

**IV. 4 Timberland Policies and Procedures**

**TIMBERLAND PORTFOLIO  
POLICIES AND PROCEDURES**

**EFFECTIVE: 09/13/2010**

**EMPLOYEES' RETIREMENT SYSTEM OF THE  
STATE OF HAWAII**

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TIMBERLAND PORTFOLIO POLICIES & PROCEDURES**

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## **EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII**

### **TIMBERLAND PORTFOLIO POLICIES & PROCEDURES**

#### **I. INVESTMENT OBJECTIVES**

##### **A. INVESTMENTS IN TIMBERLAND ASSETS**

The Employees' Retirement System of the State of Hawaii ("the ERS") has determined that, over the long-term, inclusion of direct equity timberland investments, and any other timberland-related investments, as allowed for in these Policies and Procedures (hereinafter referred to as "timber") would enhance the ERS' expected portfolio investment characteristics. Expected benefits to the ERS include: (1) the possibility of competitive rates of return with publicly traded securities, (2) returns that have a low correlation with those associated with other major asset classes, and (3) a hedge against unexpected inflation. The use of timber investments will diversify the portfolio's source of overall long-term expected real return, and reduce year-to-year portfolio volatility.

Timber investments involve the privately negotiated purchase and, to a lesser degree, leasing of forestland tracts, upon which trees are grown for commercial sale. Investments in timber will be made directly through a separate account or indirectly through a multi-investor structure (i.e., two or more investors investing in a specific timber asset as a limited liability company ["LLC"] or other investment vehicle, as appropriate) in which ERS's separate account is an investor. Investments will be managed by a qualified timberland asset manager ("timberland manager" or "manager"). Eligible investments are further described in Section I.D. Other portfolio parameters are further described in Section II.A.

The investment policies of the ERS are determined by the Board of Trustees. In general, the goal of the ERS is to obtain the optimum return on the portfolio consistent with the assumption of prudent risk.

Timber investments of the ERS shall be made in a manner consistent with the fiduciary standards of the prudent expert rule: (1) for the sole interest of the ERS' participants and their beneficiaries; and, (2) to safeguard and diversify the timber portfolio. The selection and management of timber assets will be guided to preserve investment capital, to maintain prudent diversification of assets. The diversification objective is required to mitigate overall market risk and the specific risks inherent in any single property. Management, administrative and other responsibilities for the timberland portfolio will be clearly delineated.

##### **B. ASSET ALLOCATION**

The ERS' allocation to timber investments shall remain within the limits authorized by the Board of Trustees. The target allocation is 1.5% of the ERS' total assets (within a range of 0% to 2%) of its portfolio (based on market invested net asset value).

##### **C. PORTFOLIO PERFORMANCE**

The ERS shall use the following rate of return tests to evaluate the performance of the timber investment portfolio:

1. Total Return (Income Plus Realized and Unrealized Gain/Loss)

Over rolling 5-year periods, the total timber portfolio is expected to generate a minimum total real time-weighted rate of return of 6%, net of all investment management fees and expenses. The inflation measure employed to benchmark the real rate of return calculation will be CPI-U. The timber portfolio's rate of return is expected to be generated substantially from the following sources:

- A material component of return on the portfolio will be from the biological growth of the timber.
- A material component of return attributable to the portfolio is moderate cash income from the sale of timber inventory.
- Long-term, a component of return will result from capital gains through active management, from improving property values and opportunistic purchases and sales of properties.
- The manager will also exploit other opportunities for increasing the rate of return, such as usage leases and easements, moderate use of leverage as permitted by Section II.A, below, and other active management techniques.

The portfolio and individual investments will be compared to an appropriate timber index (such as the NCREIF Timberland Index), or other relevant proxies as appropriate. In any event, the 6% minimum real rate of return hurdle will apply.

2. Risk with Regard to Individual Properties

In timber investing there exists the risk of sustaining a loss on any of the individual property investments. It is the ERS' expectation that, while specific investments may incur losses of all or part of the capital invested, a diversified portfolio of holdings will produce a positive rate of return at least equal to the expected minimum set forth in Section I.C.1., above.

**D. PROGRAM MANAGEMENT**

The selection and management of assets in the timber portfolio will be guided to generate a high level of risk-adjusted return, to provide current income, and to maintain prudent diversification of assets and specific investments.

