



STAFF REPORT ACTION REQUIRED

Toronto Atmospheric Fund Statement of Investment Objectives and Principles - 2007

Date:	June 5, 2007
To:	Executive Committee
From:	Deputy City Manager and Chief Financial Officer
Wards:	All
Reference Number:	P:\2007\Internal Services\Cf\ec07026Cf – et (AFS #5189)

SUMMARY

The Statement of Investment Objectives and Principles, as approved the Board of Directors of the Toronto Atmospheric Fund (TAF) is attached (Appendix A) as a policy and guidance framework for investing TAF's assets, currently valued at approximately \$27 million. The Statement includes Part A, i.e. conventional equities and bonds, and Part B, i.e. loans, loan guarantees, joint ventures, etc. that are directly aligned with TAF's mandate.

The Investment and the Mandate Related Finance Committees of TAF developed the Statement over the past year with the support of staff and TAF's Investment Advisor. Upon approval by City Council, this Statement will replace the Statement of Investment Policies and Procedures that currently guides TAF's investing activities.

RECOMMENDATIONS

The Deputy City Manager and Chief Financial Officer recommends that:

1. Council approve the attached Statement of Investment Objectives and Principles as approved by the TAF Board of Directors (Appendix A) with the following amendment to clause (6.1) of the "Statement of Investment Objectives and Principles":

Delete the last sentence and substitute "The asset mix of the total fund should not exceed 55% in total equities on a market basis over a full market cycle."; and

2. the appropriate City Officials be authorized and directed to take the necessary action to give effect thereto.

FINANCIAL IMPACT

There is no financial impact.

DECISION HISTORY

TAF's current Statement of Investment Policies and Procedures was approved by Council at its meeting held on September 28, 2005.

ISSUE BACKGROUND

TAF's investments are currently managed by two external managers, Philips Hager & North and Fiera/YMG Management Inc. The managers have complied with the guidelines stated in the "Statement of Investment Policies and Procedures," which was approved by City Council in September, 2005. The managers have matched or exceeded their investment performance benchmarks since inception.

They are contracted and retained by the City on behalf of TAF as required by the Toronto Atmospheric Fund Act.

At its meeting held on September 22, 23, 23, 24 and 25, 2003, City Council adopted Clause 19 of Report No. 9 of the Policy and Finance Committee, "Governance Review of the Toronto Atmospheric Fund". The following recommendations were contained in that report:

- (6b) the City CFO transmit its Statement of Investment Policies and Procedures with a commentary and recommendations to the Policy and Finance Committee and Council for their approval; and
- (6c) the process applies to future TAF amendments to its investment objectives and policies.

COMMENTS

At its meeting held on April 18, 2007, the TAF Board approved the updated "Statement of Investment Policies and Procedures" and authorized staff to request the Deputy City Manager and Chief Financial Officer to submit the statement for Council's consideration and approval.

The primary objective of TAF's investment policy is the safety of principal and the maintenance of liquidity while providing a rate of return and financial flexibility needed to achieve its goals as defined by its mandate.

The proposed Statement of Investment Objectives and Principles (Appendix A) incorporates several changes from the existing Council-approved Statement of Investment Policies and Procedures as it provides TAF's Board with greater flexibility to establish asset mix, benchmarks and risk management parameters etc.

Part A

- The geographical scope of investments under Part A has been expanded from Canada/U.S. to global [Section 7.1(a)];
- The goal of maintaining a “real rate of return” over time has been changed to maintaining the “rate of return sufficient to preserve the value of the original assets” [Section 5.1(c)].
- The Fund's assets will be invested in the major asset classes, and the portfolio will be structured to reflect an appropriate balance between fixed income and equity investments.

The asset mix will be adjusted by the Board to reflect current and future capital market conditions. Instead of the target weighted of 50% to 60% in equities as stated in the TAF policy, it is being recommended that the equity target be amended to a 55% limit on total equity exposure in the fund to provide the TAF Board with a firm guideline. As of March 31, 2007, total equities in the portfolio were 52% so the 55% limit appears to be reasonable and is preferred by the City instead of setting a range which does not provide the same level of accountability to the TAF Board.

