



**INVESTMENT POLICY
STATEMENT**
for
CITY OF ERIE
WATER RESERVE FUND

November 2015

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I. Introduction

Information about and the purpose of the City of Erie Water Reserve Fund

Primary Contact: City Controller

Telephone: (814) 870-1339

Fund Assets: \$10,268,999.00 (*as of September 30, 2015*)

About City of Erie Water Reserve Fund

The City of Erie Water Reserve Fund is a Capital Reserve Fund for anticipated capital expenditures as detailed in Section 2403 of Act 317 of the Pennsylvania General Assembly.

The Fund provides income with growth of principal to support capital need for the City of Erie. The growth portion should have a growth rate greater than inflation.

Purpose of this Investment Policy Statement

This Investment Policy Statement (the "Policy Statement") outlines the goals and investment objectives of City of Erie Water Reserve Fund ("the Fund"). Since this Policy Statement is intended to provide guidance for the City Council of Erie ("the Council") and the investment managers responsible for managing the Fund's assets, it outlines certain specific investment policies which will govern how to seek to achieve those goals and objectives. This Policy Statement, upon the review and approval of the City Council of Erie:

- Describes a risk posture for the investment of the Fund's assets;
- Specifies the target asset allocation policy for those assets;
- Establishes investment guidelines regarding the selection of investment manager(s), permissible securities and diversification of assets;
- Specifies the criteria for evaluating the performance of the Fund's investment manager(s) and of the Fund investment portfolio as a whole; and
- Defines certain responsibilities of the Council, the consultant, the investment managers, and other specified parties.

The City Council believes the investment policies described in this Policy Statement should be dynamic. These policies should reflect the Fund's current financial status, and the Council's philosophy regarding the investment of assets. These policies should be reviewed by the Council periodically and revised as necessary to ensure they continue to reflect the current financial situation of the Fund and the capital markets.

II. Responsibilities of the Fund Representatives

The City Council of Erie

As fiduciaries, the members of the City Council of Erie are fully responsible for the Fund.

The City Council of Erie

The primary fiduciary responsibilities of the Council with respect to the oversight of the investment portfolio are:

- Establish and approve an investment policy statement and periodically review that statement for continued accuracy and completeness;
- Prudently diversify, or oversee the diversification of, the portfolio assets to meet an agreed upon risk/return profile;
- Prudently select investment options, including the selection of one or more investment managers;
- Monitor the investment managers and the performance of the accounts under management;
- Evaluate the information provided by the consultant and other professional advisors and act prudently;
- Control and oversee all investment, record keeping and administrative expenses associated with the accounts;
- Review and deal with conflicts of interest as needed; and
- Disclose conflicts of interest and abstain from voting if conflicts arise.
- Appoint members of the Water Reserve Investment Committee

The Water Reserve Investment Committee

- The Water Reserve Investment Committee is a sub-committee approved by City Council to act as a liaison between City Council and the consultant. Members will include: Council President, one member of Council, the Finance Director, City Controller, and one representative from the City Clerk's Office.
- The Water Reserve Investment Committee will make recommendations to City Council on the management of the Water Reserve Fund.

The Consultant

The Council shall retain an advisor or consultant (the "consultant") to:

Assist the Council or **The Water Reserve Investment Committee**

- in strategic investment planning for the Fund by providing assistance in developing an investment policy, an asset allocation strategy, and portfolio structure;
- Provide written performance measurement reports on a quarterly basis;

- Assist the Council in its selection of investment manager(s); and
- Meet with the Council to review investment performance and consider strategy changes or other actions with respect to the investment portfolio.
- Assist City Council in rebalancing the portfolio as needed to maintain the policy statement asset mix.

The Custodian

The Custodian is responsible for the safekeeping of the Fund's investment assets. The specific duties and responsibilities of the custodian include:

- Maintain separate accounts by legal registration;
- Value the holdings;
- Collect all income and dividends owed to the Fund in its custody;
- Settle all transactions initiated by the investment manager; and
- Provide monthly reports that detail transactions, cash flows, securities held and their current value, and change in value of each security and the overall portfolio since the previous report.