With timber investments, there exists an inherent risk that the actual return of capital, income and gains will vary from the amounts expected. The investment risk associated with timber investments will be mitigated through both the structure of the Policies and the actions of the manager. The key program management parameters are as follows:

1. Institutional Quality

All assets must be of institutional investment quality. Institutional quality will be defined as being of a quality whereby the investment would be considered acceptable by other prudent expert institutional timber market participants and corporate forest product industry investors.

## 2. Diversification

Diversification reduces the chance of an adverse impact suffered by any one holding or investment type from adversely affecting a disproportionate share of the total portfolio. The timber portfolio shall be diversified by:

- regional geographical location (South, Northeast, West, Other, and International)
- non-contiguous tract and parcel locations
- type and species of tree (e.g., softwood “conifer,” such as pine, fir redwood, etc., and hardwood “deciduous,” such as oak, maple, etc.)
- end-use market of forest product (building and construction, pulp and paper, furniture and decorative wood)
- potential purchasers of inventory (mills and processing plants)
- stage of tree growth (seedling through mature)
- timing of investment

Investments will be made such that no single property purchase will represent more than 25% of the fully invested target net asset value of the allocation. These limits are subject to waiver on a case-by-case basis by the Trustees. It is also recognized that during the portfolio development and wind-down stages the full investment parameters may not, of necessity, be met.

Long-term diversification target ranges among eligible investments will be set forth in Section II of this document, and reviewed annually or more often as necessary. Interim investment goals for the implementation of the Portfolio will be set forth in an *Annual Tactical Plan* (Appendix A), as described herein.

## 3. Ownership Structure

*Account and Investment Structure:* The ERS' ownership structure will comprise an arrangement whereby separate account relationships will be established with one or more fiduciary timberland managers. The separate account timberland manager will in turn purchase, on a discretionary basis, timber assets for the ERS' account. The separate account may be structured as an LLC or employ other holding vehicles, as appropriate (e.g., 501(c) corporation, insurance annuity contract, group trust, etc.), to shield the ERS from potential tax and general liabilities. The timber investments will be subject to the standards and parameters established in this *Timberland Portfolio Policies and Procedures* document and the ERS' approval of an *Annual Tactical Plan*. The ERS will be the sole beneficial owner of all properties, and assets held for the ERS will not be commingled with any other investor or owner, subject to the following exceptions:

- (a) *Multi-Investor Structures:* Multi-investor structures consisting of two or more institutional investors pursuing a specific timber asset under an LLC or another investment vehicle may be used, provided that: (1) the ERS is shielded from potential tax and general liabilities; and (2) multi-investor structure investments may not comprise more than 25% of the portfolio based on timberland market value at the time of acquisition.
- (b) *Board Waivers:* Investments not wholly owned by the ERS (other than investments held under a multi-investor structure, as provided in (a), above, or in joint ventures, as provided in (c) below, may be purchased by the manager, subject to review by and only upon prior approval of the ERS' Board.

- (c) *Joint Ventures:* Investment managers may undertake joint venture arrangements with forest product industry companies for up to 20% of the portfolio; however, joint ventures are allowable only if the ability of the ERS to dispose of the property in an arms-length transaction at fair market value is not impeded.

4. Reporting System

There shall be a comprehensive reporting and monitoring system for the entire portfolio. Situations of underperforming investments, portfolio diversification deficiencies from the *Timberland Portfolio Policies and Procedures*, and conflicts of interest can then be identified, facilitating active portfolio management. Further definition of this reporting system is provided in Sections III.C.2.b. "Investment Management Ongoing Operations" and III.C.3. "Investment Management Portfolio Accounting and Financial Control."

5. Performance Measurement

The timberland manager will provide cash flow, valuation, and any other requested information to the ERS' Staff and the Consultant quarterly, and the ERS' custodian bank on a monthly or quarterly basis, as required by the ERS.

Performance will be calculated on a time-weighted basis. The rate of return calculations will be net of all fees and expenses. So that the performance numbers reported by the manager and the custodian bank shall be the same, the manager will be responsible for reviewing the custodian's figures and bringing any discrepancies to reconciliation.

