

San Diego County Employees Retirement Association

Investment Policy Statement

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Article 1 – Total Fund and Portfolio Design

1.1 Introduction

The San Diego County Employees Retirement Association (“SDCERA”) administers a pension fund operating under the County Employee Retirement Law of 1937 (California Government Code Sections 31450, *et seq.*) (the “37 Act”). SDCERA is governed by the Board of Retirement (the “Board”). SDCERA provides service and disability retirement benefits in addition to death and survivor benefits for the public employees of San Diego County and their beneficiaries. Benefits are funded by County contributions, member contributions and investment returns.

1.2 Purpose and Design

The purpose of this Investment Policy Statement (“Policy”) is to provide a formal plan for investing pension trust fund assets to achieve defined investment objectives consistent with the SDCERA mission statement adopted by the Board and with applicable law.

This Policy also defines the roles and responsibilities of various entities and parties involved in the investment process and facilitates internal and external communication of investment policy.

This Policy governs all asset classes, types or forms in SDCERA’s investment program and establishes the guidelines, policies and procedures for the management of SDCERA’s diversified investment portfolio by the Board and Staff. This Policy is subject to and will be applied in a manner consistent with applicable provisions of law and the applicable limitations and requirements of SDCERA’s governing documents and policies as applicable. The Board of Retirement may amend, supplement or rescind this Policy at its discretion.

The appendices to this Policy are incorporated into and form part of this Policy for all purposes. Capitalized terms not defined in this policy have the meanings assigned to them in the SDCERA Glossary of Investment Terms (“Glossary”), which definitions are also incorporated into and form part of this Policy for all purposes. Modifications to the appendices or the Glossary that would have a substantive effect on this Policy require Board consideration and adoption. Minor changes intended to clarify elements of policy that may be deemed vague or unclear may be approved by the SDCERA CEO upon recommendation by any of the parties identified in Section 1.3.

1.3 Roles of Board, Advisor, Staff and General Investment Consultant

The Board of Retirement of the San Diego County Employees Retirement Association has plenary authority and fiduciary responsibility for investment of moneys and administration of the retirement system. The assets of a public pension or retirement system are trust funds. The Board of Retirement has exclusive control of the investment of the assets of SDCERA. (California Constitution Article XVI, Section 17; California Government Code Section 31595.)

The Board and CEO of SDCERA are assisted by an outside Advisor, General Investment Consultant (“Consultant”), Staff and external legal counsel. The Board monitors the actions of Staff, the Advisor and the Consultant to ensure compliance with its policies.

1.3.1 Board of Retirement

As a fiduciary to the beneficiaries of the SDCERA Fund, the Board is responsible for formulating and adopting investment policies and providing oversight of the SDCERA Investment program. In performing its duties, the Board shall rely upon and comply with SDCERA’s governing documents and policies as they relate to the management and oversight of the SDCERA Fund. The Board shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing plan benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable administrative expenses of the system. The Board shall act in accordance with the Prudent Person Rule which states that fiduciaries must discharge their duties with respect to the system with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims. The Board establishes the Fund’s strategic asset allocation, risk limits, performance benchmarks, and policies relating to the management and implementation of the investment program (including, but not limited to, manager selection, rebalancing, proxy voting, manager retention and termination, securities lending policies, and trading policies), and selects the Advisor and Consultant. The Board must diversify the investments of the Fund so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so. All vendor selection procedures should comply with SDCERA’s Vendor Selection Policy.

The Board may from time to time assign, at its discretion and in a manner consistent with its legal duties and responsibilities, one or more investment responsibilities to the Advisor, Staff or Consultant.

1.3.2 Advisor

The Advisor makes recommendations to the Board regarding the fiduciary duties described herein and has responsibility for coordinating the activities of Staff, the Consultant, external legal counsel and all other investment related vendors to ensure that Board-defined policies and resolutions are enacted with diligence and care. Further, the Advisor exercises fiduciary responsibilities assigned by the Board under applicable law, manages the portfolio according to the Board’s policies, advises and informs the CEO and Board about investments, and recommends modifications to this Policy. The Advisor approves the execution of or executes all transactions, performs risk management functions and prepares investment reports.

The Advisor exercises due diligence in selecting all investments and external managers and reports its findings to the Board in both summary and detailed form. The Advisor is confined to the Approved Manager List (“Approved List”) in committing investment funds to external managers that are not otherwise approved under Section 2.3.

