

**Investment Policy Statement
For
Pennsylvania State Association of Boroughs
Municipal Retirement Trust
Fixed Income Fund**

(Investment Manager)

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Morgan Stanley

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I. Introduction

Purpose of this Policy Statement

This policy statement outlines the goals and investment objectives for the Pennsylvania State Association of Boroughs ("PSAB") Municipal Retirement Trust (*referred to herein as the "Trust"*) Fixed Income Fund (*referred to herein as the "Fixed Income Fund"*). This document is intended to provide guidelines for managing the Fixed Income Fund's assets. Accordingly, this document outlines certain specific investment policies that will govern how the goals for the Fixed Income Fund are expected to be achieved. This statement:

- Describes an appropriate risk posture for the investment of the Fixed Income Fund's assets,
- Establishes investment guidelines regarding the selection of investment managers, permissible securities and diversification of assets,
- Specifies the criteria for evaluating the performance of the investment manager(s) and the Fixed Income Fund as a whole,
- Defines the responsibilities of the PSAB Municipal Retirement Trust Board of Trustees and other parties responsible for the management of the Fixed Income Fund's assets.

The Board of Trustees believes that the investment policies described in this statement should be dynamic. These policies should reflect the investment needs and objectives of most of the participating Boroughs and the Board's philosophy regarding the investment of assets. These policies will be reviewed and revised periodically to ensure they adequately reflect changes related to the Fixed Income Fund, participating boroughs, and the capital markets.

Investment Objective

The Trust was established to enable each participating Borough an opportunity to allocate their pension plan assets in diversified portfolios according to their needs and circumstances. Accordingly, the Board has established two Funds within the Trust with separate and distinct investment goals and objectives. Each Fund, however, shall be invested in accordance with sound investment practices that emphasize long-term fundamentals. This Investment Policy Statement is intended to provide guidelines for managing the Fixed Income Fund's assets only.

Fixed Income Fund

The long-term investment objective for the Fixed Income Fund is capital preservation*. This is a risk-averse investment objective that is expected to reduce fluctuations in market value and emphasizes current income. Capital appreciation is a secondary objective. Furthermore, the investment objective of the Fixed Income Fund is:

* This investment objective is expected to be achieved over a full market cycle. The Board of Trustees recognizes that the nature of this fund's investments will entail fluctuations in the market value of the fund's assets, and the fund may incur losses from time-to-time. The Board of Trustees recognizes that there is no guarantee or assurance that the principal value of contributions made to the fund will be preserved.

- To diversify the Fixed Income Fund's assets in order to reduce the risk of wide swings in market value from year to-year, or of incurring large losses,
- To achieve investment results over the long-term that compare favorably with those of other fixed income portfolios, other professional investment managers and of appropriate market indexes.

It is expected that these investment objectives can be obtained through well-diversified portfolio structures in a manner consistent with this investment policy.

This investment policy is intended to be a summary of an investment philosophy that provides guidance for the Board of Trustees and other parties interested in the management of the Fixed Income Fund. It is understood that there can be no guarantees about the attainment of the goals or investment objectives outlined here.

II. Information about PSAB and the Fixed Income Fund

**Pennsylvania State Association of Boroughs
PSAB Municipal Retirement Trust**
2941 North Front Street
Harrisburg, PA 17110
Tel. (717) 236-9526

Primary Contact..... Treasurer and Secretary

Trust Year End..... Dec-31st

The Pennsylvania State Association of Boroughs first established this Trust in 1972 in order to provide participating boroughs access to professional management of their retirement fund assets in a cost effective manner. The Trust is comprised of two separate Funds, the Balanced Fund and the Fixed Income Fund. By having two separate Funds within the Trust, each with different risk and return characteristics, each participating borough can materially affect the potential return and risk level of their investments, as well as attain diversification within - and among - the two separate investment options available in the Trust.

This Investment Policy Statement is intended to provide guidelines for managing the Fixed Income Fund's assets only.

Cash Flows and Liquidity Needs

Contributions and disbursements from the Fixed Income Fund are according to the needs and circumstances of the participating boroughs. Each borough has the option to make contributions and withdrawals without advance notice, should circumstances warrant.

Regulatory Environment

The Trust operates in accordance with the requirements of the Act of the General Assembly of the Commonwealth of Pennsylvania, entitled "Nonprofit Corporation Law" approved May 3, 1933, P.L. 289, as amended.

