

**COUNCIL ROCK
SCHOOL DISTRICT**

SECTION: FINANCES

**TITLE: INVESTMENT OF
DISTRICT FUNDS**

ADOPTED: April 16, 1998

REVISED: September 1, 2016

INVESTMENT POLICY STATEMENT

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EXECUTIVE SUMMARY

Type of Fund:	Operating Cash and Capital Accounts
Planning Time Horizon:	Immediate to Five Years
Risk Tolerance:	Low, permanent loss of capital is unacceptable
Governing Law:	24 P.S. 440.1 24 P.S. 621 24 P.S. 622 24 P.S. 623 24 P.S. 218 17 CFR Part 270 65 Pa. C.S.A. 1101 et seq. 53 Pa. C.S.A. 8001 et seq. GASB, Statement No. 40 72 P.S. 3836 et seq.
Evaluation Benchmark:	Total return to exceed performance of Callan Associates' median money market funds database, 90 day Treasury Bills or prevailing short-term interest rates.

BACKGROUND AND DESCRIPTION

Council Rock School District (the “District”) was formed in July of 1969. Located in Lower Bucks County, the District covers 72 square miles with a population of roughly 60,000 people living in the five municipalities of Newtown Borough, Newtown Township, Northampton Township, Upper Makefield Township and Wrightstown Township.

The District has ten elementary schools configured K-6, three middle schools (7-8) and two high schools (9-12). The District provides a program of special education that serves the diverse needs of over 1500 students. In addition, the District also provides services for a mentally gifted population of similar numbers. We have a growing number of students who require English as a second language services.

The District has a reputation for academic excellence. Over the past three years, the District has been recognized in local, state and national publications. Standard & Poor’s, Inc. has recognized the District as an "outperformer". Our attendance rate and college acceptance rate rank among the best in the state.

The District is governed by a School Board (the “Board”) consisting of 9 elected officials responsible for all aspects of the District’s functioning, including its finances. The Board has the authority to delegate to the District’s Business Administrator (the “Administrator”) the day-to-day management of these finances in accordance with the Board’s adopted policies. These finances include funds for current expenditure, long-term reserve funds and capital funds (the “Assets”).

PURPOSE

The purpose of this Investment Policy Statement (“IPS”, “Statement”, “Policy”) is to assist the Board in effectively supervising, monitoring and evaluating the management of the Assets under its care. The District's investment program is defined in the various sections of the IPS by:

- Stating in a written document the Board's attitudes, expectations, objectives and guidelines for the management of all Assets;
- Setting forth an investment structure for managing the Assets to produce sufficient levels of income over the short-term while minimizing risk;
- Providing guidelines that control the level of overall risk and liquidity assumed;
- Encouraging effective communications among the Board, the consultant (“Consultant”), the money managers (“Managers”), the depository institutions (“Depositories”) and custodian (“Custodian”);
- Establishing formal criteria to monitor, evaluate and compare the performance results achieved by the Managers on a regular basis; and,
- Ensuring compliance with all applicable fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with all applicable laws, rules and regulations from various local, state, federal and international political entities that may impact the Assets.

This IPS has been formulated based upon consideration by the Board of the financial implications of a wide range of policies and describes the prudent investment process that the Board deems appropriate.

SPECIFIC ROLE OF THE BOARD

Recognizing that the role of the fiduciary is to manage the investment process, the Board shall:

- Set overall investment policy and routinely review overall portfolio structure and individual investments;
- Select service providers including Managers, Consultants, Depositories and Custodians;
- Assign specific tasks to service providers; and,
- Review performance of all investment advisors and service providers.

STATEMENT OF OBJECTIVES

The objectives of the Board have been established in conjunction with a comprehensive review of the current and projected financial requirements. The objectives, in priority order, are:

- Legality - All investments shall be made in accordance with applicable laws of Pennsylvania.
- Safety - Safety of principal shall be of highest priority. Preservation of capital in the portfolio of investments shall be ensured through the mitigation of credit risk and interest rate risk.
- Liquidity - Investments shall remain sufficiently liquid to meet all operating requirements that are reasonably anticipated. A fiscal year operations anticipated cash flow shall be developed so that investments can be made as early as possible, with maturities concurrent with anticipated cash demands.
- Yield - Investments shall be made with the objective of attaining a market-average rate of return throughout the budgetary and economic cycles, taking into account investment risk constraints and liquidity needs.

It shall be the policy of the Board to optimize its return through investment of cash balances in such a way as to minimize “idle” cash balances and to maximize return on deposits and investments within Statement guidelines.

