

Date: March 18, 2022

To: Chair and Members of General Committee

From: Shari Lichterman, CPA, CMA, Commissioner of
Corporate Services and Chief Financial Officer

Originator's files:

Meeting date:
April 27, 2022

Subject

2021 Treasurer's Annual Report on Investment

Recommendation

That in compliance with Provincial legislation governing municipal investment practices, the "2021 Treasurer's Annual Report on Investment" dated March 18, 2022 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 \$43.3 million, generating a net yield of 2.99%.
- Revenue allocated to the Operating Budget was \$14.5 million, while Reserve Funds received \$28.8 million.

Background

Regulation 438/97, with amendment 43/18, of the Municipal Act, 2001, requires a municipality to adopt a statement of investment policies and goals, and requires a Treasurer's report to be submitted to Council annually. This report is tabled in compliance with the regulation.

As permitted by legislation, the City maintains operating funds, 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.

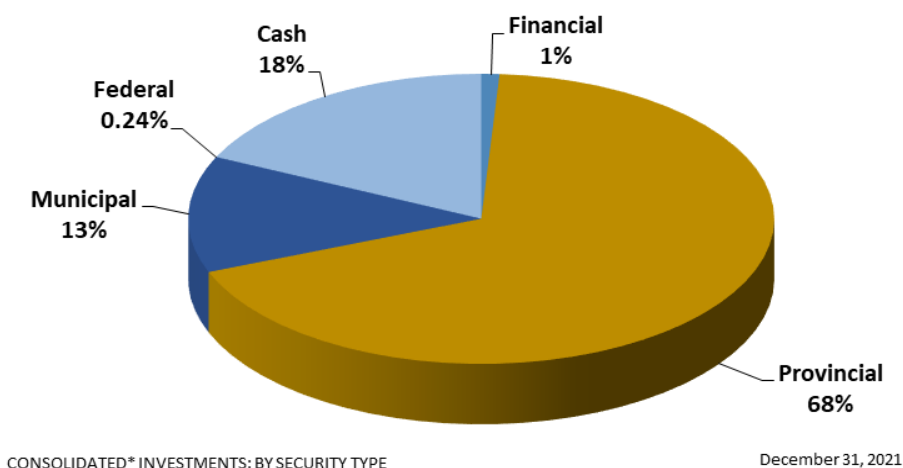
This Report outlines the implementation of these priorities and includes a summary of investment results and analysis. The City's investment practices and procedures are subject to ongoing review by both the City's Internal Auditor and the Corporation's external auditors, KPMG.

Comments

In 2021, the City earned \$43.6 million in gross investment income (net income: \$43.3 million) on average cash and portfolio investment balances of \$1.45 billion. This combination of income and balances generated a gross investment yield of 3.01% (a net investment yield: 2.99%). Details for 2021 and prior years are shown below:

	Average Balance (Book Value)	Income (Gross \$)	Yield (Gross %)	Yield (Net %)
2021	1,447,504,465	43,586,903	3.01%	2.99%
2020	1,275,724,302	41,546,859	3.26%	3.23%
2019	1,214,818,747	39,980,502	3.29%	3.27%

As at December 31, 2021, the Consolidated Investment Portfolio¹ held \$1.553 billion in cash and securities (at par value²) distributed across various security types, as outlined in Chart 1:



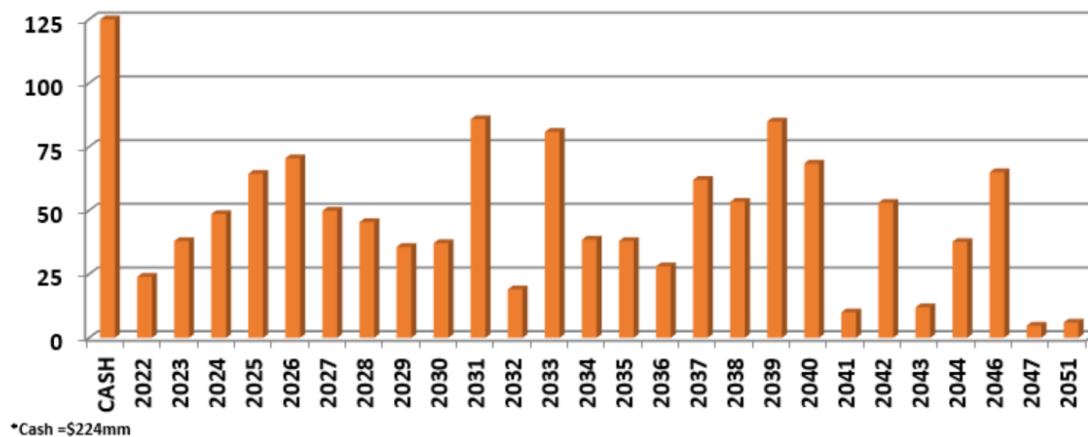
¹ Marketable securities and cash for the combined City Funds Portfolio and DCA Portfolio.

