STAFF REPORT
Action Required

Date:	September 14, 2015
To:	TAF Board of Directors
From:	Richard Rysak, Director of Finance
Re:	Draft Operating Budget for 2016

SUMMARY

TAF has submitted a draft 2016 Operating Budget to the City for review and approval; TAF is a self-funded agency with net zero impact on the City's Operating Budget. The City's Budget process is in progress with final approval expected in early 2016. TAF's 2016 budget has been prepared based on key drivers of revenue and expenses, and is attached for Board approval. Finally, it is also recommended that the Grants Fund be consolidated into the Operating Fund by 2015 year-end.

RECOMMENDATION

It is recommended that the Board of Directors:

a. Approve TAF's Draft 2016 Budget, with Revenues and Expenditures balanced at $2.6 million, and;

b. Submit TAF's Draft 2016 Budget to the City's 2016 budget process for Council's approval; and

c. Approve consolidating the internally-restricted Grant Fund into the Operating Fund by 2015 year-end.

FINANCIAL IMPACT

None. TAF is a self-funded agency and has a "net zero" impact on the City's Operating and Capital Budgets.

COMMENTS

TAF's annual Operating Budgets are framed around the following key parameters.

Investment Portfolio Returns

- The bulk of TAF's revenue is returns on investment of the endowment.
- The projected annual overall investment portfolio return is 6% on TAF's full portfolio assets. This return is based on conservative assumptions -- historical information, the professional perspective of the Investment Committee and TAF's third-party Investment Advisor. This is significantly more conservative than TAF's actual average return of 13.4% per annum over the past three years (2012, 2013 and 2014).
- The bulk of TAF's earnings are from the marketable securities portfolio including both realized revenues (from securities sold) and unrealized revenues (due to "paper" gains). The remainder is from direct investments (interest on loans, performance contract revenues, transaction fees).

- The Direct Investments revenue line also includes a credit loss provision of $65K, based on 1% of the averaged amount invested for 2016. It covers the growing amount invested via ESPA contracts in energy efficiency equipment installed on client sites.
- Investment portfolio weights influence projected revenue significantly, and also play a strategic role in addressing market volatility and advancing TAF's mandate. A major shift is envisioned during 2016 from marketable securities to direct investments. By the end of 2016 TAF expects to shift portfolio weights as follows: Equities from 60% to 48%; Direct Investments from 7% to 30% (approximately $9 million); Fixed Income from 22% to 21%; Private Equity will remain at 1%; and Cash from 10% to zero. To make the shift, TAF will gradually liquidate some of its marketable securities thereby moving towards the new portfolio investment targets envisioned by SIOP-2015 (requested).

External Funding

- Actual external funding has averaged $350K per annum for the three fiscal years 2012 to 2014. This has mainly been from governments and utilities, and has been dedicated to specific projects. Multi-year funding is recognized in the year in which it is spent.
- Projected external funding for 2016 is $550K; this increased target is based on the ground-work that has been done to raise TAF's profile and to demonstrate the organization's value proposition as an innovator and champion of low-carbon solutions.
- This year, external funding includes $50K available for internal costs related to project implementation, ie: offsetting costs normally carried by the endowment. Increasing attention is being given to raising this type of funding.

Payout Ratio

- Endowments establish a Payout Ratio (where the numerator are the operating expenses and the denominator is the NAV) to preserve their capital by constraining the outflow of capital for operations and grants. In 2006, TAF's Board established the Total Payout Ratio as between 5 to 6 percent of the NAV based on a 4-year rolling average; TAF uses a cumulative rolling average to calculate the annual payout.
- TAF has remained within the above Total Payout Ratio for the past four years, with notable challenges and boosts:
    - Core staff has grown (from 7 to 8 during that period) which significantly increased the numerator
    - Ongoing 2% per annum inflation in operating expenses results in steady numerator growth
    - Recovery of the endowment value following 2008 has increased the denominator.
- To keep the Total Payout in compliance with the policy, adjustments have been made in the Draft 2016 Budget and will be given similar attention in subsequent budgets including:
    - planned offsetting of internal costs with external funding - by $50K in 2016
    - reducing the Program Delivery expense line - by an additional $50K in 2016
- Since ongoing inflation is expected, attracting more/new capital to the endowment (ie. increasing the denominator) is an important strategy to maintain program delivery while staying within the Total Payout Ratio.

Program Delivery Expenses

- The bulk of TAF's expenses (over 80%) are dedicated to program delivery, including staffing, grants and expenses associated with development and implementation of strategic projects.

Grants

- The 2016 Grants budget is $500K. This is considered a minimum level for achieving TAF's mandate and is similar to granting levels since 2009.
- It has been TAF's practice to track grant rescissions and under-spending from prior years, and this amount is identified as a Grants Fund in the Financial Statements; it now totals just over $1M. However granting beyond the annual Grants budget would challenge compliance with the Payout Ratio targets and is not contemplated. Consequently, it is proposed that the internally-restricted Grant Fund be consolidated into the Operating Fund by 2015 year-end.

Staffing

- TAF has eight (8) core staff, unchanged from last year. 70% of core staff time is dedicated to program delivery, and the balance to administration.
- The 2016 Salary & Benefits budget is $965K; this is TAF's single largest expense, and reflects TAF's focus on innovation, demonstration and de-risking of low-carbon strategies.
- In addition, TAF has six (6) contractors supported by a combination of program allocations and external funding.

Corporate expenses

- Expenses related to communications, governance, development and administration are kept under 20% of Total Revenues, in keeping with non-profit best practices. This includes 30% of staff salaries that are not program-related.
- TAF's premises are provided at no cost by the City of Toronto. An investment estimated at $80K is required to address several challenges to make the working environment more functional and to accommodate additional program staff. Capital support is being explored with the City, but it is likely that some or all of the above amount may need to be funded from TAF's operating cash flow, and would be amortized over several years. This potential expenditure has not been budgeted since plans and costs are still being discussed with the City; such outlay may result in a variance in the depreciation expense line in 2016.

Stabilization Fund

- A Stabilization Fund was established in 2003. It is TAF's policy to transfer any above-budget earnings to the Stabilization Fund (which is part of TAF's Net Asset Value (NAV)) to be used as a buffer/reserve enabling TAF to weather market volatility without severely affecting annual operating budgets.
- Transfers from the Stabilization Fund have not been made since 2009, and the accumulated transfers to the Stabilization Fund total $7.1 million at the end of fiscal 2014.
- It is very unlikely that a transfer (ie. reduction) from the Stabilization Fund will be required for 2015.

Proposed 2016 Budget for Board Approval

Attachment A provides a three-year comparison: TAF's 2014 actual audited results, TAF's current (2015) budget, and the proposed 2016 Budget for Board's approval.

CONTACT

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