

AUBURN UNIVERSITY FOUNDATION
INVESTMENT POLICY STATEMENT

Adopted

April 17, 2004

Table of Contents

| Section | | Page |
|-----------------------|--|-------------|
| I | Management of Foundation Investments | 2 |
| | A Investment Committee Functions | |
| | B Specific Functions of the Investment Committee | |
| II | Endowment Investment Policy and Guidelines | |
| | A Investment Objective | 3 |
| | B Asset Allocation | 3 |
| | C Asset Allocation Review and Rebalancing Procedure | 6 |
| | D Performance Measurement, Monitoring, and Evaluation | 6 |
| | E Guidelines for Corrective Action | 7 |
| | F Spending Guidelines | 7 |
| | G Gift Policy | 8 |
| | H Custodian and Depository Activities | 8 |
| Appendices | | |
| | 1 Asset Allocation Input Assumptions | |
| | 2 AUF Policy and Target Portfolio with Benchmarks | |
| | 3 Fiscal 2003 – 2004 Spending Rate Calculation | |
| | 4 Table of Responsibilities by Function | |

Auburn University Foundation, ("Foundation"), investments will be managed by the Investment Committee and staff in accordance with the policies established by the Board of Directors (the "Board"). Policies currently governing significant areas of investment management are based upon actions of the Board of Directors and the Investment Committee.

I. Management of Foundation Investments

The Board of Directors has delegated responsibility for the Foundation's investments to the Investment Committee, which shall recommend and implement investment policy with regard to asset allocation, manager selection and portfolio supervision. The Investment Committee reports to the Board the status regarding the Foundation's investment policies and results; and reports any recommended changes in investment policy to the Board.

A. Investment Committee Functions

1. The Investment Committees principal function is to develop and recommend to the Board such investment and investment related policies, as it deems appropriate.
2. No member of the Investment Committee shall have or appear to have a conflict of interest that impairs or appears to impair the member's ability to exercise independent and unbiased judgment in the good faith discharge of his or her duties.
3. The Investment Committee will review regularly all investments of the Foundation.
4. The Investment Committee will make regularly scheduled reports to the Board of Directors.
5. The Investment Committee recommends to the Board appropriate policies and procedures for custodianship and access to securities held by the funds, as it may deem appropriate.
6. The Assistant Treasurer, or his/her designee, is the Secretary of the Committee and shall keep minutes of the actions of the Committee.
7. The Committee may engage an investment consultant to work with staff, and advise staff and the Committee, on investment management issues including, but not limited to investment strategy, asset allocation, market trends, investment manager and custodian selection, manager and custodian evaluation criteria, investment performance evaluation, and any other appropriate matters.

B. Specific Functions of the Investment Committee

1. Establish investment objectives for the Endowment Pool.
2. Set asset allocation and manager structure policies for the investments.
3. Establish and continue to update the investment policy, and report the recommended changes to the Board.
4. Select, and as appropriate terminate, investment managers, fund custodian, and the investment consultant for the investments.
5. Establish, monitor, and update the investment process.

6. Review investment performance against established objectives.
7. Review, at least annually, investment activity to ensure compliance with investment policy.
8. Establish and propose to the Board, the spending rate for the Endowment Pool.

II. Endowment Investment Policy and Guidelines

The goal for AUF's Endowment investment pool is to provide a real total return that preserves the purchasing power of the Endowment's assets, while generating an income stream to support the Foundation's activities in support of Auburn University. The Endowment's real total return will be sought from an investment strategy that provides an opportunity for superior total returns within acceptable levels of risk and volatility.

A. Investment Objective

For the long-term, the primary investment objective for the Endowment Pool is to earn a total return (net of portfolio management fees), within prudent levels of risk, which is sufficient to maintain in real terms the purchasing power of the Endowment's assets and support the defined spending policy.

B. Asset Allocation

To achieve its investment objective, the Endowment's assets will be allocated among seven asset classes. The asset classes are domestic equity, international equity, private capital, hedge funds/absolute return, real assets, fixed income, and cash. The purpose of allocating assets to these asset classes is to ensure the proper level of diversification within the Endowment Pool.

