Guide to Investment Policy for Housing Co-operatives

May 2023

Introduction

Co-ops should put the money they have to work. This means investing in assets that increase in value or produce income over time. You should only keep the money you need now or soon in your operating account. You should invest any extra money along with your Capital Reserve Funds and Member Deposits, Shares or Loans. Investment earnings can help funds grow, making it easier for you to meet your future needs.

Co-ops should have clear investment rules. This Policy sets out investment rules. It makes it easier for the Board to be accountable for the investment decisions it makes.

The new Model Investment Policy updates investing rules for federal co-ops whose operating agreements with CMHC have ended. They no longer have to follow the CMHC rules for investing.

CHF Canada and the Agency for Co-operative Housing worked together to draft this Model Policy. They got expert help from

- the Co-operative Housing Federation of British Columbia,
- the Co-operative Housing Federation of Toronto, and
- Encasa Financial.

When should your co-op adopt this policy?

You should adopt this Investment Policy

- when you are planning for the end of your operating agreement with CMHC
- if you don't have an investment policy.

Customizing the policy

To customize the policy for your co-op, you need

- to fill in information about your co-op
- to make choices about how to guide your investment decisions.

Information about your co-op

To fill in the information about your co-op in the policy:

- Put the legal name of your co-op on the title page
- In paragraph 1.1, you need to put the legal name of your co-op
- In paragraph 2.1, choose among Member Shares, Member Loans and Member Deposits.

Where to make choices for your co-op

This Model Policy offers good "rules of thumb" on investment decisions. You do not need to make any changes before you adopt it.

However, after consulting your co-op's investment advisor, you may want to make choices in the following places:

- Paragraph 3.1(d)

  Leave this section in the Policy if your co-op decides to invest its funds ethically and with concern about protecting the environment. If your co-op adopts this as one of its investment goals then you will only select investments that meet those standards.

- Paragraph 5.3

  This section restricts the percentage of your total investments held in a single Mutual Fund to 20%. Your investment advisor may recommend a different percentage that you want to consider.

- Paragraph 5.4

  This section restricts the percentage of your total investment held in a single Security to 5%. There are certain conditions when this rule does not apply. Your external investment advisor may recommend a different percentage that you want to consider.

- Article 6

  Article 6 lists the investments that your co-op is allowed to make. Your external investment advisor may suggest changes to the list that you want to consider.

- Article 7

  Article 7 lists the investments that you are not allowed to make. Your external investment advisor may suggest changes to the list that you want to consider.

- Article 8

  Article 8 sets out your co-op's commitment to socially responsible investment and what kinds of businesses you will not invest in. After consulting with your investment advisor, you may want to make changes to the kinds of business listed.

- Appendix B

  The Appendix shows a sample asset mix that gives guidelines for how you should invest in different asset classes. You can use the Asset Mix shown or you can get advice from your external investment advisor may recommend another.

- Appendix C

Appendix also shows performance standards that you can use to judge whether your investments are doing well. Your investment advisor may suggest different indices that you may want to consider.

Before deciding on any customizations, read the Guide and get help as required from your external investment advisor. Remember you do not have to make any changes before adopting the Policy

Overview of key points

- **Article 1 – About this Policy**
  Article 1 explains that the Policy sets out the rules for investing the co-op's money. Once the members approve the Policy, they have made the rules they want the Board to follow.

  Article 1 also explains that once the Investment Policy is adopted, it replaces any previous co-op investment rules. The Policy does not replace rules the co-op must follow because of its agreement with government or legislation.

- **Article 2 – Introduction**
  Article 2 gives a short introduction to the Policy. It covers two things:
  1. What funds you have available to invest. This includes
     - the Capital Replacement Reserve,
     - Member Deposits, Shares or Loans.

     Co-ops are not-for-profit so you never pay taxes on any earnings from investments. This means tax planning and setting money aside to pay taxes is not necessary.

  2. The reasons you invest co-op funds. You invest to earn income that will help take care of your co-op homes for current and future members. Plus, you may have other goals that need funds. Investment income will help you meet those goals.

- **Article 3 – Investment Goals**
  Article 3 sets out the goals for investing. One of the goals is to earn investment income to help you cover the cost of your current and future needs.

  Liquidity
  Another investment goal is to make all your available funds work for you and earn money. Available funds are those not needed in the operating account to cover bills as they come due. This is liquidity. You need to decide how much you need in your operating account.

  To decide if there is money in the operating account to invest, your manager should do a cash flow projection. It will show when you will have extra cash to invest and how long to invest it. For information about cash flow projections, check out *10 things to look for in your co-op's financial statements* on CHF Canada's website: https://chfcanada.coop/wp-content/uploads/2017/04/10-things-to-look-for-in-your-co-ops-financial-statements.pdf.

  For a sample cash flow projection contact your local CHF Canada contact listed, or email us at info@chfcanada.coop.

