



STAFF REPORT INFORMATION ONLY

City of Toronto 2006 Investment Report

Date:	April 16, 2007
To:	Executive Committee
From:	Deputy City Manager and Chief Financial Officer
Wards:	All
Reference Number:	P:\2007\Internal Services\CF\ec07020Cf – et (AFS #4828)

SUMMARY

This report provides a review of the City of Toronto's 2006 investment returns for all internally managed portfolios, including required disclosure of transactions in the City's own debt.

FINANCIAL IMPACT

Investment income earnings on the City's general funds, sinking funds, pension funds and trust funds accrue to each of the respective portfolios under management. Unrestricted earnings are allocated to a corporate revenue account in the operating budget. The following table highlights the 2006 operating budget impact.

2006 Budget	2006 Actual	Earnings in Excess of Budget
\$62.0 million	\$75.6 million	\$13.6 million

In addition to the above income realization, the City's general funds also outperformed their respective industry bench mark indices by a combined \$11.333 million in market value appreciation. The City's general funds have added more than \$80 million in cumulative market value in excess of the established industry benchmarks since 1999.

DECISION HISTORY

The report is required to be presented to Council on an annual basis under Ontario Regulation 610/06 Financial Activities of the *City of Toronto Act, 2006*.

ISSUE BACKGROUND

The Capital Markets Section of the Corporate Finance Division is responsible for the internal investment management of several City investment portfolios. In accordance with the Council-approved directive, the section manages the City's funds in a manner that provides the highest investment return consistent with the maximum security of principal. This strategy is applied in meeting the cash requirements of the City while conforming to all legislation governing the investment of City funds.

Management must incorporate both the legislative constraints and the risk profile of each portfolio. Investment policies and procedures approved by Council act as the governing guidelines for each of the individual portfolios under management.

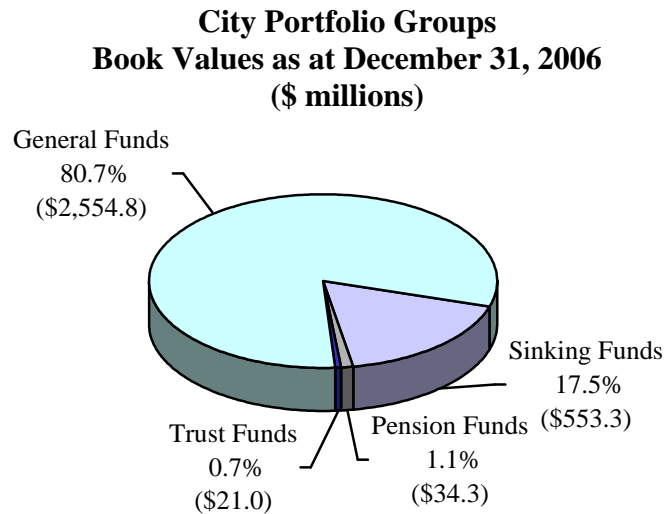
Although specific policy limits with respect to issuer names and credit quality limits vary between the portfolios, the primary objectives, in priority order, for all City investment activities are:

- (1) Ensure Safety of Principal
- (2) Maintain Adequate Liquidity (i.e. funds are available when required to meet expenditure commitments)
- (3) Maximize Rate of Return while Conforming to the Other Objectives

COMMENTS

As at December 31, 2006 the total value of all investments under internal management at cost was \$3.163 billion. These investments are managed within several individual portfolios, which are then classified by specific groups.

The following chart illustrates the percentage that each portfolio group represents of the total book value.



In 2006, the City's investment portfolios generated income in the amount of \$201.688 million. On a consolidated basis, this amount represents a 5.56% annual return. The investment return is based on earned revenues, which is comprised of interest income, realized capital gains/losses and amortized premiums/discounts.

The 2006 distribution of investment earnings and their respective annual investment return is summarized in the following chart:

Investment Portfolio Income
For the year 2006
(\$ 000's)

Portfolio	Average Portfolio Book Value	Earned Income	Investment Return
Bond Fund	\$ 2,485,105	\$ 142,093	5.72%
Money Market	503,339	20,705	4.11%
Total General Funds	\$ 2,988,444	\$ 162,798	5.45%
Sinking Funds	587,877	36,828	6.26%
Pension Funds	28,253	1,158	4.10%
Trust Funds	20,927	904	4.32%
Totals	\$ 3,625,501	\$ 201,688	5.56%

Annual income allocated in support of the City's operations is comprised of the following sources:

	<u>Millions</u>
General Funds investment income	\$162.798
Toronto District School Board net interest earnings	(3.095)
Other Net Miscellaneous Expenses	<u>(0.312)</u>
Net Income Earnings	<u>\$159.391</u>

In 2006 net income earnings of \$159.391 million were distributed to the City's operating budget (\$75.605 million) and to the City's reserve funds (\$83.786 million). Net interest earnings to the Toronto District School Board (TDSB) represent interest allocated to TDSB for operating cash positions held on deposit with the City less any interest applied against capital advances. The balance of funds accrue to:

- i. Sinking Funds (\$36.8 M) used to retire the City's debentures
- ii. Pension Funds (\$1.2 M) short-term funds used for monthly pension payments
- iii. Trust Funds (\$0.9 M) used to meet the respective trust fund objectives

The City of Toronto manages several investment portfolios for which each has specific objectives. For this reason, it is very likely that variances in the annual investment returns between the individual portfolios occur. Two individual portfolios that are managed interactively are the Bond and Money Market Funds.