1.3.3 Staff

Staff works with the Advisor to exercise the investment responsibilities assigned by the Board under applicable law.

1.3.4 General Investment Consultant

The Board employs a Consultant who serves as a fiduciary to the Fund. The Consultant works for the Board by making independent recommendations directly to the Board and assisting the Advisor and Staff with respect to the investment program in general; proposing asset allocation strategies, consistent with Board investment objectives and risk tolerance; assisting in manager searches, evaluations, and contract terms; monitoring investment management results; providing reports and analyses relating to material events affecting investment managers; preparing presentations and papers on topical issues and specific investment projects for the Board, Advisor and Staff.

1.4 Investment Manager Selection

The Advisor will work with Staff and Consultant to identify managers for inclusion in the Approved List referenced under Sections 2.3, 2.4, 3.2 and in Appendix A and based upon (1) broad sourcing from the Board, Staff, Consultants and professional networks; (2) an initial review that examines the suitability of the manager based on experience of key staff, experience managing the specific asset class for which it is under consideration, investment thesis, organizational structure, investment process, controls and general approach to risk management; (3) an extensive review and certification (as outlined in the Due Diligence checklist contained in Appendix C); and (4) a full on-site verification of the representations made throughout the review. A summary of this information will be provided to the Board to support the Board's decision to include managers on the Approved List. The list of managers for inclusion in the Approved List will be provided to the Board on no less than an annual basis and will include the specific strategy or product being recommended with full supporting documentation. All managers, strategies and products on the Approved List will continue to be monitored by Staff. Any substantive changes with any manager, product or strategy on the Approved List will be brought to the Board's attention.

1.5 Total Fund Objectives

In this Policy, the total or overall investment portfolio includes all pension trust assets invested by the retirement association to provide retirement, death and disability benefits administered by the system (The "Total Fund" or the "Fund") and will be structured and managed to achieve the following objectives in accordance with SDCERA's mission statement:

1. Control risk through proper diversification of asset classes and by establishing long-term risk and return expectations, and
2. Achieve a long-term rate of return that:
 - a. Exceeds the assumed actuarial rate of return adopted by the Board;

- b. Exceeds the return of a composite benchmark of the respective long-term target asset mix weightings across the major asset classes.

1.6 Total Fund Investment Standard

The Board of Retirement is authorized to invest in any form or type of investment deemed prudent by the Board pursuant to the requirements of Section 31595 of the 37 Act and Article XVI, Section 17 of the California Constitution. Section 31595 provides in part:

Except as otherwise expressly restricted by the California Constitution and by law, the board may, in its discretion, invest, or delegate the authority to invest, the assets of the fund through the purchase, holding, or sale of any form or type of investment, financial instrument, or financial transaction when prudent in the informed opinion of the board.

The board and its officers and employees shall discharge their duties with respect to the system:

(a) Solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system.

(b) With the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.

(c) Shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly prudent not to do so.

Article XVI, Section 17 of the California Constitution is generally consistent with Section 31595. Section 17(b) clarifies that, "A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty." This section is only intended to set forth a general summary of certain of the basic legal principles applicable to the Board of Retirement's investment policy and practices. Nothing in this Policy shall be construed to limit the applicability or meaning of any provisions of the 37 Act, the California Constitution, or other applicable law.

1.7 Total Fund Asset Mix and Benchmarks

The Board has adopted the following long-term strategic asset allocation to satisfy the investment objectives. The strategic asset allocation takes into consideration the result of an asset/liability analysis, the expected returns and risks for the various asset classes.

Asset Class	Benchmark	Percentage Limits		
		Target	Min	Max
Global Developed Equities	MSCI World Net Index	20	15	25
Emerging Market Equities	MSCI Emerging Markets Index	5	2	10
High Yield	ML High Yield Master II	5	2	10
Private Equity	Uninvested Portion: Russell 3000 Invested Portion: Russell 3000 + 3%	10	5	15
Total Growth Oriented Assets	Target Weighted Average of Subcomponents	40	35	45
Emerging Market Debt (Local)	JP Morgan GBI--EM Global Diversified (Unhedged)	10	5	15
Asset Allocation Strategies	2/3 HFRI Macro + 1/3 Barclays CTA Indices	10	5	15
Relative Value Strategies	Three-Month Treasury Bills + 2%	10	5	15
US Treasuries	Barclay's 10-year UST Futures Index*	40	20	60
Total Stable Value Assets	Target Weighted Average of Subcomponents	70	35	70
Real Estate	Uninvested Portion: DJ US Real Estate Invested Portion: NCREIF NPI	10	5	15
Natural Resources and Other Real Assets	1/3 GSCI + 1/3 Citi MLP + 1/6 S&P Materials Index + 1/6 S&P/TSX Materials Composite Index	10	5	15
Treasury Inflation Protected Securities	Barclay's Capital US TIPS	5	2	15
Total Inflation-Sensitive Assets	Target Weighted Average of Subcomponents	25	20	30
Total Fund	Target Weighted Average of Subcomponents	135		