The strategic asset allocation adopted by Board is:

| ASSET CLASSES | Target Allocation | Range |
|------------------------------------|------------------------------|--------------------|
| Domestic Equity | 30.0 | 20.0 - 40.0 |
| Large Cap Value & Growth | | |
| Mid Cap Value & Growth | | |
| Small Cap Value & Growth | | |
| International Equity | 10.0 | 5.0 - 15.0 |
| International Core Equity | | |
| Emerging Markets | | |
| Private Capital | 5.0 | 2.5 - 7.5 |
| Venture Capital | | |
| Private Equity | | |
| Hedge Funds/Absolute Return | 20.0 | 0.0 - 30.0 |
| Multi-Strategy | | |
| Real Assets | 15.0 | 10.0 - 20.0 |
| Private Real Estate | | |
| Public Real Estate | | |
| Timber, Gas & Oil | | |
| Fixed Income | 20.0 | 15.0 - 25.0 |
| Multi-Strategy | | |
| Cash | 0.0 | 0.0 - 10.0 |
| TOTAL | 100.0 | |

Auburn University Foundation has modeled the expected return and volatility of the portfolio. The assumptions for the endowment's portfolio are included in Appendix 1.

1. The purpose of equity investments in the Endowment, both domestic and international, is to provide capital appreciation, current income, with the recognition that this class of investment carries with it the assumption of potentially high market volatility over some periods.
2. The purpose of fixed income investments, both domestic and international, is to provide diversification and a highly predictable, dependable source of income. Fixed instruments should reduce the overall volatility of the Fund's assets and provide a deflation hedge.
3. The purpose of private capital investments (including Venture Capital and Private Equity) is to provide long-term appreciation of principal and diversification. The Investment Committee recognizes that private capital investments are more susceptible than stocks and bonds to extended periods of overvaluation and undervaluation, and that returns are much more manager dependent than is the case for marketable securities.
4. The purpose of hedge funds is to earn equity-like returns with less volatility overtime. Additionally, hedge funds provide an additional benefit of providing portfolio diversification thereby lowering the probability for the Endowment to have large market value variations over short-term time horizons.
5. The purpose of real assets is to achieve capital appreciation, current income and to invest in an asset-class that has low to negative correlation to unexpected inflation. Real assets also have low correlation to marketable securities – i.e. fixed income and equities.
6. The purpose of diversification is to provide reasonable assurance that no single security, or class of securities, will have a disproportionate impact on the performance of the total fund. Within all asset classes, managers (i.e., active managers or providers of passive investment products) with different investment styles will be employed. Diversification by investment style is an important step in reducing the risk of the Endowment. Investment styles within the seven asset classes are defined as follows:
 - a. Domestic Equity
 - i. *Large Capitalization (Growth)* - Managers who invest in larger capitalization companies (generally greater than \$10.0 billion) that are expected to have above average prospects for long-term growth in earnings and profitability.
 - ii. *Large Capitalization (Value)* - Managers who invest in larger companies (generally greater than \$10.0 billion) that are generally believed to be undervalued or possessing lower than average price/earnings ratios, based on their potential for capital appreciation.
 - iii. *Mid Capitalization (Growth)* - Managers who invest in mid-sized capitalization companies (generally \$2 billion to \$10 billion) that are expected to have above-average prospects for long-term growth in earnings and profitability. Future growth prospects take precedence over valuation levels in the stock selection process.

- iv. *Mid Capitalization (Value)* - Managers who invest in mid-sized capitalization companies (generally \$2 billion to \$10 billion) that are believed to be currently undervalued in the general market.
- v. *Small Capitalization (Growth)* - Managers who invest in small capitalization companies (generally up to \$2 billion) that are expected to have above-average prospects for long-term growth in earnings and profitability. Future growth prospects take precedence over valuation levels in the stock selection process.
- vi. *Small Capitalization (Value)* - Managers who invest in small capitalization companies (generally up to \$2 billion) that are believed to be currently undervalued in the general market.

b. International Equity

- i. *International Market Equity* - Managers who primarily emphasize stock selection in their portfolio construction. The country selection process is mainly a byproduct of the stock selection decision, or can be passively set according to the index country weights.
- ii. *Emerging Markets Equity* – Managers who invest in less-developed economic regions of the world such as Korea, Taiwan, Chile, India, etc.

c. Private Capital

- i. *Venture Capital* – Managers who invest in start-up and early stage, high-growth companies. The venture capitalists usually own a minority stake in the company, but are actively involved with the founders to develop strategy, secure financing and recruit management. The main investment objective is to earn returns above those generally available in the public securities market, achieved with long-term capital appreciation.
- ii. *Private Equity/Buy Out* – Managers who invest in transactions such as acquisitions, leveraged buyouts, management buyouts, reorganizations, restructurings and spin-offs. The manager usually owns a majority equity position or acquires the entire company. Private equity firms frequently use leverage.

