

City of Mississauga
Corporate Report



<p>Date: March 28, 2023</p> <p>To: Chair and Members of Budget Committee</p>	<p>Originator's files:</p>
<p>From: Shari Lichterman, CPA, CMA, Acting City Manager and Chief Administrative Officer</p>	<p>Meeting date: May 3, 2023</p>

Subject

2022 Treasurer's Annual Report on Investment

Recommendation

That in compliance with Provincial legislation governing municipal investment practices, the "2022 Treasurer's Annual Report on Investment" dated March 28, 2023 from the Acting City Manager and Chief Administrative Officer be received for information.

Executive Summary

- The City Funds investment portfolio realised net income of \$46.7 million, generating a net yield of 2.83%.
- Revenue allocated to the Operating Budget was \$14.4 million, while Reserve Funds received \$32.3 million.

Background

Ontario 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 from default, of a debt issuer, in the payment of principal or interest;
3. Liquidity – meeting current and expected annual operating needs through a combination of cash and marketable securities that can be readily converted to cash; and
4. Competitive rate of return – maximizing the return on investments while conforming to prior 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 2022, the City earned \$47.1 million in gross investment income (net income: \$46.7 million) on average cash and portfolio investment balances of \$1.65 billion. This combination of income and balances generated a gross investment yield of 2.86% (a net investment yield: 2.83%).

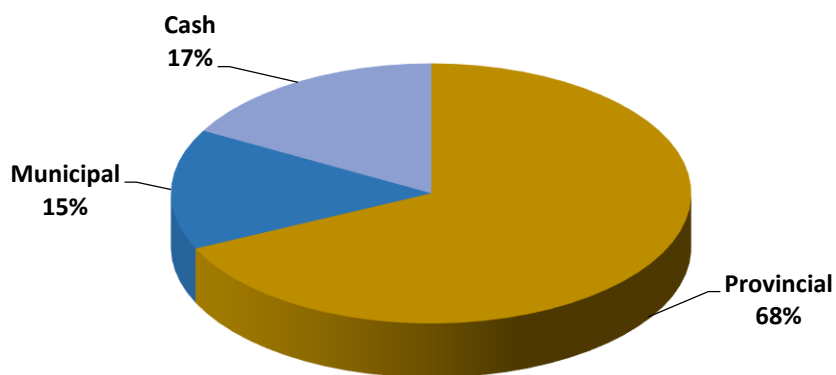
Details for 2022 and prior years are shown below:

	Average Balance <u>(Book Value)</u>	Income <u>(Gross \$)</u>	Yield <u>(Gross %)</u>	Yield <u>(Net %)</u>
2022	1,646,352,502	47,059,186	2.86%	2.83%
2021	1,447,504,465	43,586,903	3.01%	2.99%
2020	1,275,724,302	41,546,859	3.26%	3.23%

As at December 31, 2022, the Consolidated Investment Portfolio¹ held \$1.755 billion in cash and securities (at par value²) distributed across various security types, as shown below:

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

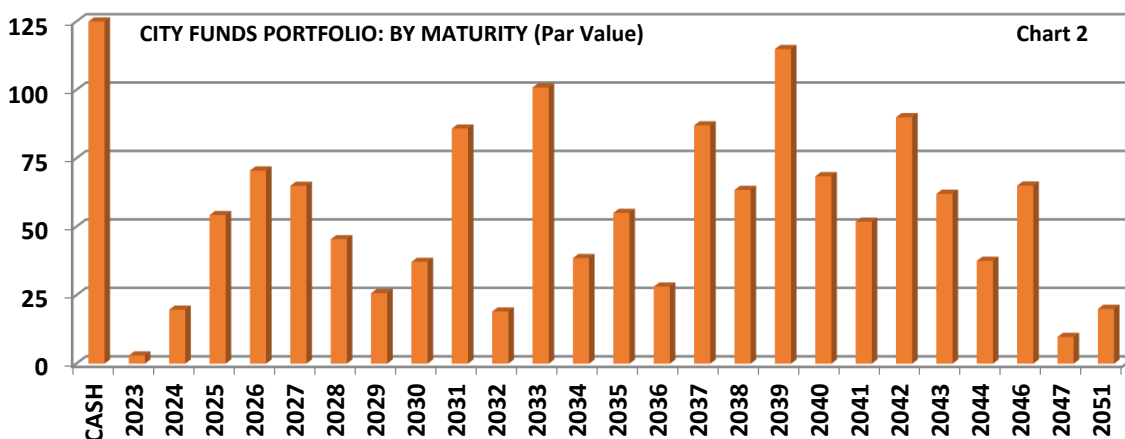
² Par Value is used, for Policy comparison purposes, to demonstrate various investment holdings across security types. Portfolio holdings, and their respective limits, can be found in Appendix 1. The Par Value represents what the portfolio is worth on a dollar basis, if each security and the cash were held to final maturity dates. The Book Value of the Consolidated Investment Portfolio (excluding cash), as at Dec 31st, 2022, is \$1.819 billion.