*The benchmark for the cash backed portion of the 10-year Treasury futures allocation will include the return on three-month Treasury bills in addition to the Barclay's 10-year Futures Index.

**Returns for the privately invested portions of the real estate, private equity and real asset portfolios will be lagged by one quarter and compared to their respective benchmark returns for the same period.

1.8 Rebalancing

The investment program's allocation to the various asset classes shall be monitored on an ongoing basis to ensure that the actual allocations lie within the ranges specified in the table above. The ranges noted above relate to the physical allocation of securities to these asset classes. When the actual allocation to an asset class falls outside of the range specified for the asset class, a rebalancing transaction shall be initiated to bring the allocation within the range. Staff shall utilize routine cash transactions, derivative overlay, or physical trading of securities to ensure that the actual allocations are in compliance with this Policy.

As a practical matter, allocations to illiquid asset classes such as private equity, infrastructure, natural resources and real estate cannot be altered meaningfully from quarter-to-quarter as they can be for publicly traded securities such as equities and bonds. Capital is committed to these asset classes over a multi-year period to ensure appropriate diversification of risks across vintage years and strategy type. Capital is drawn down for these investments over a staggered basis as investment opportunities present themselves. Further, capital invested in these asset classes is returned over time as investments are liquidated or at a predefined contract termination date. As a result, SDCERA has limited control on the allocations to these asset classes over the short-term. Regular pacing studies shall be conducted to ensure that the capital committed to these asset classes results in achieving and maintaining the target allocation over time, with due consideration to diversification of investments by type and vintage year. Over time it is expected that the allocations to these asset classes will lie within the ranges specified for these investments in this Policy.

Undesirable over or under allocations to private asset classes will be addressed using publicly traded proxies, where possible and desirable, as indicated by the benchmarks identified for natural resources and other real assets as well as for the un-invested portions of private equity and real estate as indicated in the allocation table referenced above in section 1.7.

1.9 Other Investments

The Board may also approve other opportunistic investments that do not fall within the asset class definitions and tracking error limits established herein, not to exceed 5% of the total Fund. Implicitly, the performance of those investments will be evaluated versus the Fund's target-weighted strategic benchmark. Any such investment will follow the same due diligence process as outlined in Section 1.4 and Appendix C.

1.10 Active Risk Budget

Active Risk is the risk associated with the differences in returns between the policy benchmark and the actual results of the portfolio. Tracking error may emanate from two primary sources: (1) differences between the securities held within a particular asset class composite and the asset classes composite's

benchmark (security selection risk) and (2) the difference between the asset allocation weights of the overall policy and the actual weights across asset classes (asset allocation risk).

Tracking error is measured as the standard deviation of the difference between the returns of an actual portfolio and its respective benchmark(s). The tracking error of the Fund will be measured using no less than the most recent three trailing years of monthly returns (36 periods) and will be calculated as one standard deviation of return differences between (1) the composite returns for each asset class (created using trailing manager and instrument return histories based on the current allocation) and (2) the stated benchmark return for that asset class composite. The budgeted amount of risk associated with security selection within each asset class is prescribed in the table below:

Asset Class	Benchmark	Annualized Tracking Error Limit (bps)
Global Developed Equities	MSCI World Net Index	200
Emerging Market Equities	MSCI Emerging Markets Index	400
High Yield	ML High Yield Master II	200
Private Equity	Uninvested Portion: 200	200
	Invested Portion: N/A	N/A
Emerging Market Debt (Local)	JP Morgan GBI--EM Global Diversified (Unhedged)	200
Asset Allocation Strategies	2/3 HFRI Macro + 1/3 Barclay's Hedge CTA Indices	800
Relative Value Strategies	Three-Month Treasury Bills + 2%	400
US Treasuries	Barclay's 10-yr UST Futures Index*	75
Real Estate	Uninvested Portion: 200	200
	Invested Portion: N/A	N/A
Natural Resources and Other Real Assets	1/3 GSCI + 1/3 Citi MLP + 1/6 S&P Materials Index 1/6 S&P/TSX Materials Composite Index	200
Treasury Inflation Protected Securities	Barclay's Capital US TIPS	75

