



STAFF REPORT ACTION REQUIRED

Amendments to the Toronto Atmospheric Fund Statement of Investment Objectives and Principles - 2015

Date:	November 17, 2015
To:	Executive Committee
From:	Deputy City Manager & Chief Financial Officer
Wards:	All
Reference Number:	P:\2015\Internal Services\Cf\Ec15023Cf (AFS #21933)

SUMMARY

The purpose of this report is to recommend Council confirmation of the Toronto Atmospheric Fund's (TAF) Statement of Investment Objective and Principles (SIOP) as approved by the TAF Board of Directors. The report also confirms continuation of third-party investment management of the fixed income portion of the TAF portfolio.

RECOMMENDATIONS

The Deputy City Manager & Chief Financial Officer recommends that:

1. City Council confirms approval of the Statement of Investment Objects and Principles of the Toronto Atmospheric Fund (TAF) as approved by the TAF Board of Directors (Appendix 1).
2. City Council confirm that the TAF Board be delegated the authority to invest and manage all TAF funds including the portfolio's fixed income marketable securities and cash reserves.

Financial Impact

There is no financial impact on the City as a result of the recommendations in this report.

According to TAF staff, TAF's investment performance has yielded an average annual rate of return of 13.4% per annum over the past three years.

DECISION HISTORY

Toronto Atmospheric Fund Statement of Investment Objectives and Principles (2010)
(<http://www.toronto.ca/legdocs/mmis/2010/ex/bgrd/backgroundfile-29030.pdf>)

(October 22, 2012) Report from the City Manager on Amendments to the Toronto Atmospheric Fund's Asset Mix
(<http://www.toronto.ca/legdocs/mmis/2012/ex/bgrd/backgroundfile-51785.pdf>)

(September 29, 2014) Letter from the Board of Directors, Toronto Atmospheric Fund on Statement of Investment Objectives and Principles (SIOP)
(<http://www.toronto.ca/legdocs/mmis/2015/ex/bgrd/backgroundfile-73783.pdf>)

(September 9, 2014) Report from the Toronto Atmospheric Fund on Statement of Investment Objectives and Principles (SIOP)
(<http://www.toronto.ca/legdocs/mmis/2015/ex/bgrd/backgroundfile-73784.pdf>)

(April 9, 2015) Report from Chief Executive Officer, Toronto Atmospheric Fund on Statement of Investment Objectives & Principles (SIOP), TAF Board of Directors Item TA3.4, adopted April 23, 2015
(<http://www.toronto.ca/legdocs/mmis/2015/ta/bgrd/backgroundfile-78961.pdf>)

ISSUES BACKGROUND

The Board of Directors of TAF has been delegated the authority to invest the endowment provided by the City of Toronto, complying with the Council-approved Investment Policy.

At its meeting held on November 27, 2012, Council adopted the report "Environment and Energy Efficiency Functions" which recommended that TAF's Statement of Investment Objectives & Principles (SIOP) be amended by reducing the asset mix for Public Equities from a maximum exposure of 55% to 35% and requesting the transfer of the management of the fixed income portfolio to the City.

A two-year transition period to achieve the 35% asset mix was extended by an additional year in December 2014. During this transition period, TAF, with the assistance of a third-party consultant, undertook a study of endowments of similar size to review their average asset mix. Their recommendation was to return to the original target of 55% for the Public Equity part of the portfolio.

COMMENTS

TAF's investments and oversight of the endowment fund are guided by the Statement of Investment Objectives and Principles (SIOP) that incorporates the following:

- a. Earning a real rate of return sufficient to ensure that TAF's objects can be achieved and TAF's operations and ongoing financial commitments can be sustained;
- b. Preservation of Capital: Earning a real rate of return sufficient to preserve or enhance the real value of the assets of the Fund, net of the annual rate of inflation;
- c. Liquidity: Ensuring adequate liquidity such that:
 - TAF's operations and ongoing financial commitments can be paid in an orderly and timely fashion; and
 - Funds are available as opportunities arise to contribute to mandate-related initiatives.
- d. Mandate Supported: Ensuring that investments in activities that may contravene TAF's mandate are avoided.
- e. Compliance: Ensuring that investments comply with City Council's policy direction for the investment of TAF assets, applicable legislation, and investment objectives.

The SIOP governs the investment of funds that are not immediately required for TAF's projects and effective investment management and is reviewed by the Investment Committee, revised as necessary, and recommended to the Board for approval.