Asset Class	Benchmark Index	Old Trustee Act Asset Mix Range	Current Asset Mix Actual as of March 31/07	Current Investment Policy *
Canadian equity	S&P/TSX 300 Total Return or TSX Capped Composite Index		24%	20%-30%
U.S. equity	S&P 500		28%	20%-30%
Total Equity		<u>0%-25%</u>	52%	40%-60%
Fixed Income	Scotia Capital Universe	<u>0%-75%</u>	44%	20%-60%
Total Debt				40%-60%
Cash	T-Bills		4%	0% -10%

* as approved by the TAF Board and Council in September, 2005

Part B

- Eligible investments have been broadened from loans to include other forms of investments such as securities and joint ventures [Section 10.1(c)];

- The threshold for projects requiring Council approval has been increased from \$1 million to \$2 million, and past constraints on terms limits have been eased (Section 13.2).

The proposed new Statement updates the existing Statement and will provide the TAF Board and its Committees as well as its external investment managers with greater flexibility and the capacity to achieve TAF's performance benchmarks.

CONTACT

Len Brittain, Director, Corporate Finance

Phone: 416-392-5380; Fax: 416-397-4555; E-mail: lbrittai@toronto.ca

Martin Willschick, Manager, Capital Markets

Phone: 416-392-8072; Fax: 416-397-4555; E-mail: mwillsch@toronto.ca

SIGNATURE

Joseph P. Pennachetti
Deputy City Manager and Chief Financial Officer

ATTACHMENT

Appendix A –
Toronto Atmospheric Fund Statement of Investment Objectives and
Principles - Part A and Part B

APPENDIX A



Statement of Investment Objectives And Principles

Part A and Part B

April 10, 2007



Statement of Investment Objectives and Principles

PREAMBLE

SECTION 1: MANDATE

- 1.1 The endowment of the Toronto Atmospheric Fund (“TAF”) was established by Toronto City Council in 1992 to provide an asset base for grants and loans to support local projects that help stabilize the concentration of greenhouse gases in the atmosphere and improve local air quality. The objects of the Fund are:
- a. To promote global climate stabilization by the reduction of emissions of greenhouse gases and greenhouse gas precursors into the atmosphere through public education, scientific research and technology development;
 - b. To promote public understanding of global warming and its implications for the urban environment;
 - c. To create and preserve carbon sinks;
 - d. To promote energy conservation and efficiency; and
 - e. To provide support and funding for projects related to energy efficiency and global climate stabilization in cooperation with non-government organizations, governments, industries, corporations, official committees, neighbourhood organizations, universities and public and private schools.
- 1.2 TAF’s assets (the “Fund”) are to be managed to ensure that TAF’s mandate can be carried out on an ongoing, continuing basis, and so that the value of the asset base can be preserved over time. In furtherance of these objectives, the Fund has been divided into two Parts.
- 1.3 Part A consists of that portion of the Fund that is managed by external portfolio managers who have been selected through a confidential search process by the Board of TAF and retained by the City to manage such assets.
- 1.4 Part B consists of the balance of the assets of the Fund and includes mandate related loans and related financings to underwrite projects that are approved by TAF’s Board of Directors (the “Board”) and help to carry out energy efficiency and renewable energy initiatives that are being undertaken by public, private, and non-profit institutions located in Toronto.

SECTION 2: PURPOSE AND GENERAL GOVERNANCE

- 2.1 Statement of Investment Objectives and Principles (the “Statement”) has been developed by TAF’s Investment Committee (the “Investment Committee”) and approved by TAF’s Board of Directors (the “Board”) to direct and ensure continued prudent and effective investment management of the Fund and its ongoing preservation and financial well being. This Statement is subject to City Council’s approval.
- 2.2 This Statement shall take effect on [here insert effective date.] As and from such date, this Statement shall supercede and replace all prior Statements of Investment Policies and Procedures of TAF.
- 2.3 The purpose of this Statement is to address the manner in which assets of the Fund shall be invested under Part A and Part B.
- 2.4 Responsibility for TAF’s assets historically rested jointly with the City of Toronto’s Deputy City Manager and Chief Financial Officer (“the CFO”) and the Board. Going forward, the CFO retains the authority for contractual relationship with the investment managers and custodian while relying on the expertise of TAF’s Board and Investment Committee to provide monitoring and oversight and reporting to the CFO.
- 2.5 This Statement is subject to approval by City Council. The Board of TAF is responsible for the development of a Detailed Statement of Investment Policies and Procedures (SIPP) and for the development of individual investment manager Mandates.
- 2.6 Pursuant to the TAF Act, TAF may establish committees to advise it on matters relating to Parts A and B. The Committees described under Parts A and B have been established by TAF's General By-law as starting points for governance. Pursuant to limits set out in the By-law the TAF Board may, from time to time, establish other committees and may alter the scope and duties of these committees.