III. Objectives

Risk Tolerance

Given the relationship between risk and return, a fundamental step in determining the investment policy for the Fund is the determination of an appropriate risk tolerance. The Council examined its willingness to take risk and the Fund's financial ability to take risk based upon relevant factors, including:

Factors that contribute to a higher risk tolerance are:

- 1) The Fund can take advantage of a long time horizon
- 2) The Fund can make additional contributions.
- 3) The Fund has very few distributions.

Offsetting these factors are:

- 1) The Fund must be able to meet its expenses or liabilities
- 2) Large fluctuations may effect Fund's ability to maintain the investment strategy
- 3) A 4% fixed spending policy for capital improvement needs.

Based on these factors, the Council maintains a moderate risk profile. Primary emphasis is a balance between portfolio stability and portfolio appreciation.

A typical portfolio will be diversified between fixed income and equity securities.

Investment Objectives

The Fund's assets should be invested in accordance with sound investment practices that emphasize long-term investment fundamentals. The objective of this Fund is to maximize long-term returns consistent with prudent levels of risk. Investment returns are expected to provide adequate funds to sufficiently support designated needs and preserve or enhance the real value of the Fund. In establishing the investment objectives of the Fund, the Council has taken into account the time horizon available for investment, the nature of the Fund's cash flows and liabilities, and other factors that affect the Fund's risk tolerance. Accordingly, the investment objective is a balanced investment approach expected to achieve a positive rate of return over the long-term that will provide growth of principal and contribute to the Portfolio's income needs.

Return Objectives

The return objective is a nominal fixed rate of 7.00%.

IV. Asset Allocation Strategy

The Water Reserve Fund maintains asset mix targets offering prudent diversification and providing a high probability of meeting the Fund's investment objectives. The most-current asset mix targets are provided as Appendix 1.0 of this document.

Rebalancing Procedures

The allocations to each asset class and to investment styles within asset classes are expected to remain stable over most market cycles.

Since capital appreciation (depreciation) and trading activity in each individually managed portfolio can result in a deviation from the overall Fund's asset allocation, the aggregate asset allocation should be monitored; and the Council may rebalance the Fund's assets to the target allocation on a periodic basis. To achieve the rebalancing of the Fund, the Council may re-direct contributions and disbursements from individual investment managers as appropriate, in addition to shifting assets from one investment manager to another.

V. Responsibilities of the Investment Managers

It is the Council's responsibility to select qualified investment managers to manage the assets. Such managers can include regulated banks or insurance companies; mutual funds registered under the Investment Company Act of 1940, or registered investment advisors. With respect to any mutual or other commingled funds that have been purchased by the Fund, the prospectus or Declaration of Trust documents of the fund(s) will govern the investment policies of those assets.

The following guidelines apply to each individually managed account.

Fiduciary Responsibilities

Each investment manager is expected to prudently manage the Fund's assets in a manner consistent with the investment objectives, guidelines, and constraints outlined in this Policy Statement and in accordance with applicable laws.

Each investment manager shall:

- Be a bank, insurance company or be registered as an investment adviser under the Investment Advisers Act of 1940 (where applicable);
- Maintain adequate fiduciary liability insurance and bonding for the management of this account; and
- Acknowledge in writing that it is a fiduciary with respect to the assets under its management.

Proxy Voting

Absent delegation to another service provider, each investment manager is responsible and empowered to exercise all rights, including voting rights, as are acquired through the purchase of securities, where practical. The investment manager(s) shall vote proxies according to their established Proxy Voting Guidelines. A copy of those guidelines, and/or summary of proxy votes shall be provided to the Council upon request.

VI. Investment Strategy

Selection Criteria for Investment Managers

Investment managers retained by the Council should be chosen using the following criteria:

- The investment style and discipline of the investment manager;
- How well the investment manager's investment style or approach complements other investment managers in the portfolio;
- Level of experience, financial resources, and staffing levels of the investment manager;
- How consistent an investment manager is to the style for which they were hired ;
- Reasonableness of expense ratios/fees;
- Past performance, considered relative to other investments having the same investment objective. Consideration should be given to both consistency of performance and the level of risk taken to achieve results; and
- Stability of the organization.

