PROPOSAL – COMMERCIAL MORTGAGE MANDATE

RECOMMENDED

That Romspen Investment Corporation ("Romspen") be appointed as manager of a commercial mortgage mandate. Romspen will manage a target allocation of 15% of the Diversified Bond Fund. The remaining composition of the Diversified Bond Fund will be as follows: 60% AllianceBernstein Global Bond Fund and 25% State Street Global Advisors Canadian Bond Fund.

BACKGROUND

Romspen is a manager of Canadian commercial first mortgages. The firm diversifies its portfolio by size, borrower, geography and property type. A significant portion of the loans are made to construction and pre-development projects. Most mortgages are short-term (less than two years) and as such, their valuation is not impacted by fluctuations in interest rates, which is a major concern in the current interest rate environment.

The fund under consideration and Romspen were subject to extensive due diligence by the University during the summer of 2011 for an investment by the Operating & Endowment Fund. A one-day onsite due diligence was conducted to assess the firm's key personnel, its investment process, its back office, it compliance processes, the deal pipeline and review the existing portfolio. Western representatives present for the onsite due diligence included Martin Bélanger, Director, Investments, Bruce Curwood, Director, Investment Strategy at Russell Investments and Rick Konrad, a member of the Investment Committee of Western Operating & Endowment Fund. The onsite review confirmed the stability of the organization, the strength of the investment team, the disciplined investment process, the adequacy of its back office structure and compliance processes and the quality of its deal pipeline. Some weaknesses were identified, which include higher fees than traditional fixed income managers, having less than 10% of their assets under management from institutional investors, a larger amount of pre-development and construction loans, having 10% to 15% of their loans regularly in default (although historical loan loss ratios have been small) and no mark-to-market valuation.

An additional legal due diligence was conducted by the firm Davies Ward. This review included an examination of the legal documentation for the fund and commentary on the reasonableness of the provisions in regard to this type of investment. In addition, the review included title searches on a random selection of properties held in the portfolio to confirm the security position of the Fund. Davies Ward confirmed that the legal documents were consistent and reasonable for this type of investment. The property title search confirmed that the ranking of Romspen's mortgages were correctly identified on their mortgage list.

REDEMPTIONS

The Romspen Mortgage Investment Fund provides its unitholders with the right to make redemptions on a monthly basis. Redemptions take place on the 15th day of a month, or the next succeeding business day if the 15th of the month is not a business day. Unitholders have to give a 30-day redemption notice in order to redeem their units. As such, redemptions from the Romspen Mortgage Investment Fund will have to be made outside the regular monthly cash flow process of the Western Retirement Plans.

Redemptions are also subject to other restrictions:

- If a unitholder redeems units within one year of the subscription, a 2% penalty will be applied.
- The Fund will pay the redemption price to unitholders as long as the total number units tendered do not exceed 1% of the total outstanding units. If the number of units tendered exceeds 1%, units will be redeemed on a first come first served basis.
- If the total numbers of units tendered exceeds 3% of the total outstanding units, Trustees of the fund may implement one of the following measures:
    - Impose a discount on redemptions. Unitholders have the right to retract their redemption request once they have been notified of the discount.
    - Impose a temporary suspension of redemptions of up to six months. At the end of the suspension period, Trustees may decide to extend the suspension period or revert to the normal course for redemptions.

Only once in the past have the Trustees exercised their discretion regarding redemptions greater than 3%. In May 2009 unitholders tendered redemption requests for 5.8% of the total units outstanding. The Trustees imposed a 25% discount. All unitholders subsequently exercised their right to retract their redemption request.

ALLOCATION TO ROMSPEN

An allocation to Romspen will have to manage the risk and liquidity of the fund with the operational risk of adding another manager. As such a minimum allocation is necessary in order to make worthwhile the time an effort required to monitor an additional manager. In addition, the current non-Canadian exposure of the fund needs to be taken into consideration. AllianceBernstein's neutral allocation to non-Canadian securities is 50% and they may go as high as 70%. In order to maintain an optimal allocation of 30% to 40% in non-Canadian securities, a minimum of 60% allocation to AllianceBernstein should be maintained.