Equity distributions from private equity and venture capital investments, such as the receipt of shares of a company that has gone public, will be liquidated as soon as possible.

d. Hedge Funds

- i. *Multiple Hedge Funds Strategies* – Managers who apply flexible investment styles (i.e., short selling leverage, concentration) across and within asset classes. Strategies include, but are not limited to, the following: merger arbitrage, convertible arbitrage, fixed income arbitrage, hedge equity, long/short equity market neutral, multi-strategy, and global macro managers

e. Real Assets

- i. *Private Real Estate* – Managers who invest in commercial real estate equity, held as individual assets or in commingled vehicles. Holdings generally are significant ownership of commercial buildings such as

office, warehouse, retail shopping, and apartments with the intent to earn both a high-current income and longer-term capital appreciation.

- ii. *Public Real Estate (REITs)* - Managers who invest in publicly traded real estate investment trusts and real estate operating companies.
 - iii. *Timber* – Managers who invest in timberlands and private timber companies to manage and harvest timber for pulp, construction, and fine woods. Timber investment companies are generally private investments with the objective to earn high-current income and longer-term capital appreciation.
 - iv. *Gas/Oil Partnerships* – Managers who invest gas and/or oil operating companies. The objective is to earn a high-current income with return of capital.
 - v. *Commodities* – Managers or commodities-based indexes that invest in commodities. The objective of investing in this sub asset-class is to gain additional portfolio diversification, inflation protection from unexpected inflation and positive real returns.
- f. Fixed Income
- i. *Multi-Strategy* - Managers who have the flexibility within parameters to invest in U.S. Investment Grade Bonds, Non-U.S. Investment Grade Bonds, and U.S. Non-Investment Grade.
- g. Cash
- i. *Money Market Funds* – Short-term pooled investments with a daily net asset value of \$1.00.

C. Asset Allocation Review and Balancing Procedure

1. The Investment Committee will review the strategic allocation in the seven asset classes, as well as the allocation to various styles of managers within these asset classes, at least annually.
2. Cash flows into and out of the portfolio (i.e., new gifts and spending) shall be allocated to the investment managers each month in a manner that will rebalance the portfolio consistent with asset allocation policies. Rebalancing the portfolio by means of liquidating assets managed by investment managers will be the exception, and only done, when recommended by the investment consultant and approved by the Committee. Asset allocation reports will be provided to the Committee on a quarterly basis.

D. Performance Measurement, Monitoring, and Evaluation

1. Performance (net of fees) will be calculated on a quarterly basis by the consultant.
2. In addition to reporting time-weighted total returns for each manager and the Pool, a comparison is made with relevant market benchmarks as well as the composite returns for other money managers with similar philosophies to those managers investing for the Pool. Managers should add value above these benchmarks.

Reports will include historical data in order to evaluate short-term results against longer-term strategies.

E. Guidelines for Corrective Action

Corrective action should be taken as a result of an ongoing investment managers review process. The following are instances where corrective action or termination may be in order:

1. Major organizational changes in a firm, including any changes in portfolio managers, may require a new contract and interview process. Failure on the part of the Investment Manager to notify the Committee of such changes is grounds for termination. At all times, communication with the managers should be open and informative. Investment managers should be willing and able to meet at least annually with the Committee.
2. Violation of terms of contract constitutes grounds for termination.
3. As part of its overall asset allocation strategy, the Committee will choose managers with certain styles and approaches to provide portfolio diversification. Therefore, it is critical that managers adhere to the original intent of the Committee at the time they are engaged. Any significant changes in investment approach may be grounds for termination.
4. The Committee will not, as a rule, terminate a manager on the basis of short-term performance. If the organization is sound and the firm is adhering to its style and approach, the Committee will allow a sufficient interval of time over which to evaluate performance. The Committee's consultant will provide insight regarding the appropriate length of time. The manager's performance will be viewed in light of the firm's particular style and approach, keeping in mind at all times the Pool's diversification strategy and, as well as, other organizational and relationship issues.
5. Investment managers may be replaced at any time as part of the overall restructuring of the Endowment Pool.
6. Other events or circumstances that are deemed to be in the best interest of the Foundation.

F. Spending Guideline

The long-term objective of the spending guidelines is to maintain the purchasing power of each endowment with the goal of providing a reasonable, predictable, stable, and sustainable level of income to support current operations. The Foundation Board approves an annual spending rate within a range of three to six percent (3%-6%). The rate is determined by a formula that incorporates long-term performance, net of external management and internal one percent (1%) administrative fees, and the Foundation's institutional inflation rate. The board-approved rate is applied to a three-year average market value to determine each endowment's distributable earnings.