*The benchmark for the cash backed portion of the 10-year Treasury futures allocation will include the return on three-month Treasury bills in addition to the Barclay's 10-year Futures Index.

The risk associated with asset allocation deviations will be calculated using the percentage differences between the target and actual weights and the covariance of each of the asset classes with all other asset classes, as measured by the stated benchmarks identified in the table above. The total tracking error emanating from asset allocation differences may not exceed 150 basis points using a 36 month trailing history of returns ending at the latest period for which the asset allocation risk is being measured.

It is assumed that the risk(s) emanating from security selection and those emanating from asset allocation differences are independent; however, the Advisor will stress test those correlation assumptions using a nine cell matrix that assumes three states of correlation for the security selection interaction across portfolios as well as the interaction between security selection and asset allocation. The correlation stress test will look at these two interactive components of the portfolio at correlations of zero, 0.5 and 1.0 and compares them to the maximum risk that would be allowed at each of those correlation levels. This information will be reported to the board as indicated in section 1.12.

Based on the tracking error targets established for the various asset classes and the maximum tracking error that is permissible for asset allocation deviations relative to Policy Targets, the Total Fund's tracking error is expected not to exceed 400 bps in extreme circumstances. This assumes a perfect correlation (or correlation of 1) between asset class tracking error and tracking error resulting from asset allocation deviations (in times of stress, we would expect these correlations to increase).

If the actual tracking error exceeds the targets established, the Advisor, Staff, and Consultant will bring such deviations to the Board's attention on a quarterly basis and provide a plan and timeframe to remedy such deviations. If, due to market conditions, the Advisor, Staff, and Consultant, do not believe corrective action is warranted or where taking action will have a negative impact on the Fund, the Board will be presented with a report outlining why corrective action should not be taken. Based on analysis prepared by the Advisor, Staff, and Consultant, the Board may approve temporary deviations from the tracking error targets set forth in this Policy.

1.11 Benchmark Administration

In the event that any of the benchmarks defined herein are discontinued or their composition changes, the Board may in its sole discretion substitute other benchmarks upon the recommendation of the Advisor, Staff or Consultant. Upon the adoption by the Board of those changes, the SDCERA CEO may approve the amendment of any and all contracts or related documents that would be affected by those changes.

1.12 Total Fund Measurement and Reporting Criteria

The Board relies on the Advisor, Staff and the Investment Consultant to continuously monitor the investment program and to report to the Board as outlined below:

- Staff and Investment Consultant provide comprehensive periodic reports on the entire investment program, including asset allocation, performance, attribution analysis, and risk analysis. In preparing such reports and conducting analysis, the Staff and Investment Consultant may utilize the services of the Fund's Custodian Bank.
- Staff and Investment Consultant monitor changes and developments at investment managers and at custodian(s), compliance with guidelines, etc. on an ongoing basis, and report significant changes or events with recommended actions as needed.
- Risk budget utilization, as defined under section 1.10
- Rating changes for specific managers
- Cost analysis and peer benchmarking
- Trading cost analysis and effectiveness
- Confirmation of compliance with board proxy voting policy
- Securities lending activity report
- Overall structure of investment program
- Asset liability study (every three years)

Article 2 – Public Markets Portfolio

2.1 Definition of the Public Markets Portfolio

The Public Markets Portfolio consists of the collective investments across the following asset classes:

- Global Developed Public Equities
- Emerging Market Public Equities
- High Yield Fixed Income
- Funds earmarked for Private Equity investments that are being managed in accordance with the Russell 3000 Index
- Emerging Market Debt
- U.S. Treasuries
- Asset Allocation Strategies
- Relative Value Strategies
- Funds earmarked for private Real Estate investments that are being managed in accordance with the Dow Jones US Real Estate Index
- Funds earmarked for private investments in Natural Resources and Other Real Assets that are being managed in accordance with the blended benchmark for Natural Resources (1/3 GSCI, 1/3 Citigroup MLP, 1/6 TSX Material Sector and 1/6 S&P 500 Material Sector)
- Treasury Inflation Protected Securities

2.2 Public Markets Portfolio Objectives

The objective of the Public Markets Portfolio is to outperform the target-weighted average of the asset class benchmark components while adhering to the authorized investments and tracking error guidelines outlined in sections 2.3 and 2.4, respectively.