*Benchmarks:* The ERS will employ an absolute rate of return benchmark of a 6% real rate of return over rolling 5-year periods. Other appropriate performance comparisons will also be examined, such as an appropriate timber index or other relevant proxies (e.g., the NCREIF Timberland Index).

6. Lines of Responsibility

Well-defined lines of responsibility and accountability will be required of all participants in the ERS' timber investment program. Participants are identified as:

Board of Trustees -	The fiduciaries appointed by their employee groups and the Governor to represent the beneficiaries' interests.
Staff -	Investment professionals on the staff of the ERS who will assist in the timber investment program's design, policy implementation and administration.
Consultant -	Professionals retained to support the Staff and Trustees through the provision of timber and alternative investment program knowledge and technical support.
Manager(s) -	Qualified fiduciaries who provide institutional timber investment management services and maintain a discretionary relationship with the

ERS in implementing the ERS' long-term strategic plan for timber as defined in these *Timberland Portfolio Policies and Procedures*.

The responsibilities, with respect to the timber portfolio, of the parties cited above are outlined in Section III.A.1-4. Unless otherwise stated, the remainder of the guidelines contained herein pertains to the timber investments entered into by the ERS using a separate account timberland manager(s).

#### **E. CONFLICTS OF INTEREST**

The manager will seek to avoid conflicts of interest with respect to the management of the ERS' assets, however:

1. Manager Proprietary Products – In alternative investing, unlike other asset classes, there may be situations wherein the manager may recommend its proprietary investment product(s) for investment. If considering placing the ERS in a proprietary product, an analysis of why competing non-proprietary products are not suitable must be presented by the Manager for the Staff and Consultant's review, and any investment must be approved in advance by the Board of Trustees.
2. Allocation of Investments among Accounts – There may be instances where the manager will need to allocate an investment opportunity among a number of clients or a competing product (e.g., commingled funds). The manager, as a prudent expert and fiduciary, will seek to ensure that appropriate and equitable allocation and pricing occurs with respect to the ERS' portion of any manager-apportioned property.
3. Personal Investments – The investment manager's employees are not permitted to invest personally or otherwise have beneficial interest in investments held on behalf of clients such as the ERS. The timberland manager will provide the ERS with its policies for personal investments by employees as an attachment to the Investment Management Agreement, and notify the Staff and Consultant of any changes.
4. Other Conflicts of Interest – When and if other conflicts of interest become apparent, suitable protective covenants or processes for resolving conflicts will be incorporated into the investment management agreement.

## **II. INVESTMENT POLICIES**

Long-term target diversification ranges will guide the timber investment program. Each year the program will be further implemented or modified in accordance with an *Annual Tactical Plan* prepared by the Manager, reviewed by Staff and the Consultant, and approved by the Board.

### **A. ELIGIBLE INVESTMENTS**

In general, the timberland manager will have discretion to purchase forest tracts that are expected to meet or exceed the ERS' rate of return objectives for timber investment. The rate of return must be appropriate after the consideration of any risk measures employed by the manager. Multi-investor structure investments may not comprise more than 25% of the portfolio based on timberland market value at the time a multi-investor structure is made. Lease holdings may comprise no more than 30% of the portfolio, with the remainder of holdings being fee simple. The manager is allowed to enter into joint ventures with forest product companies for up to 20% of the

portfolio. However, the structure of the joint venture must not impede, at any time, either the sale of the holding or the ability of the ERS to replace the timberland manager. Also, the manager will minimize the concentration of holdings in areas known to be frequented by natural disasters, for example coastal tracts known to be frequent hurricane paths, flood zones, etc.

Without compromising the geographical diversification targets, the manager will use reasonable efforts to mitigate the incurrence of unrelated business taxable income in the portfolio.

Leverage may be used, on a nonrecourse basis, up to 20% of the timberland market value of the portfolio, with no more than 50% leverage on any one timber investment. The single investment debt level will be measured for compliance at the time leverage is added to the portfolio. Leverage for the total portfolio will be measured for compliance at the time the leverage is added to the portfolio or a portfolio asset is purchased or sold. Leverage may not be added to any investments held as of September 15, 2010.

## **B. GEOGRAPHICAL LOCATION DIVERSIFICATION**

Over the long-term, the ERS portfolio should seek portfolio diversification with regard to major US-domestic timber growing regions. The timberland manager may seek to diversify internationally up to 20% of the portfolio based on timberland value of the portfolio at the time the investment is made. The currency exposure to the ERS from any non-U.S. dollar aspect of the allocation is expected to be negligible over the long-term.