Investment results are the critical element in achieving the investment objectives. Investment earnings are expected to be used to support the needs of the District.

AUTHORITY AND RESPONSIBILITIES

- The Board has ultimate responsibility and full authority over the Assets. It, however, has delegated day-to-day management to the Administrator.
- The Board has chosen to retain the use of a Consultant to help manage the investment process. The Consultant will assist the Administrator in the day-to-day management of the Assets within the context of the IPS. The Consultant has acknowledged its fiduciary responsibility in writing.
- The Custodian/Depository will be responsible for the safekeeping of all Assets. The Custodian will be responsible for the processing of securities transactions as determined by the Managers and the Administrator. The Custodian/Depository will also provide administrative, accounting, and disbursement services.

- Managers will be retained to manage Assets within their area of expertise. Managers will be responsible for security selection within the context of this Statement and are expected to exercise the appropriate level of due care in the management of the Assets.

CONDITIONS AND ASSUMPTIONS

Types of Assets

- Operating Capital - It is expected that the majority of Assets will be spent over the course of the year for operations. Large deposits in August and September should be assumed.
- Fund Balances – It is expected that committed fund balances shall be invested in eligible securities with maturities no less than one week prior to their expected need rather than actively managed. Unassigned fund balances are eligible for active management.
- Revenues & Other Financing Sources (other than Bond Proceeds) – It is expected that these funds shall be actively managed along with unassigned fund balances in order to match expected cash needs.
- Bond Proceeds – It is expected that municipal bond proceeds shall be actively managed to minimize the difference between yield of those bonds and investment income while also maintaining appropriate liquidity to match liabilities.

Time Horizon

This Policy is based upon an investment horizon of less than one year, therefore, interim fluctuations should be viewed with appropriate perspective.

Short-term liquidity requirements have been anticipated and will be handled through the strategic use of asset/liability management.

Risk Tolerance

The Board recognizes that permanent loss of capital is unacceptable and as such has outlined liquidity and preservation of capital as two of its foremost objectives. That being said, the Board also recognizes that income production can be helpful in offsetting future liabilities and has chosen to monitor the risk of the investment portfolio on an ongoing basis.

Risk can be measured in many different ways. The Board will monitor volatility statistics with the goal of being in the lower half of its respective peer group over rolling three year periods of time. Some, but not all, of these measures may include; beta, standard deviation, downside risk, residual risk and tracking error.

Should the portfolio realize unexpected results in the above risk statistics, the Board, with the help of its Consultant, will attempt to find the source of such volatility and ascertain its future usefulness in the investment of the Assets.

Performance Expectations

The desired investment objective is a rate of return on assets that is greater than prevailing short-term interest rates, net of all fees.

The Board of School Directors realizes that market performance varies and that any given rate of return may not be meaningful during some periods. Accordingly, relative performance benchmarks for the Managers are set forth in the "Control Procedures" section.

Over a complete market cycle, the Assets' overall annualized total return, after deducting for advisory, money management, and custodial fees, as well as total transaction costs, should perform above the following benchmarks:

- Callan Associates' median money market funds database;
- 90 day Treasury Bills; and,
- Prevailing short-term interest rates.

Investment Constraints

The Assets are limited to investments permitted under 24 P.S. 440.1 and uninvested assets with Depositories under the guidelines outlined in 72 P.S. 3836 et seq. The current definition of each is found under "Securities Guidelines".

Strategic Allocation

The Administrator, with advice from the Consultant, shall balance the Assets of the District between uninvested cash and investments on a regular basis. It is the intent of this policy that at a minimum one month's spending needs will always be maintained with Depositories in an account with daily liquidity.

SECURITIES GUIDELINES

Managers selected to manage the Assets must adhere to the following guidelines as outlined in 24 PS 4-440.1(a).

Furthermore, although considered legal under governing law, the following securities are not authorized unless receiving prior written approval by the Administrator **and the Superintendent of the District (or a designee of the Superintendent)**:

- General Obligation bonds of municipal entities issued by the state of Pennsylvania or any of its agencies or instrumentalities backed by the full faith and credit of the Commonwealth, or of any political subdivision of the Commonwealth of Pennsylvania or any of its agencies or instrumentalities back by the full faith and credit of the political subdivision; and,
- Mortgage-backed, interest-only or principal-only investments issued by agencies or instrumentalities of the United States Government.
- Other such investments as may be from time-to-time allowed under Pennsylvania code.