2.3 Authorized Investments for the Public Markets Portfolio

The Advisor has the authority to use or direct Staff to use the following instruments in order to attempt to replicate or outperform the benchmarks stated in sections 1.7 and 1.10, on a collective or individual basis (diversification may cause some asset classes to outperform and some to underperform, based on

style-specific factors; however, the relative performance of any individual investment or asset class composite is considered less relevant than that of the whole), subject to the tracking error limits outlined in section 1.10.

- ETFs, futures contracts, total return swaps, separate accounts, and commingled funds that offer at least monthly liquidity,
- Any instrument included in any stated policy benchmarks,
- Any instrument, whose performance is based upon the performance of any policy benchmark or subset thereof,
- REITS, MLPs, ETFs and other liquid investment vehicles intended to replicate the exposures contemplated under the Natural Resources, other Real Assets, Private Equity and Real Estate portfolios,
- Enhanced total return swaps,
- Publicly traded debt instruments,
- Publicly traded equity instruments,
- Commitments to separate accounts, limited partnership agreements and commingled investment vehicles that do not offer at least monthly liquidity provided that the fund manager is on the Approved List, subject to the limits set forth in section 2.4.

2.4 Public Markets Portfolio Restrictions

The Advisor, Staff and Consultant are expressly forbidden from using any of the instruments outlined above to circumvent or distort adherence to the intended asset class limits, tracking error limits or any other element of policy, expressed herein.

Commitments to investment vehicles with Approved List managers that do not offer monthly or more frequent liquidity are restricted as follows:

	Limits (% of total Fund)	
	Individual Fund	Total Exposure
Managers without Initial Lock-Ups of One-Year or Greater	2.0%	10.0%
Managers with Initial Lock-Ups of One-Year or Greater	1.0%	5.0%

Any allocation that exceeds those amounts or that is with a manager that is not on the Approved List must be approved by the Board.

2.5 Authority to Execute Documents

The Board hereby authorizes any officer of the Advisor, the SDCERA CEO and the Assistant Chief Investment Officer of SDCERA to execute any and all agreements, instruments, notices, documents and certificates necessary or desirable in connection with any investment outlined in section 2.3 above that is in compliance with all other provisions expressed within this policy.

2.6 Conflicts of Interest

Conflicts of interest, including but not limited to the appearance of conflicts in the selection and engagement of external investment managers, will be avoided by the Advisor, Staff, the Board of Retirement, the Consultant, and others involved in the implementation of this Policy at all times. Potential or actual conflicts must be evaluated during due diligence and after engagement under applicable ethics policies and statutory provisions. The Advisor, Staff and Consultant will develop guidelines and procedures to identify actual or potential conflicts of interest affecting external managers to be engaged and shall employ reasonable diligence to identify conflicts of interest affecting Board members, employees, advisors and consultants with respect to all investment managers accessed under the Public Markets Portfolio whether or not they are currently a member of the Approved List.

Any conflicts that are identified must result in either a rejection of the investment or, if the investment still has merit despite the conflict, a Board resolution to invest following a full disclosure of the salient facts.

Article 3 – Private Markets Portfolio

3.1 Private Markets Portfolio Objectives

The Private Markets portfolio represents the combined private investments deployed through private equity, natural resources, other real asset and real estate investments. The liquidity profile of the Fund allows SDCERA the ability to invest in the less liquid strategies, noted above, in order to achieve diversification and an enhanced risk return profile. The common objectives of these portfolios are twofold:

1. To outperform publicly traded alternatives on a risk adjusted basis through skillful investment and operations, and
2. To access attractive investment opportunities that would not be available through a publicly traded alternative.