The annual one percent (1%) administrative fee is also calculated on the trailing three-year average market value of the Pool. The monies generated by this assessment are used to fund the development activities of the Foundation.

An example of the Spending Rate Calculation can be found in Appendix 3.

G. Gift Policy

It is anticipated that from time to time the Foundation will receive gifts in the form of marketable securities. In such event, the Office of Treasury Services will liquidate the securities as soon as possible. In the event that the securities are restricted from sale for a designated period of time due to regulatory or donor restrictions, the Foundation will hold said securities until the restricted period has elapsed and then liquidate the securities as soon as possible thereafter. The Foundation will make no attempt to add value to the Pool by holding gifted securities.

H. Custodian and Depository Activities

The custodian and depository activities of the Pool, including agreements with any banks for the temporary, short-term investment of cash and equivalents will be subject to annual review by the Committee to assure that the Foundation is receiving competitive rates and services.

Appendix 1

Asset Allocation Input Assumptions

Expected Returns, Risks, and Correlations

| | Expected Return | Expected Std. Deviation | U.S. Lg Cap Equities | U.S. Mid Cap Equities | U.S. Small Cap Equities | Non-U.S. Equities | Emerg. Mkt. Equities | U.S. Aggregate Bond | High Yield Bond | World Bond | U.S. Cash | Hedge | Absolute Return | Private Equity | Private Real Estate | REITs | U.S. Inflation |
|-------------------------|-----------------|-------------------------|----------------------|-----------------------|-------------------------|-------------------|----------------------|---------------------|-----------------|------------|-----------|-------|-----------------|----------------|---------------------|-------|----------------|
| U.S. Lg Cap Equities | 9.50 | 18.00 | 1.00 | | | | | | | | | | | | | | |
| U.S. Mid Cap Equities | 10.25 | 20.00 | 0.94 | 1.00 | | | | | | | | | | | | | |
| U.S. Small Cap Equities | 10.50 | 26.00 | 0.78 | 0.90 | 1.00 | | | | | | | | | | | | |
| Non-U.S. Equities | 10.00 | 19.00 | 0.68 | 0.64 | 0.52 | 1.00 | | | | | | | | | | | |
| Emerg. Mkt. Equities | 11.25 | 28.00 | 0.55 | 0.57 | 0.60 | 0.43 | 1.00 | | | | | | | | | | |
| U.S. Aggregate Bond | 5.00 | 6.50 | 0.04 | 0.06 | -0.12 | 0.06 | -0.24 | 1.00 | | | | | | | | | |
| High Yield Bond | 7.00 | 10.00 | 0.53 | 0.58 | 0.54 | 0.42 | 0.30 | 0.30 | 1.00 | | | | | | | | |
| World Bond | 5.25 | 8.50 | -0.09 | -0.13 | -0.26 | 0.26 | -0.32 | 0.67 | 0.10 | 1.00 | | | | | | | |
| U.S. Cash | 3.00 | 2.00 | 0.08 | -0.02 | -0.17 | 0.01 | -0.07 | 0.32 | -0.06 | 0.02 | 1.00 | | | | | | |
| Hedge | 10.50 | 13.00 | 0.84 | 0.88 | 0.84 | 0.57 | 0.57 | 0.05 | 0.49 | -0.13 | 0.07 | 1.00 | | | | | |
| Absolute Return | 8.00 | 5.50 | 0.47 | 0.47 | 0.44 | 0.34 | 0.33 | 0.15 | 0.47 | -0.08 | 0.37 | 0.62 | 1.00 | | | | |
| Private Equity | 12.50 | 28.00 | 0.44 | 0.40 | 0.40 | 0.34 | 0.29 | -0.19 | 0.12 | -0.16 | 0.07 | 0.49 | 0.22 | 1.00 | | | |
| Private Real Estate | 8.50 | 11.50 | 0.00 | -0.07 | -0.10 | 0.06 | -0.18 | 0.00 | -0.14 | -0.06 | 0.24 | -0.04 | 0.08 | 0.07 | 1.00 | | |
| REITs | 8.50 | 15.00 | 0.49 | 0.62 | 0.61 | 0.41 | 0.22 | 0.20 | 0.55 | -0.02 | -0.07 | 0.49 | 0.45 | 0.03 | -0.06 | 1.00 | |
| U.S. Inflation | 2.50 | 2.00 | -0.19 | -0.19 | -0.11 | -0.34 | -0.04 | -0.13 | -0.18 | -0.23 | 0.34 | -0.05 | 0.26 | 0.00 | -0.05 | -0.12 | 1.00 |

Expected returns are for the next 10 years; correlations are historical (1981-2003)

Appendix 2

AUF Policy Portfolio

Table 1 is AUF's Policy Endowment Portfolio with the Board approved ranges for each asset class and the corresponding benchmarking for performance measurement.

