State of Wisconsin
Board of Commissioners of Public Lands
School Trust Fund Investment Policy Statements

An Investment Management Framework for State of Wisconsin School Trust Funds, including the Common School Fund, the Normal School Fund, the Agricultural College fund, and the University Fund.

Approved at 11/1/2016 BCPL Board Meeting

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Mission Statement, Authority, and Purpose

The Board of Commissioners of Public Lands (BCPL) is the oldest state agency and the only agency created within the State Constitution. The forefathers of this State placed a high value on public education, and wanted to create an independent board to oversee the valuable federal land grants that were to be dedicated into a permanent trust created for the benefit of Wisconsin schoolchildren. The constitution included language that formed the BCPL, with membership to be comprised of three statewide elected constitutional officers: the Secretary of State, State Treasurer, and Attorney General. The BCPL was entrusted with the authority to manage the sale of those lands and resultant monies to benefit the education of current and future generations. It is widely believed that the School Trust Funds remain relevant today because the management of School Trust assets was removed from the political and budgetary pressures found in the legislative and executive branches of state governance.

The school trust lands and the proceeds from their sale, plus additional monies as directed by the State Constitution, have been placed into four distinct state trust funds (the School Trust Funds): the Common School Fund, Normal School Fund, University Fund, and Agricultural College Fund. The beneficiaries of the Common School Fund are K-12 public schools located in Wisconsin. Earnings from the investment of Common School Fund principal are currently directed to provide the sole state aid for the purchase of public school library media and resources. The University of Wisconsin is the beneficiary of the other three School Trust Funds managed by the BCPL.

Mission Statement

The mission of the BCPL is to manage the assets of the School Trust Funds in a manner that maintains significant, stable, and sustainable distributions to fund beneficiaries, and to manage all assets and programs entrusted to the Board in a prudent and professional manner, in accordance with the Wisconsin Constitution and applicable state law.

General Authority

The Wisconsin Constitution (Article X) entrusts the management and sale of school trust lands and the investment of funds arising therefrom to the BCPL. As most of the school trust lands are remnants of federal land grants, there are some federal statutes that effect such lands and resulting land sale proceeds. Chapter 24 of the Wisconsin Statutes governs school trust lands and trust funds managed by BCPL. Wisconsin Statutes Chapter 112 includes both the Uniform Fiduciaries Act and the Uniform Prudent Management of Institutional Funds Act, which govern the management of the School Trust Funds. There are no state regulations regarding school trust lands or trust funds.

Investment Authority

The Wisconsin Constitution states that "…The Commissioners shall…invest all moneys arising from the sale of such lands …in such manner as the legislature shall provide...".[1] This provision has been interpreted by the Wisconsin Supreme Court to mean that the State Legislature has the authority to specify the universe of investments available to the BCPL, but may not direct the BCPL to make any particular investment.

Prior to August 2015, the State Legislature limited the investment authority of the BCPL to certain fixed-income securities.

The enactment of Wisconsin Act 60 in August 2015 greatly expanded the investment authority available to the BCPL for management of the School Trust Funds. This statute included language replacing the previous list of authorized investments with the Prudent Investor Standard: "The board shall manage and invest moneys belonging to the trust funds in good faith and with the care an ordinary prudent person in a like position would exercise under similar circumstances, in accordance with the *Uniform Prudent Management of Institutional Funds Act*."[22]

Purpose of This Policy

This Investment Policy Statement (Policy) governs the investment of assets for each of the four School Trust Funds of the State of Wisconsin. Prior statutes provided a de facto investment policy for the BCPL, and removal of these constraints allows the transition of BCPL asset management into industry best practices starting with the creation of this Policy.

This policy is established to provide the framework for management of School Trust Fund assets and sets forth the investment objectives, philosophy, guidelines, and practices for the BCPL, staff, external investment managers (managers), and consultants. The Policy is intended to provide parameters to ensure long-term prudence and care in execution of the investment program, while allowing the flexibility to capture investment opportunities made available to staff and managers. The Policy shall also provide the standards by which the BCPL can evaluate staff, managers, investment consultants, custodians and other service providers.

No investment or action pursuant to an investment may be taken unless permitted by this Policy or by action of the BCPL, and any exceptions to this policy must be approved by the BCPL.

This Policy is supplemented by agency operating procedures and policies, along with language contained within contractual agreements between the BCPL and investment managers and other service providers.

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[1] Article X, Section 8 - Wisconsin Constitution

[2] Chapter 24.61(2)(a) and 112.11(3) - Wisconsin Statutes

Formal Review Schedule

The BCPL acknowledges that investments are subject to short-term volatility, but that maintaining a long-term outlook will provide better results for the investment of the permanent School Trust Funds. This long-term perspective will constrain impulsive and potentially harmful decision-making in reaction to short term market fluctuations and conditions. In order to preserve this long-term view, the BCPL has adopted the following formal review schedule:

Formal Review Agenda Item	Formal Review Schedule
Asset Allocation Policy	At least every four years
Asset Management Structure	At least every four years
Internal Investment Policy	At least every four years
Total Fund Performance	At least quarterly
Asset Class Performance	At least quarterly
Investment Manager Performance	At least quarterly

Description of the School Trust Funds

Common School Fund

The Common School Fund is the largest trust fund managed by BCPL, and was established in the State of Wisconsin Constitution in 1848. This Fund was originally endowed with a federal land grant of the 16th Section of each Wisconsin township (nearly one million acres in total) for the purposes of education. Another grant of 500,000 acres, originally dedicated to 'internal improvements', was added to the Common School Fund due to a successful petition to the United States Congress by the forefathers of this state. Except for about 6,100 acres that remain in trust, all of the school trust lands from these original grants were sold to establish the Fund.

Principal has continued to grow because the Wisconsin Constitution provides that the Fund receive all monies and the clear proceeds of all fees, fines and forfeitures (including unclaimed and escheated property) that accrue to the state.

Common School Fund Earnings are delivered in April (mid fiscal year) to the Department of Public Instruction, which then distributes the earnings as library aid to all public K-12 school districts in the state. These payments are currently directed to provide the sole state aid for the purchase of public school library media and resources. The Wisconsin Constitution provides each school district to receive a share of total distributable earnings based on the number of children aged 4 through 20 living in that district.

As of December 31, 2015, the Common School Fund had total financial assets of $988 million invested in the following security types:

State and Municipal Bonds		$ 306,484,997
Farm Credit Bonds		118,777,080
BCPL State Trust Fund Loans		407,222,405
FDIC-Insured Accounts		40,000,000
State Investment Fund		115,602,795
	Total	$ 988,087,277

Remaining land assets of the Common School Fund have the following properties:

Productive Timberland		3,263
Non-Timbered (primarily wetlands)		1,051
Land with Management Impediments		1,870
	Total	6,176 acres*

*A few productive timberland acres have management impediments.

The management impediment category includes lands that have no legal access, or where logging would not be economically viable because of low timber value, small tract size or parcel remoteness.

Normal School Fund

At the time of Wisconsin's statehood, there was only one "school fund" established in the state constitution for the support and maintenance of both common (public K-12) and normal schools (teacher colleges). From this single fund, whatever trust assets or income not needed for common schools was to be used for the normal schools. In the early days of statehood, the legislature was primarily concerned with funding of the common schools and allocated few resources to normal schools.

In 1850, Wisconsin received a federal grant of more than three million acres of land pursuant to the Swamp Land Act. The proceeds from the sale of these lands were to be used for the purpose of drainage and reclamation of "swamp and overflowed lands" *to the extent necessary*. By 1865, the Wisconsin legislature was convinced that the State needed only half of those swamp lands for drainage purposes. The other half of the land grant was directed by the Constitution to the school fund. The legislature made the additional finding that the common schools did not need additional funding at that time so these lands and resulting sales proceeds would be used to endow the Normal School Fund. One year later in 1866, Wisconsin established its first Normal School in Platteville.

Nearly all of these original swamp lands were sold in the 1800s. The scattered parcels that remained within the Trust were difficult to sell because the parcels had little monetary value and/or severe management impediments, including the lack of legal access. Many of these impediments continue to affect the marketability of these lands, and the Normal School Fund retains ownership of slightly more than 70,800 acres today.

Over the years, the normal schools became state teacher colleges and then state universities that were eventually folded into the University of Wisconsin System (UW). The UW, as the successor in interest of the original normal schools, is now the beneficiary of the Normal School Fund. Additions to principal come from the proceeds of timber sales.

Earnings are distributed to the University of Wisconsin throughout each fiscal year, and are currently dedicated to fund scholarships for UW-Madison and UW-Extension students as well as programs at UW-Stevens Point.

As of December 31, 2015, the Normal School Fund had total financial assets of approximately $26.6 million invested in the following security types:

State and Municipal Bonds		$ 12,520,446
BCPL State Trust Fund Loans		12,417,955
State Investment Fund		1,634,843
	Total	$ 26,573,244

Remaining land assets of the Normal School Fund have the following properties:

Productive Timberland		27,610
Non-Timbered (primarily wetlands)		20,699
Land with Management Impediments		22,239
	Total	70,817 acres*
*A few productive timberland acres have management impediments.		