3.1.1 Private Equity

Strategic Objective

The objective of the Private Equity Portfolio is to invest globally in equity and debt securities of operating companies not traded on the public markets. The Private Equity Portfolio will be allocated across the following four primary strategies:

- Buyouts and Growth Capital – including but not limited to large buyouts, mid-market buyouts, expansion capital, and capital for acquisitions;
- Venture Capital – including but not limited to early stage venture capital, late stage venture capital, and venture debt;
- Distress and Special Situations -- including but not limited to turnarounds, restructurings, rescue financing, distress for control strategies, distressed securities trading, and opportunities arising from government initiatives, etc.;
- Opportunistic and Other – including but not limited to secondary fund-of-funds, secondary direct funds, and royalty funds (including healthcare and intellectual property).

Performance Objective

The primary performance objective of the Private Equity Portfolio is to generate net annualized long-term returns in excess of the Private Equity Performance Benchmark.

Investment Guidelines

1. Permissible investments include limited partnerships and similar structures; separate accounts, pooled accounts and similar structures; co-investments, and direct investments. These investments may be acquired through both the primary and secondary markets.
2. The Private Equity Portfolio shall adhere to these long-term allocation targets and ranges:

<u>Strategy</u>	<u>Long-Term Target</u>	<u>Allowable Range:</u>	
		<u>Minimum</u>	<u>Maximum</u>
Buyouts & Growth	4.5%	3.0%	8.0%
Venture Capital	1.0%	0.0%	2.0%
Distress & Special Situations	3.0%	1.0%	3.0%
<u>Opportunistic</u>	<u>1.5%</u>	<u>1.0%</u>	<u>2.0%</u>
Total (% of entire SDCERA portfolio)	10.0%		

- 3.1.2** Investments in non-OECD countries may not exceed 50% of the Private Equity Portfolio.

Natural Resources and Other Real Assets

Strategic Objective

The objective of the Real Assets Portfolio is to invest funds directly in assets that are tangible or physical in nature, or to invest funds in the security interests, obligations, options and other rights to the cash flow streams associated with those assets.

Investments within the Real Assets portfolio will be allocated across two segments:

1. Natural Resources
2. Infrastructure and Other Real Assets

Natural Resources shall include, but is not limited to, farmland, livestock, timberland, energy, oil and gas, metals and mining, water, and any rights associated with those assets (e.g. mineral and water rights, royalty trusts, etc).

Infrastructure and other Real Assets shall include, but is not limited to, infrastructure, shipping, storage, water plants, and any rights associated with those assets.

The portfolio shall be managed with the objective of preserving capital while maximizing the risk-adjusted returns through income generation and long-term capital appreciation, enhancing diversification, and hedging against inflationary risks.

Performance Objective

The primary performance objective of the Portfolio is to generate annualized net returns which exceed the return of the Real Assets Performance Benchmark over time.

Investment Guidelines

1. Permissible investments shall include futures, physicals, security interests (including equity and debt), Master Limited Partnerships (MLPs), private partnerships, commingled funds, separate accounts, co-investments and direct investments.
2. The Portfolio shall adhere to the following long-term allocation targets and ranges:

	Long-Term	Allowable Ranges	
<u>Strategy</u>	<u>Target Allocation</u>	<u>Min</u>	<u>Max</u>
Natural Resources	7%	5%	9%
Infrastructure & other Real Assets	3%	1%	5%
Total	10%	-	-

3. Investments in non-OECD countries may not represent more than 50% of the Portfolio.

3.1.3 Real Estate

Definition of real estate

The real estate portfolio consists of investments in private real estate defined by property types:

- Office
- Multifamily – apartments
- Retail
- Industrial
- Hotel
- Residential
- Self-storage
- Mixed use properties
- Land
- Student housing
- Assisted living facilities
- Any other property types recognized by the National Council of Real Estate Investment Fiduciaries (NCREIF), the National Association of Real Estate Investment Trusts (NAREIT) or SDCERA’s real estate consultant

Real estate’s primary goal is to provide current income with the potential for appreciation and preservation of capital. Additional goals are to provide market competitive returns, diversify from other portfolio asset classes, and act as a small inflation hedge.

Real estate performance objectives

Real estate performance objectives are to meet or exceed on a net basis the NCREIF Property Index (NPI) over a rolling five year period.

Investment guidelines

1. Permissible investments shall include but are not limited to individual managed accounts, commingled funds, co-investments, security interests, publicly traded indexes, and direct investments.
2. An acceptable allocation between core and non-core investment strategies will be adhered to. Core investments are broadly defined as existing, close to fully leased up properties located principally in recognized markets. Non-core investments encompass property and/or investment strategies that are accompanied by higher levels of leverage or that require greater operating expertise. The objective is to move a non-core investment to core status.