Investments:

Authorized types of investments for the Assets shall be:

- United States Treasury bills;
- Obligations of the United States Government or its agencies or instrumentalities;

- Obligations of the United States of America or any of its agencies or instrumentalities backed by the full faith and credit of the United States of America. Zero-coupon Treasuries and Treasury Inflation Protected Securities are specifically allowed by this Statement; and,
- Shares of an investment company registered under the Investment Company Act of 1940 (54 Stat. 789, 15 U.S.C. § 80a-1 et seq.), whose shares are registered under the Securities Act of 1933 (48 Stat. 74, 15 U.S.C. § 77a et seq.), provided, that the following conditions are met:
 - The only investments of that company are in the authorized investments for school district funds listed above and repurchase agreements fully collateralized by such investments;
 - The investment company is managed so as to maintain its shares at a constant net asset value in accordance with 17 CFR 270 2a-7 (relating to money market funds); and,
 - The investment company is rated in the highest category by a nationally recognized rating agency.

Any idle cash not invested by the Managers shall be invested daily through an automatic interest bearing sweep vehicle managed by the Custodian in accordance with the above referenced criteria.

Please see Addendum A (“Specific Limitations and Definitions”) for restrictions on investments specific to bond proceeds, compliance with GAAP and reporting requirements.

Noninvested Assets (Cash/Cash Equivalents):

Authorized types of deposits for District Assets shall be:

- Deposits in savings accounts or time deposits or share accounts of institutions insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation or the National Credit Union Share Insurance Fund to the extent that such accounts are so insured, and, for any amounts above the insured maximum, provided that approved collateral as provided by law therefore shall be pledged by the Depository.
 - Assets pledged as collateral may be pooled in accordance with the act of August 6, 1971 (P.L.281, No.72), relating to pledges of assets to secure deposits of public funds.

SELECTION OF CUSTODIAN¹

The Board will select appropriate Custodians to safe keep the Assets. Custodians must meet the following minimum criteria:

- Be a National bank, Federal Savings bank, state bank or trust company that either:
 - Maintains an account in its name in a clearing corporation, or,
 - Is a member of the Federal Reserve System through which Custodian participates in a clearing corporation or the Federal Reserve book-entry system;

¹ For purposes of this policy, investment pools organized in accordance with provisions of Section 3 of Pa Intergovernmental Cooperation Act No. 180 of the 1972 General Assembly and Section 521 of Article V of the Act No. 14 of the 1949 Session of the General Assembly of the Commonwealth of Pennsylvania, as amended, are allowable investment vehicles and custodians of District assets.

- Be legally qualified to accept custody of securities;
- Hold all assets for the District in the name of the District, Custodian, Custodian's agent, clearing corporation or the Federal Reserve book-entry system;
- Maintain insurance sufficient to meet the requirements as outlined by the District from time to time;
- Provide annual filings including SOC-1 Reports as proof that an audit is being performed on internal controls; and,
- Provide business continuity and other reasonable reports as requested by District;

SELECTION OF MANAGERS

The Board will select appropriate Managers to manage the Assets. Managers must meet the following minimum criteria:

- Be a bank, insurance company, investment management company, or investment adviser as defined by the Registered Investment Advisers Act of 1940;
- Provide historical quarterly performance numbers calculated on a time-weighted basis, based on a composite of all fully discretionary accounts of similar investment style, and reported net and gross of fees. Historical returns must be in compliance with the Global Investment Performance Standards (GIPS®) as prepared by the CFA Institute© (formally AIMR©) unless a special exception has been granted by the Board;
- Provide performance evaluation reports prepared by an objective third party that illustrate the risk/return profile of the manager relative to other managers of like investment style;
- Provide detailed information on the history of the firm, key personnel, key clients, fee schedule, and support personnel. This information can be a copy of a recent Request For Proposal (RFP) completed by the Manager;
- Clearly articulate the investment strategy that will be followed and document that the strategy has been successfully adhered to over time; and,
- Selected firms shall have no outstanding legal judgments, past judgments or credible claims which may reflect negatively upon the firm.

