



**THE FUTURE**  
**MEETING PRIORITIES SHARING BENEFITS**  
**Alberta Heritage Savings Trust Fund Business Plan**

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The business plan was reviewed and approved by the Legislature's Standing Committee on the Alberta Heritage Savings Trust Fund on January 17, 2001.

## **INTRODUCTION**

- The Alberta Heritage Savings Trust Fund (the Fund) was created in 1976 as a means to provide savings of non-renewable resource revenue. The Fund grew from a portion of Alberta's oil and gas revenue being deposited into the Fund since inception in 1976 and until 1987. As well, prior to 1982, the Fund kept its investment income. The size of the Heritage Fund peaked in 1987 at \$12.7 billion (at cost) and then declined by the amount of the annual Capital Projects Division expenditures (the last year of spending by the Capital Projects Division was 1994-95).
- The Fund has subsequently grown again from income retained in the Fund in recent years to protect the real value of the Fund. The current value of the Fund, at cost, is \$12.256 billion.
- On January 1, 1997 the Heritage Fund was restructured in response to a public review of the Fund. The restructuring included a new governance structure as well as the establishment of clearer investment objectives and performance measures. The Fund's first business plan was implemented in January 1997.

## **FISCAL CONTEXT**

- Assets and income of the Heritage Fund are fully consolidated with the assets and revenue of the province.
- In March 1999, the Fiscal Responsibility Act (FRA) was approved by the Legislature. The FRA sets out a legislated schedule to eliminate the Province's accumulated debt by March 31, 2025. The FRA also grants the Minister of Revenue the discretion to protect the real value of the Alberta Heritage Savings Trust Fund when revenue is sufficient to do so. A payment to the Fund of \$230 million to protect its real value was made at the end of the 1999-2000 fiscal year.

## **PURPOSE**

- This is the fifth business plan for the Heritage Fund, which amends the previous business plans and incorporates updated financial information and income forecasts. This plan sets out the broad objectives of the Fund as expressed in the legislation, specific investment objectives, goals and strategies to achieve the Fund's objectives, and performance measures.

## **2001-04 BUSINESS PLAN**

The 2001-04 business plan incorporates the following changes:

1. Increase the Endowment Portfolio foreign and total equity weightings. The Endowment Portfolio is now larger than the Transition Portfolio and the focus of the Fund continues to move to the long term, with an exposure to equities. As equities are expected to outperform fixed assets over the long term, it is appropriate to increase the total equity weighting of the Endowment Portfolio and also the exposure to foreign equities. The increased weighting to equities and to foreign equities will also improve the diversification and risk profile of the Endowment Portfolio. A 5% increase in the weighting to total equities and foreign equities at the expense of debt investments is provided for along with corresponding changes in the benchmarks.

2. Amend the Endowment Portfolio benchmarks. Consistent with the change in the equity weightings is a change in the foreign equity benchmark to reflect specific benchmark allocations to US and non-North American equities and appropriate index comparisons, respectively, the Standard & Poors 500 Index and the Morgan Stanley EAFE Index. These changes will allow for closer monitoring of the Endowment Portfolio's, and eventually the Heritage Fund's, investment performance, portfolio diversification and risk control.
3. Establish a revised range for the transfer of assets from the Transition Portfolio to the Endowment Portfolio. Initially, \$1.2 billion was transferred annually or \$100 million monthly. For the 2000-01 fiscal year, a range of \$1.2 billion to \$2.4 billion was established for the annual transfer and \$2.4 billion is expected to be transferred by the fiscal year end. A range of \$1.2 billion to \$3.6 billion is now established for the annual transfer. As the Endowment Portfolio now exceeds the Transition Portfolio, the Transition Portfolio's focus has moved to providing greater liquidity to facilitate the transfers to the Endowment Portfolio. This requires the Portfolio to maintain short-term assets that act as a drag on the total fund performance. To maintain the Heritage Fund performance and reduce the "cash drag", the transfers are increased so as to liquidate the Transition Portfolio by 2003. This would also allow flexibility to take advantage of market conditions or opportunities without compromising the discipline of "dollar-averaging" (the systematic investing of funds over time) used in the transition.
4. Eliminate the Transition Portfolio performance benchmark. With the Transition Portfolio rapidly reducing in size and the increasing need for investments to be liquid, the performance benchmark would need continual adjustment as the term of the Portfolio reduces. More importantly, the Endowment Portfolio performance will be the major determinant of the Heritage Fund returns. The pertinent benchmarks are now the total return of the Heritage Fund, including the Transition Portfolio, and the benchmark for the Endowment Portfolio, which will eventually be the return for the whole Fund. The individual benchmark for the Transition Portfolio has been eliminated, as it will be increasing meaningless as the Portfolio's assets decline and liquidity needs grow.
5. Increase investment limits in the Transition Portfolio for bonds but leave Alberta bond holdings at 15%. The limits allow for increased diversification now that Alberta holdings have been reduced to an adequate level.