The long-term allocations to these investment strategies are:

<u>Strategy</u>	Long-Term	Allowable Ranges	
	<u>Target Allocation</u>	<u>Min</u>	<u>Max</u>
Core	7%	5%	10%
Non-Core	3%	0%	5%
Total real estate allocation	10%		

3.2 Private Markets Portfolio Restrictions

The Board grants to Staff the authority to commit funds to limited partnerships or other investment vehicles managed by Approved List managers in accordance with the following limits:

	Limits (% of total Fund)	
	Individual Fund	Total Exposure
Private Equity	1.00%	5.00%
Real Estate	1.00%	5.00%
Natural Resources	1.00%	5.00%
Infrastructure	1.00%	5.00%
Other Real Assets	1.00%	5.00%

Any allocation that exceeds those amounts or that is with a manager that is not on the Approved List must be approved by the Board.

3.3 Commitment Pacing and Ratios for the Private Markets Portfolio

Due to the lengthy investment periods that accompany the private asset classes in which SDCERA is targeting and the cash flow associated with realized investment returns due to sale or other liquidity events, it is necessary to commit a larger percentage of capital than the targeted investment amount. Taken together, the sum of the NAV of existing fund investments and the undrawn commitments across those investments represents the total exposure to private markets (“Total Exposure”). The ratio of the Fund’s Total Exposure to target allocation may range from a minimum of 1.5:1 to a maximum ratio of 2.25:1. The target allocation range will be presented to the Board on a regular basis as part of the asset class pacing analysis / strategy.

3.4 Conflicts of Interest

Conflicts of interest, including but not limited to, the appearance of conflicts in the selection and engagement of external investment managers, will be avoided by the Advisor, Staff, the Board of Retirement, the Consultant, and others involved in the implementation of this Policy at all times. Potential or actual conflicts must be evaluated during due diligence and after engagement under applicable ethics policies and statutory provisions. The Advisor, Staff and Consultant will develop guidelines and procedures to identify actual or potential conflicts of interest affecting external managers to be engaged and shall employ reasonable diligence to identify conflicts of interest affecting Board members, employees, advisors and consultants with respect to all investment managers accessed under the Private Market Portfolio whether or not they are currently a member of the Approved List.

Any conflicts that are identified must result in either a rejection of the investment or, if the investment still has merit despite the conflict, a Board resolution to invest following a full disclosure of the salient

facts.

Article 4 – Derivatives and Leverage

4.1 Derivative Definition

For the purposes of this policy, derivatives include, without limitation, futures contracts; options; options on futures contracts; forward contracts; swap agreements, including swap contracts with embedded options; any instrument or contract intended to manage transaction or currency exchange risk in purchasing, selling or holding investments; and any other instrument commonly used by institutional investors to manage institutional investment portfolios. Derivatives may be purchased through a national exchange or through a direct Over-the-Counter (“OTC”) arrangement with a counterparty.

4.2 Derivative and Overlay Objectives

At a macro level, derivatives may be used to maintain the program’s strategic asset allocation. Staff will have discretion to engage in derivative transactions to achieve, maintain or hedge any asset class exposure consistent with this Policy at a lower cost and/or risk than would be the case with direct investments in the underlying securities. The usage of derivatives within each portfolio shall be consistent with the investment guidelines defined for that portfolio.

At a micro level, external managers retained by the Board may be permitted to utilize derivatives to implement their investment strategies. Each individual manager’s guidelines shall specify guidelines regarding derivatives usage.

4.3 Guidelines for Use of Derivatives

The following guidelines shall apply with respect to the use of OTC derivatives:

SDCERA may enter into OTC derivative or swap transactions with high-quality counterparties that have an ISDA (International Swaps and Derivatives Agreement) in place with SDCERA and are rated “A” or higher by S&P (Standard and Poors) or a comparable rating by another rating agency.

- The exposure to any one single counterparty shall not exceed 35% of the total derivatives exposure in aggregate at the total fund level.
- There should be adequate diversification of counterparties to minimize the risk to SDCERA of any counterparty default. At a minimum, SDCERA shall maintain five counterparties to execute derivative transactions.
- Reset periods with respect to equity and fixed income swaps should occur at least every three (3) months and expiration and reset dates should be staggered to avoid excessive cash outflows occurring over a single month. Swaps in respect of commodity transactions shall occur on a monthly basis.