The following portfolios were reviewed:

Table 1

	AllianceBernstein Global Bond	SSgA Canadian Bond	Romspen
Existing Portfolio	67%	33%	0%
Portfolio 1	65%	25%	10%
Portfolio 2	65%	20%	15%
Portfolio 3	60%	30%	10%
Portfolio 4	60%	25%	15%

1) Performance

Tables 2 and 3 below compare the existing Diversified Bond Fund with various portfolios that include an allocation to Romspen ranging from 10% to 15%. The entire period is from February 2007 to December 2011, which is when the Diversified Bond Fund adopted its current structure. All proposed portfolios result in higher returns for most of the periods under consideration.

Table 2

	Annual Returns (As of December 31)			
	2011	**2010**	**2009**	**2008**
Existing Fund	8.91%	8.54%	11.57%	-1.07%
10% Romspen/ 25% SSgA / 65% AllianceBernstein	8.91%	8.80%	11.84%	-0.41%
15% Romspen/ 20% SSgA / 65% AllianceBernstein	8.91%	8.96%	12.07%	-0.19%
10% Romspen/ 30% SSgA / 60% AllianceBernstein	8.95%	8.67%	11.37%	0.14%
15% Romspen/ 25% SSgA / 60% AllianceBernstein	8.94%	8.82%	11.60%	0.36%
DEX Universe	9.37%	6.74%	5.42%	6.40%

Table 3

	Annualized Returns (As of December 31, 2011)				
	1-Yr	**2-Yr**	**3-Yr**	**4-Yr**	**Since Inception**
Existing Fund	8.91%	8.73%	9.67%	6.88%	6.50%
10% Romspen/ 25% SSgA / 65% AllianceBernstein	8.91%	8.86%	9.84%	7.18%	6.88%
15% Romspen/ 20% SSgA / 65% AllianceBernstein	8.91%	8.93%	9.97%	7.34%	7.07%
10% Romspen/ 30% SSgA / 60% AllianceBernstein	8.95%	8.81%	9.65%	7.19%	6.88%
15% Romspen/ 25% SSgA / 60% AllianceBernstein	8.94%	8.88%	9.78%	7.34%	7.07%
DEX Universe	9.37%	8.04%	7.16%	6.97%	6.44%

2) Risk

Tables 4 and 5 show the standard deviation of returns and the semi-standard deviation of returns. The Standard deviation measures the volatility of returns around the mean return, while the semi-standard deviation measures the volatility of returns around 0%, but only for those returns that are negative.

Given Romspen's lower volatility, adding any allocation results in a lower volatility for the Diversified Bond Fund. The new portfolios remain more volatile than the DEX Universe Bond Index over periods greater than three years due to the high volatility experienced by AllianceBernstein during the financial crisis.

Table 4

	Standard Deviation (As of December 31, 2011)		
	3-Yr	**4-Yr**	**Since Inception**
Existing Fund	3.18%	4.51%	4.17%
10% Romspen/ 25% SSgA / 65% AllianceBernstein	2.91%	4.18%	3.85%
15% Romspen/ 20% SSgA / 65% AllianceBernstein	2.80%	4.04%	3.72%
10% Romspen/ 30% SSgA / 60% AllianceBernstein	2.85%	4.05%	3.74%
15% Romspen/ 25% SSgA / 60% AllianceBernstein	2.73%	3.91%	3.60%
DEX Universe	3.21%	3.58%	3.44%

Table 5

	Semi-Standard Deviation (As of December 31, 2011)		
	3-Yr	**4-Yr**	**Since Inception**
Existing Fund	1.09%	2.86%	2.63%
10% Romspen/ 25% SSgA / 65% AllianceBernstein	0.91%	2.61%	2.38%
15% Romspen/ 20% SSgA / 65% AllianceBernstein	0.83%	2.51%	2.29%
10% Romspen/ 30% SSgA / 60% AllianceBernstein	0.88%	2.48%	2.27%
15% Romspen/ 25% SSgA / 60% AllianceBernstein	0.80%	2.38%	2.17%
DEX Universe	1.30%	1.57%	1.57%

3) Risk-Adjusted Returns

Tables 6 to 8 review the following measures of risk-adjusted returns:

- Sharpe ratio: measures the excess return over the risk-free rate by unit of total volatility
- Information ratio: measures a portfolio manager's ability to generate excess returns relative to a benchmark, but also attempts to identify consistency.