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, 2021, is \$1.332 billion.

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, 2021, is in Chart 2.

CITY FUNDS PORTFOLIO: BY MATURITY (Par Value)

Chart 2



Investment Income Analysis

During 2021, the City Funds Portfolio³ generated gross investment income of \$43.3 million on average monthly balances of \$1.448 billion. This translated into a net investment yield of 2.99%. Income type was comprised of \$33 million in net interest income (76.2% of return), while \$10.3 million (23.8%) was attributed to realised capital gains.

The City Funds' Portfolio net return of 2.99% outperformed a composite passive index⁴, which returned 1.20%, by 1.79 percentage points. This outperformance provided incremental revenue to the City of \$25.9 million (using average monthly balances; actual City net investment income of \$43.2 million at a 2.99% yield vs. the 2021 passive index return of \$17.4 million at 1.20%).

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 as well debenture issuance.

³ This excludes the DCA Portfolio. The DCA Portfolio earned \$3,459,904 of income on average monthly cash & investment balances of \$143 million, yielding 2.41%.

⁴ The passive index return is calculated using the "average yield" of 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 weights in the constructed index (bracketed): 91-Day GOC T-Bill yield: 0.11% (14%); BOA Merrill Lynch Index of Canadian Government Bonds: 0.97% (43%); BOA Merrill Lynch Indices of High Grade (AAA/AA) Corporate Bonds: 1.78% (43%).

The Investment unit continues to demonstrate value to the City with costs of approximately 2.56 basis points (0.0256%), which is well under fees which would be charged by an externally managed public fund. An indicative comparative example would be management fees charged by the ONE Fund (~15 basis point range 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 0.0256% incurred by the City.

Using 40 basis points as a cost benchmark, when calculating management costs 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 externally managed example represents a net saving to the City of \$4.3 million for 2021.

Investment Outlook for 2022

Interest rates have risen sharply to start the year as capital markets adjust to higher inflation and Bank of Canada (BOC) monetary tightening. While short-term interest rates, as governed by the BOC remained anchored at low levels throughout the Pandemic, those days are gone.

With the BOC embarking on a higher rate regime in March (increasing the Overnight Bank Rate by 0.25%), bond markets have already priced in another 0.75% of rate hikes by the Fall. 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 decided that interest rates are simply too low. Whereas that yield on those bonds closed out 2021 around 2.15%, by mid-March, the interest rate on that bond issue was flirting with 3% (0.85% higher). This level of rates is expected to persist throughout 2022 and while this may bode ill for borrowers, as an investor, the City will benefit from higher re-investment rates throughout the year.

Reinvestment rates that as recently as 6 months ago were expected, at best, to be in the 2% range are now expected to be, on average, 75 basis points higher (2.75%). While reinvestment rates will provide greater support to future interest income, by improving the base average earnings yield, there will be less opportunity to realise income from capital gains. Accordingly, overall realised investment income for 2022 is expected to be somewhat lower than that of 2021, with a target forecast of \$37 million.

Financial Impact

The City earned \$43.3 million in net investment income during 2021, of which \$14.5 million was allocated to the Operating Budget, and \$28.8 million was allocated to Reserve Funds.

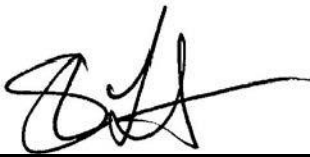
Conclusion

In compliance with Provincial Regulation 438/97, amended to 43/18, all investment transactions during 2021 were made in accordance with the existing Investment Policy.

As at December 31, 2021, the City Funds Portfolio held \$1.45 billion (book value basis) in various securities, and cash. The net income for the Portfolio was \$43.3 million translating into a net investment yield of 2.99%. As per Policy, investment proceeds were distributed between the Operating Budget (\$14.5 million) and Reserve Funds (\$28.8 million). Looking ahead, investment income is expected to settle into the \$37 million range for 2022.

Attachments

Appendix 1: Total Investment Portfolio – By Investment Type (as at December 31st, 2021)



Shari Lichterman, CPA, CMA, Commissioner of Corporate Services and Chief Financial Officer

Prepared by: Mark Waugh, Manager, Treasury