging sectors may therefore help provide an effective hedge against inflation, as part of a well-diversified Real Asset strategy.

The Real Asset Program may seek modest exposure in these areas. Emerging sub-strategies may have a limited universe of qualified, institutional-quality managers.

h. Climate Change

An investment strategy that focuses on the global political and economic momentum in favor of reducing greenhouse gas emissions.

i. Farmland/Agribusiness

An investment strategy targets the market segment of agriculture. Farmland consists of two main property types: row and permanent crop properties. Row crops are harvested from soil and are categorized as commodity, (corn and soybean) and vegetable, (potatoes and lettuce). Permanent crops grow on trees and have three categories: citrus fruit, (oranges and grapefruits); fruit, (apples and grapes); and nuts.

INVESTABLE INSTRUMENTS

Investment Vehicles

Real Asset investments can be made through a variety of different vehicles. The Real Asset Program will make diverse use, where appropriate, of the available investment options:

- a. **Open-end funds**
- b. **Closed-end funds**
- c. **Commingled funds**
- d. **Fund of funds**
- e. **Separate accounts**

Derivatives

Exposure to economic risk through the use of derivatives must be consistent with the Plan's overall investment policy, as well as its individual manager specific investment guidelines. Investment managers are not authorized to use derivative securities, or strategies, that do not comply with the Plan's basic objective of achieving the highest return on investment funds, consistent with safety, and in accordance with accepted investment practices.

Managers are specifically prohibited from using derivative or synthetic securities that expose the Plan to potentially high price volatility or are either speculative or leveraged, or whose marketability may become severely limited.

Generally, the Plan allows for the following uses of derivatives:

- Equity and Bond index futures contracts are permitted.
- An international manager may defensively hedge currency as a part of the investment management and risk reduction process and as described in the section pertaining to the international equity and fixed income managers. Currency forward or futures contracts may be used in this process.
- New York Stock Exchange listed American Depository Receipts (ADRs) may be used by the domestic equity managers for up to 10 % of the portfolio investments at cost. The international equity manager may use ADRs in place of the foreign securities when their research indicates the ADR issues are more attractively valued.
- The fixed income investment managers may hold derivative securities known as Collateralized Mortgage Obligations (CMOs) collateralized by GNMA, FNMA, FHLMC mortgage-backed instruments. The CMOs must possess price risk characteristics consistent with, or superior to, the risk characteristics of the underlying conventional mortgage pass-through securities. Fixed income managers may also purchase securities of other categories, including options and financial futures contracts traded over-the-counter or on organized securities exchanges. Offsetting cash positions must be maintained against all delayed settlement transactions.
- Derivative securities should not be utilized by portfolio managers to materially increase a portfolio's duration or leverage as characterized by its stated investment style. Managers must be granted specific written authorization from the Plan in order to implement applications of derivative instruments not listed above.

Mini-Tender Offers

Mini-Tender offers are tender offers for less than five percent of a company's stock. As a fiduciary, a manager will deal with mini-tender offers with the diligence and good faith expected for any investment decision. Upon approval by the Board of a written agreement with the manager that the manager will indemnify the Board against any losses to the extent such losses were the result of the manager's negligence, a manager may participate in mini-tender offers.

Credit Unions

No retirement fund assets shall be deposited in any such institution in excess of an amount insured by an agency of the Federal Government, and shall be made only if the rate of return and degree of safety offered are competitive with other investment opportunities.

Manager Discretion

Any manager who is engaged in or has a direct pecuniary interest in a business other than investment counseling, such as a broker or dealer in securities shall not be permitted to use such business with regard to the Plan assets without prior written approval by the Board.

Subject to these guidelines and policies, the Fund's Investment Managers have full discretion to sell, substantiate, redeem or convert securities, as they deem advisable.

It is the intention of the Board to contract with an independent agency to vote domestic equity proxies according to the plan proxy voting guidelines. However, international equity proxies are to be voted by the investment managers or any agent or service selected by the investment manager.