PART A

SECTION 3: GOVERNANCE

- 3.1 With the advice and analysis of the Investment Committee, the Board is responsible for conducting confidential searches and engaging the services of external portfolio managers to invest Part A of the Fund in a manner that is consistent with this Statement and the SIPP (as the same may be amended or replaced from time to time) and specific Mandates developed for the investment manager(s). The previous Statement of Investment Objectives, Policies and Procedures was dated

November 23, 1999 (Report of the Policy and Finance Committee, dated December 7, 1999 adopted by City Council at its meeting held December 14, 15, and 16, 1999, further amended by Report No. 15 of the Policy and Finance Committee, adopted by City Council at its meeting November 26, 27 and 28, 2002.) TAF's current Statement of Investment Policies and Procedures was approved by Council at its meeting September 28, 2005.

3.2 The Board delegates some of their responsibilities with respect to overseeing the ongoing investment of Part A of the Fund to the Investment Committee. The Investment Committee is a standing committee of the Board and operates in accordance with its Terms of Reference. The duties of the Board are as follows:

- a. To appoint the members of the Investment Committee who possess excellent experience and credentials in the financial and investment communities;
- b. To consider and approve the Investment Committee's recommendations regarding this Statement, the SIPP, and Manager Mandates and any changes therein;
- c. To consider and approve the Investment Committee's recommendations regarding engaging and terminating any portfolio managers, agents or advisors that will assist in the management of Part A of the Fund; and
- d. To provide annually to the City of Toronto's CFO a copy of the SIPP most recently approved by the Board.

3.3 The Investment Committee is responsible for:

- a. Advising the Board on the selection of the portfolio manager(s), ("the Manager(s)"), the Custodian, the Investment Advisor (the "Advisor"), and any other agents or advisors that may be necessary to prudently manage Part A of the Fund;
- b. Formulating and recommending when necessary, changes to this Statement, the SIPP, and the Mandates;
- c. Reviewing the SIPP and Mandates at least once per year and ensuring that the investments of Part A of the Fund are aligned with TAF's mandate;
- d. Communicating as soon as reasonably possible any changes to the SIPP to the Manager and any other relevant parties before they come into effect;
- e. Monitoring the Manager(s) and any other agents or advisors with respect to performance and meeting benchmarks in the SIPP;

- f. Informing the Manager(s) of any significant cash flows that are to be added to or subtracted from Part A of the Fund; and
- g. Providing quarterly reports to the Board on the performance of Part A of the Fund and any other aspects of asset management, that the Investment Committee deems appropriate or as requested by the Board.

SECTION 4: INVESTMENT PRINCIPLES

4.1 The following principles form the basis of TAF's investment policy for Part A of the Fund. They are derived from an understanding of TAF's mandate and well-documented research and analysis relating to the performance of the Canadian and foreign securities markets.

- a. TAF's investment horizon is long-term, meaning at least 20 years. Asset management decisions should seek to maximize risk-adjusted return over the long-term, not over the short-term.
- b. Publicly listed equity securities provide the opportunity to invest broadly in the industrial makeup of Canada and other countries. Astute diversification provides the opportunity to enhance returns and reduce risk. Historically, equities have outperformed bonds over the last 50 – 100 years. Given that a key purpose of management of TAF's endowment is to preserve the value of these assets over the long-term, then investment in publicly listed equities must form an important component of the Fund's assets for the foreseeable future.
- c. While equity investments have exhibited higher returns in the longer term, they have been accompanied by higher volatility than fixed income investments, with the added incidence of periods of unfavourable returns in the short run, and this relationship is likely to prevail in the future.
- d. The most prudent way to manage risk is through diversification including diversification of asset classes and types, as well as through engagement of multiple asset managers with different, but complementary investment philosophies.
- e. TAF can further align its investments with its mandate by seeking to use its shareholder interest in concert with other likeminded shareholders to influence the greenhouse gas policies of companies in its portfolio. Thus, TAF can serve its own mandate best by being a shareholder in any company permitted under the Trustee Act, rather than prohibiting investments in companies whose policies may not be in accord with TAF's mandate.
- f. Professional, active management that selects a broad mix of individual equity securities that are appropriate to implement these principles will outperform over the long term—on a risk-adjusted basis—a purely passive management

approach that focuses only on placement of assets in indexed funds and may not achieve adequate industry diversification.

- g. New research over the past five years indicates that securities that are selected for their appropriateness to various social and environmental screens are outperforming their benchmarks in certain market environments. Climate change exposes corporations to new costs, liabilities—and opportunities—that may affect the share value of such companies over the long-term. Risks and opportunities related to climate change should be factored into the asset managers security evaluation process.