## HERITAGE FUND STRUCTURE

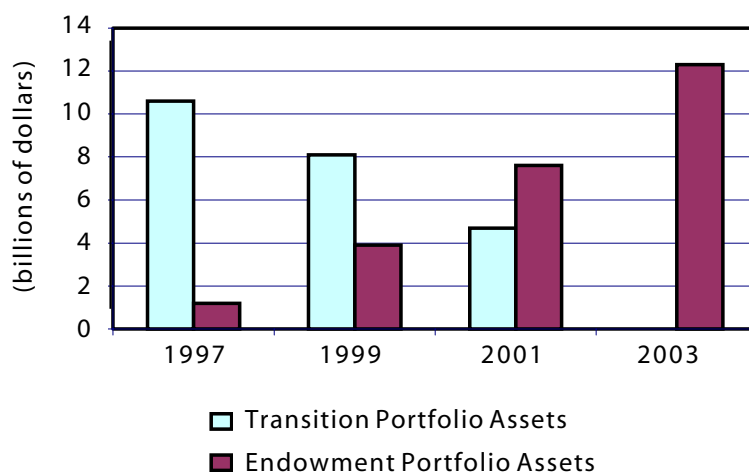
The **mission** of the Heritage Fund is as follows:

*"To provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns for current and future generations of Albertans."*

- The government keeps its books on a consolidated basis and therefore Heritage Fund income is included in consolidated income for the province. Consequently, the level and variability of Heritage Fund income is important to the government's fiscal plan. The government's fiscal plan includes consolidated annual income from the Heritage Fund of \$551 million for 2001-02, down from \$733 million in 2000-01.

- Income will vary significantly from year to year for the following reasons:
  1. An investment policy to maximize long-term returns implies a significantly higher weighting towards investments in equities in comparison to the equity holdings at the time the Fund was restructured. Equities have historically provided investors with higher total returns (dividends and capital gains) than fixed income investments, however, dividend rates in general are lower than interest rates thereby providing lower current income. The timing of realizing capital gains is also uncertain.
  2. The well-established capital market principle that increased returns, as provided by equity investments, are accompanied with increased risk or return volatility means that the Fund's income will be more variable.
- In order to provide for an orderly transition between the need for current income and long-term investment goals, the Heritage Fund was divided into two separate portfolios: a Transition Portfolio and an Endowment Portfolio.
- The overall performance of the Fund is compared to the Province's borrowing cost.
- The Transition Portfolio is invested primarily in interest-bearing securities to generate current income to support the Province's fiscal plan and to provide liquidity to facilitate transfers to the Endowment Portfolio. The Transition Portfolio has supported the Province's current income but now sees its role diminish as it is reduced in size and the Endowment Portfolio grows over the transition period.
- The Endowment Portfolio, which will be the whole Heritage Fund within a few years, is invested in a diversified portfolio including interest bearing securities, Canadian equities, international equities, and real estate. The Portfolio is invested to generate long-term returns to support the Province's income and spending needs.
- The 1996-1997 re-structuring of the Heritage Fund allowed for a ten-year transition where all assets would be transferred from the Transition Portfolio to the Endowment Portfolio by December 31, 2005 based on minimum annual transfers of \$1.2 billion. With the \$2.4 billion transfer for 2000-01 and \$3.6 billion for 2001-02, the Transition Portfolio should be eliminated by 2003.

**SCHEDULE OF TRANSITION\***  
(at March 31)



\* Based on annual transfers of \$1.2 billion to March 31, 2000; \$2.4 billion to March 31, 2001 and \$3.6 billion thereafter until the Transition Portfolio is eliminated.

