TA13.6

REPORT FOR ACTION

Draft Operating Budget for 2017

Date: November 23, 2016
To: TAF Board of Directors
From: Richard Rysak, Director of Finance

SUMMARY

TAF's draft 2017 Operating Budget is attached for Board approval. The new $17 million provincial endowment was received in November 2016 and thus the proposed budget reflects a significant change as GTHA-wide programming is developed and phased into TAF operations during 2017. While operations will be integrated, TAF is implementing separate fund accounting to enable tracking and reporting of each fund's performance and expenditures. For information purposes, the income and expense for Toronto and Ontario endowments are shown separately. The consolidated draft TAF 2017 Operating Budget is submitted for Board approval. TAF has submitted this draft 2017 Operating Budget to the City for review and approval which reflects a net zero impact on the City's Operating Budget.

RECOMMENDATION

The Director of Finance recommends that that the Board of Directors approve TAF's 2017 Operating Budget with total expenditures of $3.7 million which includes adding two core positions during fiscal 2017.

FINANCIAL IMPACT

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

COMMENTS

TAF 2017 Operating Budget is a consolidated budget based on projected revenue generation from the existing Toronto endowment fund and the new Ontario endowment fund, and program implementation that is relevant to the mandate of each of the two funds. Attachment 1 is a budget table which provides a three-way comparison: the proposed 2017 Operating Budget for Board approval, which is compared to the 2016 Operating Budget and 2015 actual audited results. The unaudited year-to-date results for 2016-Q3 are presented as a separate agenda item.

Projected Investment Portfolio Returns (Lines A1 & A2)

- The bulk of TAF's revenues are returns from the marketable securities portfolio including both realized revenues (from securities sold) and unrealized revenues (due to "paper" gains). The remainder of revenues come from direct investments: interest on loans, performance contracts and transaction fees.
- The projected annual overall investment return is 5% on full portfolio assets. This return is based on conservative assumptions including the professional perspective of the Investment Committee and TAF's third-party Investment Advisor - and is significantly more conservative than TAF's actual average return of 15.6% per annum over the last three audited years (2013, 2014 and 2015).
- Holding the Ontario endowment of $17 million in low-yielding fixed income investments while implementing a gradual shift into equities during 2017 is projected to reduce TAF's overall portfolio performance in 2017.

External Funding (Line A3)

- Actual external funding has averaged $320K per annum for the last three fiscal years of 2013 to 2015 whereby TAF attracted grants from governments and utilities for specific projects. Multi-year funding is recognized by TAF as external revenue in the fiscal year in which project expenditures are incurred.
- Projected external funding for 2017 is $400K. The benefits of receiving external funding must be balanced with TAF's challenge to implement new programs, and we are particularly impacted by this issue in 2017 as we work to launch our new GTHA programming.
- The above external funding projection includes $50K to be raised to cover internal costs related to project implementation which will offset program costs normally carried by the endowment.

Program Delivery Expenses (Line B4)

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

Program Delivery – Staffing Growth

- The proposed 2017 Budget increases core staff from eight (8) to ten (10) full-time positions specifically to enhance TAF's internal greenhouse gas quantification and finance innovation capacity. The proposed 2017 salary & benefits budget of $1,148K is TAF's single largest expense reflecting TAF's main service of innovation, demonstration and de-risking of low-carbon strategies. Of this amount, 70% is dedicated to program delivery and the balance to administration.
- In addition, TAF engages contractors (currently 8 people) who are funded by a combination of internal program allocations and external funding.

Program Delivery – Grants for Toronto and GTHA-wide (Line B1)

- The grantmaking budget from the Toronto endowment will remain at $500K, the same level as the previous three years. Grants funded from this budget will be focused on funding GHG and air pollution reductions initiatives benefiting the City of Toronto.
- The grantmaking budget funded by the Ontario endowment will be $306K. Grants funded from this budget will be focused on funding GHG reductions initiatives benefiting the GTHA.

