



**STAFF REPORT
ACTION REQUIRED**

Toronto Atmospheric Fund Statement of Investment Objectives and Principles - 2010

Date:	March 31, 2010
To:	Executive Committee
From:	Deputy City Manager and Chief Financial Officer
Wards:	All
Reference Number:	P:\2010\Internal Services\Cf\Ec10013cf (AFS #10690)

SUMMARY

At its meeting held on March 8, 2010, the Board of Directors of the Toronto Atmospheric Fund (TAF) approved the attached “Statement of Investment Objectives & Principles” (SIOP) (Schedule A) and requested the Deputy City Manager and Chief Financial Officer to submit the statement to Council for approval.

TAF’s Investment Committee developed the SIOP over the past year with the support of staff. This revised policy establishes a more integrated and mandate-oriented approach to investing TAF’s assets.

Upon approval by City Council, this Statement will replace the Statement of Investment Policies and Procedures that was approved in 2007.

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 TAF’s Board of Directors (Appendix A).

Financial Impact

There is no financial impact occurring from the adoption of this report.

ISSUES BACKGROUND

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:

- 6 (b) 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

- 6 (c) the process applies to future TAF amendments to its investment objectives and policies.

The proposed SIOP is consistent with TAF’s mandate, all elements of governance with the Board and Investment Committee’s responsibilities as set out in the TAF Act (2005), the City’s Relationship Framework (2006) and the current SIOP which was approved by Council at its meeting held on July 16th, 17th, 18th and 19th, 2007.

COMMENTS

The core commitment to maximizing investment returns over the long-term, using the ‘prudent investor’ approach, and maintaining adequate liquidity have been retained in the proposed SIOP. The most significant changes are the principles that ‘green’ investing can improve the risk/return profile of equity portfolios in the coming decades and that TAF should leverage its competency in direct financing to maximize both revenue and mandate-related returns on investments.

Principles from the current SIOP that have been retained in the proposed SIOP

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

The main objectives of the original SIOP remain unchanged such as maintaining the original asset value of the Fund over the long-term, utilizing the ‘prudent investor’ approach by maintaining diversified asset classes while complying with statutory legislation and Council-approved mandate statements.

The proposed SIOP maintains TAF’s ability to provide capital to projects that support its mandate of stabilizing the concentration of greenhouse gases in the atmosphere and improving local air quality but cannot easily access traditional financial markets.

Differences between proposed and existing SIOP

The current SIOP has a simple limit of 55% on the equity exposure in the portfolio while the recommended SIOP explicitly defines this asset mix and the investment ranges of the Fund. The new SIOP utilizes the full-portfolio approach by requiring the portfolio to be structured to reflect an appropriate balance between publicly traded equities, fixed-income securities, private debt and equity investments and sets out a desired range for each asset class, as described below.

Recommended Asset Mix and Investment Ranges Contained in Recommended SIOP

			Min	Max
Public Market Investments (total)			50%	100%
	Min	Max		
Public Equities	20	55		
Fixed Income	25	80		
Cash	0	20		
Private Direct Lending/Investment (previously Part B)			0	40%
Private Pooled Equity			0%	10%

Under the proposed SIOP, TAF's investment portfolio will be well-positioned to achieve two equally important objectives consisting of maximizing risk-adjusted returns while minimizing greenhouse gas emissions.

The recommended SIOP is based upon evidence in the marketplace over the past five years that demonstrates that ‘green’ or ‘socially-responsible’ investing performs as well or better than average, and a body of research which indicates that it can actually improve risk-adjusted returns over the long-term when compared to the more traditional investment strategies.

The recommended SIOP maintains the same focus as the current SIOP, namely to provide capital to “for-profit” and “not-for-profit” organizations which deliver mandate-related benefits as well as market rates of return, complying with applicable legislation and the relevant and applicable aspects of its investment and governance policies.