As with Common School Fund lands, the management impediment category includes parcels with no legal access, or where logging has reduced economically viability.

University Fund

In both 1838 and 1854, Congress granted to the Territory of Wisconsin the equivalent of two townships, or 72 square miles of land, to be sold to support a university. Wisconsin sold nearly all these lands shortly after obtaining title, and made no provision for adding to this fund. The principal balance of the University Fund remains fixed at the amount originally received for the land sales, and the BCPL makes an annual distribution of earnings to the University of Wisconsin.

As of December 31, 2015, the University Fund had total financial assets of $234,130 invested as follows:

State and Municipal Bonds		$ 31,312
BCPL State Trust Fund Loans		199,383
State Investment Fund		3,435
	Total	$ 234,130

Remaining land assets of the University Fund have the following properties:

Productive Timberland		0.0
Non-Timbered (primarily wetlands)		30.0
Land with Management Impediments		3.0
	Total	33.0 acres

Agricultural College Fund

The Agricultural College Fund was established with an 1862 act of Congress granting land to create a permanent endowment to support “colleges of agriculture and mechanical arts” in each state. The Morrill Act gave rise to land grant colleges across the nation by providing that each state was entitled to 30,000 acres of land for each member of Congress. Wisconsin had eight Congressional representatives at that time, so received title to 240,000 acres of land under this law. Wisconsin sold all these lands shortly after obtaining title, and made no provision for adding to this fund. The principal balance of the Agricultural College Fund remains fixed at the amount originally received for these lands, and the BCPL makes an annual distribution of earnings to the University of Wisconsin.

As of December 31, 2015, the Agricultural College Fund had total financial assets of $305,282 invested as follows:

State and Municipal Bonds		$ 134,985
BCPL State Trust Fund Loans		139,879
State Investment Fund		30,418
	Total	$ 305,282

Roles and Responsibilities

The BCPL

The Board of Commissioners of Public Lands is the primary body charged with overseeing investment activities relating to the Funds. The three elected members of the BCPL are fiduciaries subject to certain statutory and common law duties and standards.

The BCPL is responsible for the prudent investment of all assets and programs entrusted to the Board, in accordance with the Wisconsin Constitution and applicable federal and state laws. The BCPL is responsible for establishing and maintaining all policies and guidelines by which the Funds are managed, and by which the Executive Secretary and Investment Committee operate. The BCPL relies on the Executive Secretary, Investment Committee, agency staff, and managers to properly administer the Funds and implement strategies for the investment of Trust assets.

Executive Secretary and Agency Staff

The Board of Commissioners of Public Lands appoints an Executive Secretary to act on its behalf. The Executive Secretary has a primary responsibility to manage the school trust funds and assets under the control of the BCPL as provided by law. In addition to the Executive Secretary, agency staff includes the Deputy Secretary/Legal Counsel, Chief Investment Officer, Senior Forester, Senior Accountant, and five full and part-time support staff.

Investment Committee

The Board of Commissioners of Public Lands hereby appoints the Executive Secretary, Deputy Secretary and Chief Investment Officer to the BCPL Investment Committee, which will have the responsibility for implementing BCPL policy, management of the investment program, implementing a transparent process for selection and termination of investment managers, and reporting to the BCPL regarding the performance of investment portfolios.

Investment Managers

Managers may be hired to provide specialized asset management capabilities, and will serve at the pleasure of the BCPL. Managers will be provided with explicit written investment guidelines that detail permissible securities and strategies, along with providing performance evaluation criteria. Each manager will select, buy, and sell specific securities or investments within the parameters specified in their investment guidelines and in adherence to this Policy. Managers will construct and manage investment portfolios that are consistent with the investment philosophy and disciplines for which they were hired. Managers will provide performance reporting at intervals and in a format specified by the BCPL Investment Committee.

Custodian

A custodian bank is a specialized financial institution engaged to safeguard Trust Fund financial assets. The custodian is responsible for collecting income and safely keeping all cash and securities, processing transactions, and providing accounting and investment reports to the Agency.

Conflicts of Interest

Members of the BCPL, the Executive Secretary, Agency Staff, Managers, Consultants, and Custodians involved in the investment process will refrain from personal business activity that could conflict with the proper execution and management of the BCPL investment program, or that could impair their ability to make impartial recommendations and decisions. Potential conflicts of interest, or anything that might create an appearance of a conflict of interest, must be disclosed in writing to the Executive Secretary.

Adherence to CFA Institute Code of Ethics and Standards of Professional Conduct

The CFA Institute Code of Ethics and Standards of Professional Conduct and Asset Manager Code of Conduct comprise the current industry standards and best practices for the conduct of fiduciaries. These documents are attached as Addendum 1 to this policy. This investment policy hereby requires members of the BCPL, the Executive Secretary, Agency Staff, Managers, Consultants, and Custodians to adhere to these standards.

Investment Philosophy

In order to meet the investment objectives of the BCPL, the following principles have been adopted:

- Strategic asset allocation is a fiduciary duty and allocation across asset classes is the most important determinant of long-term total return and return variability.
- Diversification by asset class and within asset classes is a primary risk control element.
- Each trust or fund invested by the BCPL shall have a strategic asset allocation and investment strategy that is appropriate given its specific requirements for return, risk, time horizon, and liquidity.
- Capital markets exhibit periodic inefficiencies that may be exploited through shorter-term tactical shifts in asset allocations to increase expected investment performance. The amount of any tactical allocation shall be limited to ranges specified within the approved asset allocation.
- Over the long term, active management can add value at the asset class, sector, and security levels by exploiting market inefficiencies and their resulting valuation opportunities. Better opportunities for active management exist with inefficient asset types and markets.
- The cost of investment management is an important element of long-term investment returns, and costs are contained through lower-cost internal management, passive management approaches, external fee negotiations, and a focus on net performance.
- Fund and portfolio results are most appropriately measured against market indices. Peer comparisons are problematic due to differences in liability structures, investment styles, risk preferences, and changes in these investment attributes over time. Results are to be evaluated on the basis of investment return as well as return for the level of assumed risk.

- The BCPL State Trust Fund Loan Program, a direct lending program to Wisconsin municipalities and school districts since 1871, provides an important strategic advantage to BCPL asset management with superior risk and return characteristics.
- Legacy land assets shall be managed to increase the quality and value of land holdings where possible, generate long-term capital gains through timber harvests utilizing industry-best sustainable timber management standards, and improve management efficiencies through the rearrangement of land assets into larger blocks with the sale of excess parcels.
- The rate of growth in fund principal has declined to levels that are at or below the levels of long-term expected inflation. To maintain purchasing power for future generations, interest income and short-term capital gains shall be distributed to beneficiaries as required by law and precedence. Starting in FY2018, capital gains on investments held one year and longer shall be added to the principal of each School Trust Fund.
- The transition from the legacy portfolios of fixed-income securities to new asset classes and allocations will require special considerations to meeting the expectations of beneficiaries, including the maintenance and stability of annual income distributions. The establishment of targeted annual distributions coupled with segregated smoothing accounts is required to ensure the stability of future distributions.

Return Objectives, Smoothing Accounts and Annual Distributions

The mission of the BCPL is to maintain significant, stable, and sustainable distributions to fund beneficiaries. Sustainability in this context means that asset management of the School Trust Funds is to take a multi-generational approach, needing to be accountable to both current and future beneficiaries.

In order to serve the mission of the School Trust Funds, the return objective of the BCPL will be to achieve the highest level of investment performance that is compatible with its risk tolerance and prudent investment practices. In practice, this objective is defined as the return necessary to maintain current levels of income distribution to fund beneficiaries plus long-term expected annual inflation and investment management expenses. The long-term goal of this policy is to generate returns that increase annual income distributions to beneficiaries at or above the rate of inflation.

Establishment of Smoothing Accounts for the Common School Fund and Normal School Fund

Beneficiaries of the Common School Fund and the Normal School Fund are dependent on the distribution of Trust Fund income to fund operations. This is less true for the University Fund and Agricultural College Fund, as the beneficiary of these two funds is the general fund of the University of Wisconsin (UW), with annual distributions of trust fund income currently a small part of the UW budget.

For the Common School Fund and the Normal School Fund, the transition to an asset allocation model that assumes additional risk will increase both earnings expectations and volatility. The stability of beneficiary distributions in an environment of higher volatility requires the establishment of targeted annual distributions with associated smoothing accounts.

Targeted Annual Distribution Prior to the Initial Full Funding of Smoothing Accounts

Targeted annual distributions are hereby established at 3.25% of the Common School Fund principal balance net of restricted funds and 1.50% of the Normal School Fund principal balance net of restricted funds, calculated at the end of the calendar year two years prior to the distribution, using cost basis accounting (e.g. the calculation of targeted distribution for April 1, 2019 will be based on the appropriate fund balance as of December 31, 2017). The establishment of targeted annual distributions will allow beneficiaries of the Common School Fund and Normal School Fund to have confidence in budgeting for operations supported by these distributions. The full funding of smoothing accounts, as described below, will allow a future change in the distribution formula for the Common School Fund and Normal School Fund.