- Swaps and OTC derivatives with the same counterparty should be settled on a net basis at each reset date to minimize SDCERA's exposure to the counterparty.

4.4 Guidelines for Use of Leverage

Financial leverage may be utilized in implementing investment strategies so long as the use of leverage is consistent with the spirit of this Investment Policy Statement and does not materially alter the risk level of the investment program given the current asset allocation as approved by the Board. Risk constraints established by the Board (for the total portfolio, the individual asset classes, and individual managers) control the use of leverage. The Board will continue to exercise oversight over the use of leverage at the total fund and manager level by its approval of internally or externally managed investment strategies.

4.5 Derivative and Leverage Restrictions

Under no circumstances may derivatives or leverage be used to circumvent the intent or limits otherwise prescribed by this policy.

4.6 Conflicts of Interest

Conflicts of interest, including but not limited to the appearance of conflicts in the selection and engagement of external investment managers, will be avoided by the Advisor, Staff, the Board of Retirement, the Consultant, and others involved in the implementation of this Policy at all times. Potential or actual conflicts must be evaluated during due diligence and after engagement under applicable ethics policies and statutory provisions. The Advisor, Staff and Consultant will develop guidelines and procedures to identify actual or potential conflicts of interest affecting external managers to be engaged and shall employ reasonable diligence to identify conflicts of interest affecting Board members, employees, advisors and consultants with respect to all investment managers accessed in connection with derivatives and leverage whether or not they are currently a member of the Approved List.

Any conflicts that are identified must result in either a rejection of the investment or, if the investment still has merit despite the conflict, a Board resolution to invest following a full disclosure of the salient facts.

Article 5 – Securities Lending

SDCERA may enter into agreements establishing securities lending programs. These programs may be established with the master custodian or one or more third-party securities lending agents. Staff shall assess the suitability of such programs taking into consideration the nature and diversity of the collateral investment pools provided by the lending agent, as well as the agent’s track record, reputation, costs and other relative merits between the programs. The focus of the securities lending program should be to keep risks low, with the preservation of capital taking precedence over income maximization.

5.1 Lending Guidelines

- All security loans shall be secured by cash or non-cash collateral equal to 102% or more of the value of the securities loaned in the case of domestic securities, and 105% or more in the case of international securities.
- All security loans shall be marked to market on a daily basis.
- The collateral received against security loans shall be well diversified, maintain adequate liquidity, and focus on principal preservation.

5.2 Cash Reinvestment Guidelines

- All securities purchased for the collateral reinvestment portfolio shall have an investment grade rating by at least one Nationally Recognized Statistical Rating Organization (“NRSRO”); or, in the case of securities that have a remaining maturity of 13 months or less, a top-tier rating by a NRSRO, or, if unrated, be of comparable quality.
- The dollar-weighted average maturity to reset shall not exceed 90 days.
- No instrument will have a maturity or weighted average life in excess of 18 months, with the exception of floating rate securities, which may have a five-year maturity or weighted average life.

5.3 Conflicts of Interest

Conflicts of interest, including but not limited to the appearance of conflicts in the selection and engagement of external investment managers, will be avoided by the Advisor, Staff, the Board of Retirement, the Consultant, and others involved in the implementation of this Policy at all times. Potential or actual conflicts must be evaluated during due diligence and after engagement under applicable ethics policies and statutory provisions. The Advisor, Staff and Consultant will develop guidelines and procedures to identify actual or potential conflicts of interest affecting external managers to be engaged and shall employ reasonable diligence to identify conflicts of interest affecting Board members, employees, advisors and consultants with respect to securities lending.

Any conflicts that are identified must result in either a rejection of the investment or, if the investment still has merit despite the conflict, a Board resolution to invest following a full disclosure of the salient

facts.

Article 6 – Proxy Voting Policy

SDCERA recognizes that the ownership of equities entitles proxies to be voted. Each external manager retained by SDCERA shall be responsible to vote proxies relating to the portfolios that they manage on behalf of SDCERA. The managers will vote proxies with the same care, skill, diligence and prudence as is exercised in managing its other assets, including the disclosure and avoidance of any actual or potential conflicts of interest. On an annual basis, the manager will provide Staff and / or Consultant a summary of proxies and how they voted on them.