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## Heritage Fund Assets Breakdown as at December 31, 2000

(thousands of dollars)

<b>Heritage Fund Investments</b>	<b>At Cost*</b>	<b>Fair Value</b>
<b>Endowment Portfolio</b>		
Cash	74,895	74,895
Fixed Income Securities	2,827,116	2,775,656
Canadian Equities	1,321,123	1,591,538
Foreign Equities	2,409,544	2,257,774
Real Estate	364,577	383,497
Total Investments - Endowment Portfolio	6,997,255	7,083,360
<b>Transition Portfolio</b>		
Cash	39,312	39,312
Fixed Income Securities	4,650,653	4,666,151
Provincial Corporation Debentures	379,490	458,861
Subtotal	5,069,455	5,164,324
Loans		
Ridley Grain Ltd.	91,245	91,245
Vencap Acquisition Corporation	6,114	6,114
Subtotal	97,359	97,359
Total Investments - Transition Portfolio	5,166,814	5,261,683
<b>Total Heritage Fund Investments</b>	<b>12,164,069</b>	<b>12,345,043</b>
Accrued Interest and accounts receivable	104,240	104,240
Due to the General Revenue Fund	(11,990)	(11,990)
<b>Heritage Fund Equity</b>	<b>12,256,319</b>	<b>12,437,293</b>

\* Cost includes amortization of purchase price discount or premium.

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## GOALS, STRATEGIES AND OUTPUTS, OUTCOMES AND PERFORMANCE MEASURES

The legislated investment objective of the **Endowment Portfolio** is:

**Investments shall be made with the objective of maximizing long-term financial returns.**

- Given a long-term investment horizon, investment practice suggests that a mix of equities (including real estate) and interest-bearing securities best achieves the objective of optimizing financial returns as it provides enhanced returns and diversifies risk. A long-term investment horizon generally means 10 years, however, for investment performance comparisons a minimum period of 4 years will be examined. Emphasis on “long-term” in the investment objective is designed to help the investment manager continue to plan and execute strategies in a long-term context at times when short-term pressures exist.

The legislated investment objective of the **Transition Portfolio** is:

**Investments shall be made with the objective of supporting the government's short-term to medium-term income needs as reflected in the government's consolidated fiscal plan.**

*What is the best approach in achieving this objective?*

- To support the Province's revenue needs, the Transition Portfolio is required to generate a stable source of income. Consequently, it is important the assets be revenue generating, and not exposed to significant credit risk. Additionally, due to the transfer program, assets need to be liquid (easily traded) so as to facilitate the monthly transfers to the Endowment Portfolio. This is accomplished by having a high quality portfolio of bonds and money market securities.
- The Endowment Portfolio contains a substantial holding in fixed income securities including bonds and mortgages. These assets, like the Transition Portfolio, provide a stable source of revenue to the Province, as does the income from real estate investments.
- In the past, the Transition Portfolio has been compared to the cost of the Province's debt. As the Transition Portfolio declines in size and the liquidity needs increase, due to the transfer program, this comparison has become less and less meaningful.
- The total Heritage Fund represents the Province's asset that is compared against the province's liabilities. Hence, the performance of the Heritage Fund is compared against the cost of the Province's debt.

## GOAL 1: EARN INCOME TO SUPPORT THE GOVERNMENT'S CONSOLIDATED FISCAL PLAN

STRATEGIES/OUTPUTS	OUTCOMES	PERFORMANCE MEASURES/ BENCHMARKS																				
<ul style="list-style-type: none"> <li>Invest Transition Portfolio assets in accordance with the investment industry standard "Prudent Person Rule" which assigns the investment manager responsibility to restrict investment to assets that would be approved by a prudent investor.</li> <li>Invest in interest bearing securities (Canadian dollar issues; non-Canadian dollar issues would be swapped into Canadian dollars) that are rated at time of purchase a minimum of investment grade (BBB or equivalent) by a recognized rating agency or in the absence thereof by Alberta Revenue.</li> <li>Maintain sufficient liquidity to accommodate the transfers to the Endowment Portfolio.</li> <li>Limit investments to the various categories of interest-bearing securities (% of market value): <table data-bbox="168 919 669 1239"> <thead> <tr> <th></th> <th>Maximum (%)</th> </tr> </thead> <tbody> <tr> <td>Canada &amp; Guaranteed .....</td> <td>No Limit</td> </tr> <tr> <td>Alberta .....</td> <td>15</td> </tr> <tr> <td>Other Provincial Debt .....</td> <td>55</td> </tr> <tr> <td>Municipal .....</td> <td>5</td> </tr> <tr> <td>Asset-backed .....</td> <td>15</td> </tr> <tr> <td>Private Corporate .....</td> <td>10</td> </tr> <tr> <td>Public Corporate .....</td> <td>35</td> </tr> <tr> <td>Mortgages .....</td> <td>5</td> </tr> <tr> <td>Other Sovereign<sup>1</sup> .....</td> <td>5</td> </tr> </tbody> </table> </li> </ul>		Maximum (%)	Canada & Guaranteed .....	No Limit	Alberta .....	15	Other Provincial Debt .....	55	Municipal .....	5	Asset-backed .....	15	Private Corporate .....	10	Public Corporate .....	35	Mortgages .....	5	Other Sovereign <sup>1</sup> .....	5	<ul style="list-style-type: none"> <li>A level of income to the government's fiscal plan without undue variation to the Province's bottom line.</li> <li>Investments consistent with the objectives of the Transition Portfolio.</li> </ul>	<p><b>Primary Performance Measure</b></p> <ul style="list-style-type: none"> <li>The market value rate of return on the Transition Portfolio, which is included in the total return for the Heritage Fund.</li> </ul> <p><b>Benchmark</b></p> <ul style="list-style-type: none"> <li>The market value rate of return for the Heritage Fund will be compared against the borrowing cost of the province on a moving four-year basis.</li> <li>Measuring performance on a market value basis is the accepted standard in the investment industry because it should lead to the best long-term investment and liability management decisions. However, because Heritage Fund income and debt servicing costs are accounted for on a cost basis, a comparison of returns on a cost basis will also be reported and explained in relation to the market value results.</li> </ul>
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<sup>1</sup> Would be swapped into Canadian dollars to eliminate currency risk.

