Item 8.8.

Section I – Items for Board of Directors Action

TO: Chair and Members of the Board of Directors
Meeting #6/19, Friday, June 21, 2019

FROM: Michael Tolensky, Chief Financial and Operating Officer

RE: **TRCA INVESTMENT MANAGEMENT STRATEGY**
Proposed updates to align with those available to TRCA's partner municipalities

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KEY ISSUE
Toronto and Region Conservation Authority (TRCA) voluntarily adheres to the investing regulations in the Municipal Act (the Act) in order to align its investing activities with those available to its partner municipalities. As the Act has been updated and TRCA's partner municipalities are no longer limited to a prescribed restricted list of eligible investments, TRCA is proposing to modernize its investment strategy to balance achieving greater potential returns with managing acceptable risk.

RECOMMENDATION

THAT staff be authorized to negotiate an agreement with RBC Dominion Securities, TRCA's existing investment broker, to provide a comprehensive investment management solution.

THAT staff be authorized to sell investment holdings with its current RBC Dominion Securities brokerage and One Investment Program accounts and hold in cash deposit accounts where deemed advantageous for TRCA.

AND FURTHER THAT prior to any new investments of funds, TRCA staff report back to the Executive Committee with an updated investment policy for approval, that reflects a practical approach to manage risk and improve financial returns.

BACKGROUND
At the June 7, 2019 Executive Committee (#5/19), a similar report was brought forward and was referred to the next Board of Directors meeting per RES.#B66/19, with the request:

> *THAT the staff report be amended to include a comparison between the investment strategies of TRCA's partner municipalities and other Conservation Authorities;*

TRCA's current investment policy was written in June 1997, with an update in 2016 to permit the organization to invest in the One Investment Program. The current policy is written in accordance with the investment regulations set out in the Municipal Act.

In 2015, the Province of Ontario approved amendments to Ontario Regulation 610/06, Financial Activities, under the City of Toronto Act, 2006, to provide a framework for Toronto to invest in accordance with the Prudent Investment Standard (the Standard). This Standard is akin to that which governs trustees and pension fund administrators and creates a fiduciary responsibility. These reforms enabled the City to earn improved risk-adjusted rates of returns on its investments as it was no longer restricted to a prescribed and limited list of eligible investments. Under section 418.1 of the Municipal Act, municipalities other than the City of Toronto are authorized to opt into the Prudent Investment Standard. The section of the Act came into effect on March 1, 2018 and is applicable to TRCA's partner municipalities.

In accordance with the Prudent Investment Standard, investments shall be made with judgement and care – under the circumstances then prevailing – which persons of prudence, discretion and integrity exercise in the management of investments, considering the necessity of safety of capital as well as the probable income to be derived.

The standard to be used by investment officials shall be the "prudent person" standard as required by the Regulation and shall be applied in the context of managing the overall portfolio. Investment Officers acting in accordance with written procedures and the investment policy and exercising due diligence shall take all necessary actions to ensure the maximum performance of investments on a portfolio basis, subject to the prescribed risk parameters dictated by the investment policy. The duty under the regulation includes a duty to obtain the advice that a prudent investor would obtain under comparable circumstances.

RATIONALE

In compliance with the Municipal Act, TRCA's investment brokerage account with RBC Dominion Securities has been historically restricted to risk averse investments with limited returns, as proven by the organization's three-year money-weighted rate of return of 1.64% (2016-2018). Since the beginning of 2017, TRCA staff have purchased only one investment using the brokerage account.

As TRCA's partner municipalities are no longer bound by the rules previously guiding the TRCA investment strategy, TRCA staff obtained a legal memorandum to further clarify the organization's regulatory position. The legal memorandum concluded that TRCA's investment strategy is not required to follow regulations in the Municipal Act. Accordingly, TRCA would like to review its investment strategy with an aim to improve its financial returns and appropriately manage risk. TRCA staff propose to do this by aligning the organization with an investment manager, in order to create a fiduciary relationship between TRCA and an experienced investment manager to better balance risk and return.

Through conversations with TRCA's partner municipalities, there are a variety of challenges in adopting the changes to the Act, which do not apply to conservation authorities. The operational and governance changes needed to adhere to the Prudent Investment Standard are considered to be arduous to implement, including the creation of a investment boards/joint investment boards. Prior to partner municipalities taking this matter to their councils for approval, staff are analyzing the cost/benefit of adopting the Standard; however, without a history of performance, it is difficult to demonstrate this element. As the One Investment Program works with municipalities throughout the Province to develop a solution, there are also concerns about potential performance and management fees, given the existing portfolio returns and fees (Attachment 1 Toronto is TRCA's only partner municipality that is actively working to adopt the Standard, which has taken approximately 18 months, and the remaining municipal partners continue to hold exploratory discussions to date; however, they are not in a rush to adopt the Standard given the concerns raised above.

Regarding the investment portfolios of other conservation authorities, TRCA has provided background information in Attachment 1. There is a substantial concentration in term deposits, guaranteed investment certificates (GICs) and bonds, in order to focus on the preservation of their financial assets' liquidity. Given this investment strategy, the utilization of an investment manager for these conservation authorities would be cost prohibitive. TRCA staff further note that although investments in these investment categories are often perceived to be risk averse, they do represent an opportunity cost in terms of rising interest rates.