SECTION 5: INVESTMENT OBJECTIVES

5.1 The main objective of management of Part A of the Fund is to ensure as high a rate of return as possible, at a moderate level of risk, consistent with the ‘prudent investor’ approach as outlined in Sections 27-31 of the Trustee Act (Ontario). Specific objectives of TAF’s investment management policy include:

- a. Earning a rate of return sufficient to ensure that TAF can annually expend funds to achieve its mandate for grants, special projects and related administrative activities;
- b. Aiming to expend funds in a target range to be set by the TAF Board as market conditions warrant;
- c. Earning a rate of return sufficient to preserve the value of the original assets of Part A of the Fund (\$23 million), over time;
- d. Ensuring adequate liquidity such that TAF’s operations and on-going financial commitments can be paid in an orderly and timely fashion; and
- e. Investing, over the long term, in “best of class” equities that seek to minimize exposure to companies whose share value may be at risk from climate change.

SECTION 6: INVESTMENT POLICY PORTFOLIO AND BENCHMARKS

6.1 To maintain a diverse asset mix that minimizes risks and allows a prudent portfolio approach, the Fund’s assets will be invested in the major asset classes, and the portfolio will be structured to reflect an appropriate balance between fixed income and equity investments. For a long term portfolio with the objectives of annual income and preservation of capital, it would be expected to have a target average weighting of 50-60% equities over a full market cycle.

6.2 TAF will seek to identify and potentially invest funds in “best of class” companies, measured in part by the climate-related risk entailed by a company’s management and operations. Such analysis, which may require the development of

specialized tools, should take into account a variety of risks that climate change may pose to industry, including regulatory, reputational, and weather-related risks, and assess a company's capacity to take advantage of new product and technology opportunities and the emerging emissions trading market. Any development of specialized analytical tools shall be undertaken by the Investment Committee in consultation with the Board

SECTION 7: PERMITTED INVESTMENTS, CONSTRAINTS AND EXCEPTIONS

7.1 The following equity investments may be made by the Managers:

a. Permitted Investments

In accordance with the Prudent Investor Standard, allowable securities will be any Limited Liability security that trades in a recognized senior Canadian or Global market or exchange or pooled funds that hold these securities.

b. Investment Constraints

The individual Manager Mandates must include detailed provisions for allowable investments that provide criteria for fixed income credit quality, diversification by sector, issuer and security and liquidity.

PART B

SECTION 8: PURPOSE

Sections 8 - 13 address the manner in which Part B of the Fund shall be invested.

8.1 This *Statement of Investment Objectives and Principles—Part B* (the “Statement—Part B”) has been developed by TAF’s Mandate Related Finance Committee (the “Finance Committee”) and approved by TAF’s Board of Directors (the “Board”) to maximize TAF’s impact in accordance with its mandate while continuing prudent and effective management of the Fund.

8.2 The Terms of Reference of the Committee, appended to this Statement—Part B, outlines the roles and responsibilities of the Finance Committee and the manner in which it has been directed by the Board to conduct its activities.

SECTION 9: GOVERNANCE

9.1 With the advice and analysis of the Mandate Related Finance Committee, the Board is responsible authorizing funds to invest Part B of the Fund in a manner that is consistent with TAF’s mandate.

- 9.2 The Board delegates some of their responsibilities with respect to overseeing the ongoing investment of Part B of the Fund to the Mandate Related Finance Committee. The Mandate Related Finance Committee is a standing committee of the Board and operates in accordance with its Terms of Reference. The duties of the Board are as follows:
- a. To appoint the members of the Mandate Related Finance Committee who possess excellent experience and credentials in the financial, investment, business, and technology communities; and
 - b. To consider and approve the Mandate Related Finance Committee's recommendations regarding investment of TAF's assets under Part B.
- 9.3 The Mandate Related Finance Committee is responsible for:
- a. Formulating and recommending, when necessary, changes to this Statement with respect to Part B;
 - b. Formulating and recommending criteria and guidelines for investments that align with TAF's mandate under Part B;
 - c. Reviewing applications for investment pursuant to Part B;
 - d. Reviewing the criteria and guidelines for investments at least once per year to ensure that the investments made by TAF under Part B comply with the Board's priorities and strategic directions; and
 - e. Providing annual reports to the Board on the performance of Part B of the Fund and any other aspects of investment management that the Mandate Related Finance Committee deems appropriate or as requested by the Board.