The bulk of “Direct Investment” would be “senior debt” backed by tangible security and collateral, generate market rates of return, and be offered only once rigorous due diligence has been undertaken on the sponsoring organization (including management, track-record, credit rating and position in the marketplace). Each transaction is to be thoroughly vetted by the Investment Committee to ensure the risk/reward ratio and transaction structure are viable, and TAF’s capital remains within acceptable risk parameters. Borrowers pay the associated legal costs related to a transaction, as is the customary practice.

TAF will seek financing partners through the syndication and sale of investment opportunities in order to leverage its investments.

Implementation of the revised SIOP

The TAF Board has recently appointed new members to the Investment Committee, building on its extensive expertise in public and private investment. The Investment Committee continues to take an active and proactive role in overseeing all aspects of TAF's investment activity, including regular review of the SIOP, as required in its Terms of Reference, and implementation of all policy directions.

The recommended SIOP updates the existing policy and provides the TAF Board, its Investment Committee and external investment managers with the flexibility and capacity to achieve TAF's performance benchmarks by earning a rate of return sufficient to ensure that TAF can annually expend funds in a target range to be set by the Board, and as market conditions warrant, to fund its mandate for grants, special projects and related activities.

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SIGNATURE

Cam Weldon

Deputy City Manager and Chief Financial Officer

ATTACHMENT

Appendix A – Statement of Investment Objectives and Principles



**Statement of Investment Objectives
And Principles**

Approved by City Council
[Month, Day, Year]

Statement of Investment Objectives and Principles

Section 1: Mandate

- 1.1 The Toronto Atmospheric Fund (“TAF”) is constituted under the Toronto Atmospheric Fund Act, 2005 (the “TAF Act”).
- 1.2 TAF was established by Toronto City Council in 1991 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:
 - 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;
 - To promote air quality improvement;
 - To promote public understanding of global warming and their implications for the urban environment;
 - To create and preserve carbon sinks;
 - To promote energy conservation and efficiency; and
 - To provide support and funding for projects related to energy efficiency, global climate stabilization and air quality improvement in cooperation with non-government organizations, governments, industries, corporations, official committees, neighbourhood organizations, universities and public and private schools.
- 1.3 TAF’s assets (the “Fund”) are to be managed to ensure that TAF’s mandate can be carried out on an ongoing, continuing basis.

Section 2: Purpose of the Statement of Investment Objectives and Principles

- 2.1 The Statement of Investment Objectives and Principles (the “Statement”) has been recommended by TAF’s Investment Committee (the “Investment Committee”) and approved by TAF’s Board of Directors (the “Board”) as the guidelines required under the TAF Act for the investment of the money of the Fund that is not immediately required for the Fund’s projects, and to direct and ensure continued prudent and effective investment management of the Fund and its ongoing preservation and financial well being pursuant to the TAF Act.
- 2.2 This Statement is subject to City Council’s approval and shall take effect once approved by City Council. As and from such date, this Statement shall supersede and replace all prior Statements of Investment Objectives and Principles of TAF.
- 2.3 As it will require several months to effectively transition the Fund from its current policy and asset mix, TAF will be considered to be in compliance with this statement if the Fund is in compliance within 12 months of City Council approval.

Section 3: Governance

- 3.1 In developing investment objectives and principles, TAF considers the City’s objectives as articulated in the Toronto Atmospheric Fund (TAF) – City of Toronto Relationship Framework, embraces the City’s objectives and indicates the weight given to them in guiding TAF’s investment activities and responds to other investment requirements, which City Council may direct, in the recognition that the City is ultimately responsible for TAF investments having entrusted the asset to TAF.
- 3.2 The Chief Financial Officer has contracted external investment managers on behalf of TAF. TAF’s Board is responsible for providing day-to-day instructions to the investment managers. TAF’s investments, managed by external investment managers, are guided by TAF’s approved Statement of Investment Objectives and Principles and the Statement of Policies and Procedures.
- 3.3 According to the TAF Act, Council may at its sole discretion delegate authority for investment management functions to the TAF Board consistent with investment guidelines as approved by Council. The duties of the Board in relation to investments of the Fund are as follows:
 - To appoint the members of the Investment Committee who possess the necessary experience and credentials to fulfill its objectives and Terms of Reference;