Interest Expense (Line B3)

- This new budget line is primarily the interest to be paid on the loan from the Federation of Canadian Municipalities (FCM) for the energy retrofit of seven TCHC buildings.
- Interest will also be paid on a line of credit to cover initial operating expenses for the GTHA program, which will be repaid as the Ontario endowment is deployed into investments.

Total Corporate Expenses (Line C1)

- Expenses related to communications, governance, development and administration are kept under 20% of Total Expenditures in keeping with best practices of non-profit organizations. This budget line includes 30% of staff salaries.

Corporate Expenses – Premises

- As per TAF's Relationship Framework with the City of Toronto, the current premises at 75 Elizabeth Street are provided to TAF by the City of Toronto free of charge.
- Due to growth of TAF contract staff due to external fundraising plus increasing needs for meeting space to accommodate TAF's role as a community convenor, the TAF Board approved a request in 2016 for up to $100K to be spent on renovations of the current premises. Subsequently we were advised by the City not to proceed with any renovations due to imminent plans for re-development of the site.
- TAF then explored the option of alternative space in March 2016, however City Real Estate has indicated that office space is in short supply and no options have yet been identified for TAF. TAF has indicated has floated the option of receiving cash-in-lieu of City premises, to help offset the expense of seeking office space at a non-City location.
- Given the uncertainty and unsuitability of the current premises and lack of alternative options provided by the City, alternative office arrangements will likely be needed by the end of 2017. Based research of TAF's premises needs and the current market rates, we estimate rent and operating costs at a minimum of $100K per year. This level of expense can be managed without exceeding 20% of operating budget dedicated to Administration costs. This amount has been included in the attached 2017 Budget in the corporate expenditures line, and would cover a partial year of rent/operating costs plus furnishings and moving costs.

Corporate Expenses – Amortization/Depreciation (Line C2)

- This non-cash expense is due to TAF owning a growing pool of installed energy efficiency equipment installed in ESPA client buildings; it is funded from capital (see Line X).

Stabilization Fund (Lines D2 & D3)

- A Stabilization Fund was established by the Board 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) to be used as a buffer/reserve enabling TAF to weather market volatility without severely affecting annual operating budgets.
- Due to strong investment portfolio performance, TAF has not accessed the Stabilization Fund since 2009. The Stabilization Fund has grown to $7.1 million at the end of fiscal 2015 at which time the Board decided to cap it at a maximum of 25% of NAV; the Stabilization Fund cap will be re-set when the 2016 NAV is established by the audit.
- Based on favourable Q3 results it is very unlikely that the 2016 budgeted Stabilization Fund draw will be used.
- The draw from the Stabilization Fund in the proposed 2017 budget has two components:
    - for potential operating shortfalls, if needed
    - as non-cash backstop for depreciating ESPA-financed and installed energy efficiency equipment.

Compliance with Payout Ratio

- Endowments typically establish a Payout Ratio (where the numerator represents the total annual operating expenses and the denominator is their 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 to range between 5 to 6 percent of the NAV based on a 4-year rolling average.
- TAF has complied with the Total Payout Ratio during the past four years, with notable negatives and positives during this period:
    - Ongoing 2% per annum inflation in operating expenses results in steady numerator (and hence payout) increase
    - Core staff increased (from 7 to 8 during that period) which increased the numerator and hence the payout
    - Strong recovery of the endowment value following a very challenging fiscal 2008 has increased the denominator for the past several years. Specifically the NAV has climbed from $20.1 million at the end of 2008 to $28.5 million at the end of 2015.
    - Finally, the NAV has recently grown substantially due to the receipt of $17 million in cash from the Province in November 2016.
- Note that the new, larger fund comprised of both the City and Ontario funds will continue to be subject to the same Payout Ratio policy.
- The proposed 2017 Budget maintains compliance with the Payout Ratio.

CONTACT

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SIGNATURE

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