Ethical investments and respect for the environment
Co-ops care about where they invest. This concern includes more than just the potential for earnings. It includes avoiding certain investments that may not align with the co-op's ethics and principles. For example, you may decide not to invest in companies that

- have poor labour practices, or
- manufacture weapons, or
- log old growth forests.

This is socially responsible investing. See Article 8. For more information, go to https://encasa.ca/responsible-investing/.

Balancing risk and return
Here are 3 important things to remember:

1. Some investments don't protect your principal.
   Principal is the amount you invested. Some investments do not risk your principal while others do. This means the investment may drop in value. When you sell the investment, you may get less than you paid for it.
2. If the risk of losing your principal is high, you should expect higher *possible* gains.
3. Generally, the investment market increases in value over time. But it will rise and fall in value in the shorter term.

Some people drive their cars fast, go hang gliding or swim with sharks. Others never go faster than the speed limit, read books or swim in a pool. We all feel comfortable with different levels of risk. Your co-op will decide the acceptable level of risk for investing. Most co-ops do not choose investments that are high risk. They are cautious with their members' money.

When you will need to sell the investments affects the level of risk you will accept. Can you hold the investment long enough to weather the short-term ups and downs? And take advantage of the increase in the investment market over time? If you need to use the money soon, you may choose a less risky investment. For money you need later, you may choose a riskier asset.

Most investors choose a variety of investments to balance out the risk.

- **Article 4 – External Advice**

  Co-ops rely on experts to help them make decisions. You hire managers, lawyers, auditors, engineers etc. Investing takes specialized knowledge so Article 4 of the Policy requires you to hire an external investment advisor.

  Encasa Financial is an external investment advisor that many co-ops across Canada use. It is owned by

  - The Housing Services Corporation
  - The Co-operative Housing Federation of Ontario
  - BC Non-Profit Housing Association

- The Co-operative Housing Federation of British Columbia.

For more information about Encasa Financial, go to https://encasa.ca/.

Whatever external investment advisor you select

- The advisor must be from outside the co-op and may not be related to any member of the co-op's Board of Directors. This will protect against any conflicts of interest.
- The advisor must understand the co-op's investment policy and help the co-op to follow it.

- **Article 5 – Asset Mix**

Asset classes are groups of similar investments. Cash, fixed-Income securities and equities are different classes.

With cash investments, there is no risk and the investor always has access to the principal. Cash investments pay a low rate of return. This investment class includes savings accounts and operating accounts.

Fixed-income securities are investments that pay interest at a fixed rate. The principal is repaid on a fixed date. Examples are bonds, guaranteed investment certificates (GICs), term deposits and government treasury bills. The investor does not have access to the principal during the term of the investment. So, the interest rate is usually higher than the rate on cash investments.

Equities are shares or stocks and represent a share in the ownership of a company. The principal is not guaranteed. The co-op may receive a payment from the company based on its earnings. This is a dividend. The prices of shares go up and down. It is possible that when the co-op sells the shares, they might be worth less than when the co-op bought them.

You will decide how to invest in different classes of asset. How you invest among asset classes is called the asset mix.

Appendix B – Asset Mix shows a sample asset mix. For each asset class, there is a recommended and a minimum and maximum amount. Using the Recommended column as an example:

- 70% of the monthly gross housing charge potential (GHCP) should be in cash. GHCP is the total amount of housing charges earned if there are no vacancies and no arrears. It includes rent subsidies and supplements.
- 75% of the co-op's total investments should be in fixed-income securities.
- 15% of the co-op's total investments should be in equities.

You may choose to use the sample asset mix or another asset mix based on the advice of your external investment advisor.

Without making any decisions, the co-op's asset mix may change over time.

Consider this example. Your co-op had the following asset mix at the beginning of last year:

Asset Class	Recommended	Invested
Cash	70% of GHCP	$10,000
Fixed-Income Securities	75%	$75,000
Equities	15%	$15,000
Total	100%	$100,000

You can see that investments match the recommended asset mix from the Model Policy. During the year, your Equities increased in value more than your Fixed-Income Securities. So now your asset mix looks like this:

Asset Class	Current	Current Value	Recommended	Recommended
Cash	70% of GHCP	$10,000	70% of GHCP	$10,000
Fixed-Income Securities	70%	$80,000	75%	$86,500
Equities	21%	$25,000	15%	$17,500
Total	100%	$115,000	100%	$115,00

If the current value is not between the minimum and maximum, you should re-balance your investments. Your investment advisor will help you return to the recommended asset mix over time. The advice will depend on

- what investments you may need to sell,
- extra funds you may be investing, and
- what is happening in the investment market.

You should not re-balance your investments without the help of your external investment advisor.

As housing charges increase, you will need to have more cash to maintain 70% of the monthly gross housing charge potential.