III. Responsibilities of the Trust Representatives

A. Participating Boroughs

Each borough is best positioned to make decisions on how to allocate assets among the two Funds (Balanced or Fixed Income) offered by the Trust. As such, investment direction of borough contributions is each borough's responsibility. It is also each borough's responsibility to re-allocate assets as circumstances and/or risk tolerance change to either the Balanced or Fixed Income Fund. Each borough bears the risk of investment results in the Trust that derives from the options offered and the strategies they select.

B. Board of Trustees

The Board of Trustees (the "*Board*"), comprised of 12 members, each appointed for a four-year term, is responsible for the oversight of the Trust's assets. The Board is responsible for defining the objectives and policies for each Fund in the Trust, subject to the

overall guidelines set forth in this policy, Act 289 and other applicable State and Federal laws. It is expected that the objectives and policies described here will be used as the criteria for selecting and monitoring the appropriate investment manager(s), and mutual or other commingled funds for the management of the Trust's assets.

The Board has the responsibility to make changes in investment policy and investment alternatives and to implement approved policy, guidelines and objectives.

The Board may also appoint consultants, record keepers, and administrators to assist in the management of the Trust's/Fixed Income Fund's assets.

The Board will provide information regarding the investment options and basic principles of investing to participating boroughs to help address the various risk elements important to boroughs in a retirement plan. However, the dissemination of information and the selection of Funds by the Board do not constitute investment advice to the boroughs. The Board expects each borough to seek appropriate independent advice as each borough deems necessary.

C. PSAB Staff

The PSAB Treasurer has been delegated the following responsibilities for the oversight of the Trust's/Fixed Income Fund's assets:

- The Treasurer shall keep the Board informed of any significant events that impact the Trust or its Fixed Income Fund and may recommend changes in approved policy, Guidelines and objectives of the Trust,

- The day-to-day oversight of the Trust's/Fixed Income Fund's assets,
- Acting as the primary contact between the Board, the investment managers, investment consultant, custodian, and any other parties interested in the management of the Trust's/Fixed Income Fund assets,
- Such other duties as may be described in this policy, applicable State and Federal laws, or delegated by the Board of Trustees.

D. Investment Consultant

The Investment Consultant retained by the Board shall have the following responsibilities:

- To assist the Board in strategic planning for the Trust and the Fixed Income Fund. This includes providing assistance in developing an investment policy, asset allocation strategy, and investment manager structure;
- To provide to the Board quarterly performance measurement reports on each of the investment managers or funds and on each Fund as a whole and to assist the Board in interpreting the results;
- To act as a liaison between investment managers and the Trust, and thereby facilitate the communication of important information in the management of the Trust;
- Such other duties as may be mutually agreed to.

IV. Responsibilities of the Investment Managers

It is the intention of the Board of Trustees to utilize separately managed accounts to implement the investment strategy of the Trust and its Funds, where practical. Mutual funds or other commingled investment vehicles may also be used from time to-time to implement the investment strategy of the Fixed Income Fund. For mutual and other commingled funds, the prospectus or Trust documents of the fund(s) will govern the investment policies of the fund investments. Investment managers, however, shall be guided by the general principles and constraints outlined in this investment policy. The following guidelines apply to the separately managed accounts:

Fiduciary Responsibilities

Each investment manager is expected to manage the Fixed Income Fund's assets in a manner consistent with the investment objectives, guidelines, and constraints outlined in this statement and in accordance with State and Federal laws, including Act 289. This would include discharging responsibilities with respect to the Fixed Income Fund consistent with "Prudent Investor" * standards, and all other fiduciary responsibility provisions and regulations. Each investment manager shall at all times be registered as an investment advisor under the Investment Advisers Act of 1940

* Refers to a legal standard of care. In general, this standard of care governs the fiduciary responsibilities of the investment manager that traces back to *Harvard College v. Amory* which found that trustees should "... observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested."

(where applicable), and shall acknowledge in writing that they are a fiduciary of the Fixed Income Fund with respect to the assets they manage. The assets in the Fixed Income Fund will be managed by experienced investment management firms.

Security Selection/Asset Allocation

Except as noted below, each investment manager shall have the discretion to determine their portfolio's individual security selections.

The Board has established for the Fixed Income Fund an asset allocation strategy defining the mix of asset classes. This strategy, described below, sets a long-term percentage target for the amount the Fixed Income Fund's market value that is to be invested in anyone asset class. The allocation strategy also defines the allowable investment shifts between the asset classes, above and below the target allocations.