(Continued...)



**GOAL 1: EARN INCOME TO SUPPORT THE GOVERNMENT'S CONSOLIDATED FISCAL PLAN (CONTINUED)**

STRATEGIES/OUTPUTS	OUTCOMES	PERFORMANCE MEASURES/ BENCHMARKS
<ul style="list-style-type: none"> <li>• Transfer cash, short-term fixed income securities or other appropriate securities to the Endowment Portfolio to meet the requirement of transferring at least \$1.2 billion (at cost) annually. Transfer for 2001-02 will be set at \$1.2 billion to \$3.6 billion. Cash forecasting is done to ensure that the appropriate type and amount of securities are available for transfer on a monthly basis (averages up to \$300 million per month).</li> <li>• Reduce the Fund's investment in Alberta provincial corporations, subject to liability management considerations.</li> <li>• Reduce investment limit for Alberta once investment in Alberta provincial corporation debt is reduced.</li> <li>• Reduce the Fund's investment in project loans. Remaining project loans include Vencap and Ridley Grain Ltd. with a total cost value of \$97.1 million.</li> <li>• The Endowment Portfolio has a minimum weighting of 25% of assets in fixed income investments.</li> </ul>	<ul style="list-style-type: none"> <li>• Orderly transfer of assets from the Transition Portfolio to the Endowment Portfolio.</li> <li>• The holdings of Alberta Social Housing Corporation (ASHC) debentures and Agriculture Financial Services Corporation (AFSC) debentures will be significantly reduced by 2001-02. Debentures will be paid out on interest rate re-set dates and the proceeds will be re-deployed within the Transition Portfolio<sup>2</sup>.</li> <li>• Alberta limit reduced to 15%.</li> <li>• Provides a stable source of income to the Province.</li> </ul>	

<sup>2</sup> To reduce the Fund's investment in debentures of these two provincial corporations, the General Revenue Fund (GRF) will borrow funds in the market and lend the funds to AFSC and lend, or grant, funds to ASHC. The Corporations will use the funds to repay the debentures held by the Heritage Fund Transition Portfolio generally on the dates when the interest rates on these debentures are re-set (every five years). In turn, the Fund will use this cash to invest in external assets.