Amount and Funding of Smoothing Accounts

A segregated smoothing account will be established for both the Common School Fund and Normal School Fund from net investment income earned above the targeted annual distribution. The State Constitution does not allow the distribution of fund principal, making it is necessary to establish these segregated smoothing accounts *from earnings.* Until full funding of the smoothing account is achieved, Common School Fund earnings above 3.25% (and Normal School Fund earnings above 1.50%) will be divided with 25% of excess earnings to be distributed to current beneficiaries and 75% directed to their respective smoothing accounts. The definition of excess earnings is the amount of calendar year interest income, dividends, short term capital gains and other earnings, less management expenses, that is above the targeted distribution. Distributions from this smoothing fund will be used to supplement the normal distribution of earnings during years when income does not meet the targeted annual distribution (i.e. when Common School Fund earnings fall below 3.25%, the annual distribution of earnings will be supplemented from the smoothing account to reach the 3.25% target).

The market conditions that might cause a decline in distributable earnings could persist for several years, and the size of the smoothing accounts must be adequate to supplement distributions during this full period. A prudent amount to be maintained within each smoothing account is hereby established at 50% of the targeted annual distribution for the Common School Fund and 60% of the targeted annual distribution of the Normal School Fund. This amount will change on annual basis to the new targeted annual distribution of each fund, and all interest earnings and short-term capital gains above the targeted annual distribution shall be retained in each smoothing fund until the smoothing fund reaches the full finding level. As such, the annual distribution to beneficiaries will be limited to the targeted annual distribution during the years it takes to fully fund these segregated accounts. The amount maintained within each smoothing account shall be reconsidered upon any change in the asset allocation policy.

Annual Distributions Following the Initial Full Funding of Smoothing Accounts

Following the initial year of full funding of the smoothing accounts for the Common School Fund and Normal School Fund, the definition of the targeted annual distribution will change to the average net earnings over the prior five years. To prevent an unintended drop-off in distributions caused by this change in policy, during the first five years of this change the annual earnings distribution may not be less than the amount distributed in the year prior to the change in distribution policy.

If distributable earnings are less than the targeted annual distribution, a transfer from the appropriate smoothing fund will supplement the distribution to beneficiaries. If earnings are greater than the targeted annual distribution, any 'excess earnings' will first be applied to restore the smoothing accounts, with any remainder distributed to beneficiaries. Over time, this process allows for increases in the annual distribution to beneficiaries with the growth in fund principal and earnings.

As defined within this policy, distributable earnings include interest, dividends and short-term capital gains. Beginning in FY2018, all long-term capital gains (gains and losses on the sale of assets held one year or longer) shall be retained and added to fund principal.

Additions to Fund Principal

Constitutional Additions to the Common School Fund

Article X, Section 2 of the State Constitution requires that:

> “The proceeds of all lands that have been or hereafter may be granted by the United States to this state for educational purposes… and all moneys and the clear proceeds of all property that may accrue to the state by forfeiture or escheat; and the clear proceeds of all fines…for any breach of the penal laws, and all moneys arising from any grant to the state where the purposes of such grant are not specified… shall be set apart as a separate fund to be called "the school fund”…[4]

As mentioned earlier, the Common School Fund was originally established with federal land grants totaling about 1.5 million acres. The fund has stayed relevant during the past 168 years because the proceeds from the original land sales have been supplemented through the above constitutional provision. However, the increase in the number of municipal courts, improved systems for returning unclaimed property, and changes in the state regulatory environment have combined to slow down the growth of fund principal in recent years.

This trend magnifies the importance that all sources of fees, fines, and forfeitures that accrue to the state are secured for the Common School Fund, as directed in the constitution. An important element of the fiduciary duty of the BCPL is that all reasonable measures are taken to ensure that funds that legally belong to the Common School Fund are so deposited, and that the BCPL challenges any diversion of such funds to the fullest extent possible.

Long-Term Capital Gains

Beginning in FY2018, long-term capital gains (gains and losses on the sale of assets held one year or longer) shall be retained and added to the principal of each School Trust Fund at the time earned.

This policy continues a BCPL accounting standard that dates from the mid-1800s. In early BCPL history, BCPL-managed lands included both agricultural and timberland parcels. BCPL categorized the sale proceeds from seasonal crops (mostly hay) as income to be distributed to Trust Fund beneficiaries. However, the proceeds from timber sales were added to Trust Fund principal. These distinct treatments make sense in that the harvesting of seasonal crops does not normally deplete the value of a land asset, while timber harvests can have a significant and detrimental impact on land values. This principle is consistent with accounting standards for short-term and long-term capital gains. Short-term capital gains are generally treated like annual interest income, with no impact on the inherent value of the asset. Long-term capital gains are added to trust principal, because the distribution these gains could diminish the value of trust assets for future beneficiaries.

Unique Elements of BCPL-Managed Funds

BCPL State Trust Fund Loan Program

Since first authorized by the State of Wisconsin legislature in 1871, the primary investment vehicle for the BCPL has been the State Trust Fund Loan Program, a direct lending program to Wisconsin municipalities and school districts. This program has provided funding for countless public projects throughout the state, and continues to be a major source of funding for economic development, local infrastructure, school repairs and improvements, and the purchase of vehicles and capital equipment. This program is highly valued by municipalities and school districts because there are no fees, the simplified borrowing process requires no third-party assistance, loan terms are flexible including prepayment without penalty, and interest paid is returned to communities across Wisconsin as public school library aid.

In addition to providing an important source of funding to Wisconsin communities, the loan program originates investment assets with very low default risk. In fact, there has not been a single loan default in the 145-year history of the program. One major reason for this success is that Wisconsin statutes require the BCPL to intercept state aid upon a borrower loan default. State funding of local expenditures is a major source of revenues for individual municipalities and school districts in Wisconsin, and this potential intercept provides a significant incentive for borrowers to stay current on BCPL loan payments.

The state aid intercept allows the BCPL to make loans to communities with lower credit ratings and expect full repayment of principal and interest when due. Trust Fund beneficiaries gain from expansion of the program to all communities within the state, without the additional costs and complexity that would be required with a full underwriting of borrower credit quality. Value is created because the potential credit rating on the loan itself increases to approximately Aa1/AA+ (because of the state aid intercept) regardless of the underlying credit quality of the borrower.

An analysis comparing the yields generated by the BCPL loan portfolio to corporate bonds indicates that the Trust Fund Loan Program generates excess returns, providing a substantial advantage to Trust Fund beneficiaries.[3] Program yields are higher than would be expected in the open market for the level of underlying default risk. These excess returns provide an opportunity for BCPL to explore the possibility of creating an on-going source of capital gains by selling loans on the secondary market. The creation of a pipeline for selling loans might also provide the BCPL with additional flexibility in the management of Trust assets. For example, if the total amount of outstanding loans exceeds the target allocation for that asset class, BCPL could sell excess loans rather than take actions designed to reduce loan demand.

Land Assets

The BCPL has managed State of Wisconsin School Trust Lands since statehood in 1848. Originally granted to Wisconsin from the Federal Government, School Trust Lands eventually totaled almost 4 million acres with the vast majority sold during the 1800s. The BCPL continues to manage approximately 77,000 acres that are concentrated within a nine county consolidation zone in North Central Wisconsin. About 6,100 acres are held in the Common School Fund, with 70,800 acres in the Normal School Fund.

Land assets play an important role in strategic asset allocation by providing diversification and inflation protection to the Trust Fund portfolios. At some point in the future, the BCPL may want to reconsider the current asset allocation to timberland, but it is in the best interest of Trust Fund beneficiaries to take reasonable steps in maximizing the value of BCPL-managed land assets prior to any land sales.

Article X, Section 7 of the State Constitution created the BCPL to sell the lands granted to Wisconsin by the Federal Government and invest the proceeds within a trust to benefit public schools. Section 8 requires that these lands be appraised before sale, and allows the Board to withhold land from sale "when they shall deem it expedient." Section 8 also provides that funds shall be invested "in such manner as the legislature shall provide.

In 2006, the Wisconsin Legislature unanimously approved legislation with the moniker of "Land Bank Authority", which provided limited authority to the BCPL to purchase replacement land assets. This law authorized BCPL to use the proceeds from the sale of School Trust Land sales solely for the purchase of replacement school trust lands when the BCPL determined that the purchase would improve timberland management, address forest fragmentation, or increase public access. The legislation capped the total acreage owned within the combined School Trust Funds, but allowed the BCPL to rearrange holdings into more productive, accessible, and larger tracts that could be managed more efficiently. The law recognized the importance of maintaining land as an asset within the Trust Fund portfolios while also providing a mechanism to improve underperforming parcels.

Since that time, the BCPL has sold about 14,200 acres and purchased about 13,000 acres of replacement School Trust Lands. These replacement lands have improved the quality and value of the land portfolio by:

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[3] BCPL Board Meeting Agenda and Minutes - January 19, 2016. Item 5, Pages 2-3. "Analysis of Trust Fund Loan Program Yields"

- Providing access to over 3,000 acres of previously landlocked parcels;
- Increasing timber revenues as newly acquired lands contain more upland acreage and timber; and
- Improving management efficiencies and economies of scale through blocking and creation of larger tracts.