- Capture ratios: measure how well a manager does when the market is going up and when the market is going down. A capture ratio greater than 100% when the market is up is preferred and a capture ratio smaller than 100% when the market is down is preferred.

As seen in tables 6 and 7, an allocation to Romspen increases both the Sharpe ratio and the information ratio of the Diversified Bond Fund.

Table 6

	Sharpe Ratio (As of December 31, 2011)		
	3-Yr	**4-Yr**	**Since Inception**
Existing Fund	2.82	1.22	1.10
10% Romspen/ 25% SSgA / 65% AllianceBernstein	3.13	1.39	1.29
15% Romspen/ 20% SSgA / 65% AllianceBernstein	3.30	1.48	1.38
10% Romspen/ 30% SSgA / 60% AllianceBernstein	3.13	1.44	1.32
15% Romspen/ 25% SSgA / 60% AllianceBernstein	3.31	1.53	1.43
DEX Universe	2.01	1.57	1.31
Risk-free rate (91-day T-Bills)	0.72%	1.37%	1.93%

Table 7

	Information Ratio		
	3-Yr	**4-Yr**	**Since Inception**
Existing Fund	1.14	-0.03	0.02
10% Romspen/ 25% SSgA / 65% AllianceBernstein	1.18	0.08	0.17
15% Romspen/ 20% SSgA / 65% AllianceBernstein	1.19	0.13	0.25
10% Romspen/ 30% SSgA / 60% AllianceBernstein	1.18	0.09	0.19
15% Romspen/ 25% SSgA / 60% AllianceBernstein	1.19	0.15	0.26

Table 8 presents the up and down capture ratios of the Diversified Bond Fund with various portfolios that include Romspen. Adding Romspen tends to remove a little of the upside potential of the existing fund. However, it does provide significant downside protection.

Table 8

	Capture Ratios					
	3-Yr		4-Yr		Since Inception	
	Up	Down	Up	Down	Up	Down
Existing Fund	108.3%	10.2%	98.8%	99.1%	98.6%	92.6%
10% Romspen/ 25% SSgA / 65% AllianceBernstein	105.6%	-11.6%	95.9%	75.6%	96.6%	69.0%
15% Romspen/ 20% SSgA / 65% AllianceBernstein	104.3%	-23.9%	94.5%	63.8%	95.5%	57.1%
10% Romspen/ 30% SSgA / 60% AllianceBernstein	105.0%	-4.9%	96.0%	75.6%	96.7%	69.5%
15% Romspen/ 25% SSgA / 60% AllianceBernstein	103.7%	-17.1%	94.6%	63.8%	95.6%	57.6%

4) Fees

Table 9 compares the fees of the existing portfolio with various portfolios. Given that Romspen is more expensive than a typical bond fund (investment management fees are 1.00%). An allocation to Romspen would increase the fees charged by the Diversified Bond Fund.

Table 9

	MER
Existing Fund	0.17%
10% Romspen/ 25% SSgA / 65% AllianceBernstein	0.27%
15% Romspen/ 20% SSgA / 65% AllianceBernstein	0.31%
10% Romspen/ 30% SSgA / 60% AllianceBernstein	0.26%
15% Romspen/ 25% SSgA / 60% AllianceBernstein	0.31%

5) Other Considerations

The previous analysis shows what would happen if we add Romspen to the Diversified Bond Fund and the environment is the same as the one experienced over the past three to five years. This is an unlikely scenario. As table 10 shows, yields on traditional fixed income securities are currently extremely low. If interest rates stay the same during 2012, Romspen should provide more than 500 bps of value added above the existing yield of the Diversified Bond Fund (before fees). If interest rates were to go up, the margin would be even larger.

Table 10

As of December 31, 2011	Yield
SSgA Canadian Bond	2.31%
AllianceBernstein Global Bond	2.92%
Romspen Mortgage Fund	8.50%[i]

[i] Romspen expects net returns of 7.50% to 8.00% for 2012.

CONCLUSION

Given the challenging interest rate environment that we're facing, the Diversified Bond Fund would benefit from an allocation to a strategy that has little correlation with interest rates.