## GOAL 2: MAKE INVESTMENTS IN THE ENDOWMENT PORTFOLIO TO MAXIMIZE LONG TERM FINANCIAL RETURNS

STRATEGIES/OUTPUTS	OUTCOMES	PERFORMANCE MEASURES/ BENCHMARKS																																									
<ul style="list-style-type: none"> <li>Invest Endowment Portfolio assets in accordance with the investment industry standard "Prudent Person Rule" which assigns the investment manager responsibility to restrict investment to assets that would be approved by a prudent investor.</li> <li>To diversify risk and enhance expected returns, allocate the Endowment Portfolio assets among the following asset classes and within the noted ranges (expressed as a % of the Endowment Portfolio's market value): <table border="1" data-bbox="167 720 524 846"> <thead> <tr> <th>Asset Class</th> <th>Holdings (%)</th> </tr> </thead> <tbody> <tr> <td>Interest-Bearing Securities<sup>3</sup></td> <td>25% to 45%</td> </tr> <tr> <td>Equity<sup>4</sup></td> <td>75% to 55%</td> </tr> </tbody> </table> </li> <li>Diversify investments within each subcategory of the asset classes set out above.</li> <li>The Investment Operations Committee (see Attachment A) will recommend minimum and maximum holdings for the asset classes and review periodically the benchmarks to be used in measuring performance.</li> <li>The Investment Management Division of Alberta Revenue will vary the allocation of assets within the above policy ranges based on the outlook for financial markets.</li> <li>The Investment Operations Committee will determine the extent of use of external investment managers to manage portions of the Endowment Portfolio, and the criteria for their selection.</li> </ul> <p><sup>3</sup> Includes money market instruments, bonds and mortgages.</p> <p><sup>4</sup> Includes Canadian public and private equities, foreign equities and Canadian real estate. Foreign investments will be limited to 40% of market value.</p>	Asset Class	Holdings (%)	Interest-Bearing Securities <sup>3</sup>	25% to 45%	Equity <sup>4</sup>	75% to 55%	<ul style="list-style-type: none"> <li>The market rate of return on the Portfolio is expected to exceed the cost of the Province's debt.</li> <li>The Portfolio is expected to generate a real rate of return of 5% at an acceptable level of risk over a moving four-year period.</li> <li>Market rate of return is expected to be greater than a passively invested benchmark portfolio.</li> </ul>	<p><b>Performance Measures</b></p> <ul style="list-style-type: none"> <li>The market value rate of return will be compared against the borrowing cost of the province on a moving four-year basis.</li> <li>The market value rate of return will be compared against the level of inflation to determine whether the long term capital market assumptions on which the investment policy is based are achieving the returns relative to expectations.</li> <li>The market value rate of return will be compared against a "policy benchmark return" to determine the impact of fund management on performance.</li> </ul> <table border="1" data-bbox="1076 1003 1481 1402"> <thead> <tr> <th rowspan="2">Asset Class</th> <th colspan="2">Benchmark</th> </tr> <tr> <th>Policy Allocation</th> <th>Return Index</th> </tr> </thead> <tbody> <tr> <td>Money market</td> <td>2%</td> <td>SC 91-day T-Bill</td> </tr> <tr> <td>Bonds</td> <td>33%</td> <td>SC Universe</td> </tr> <tr> <td>Subtotal</td> <td><u>35%</u></td> <td></td> </tr> <tr> <td>Canadian Equity</td> <td>23%</td> <td>TSE 300</td> </tr> <tr> <td>Foreign Equity</td> <td>35%</td> <td></td> </tr> <tr> <td>    U.S.</td> <td>17.5%</td> <td>S&amp;P 500</td> </tr> <tr> <td>    EAFE</td> <td>17.5%</td> <td>MSCI EAFE</td> </tr> <tr> <td>Real Estate</td> <td>7%</td> <td>RCPI</td> </tr> <tr> <td>Subtotal</td> <td><u>65%</u></td> <td></td> </tr> <tr> <td>Total</td> <td><u>100%</u></td> <td></td> </tr> </tbody> </table> <ul style="list-style-type: none"> <li>The market value rate of return will be compared against a sample of other large pension and endowment funds to measure whether the investment policy is resulting in competitive fund returns.</li> <li>The returns on the real estate component will be adjusted to reflect a comparable calculation base with the RCPI.</li> <li>Each external manager mandate is tied to an appropriate market index as a benchmark.</li> </ul>	Asset Class	Benchmark		Policy Allocation	Return Index	Money market	2%	SC 91-day T-Bill	Bonds	33%	SC Universe	Subtotal	<u>35%</u>		Canadian Equity	23%	TSE 300	Foreign Equity	35%		U.S.	17.5%	S&P 500	EAFE	17.5%	MSCI EAFE	Real Estate	7%	RCPI	Subtotal	<u>65%</u>		Total	<u>100%</u>	
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**GOAL 3: TO IMPROVE ALBERTANS' UNDERSTANDING AND THE TRANSPARENCY OF THE ALBERTA HERITAGE SAVINGS TRUST FUND**