The following ranges set forth the geographic diversification targets for the timberland manager to fulfill:

<b>Region</b>	<b>Range</b>	<b>Midpoint</b>
South	45% - 65%	55%
West	25% - 45%	35%
Northeast	0% - 20%	10%
Other/International	0% - 20%	10%

## **C. TREE MATURITY DIVERSIFICATION**

The ERS portfolio will seek to diversify by maturity of timber ranging from immature, pre-merchantable trees through mature, merchantable timber. The manager will create a sustainable timberland portfolio where tree seeding, planting, growth and purchases will replace trees harvested and properties sold.

## **D. TREE SPECIES DIVERSIFICATION**

The portfolio will be diversified by timber type and include both hardwoods and softwoods.

## **E. END USE DIVERSIFICATION**

The ERS portfolio will be structured to sell into several commercial industries, such as paper goods and cardboard, various building and construction materials markets, and finished carpentry and furniture. The manager will also take into account the number of regional processors or purchasers of timber inventory.

## F. TRACT AND PARCEL DIVERSIFICATION

The portfolio will be composed of numerous non-contiguous tracts with the goal of diversifying the risk of natural disasters such as fire, disease, pests, etc.

## III. PROCEDURES FOR TIMBER PROGRAM MANAGEMENT

### A. RESPONSIBILITIES

The timber investment program shall be implemented and monitored through the coordinated efforts of the Board of Trustees for the Employees' Retirement System of the State of Hawaii (the "Board"); the ERS' Staff (the "Staff"); the Consultant ("Consultant"); and the qualified Timberland Investment Manager(s) (the "Manager" or "Timberland Manager"). Delegation of responsibilities for each participant is described in the following sections.

#### 1. Board of Trustees

The Board of Trustees shall approve the investment policies and objectives that the Trustees judge to be appropriate and prudent to implement its strategic plan for the investment of ERS' assets. The Board shall review the performance criteria and policy guidelines for the measurement and evaluation of the timberland managers of the ERS' assets; review the Consultant and Staff's recommendations to retain a qualified timberland manager(s) and set discretionary investment limits; supervise the investment of the ERS' assets to ensure that the ERS' investment remains in accordance with the Board's strategic planning and the Employees' Retirement System of the State of Hawaii Objectives and Policies and the *Timberland Portfolio Policies and Procedures* documents.

The Board of Trustees will guide the execution of the program by review and approval of a long-term strategic plan prepared by the Consultant and set forth in these *Timberland Portfolio Policies and Procedures*, and reviewed by Staff, which will be updated and revised periodically as appropriate, and an *Annual Tactical Plan* prepared by the Timberland Manager, and reviewed by Staff and Consultant, which details goals and objectives for the next twelve months. The Board will monitor the program's progress and results through a performance measurement report prepared quarterly by the Manager and reviewed and commented upon by the Consultant.

#### 2. Staff

The Staff will review investment objectives and policy language developed by the Consultant. The Staff will guide the execution of the program in accordance with the long-term strategic plan set forth in these *Timberland Portfolio Policies and Procedures*, which will be updated and revised periodically as appropriate. The Staff and the Consultant will review and comment upon the Manager's *Annual Tactical Plan*, which details goals and objectives for the next twelve months. The Staff and Consultant will also review the Manager's quarterly portfolio reports, and review the Managers' and the portfolio's performance in relation to assigned responsibilities.

The Staff will coordinate program compliance among all participants and communicate the investment policies, objectives and performance criteria to the timberland manager. The Staff will coordinate the receipt and distribution of capital.

The Staff and Consultant will identify qualified timberland manager(s) for implementation of the timber investment program, and will advise the Board of Trustees of any material changes in the manager organization(s).

3. Consultant

In cooperation with the Staff and Board, the Consultant shall assist in the Policies & Procedures development and timberland manager search, shall advise on program compliance; review and comment on the *Annual Tactical Plan* submitted by the Manager and review and comment on the Manager's quarterly reports; conduct performance measurement employing information provided by the custodian; review and periodically update all program documentation and review management relationships; conduct manager searches when requested; and provide special project research pertaining to technical timber and alternative investments issues as requested by the ERS.