Moving forward, the goal of BCPL land management is to accelerate the consolidation of remaining School Trust Lands into productive tracts of timberland. All parcels will be identified either for retention in the BCPL-managed portfolio or as excess land. Reasonable efforts will be taken to improve the marketability of excess lands that have curable defects or impediments to value. The sale of any parcel will be completed in a manner that maximizes the net present value of sale proceeds. Consolidation of land assets has been a goal of the BCPL for many years, and continued progress will require the dedication of agency resources and the availability of Land Bank Authority and other tools.

General Risk Objectives

The investment risk objective for the School Trust Funds is based on the following principles:

- An increase in risk is compensated through higher expected long-term portfolio returns.
- Risk can be mitigated through diversification of asset classes and investment approaches. Diversification takes advantage of the different responses to market, economic, and political conditions inherent within distinct asset classes. Diversification also limits portfolio exposure to individual sources of risk, and reduces the variability of portfolio returns.
- The primary determinant of long-term investment performance is the strategic asset allocation.
- Capital markets exhibit periodic inefficiencies that may be exploited through shorter-term tactical shifts in asset allocations to increase expected investment performance. The amount of any tactical allocation shall be limited to ranges specified within the approved asset allocation.

The BCPL shall establish a long-term asset allocation policy for each fund that balances the return objective with the risk level that is appropriate for that fund. These policies provide for the appropriate level of diversification and allow for tactical allocations designed to take advantage of market inefficiencies. In determining the suitable risk levels, the BCPL has considered the purpose and characteristic of each fund; sources, amounts and timing of anticipated additions to fund principal; constitutional and statutory fund distribution requirements to beneficiaries; liquidity requirements; and general economic conditions.

General Constraints

The Prudent Investor Standard

Wisconsin Statutes Section 112.11 requires the BCPL to manage and invest moneys in accordance with the *Uniform Prudent Management of Institutional Funds Act,* which states:

112.11 (3) STANDARD OF CONDUCT IN MANAGING AND INVESTING AN INSTITUTIONAL FUND.

(a) Subject to the intent of a donor expressed in a gift instrument, an institution, in managing and investing an institutional fund, shall consider the charitable purposes of the institution and the purposes of the institutional fund.

(b) In addition to complying with the duty of loyalty imposed by law other than this section, each person responsible for managing and investing an institutional fund shall manage and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.

(c) In managing and investing an institutional fund, an institution:

1. May incur only costs that are appropriate and reasonable in relation to the assets, the purposes of the institution, and the skills available to the institution.
2. Shall make a reasonable effort to verify facts relevant to the management and investment of the fund.

(d) An institution may pool 2 or more institutional funds for purposes of management and investment.

(e) Except as otherwise provided by a gift instrument, the following rules apply:

1. In managing and investing an institutional fund, the following factors, if relevant, shall be considered:
    a. General economic conditions.
    b. The possible effect of inflation or deflation.
    c. The expected tax consequences, if any, of investment decisions or strategies.
    d. The role that each investment or course of action plays within the overall investment portfolio of the fund.
    e. The expected total return from income and the appreciation of investments.
    f. Other resources of the institution.
    g. The needs of the institution and the fund to make distributions and to preserve capital.
    h. An asset's special relationship or special value, if any, to the charitable purposes of the institution.
2. Management and investment decisions about an individual asset shall not be made in isolation but rather in the context of the institutional fund's portfolio of investments as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution.
3. Except as otherwise provided by law other than this section, an institution may invest in any kind of property or type of investment consistent with this section.
4. An institution shall diversify the investments of an institutional fund unless the institution reasonably determines that, because of special circumstances, the purposes of the fund are better served without diversification.
5. Within a reasonable time after receiving property, an institution shall make and carry out decisions concerning the retention or disposition of the property or to rebalance a portfolio, in order to bring the institutional fund into compliance with the purposes, terms, and distribution requirements of the institution as necessary to meet other circumstances of the institution and the requirements of this section.

6. A person that has special skills or expertise, or is selected in reliance upon the person's representation that the person has special skills or expertise, has a duty to use those skills or that expertise in managing and investing institutional funds.

State Statutes

The BCPL is a state agency with an operating budget that requires legislative approval. The BCPL is funded through agency operations, and has not required any general tax revenue in several decades.

The State Legislature also has the authority to specify the universe of investments available to the BCPL, although it may not direct the BCPL to make any particular investment. In addition, statutes also provide the authority and general terms of the BCPL State Trust Fund Loan Program. Recent changes to statutes require the BCPL to utilize the Prudent Investor Standard, which is believed to be in the long-term best interest of Trust Fund beneficiaries. While the School Trust Funds are protected within the State Constitution, the state legislature is a political body that controls the future course of agency policies and procedures.

General Investment Guidelines and Restrictions

1. All investments made shall be subject to the quality and diversification restrictions established by the Prudent Investor Standard.
2. Assets may be held in commingled funds and/or privately managed separate accounts. Exposure through commingled funds, ETFs, and mutual funds shall be evaluated on a case-specific basis through analysis of the prospectus or offering document.
3. No more than 5% of the stock of any corporation may be owned by any School Trust Fund.
4. With the exception of debt instruments issued by the State of Wisconsin and the United States of America (including various agencies and government-sponsored enterprises including the Federal Farm Credit System), investments representing the debt or equity of any one company, institution, or real estate project shall not exceed 5% of the market value of any School Trust Fund.
5. Cash management will be controlled on a portfolio-wide basis, and managers are expected to remain fully invested in the types of securities for which they have responsibility, unless otherwise authorized.
6. Any use of leverage will require BCPL Board approval and be consistent with the strategy for which the BCPL hired the manager, and controlled with the specific guidelines of that manager.
7. The BCPL recognizes that the Funds are exposed to currency risk through international equity, fixed income, and absolute return allocations. The BCPL prefers to utilize unhedged benchmarks and does not require managers to hedge the currency exposure in their portfolios.

Permitted Investments

The BCPL may invest in the following securities and investment activities as long as such investments comply with the Prudent Investor Standard.

Equities

1. Common stock, preferred stock, initial public offerings, Real Estate Investment Trusts (REIT's), securities of foreign issuers listed on U.S. Exchanges, and any security convertible to common stock or American Depository Receipts (ADR's) that are registered by the U.S. Securities and Exchange Commission (SEC) of any corporation whose securities are listed on at least one U.S. stock exchange that has been approved by or is controlled by the SEC or on the National Association of Securities Dealers (NASD).
2. Preferred stock, common stock, and convertible issues of any non-U.S. Corporation; which may be denominated in a foreign currency, provided that the securities are traded on one or more national stock exchanges or included in a nationally recognized list of stocks.
3. The BCPL shall not be invested in more than five percent of the voting stock of any company.
4. The BCPL shall not make direct investments in the common stock of any individual corporation without prior BCPL Board approval. This policy shall not prohibit the actions of any external manager hired by BCPL or the investment of BCPL in externally managed funds that purchase common stocks.

Fixed Income

1. Bonds, notes or other obligations of the United States government, its agencies, government-sponsored enterprises, corporations, or instrumentalities for which the credit of the United States government is pledged for the payment of the principal and interest.
2. Bonds, notes or other obligations issued by any state, its municipalities, or other political subdivisions.
3. Bonds, notes or other obligations issued by the State of Wisconsin, its agencies or authorities, or Wisconsin municipalities or school districts and their agencies or authorities.
4. Bonds, notes, commercial paper or other obligations of any corporation organized and operating within the United States.
5. Debt obligations of non-U.S. governmental or quasi-governmental entities, these may be denominated in foreign currencies; obligations, including but not limited to bonds, notes or commercial paper of any corporation organized outside of the United States. Currency transactions, including spot or cash basis currency transactions, forward contracts and buying or selling options or futures on foreign currencies, shall be permitted.
6. Collateralized obligations, including but not limited to mortgages, held in trust that: (1) are publicly traded and are registered by the SEC or other Self-Regulatory Organization (SRO) and (2) have underlying collateral that is either an obligation of the United States government or else has an investment grade rating (unless otherwise approved by the Investment Committee).
7. High yield fixed income securities rated below 'BBB' according to the Standard and Poor's rating system and below 'Baa' according to the Moody's investors rating system.

Real Estate

Direct investment in real estate is allowed (subject to any statutory limitations), including but not limited to investments through limited partnerships or limited liability companies that have a direct ownership interest in real estate properties, whether income-producing or non-income producing.

Absolute Return

Liquid multi-asset/global tactical asset allocation funds that have the ability to shift capital tactically based on relative valuations, providing broad diversification across a range of global investments.

