

City of Mississauga Corporate Report



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Date: 2021/04/13

To: Chair and Members of Budget Committee

From: Gary Kent, CPA, CGA, ICD.D, Commissioner of
Corporate Services and Chief Financial Officer

Originator's files:

Meeting date:
April 28, 2021

Subject

2020 Treasurer's Annual Report on Investment

Recommendation

That in compliance with Provincial legislation governing municipal investment practices, the report titled "2020 Treasurer's Annual Report on Investment" dated April 13, 2021 from the Commissioner of Corporate Services and Chief Financial Officer be received for information.

Executive Summary

- The City Funds investment portfolio earned net income of \$41.2 million, generating a net yield of 3.23%.
- Revenue allocated to the Operating Fund was \$14.4 million, while Reserve Funds received \$26.8 million.

Background

2020 was a difficult year financially for the City of Mississauga as it dealt with the impacts of COVID-19. As noted in previous reports to General and Budget Committees, the Treasury section of the Finance Division supported the City's efforts to minimize the financial impact of COVID-19 through monitoring cash balances and ensuring that cash flow was sufficient to meet the City's needs, appropriate timing of debt issuance to minimize cost to 2020 operations, providing support to other City areas as revenues were deferred, requesting deferrals for payments to other agencies such as the Region of Peel and School Boards, providing support to various City work units as electronic payment took on added significance and investing funds in the correct duration to maximize investment income in a year with abnormal cash flows.

This year-end Treasurer's report is provided to Budget Committee in accordance with Regulation 438/97, as amended.

The City maintains an operating fund, a number of reserves and reserve funds, and trust funds for various purposes. These funds are invested in accordance with the Municipal Act and Ontario regulations, the Funeral, Burial and Cremation Services Act, the Trustee Act and the City's Corporate Policy and Procedures on Investment.

The four major priorities of the City's Investment Policy are:

1. Legality of investments – conforming to legislative constraints;
2. Preservation of principal – avoiding the loss of monies which may result from the default of a debt issuer in the payment of principal or interest;
3. Maintenance of liquidity – the ease by which an investment can be sold and cash received and
4. Competitive rate of return – maximizing the return on investments while conforming to other objectives.

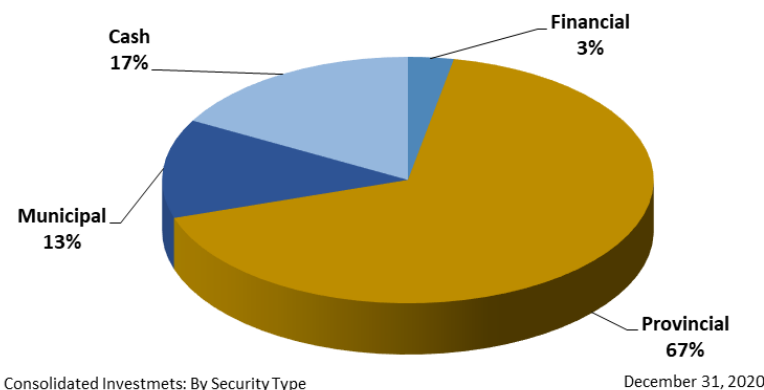
This Report provides a summary of investment results and analysis. The City's investment practices and procedures are subject to ongoing review by both the City's Internal Auditor and the Corporation's external auditors, KPMG.

Comments

In 2020, the City earned \$41.5 million in gross investment income (net income: \$41.2 million) on average cash and portfolio investment balances of \$1.27 billion. This generated a gross investment yield of 3.26% (net investment yield: 3.23%). Details for 2020 and prior years are shown below:

	Average Balance <u>(\$ Book Value)</u>	Income <u>(Gross \$)</u>	Yield <u>(Gross %)</u>	Yield <u>(Net %)</u>
2020	1,275,724,302	41,546,859	3.26%	3.23%
2019	1,214,818,747	39,980,502	3.29%	3.27%
2018	1,092,921,270	33,753,606	3.09%	3.06%