Consolidated* Investments: By Security Type

Dec 31st ,2022

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, 2022, is in Chart 2:



*City Cash xDCA = \$210mm

Investment Income Analysis

During 2022, the City Funds Portfolio³ realised gross investment income of \$47.1 million, the highest income in over 10 years, on average monthly balances of \$1.646 billion. This translated into a net investment yield of 2.83%. Income type was comprised of \$43.8 million in net interest income (comprising 93% of the return), while \$3.3 million (7%) was attributed to realised capital gains on dispositions.

The City Funds' Portfolio gross yield of 2.86% performed similarly (-0.19%) to a passive comparable index⁴ used for benchmarking (3.05%). The general unavailability of capital gains

³ This excludes the DCA Portfolio. The DCA Portfolio realised \$5,812,175 of investment income (versus \$3,459,904 for 2021) on average monthly cash & investment balances of \$143 million, yielding 2.72% (versus 2.30%).

⁴ A comparable passive index for benchmarking is calculated using the "average yield" of a *theoretical portfolio* that is comparable to the City's Investment Policy. It is constructed using the following indices, their monthly yields-to-maturity (averaged for the year),

income throughout the year inhibited any excess portfolio income that would normally occur, and which had been averaging an income contribution of between \$6 million and \$10 million over the last 4 years. (Note: when interest rates rise, the prices of fixed income securities, like bonds, fall thereby removing opportunities for capital gains.) In light of the ongoing aggressive monetary tightening campaign by the Bank of Canada, and its subduing effect on asset prices at large, capital gains are not being forecast for the next several years. Nevertheless, the highest returns (since pre-2008) on cash and short-term securities are working hard to compensate.

Investment Management

The Investment Unit, which is a section of Treasury, is responsible for monitoring day-to-day, as well as upcoming, operating cash needs, cash flow forecasting and monitoring, investment portfolio management and administration, the timing and management of both temporary bank borrowing as well capital debenture borrowing and the coordination of the City's annual credit rating.

The Investment unit continues to demonstrate value to the City with costs of approximately 2.4 basis points (0.024%), which is well under fees which would be charged by an externally managed public fund. Comparative examples for management fees charged by third party managers would see 15 basis points (0.15%) for a money market fund, and as much as 40 basis points (0.40%) for a bond fund). Both are materially higher than the 0.024% incurred by the City.

Using 40 basis points as a cost benchmark for a bond portfolio, 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 an externally managed fund represents a hard dollar financial benefit to the City of over \$5 million for 2022.

Investment Outlook for 2023

Interest rates rose sharply during 2022 and remain at elevated levels, as financial markets adjust to a stronger post-Pandemic economy, higher inflation and tighter Bank of Canada (BOC) monetary policy. With more than 425 basis points of rate hikes pushed in to the system (between March 2022 and Jan 2023, with overnight BOC rate going to 4.5%), the Bank of Canada has delivered its fastest, and tightest, monetary policy in several decades.

While the outlook for fixed income investments has certainly brightened (with higher interest rates across the board), the same cannot be said for other investment types, or the economy at large. Global central banks have unequivocally stated that they intend to slay the inflation dragon, with the corollary being that tighter monetary policy will lead to economic "pain". While this pain cannot be currently found in the Canadian jobs market (as several hundreds of thousands of jobs have been created during the Oct 2022 to March 2023 period), this pain can certainly be found by borrowers.

and their respective weights in the constructed index (bracketed): 91-Day GOC T-Bill yield: 2.01% (14%); BOA Merrill Lynch Index of Canadian Government Bonds: 2.73% (43%); BOA Merrill Lynch Indices of High Grade (AAA/AA) Corporate Bonds: 3.71% (43%).

All interest rates related to consumer, business and government debt have skyrocketed relative to levels seen in early 2022. For example, the Province of Ontario 10-year yield closed out 2022 in the 4% range, which is 200 basis points higher than year ago levels. Some consumer borrowing rates (5 year mortgages, for example), which had been offered around 2% in March 2022, are now being offered in the 6% range.

For the City Funds Portfolio, higher overnight bank rates are a welcome event given the City's necessity to maintain riskless operating cash balances. The City is being rewarded for doing regular business as returns to cash and short-term investments (which have been torturously low for savers since 2008) are now expected to stay above the rate of inflation for 2023, and beyond. Accordingly, overall realised investment income for 2023 is expected to be somewhat higher than that of 2022, with a target forecast of \$47 - \$50 million.

Financial Impact

The City earned \$46.7 million in net investment income during 2022, of which \$14.4 million was allocated to the Operating Budget, and \$32.3 million was allocated to Reserve Funds.

Conclusion

In compliance with Provincial Regulation 438/97, amended to 43/18, all investment transactions during 2022 were made in accordance with the existing Investment Policy.

As at December 31, 2022, the City Funds Portfolio held \$1.59 billion (book value basis) in various securities, and cash. The net income for the Portfolio was \$46.7 million translating into a net investment yield of 2.83%.

As per Policy, investment proceeds were distributed between the Operating Budget (\$14.4 million) and Reserve Funds (\$32.3 million). Looking ahead, 2023 investment income is expected to range between \$47 and \$50 million.

Attachments

Appendix 1: Total Investment Portfolio – By Investment Type (as at December 31st, 2022)



Shari Lichterman, CPA, CMA, Acting City Manager and Chief Administrative Officer

Prepared by: Mark Waugh, Manager, Treasury