Diversified Inflation Strategies

1. Inflation-indexed bonds, including investments in actively or passively managed investment vehicles. Treasury Inflation Protected Securities (TIPS) are an example of inflation-indexed bonds.
2. Commodities, including but not limited to futures and/or swaps on individually traded commodities or indexes comprising groups of commodities like the Goldman Sachs Commodity Index (GSCI) or Bloomberg Commodities Index.
3. Master Limited Partnerships (MLPs) focused in energy sector including companies that own or operate energy assets or are involved in the transportation, processing, and storage of natural resources.

4. Natural resources securities including securities of natural resource companies and industrial companies related to the natural resources industry and instruments that derive their value from natural resources.

Cash Investment Guidelines

The BCPL will maintain cash positions in amounts necessary for liquidity, distributions to beneficiaries, and ongoing investment activities including risk reduction when appropriate. In addition to the State Investment Fund, eligible securities include:

1. Bond Anticipation Notes, Note Anticipation Notes, and Tax Revenue Anticipation Notes issued by Wisconsin School Districts and Municipalities.
2. Deposit accounts with banks incorporated within the United States.
3. Commercial paper issued by corporations organized and operating within the U.S. and rated “prime” quality by a national rating service.
4. Repos secured by U. S. obligations or other securities backed by the U.S., A1 or P1 commercial paper, corporate obligations rated AA or better and maturing in five years or less, or asset-backed securities rated AAA. All repo collateral must have a market value of at least 102% of the market value of the contract.

State of Wisconsin
School Trust Fund Investment Policy Statements

Common School Fund
Normal School Fund
University Fund
Agricultural College Fund

Common School Fund

Investment Policy Statement

Fund Purpose

The Common School Fund is a permanent trust fund established in 1848 within the State Constitution for the purpose of education. The beneficiaries consist of all K-12 public school districts located in Wisconsin, and earnings from investment of the Common School Fund are currently directed to provide the sole state aid for the purchase of public school library media and resources.

Funding Sources

This Fund was originally established with federal land grants totaling about 1.5 million acres. Except for about 6,100 acres that remain in trust, all lands from these original grants were sold to establish the Fund.

Principal has continued to grow because the State Constitution provides that the Common School Fund receive all monies and the clear proceeds of all fees, fines and forfeitures (including unclaimed and escheated property) that accrue to the state.

Beginning in FY2018, capital gains on investments held one year and longer shall be added to the principal of the Fund.

Distribution Policy

Interest income and short-term capital gains are distributed to beneficiaries in accordance with the State Constitution and agency policy. Initially, the targeted annual distribution will be at 3.25% of the Common School Fund principal balance (net of restricted funds) calculated at the end of the calendar year two years prior to the distribution, using cost basis accounting (e.g. the calculation of targeted distribution for April 1, 2019 will be based on the fund balance on December 31, 2017). Excess earnings (defined as the amount of calendar year interest income, dividends, short term capital gains and other earnings, less management expenses, that is above the targeted distribution) will be divided with 25% of the excess earnings to be distributed to current beneficiaries and 75% retained to fund a smoothing account. Once that account reaches the recommended level, the distribution will be targeted at the 5-year moving average of fund net earnings.

Investment Objective

The annual return objective will be to maximize expected earnings within acceptable risk parameters, while maintaining a high probability of generating distributable earnings at 3.25% of fund principal. The long-term return objective is to produce annual distributable earnings of 3.25% of the principal balance plus long-term capital gains that increase fund principal at or above the rate of inflation.

Portfolio Constraints

Wisconsin Constitution

The Wisconsin Constitution requires that all Common School Fund income is distributed to beneficiaries, with principal balances maintained within the fund. Most other endowments distribute both interest and principal to meet the needs of beneficiaries, and pay out a fixed percentage of the beginning principal balance regardless of investment results. The inability to distribute Common School Fund principal is critical to asset management policy, and requires that Common School Fund assets are managed differently than the peer group of endowments. The diversification obtained by other endowments may eventually be supportable through the establishment of a smoothing account to stabilize future distributable income.

However, even at the outset of this policy the portfolio must generate capital gains to grow fund principal at or above the rate of inflation to maintain benefits for future generations. Therefore, some allocation must be made to assets that have the ability to generate the necessary capital gains. This allocation for capital gains purposes must be balanced by the fact that it will necessarily reduce current income distributions and delay funding of the smoothing account. A balance between the competing needs of current and future generations of beneficiaries is a goal of this policy and the BCPL.

Beneficiary Dependence on Annual Distributions

Common School Fund beneficiaries depend on the annual distribution of earnings to fund their entire budget to purchase school library materials. This dependence significantly reduces the amount of acceptable risk at the outset of this policy and prior to the funding of a smoothing account to supplement distributions during years when income does not meet the targeted annual distribution.

Liquidity

Liquidity to fund expected near-term demand from the BCPL State Trust Fund Loan Program is a goal of this policy, as this program provides excess investment returns for Trust Fund beneficiaries. Annual loan disbursements from 2000-2015 have averaged $100 million, but required liquidity varies with market conditions including macro and seasonal loan demand. Depending on market conditions, future liquidity requirements for the loan program could be met thorough the sale of investments.

Legacy Assets and Investment Policy Transition

The Common School Fund must transition from a fixed-income portfolio to a diversified portfolio as required by the recent implementation of the Prudent Investor Standard. The goal of this new policy will be to provide stable distributions in addition to capital gains that increase fund principal at or above the rate of inflation. The allocation to new asset classes will be systematic and determined by the confidence level in maintaining targeted distribution amounts to beneficiaries. In addition, the entry point into new asset classes must consider current available valuations within a historic context, with the timing of additional diversification benefits secondary to relative values. In addition, initial allocations within asset classes are likely to be tilted towards assets that produce distributable income. Once the smoothing account is funded to the recommended level, and assuming there are relative values to be found in targeted asset classes, it may be possible to accelerate the transition to a diversified asset allocation.

Strategic Asset Allocation

The Common School Fund is a permanent endowment for education and therefore similar to endowments that have been established for institutions of higher learning throughout the United States. This peer group of College and University Endowments generally utilizes the common method of distributing a percentage of both principal and interest each year regardless of investment results. Because constitutional constraints prevent the Common School Fund from distributing principal, the asset allocation of these endowments is considered useful only for long-range planning purposes. The immediate adoption of the full peer group allocation model would increase portfolio risks to an unacceptable level. This peer group, narrowed by size to include seventy-seven U.S. College and University Endowments with assets between $500 million and $1 billion, had an average asset allocation during 2015 as shown below:

Asset Class	2015 NACUBO Allocation*
Fixed Income	9%
Domestic Equities	21%
International Equities	20%
Real Estate	4%
Private Equity	7%
Venture Capital	3%
Other Alternative Strategies**	34%
Cash	4%

* 2015 NACUBO-Commonfund Study of Endowments with total assets from $501 million to $1 billion. Full study is available from the National Association of College and University Business Officers.
** Other alternative strategies include hedge funds, absolute return, market neutral, long/short, 130/30, event-driven, derivatives, energy and natural resources, commodities, managed futures, and distressed debt.

BCPL has several strategic advantages available for asset management, and Common School Fund asset allocations should be designed to maximize the impact of these strengths, which include:

- The BCPL State Trust Fund Loan Program;
- BCPL staff, which provides low-cost in-house expertise in the Wisconsin credit markets, fixed-income investing, real estate and forestry;
- Strong institutional and professional relationships with other state agencies and staff, including the State of Wisconsin Investment Board (SWIB); and
- Strong institutional and professional relationships with the University of Wisconsin and staff.

One example of capitalizing on these strengths was the collaboration between BCPL and experts from the UW-Madison School of Business to develop the target asset allocation shown below. To determine this target, an analysis was completed of the historic and projected risk and return of various asset classes, the correlation among these asset classes as well as the effect of the expected investment performance on the distributable income of the Fund.

UW advisors noted that bonds previously purchased by BCPL staff for the Common School Fund portfolio "have unusually favorable risk/return characteristics (and)… barring liquidity or return requirements, it remains prudent to recommend the portfolio remains invested primarily in these bonds." Corporate bonds should be added to the portfolio mix to reduce amounts currently invested in cash equivalents, but only if market conditions restrict the availability of the more favorable mix of Trust Fund Loans, State and Municipal Bonds, and Farm Credit Bonds.

An allocation to public equities was proposed to enhance the ability to generate capital gains, but our advisors maintained this allocation should be kept small to control overall portfolio risks. Theoretically, since the primary goal of this equity allocation would be to generate capital gains, investment should lean towards stocks that generate returns in the form of capital gains rather than dividends. In practice however, the current interest rate market makes it difficult for Common School Fund assets to generate sufficient earnings to meet the targeted 3.25% annual distribution. Any shift of allocation from income producing to non-income producing assets would exacerbate this problem. Therefore, as long as market conditions persist with interest rates near historically low levels, equity investments should focus on stocks with an above-average dividend yield. An allocation to high-yielding stocks will still provide some exposure to capital gains (and losses), but will also increase the ability of BCPL to meet the targeted earnings distribution**.** As interest rates increase in the future, the corresponding increase in earnings from fixed-income assets will allow a potential shift of the equity allocation from current income to long-term capital gains.

