REPORT FOR ACTION

Draft 2018 Operating Budget

Date: December 6, 2017
To: The Atmospheric Fund Board of Directors
From: Richard Rysak, Director of Finance

SUMMARY

TAF's draft 2018 Consolidated Operating Budget is attached for Board approval. The proposed budget reflects returns from both the Toronto and Ontario endowments as well as our GTHA-wide programming costs. The draft budget has been submitted for City approval with no change in core staff positions (currently 10) and "net zero" impact on the City's budget.

RECOMMENDATION

The Director of Finance recommends that the Board of Directors approve TAF's 2018 Consolidated Operating Budget with total expenditures of $4.4 million.

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

Overall Structure and Principles

- The 2018 Consolidated Operating Budget reflects projected revenues from both endowments based on the investment profile of each fund, and expenditures relevant to the mandate of each of the funds. TAF has implemented "fund accounting" that enables annual audit and reporting of both endowments' performance and expenditures.
- Attachment A provides a comparison of: (1) the proposed 2018 Consolidated Operating Budget for Board approval, (2) the 2017 Consolidated Operating Budget, and (3) TAF's 2016 actual audited results which included only minimal revenue from the Ontario endowment.
- TAF generally projects investment revenues conservatively, sets ambitious fundraising targets based on past experience, and overestimates expenses including contingencies. For instance, the past four annual budgets contemplated but has not drawn on the Stabilization Fund to bridge operating deficits; instead, TAF's publicly-traded securities

have performed over projections thereby growing the Stabilization Fund which was $7.1 million at the end of fiscal 2016.

Investment Portfolio Returns (Lines A1 & A2)

- The bulk of TAF's revenues are returns from its marketable securities portfolio including both realized revenues (from securities sold) and unrealized revenues ("paper" gains) from securities which TAF continues to hold. The remainder of portfolio revenues come from direct investments: interest on loans, ESPA performance contracts and transaction fees.
- The investment return for fiscal 2018 on the full portfolio is budgeted at 5.5%. This reflects conservative assumptions and perspectives of TAF's Investment Committee and third-party Investment Advisor, and is significantly more conservative than TAF's actual average portfolio return of 14.0% per annum over the past four years. Any portfolio performance shortfalls will be bridged from the Stabilization Fund.
- As guided by TAF's Investment Committee, the $17M received from the Province in late 2016 has been gradually deployed into investments to match the SIOP target asset mix. At the end of 2017-Q3, the Ontario endowment was invested 42% in global equities and 58% in fixed income holdings. It is expected that by the end of 2017, the Ontario endowment will reach our target of holding 55% in global equities and will start to participate in new Direct Investments.

External Funding (Line A3)

- For the past four years TAF has attracted on average $430K annually in grants for specific projects primarily from governments and utilities. Multi-year funding agreements are recognized by TAF as external revenue only as TAF incurs related project expenditures and the rest of the committed funding is carried on the balance sheet as revenues deferred into the future.
- External funding revenue for 2018 is budgeted at $500K. This includes $50K for internal operating costs, offsetting costs normally covered by the endowments. The benefits of receiving external funding must be balanced with TAF's (limited) capacity to implement new programs.
- This portion of TAF's budget is managed on a contingency basis, i.e. expenditures are not incurred unless external funding is secured. This fiscally-prudent approach can create budget variances when actual fundraising efforts either exceed the budget or when they do not meet projections.

Program Delivery Expenses (Line B3)

- Approximately 80% of TAF's expenses are dedicated to program delivery, including grants by TAF to third parties, program staffing, and expenses associated with development and implementation of strategic projects.
- Projected Grants (Line B2) are expected to increase from $806K in 2017 to $900K in 2018. If not fully expended in a given year, up to 25% of the grants budget may be deferred into the next year. Grants can be rescinded by TAF if the original granting conditions have not

been met, or cannot be met, or when the recipient no longer needs the grant, and such situations may create budget variances.

Program Delivery Staffing Expenses

- During 2017, with revenues from the Ontario endowment, TAF increased its core staff complement from eight (8) to ten (10) full-time positions by adding a GHG Quantification specialist and Impact Investing Account Manager. Generally 70% of TAF's core staff time is dedicated to program delivery and the balance to corporate activities such as communications, governance, development and administration.
- In addition, TAF engages contractors (currently six) funded primarily by external funding who are focused on specific program delivery.

Total Corporate Expenses (Line C1)

- Corporate expenditures (Line C1) relate to communications, governance, development and administration. This budget line also includes 30% of core staff salaries.
- The total of $691K in this budget line is below 20% of total budgeted expenditures in keeping with best practices of non-profit organizations.
- As per the TAF/City of Toronto Relationship Framework, the City provides TAF's premises, currently at 75 Elizabeth Street. Since the City could not find new premises to accommodate TAF's growth and re-development of this building site is at least 5 years away, the City is coordinating an interior renovation. The previously-approved budget of $110K is reflected in this proposed budget.

Corporate Expenses – Amortization/Depreciation (Line C2)

- This non-cash expense line is due to TAF owning a growing pool of ESPA-financed energy efficiency equipment installed in client buildings.

Stabilization and Operating Funds (Lines D2 & D3)

- The $45.2 million NAV at the end of fiscal 2016 is made up of three funds: a) unrestricted Operating Fund of $21.2 million, b) internally-restricted Stabilization Fund of $7.1 million, and c) externally-restricted Province of Ontario Fund of $17 million.
- The Stabilization Fund was established by the Board in 2003. It is TAF's policy to transfer any above-budget portfolio earnings to the Stabilization Fund (which is part of TAF's Net Asset Value) to be used as a buffer enabling TAF to weather market volatility without severely impacting annual operating budgets. Also at the end of fiscal 2015 the Board decided to cap the Stabilization Fund at a maximum of 25% of NAV which resulted in the Stabilization Fund being capped at $7.1 million at the time.
- The proposed 2018 budget includes draws - <u>if needed</u> – from: a) the Stabilization Fund to cover potential revenue shortfalls in the investment portfolio, and b) the Operating Fund for other operating contingencies including a non-cash backstop for depreciating ESPA-financed energy efficiency equipment. Based on very favourable 2017 results it is very unlikely that the Stabilization Fund will be drawn at the end of fiscal 2017.

Compliance with Payout Ratio

- Endowments typically establish a Payout Ratio (where the numerator represents annual operating expenses and the denominator is the endowment's NAV (Net Asset Value)) to preserve endowment's 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% and 6% of the NAV based on a 4-year rolling average.
- The new, larger fund comprised of both the City and Ontario endowment funds will continue to be subject to the same Payout Ratio policy.
- The notable payout ratio drivers include:
  - Ongoing 2% per annum inflation in operating expenses results in a steady numerator (and payout) increase;
  - Core staff increases (to 10 in 2017) which increased the numerator and hence the payout;
  - Strong market recovery following 2008 depletion has increased the denominator with the Toronto NAV climbing from $20 million to $28.5 million at the end of 2015; and
  - Substantial NAV increase in late 2016 when $17 million came from the Province.
- TAF has complied with the Total Payout Ratio during the recent years and the proposed 2018 Budget maintains such compliance.

CONTACT

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SIGNATURE

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