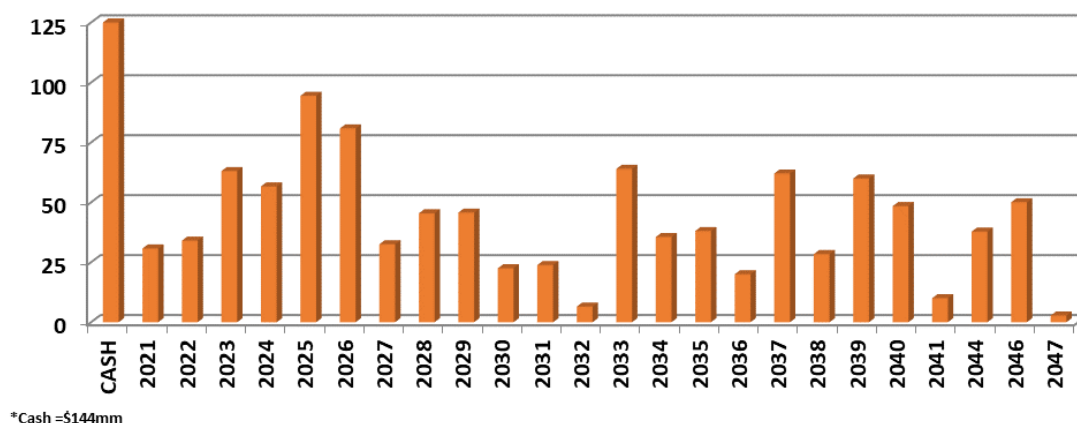
As at December 31, 2020, the Consolidated Investment Portfolio¹ held \$1,273 million in cash and securities (at par value²) distributed across various security types, as outlined in Chart 1:



Province of Ontario marketable securities (bonds) represents the largest and most-liquid position in the portfolio. The City Funds investment maturity schedule, as at December 31st, 2020, is in Chart 2.

CITY FUNDS PORTFOLIO: BY MATURITY (Par Value)

Chart 2



Investment Income Analysis

In an April 8, 2020 report to General Committee, staff expressed concern that investment results would fall several million dollars below budget. This was based upon the uncertainty posed by COVID-19 on the finances of the City including reduced revenues from transit, recreation and culture, unknown timing for payments to the Region of Peel and School Boards, the possibility of a deficit in 2020, a poor outlook for the economy in general as businesses were shut down or

¹ Marketable securities and cash for the combined City Funds Portfolio and DCA Portfolio.

² Par Value is used, for Policy comparison purposes, to demonstrate various investment holdings across security types. Portfolio holdings, and their respective limits, can be found in Appendix 1. The Par Value represents what the portfolio is worth on a dollar basis, if each security and the cash were held to final maturity dates. The Book Value of the Consolidated Investment Portfolio (excluding cash), as at Dec 31st, 2020, is \$1,099 million.

employees worked from home and dysfunctional financial markets where the stock and bond markets had just collapsed.

By year end the stock and bond markets had largely corrected, significant government stimulus was provided to keep the economy alive, many households were the beneficiaries of this stimulus and bond rates and inflation remained low. Through close monitoring of market conditions, certainty of payment dates to the Region and School Boards and ongoing analysis of the City's revenue receipts, staff were able to minimize City debt requirements for the year and to maximize our ability to invest bank balances in a timely way. Additionally, the federal and provincial governments provided funding to offset revenue losses and additional costs caused by COVID-19 such that the City did not need to use the \$250 million line of credit negotiated with the City's banker in March 2020.

The City Funds Investment Portfolio³ generated gross investment income of \$41.5 million on average monthly balances of \$1.27 billion. This translated into a net investment yield of 3.23%. Income type (gross) was comprised of \$30.6 million in net interest income (74% of return), while \$10.9 million (26%) attributed to realised capital gains.

The City Funds' Portfolio net return of 3.23% outperformed a composite passive index⁴, which returned 1.07%, by 2.16 percentage points. This outperformance provided incremental revenue to the City of \$27.6 million (using average monthly balances; actual net investment income of \$41.2 million at a 3.23% yield vs. the passive index return of \$13.6 million at 1.07%).

Investment Management

The Investment Unit, which is a section of Treasury, is responsible for monitoring day-to-day operating cash balances, cash flow forecasting and monitoring, investment portfolio management and administration, the coordination of the City's annual credit rating review and the timing and management of cash proceeds from both temporary bank borrowing and long-term debenture issuance.