The asset allocation strategy for each investment manager's portfolio can deviate from the individual Fund's target asset allocation, however, the Board is responsible for monitoring the aggregate asset allocation of the Fixed Income Fund, and may re-balance to the target allocation on a periodic basis.

Proxy Voting

The investment managers are responsible and empowered to exercise all rights, including voting rights, as are acquired through the purchase of securities, where practical. Each investment manager shall vote proxies according to their established Proxy Voting Guidelines. A copy of those guidelines, and/or summary of proxy votes shall be provided to the Board upon request.

The Board is responsible for voting any proxies received from Investment Companies retained in the Fixed Income Fund and for any other "Trustee Directed" investments. The Board, as a Named Fiduciary of the Fixed Income Fund, shall vote the proxies according to the best long-term interests of the Fixed Income Fund. A summary of proxy votes shall be maintained by the Board outlining the proxies received and their disposition.

V. Fund Performance Objectives

In consideration of the structure of the Fixed Income Fund, the needs of participating boroughs, and the risk tolerance of the Board, the Board of Trustees has adopted an investment objective of Capital Preservation for the Fixed Income Fund as described in Section I above. The Board will monitor the Fixed Income Fund's performance on a quarterly basis. In addition, the Board will evaluate each investment manager's or fund's contribution toward meeting the investment objectives outlined below over a five- to 10-year time period and a full market cycle, unless otherwise noted.

Primary Benchmark: It is desired that the Fixed Income Fund earn returns higher than the "market," as represented by a benchmark index or mix of indexes reflective of the Fixed Income Fund's return objectives and risk tolerance. This benchmark or "policy index" for the Fixed Income Fund is to be constructed as follows:

Fund	Primary Performance Benchmark
Fixed Income Fund	50% ML 1-3yr Treasury 50% Bloomberg Barclays US Aggregate

The Fixed Income Fund is expected to exceed the average annual return of this benchmark on a risk-adjusted basis over a five- to 10-year rolling time period and a full market cycle.

Secondary Performance Targets: Performance of the Fixed Income Fund shall also be compared to an economic goal tied to the overall U.S. inflation rate as described in the table below:

Fund	Secondary Performance Benchmark
Fixed Income Fund	Inflation + 1.00%

Inflation shall be measured by the U.S. All Urban Consumers Price Index ("CPI").

The Fixed Income Fund is expected to exceed their respective policy index return and real return goal each measured on a compound average annual return basis after the deduction of investment management fees and annualized over a five- to 10-year rolling time period and a full market cycle.

VI. Asset Allocation Strategy

In line with the Fixed Income Fund's return objectives and risk parameters, the mix of assets for the Fixed Income Fund should generally be maintained as follows (percent's are of the market value of the Fixed Income Fund):

Asset Class	Minimum	Maximum
Domestic Investment Grade Fixed Income (Maturities > 1 year)	70%	100%
Cash and Cash Equivalents (Maturities < 1 year)	0%	30%

Deviations from these asset mix guidelines may be authorized in writing by the Board, which may determine if the aggregate deviation constitutes a material departure from the spirit of the target allocation.

The maximum percentage designated for the "Cash and Cash Equivalents" category is intended to apply after the initial start-up of any one portfolio within the Funds. The Board recognizes that this initial start-up period to become fully invested could be as long as three months after the initiation of a portfolio.

Rebalancing/Tactical Asset Allocation Procedures

Each investment manager will be expected to maintain the asset allocation of their portfolio consistent with the target asset allocation established for their portfolio (as described in the attachments to this investment policy). Since capital appreciation (depreciation) and trading activity in each individually managed portfolio can result in a deviation from the overall Fund's asset allocation, the aggregate asset allocation will be monitored and the Board may rebalance on a periodic basis. To achieve the rebalancing of the Fixed Income Fund, the PSAB Treasurer may re-direct contributions and disbursements

from individual investment managers as appropriate, in addition to shifting assets from one investment manager to another.

Tactical Asset Allocation

The Board may make periodic tactical shifts in the asset allocation or the investment style allocations of the Fixed Income Fund based on their assessment of current and prospective market conditions. These tactical shifts may entail shifting assets between investment managers and/or redirecting cash flows of the Fixed Income Fund. These asset allocation shifts are to remain consistent with the maximum and minimum ranges outlined in the table above.

VII. Investment Strategy

A. Selection Criteria for Investment Managers

Investment managers retained by the Board shall be chosen using the following criteria:

- Past performance, considered relative to other investments having similar investment objectives. Consideration shall be given to both consistency of performance and the level of risk taken to achieve results,
- The investment style and discipline of the investment manager and/or fund,
- How well the manager's investment style or approach complements other assets in the Fixed Income Fund,
- Level of experience, financial resources, and staffing levels of the investment manager,
- An assessment of the likelihood of future investment success, relative to other opportunities.