Security Selection/Asset Allocation

- Except as noted below, each investment manager shall have the discretion to determine its portfolio's individual securities selection;

- The Fund's portfolio is expected to operate within an overall asset allocation strategy defining the portfolio's mix of asset classes. This strategy, described below, sets a long-term percentage target for the amount of the portfolio's market value that is to be invested in any one asset class. The allocation strategy also defines the allowable investment shifts between the asset classes, above and below the target allocations; and
- The Council through the Water Reserve Investment Committee is responsible for monitoring the aggregate asset allocation, and may direct a re-balancing of assets to the target allocation on a periodic basis.

Diversification Requirements

The primary method to reduce risk for the Fund portfolio is diversification through asset allocation. By allocating assets in different asset classes, the portfolio can reduce risk by avoiding concentration as well as reduce risk through the low-correlation between different asset classes.

Each investment manager has discretion with regard to security selection and allocation within its respective portfolio. Unless otherwise noted below, under normal market conditions, each investment manager is expected to be invested consistent with its investment style as described in its relevant documentation.

To minimize the risk of large losses, each investment manager shall maintain adequate diversification in their portfolio subject to the constraints outlined in this investment policy, and in their investment management agreement with the Fund.

Cash and Equivalents

It is generally expected that the investment manager will remain fully invested in securities; however, it is recognized that cash reserves may be utilized from time to time to provide liquidity or to implement some types of investment strategies. Cash reserves should be held in the custodian's money market fund, short-term maturity Treasury securities, and insured savings instruments of commercial banks and savings and loans.

Manager Style Deviations

Actions that may cause a significant deviation from these investment guidelines should be brought to the attention of the Council and the consultant by the investment manager prior to execution. Such actions may be authorized by the Council if it determines they do not constitute an inappropriate departure from the spirit of this Policy Statement. Similarly, unanticipated market action should also be brought to the attention of the Council and consultant by the investment manager.

Exclusions

The Fund's assets should not be invested in the following unless agreed to by the Council pursuant to an approved strategy and specifically approved in writing by the Council:

- Purchases of letter stock, private placements, or direct payments;
- Private placement convertible issues, also known as "144A" convertible securities;
- Commodities transactions unless by managers approved for that strategy;
- Purchases of real estate, oil and gas properties, or other natural resources related properties with the exception of Real Estate Investment Trusts or securities of real estate operating companies;
- Investments by the investment manager in their own securities or of their affiliates, or subsidiaries (excluding money market or other commingled funds as authorized by the Council); and
- Any other security transaction not specifically authorized in this Policy Statement.
- Any other Limited Partnership.

VII. Constraints

Time Horizon

The time horizon is in perpetuity.

Liquidity Requirements and Spending

The Fund has a fixed spending policy of 4.0% of the Fund's 3rd calendar quarter market value. This target can be more or less than 4% based at the direction of City Council. There is a moderate liquidity need. Spending should come from unallocated cash, then from securities in order to rebalance the Fund's asset mix upon recommendation of the investment consultant.

Tax, Legal / Regulatory and Unique Considerations

The Fund is not subject to federal or state income taxes.

The Fund is subject to the following regulation(s):

Uniform Management of Institutional Funds Act unless superseded by Uniform Prudent Management of Institutional Funds Act and state laws & regulations.

Pennsylvania 3rd Class City Code (optional charter Mayor-Council Plan A.)

VIII. Performance Evaluation

As noted above, the consultant will provide quarterly performance measurement reports and the Council should monitor the Fund's performance on a quarterly basis. The Council will evaluate the Fund's success in achieving the investment objectives outlined in this Policy Statement over a three- to five-year time horizon and a full market cycle.

The Fund's (and investment managers') performance should be reported in terms of time-weighted rate of return and changes in dollar value. At the time of retention, the Council and investment manager(s) will agree to appropriate benchmark(s). The returns should be compared to these appropriate market indexes for the most recent quarter and for annual and cumulative prior time periods. The Fund's asset allocation should also be reported on a quarterly basis.