CONTROL PROCEDURES

Duties and Responsibilities of the Managers

The duties and responsibilities of each Manager retained by the Board include the following:

- Managing the Assets under its care, custody and/or control in accordance with the IPS objectives and guidelines set forth herein, and also expressed in separate written agreements when deviation is deemed prudent and desirable by the Board;
- Exercising investment discretion [including holding cash equivalents as an alternative] within the IPS objectives and guidelines set forth herein;
- Promptly informing the Administrator and the Consultant in writing regarding all significant and/or material matters and changes pertaining to the investment of the Assets, including, but not limited to:

- Investment strategy
 - Portfolio structure
 - Tactical approaches
 - Ownership
 - Organizational structure
 - Financial condition
 - Professional staff
 - Recommendations for guideline changes
 - All legal, SEC and other regulatory agency proceedings affecting the firm;
- Utilize the same care, skill, prudence and due diligence under the circumstances then prevailing that experienced, investment professionals acting in a like capacity and fully familiar with such matters would use in like activities for like assets with like aims in accordance and compliance with applicable laws, rules and regulations from local, state, and federal entities as it pertains to fiduciary duties and responsibilities; and,
 - Acknowledge and agree in writing to their fiduciary responsibility to fully comply with the entire IPS set forth herein, and as modified in the future.

Brokerage Policy

All transactions effected for the District will be "subject to the best price and execution."

Performance Objectives

Investment performance will be reviewed quarterly to determine the continued feasibility of achieving the investment objectives and the appropriateness of the IPS for achieving those objectives.

It is not expected that the IPS will change frequently. In particular, short-term changes in the financial markets should not require adjustments to the IPS.

Audit

The Board directs that all investment records be subject to annual audit by the District's independent auditors.

The audit shall include, but not be limited to, independent verification of amounts and records of all transactions, as deemed necessary by the independent auditors.

It shall be the responsibility of the investment advisor to maintain necessary documents to permit independent audit of the District's Assets.

Monitoring of Managers

Quarterly performance will be evaluated to test progress toward the attainment of longer-term targets. It is understood that there are likely to be short-term periods during which performance deviates from market indices.

On a timely basis the Board will meet to focus on:

- Manager's adherence to the IPS guidelines
- Material changes in the Manager's organization, investment philosophy and/or personnel, and

- Comparisons of the Manager's results to appropriate indices and peer groups, specifically:

<i>Asset Category</i>	<i>Index</i>	<i>Peer Group Universe</i>
Cash	90 Day T-Bills	Money Market Database or Active Cash

The risk associated with each Manager's portfolio, as measured by the variability (standard deviation) of quarterly returns, must not exceed that of the index and the peer group without a corresponding increase in performance above the benchmark and peer group.

In addition to the information covered during the quarterly reviews, the Board will meet at least annually to focus on:

- The Manager's performance relative to managers of like investment style or strategy. Each Manager is expected to perform in the upper half of the respective style universe; and,
- The Asset's investment performance results compared to the Manager's overall composite performance figures to determine unaccounted for dispersion between the Manager's reported results and the Asset's actual results.

The Board is aware that the ongoing review and analysis of Managers is just as important as the due diligence utilized during the manager selection process. Accordingly, a thorough review and analysis of a Manager will be conducted, should:

- A Manager perform in the bottom quartile (75th percentile) of their peer group over an annualized period;
- A Manager fall in the southeast quadrant of the risk/return scatterplot for a 3-year time period; or,
- A Manager have a 3-year risk-adjusted return (as measured by Sharpe Ratio) that falls below that of the median manager within the appropriate peer group.

Furthermore, performance which may require the replacement of a Manager include:

- A Manager that consistently performs below the median (50th percentile) of its peer group over rolling three-year periods; or
- A Manager with negative alpha for a 3-year time period.

Major organizational changes also warrant immediate review of the Manager, including:

- Change in professionals;
- Significant account losses;
- Significant growth of new business;
- Change in ownership; or,
- Significant deviation from investment style.

The performance of the Managers will be monitored on an ongoing basis, and it is at the Board's discretion, with the assistance of the Consultant, to take corrective action by replacing a Manager if deemed appropriate at any time.

Monitoring of Investment Consultant

The Board shall review the performance of the Consultant on a regular basis using the same criteria for the whole portfolio that each Manager is expected to achieve. Given that allocation variances from the peer median will produce absolute returns that can deviate from the median over short time periods; the Board shall place a greater emphasis on risk-adjusted return measures such as Alpha, Sharpe Ratio, Treynor Ratio, Information Ratio and Sortino Ratio. Consultant shall provide the Board quarterly comparisons of these metrics versus the appropriate peer group and benchmarks.

The Consultant, as a fiduciary of the Assets, is required to provide unbiased investment services to the District and must inform the Board of any changes to key personnel, investment strategy or other organizational issues. The Consultant shall provide to the Board any information deemed appropriate to ascertain its ability to fulfill its duties. This information may include financial statements, proof of regulatory registration and disclosures regarding its ability to perform its duties without conflict.