With the consent of the Board, compliance with the foregoing guidelines may be waived, either with respect to a specific transaction or transactions, or generally. The Board will, in addition, consult with the investment manager from time to time, at the investment manager's request, as to the continuing applicability of the guidelines and whether amendments may be appropriate.

Performance Goals

In order to insure that investment opportunities available over a specific time period are fairly evaluated, the Board of Administration will utilize comparative performance statistics to evaluate investment results. Accordingly, each investment manager is expected to achieve the following minimum performance standards over a rolling five year time period or a full market cycle.

Domestic Equity Managers

- (1) Performance within the top half of the appropriate ICC Equity Style Universe.
- (2) Net of fees, manager performance shall exceed the return of the appropriate benchmark by the following:
 - 100 basis points for active large-cap equity managers,
 - 0 basis points for passive large-cap equity managers,
 - 150 basis points for mid-cap equity managers, and
 - 200 basis points for small-cap equity managers.
- (3) The risk associated with the manager's portfolio as measured by the variability of quarterly returns (standard deviation) must not exceed that of the manager's benchmark index without a corresponding increase in performance above that index.

Domestic Fixed Income Managers

- (1) Performance within the top half of ICC Bond Funds Universe.
- (2) Net of fees, manager performance shall exceed by 50 basis points, the return of the Barclays Capital Aggregate Bond Index.

- (3) The risk associated with the manager's portfolio as measured by the variability of quarterly returns (standard deviation) must not exceed that of the Barclays Capital Aggregate Bond Index without a corresponding increase in performance above the index.

International Equity Managers

Developed Markets

- (1) Performance within the top half of ICC International Developed Markets Equity Fund Universe.
- (2) Net of fees, manager performance shall exceed by 150 basis points, the return of the Morgan Stanley EAFE Index for international equity managers.
- (3) The risk associated with the manager's portfolio as measured by the variability of quarterly returns (standard deviation) must not exceed that of the MSCI EAFE Index without a corresponding increase in performance above the index.

Emerging Markets

- (1) Performance within the top half of ICC Emerging Markets Equity Fund Universe.
- (2) Net of fees, manager performance shall exceed by 200 basis points, the return of the MSCI Emerging Market Free Index for emerging markets managers.
- (3) The risk associated with the manager's portfolio as measured by the variability of quarterly returns (standard deviation) must not exceed that of the MSCI EMF Index without a corresponding increase in performance above the index.

International Fixed Income Managers

- (1) Performance above median in ICC International Bond Fund Universe.
- (2) Net of fees, manager performance shall exceed by 75 basis points, the return of the Citigroup World Government Bond Index.
- (3) The risk associated with the manager's portfolio as measured by the variability of quarterly returns (standard deviation) must not exceed that of the Citigroup World Government Bond Index without a corresponding increase in performance above the index.

Real Estate Managers

- (1) Performance above median in ICC Real Estate Funds Universe.
- (2) Net of fees, manager performance shall exceed by 150 basis points, the return of the National Counsel of Real Estate Investment Fiduciaries (NCREIF) Classic Property

Index or the NCREIF Classic Property Pacific Index for the portfolio with the majority of properties in California.

- (3) The risk associated with the manager's portfolio must not exceed that of the NCREIF or NCREIF Pacific Index without a corresponding increase in performance above the index.

Private Equity

The Private Equities portfolio is an illiquid investment with a five to ten year investment horizon. The return expectation for Private Equity managers is S&P 500 Index plus 300 basis points over time.

High Yield and Bank Loan Investments

The objective for the investment managers of the High Yield and Bank Loan component of the total portfolio are:

- (1) Achieve rates of return, which exceed either the Merrill Lynch High Yield BB – B Rated Index (H0A4) or the CSFB Leveraged Loan Index by 150 basis points net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.
- (2) Achieve performance results that will rank in the top half of a broad high yield manager database.
- (3) Achieve returns that will rank in the top half of investment managers which utilize a similar investment style.

Convertible Bond Investments

The objective for the investment managers of the Convertible Bond component of the total portfolio are:

- (1) Achieve rates of return which exceed the Merrill Lynch Global 300 Convertible Index by 150 basis points net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.
- (2) Achieve performance results that will rank in the top half of a broad Convertible Bond manager database.