4. Timberland Manager(s)

The Timberland Manager shall acquire and manage, on a discretionary basis, commercial timberland investments on behalf of the ERS and in accordance with the Investment Objectives as described in Section I of the ERS' *Timberland Portfolio Policy and Procedures* document and the Investment Policies as described in Section II. The *Timber Portfolio Policies and Procedures* and the *Annual Tactical Plans* will dictate the strategy and allocation of assets executed by the Manager.

(a) Subcontracting

In timber investing, it is common practice for the asset Manager to subcontract property management and other field service responsibilities to regional forestry consulting firms (e.g., inventory modeling, timber sales and transaction sourcing and other site-specific maintenance activities). Though the use of subcontractors is allowed within the ERS' portfolio, the Manager is held fully accountable for the performance of the subcontractors. Additionally, any subcontractor employed by the Manager must be held to a fiduciary standard with respect to the ERS' asset, no less than that of the Manager itself.

**B. INVESTMENT PROCEDURE**

Timber investments in compliance with the ERS' Policies (Section II) and the Investment Objectives (Section I) shall be made and managed through the following process:

1. Timber Acquisition, Management and Disposition: Periodically, the Staff and the Consultant will review and modify, as necessary, the *Timberland Portfolio Policies and Procedures* that specify long-term diversification parameters for the Timber portfolio. Any modifications to the plan will be incorporated as necessary. The *Timberland Portfolio Policies and Procedures* will then be submitted to the Staff for review and the Board of Trustees for final approval.
2. Annual Tactical Plan: Annually, the Timberland Manager will prepare a tactical plan which reviews the current status of the portfolio, recent historical and prospective market conditions, and proposes the steps to be taken over the next twelve month period to further implement the long-term strategic plan. The *Annual Tactical Plan* will be reviewed by the Consultant and

Staff and approved by the Board. The outline for the *Annual Tactical Plan* is provided in Appendix A.

## C. MANAGER RESPONSIBILITIES

### 1. Investment Management

Managers are directly accountable for the following investment management responsibilities. This section designates certain investment responsibilities that the Timber Manager will perform or cause to be performed.

- a. Acquisition – The Manager will be responsible for sourcing, evaluating and selecting, on a discretionary basis with fiduciary responsibility, timber investments to be made on behalf of the ERS.

The acquisition process will be made with a view to maximize the ERS' risk adjusted rate of return, within the portfolio diversification parameters set forth in the Objectives and Policies statement and Program Management (Section I.B.) of this document. The process will include, but not be limited to, the following services:

- (1) Review and maintain a record of opportunities available in the market over time.
- (2) Evaluate opportunities and identify investments that will provide the most attractive risk and return characteristics, and are in accordance with the long-term and short-term objectives of the portfolio.
- (3) Conduct full and proper acquisition due diligence and fully document the process. Due diligence will be conducted to a standard of completeness attributable to a prudent expert. Prospective investments will be inventoried and evaluated on the Manager's financial model at an appropriate discount rate, in determining appropriate acquisition pricing.

The Timberland Manager will make available for review by the ERS, or its agents, the Manager's policies, procedures, and standards for conducting property evaluation and due diligence and the due diligence documentation performed on any investment made on the ERS' behalf.

- (4) Negotiate purchase agreements and other closing documents on ERS' behalf, with a view to maximize returns, minimize expenses, safeguard ERS' assets, and secure investor rights, and make timberland investments on the ERS' behalf.

- b. Ongoing Operations – The Manager shall manage or cause to be managed, the portfolio and individual properties such as to enhance the ERS' value in the investment. The Manager shall be responsible for conducting or supervising the following services with respect to each investment:

- (1) Management Plan – The Manager will develop and execute a management plan for each holding and the overall portfolio to maximize the value of the investments for the ERS.

- (2) Property Management – The Manager will monitor budgeted versus actual performance for the properties and shall take all necessary or appropriate steps consistent with applicable capital and operating budgets to assure the ERS' investment is managed to or above its anticipated performance level. This process will involve applying silvicultural<sup>2</sup> and other forest management techniques to maximize inventory yield and property value, and minimize risk of loss. It will also involve techniques to maximize return and provide cash flow, such as negotiating hunting and usage leases.