ADDENDUM A
Specific Limitations and Definitions

Limitations

Bond Proceeds

Bond proceeds shall be invested in accordance with the Local Government Unit Debt Act and applicable federal and state laws, subject to approval by the Board.

Under no circumstances should the Manager invest bond proceeds in a manner that would cause the issue to become an “arbitrage bond” under 26 U.S.C. 148. Yield in excess of the rebate requirement should be minimized for all such funds.

Compliance with GAAP

- Assets shall not be invested in foreign currency and shall not have any related risk that would require disclosure pursuant to GASB Statement 40;
- Assets shall limit the exposure to loss of principal due to market changes in interest rates; and,
- Assets in authorized instruments that are not backed by the “full faith and credit” of the federal or state government shall be limited to those with the highest two (2) credit ratings available for such instruments issued by a recognized organization.
 - If the rating of any instrument is reduced after the purchase and is no longer in compliance with this policy, the individual responsible for District investments shall replace the investment immediately upon receipt of notice of the rating change and notify the Board of the rating change, action taken and replacement investment.
 - When District funds are invested in any one (1) issuer other than designated depository accounts, the amount of the investment shall be unlimited, but the Board shall be notified of such investment monthly.
 - For purposes of interest rate disclosure in the annual financial report, the method of determining interest rate risk shall be based on weighted average maturity.

Reporting Requirements

The Administrator or designee shall report the following to the Board on a monthly basis:

- Amount of funds invested;
- Interest earned and received to date;
- Types and amounts of each investment and the interest rate on each;
- Names of the institutions where investments are placed;
- Current market value of the funds invested; and,
- Collateralization of deposits exceeding insurance limits.

The Board shall consider statements from Custodians/Depositories as sufficient to fulfill these requirements.

Definitions

Alpha – the measure of a manager’s contribution to performance due to security or sector selection.

Beta – a measure of systematic (market) risk of a portfolio. It is expressed as a percentage of the total market.

Bond Proceeds – the cash received from issuing municipal debt prior to its expenditure.

Concentration of credit risk - the risk associated with the consolidation of investments in a single pool, institution, or instrument.

Credit risk - the risk of loss of principal due to the failure of the security issue or backer of the issue.

Custodial credit risk - the risk of loss associated with consolidation of investments with a single institution where the District may rely on the institution to hold investments on behalf of the District or through collateral action when the instruments are not in the District name.

Downside Risk – the standard deviation of a portfolio measured only when the portfolio underperforms its benchmark.

Financing Sources (Other) – the total income received by the District from sources other than fund balance or bond proceeds e.g. property tax and grants.

Foreign currency risk - the risk associated with investment in foreign currency that is subject to market fluctuation and associated currency conversion.

Fund Balance – the difference between total assets and total liabilities.

Fund Balance (Assigned) – the portion of fund balance intended for a particular purpose.

Fund Balance (Committed) – the portion of the fund balance limited by board policy or board action.

Fund Balance (Restricted) – the portion of the fund balance limited by external parties or legislation e.g. debt covenants.

Fund Balance (Unassigned) – the portion of the fund balance available for consumption or not limited in any manner.

Idle Cash – the amount of money in non-interest bearing deposits or investments.

Information Ratio – the measure of excess return created by a manager (alpha) over residual risk.

Interest rate risk - the risk that the market value of securities will fall due to changes in general interest rates.

Investment program - the specifically enumerated and Board-approved investment strategy.

Investments – the securities that are purchased with cash that are not in a deposit account. These are limited by the School District Code.

Maturity (Short-term) - any period thirteen (13) months or less.

Maturity (Long-term) - any period exceeding forty-eight (48) months' duration.

Maturity (Mid-range) - any period between short-term and long-term.

Residual Risk – the firm-specific (non-market) or diversifiable risk of a portfolio.

Sharpe Ratio – the measure of the risk-adjusted return of a portfolio. Expressed as excess return per unit of standard deviation of the portfolio.

Sortino Ratio – the excess return of a portfolio per unit of bad risk (downside risk).

Standard Deviation – the average deviation of the observations of a portfolio's return from its sample mean.

Tracking Error – the volatility of return differences between the portfolio and the benchmark over time.

Treynor Ratio – the measure of excess return per unit of systematic market risk (beta) experienced by a portfolio.

Uninvested Cash – the assets on deposit with a depository in an interest bearing account. This is cash that hasn't been used to purchase securities.