RECOMMENDATION TO Executive Committee

AGENDA ITEM: IV.E.

AAR Investment Policy Recommendation

BACKGROUND: Major bond rating agencies (S&P, Moody's, and Fitch) use upper and lower-case letters rating the credit quality of a bond. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered Investment Grade and indicates that a municipal or corporate bond has a relatively low risk of default. The Arizona Association of REALTORS® (AAR) investment policy restricts AAR to only investing in bonds with a rating of no less than A by nationally recognized rating service. The AAR's investment advisors, UBS Financial Services, has advised that AAR is significantly limiting its investment universe by not allowing Investment Grade bonds into portfolios. Many high quality corporations now hold a BBB rating, but are still considered Investment Grade. (*See attached letter from UBS Financial Services Account Vice President T. Ryan Moore, CFP)*

BUDGET IMPACT:

None.

RECOMMENDATION FROM: *SUE FLUCKE, PRESIDENT, PAULA SERVEN, TREASURER and MICHELLE LIND, CHIEF EXECUTIVE OFFICER*

Amended POLICY EXC.12 and T.2 - OPERATING FUNDS AND INVESTMENT POLICY as follows:

All AAR Funds not immediately required shall be invested by the CEO and Controller at the direction of the Treasurer and Executive Committee. Permitted investments shall include: Obligations of the US Treasury; obligations of an agency of the US Government; obligations of and obligations fully guaranteed by any of the fifty (50) states of the United States of America; Auction Preferred Stock (APS) and/or Auction Rate Certificates (ARC) and/or Variable Rate Demand Obligations (VRDO) and corporate bonds with **AN INVESTMENT GRADE RATING ~~a rating of no less than A~~** by a nationally recognized rating service. Funds invested in certificates of deposit shall not exceed the total amount insured, including interest earned to maturity, so that a guarantee is made of return of principal and interest.

FOR MORE INFORMATION CONTACT: *Sue Flucke at SueFlucke@kw.com, Paula Serven at PServen@cox.net or Michelle Lind (602-248-7787) at MichelleLind@AARonline.com.*

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Michelle Lind and the Arizona Association of Realtors Board of Directors,

As you are aware, the Arizona Association of Realtors Investment Policy Statement (IPS) restricts us to only investing in bonds with a rating of no less than A by nationally recognized rating service. While it is prudent for an organization such as yours to limit investments into safe assets, you are greatly limiting your investment universe by not allowing Investment Grade bonds into portfolios. Major bond rating agencies (S&P, Moody's, and Fitch) use upper and lower-case letters rating the credit quality of a bond. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered Investment Grade and indicates that a municipal or corporate bond has a relatively low risk of default. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality and speculative in nature and would not be appropriate investments for your organization.

After the credit crisis in 2008, the major ratings agencies all began aggressively reducing the credit ratings on almost all corporate bonds. As a result, a lot of high quality corporations now hold a BBB rating, but are still considered Investment Grade. As an example Moody's has the following companies rated 'BBB':

Nordstrom's
Dow Chemical
Hewlett Packard
AT&T Broadband
Mattel
Dr. Pepper/Snapple Group
Bank of America
Comcast
Time Warner
American Express
Walgreen's
Campbell Soup
AutoZone
FedEx
Safeway
NBC Universal Media

In our call with Colleen Brophy, Portfolio Manager for UBS Private Bank, she gave her opinion that AAR is missing out on substantial additional return without taking on much additional risk by altering the IPS to allow for Investment Grade bonds instead of only 'A' or better. I've included a chart that shows the return and risk profile of 'AAA', 'AA', 'A' and 'BBB' rated corporate bonds for the last 3 years. As you can see, 'BBB' rated bonds have earned about 2% more per year than AAA bonds, and 1% per year more than 'A' rated bonds without taking on significantly more risk.

I understand the Board of Directors desire to be conservative with the funds that their members have entrusted them with, and rightfully so. The landscape of the investment universe has changed so dramatically over the last five years that your previous IPS greatly reduces the investable options for the portfolio. It would give you much greater flexibility if the IPS allowed for Investment Grade bonds instead of limiting it to 'A' rated or better.

Regards,

Ryan Moore

T. Ryan Moore, CFP
Account Vice President
Biltmore Financial Group
UBS Financial Services, Inc.