In addition to the requirements for the co-op's asset mix set out in Appendix A, the Policy limits the amount that can be invested

- in one mutual fund to 20% of total invested assets
- in one security to 5% of total invested assets unless the security is
  - backed by the Government of Canada or a province of Canada, or
  - a Co-operative Housing Investment Pool (CHIP) account sponsored by a co-op housing federation or
  - a deposit such as a term deposit, GIC or savings account at a Canadian credit union, caisses populaires, bank or trust company or
  - an Encasa Fund.

- **Article 6 – Permitted Investments**

  Article 6 sets out the investments you can make. For a description of the investments, check the special meanings in Article 2 of the Policy. If you have had advice from your external investment advisor, you can invest in

  - mutual funds,
  - bonds,
  - publicly traded shares or
  - other equities.

  Make sure the external investment advisor knows what the permitted investments are.

  Remember that each of the investments listed will be in a particular class of asset. You may have a number of investments in one class. The total invested in the class should not exceed the percentage set out in the asset mix in Appendix B.

  You may help protect the co-op against a decrease in value of an investment by

  - having different investments in each asset class and
  - having different classes as part of your asset mix.

  When a co-op does this, it spreads the risk around. This is risk diversification. If the value of one investment or class of investments decreases, the value of other investments may stay the same or even increase.

- **Article 7 - Prohibited Investments**

  Article 7 sets out the investments you can not make. Only the investments listed in Article 6 are allowed.

  Investment Grade Bonds

  You can invest in bonds that have a good rating. A bond is like an IOU. You buy a bond and the seller agrees to pay you back on a certain date. You earn a fixed rate of interest.

  There are bond rating companies that decide how likely it is that the seller will

- pay your principal back on time and
- pay interest as agreed.

A Government of Canada Bond is risk-free. It is certain that you will receive your interest and will be paid back on time.

Other bonds may be riskier. Bonds that are rated AAA are the safest. Junk bonds are the riskiest. They are rated C or D.

The Policy says that you will sell any bonds if the rating drops below an investment grade rating. Investment grade bonds are rated from AAA to BBB. Your external investment advisor will guide the co-op on how to sell downgraded bonds to avoid a loss.

- **Article 8 – Socially Responsible Investing**

  One of the investment goals set out in Article 3 is:

  To make investments that are ethical and respect the environment.

  Investing in a socially responsible way will help you meet that goal. Socially responsible investing means balancing potential earnings with social and environmental good.

  In order to be socially responsible, the policy says you

  - will consider investments that support affordable housing, co-operatives and protecting the environment
  - will not investment in Equities where the main focus is tobacco, pornography, gambling or weapons.

  External investment advisors have tools to check whether investments are socially responsible.

- **Article 9 – Reserve Funds**

  The Policy requires you to have an up-to date capital replacement plan or asset management plan.

  Part of these plans is a schedule for capital repairs and replacements and how much they will cost. This information will guide investment decisions.

  You can invest capital reserve funds with other co-op funds. But the bookkeeping must keep track of the capital reserve funds separately.

  If you invest capital reserve funds together with other funds, investment earnings will be reported on the total investment. You must divide the earnings among the capital reserve fund and the other funds invested. This is allocating earnings. You must add earnings on the capital reserve fund to the capital reserve fund.

Here is an example of how to allocate earnings:

You have invested $100,000:

- $50,000 or 50% of total investment from the capital reserve fund
- $25,000 or 25% of total investment from member deposits
- $25,000 or 25% of total investment from other funds.

Let's say the last investment report showed that the investment had earned $4,000. Of that

- allocate 50% or $2,000 to the capital reserve fund
- allocate 25% or $1,000 to earnings from the member deposits
- allocate 25% or $1,000 to earnings from other funds.

You allocate earnings based on the percentage of the total investment.

- **Article 10 – Administration**
  Article 10 gives the authority for administering the Policy and making investment decisions to the Board. It sets out what administering the Policy involves.

  Once you adopt the Policy, the Board will hire an external investment advisor as described in the Policy if necessary. The external investment advisor will work with the Board to change the co-op's current investments to comply with this Policy.

- **Appendix A – Glossary**
  The Glossary lists words in the Policy that may need explanation. These are financial terms that may not be familiar. These special words begin with a capital letter in the Policy.

- **Appendix B – Asset Mix**
  Use the sample asset mix in the Model Policy unless your external investment advisor recommends a different one.

- **Appendix C – Performance Standards**
  Use the performance standards to evaluate your investments. The standards are indices for different classes of asset. Each index is made up of the performance of a selection of investments in a particular class. The Policy sets out that your:
  - cash investments should do as well as the DE X 91-day Treasury Bill Index
  - fixed-income securities should do as well as the FTSE Russell Universe Bond Index
  - equities should do as well as the S&P/TSX Total Return Index or the MSCI World Total Return Index

  These indices are publicly available and are widely used in the investment industry.

Where to get more information?

If you have questions or want more information, please contact info@chfcanada.coop at CHF Canada.

If you are interested in Encasa Financial, email info@encasa.ca or call toll free at 1-888-791-6671 or visit their website at www.encasa.ca.