The Investment unit continues to demonstrate value to the City with costs of approximately 2.93 basis points (0.0293%), which is well under fees charged by an externally managed public fund. As an example, management fees for the ONE Fund are in the 19 basis point range (0.19%) for the money market fund, and as much as 40 basis points (0.40%) for the bond fund (both of which are significantly higher than the 0.0293% incurred by the City).

³ This excludes the DCA Portfolio. The DCA Portfolio earned \$2,870,048 on average monthly cash & investment balances of \$112 million, yielding 2.57%.

⁴ The passive index return is calculated using the "average yield" for a constructed portfolio that is comparable to the City's existing Investment Policy. It is constructed using the following indices, their monthly yields (averaged for the year), and their respective (passive index weight): 91-Day GOC T-Bill yield: 0.54% (14%); BOA Merrill Lynch Index of Canadian Government Bonds: 0.73% (43%); BOA Merrill Lynch Indices of High Grade (AAA/AA) Corporate Bonds: 1.57% (43%).

Using the 40 basis point ONE Bond Fund cost benchmark, calculated against monthly balances for the City Funds Portfolio (excluding the cash component), the difference between the City's in-house investment management costs and the ONE Fund's fees represents a net saving to the City of \$3.7 million for 2020. These cost savings were supplemented by a realized return (i.e. excluding unrealised market value adjustments) that is greater than the realized returns of the ONE Government Bond Fund (Income Earned Yield, excluding market valuation adjustments, to Nov/20: 2.06%) vs. the City Funds net realized return of 3.23%.

Investment Outlook for 2021

The collapse in interest rates, which occurred throughout 2020 has completely evaporated in the first 3 months of 2021. While short-term interest rates, as governed by the Bank of Canada have remained anchored at extremely low levels (0.25% for the Overnight Bank Rate), longer-term interest rates (10 years and greater) which are beyond the control of the central bank, have risen rapidly and significantly.

The Province of Ontario 10-year yield, which is a barometer of benchmark rates for all provinces, provides a demonstration of how capital markets have re-priced economic growth, inflation and fixed income return expectations over the course of 2021. Whereas the yield on those bonds, pre-pandemic, was slightly less than 2% (Feb/2020), this rate is now actually higher (at ~2.05%) than year ago levels.

Other medium to long-term interest rates on both provincial and municipal bonds are also higher, thereby unwinding all of the market-based low-interest rate stimulus that was prevalent throughout most of 2020. While this may bode poorly for certain types of debt issuers, as a net portfolio investor, the City will benefit via higher re-investment rates during 2021.

Reinvestment rates that as recently as 3 months ago were expected, at best, to be in the 1.50% to 1.75% range are now expected to be 50 to 75 basis points higher (2% to 2.50%). While reinvestment rates will provide greater support to investment income, and improve the base earnings yield of investments going forward, it is expected that there will be less income realised from capital gains as there will be fewer opportunities to realise capital gains in a rising rate environment. Accordingly, overall realised investment income for 2021 is expected to be lower than in 2020, with a current forecast target of \$33 million.

Financial Impact

The City earned \$41.2 million in net investment income during 2020, of which \$14.4 million was allocated to the Operating Budget, and \$26.8 million was allocated to Reserve Funds.

Conclusion

In compliance with Provincial Regulation 438/97, as amended, all investment transactions during 2020 were made in accordance with the existing Investment Policy.

As at December 31, 2020, the City Funds Portfolio held \$1.17 billion (book value basis) in various securities, and cash. The net income for the Portfolio was \$41.2 million resulting in a net investment yield of 3.23%. As per Policy, investment proceeds were distributed between the Operating Budget (\$14.4 million) and Reserve Funds (\$26.8 million). While better interest rates are expected during 2021, investment income is likely to fall to the \$33 million range.

Attachments

Appendix 1: Total Investment Portfolio - By Investment Type (as at December 31, 2020)



A handwritten signature in black ink that reads "G. Kent." with a period at the end. The signature is written in a cursive, flowing style.

Gary Kent, CPA, CGA, ICD.D, Commissioner of Corporate Services and Chief Financial Officer

Prepared by: Mark Waugh, Manager, Treasury