One strategic advantage that may offer unique investment opportunities is the relationship that BCPL maintains with other state agencies. The current political environment appears to favor a limitation on future bond issuance by the State of Wisconsin. This reluctance to borrow for capital projects may provide opportunities for the BCPL to negotiate favorable terms for the investment of equity financing in properties leased to state agencies. In general, commercial real estate investment would provide both current income and long-term capital gains, and increase portfolio diversification. An allocation to real estate would benefit the Common School Fund, whether that investment was in property leased to the State, in a diversified fund or some other instrument, or alongside SWIB if provided that opportunity. If an investment in any individual property is considered, BCPL should work in partnership with an experienced real estate investment management or development company able to provide specialized expertise and reporting.

Another area of potential advantage for BCPL investment is within the venture capital asset class. This advantage stems from institutional relationships between BCPL and the University of Wisconsin and the

State of Wisconsin Investment Board, along with potential investment opportunities within local biotechnology and other tech industries in Wisconsin. While venture capital investments will generally produce no annual income, a small allocation to funds invested in Wisconsin start-up companies increases the potential for capital gains and could be important factor in the long-term growth of fund principal. In addition to providing additional diversification to the portfolio, this type of investment will tend to help grow the state economy and subsequently improve the credit quality of current investments in Wisconsin state and municipal debt.

The target asset allocation will be reviewed by the Investment Committee on an annual basis for reasonableness given progress towards the allocation target, and current economic and market conditions. Recognizing that a long-term target allocation utilizing new asset classes can take years to implement prudently, the Board delegates implementation of the strategic asset allocation policy to the BCPL Investment Committee including interim funding levels of asset classes, and the setting of interim asset allocation targets and benchmarks.

Based on its long-term return expectations and its determination of the appropriate risk tolerance, the BCPL has chosen the following strategic asset allocation policy for the Common School Fund (current allocation as of December 31, 2015):

Common School Fund Target Asset Allocation

Asset Class	Current Asset Allocation	Target Asset Allocation	Range
Fixed Income and Cash	**100%**	**77%**	**62.5% to 87.5%**
State & Municipal Bonds	**31%**	**25%**	**10% to 50%**
Farm Credit (Agency) Bonds	**12%**	**10%**	**5% to 25%**
BCPL Trust Fund Loans	**41%**	**40%**	**25% to 60%**
Investment Grade Corporate Bonds	**0%**	**0%**	**0% to 40%**
Cash	**16%**	**2%**	**0% to 10%**
Public Equities	**0%**	**15%**	**12.5% to 17.5%**
Real Estate	**0%**	**5%**	**0% to 15%**
Venture Capital	**0%**	**3%**	**0% to 5%**

Rebalancing

Rebalancing is the term that describes the periodic movement of funds from one asset or asset class to another in order to realign assets to the strategic asset allocation target. A rebalancing strategy is an important element of asset allocation policy. Systematic rebalancing can reduce portfolio volatility and increase portfolio return over the long-term. However, frequent rebalancing resulting from excessively tight ranges can lead to unnecessary transaction costs.

The Investment Committee will be responsible for developing and implementing a rebalancing plan that is appropriate for existing market conditions, with a primary objective of minimizing transaction costs, market impact, opportunity costs and portfolio disruptions. To the extent possible, cash flows and revenues will be used to maintain the strategic target allocation.

Recognizing that at times it may be impractical or costly to reallocate assets when an upper or lower limit is breached, the asset class will be rebalanced to within its strategic asset allocation range as soon as is practically possible, subject to reasonable transaction costs.

Tactical Asset Allocation

Capital markets exhibit periodic inefficiencies that may be exploited through shorter-term tactical shifts in asset allocations to increase expected investment performance. The amount of any tactical allocation shall be limited to ranges specified within the approved asset allocation.

Benchmark

Recognizing that a long-term target allocation to alternative asset classes can often take a matter of years to implement prudently, the Investment Committee will review benchmarks to be adjusted as progress is made towards the long-term strategic asset allocation target.

The Board has selected the following benchmarks for the Common School Fund:

Asset Class	Benchmark
Fixed Income	S&P Taxable Municipal Bond
Domestic Equities	Russell 3000 Index
International Equities	MSCI ACWI Ex USA Index
Cash	S&P U.S. Treasury Bill Index
Real Estate	NCREIF Property Index

Normal School Fund

Investment Policy Statement

Fund Purpose

The University of Wisconsin, as the successor of the original normal schools, is the beneficiary of the Normal School Fund. Distributions are currently directed by Statute to provide funding for UW student scholarships and program funding at the UW-Stevens Point.

Funding Sources

This Fund was originally established with federal land grants totaling about 1.75 million acres. Except for about 70,800 acres that remain in trust, all lands from these original grants were sold to establish the Fund. Additions to principal come from the gross proceeds of timber sales.

Distribution Policy

This fund was originally established for monies not needed by common schools, and is governed by the same constitutional language that constrains investment of the Common School Fund. This language requires that net income and short-term capital gains are distributed to beneficiaries, with long-term capital gains to be retained within the fund. Gross timber revenues are considered long-term capital gains, and these monies are added to Normal School Fund principal when received. The expenses of managing land and timber assets are deducted from investment income prior to the annual distribution to the University of Wisconsin.

Initially, the targeted annual distribution will be at 1.50% of the Normal School Fund principal balance (net of restricted funds) calculated at the end of the calendar year two years prior to the distribution, using cost basis accounting (e.g. the calculation of targeted distribution made in 2019 will be based on the fund balance on December 31, 2017). Excess earnings (defined as the the amount of calendar year interest income, dividends, short term capital gains and other earnings, less management expenses, that is above the targeted distribution) will be retained to fund a smoothing account. Once that account reaches the recommended level, the distribution will be targeted at the 5-year moving average of fund net earnings.

Investment Objective

The annual return objective will be to maximize expected earnings within acceptable risk parameters while maintaining a high probability of generating distributable earnings at 1.50% of fund principal plus the expenses of managing land and timber assets. The targeted long-term return objective is to produce annual distributions to beneficiaries of 1.50% of the principal balance plus management expenses plus long-term capital gains that increase fund principal at or above the rate of inflation.

Portfolio Constraints

Wisconsin Constitution

The Wisconsin Constitution requires that all Normal School Fund income is distributed to beneficiaries, with principal balances maintained within the fund. Most other endowments distribute both interest and principal to meet the needs of beneficiaries, and pay out a fixed percentage of the beginning principal balance regardless of investment results. The inability to distribute Normal School Fund principal is critical to asset management policy, and requires Normal School Fund assets to be managed differently than the peer group of endowments.

It is important for the portfolio to generate capital gains at or above the rate of inflation to maintain the current level of benefits for future generations. Timber sales have contributed an annual average of more than $500,000 to principal growth during the fiscal years from 2012 to 2015, and helped to grow fund principal (11.50%) at more than double the rate of inflation (5.5%) during this period. It is expected that timber sale additions to fund principal will continue to outpace inflation into the foreseeable future, which eliminates the immediate need for an allocation of financial assets to achieve that goal.

Beneficiary Dependence on Annual Distributions

Earnings are distributed to the University of Wisconsin and are currently dedicated to fund scholarships for UW-Madison and UW-Extension students as well as programs at UW-Stevens Point. While this distribution is a small percentage of the total budget of the University, these monies remain an important source of funding for these scholarships and academic programs.

Liquidity

Liquidity is necessary only for the amount and timing of distributions.

Legacy Assets and Investment Policy Transition

The Normal School Fund retains approximately 70,800 acres and is responsible for the costs associated with the management of those lands. With a relatively small base of financial assets available to generate the funds required for land and timber asset management expenses, it is necessary to maximize the annual income generated by financial investments.

Strategic Asset Allocation

BCPL collaborated with experts from the UW-Madison School of Business to develop the target asset allocation shown below. To determine this target, an analysis was completed of the historic and projected risk and return of various asset classes, the correlation among these asset classes as well as the effect the expected investment performance on the distributable income of the Fund.

UW advisors noted that bonds previously purchased by BCPL staff for the Common School Fund portfolio “have unusually favorable risk/return characteristics (and)… barring liquidity or return requirements, it remains prudent to recommend the portfolio remains invested primarily in these bonds." Corporate bonds should be added to the portfolio mix to reduce amounts currently invested in cash equivalents, but only if market conditions restrict the availability of the more favorable and current mix of Trust Fund Loans, State and Municipal Bonds, and Farm Credit Bonds.

The Normal School Fund target allocation has no exposure outside of fixed income assets because:

- Timber revenue added to fund principal is expected to continue exceeding long-term inflation expectations, which eliminates the need of financial assets to provide additional protection against future inflation; and
- The relatively small base of financial assets within the Normal School Fund must generate all funding required to manage land and timber assets to achieve BCPL goals including:
    1. Generate long-term capital gains through timber harvests utilizing industry-best sustainable timber management standards; and
    2. Increase the quality and value of land holdings through the rearrangement of land assets into larger blocks, and taking reasonable efforts to improve the marketability of parcels with curable impediments prior to the sale of any parcel.