B. Investment Manager Structure

The Fund will utilize a single-manager structure of intermediate duration fixed income instruments to invest the Fixed Income Fund's assets.

C. Investment Policies and Constraints

Investment activity must be consistent within the requirements of this policy and applicable laws.

D. Allowable Securities

Domestic fixed and variable rate bonds and notes issued by the U.S. Government and its Agencies, U.S. corporations, securitized mortgages (*e.g.* GNMA's, FNMA's, FHLMC's), collateralized mortgage obligations, asset-backed securities, Yankee bonds and notes (bonds or notes issued by non-U.S. based companies and governments but traded in the U.S.), taxable municipal bonds and preferred stock.

E. Diversification

To minimize the risk of large losses, each Investment Manager shall maintain adequate diversification in their portfolio. Subject to the constraints outlined in this investment policy, and in their investment management agreement with the Fixed Income Fund, each Investment Manager shall have the discretion to determine their portfolio's individual security selections.

- Fixed income securities (except for those listed below) should be rated "BBB-"* (or its equivalent) or higher at the time of purchase by a nationally recognized statistical rating agency. Asset backed securities, mortgage backed securities, and CMOs should be rated "AAA" (or its equivalent) at the time of purchase by a nationally recognized statistical rating agency.
- Fixed income securities holdings of a single issuer, issue, or asset pool, except for direct obligations of the U.S.

* All rating categories, include qualifiers "+" and "-" for S & P and "1", "2" and "3" for Moody's. In the event of a "split rated" security, that is a security with non-equivalent rating classifications from different rating agencies, the higher of the quality ratings shall apply.

Government or its Agencies, are limited to no more than 10% of the market value of the investment manager's portfolio.

- No more than 30% of the market value of an investment manager's portfolio may be invested in a single sector of the corporate fixed income market, (*e.g.* Industrials, Financials, Utilities). Sector definitions shall be according to the investment manager's own classifications, which should be provided to the Board upon request.
- The maximum effective maturity of any single fixed income security is 40 years. The dollar weighted average effective duration of the fixed income portfolio should be within $\pm 25\%$ of the weighted average duration of the fixed income policy index for this portfolio.
- Mortgage backed securities may be purchased on a "when issued" or "TBA" basis (a forward contract transaction for mortgage backed issues that are to be issued in the near term). A short-term investment can back a "when issued" commitment as long as its effective duration does not exceed 180 days. These short-term investments should be considered within the fixed income allocation of the portfolio.
- Investments in collateralized mortgage obligations are limited to no more than 10% of the market value of the portfolio.
- Purchases of mortgage securities whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security and pays no principal (*e.g.* interest only securities) are prohibited.

Similarly, the purchase of mortgage securities whose payment represents the principal payments on the outstanding principal balance of the underlying mortgage backed security and pays no interest (*e.g.* principal only securities) is also prohibited.

- Purchases of mortgage securities whose payment of interest is determined by an index opposite to the changes in a market index (*e.g.* inverse floaters) is prohibited.

Cash and Equivalents

It is generally expected that the investment manager will remain fully invested in fixed income securities, however, it is recognized that cash reserves may be utilized from time to time to provide liquidity or to implement some types of investment strategies. Cash reserves should be held in the custodian's money market fund*, or invested in short-term Treasury securities, or high quality money market instruments.

Transactions or unanticipated market actions that cause a deviation from these policy guidelines should be brought to the attention of the Board by the investment manager prior to executing transactions, when practical. Such deviations may be authorized in writing by the Board, which can determine if the deviation constitutes a material departure from the spirit of this policy.

* Investments in money market funds other than the custodian's money market fund must be approved by the Board prior to purchase. For investments in mutual or commingled funds, the prospectus or Trust documents of the fund(s) will govern the investment policies of the fund investments. Accordingly, it is understood that the investment manager for the separately managed account shall not be responsible for the investments in the fund.