TABLE 1

| | Minimum | Policy | Maximum | Benchmark |
|------------------------|----------------|---------------|----------------|--|
| Domestic equities | 20.0 | 30.0 | 40.0 | 80% S&P500, 10% S&P 400, 10% Russell 2000 |
| International equities | 5.0 | 10.0 | 15.0 | EAFE |
| Private Capital | 2.5 | 5.0 | 7.5 | Venture Economics – (Venture/Private Equity Composite) |
| Absolute Return | 0.0 | 20.0 | 30.0 | LIBOR +5% |
| Real Assets | 10.0 | 15.0 | 20.0 | 50% NCREIF Property, 25% GSCI, 25% NCREIF Timberland |
| Fixed Income | 15.0 | 20.0 | 25.0 | Lehman Aggregate |
| Cash | 0.0 | 0.0 | 10.0 | One-month LIBOR |

Table 2 is Fiscal-Year 2003-2004 Target portfolio. At the beginning of each fiscal year, AUF's Investment Committee meets to review the endowment portfolio's asset allocation and to establish the target allocations for the upcoming 12 months. The current target portfolio that is rebalanced monthly is:

Table 2

| | Policy | Benchmark |
|------------------------|---------------|--|
| Domestic equities | 30.0 | 80% S&P500, 10% S&P 400, 10% Russell 2000 |
| International equities | 10.0 | EAFE |
| Private Capital | 5.0 | Venture Economics – (Venture/Private Equity Composite) |
| Absolute Return | 20.0 | LIBOR +5% |
| Real Assets | 15.0 | 50% NCREIF Property, 25% GSCI, 25% NCREIF Timberland |
| Fixed Income | 20.0 | Lehman Aggregate |
| Cash | 0.0 | One-month LIBOR |

Appendix 3

Sample Spending Rate Calculation (Fiscal-Year 2003-2004)

In accordance with the Auburn University Foundation Spending Plan, the AUF endowment spending rate for fiscal year 2003-2004 is based on the following calculations:

Net Total Return - Institutional Inflation Rate - Administrative Fee = Spending Rate

- **Expected Net Total Return** is the expected long-term performance of the endowment pool, as measured by AUF's Investment Consultant, less investment manager and investment advisory fees.
- **Expected Institutional Inflation Rate** is an expected long-term composite of the average tuition increases, faculty salary increases, and the Consumer Price Index.
- **Administrative Fee** is a percentage of the endowment pool's market value that provides support for the Foundation's development activities.

Rate Calculation

| | Percent |
|--|----------------|
| Gross Total Return | 9.1 |
| Less expenses (ie. Inv. Mgrs., Custody, Consulting) | <u>- .4</u> |
| Net Total Return | 8.7 |
| Less Institutional Inflation Rate | -3.5 |
| Less Administrative Fee | <u>-1.0</u> |
| Rate Calculation for FY 2003-2004 | 4.2 |
| Spending Rate * | 3.75 |

*The spending rate will fluctuate based upon the rate approved by the Foundation Board of Directors.

Appendix 4

Responsibility Table

| FIDUCIARY LEVEL | WRITTEN INVESTMENT POLICY | WRITTEN INVESTMENT STRATEGY | TACTICAL ALLOCATION AMONG ASSET CLASSES | STRATEGY WITHIN AN ASSET CLASS | MANAGER & FUND SELECTIONS | SECURITY SELECTION |
|--|--|--|--|---|--|-------------------------------|
| BOARD OF DIRECTORS | APPROVES | INFORMED | INFORMED | | | |
| INVESTMENT COMMITTEE | RECOMMENDS | APPROVES | APPROVES | APPROVES | APPROVES | INFORMED |
| INVESTMENT CONSULTANT & STAFF | RECOMMENDS | RECOMMENDS | RECOMMENDS | RECOMMENDS | RECOMMENDS AND MONITORS | MONITORS |
| INDIVIDUAL MANAGERS | | | | | | APPROVES |