Normal School Fund Asset Allocation Target

Asset Class	Current Asset Allocation	Target Asset Allocation	Range
Fixed Income and Cash	**100%**	**100%**	
State & Municipal Bonds	47%	45%	25% to 60%
Farm Credit Bonds	0%	10%	5% to 25%
BCPL Trust Fund Loans	47%	45%	25% to 60%
Investment Grade Corporate Bonds	0%	0%	0% to 40%
Cash	6%	0%	0% to 10%

Rebalancing

Rebalancing is the term that describes the periodic movement of funds from one asset or asset class to another in order to realign assets to the strategic asset allocation target. A rebalancing strategy is an important element of asset allocation policy. Systematic rebalancing can reduce portfolio volatility and increase portfolio return over the long-term. However, frequent rebalancing resulting from excessively tight ranges can lead to unnecessary transaction costs.

The Investment Committee will be responsible for developing and implementing a rebalancing plan that is appropriate for existing market conditions, with a primary objective of minimizing transaction costs, market impact, opportunity costs and portfolio disruptions. To the extent possible, cash flows and revenues will be used to maintain the strategic target allocation.

Recognizing that at times it may be impractical or costly to reallocate assets when an upper or lower limit is breached, the asset class will be rebalanced to within its strategic asset allocation range as soon as is practically possible, subject to reasonable transaction costs.

Tactical Asset Allocation

Capital markets exhibit periodic inefficiencies that may be exploited through shorter-term tactical shifts in asset allocations to increase expected investment performance. The amount of any tactical allocation shall be limited to ranges specified within the approved asset allocation.

Benchmark

Recognizing that a long-term target allocation to alternative asset classes can often take a matter of years to implement prudently, the Investment Committee will review benchmarks to be adjusted as progress is made towards the long-term strategic asset allocation target.

The Board has selected the following benchmarks for the Common School Fund:

Asset Class	Benchmark
Fixed Income	S&P Taxable Municipal Bond
Cash	S&P U.S. Treasury Bill Index

University Fund

Investment Policy Statement

Fund Purpose

The purpose of the University Fund is to support the University of Wisconsin.

Funding Sources

In 1838, Congress granted to the Territory of Wisconsin the equivalent of two townships, or 72 square miles of land, to be sold to support a university. In 1854, Congress granted an additional two townships of land to benefit a university. Most of these lands were sold soon after Wisconsin obtained title, and no provision was made in the law for adding to the principal of this fund.

Distribution Policy

All interest earnings and short-term capital gains are distributed to the University of Wisconsin.

Investment Objective

The return objective of the University Fund is to maximize long-term capital gains so that fund principal grows at levels higher than the rate of inflation. The Prudent Investor Standard is now available to guide management of fund assets and distribution of current income has very little impact on University of Wisconsin operations. Fund principal should be allowed to grow so that the University Fund may be relevant to future generations of University Wisconsin students.

Portfolio Constraints

Fund size limits the availability of alternative investments and the flexibility of the strategic asset allocation.

Strategic Asset Allocation

The beneficiary is not dependent in any manner from distributions of this fund, so the University Fund should be fully allocated in a manner to generate long-term capital gains. The small size of the Fund makes it efficient to utilize passively managed equity mutual funds or ETFs that are focused on long-term capital gains.

Benchmark

The Board has selected the following benchmarks for the University Fund: Russell 2000 Index.

Agricultural College Fund

Investment Policy Statement

Fund Purpose

The purpose of the Agricultural College Fund is to support the University of Wisconsin.

Funding Sources

The Agricultural College Fund was established with an 1862 act of Congress that granted land to create a permanent endowment to support "colleges of agriculture and mechanical arts" in each state. The Morrill Act gave rise to land grant colleges across the nation by providing that each state was entitled to 30,000 acres of land for each member of Congress. Wisconsin had eight Congressional representatives at that time, so received title to 240,000 acres of land under this law. These lands were sold shortly after Wisconsin obtained title, and no provision was made in the law for adding to the principal of this fund.

Distribution Policy

All interest earnings and short-term capital gains are distributed to the University of Wisconsin.

Investment Objective

The return objective of the Agricultural College Fund is to maximize long-term capital gains so that fund principal grows at levels higher than the rate of inflation. The Prudent Investor Standard is now available to guide management of fund assets and distribution of current income has very little impact on University of Wisconsin operations. Fund principal should be allowed to grow so that the Agricultural College Fund may be relevant to future generations of University Wisconsin students.

Portfolio Constraints

Fund size limits the availability of alternative investments and the flexibility of the strategic asset allocation.

Strategic Asset Allocation

The beneficiary is not dependent in any manner from distributions of this fund, so the Agricultural College Fund should be fully allocated in a manner to generate long-term capital gains. The small size of the Fund makes it efficient to utilize passively managed equity mutual funds or ETFs that are focused on long-term capital gains.

Benchmark

The Board has selected the following benchmarks for the Agricultural College Fund: Russell 2000 Index.

Addendum 1

CFA Institute Code of Ethics and Standard of Professional Conduct
CFA Institute Asset Manager Code of Conduct

CFA Institute

CODE OF ETHICS AND STANDARDS OF PROFESSIONAL CONDUCT

PREAMBLE

The CFA Institute Code of Ethics and Standards of Professional Conduct are fundamental to the values of CFA Institute and essential to achieving its mission to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society. High ethical standards are critical to maintaining the public's trust in financial markets and in the investment profession. Since their creation in the 1960s, the Code and Standards have promoted the integrity of CFA Institute members and served as a model for measuring the ethics of investment professionals globally, regardless of job function, cultural differences, or local laws and regulations. All CFA Institute members (including holders of the Chartered Financial Analyst® [CFA®] designation) and CFA candidates must abide by the Code and Standards and are encouraged to notify their employer of this responsibility. Violations may result in disciplinary sanctions by CFA Institute. Sanctions can include revocation of membership, revocation of candidacy in the CFA Program, and revocation of the right to use the CFA designation.

THE CODE OF ETHICS

Members of CFA Institute (including CFA charterholders) and candidates for the CFA designation ("Members and Candidates") must:

- Act with integrity, competence, diligence, respect and in an ethical manner with the public, clients, prospective clients, employers, employees, colleagues in the investment profession, and other participants in the global capital markets.
- Place the integrity of the investment profession and the interests of clients above their own personal interests.
- Use reasonable care and exercise independent professional judgment when conducting investment analysis, making investment recommendations, taking investment actions, and engaging in other professional activities.
- Practice and encourage others to practice in a professional and ethical manner that will reflect credit on themselves and the profession.
- Promote the integrity and viability of the global capital markets for the ultimate benefit of society.
- Maintain and improve their professional competence and strive to maintain and improve the competence of other investment professionals.

STANDARDS OF PROFESSIONAL CONDUCT

I. PROFESSIONALISM

A. Knowledge of the Law. Members and Candidates must understand and comply with all applicable laws, rules, and regulations (including the CFA Institute Code of Ethics and Standards of Professional Conduct) of any government, regulatory organization, licensing agency, or professional association governing their professional activities. In the event of conflict, Members and Candidates must comply with the more strict law, rule, or regulation. Members and Candidates must not knowingly participate or assist in and must dissociate from any violation of such laws, rules, or regulations.

B. Independence and Objectivity. Members and Candidates must use reasonable care and judgment to achieve and maintain independence and objectivity in their professional activities. Members and Candidates must not offer, solicit, or accept any gift, benefit, compensation, or consideration that reasonably could be expected to compromise their own or another's independence and objectivity.

C. Misrepresentation. Members and Candidates must not knowingly make any misrepresentations relating to investment analysis, recommendations, actions, or other professional activities.

D. Misconduct. Members and Candidates must not engage in any professional conduct involving dishonesty, fraud, or deceit or commit any act that reflects adversely on their professional reputation, integrity, or competence.

II. INTEGRITY OF CAPITAL MARKETS

A. Material Nonpublic Information. Members and Candidates who possess material nonpublic information that could affect the value of an investment must not act or cause others to act on the information.

B. Market Manipulation. Members and Candidates must not engage in practices that distort prices or artificially inflate trading volume with the intent to mislead market participants.

III. DUTIES TO CLIENTS

A. Loyalty, Prudence, and Care. Members and Candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. Members and Candidates must act for the benefit of their clients and place their clients' interests before their employer's or their own interests.

B. Fair Dealing. Members and Candidates must deal fairly and objectively with all clients when providing investment analysis, making investment recommendations, taking investment action, or engaging in other professional activities.

C. Suitability.

1. When Members and Candidates are in an advisory relationship with a client, they must:
   - **a.** Make a reasonable inquiry into a client's or prospective client's investment experience, risk and return objectives, and financial constraints prior to making any investment recommendation or taking investment action and must reassess and update this information regularly.
   - **b.** Determine that an investment is suitable to the client's financial situation and consistent with the client's written objectives, mandates, and constraints before making an investment recommendation or taking investment action.
   - **c.** Judge the suitability of investments in the context of the client's total portfolio.
2. When Members and Candidates are responsible for managing a portfolio to a specific mandate, strategy, or style, they must make only investment recommendations or take only investment actions that are consistent with the stated objectives and constraints of the portfolio.