Periodic Reviews of Manager Performance

The performance of each manager will be reviewed versus its benchmark every quarter. These benchmarks consist of both asset class indexes and peer group universes. Each manager's performance should exceed their passive index benchmark and each manager should be above the median of an appropriate universe.

As good managers will occasionally have poor performance for several periods, there is some grace period permitted for performance to improve. Conversely, the performance will be reviewed with sufficient frequency to permit identification of substandard performance as quickly as possible.

Procedure:

1. Each manager is expected to produce performance equal to or better than their benchmark index for one year, three year, and five year cumulative periods.

Managers are considered to achieve this objective if their performance exceeds their benchmark for two of the three periods of one year or longer.

2. The expectation to produce above median performance in an appropriate peer group for one year, three year, and five year cumulative periods will be factored in only when the majority of investment managers are underperforming the benchmark.

Managers are considered to achieve this objective if they rank above the median manager for two of the three periods of one year or longer and the performance in the third period is not less than the 62nd percentile.

3. If a manager has less than five years performance, we will review the periods reported by the consultant, such as one quarter, one year and since inception. However, no action will be taken for placement on the watch list until two years after inception date.

4. If there is a failure to meet the performance objective, the following rules should be applied:

- a) A manager's (with at least two years of performance since inception) failure to meet their objective for four successive quarters will place the manager on the watch list. If a manager is consistently on the borderline, sometimes meeting objectives and sometimes failing to meet objectives, the manager may be placed on the watch list.
- b) During the next four quarters, the manager's performance will be closely monitored to see if it is warranted for the manager to be placed on probation.
- c) A manager placement on probation should result in review by the Investment Committee. Upon a critical review of the manager, the Investment Committee may grant up to one year further for improvement to take place upon officially recognizing the substandard performance and explicitly granting an extension of time for improvement. At the time of granting such extraordinary extension, the Investment Committee may delegate to the Director, Retirement Services, the authority to direct the manager to immediately suspend all trading except as specifically directed by the Director. If there has been improvement in performance, the Investment Committee may extend the probation beyond one year.

- d) During the period of any such extraordinary extension, the investment staff should monitor the portfolio and transactions of such manager to ensure that excessive risk is not being taken in an attempt to "catch up". If in the judgment of the Director, such manager is managing the portfolio in such a manner that indicates that excessive risk is being taken, the Director should use the previously delegated authority to terminate or restrict the manager's activities.
- 5. In order to be taken off probation and placed on the watch list, a manager must beat their benchmark for 2 successive quarters (i.e. March and June) OR beat their benchmark at one-year following four quarters of good performance.
- 6. In order to be taken off the watch list, a manager must beat their benchmark for an additional 2 successive quarters (i.e. September and December) OR have an additional four quarters of good performance.

Extraordinary Reviews of Managers

If an event occurs within a manager's organization that is likely to impact the manager's organization, the Director, Retirement Services, shall make a determination whether such event compromises the investment process or in any other manner might negatively impact the management of the Plan's assets.

Such events would include but are not limited to:

- a) Loss of any significant investment professional directly involved with the management of Plan assets or of such significance to the manager's overall investment process as to call into question the future efficacy of that process.
- b) Sale, offer for sale, or offer to purchase the manager's business to/by another entity.
- c) Significant financial difficulty or loss of a sizable portion of the manager's assets under management.
- d) Filing or announcement of regulatory action of non-trivial nature, particularly that involving violations of the Investment Advisers Act of 1940, the Securities Act of 1933, or the Securities Exchange Act of 1934, or any state Blue Sky Law to which the manager is subject.
- e) Any other event which in the discretion of the Director appear to put the Fund's assets at risk of loss, either actual or opportunity.

Any of these events may trigger a due diligence visit to the firm by the Investment Committee, being placed on the watch list, being put on probation or termination depending on the seriousness of the event and the probability of impacting the management of the Plan's assets.