The Manager shall keep itself informed of the overall market conditions relative to the managed investments and the managed investments' valuations. The Manager will also be responsible for ensuring compliance with all environmental and other governing laws. All such activities will be undertaken with the intention to maximize value to the ERS.

- (3) Sale of Timber Inventory – The Manager will maintain an awareness of current market pricing and future pricing forecasts, and sell inventory according to the management plan, or opportunistically as determined at the Manager's discretion.
  - (4) Valuation and Appraisals – Properties will be appraised by an outside appraiser at least every three years, or as necessary. Appraisals will also be updated by an outside appraiser, as necessary or requested by the Manager. The Manager will provide updated valuations of each investment quarterly, based on inventory measures and updated outside appraisals as available.
  - (5) Disbursement, Receipt and Cash Management – The Manager will develop procedures for funding investment on a timely basis and coordinating the receipt of cash distributions from the sales and other income sources.
- c. Disposition – Ongoing, and based on timber market circumstances, the Manager shall review the managed investments with respect to continued timely return of capital, income and gains, including both planned and opportunistic sales of timber inventory and properties. The Manager shall identify qualified buyers, solicit and evaluate offers, and negotiate property sales.

## 2. Portfolio Accounting and Financial Control

The Manager's accounting, reporting, financial control, and administration systems shall meet the following objectives:

- a. Financial Control – The Manager will provide control systems to protect assets, detect errors and insure the reliability of information generated by the accounting system.
  - (1) Books and Records – The Manager shall maintain books of account with correct entries of all receipts and expenditures incident to the management of the investment. These books, together with all records, correspondence, files and other documents, shall at all times be open to the inspection of the ERS. The Manager shall maintain complete and accurate records of all transactions related to the managed investment,

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<sup>2</sup> Silviculture is the theory and practice of controlling the establishment, composition and growth of forests. Examples of silvicultural practices include planned cutting, planting, thinning, fertilizing, proper drainage, controlling insects and other similar activities.

including receipts and all correspondence relating thereto on such forms as the ERS' auditors may reasonably require and make such records available for inspection and copying by the ERS at all reasonable times. The Manager shall bear the costs associated with the retention of such records and if the ERS shall request copies of such records, the Manager shall bear the cost of duplicating and sending such records to the ERS.

- b. Financial Statements – On a quarterly basis, the Manager will create unaudited financial statements, and annually, audited financial statements for the overall portfolio.
- c. Accounting Policies – Accounting policies for the ERS are outlined below:
  - (1) Current Value Reporting – Accounting data shall be computed using current values. The Manager will report performance in compliance with the CFA Institute standards, or other appropriate standards as agreed to with the ERS. The Manager will be held to a standard of a prudent expert in valuing the underlying value of the investments.

### 3. Reporting Requirements

- a. Manager Quarterly Report – On a quarterly basis, within 45 days following the quarter-end, the Manager(s) shall provide the Staff and Consultant with a report on the portfolio which will address activities occurring during the prior quarter, an updated list of holdings, cash flows, valuations, return calculation, and any and all other items of which the ERS should be apprised.
- b. Custodian Bank Monthly Statement – On a monthly basis, the Manager(s) shall provide the Custodian Bank a report of the ERS' account cash flows and valuations, and any other information reasonably requested.
- c. Funding Procedures – The Manager shall provide the ERS, on a best efforts basis, with ten (10) business days notice of funding for purchases. The ERS shall also be provided with documented wiring instructions in advance.
- d. Annual Tactical Plan – Within 60 days of calendar year end, the Manager will submit an *Annual Tactical Plan* for review by the Staff and the Consultant, and for approval by the Board of Trustees. The *Annual Tactical Plan* (outlined in Appendix A) will include: (1) a review of the current status of the portfolio, (2) perceived investment environment, (3) the types and amount of property investments to be sought and underlying rationale, (4) goals for other management responsibilities such as situations being monitored and adding value, and (5) outline the steps anticipated toward portfolio development over the course of the coming fiscal year.
- e. Notice – The Manager shall notify the Staff and Consultant as soon as practicable in writing of any investigation, examination or other proceeding involving the investments commenced by any regulatory agency or of any action, suit or proceeding commenced against or by the Manager or any parties affiliated with the portfolio.
- f. Other Information – The investment Manager will also provide any other reasonable information requested by the Staff, or the ERS' Custodian Bank, the Consultant or other agent of the ERS.