STRATEGIES/OUTPUTS	OUTCOMES	PERFORMANCE MEASURES/ BENCHMARKS
<ul style="list-style-type: none"> <li>• Release quarterly and annual reports on a timely basis.</li> <li>• Release summary reports of the Heritage Fund's investment activities and results for Albertans on a timely basis.</li> <li>• Publish the Heritage Fund business plan annually.</li> <li>• The Legislature's Standing Committee will hold annual public accountability meetings around Alberta to report on the Fund's results and to answer questions on the Fund's performance.</li> </ul>	<ul style="list-style-type: none"> <li>• Improved understanding by Albertans of the management, operations and performance of the Heritage Fund.</li> </ul>	<p><b>Performance Measures</b></p> <ul style="list-style-type: none"> <li>• Timeliness of reports and public accountability meetings.</li> <li>• Satisfaction of Albertans regarding information provided about the Fund.</li> </ul> <p><b>Benchmark</b></p> <ul style="list-style-type: none"> <li>• Annual report will be released by June 30 of each year.</li> <li>• Quarterly reports will be released within two months after the conclusion of the quarter.</li> <li>• The Standing Committee will hold public accountability meetings around the province in the fall of each year.</li> </ul>

## MANAGEMENT AND ACCOUNTABILITY

- A clear mission statement and new investment objectives for the Heritage Fund have been established in legislation.
- A Standing Committee of the Legislature has been established to provide overall direction, evaluate the performance of the Fund and report regularly to Albertans.
- The Investment Operations Committee reviews and recommends to the Minister of Revenue the business plan, annual report and the investment policies for the Fund. It also reviews and approves financial statements and quarterly reports. The Committee includes a majority of private sector members with relevant financial and business expertise.
- Ongoing investment decisions will be made within Alberta Revenue consistent with the allocation of responsibilities set out in Attachment A.
- For each component of the Fund that is externally managed, an investment management mandate describing its purpose, goals and constraints will be established.
- The investment management mandates of external managers will be consistent with this Business Plan.
- The Auditor General is the auditor of the Fund.
- There are restrictions on the kind of investments that can be made. Fund assets are to be invested prudently and cannot be used directly for economic development or social investment purposes.

## INCOME AND EXPENSES

- The rates of return on, and the income from, the Fund likely will become more volatile as the Endowment Portfolio grows and as equity investments increase. While equity investments have historically, over long periods of time, provided higher rates of return than fixed income investments they are also significantly more volatile. Capital gains on traditional equity investments are not recognized as income until the investment is sold, so strong performance reflected in rates of return may not be reflected in income for some time. Unlike traditional equity instruments, income and expenses on equity index swaps are accrued as earned, as a result, market value gains and losses are realized as they occur.
- Following are current projections of Heritage Fund income based on the assumptions noted. Actual results will vary from projected income depending on the extent to which actual interest rates and equity market returns vary from the assumptions used. Forecast investment income decreases in 2001-02 due to the lower current interest rate environment and the increasing investment in equities in the Endowment Portfolio, which contribute lower “current income”.
- The income projections **include**:
  - interest income
  - dividend income
  - capital gains or losses only when they are realized, such as when an investment is sold
  - income and expense on index swaps and interest rate swaps accrued as earned

- The income projections **do not include**:
  - unrealized capital gains

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### Heritage Fund Income Forecast and Underlying Assumptions

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	2000-01	2001-02	2002-03	2003-04
<b>Forecast Investment Income<sup>1</sup></b>				
(\$ millions)				
<b>Heritage Fund</b>	<b>787</b>	<b>582</b>	<b>753</b>	<b>891</b>
<b>Consolidated<sup>2</sup></b>	<b>733</b>	<b>551</b>	<b>735</b>	<b>874</b>
Assumptions				
1. Interest Rates (nominal)				
Transition Portfolio				
(re-investment rates)				
Money Market (3 months)	5.45%	4.75%	5.00%	5.00%
bonds (2-3 year rate)	5.70%	5.00%	5.25%	5.25%
Endowment Portfolio				
Fixed Income Securities	6.19%	6.19%	6.19%	6.19%
2. Equities				
Estimated Income Rates <sup>3</sup>	4.7%	5.8%	6.7%	7.5%
3. Rates of Return on Equities <sup>4</sup>				
Canadian	9.12%	9.12%	9.12%	9.12%
Foreign	10.22%	10.22%	10.22%	10.22%
4. Endowment Portfolio Asset Mix				
Money Market	3%	2%	2%	2%
Bonds	37%	33%	33%	33%
Equities	65%	65%	65%	65%
Sensitivity Analysis (\$ millions)				
1% change in interest rates <sup>5</sup>		33.3	45.0	47.2
1% change in equity returns		18.7	40.7	58.7

<sup>1</sup> Based on January 2001 forecast interest rates and anticipated capital gains and losses.

<sup>2</sup> Net of income from Heritage Fund holdings of Alberta government securities.

<sup>3</sup> Estimated equity income consists of estimated dividends and realized capital gains.