VIII. Exclusions

For mutual and other commingled funds, the prospectus or Trust documents of the fund(s) will govern the investment policies of the fund investments. Investment managers, however, shall be guided by the general principles and constraints outlined in this investment policy. The Fixed Income Fund's assets in separately managed accounts may not be used for the following purposes:

- Short Sales
- Leveraged transactions
- Commodities transactions
- Puts, calls, straddles, or other option strategies
- Purchases of real estate, oil and gas properties, or other natural resources related properties with the exception of Real Estate Investment Trusts or marketable real estate securities
- Investments in limited partnerships except for publicly traded Master Limited Partnerships
- Investments in futures, use of margin, or investments in any derivatives not explicitly permitted in this policy statement
- Investments by the investment managers in their own securities, their affiliates, or subsidiaries (excluding money market or other commingled funds as authorized by the Board)

The investment manager acknowledges the general guidelines presented in this investment policy and will seek to manage the portfolio in accordance with these guidelines. The investment manager will monitor the portfolio and will use its best efforts to correct any deviations from these guidelines as soon as reasonably practicable.

Any other security transaction not specifically authorized in this policy statement, unless approved, in writing, by the Board Requests by investment managers to execute transactions that are not currently authorized in this policy should be made prior to executing such transactions.

IX. Investment Transactions

Trading for the Fixed Income Fund is directed by and is the responsibility of each investment manager to whom the Board has granted the discretionary authority to determine (subject to the investment objectives and policies outlined herein) the securities to be bought or sold on behalf of the Fixed Income Fund, the amount of such securities, and the brokers or dealers to be used in such transactions. The investment manager is generally obligated, absent the Board's direction to the contrary, to effect transactions with or through those brokers or dealers that in the investment manager's view, are capable of providing best price and execution of client orders.

X. Meetings and Communications

For separately managed accounts:

- As a matter of course, each investment manager should keep the Board apprised of any material changes in the investment manager's outlook, investment policy, and tactics;
- Each investment manager should meet with the Board on a periodic basis (typically once every two years) to review and explain their portfolio's investment results. These meetings are expected to be held at PSAB's main offices in Harrisburg, but may be held at other mutually convenient locations;

- Each investment manager should be available on a reasonable basis for telephone communication when needed;
- Any material event that affects the ownership or capital structure of the investment management firm, changes in senior investment personnel or any other material event that affects the management of this account must be reported promptly to the Board or their Investment Consultant. This requirement does not include routine employee stock ownership transactions or partnership announcements;

All accounts:

- Morgan Stanley will provide written performance reports for each individual portfolio or fund and Fixed Income Fund composites not less than quarterly;
- The custodian should provide monthly statements of assets and transactions.

XI. Performance Evaluation

As noted above, the Board will monitor the Fixed Income Fund's performance on a quarterly basis. The Board will evaluate the Fixed Income Fund's success in achieving the investment objectives outlined in this document over at least a five- to 10-year time horizon. The Board realizes that most investments go through cycles. Therefore, there will be periods of time in which the investment objectives are not met or when some investment managers (or funds) fail to meet their expected performance targets.

Each and investment manager's or fund's performance should be reported in terms of rate of return and changes in dollar value. The

returns should be compared to appropriate market indexes and peer group universes, for the most recent quarter and for annual and cumulative prior time periods.

The Fixed Income Fund's asset allocation in separately managed accounts and the allocation to each commingled fund should also be reported on a quarterly basis (for the purposes of calculating the asset allocation of the Fixed Income Fund as a whole, the asset allocation of each commingled fund shall be assumed to be fully invested in the policy index to which it is compared). Risk as measured by volatility, or standard deviation, should be evaluated after twelve quarters of performance history have accumulated. An attribution analysis should also be performed for the separately managed accounts, to evaluate how much of the Fixed Income Fund's investment results are due to the investment managers' investment decisions, as compared to the effect of the financial markets. It is expected that this analysis will use the "policy index" as the performance benchmark for evaluating both the returns achieved and the level of risk taken.

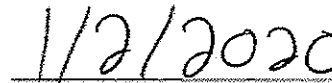
Performance dispersion of each individual manager relative to other managed accounts of a similar style will be assessed from time-to-time. Such assessments will take into account the nature of the investment manager's style, portfolio constraints, and the market environment.

XII. Approval

It is understood that this investment policy is to be reviewed periodically by the Board to determine if any revisions are warranted by changing circumstances including, but not limited to, changes in financial status, risk tolerance, changes in the Fixed Income Fund or changes involving the investment managers.

The Board of Trustees understands and agrees that the provisions of this document are subject to any relevant investment advisory agreement and to the extent of any conflict the terms of the investment advisory agreement controls. The Board of Trustees further understands that this investment policy statement does not provide any additional rights other than those that are described in the investment advisory agreement.


Authorized Signature, Board of Trustees


Date