- To consider and, if appropriate, approve the Investment Committee’s recommendations regarding TAF’s Statement of Investment Objectives and Principles;
 - To consider and, if appropriate, approve the Investment Committee’s recommendations regarding engaging and terminating the investment manager(s) (“the Manager(s)”) and therefore their Mandates that will assist in the management of the Fund; and
 - To consider and, if appropriate, approve the Investment Committee’s recommendations for direct investment transactions which are consistent with TAF’s mandate.
- 3.4 The Board delegates certain responsibilities with respect to overseeing the ongoing investment 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. On behalf of the Board, the Investment Committee is responsible for:
- Formulating, and recommending for approval by the Board, changes to the Statement of Investment Objectives and Principles and the Mandates;
 - Reviewing the Statement of Investment Objectives and Principles and the Mandates at least once per year for continued alignment with TAF’s mandate;
 - Monitoring the progress and performance of the Manager(s) and other investments and providing quarterly reports to the Board on the performance of the total Fund and any other aspects of investment management that the Investment Committee deems appropriate or as requested by the Board;
 - Advising the Board on the selection of the Manager(s), the Custodian, and any other agents or advisors that may be necessary to prudently manage the Fund;
 - Communicating changes to the Statement of Investment Objectives and Principles and Mandates to the Manager(s) and any other relevant parties;
 - Recommending individual direct investments, including financial partners, legal agreements and any other terms; and
 - Recommending actions which TAF should pursue as an investor to influence policies and investment conditions in the interests TAF’s mandate.

Section 4: Investment objectives and PRINCIPLES

- 4.1 The main objectives of management of the Fund are to:

- Ensure a rate of return sufficient to ensure that TAF can annually expend funds in a target range to be set by the TAF Board, and as market conditions warrant, to achieve its mandate for grants, special projects and related administrative activities;
 - Accept a level of risk consistent with the ‘prudent investor’ approach as outlined in Sections 27-31 of the Trustee Act (Ontario); and
 - Ensure adequate liquidity such that TAF’s on-going financial requirements can be met in an orderly and timely fashion.
- 4.2 The following beliefs and principles are intended to guide TAF’s investment of the Fund.
- 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. It is prudent to manage risk through diversification of uncorrelated asset classes.
 - c. ‘Green’ investing, including consideration of environmental, social and governance factors, is expected to improve the risk/return profile of portfolios in the coming decades, and will allow TAF to use the full weight of its fund towards its mandate. Rather than prohibiting investments in companies whose policies and climate risk profiles may not be in accord with TAF’s mandate, TAF can serve its mandate by investing as permitted under the Trustee Act in a way that helps stabilize the concentration of greenhouse gases in the atmosphere, improves local air quality and offers revenue generation.
 - d. TAF’s investments should yield two equally important results, namely sufficient risk-adjusted returns, and greenhouse gas reduction and air quality improvement.
 - e. Publicly listed equity securities and private (pooled) equities provide the opportunity to invest broadly in the industrial makeup of Canada and other countries and have, historically, outperformed fixed income securities over the long term.
 - f. Investment in publicly-traded, high quality fixed income securities help to meet short term cash flow needs and help protect capital in the event of deflation or global economic recession scenarios.
 - g. TAF’s growing competency, influence and differentiation is in direct investment. Financing will focus on maximizing risk-adjusted return,

advancing greenhouse gas emission reductions and air quality improvement, and market transformation, and attracting and leveraging co-investors and additional investment, including opportunities to generate fees. This intention to yield both risk-adjusted return and GHG reduction and air quality improvement results may entail a higher-than-average allocation to private debt than other funds.

- h. TAF’s shareholder actions as an investor can be used, in concert with likeminded investors, to influence companies in their portfolio and regulatory, policy and investment conditions to help stabilize the concentration of greenhouse gases in the atmosphere and improve local air quality.