Risk as measured by volatility, or standard deviation, should be evaluated after twelve months of performance history have accumulated. An attribution analysis should also be performed by the consultant to evaluate how much of the Fund's investment results are due to the investment managers' investment decisions, as compared to the effect of the financial markets. This analysis will use the policy index as the performance benchmark for evaluating both the returns achieved and the level of risk taken for the total portfolio and the individual investment managers.

IX. Guidelines for Corrective Action

The Council recognizes the importance of a long-term focus when evaluating the performance of investment managers. The Council understands the potential for performance over short-term periods to deviate significantly from the performance of representative market indexes. Council. If the investment manager is sound and is adhering to its investment style and approach, the Council will allow a sufficient interval of time over which to evaluate performance. The Council expects the consultant to provide guidance to determine an appropriate length of time. The investment manager's performance will be viewed in light of the firm's particular investment style and approach, keeping in mind at all times the Fund's diversification strategy as well as the overall quality of the relationship. The Council, however, may require an extra level of scrutiny, or consider termination, of an investment manager based on factors such as:

- Any material event that affects the ownership or capital structure of the investment management firm, or the management of this account;
- Any legal or regulatory action taken against the manager;
- Any material servicing deficiencies, including a failure to communicate in a timely fashion significant changes as outlined in Section X of this investment Policy Statement;
- Violation of the terms of the contract or changes to agreed upon services without prior written approval of the Council;
- Significant style drift from the intended investment style that the manager was engaged to implement.

An investment manager or consultant may be replaced at any time as part of an overall restructuring of the portfolio or any other reason determined by the Council.

X. Meetings and Communications

- As a matter of course, each investment manager should promptly communicate to The Water Reserve Investment Committee, the Council and the Fund's consultant any material changes in the investment manager's outlook, investment policy, and tactics.
- Each investment manager should be available on a reasonable basis for telephone communication when needed.
- Any material event that affects the ownership of each investment management firm, any brokerage affiliation of such firm, its key investment personnel, or its management must be reported promptly to the Council and the Fund's consultant.
- The Water Reserve Investment Committee should obtain and review written performance measurement reports not less than quarterly.
- The consultant should generally meet with the Water Reserve Investment Committee or Council representative quarterly.

XI. Approval

This Policy Statement has been prepared for the review and approval of the City Council of Erie. It is recommended that the Fund's other professional advisors review the Policy Statement. These professionals should be called upon by the City Council of Erie to check relevant documentation, particularly in the case of trusts or retirement plans or where there are legal constraints or prohibitions that impact the Fund's investment portfolio. The review and approval of the Policy Statement is the ultimate responsibility of the City Council of Erie.

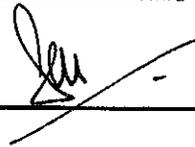
Upon final approval by the City Council of Erie, the Policy Statement should be sent to the Fund's investment managers. It is the Fund's responsibility to confirm the investment manager's acceptance of the Policy Statement, and it is the investment manager's responsibility to adhere to the Policy Statement in managing the Fund's account.

It is understood that this Policy Statement is to be reviewed periodically by the Fund to determine if any revisions are warranted for any reasons including changing circumstances such as, but not limited to, changes in financial status, risk tolerance, or changes involving the Investment Managers.

Adopted by resolution of Council on: 12/2/15

By: 
Council President

1-27-16
Date

Investment Consultant: 

Read and acknowledged by _____
(Investment Manager) Date _____

Appendix 1.0

City of Erie Water Reserve Fund

Asset Allocation Targets

(November 2015)

| | |
|----------------------|---------------|
| Large Cap Equity | 25.0% |
| Mid Cap Equity | 10.0% |
| Small Cap Equity | 5.0% |
| International Equity | 10.0% |
| Emerging Mkts Equity | 5.0% |
| Preferred Stock | 5.0% |
| Fixed Income | 35.0% |
| Cash | <u>5.0%</u> |
| TOTAL | 100.0% |