If TRCA were to enter a joint investment opportunity with a partner municipality in the future, it would be a timely and costly process to implement in terms of legal and other professional costs. Whether or not the overall benefit would exceed this cost, over and above a direct fee investment manager approach is not clear. Further, governance remains an important concern in determining whether to join the One Investment Program or partner municipalities in a joint investment opportunity. TRCA would take on a more passive approach relying on the Investment Board's decisions given TRCA's relatively small size, rather than a more active informed approach. Currently, TRCA is able to obtain comprehensive services at a competitive cost with the existing provider, RBC DS, offering a 0.5% all-in management fee, to receive enhanced governance from a professional investment manager, would provide the organization with a substantial advantage over the current approach , particularly over the next 1-2 years as partner municipalities incur the costs to develop the legal agreements and framework.

In accordance with TRCA's procurement policy and the Broader Public Sector procurement directive for non-competitive procurement, "procurement of financial services of financial analysts or the management of investments by organizations who have such functions as a primary purpose;" and "procurement of financial services respecting the management of financial assets and liabilities, including ancillary advisory and information services, whether or not delivered by a financial institution" are not required to follow a competitive procurement process. Given that (1) RBC is TRCA's current banking provider, (2) RBC Dominion Securities have offered to waive transactional fees on the sale of the existing portfolio, and (3) RBC Dominion Securities further offered to waive all fees on an ongoing basis, except for a competitive annual management fee of 0.5%, TRCA staff believe that there is reasonable grounds to engage in a non-competitive process.

RBC Dominion Securities' process for supporting TRCA in developing a strategic investment solution involves assessing:

- Risk appetite - TRCA's willingness to accept investment risk in the pursuit of the organization's objectives;
- Risk capacity – the amount of investment risk TRCA can financially tolerate;
- Investment objectives – the amount of investment risk TRCA must accept in order to achieve its goals;
- Disbursement quota – the investment cash flow needed to match spending commitments;
- Liquidity considerations – TRCA's need to access long-term funds at short notice; and
- Special considerations – legal restrictions, contractual obligations, time horizons, etc.

The investment manager will work with TRCA staff to tailor its investment strategy and will propose a solution, including an updated investment policy for Executive Committee and Board of Directors approval, as well as implementation and monitoring services. Monitoring will include monthly performance reports, performance review meetings, annual Executive Committee presentations, annual investment policy review and continuous availability for financial advice. The proposed practices will significantly increase transparency and accountability for TRCA's investment decisions.

Regarding the report's second recommendation, it is unclear in the administrative by-law as to whether delegated authority to staff has been provided to sell investment holdings. As a result staff have suggested a recommendation to this effect.

DETAILS OF WORK TO BE DONE
Upon approval of the recommendations, TRCA staff will develop an updated investment policy for approval, reflecting a modernized strategy to manage risk and improve financial returns.

Living City, the TRCA 2013-2022 Strategic Plan
This report supports the following strategy set forth in the TRCA 2013-2022 Strategic Plan:
Strategy 7 – Build partnerships and new business models

Report prepared by: Pamela Papadopoulos, extension 5973
E-Mail: pamela.papadopoulos@trca.ca
For information contact: Michael Tolensky, extension 5965
E-Mail: michael.tolensky@trca.ca
Date: June 3, 2019
Attachment: 1

Attachment 1: 2017 Conservation Authority Investment Portfolios & Cumulative TRCA One Fund Returns

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Attachment 1 – 2017 Conservation Authority Investment Portfolios & Cumulative TRCA One Fund Returns

2017	Term Deposits	GICs	Bonds	One Fund - Bonds	One Funds - Equity	Total
TRCA	$ -	$ 4,991,000	$ 10,313,000	$ 6,193,000	$ 500,000	$ 21,997,000
Grand River	$ 726,046	$ -	$ 14,595,000	$ -	$ -	$ 15,321,046
Halton	$ -	$ 4,000,000	$ -	$ 7,002,559	$ 499,998	$ 11,502,557
Niagara	$ 4,076,320	$ -	$ -	$ -	$ -	$ 4,076,320
CLOCA	$ -	$ 3,925,876	$ -	$ -	$ -	$ 3,925,876
CVC	$ 2,927,531	$ -	$ -	$ -	$ -	$ 2,927,531

Book Value Returns on 2017 Investments (Per Financial Statements):

	TRCA	Other CAs
Term Deposits	N/A	1.80%
GICs	1.75% - 2.46%	0.95% - 2.00%
Bonds	1.58% - 3.62%	1.30% - 2.82%

TRCA One Fund Returns (2016 - Present):

Book Value:

	Sept 9, 2016 Invested	June 10, 2019 Book Value	2.75 Year Return	Annualized Return
Bond	$3,500,000	$3,722,070	6.34%	2.31%
Corporate Bond	$2,500,000	$2,669,986	6.80%	2.47%
Equity	$500,000	$500,000	0.00%	0.00%

Market Value:

	Sept 9, 2016 Invested	June 10, 2019 Market Value	2.75 Year Return	Annualized Return
Bond	$3,500,000	$3,617,828	3.37%	1.23%
Corporate Bond	$2,500,000	$2,631,869	5.27%	1.92%
Equity	$500,000	$649,838	29.37%	10.68%

Annual fees paid to the One Investment Program are as follows:

- Bond Portfolio - 0.40% (***Fees are approx. 24.54% of annualized return***)
- Corporate Bond Portfolio - 0.45% (***Fees are approx. 19.99% of the annualized return***)
- Equity Portfolio - 0.60% (***Fees are approx. 5.32% of the annualized return***)