SECTION 10: INVESTMENT BELIEFS

- 10.1 The following beliefs form the basis of TAF's investment policy for Part B of the Fund.
- a. TAF believes that greenhouse gas reduction projects, technologies, and companies offer significant opportunities for investment and revenue generation. Hence, the purpose of TAF's mandate related investments is to align TAF's asset management with the Fund's mandate. As in the case of Part A, TAF's investment horizon for Part B is long-term. Mandate-related lending decisions should seek to maximize risk-adjusted return as well as greenhouse gas emission reductions over the long-term, not over the short-term.
 - b. Mandate-related lending and investments entail primarily three kinds of risk:

- i. Credit risk—the overall willingness and capacity to repay the loan, along with potential collateral to secure or additional capital to fall back on;
 - ii. Project and business risk—the probability of the project/business generating the anticipated cash flows and/or emission reductions or cost savings required to repay the loan or attract a purchaser; and
 - iii. Market risk—unfavorable changes in interest rates and inflation, and market acceptance of the investment.
- c. Ways to manage risk include diversification, portfolio mix, syndication, and co-investment with partners with strategic and experienced partners and analysis. Diversification can be carried out through investment in a variety of financing approaches, including:
 - i. term loans;
 - ii. securities;
 - iii. loan guarantees;
 - iv. loan syndications;
 - v. leasing; and
 - vi. joint ventures.

Risk management can be further enhanced by investing in multiple sectors and technologies, and by making capital available to the general public, as well as to institutions and companies for their projects.

SECTION 11: INVESTMENT OBJECTIVES

- 11.1 In making mandate related investments, TAF seeks opportunities in which it adds value by providing capital to projects, borrowers and invested companies that cannot easily be obtained in commercial financial markets, or where the private financial institution needs additional encouragement and assurances to enter a market or investment, or that are difficult to finance through more traditional sources.
- 11.2 TAF will seek out financing partners and opportunities in order to leverage its investments to the maximum extent possible in individual projects.
 - a. Project and business financing—TAF will seek co-funders of projects during the initial stages of project development and commissioning; and
 - b. Syndication—At a later date after a suitable volume of projects has been funded, TAF will seek to bundle the projects together and syndicate TAF's portion of financing;

- 11.3 Mandate related financing will be as synergistic with TAF's Grants Program as possible, so that TAF's grants eventually germinate larger projects and technology applications that can be scaled up with mandate related financing.
- 11.4 TAF's mandate related investments aim to ensure the following financial objectives:
 - a. Earning a rate of return sufficient to ensure that TAF's objects can be achieved and TAF's ongoing administrative, grant, and special project commitments can be sustained;
 - b. Investing in a manner that complies with applicable legislation and complies with any relevant aspects of City Council's investment and governance policies as they apply to TAF; and
 - c. Full cost recovery for any administrative and legal expenses in addition to the rate of return expectations.

SECTION 12: INVESTMENT CRITERIA

- 12.1 Investments must contribute to projects that support TAF's environmental objective of stabilizing the concentration of greenhouse gases in the atmosphere and improving local air quality. Hence, each project should demonstrate:
 - a. Significant local greenhouse gas emission reductions; and/or
 - b. A reduction in smog precursor emission locally; and/or
 - c. Opportunity to acquire and/or retire emissions credits.
- 12.2 TAF's mandate related lending will support innovative technologies that hold a promise of deep reductions in greenhouse gas emission reductions by potentially leading to market transformation related to a particular sector of the city's economy, such as high rise residential buildings, or to a particular energy end use, such as lighting.
- 12.3 TAF will be open to both public and private sector investment opportunities.
- 12.4 TAF's pricing will be subject to investment risk at the time of investment, as well as the availability of subsidies from senior levels of government. Such pricing will allow for market movement or room to share with other financial participants at the time of project commissioning.

SECTION 13: BOARD AND COUNCIL APPROVALS

13.1 The TAF Board, acting on advice from its Mandate Related Investment Committee, will make all final decisions regarding:

- a. Investment portfolio mix;
- b. Investment criteria;
- c. Individual applications;
- d. Financial partners; and
- e. Legal agreements.

The TAF Board may delegate financing decisions on individual projects to staff if applications meet all specific criteria for investment approved by the Board.

13.2 For a project amount greater than \$2,000,000, or a financial commitment involving payments longer than a 12-year term, City Council will need to consider and give its final approval. For a project less than \$2,000,000 or a financial commitment involving payments less than a 12-year term, City Council specifically authorizes TAF to enter into such projects and commitments.

P. Jessup
K. Rodgers
T. Stoate
FINAL VERSION
April 10, 2007