<sup>4</sup> Includes an assumed 1.62% dividend yield on Canadian equities and 1.22% on foreign equities, and reflects year-to-date market change. For the remaining years, the annual returns move to the long-term assumed rate of return.

<sup>5</sup> Impact of a 1% change over the three years on interest income only.

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- Investment income is in part dependent on prevailing market conditions that are subject to occasional volatile movements. A significant portion of the current portfolio is invested in bonds, and has a predictable income stream. As these holdings mature, the future income will be increasingly dependent on the prevailing market conditions at the time of re-investment.

- The income projections for the Heritage Fund are net of estimated investment expenses as outlined below. The investment expenses include both direct and indirect administrative expenses, which include staff time, supplies and services and investment transaction and advisory services.

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### Heritage Fund Investment Expenses

(millions of dollars)

	2000-01	2001-02	2002-03	2003-04
Direct	1.7	2.0	2.4	2.4
External/Internal Managed Pools	5.6	7.6	10.0	10.0
Total	7.3	9.6	12.4	12.4
As a % of Assets	0.06%	0.08%	0.10%	0.10%

## **ATTACHMENT A**

### **HERITAGE FUND ALLOCATION OF RESPONSIBILITIES**

- The *Alberta Heritage Savings Fund Act* sets out the governance structure for the Heritage Fund. The general division of responsibilities is described below.

#### **Standing Committee on the Alberta Heritage Savings Trust Fund**

(A Committee of the Legislative Assembly)

1. Review and approve annually the Business Plan for the Heritage Fund.
2. Receive and review quarterly reports from the Minister of Revenue on the operation and results of the operation of the Heritage Fund and make them public.
3. Approve and release the Heritage Fund Annual Report on, or before, June 30 following the conclusion of the fiscal year for which the annual report was made.
4. Review after each fiscal year end the investment activities and the performance of the Heritage Fund and report to the Legislative Assembly as to whether the mission of the Heritage Fund is being fulfilled.
5. Hold public meetings with Albertans on the Heritage Fund's investment activities and results.

#### **Treasury Board**

1. Annually review and approve the Business Plan of the Heritage Fund.

#### **Minister of Revenue**

1. Approve the Statements of Investment Policy for each portfolio, including any proposed changes thereto.
2. Approve and present the annual Business Plan of the Heritage Fund to Treasury Board and to the Standing Committee.

#### **Investment Operations Committee**

1. Review and recommend the Business Plan to the Minister of Revenue for transmittal to Treasury Board and the Standing Committee.
2. Review and recommend the investment policy statements for the Endowment Portfolio and the Transition Portfolio to the Minister of Revenue.
3. Review and approve the financial statements and recommend the annual report.
4. Approve the quarterly reports for transmittal to the Standing Committee.
5. Advise on the extent of use of external managers and the criteria for selection.

### **Alberta Revenue**

1. Serve as investment manager of the assets of the Heritage Fund.
2. Prepare and recommend a Business Plan to the Investment Operations Committee and the Minister of Revenue.
3. Prepare, and recommend to the Investment Operations Committee and the Minister of Revenue, Statements of Investment Policy for each portfolio and any proposed changes to the investment policies.
4. Prepare a quarterly report on the investment activities and results of the Heritage Fund, including income forecasts.
5. Prepare financial statements for the Heritage Fund.
6. Prepare the annual report of the Heritage Fund.



## **ATTACHMENT B**

### **DESCRIPTION OF BENCHMARK INDICES FOR THE ENDOWMENT FUND**

#### **Scotia Capital 91-day T-Bills Index (SC 91-day T-Bill Index)**

Reflects the performance of the Canadian money market as measured by investments in 91-day Treasury Bills.

#### **Scotia Capital Universe Bond Index (SC Universe Index)**

Covers all marketable Canadian bonds with terms to maturity of more than one year. The purpose of this index is to reflect performance of the broad Canadian bond market in a manner similar to the way the TSE 300 represents the Canadian equity market.

#### **Toronto Stock Exchange 300 Total Return Index (TSE 300 Index)**

An index of 300 stocks, in 14 subgroups, listed on the Toronto Stock Exchange, designed to represent the Canadian equity market. It is a capitalization-weighted index calculated on a total return basis.

#### **Standard & Poor's 500 Index (S & P 500 Index)**

Covers 500 industrial, utility, transportation and financial companies of the US markets, mostly New York Stock Exchange issues. It is a capitalization-weighted index calculated on a total return basis with dividends reinvested.