Section 5: DIVERSIFICATION OF ASSET CLASSES

5.1 To maintain a diverse asset mix that minimizes risks and allows a prudent portfolio approach, the Fund’s assets will be invested in a diversified portfolio of securities across generally uncorrelated asset classes. In developing the optimal allocation, consideration is given to a) liquidity needs and risks, b) capital impairment risk, and c) interest rate/inflation risk.. The portfolio will be structured to reflect an appropriate balance between publicly traded equities and fixed income, private debt and equity investments, and cash.

5.2 The desired asset mix and initial ranges of the Fund will be as follows:

			Min	Max
Public Market Investments (total)			50%	100%
	Min	Max		
Public Equities	20	55		
Fixed Income	25	80		
Cash	0	20		
Private Direct Lending/Investment (previously Part B)			0	40%
Private Pooled Equity			0%	10%

5.3 While purchase of an investment which would be out of compliance with the asset mix guideline will not be authorized, there may be circumstances when exceptions occur. Exceptions, if any, will be noted in the quarterly report to the Investment Committee and shall state the reason(s) for the exception, type(s) of risk (term structure, percentage limit, credit quality, and issuers), dollar amount of the investment, expected duration of the exception, and action plan to restore conformity. Amounts exceeding the established guideline by no more than 0.5% will be considered immaterial and need not be documented by an exception report.

Section 6: OBJECTIVES AND CONSTRAINTS WITHIN EACH ASSET CLASS

6.1 Cash

The main consideration is liquidity. Cash should be in low risk instruments such as or equivalent to Government of Canada Treasury Bonds with a maturity of 90 days or less.

6.2 Public Fixed Income

Safety of principle and liquidity are of primary consideration.

6.3 Public Equities

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.

Investment will be prioritized in a highly liquid portfolio of global equities which are comprised of companies which help stabilize the concentration of greenhouse gases in the atmosphere and improve local air quality and minimizes exposure to companies whose share value may be at risk from climate change or other ESG issues.

6.4 Direct Investments

TAF will provide capital to for-profit and not-for-profit organizations in a manner that complies with applicable legislation and any relevant and applicable aspects of City Council's investment and governance policies. This asset class was previously referred to as "Part B". Investments can include (but would not be limited to) mortgages, debentures, options, securities and loan guarantees. The bulk of Direct Investment would be "senior debt" backed by tangible security and hard collateral.

Each transaction will be thoroughly vetted by the Investment Committee to ensure the risk/reward ratio and transaction structure are viable, that TAF's capital remains within acceptable risk parameters, and that projects fit with TAF's value proposition.

Investments would be characterized as:

- a. having a high-quality sponsoring organization, including its management, track-record, credit rating and position in the marketplace,

- b. demonstrating provable or conservatively estimated cash flows,
- c. generating monthly payments of principal and interest,
- d. providing market rates of returns on the capital invested with consideration to both risk and mandate-related benefit, and
- e. having market transformation capacity or be market leading projects or organizations in keeping with TAF's mandate.

The Investment Committee also takes the following combination of elements into consideration to work towards a positive investment outcome:

- a. The mandate-related fit such that each project demonstrates significant present or future local greenhouse gas emission and/or smog precursor reductions, and/or projects with potential for transferability that would lead to climate change and air pollution solutions in other jurisdictions, and/or opportunity to acquire and/or retire emissions credits.
- b. The potential for innovation and market transformation, with emphasis on projects that cannot easily access commercial financial markets, or where other investors need additional encouragement and assurances to enter a market or investment, or that are difficult to finance through more traditional sources, and that contribute to projects that support TAF's mandates of stabilizing the concentration of greenhouse gases in the atmosphere, improving local air quality and accelerating solutions to climate change and air pollution.

Generally (and unless agreed to specifically by the Investment Committee), associated legal costs related to a transaction are to be covered by borrower, as is customary practice.

TAF will seek financing partners and syndication and sale of investment opportunities in order to leverage its investments to the maximum extent possible in order to make its asset available for subsequent investment.

6.5 Private Equities

TAF will invest in a pooled or third party portfolio of private equities which comprise of companies which help in addressing climate change and air quality issues and minimize exposure to companies whose share value may be at risk from climate change.

Dated: 11 February 2010