#### **D. CONSULTANT RESPONSIBILITIES**

The Consultant shall review and submit to Staff comments on the Manager's quarterly reports of the ERS' timber investments. The Consultant shall also be responsible for reviewing the *Annual Tactical Plan*, and submitting comments to Staff, with comments to the Manager. The Consultant will incorporate quarterly performance measurement information received from the custodian bank in the investment measurement report for the total portfolio.

The Consultant in conjunction with Staff and the Board of Trustees will also be responsible for the initial development and ongoing review and recommendation of revisions to the ERS' Policies and Objectives, *Timberland Portfolio Policies and Procedures* for approval by the Board. The Consultant may also be requested to perform special projects as requested by the Staff or Board.

## EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF HAWAII TIMBER ANNUAL TACTICAL PLAN GUIDELINES

**Tactical Plan:** The Tactical Plan is a report which outlines the steps to be taken in the next 12 month period to further implement the timber portfolio, and any other actions or considerations germane to the active management and success of the portfolio. It also documents the reasons for the particular courses of action to be taken, and importance of items under consideration.

The Staff and Consultant shall review the *Annual Tactical Plan*, submit comments, and recommend approval of the finalized plan to the Board of Trustees. All sections should be as brief as possible using a format as follows:

### I. FUNDING LEVEL

Annual Tactical Plan Period: 1/1/xx through 12/31/xx

#### A. Funding Tables:

1. Current Funding Position (As of x/xx/xx)

Total Fund Market Value	\$xx billion
Market Value (Excl. Multi-Investor Structure Investments)	\$xx billion
Multi-Investor Structure Investments	\$xx billion
 Target for Timber	 \$xx million
 Current Net Asset Value Deficit/(Surplus)	 \$(xx) million

2. Please discuss any planned undertakings with respect to the allocation's size in the next 12 months.

3. Leverage – List individual investments where leverage is used and the specific dollar and percentage amount of leverage used on the investment. Also state the total percentage and dollar amount of leverage used relative to the total portfolio timberland market value.

### II. DIVERSIFICATION AND PORTFOLIO STATUS

#### A. Geographic Diversification

	% Range	\$ NAV	% NAV
South	45-65	0	0%
West	25-45	0	0%
Northeast	0-20	0	0%
Other*	0-20	0	0%
International*	0-20	0	0%
Totals		0	100%

Note: While Other and International are listed separately, the combined total of the two will not exceed 20%.

1. Discuss all planned undertakings with respect to the allocation's geographic diversification in the next 12 months.
  2. Discuss the outlook for each region regarding property purchase and sales, timber prices, and any other relevant factors.
- B. Timber Maturity – Discuss the composition and plans for the portfolio with respect to biological maturity.
- C. Species, End-Use, Tract & Parcel Diversification – Describe and comment on the portfolio's diversification with regard to the listed considerations and any specific actions to be undertaken.
- D. Current Status of the Portfolio – Comment on the portfolio's current status with regard to any other material considerations and specific actions to be undertaken. Include comments specific to the portfolio's:
1. Return
  2. Risk
  3. Diversification
  4. Leverage

### **III. MARKET ENVIRONMENT**

- A. Recent Past – Please discuss the market environment in which the portfolio has been operating for the past year, and any ramifications.
- B. Coming Year – Discuss the expected market environment for the next year, and any ramifications.
- C. Are any material transactions planned or anticipated in the next year? If so, please discuss the underlying rationale.

### **IV. PORTFOLIO MANAGEMENT**

- A. Discuss objectives and plans for other portfolio or property management responsibilities, such as situations being monitored and adding value, property sales, etc.
- B. Specific situations being monitored, underperforming investments.
- C. Discuss projected changes in capital calls and distributions.
- D. Other items relevant to the ERS' portfolio and any items of which the Trustees should be apprised.

### **SUMMARY**

Investment Objectives: Summary of basic goals for the portfolio for the next 12 months.

NOTE:

The information contained in Appendices A, B, C, E, and F are included in this manual solely for use as an educational guide for Trustees and staff in their decision-making process. These Appendices are not part of the Board's investment policies and procedures. The Board's adopted policies and procedures are the sole governing instruments.