#### **Morgan Stanley Capital International Europe, Australia, Far East Index (MSCI EAFE Index)**

An index of over 900 securities listed on the stock exchanges of countries in Europe, Australia and the Far East. The index is calculated on a total return basis, which includes re-investment of gross dividends before deduction of withholding taxes.

#### **Russell Canadian Property Index (RCPI)**

An index comprised of institutionally held real estate investments consisting of over 1,100 properties distributed across Canada.

## ATTACHMENT C

### GLOSSARY

#### **active management**

Attempts to achieve portfolio returns greater than a specific index while controlling risk, either by forecasting broad market trends or by identifying particular mispriced sectors of a market or securities in a market. The opposite of passive management.

#### **asset allocation**

The investment process by which the investment manager chooses or allocates funds among broad asset classes such as stocks and bonds.

#### **asset-backed securities**

These are debt instruments collateralized by a pool of assets such as automobile loans or equipment leases.

#### **asset (or investment) class**

Refers to a broad category of investments with similar characteristics (the typical asset classes are cash, stocks, bonds and real estate).

#### **benchmark index**

A statistical yardstick tracking the ups and downs of a particular market by monitoring a representative group of securities over time. For example, the Scotia Capital Universe Bond Index is a benchmark index that is designed to reflect the changes in the Canadian bond market.

#### **bond**

A financial instrument representing a debt where the issuer (corporation or government) promises to pay to the holder a specific rate of interest over the life of the bond. On the bond's maturity date, the principal is repaid in full to the holder.

#### **capital gain (or capital loss)**

The market value received on the sale of an asset, which is higher (lower) than its purchase price (also called cost). If an asset is bought for \$50 and sold for \$75, the realized capital gain or profit is \$25.

#### **diversification**

The allocation of investment assets within an asset class and among asset classes. In general, the greater the number of holdings within an asset class and among asset classes, the greater the diversification, which reduces risk.

#### **dividends**

Earnings distributed to shareholders of a company proportionate to their ownership interest.

#### **duration (or modified duration)**

Modified duration is a measure of price volatility and is the weighted average term to maturity of the security's cash flows (i.e., interest and principal), with weights proportional to the present value of the cash flows. Bonds with a longer duration are more price sensitive to interest rate changes than bonds with short durations.

#### **equities**

Equities are synonymously called stocks or shares and represent an ownership interest in a company (could be either a public or private firm). The shareholder normally has voting rights and may receive dividends based on their proportionate ownership.

#### **inflation**

Increases in the general price level of goods and services. Inflation is one of the major risks to investors over the long-term as savings may actually buy less in the future.

#### **interest-bearing securities**

Investments which are required to pay a fixed interest rate at periodic intervals such as bonds, mortgages and debentures.

**investment grade**

An investment grade bond is rated a minimum of BBB (or equivalent) by a rating agency, with AAA being the highest grade. Bonds rated below BBB are generally classified as being speculative grade and carry higher levels of credit risk than investment grade bonds (i.e., they have a higher probability of default on interest or principal payments).

**long-term**

A long-term investment horizon in the context of the Endowment Portfolio means a period of time that would include two business cycles, which would generally mean about 10 years.

**market value rate of return**

An annual percentage, which measures the total proceeds returned to the investor per dollar invested. Total proceeds for market value rates of return = "money in the bank" plus paper profits or losses (paper profits or losses are also called unrealized capital gains or losses). "Money in the bank" means cash interest and dividends and realized capital gains or losses from selling the investment.

**median return**

The median return of a group of investment managers reflects the return associated with the manager ranked at the 50th percentile (the 50th percentile is that point where half the managers had a higher return, and half the managers had a lower return).

**money market instruments**

Debt instruments such as Treasury Bills or corporate paper with a maturity of less than one year.

**Mortgage-Backed Securities (MBS)**

A debt instrument that has an ownership claim in a pool of mortgages or an obligation that is secured by such a pool.

**mortgage investment**

A debt instrument collateralized by real assets (e.g., a building) and requiring periodic payments consisting of interest and principal.

**nominal rate of return**

A measure of the earnings performance of a fund measured in current dollars.

**passive management**

Buying or investing in a portfolio that represents a market index without attempting to search out mispriced sectors or securities. The opposite of active management.

**portfolio**

A collection of investments owned by an investor.

**real rate of return**

The nominal rate of return minus the rate of inflation.

**realized/unrealized**

Terms generally used to describe capital gains or losses. A gain or loss is generally realized when an asset is sold; prior to sale the gain or loss is unrealized and it is only a potential or "paper" gain or loss.