D. Performance Presentation. When communicating investment performance information, Members and Candidates must make reasonable efforts to ensure that it is fair, accurate, and complete.

E. Preservation of Confidentiality. Members and Candidates must keep information about current, former, and prospective clients confidential unless:

1. The information concerns illegal activities on the part of the client or prospective client,
2. Disclosure is required by law, or
3. The client or prospective client permits disclosure of the information.

IV. DUTIES TO EMPLOYERS

A. Loyalty. In matters related to their employment, Members and Candidates must act for the benefit of their employer and not deprive their employer of the advantage of their skills and abilities, divulge confidential information, or otherwise cause harm to their employer.

B. Additional Compensation Arrangements. Members and Candidates must not accept gifts, benefits, compensation, or consideration that competes with or might reasonably be expected to create a conflict of interest with their employer's interest unless they obtain written consent from all parties involved.

C. Responsibilities of Supervisors. Members and Candidates must make reasonable efforts to ensure that anyone subject to their supervision or authority complies with applicable laws, rules, regulations, and the Code and Standards.

V. INVESTMENT ANALYSIS, RECOMMENDATIONS, AND ACTIONS

A. Diligence and Reasonable Basis. Members and Candidates must:

1. Exercise diligence, independence, and thoroughness in analyzing investments, making investment recommendations, and taking investment actions.
2. Have a reasonable and adequate basis, supported by appropriate research and investigation, for any investment analysis, recommendation, or action.

B. Communication with Clients and Prospective Clients. Members and Candidates must:

1. Disclose to clients and prospective clients the basic format and general principles of the investment processes they use to analyze investments, select securities, and construct portfolios and must promptly disclose any changes that might materially affect those processes.
2. Disclose to clients and prospective clients significant limitations and risks associated with the investment process.
3. Use reasonable judgment in identifying which factors are important to their investment analyses, recommendations, or actions and include those factors in communications with clients and prospective clients.
4. Distinguish between fact and opinion in the presentation of investment analysis and recommendations.

C. Record Retention. Members and Candidates must develop and maintain appropriate records to support their investment analyses, recommendations, actions, and other investment-related communications with clients and prospective clients.

VI. CONFLICTS OF INTEREST

A. Disclosure of Conflicts. Members and Candidates must make full and fair disclosure of all matters that could reasonably be expected to impair their independence and objectivity or interfere with respective duties to their clients, prospective clients, and employer. Members and Candidates must ensure that such disclosures are prominent, are delivered in plain language, and communicate the relevant information effectively.

B. Priority of Transactions. Investment transactions for clients and employers must have priority over investment transactions in which a Member or Candidate is the beneficial owner.

C. Referral Fees. Members and Candidates must disclose to their employer, clients, and prospective clients, as appropriate, any compensation, consideration, or benefit received from or paid to others for the recommendation of products or services.

VII. RESPONSIBILITIES AS A CFA INSTITUTE MEMBER OR CFA CANDIDATE

A. Conduct as Participants in CFA Institute Programs. Members and Candidates must not engage in any conduct that compromises the reputation or integrity of CFA Institute or the CFA designation or the integrity, validity, or security of the CFA Institute programs.

B. Reference to CFA Institute, the CFA Designation, and the CFA Program. When referring to CFA Institute, CFA Institute membership, the CFA designation, or candidacy in the CFA Program, Members and Candidates must not misrepresent or exaggerate the meaning or implications of membership in CFA Institute, holding the CFA designation, or candidacy in the CFA program.

CFA Institute

ASSET MANAGER CODE OF PROFESSIONAL CONDUCT

The Asset Manager Code of Professional Conduct outlines the ethical and professional responsibilities of firms ("Managers") that manage assets on behalf of clients. By adopting and enforcing a code of conduct for their organizations, Managers demonstrate their commitment to ethical behavior and the protection of investors' interests.

GENERAL PRINCIPLES OF CONDUCT

Managers have the following responsibilities to their clients.
Managers must:

1. Act in a professional and ethical manner at all times.
2. Act for the benefit of clients.
3. Act with independence and objectivity.
4. Act with skill, competence, and diligence.
5. Communicate with clients in a timely and accurate manner.
6. Uphold the applicable rules governing capital markets.

ASSET MANAGER CODE OF PROFESSIONAL CONDUCT

A. LOYALTY TO CLIENTS

Managers must:

1. Place client interests before their own.
2. Preserve the confidentiality of information communicated by clients within the scope of the Manager–client relationship.
3. Refuse to participate in any business relationship or accept any gift that could reasonably be expected to affect their independence, objectivity, or loyalty to clients.

B. INVESTMENT PROCESS AND ACTIONS

Managers must:

1. Use reasonable care and prudent judgment when managing client assets.
2. Not engage in practices designed to distort prices or artificially inflate trading volume with the intent to mislead market participants.
3. Deal fairly and objectively with all clients when providing investment information, making investment recommendations, or taking investment action.
4. Have a reasonable and adequate basis for investment decisions.
5. When managing a portfolio or pooled fund according to a specific mandate, strategy, or style:
   a. Take only investment actions that are consistent with the stated objectives and constraints of that portfolio or fund.
   b. Provide adequate disclosures and information so investors can consider whether any proposed changes in the investment style or strategy meet their investment needs.
6. When managing separate accounts and before providing investment advice or taking investment action on behalf of the client:
   a. Evaluate and understand the client's investment objectives, tolerance for risk, time horizon, liquidity needs, financial constraints, any unique circumstances (including tax considerations, legal or regulatory constraints, etc.) and any other relevant information that would affect investment policy.
   b. Determine that an investment is suitable to a client's financial situation.

C. TRADING

Managers must:

1. Not act or cause others to act on material nonpublic information that could affect the value of a publicly traded investment.
2. Give priority to investments made on behalf of the client over those that benefit the Managers' own interests.
3. Use commissions generated from client trades to pay for only investment-related products or services that directly assist the Manager in its investment decision making process, and not in the management of the firm.
4. Maximize client portfolio value by seeking best execution for all client transactions.
5. Establish policies to ensure fair and equitable trade allocation among client accounts.

D. RISK MANAGEMENT, COMPLIANCE, AND SUPPORT

Managers must:

1. Develop and maintain policies and procedures to ensure that their activities comply with the provisions of this Code and all applicable legal and regulatory requirements.
2. Appoint a compliance officer responsible for administering the policies and procedures and for investigating complaints regarding the conduct of the Manager or its personnel.
3. Ensure that portfolio information provided to clients by the Manager is accurate and complete and arrange for independent third-party confirmation or review of such information.
4. Maintain records for an appropriate period of time in an easily accessible format.
5. Employ qualified staff and sufficient human and technological resources to thoroughly investigate, analyze, implement, and monitor investment decisions and actions.
6. Establish a business-continuity plan to address disaster recovery or periodic disruptions of the financial markets.
7. Establish a firmwide risk management process that identifies, measures, and manages the risk position of the Manager and its investments, including the sources, nature, and degree of risk exposure.

E. PERFORMANCE AND VALUATION

Managers must:

1. Present performance information that is fair, accurate, relevant, timely, and complete. Managers must not misrepresent the performance of individual portfolios or of their firm.
2. Use fair-market prices to value client holdings and apply, in good faith, methods to determine the fair value of any securities for which no independent, third-party market quotation is readily available.

F. DISCLOSURES

Managers must:

1. Communicate with clients on an ongoing and timely basis.
2. Ensure that disclosures are truthful, accurate, complete, and understandable and are presented in a format that communicates the information effectively.
3. Include any material facts when making disclosures or providing information to clients regarding themselves, their personnel, investments, or the investment process.
4. Disclose the following:
   a. Conflicts of interests generated by any relationships with brokers or other entities, other client accounts, fee structures, or other matters.
   b. Regulatory or disciplinary action taken against the Manager or its personnel related to professional conduct.
   c. The investment process, including information regarding lock-up periods, strategies, risk factors, and use of derivatives and leverage.
   d. Management fees and other investment costs charged to investors, including what costs are included in the fees and the methodologies for determining fees and costs.
   e. The amount of any soft or bundled commissions, the goods and/or services received in return, and how those goods and/or services benefit the client.
   f. The performance of clients' investments on a regular and timely basis.
   g. Valuation methods used to make investment decisions and value client holdings.
   h. Shareholder voting policies.
   i. Trade allocation policies.
   j. Results of the review or audit of the fund or account.
   k. Significant personnel or organizational changes that have occurred at the Manager.
   l. Risk management processes.

NOTIFICATION OF COMPLIANCE

Managers must notify CFA Institute of their claim of compliance through the Asset Manager Code of Professional Conduct claim of compliance form at www.cfainstitute.org/assetcode. This form is for communication and information-gathering purposes only and does not represent that CFA Institute engages in enforcement or quality control of an organization's claim of compliance. CFA Institute does not verify either the Manager's claim of compliance or actual compliance with the Code.

For additional information on complying, please visit www.cfainstitute.org/assetcode.