Corporate Finance staff agrees with the changes to the SIOP that were recommended by the TAF Board, namely the revision of the public equity portion of the asset mix back to 55% from 35% as reflected in "Table 1 – Recommended Asset Mix" and to re-instate the TAF Board's delegated authority to invest and manage all TAF funds, including fixed income marketable securities and cash reserves.

Corporate Finance staff also supports the other requests of the TAF Board such as revising the SIOP to remove the restrictions on cash holdings to maturities of less than one year and to allow the ability of TAF to employ money market funds and/or pools; giving preference to investments in securities which offer the same characteristics as traditional fixed income securities but where proceeds are earmarked for activities that support TAF's mission and investment beliefs; and to ensure portfolio diversification by restricting allocation to any one direct investment to not more than 10 percent of the portfolio.

The TAF Board also requested various small 'housekeeping' amendments that are reflected in the revised SIOP.

To ensure compliance with the SIOP, TAF's financial statements are audited by the City-appointed auditor every fiscal year.

The following principles are intended to guide TAF's investments:

- TAF's investment horizon is long-term, meaning at least 20 years. Asset management decisions seek to maximize risk-adjusted return over the long-term.
- It is prudent to manage risk through diversification of uncorrelated asset classes.
- TAF's investments should yield sufficient risk-adjusted returns as well as greenhouse gas reduction and air quality improvement. 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. Investments in publicly-traded, high quality fixed income securities help to meet short term cash flow needs and protect capital in the event of deflation or global economic recession.
- Financing will focus on maximizing risk-adjusted returns, advancing greenhouse gas emission reductions and air quality improvements and attracting and leveraging co-investors, including opportunities to generate fees.

To maintain a diverse asset mix that minimizes risks and allows a prudent portfolio approach, the Fund's assets are 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 is structured to reflect an appropriate balance between publicly-traded equities, fixed income, private debt, equity investments and cash.

The SIOP outlines the desired asset mix and initial ranges for the Fund. These are shown in Table 1. TAF's asset mix (as at September 30, 2015) is shown in Table 2.

It should be noted the amounts in Table 2 are based on market value and calculated before rebalancing.

Table 1 – Recommended Asset Mix

			Min	Max
Public Market Investments (total)			35%	100%
	Min	Max		
Public Equities	15	55		
Fixed Income	20	80		
Cash	0	20		
Direct Investments (Private debt and other instruments))			0	60%
Private Pooled Equity			0%	5 %

As of September 30, 2015, the value of the public equities component of the portfolio exceeded the approved asset mix by 1.8% and TAF will be rebalancing the portfolio so that the asset mix will be in compliance with their approved investment policy.

**Table 2 – Current Asset Mix of the TAF Portfolio (as at September 30, 2015)
(Based on Market Value, before rebalance)**

	Current Weight (%)
Public Market Investments (total, includes the Private Pooled Equity)	89.3
Public Equities	56.8
Fixed Income	21.8
Cash	9.2
Direct Investments (Private debt and other instruments)	10.7
Private Pooled Equity	1.5

CONTACT

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SIGNATURE

Roberto Rossini
Deputy City Manager & Chief Financial Officer

ATTACHMENT

Appendix 1 – Toronto Atmospheric Fund SIOP 2015

Appendix 1



Statement of Investment Objectives & Principles (SIOP)

Approved by City Council
[Month, Day, Year]



Statement of Investment Objectives & Principles (SIOP)

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 & 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 supercede 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 Council-approved Statement of Investment Objectives and Principles.
- 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. Where practicable, preference should be given to investments in green bonds which offer the same characteristics as traditional fixed income securities, where proceeds are earmarked for ‘green’ activities in line with TAF’s mission.
- 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)			35%	100%
	Min	Max		
Public Equities	15	55		
Fixed Income	20	80		
Cash	0	20		
Direct Investments (Private debt and other instruments))			0	60%
Private Pooled Equity			0%	5 %

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 and safety of principle. If invested, cash should be held in short-term, 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) senior debt, subordinated debt, mortgages, debentures, performance contract financing, purchase order financing, options, securities, loans and loan guarantees.

As a guideline, no more than 10 percent of the Net Asset Value will be invested in any single transaction. As per the TAF/City of Toronto Relationship Framework (2013), Council approval is required for any transaction above \$2 million.

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; and
- c) The risk mitigation and prudence of diversification within this asset class.

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 Pooled Equities

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

Proposed revision November 2015, of version dated February 11, 2010.