The Bond Fund is positioned towards funding the City's future reserve and reserve fund requirements and therefore takes a longer view of the market. The Money Market portfolio is primarily focused on ensuring that adequate liquidity is maintained to meet the immediate cash flow requirements of the City's daily operations.

Together, these two portfolios provide the necessary diversification required in managing the City's total cash flow needs and the exposure to interest rate changes. Current revenues can be held in short term investments until such time when the movement to longer dated securities proves more suitable. Likewise, longer dated securities can be sold to meet short term expenditures if the opportunity to realize capital gains presents itself. Traditionally, the Bond Fund provides an opportunity to obtain higher investment yields.

Market Value Performance

Another measurement of portfolio performance is a comparison of the total market value return to an established industry index. The market value represents the price of the investments when buying or selling in the financial markets at a given point in time. The relevance of this comparison is dependent upon the similarities between the investment

policies and objectives governing the management of the City's funds and that of the selected industry index.

The following table compares the market value performance of the City's General Fund Money Market and Bond portfolios to their respective benchmark indices for 2006:

**Investment Portfolio
2006 Market Value Performance**

Portfolio Group	Book Value at Dec 31 /06	Market Value at Dec 31 /06	2006 Market Value Return	Bench Mark Returns
General Fund - Bond Fund	\$2,554,805,696	\$2,540,465,219	4.37%	3.92% Scotia Capital All Governments
General Fund - Money Market	\$ 26,000,000	\$ 26,255,149	3.98%	3.95% 30 Day T-Bill

The City's Bond Portfolio is measured against the Scotia Capital All Governments Index. In 2006, the market value of the City's Bond Portfolio reflected a 4.37% return compared to the index return of 3.92%. In comparison to the benchmark index, based on the portfolio's average book value in 2006 of \$2.485 billion, the impact of a 45 basis point or 0.45% out performance translates into an additional \$11.182 million in market value created by this portfolio. This is primarily attributed to management's active trading strategies of Federal Government bonds.

The money market component of the General Fund produced a market value return in 2006 of 3.98% compared to the Scotia Capital 30 Day T-Bill Index, which returned 3.95%. Based on an average book value in this portfolio of \$.503 billion, the out performance of the benchmark by 3 basis points or .03% translates into an additional \$.151 million in market value created by this portfolio.

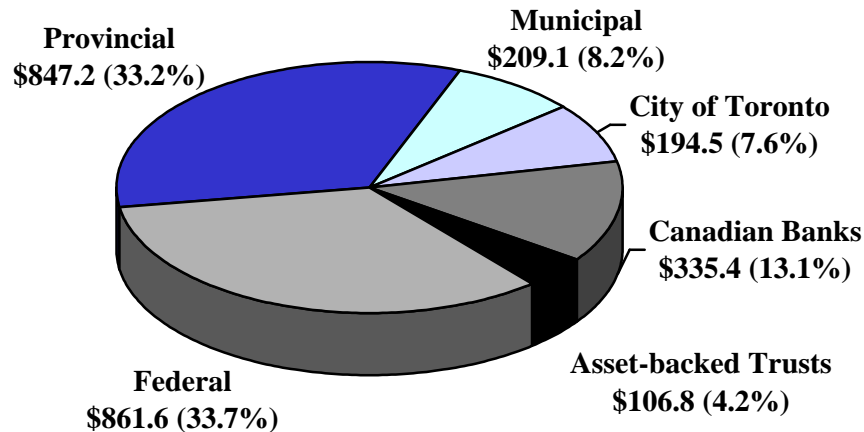
The City's General Fund has consistently outperformed the respective industry benchmarks since 1999 adding more than \$80 million in cumulative market value to this portfolio in excess of the established benchmarks. The market value of a portfolio is not realized as income until investments are sold.

Sector Analysis

The General Funds maintain a large weighting in federally guaranteed bonds. This reflects the conservative nature of these portfolios. At December 31, 2006, 33.7% of this portfolio's \$2.555 billion book value was invested in the federal government sector. In order to enhance the portfolio's yield, the balance of this portfolio was invested in the provincial, municipal, banking and corporate sectors.

The following chart illustrates the distribution of this portfolio by sector group.

City General Funds – Portfolio Distribution
Book Value as at December 31, 2006
(\$ millions)



Record of Transactions in City of Toronto Debt

In 2006 the City of Toronto purchased a principal value of \$21.969 million of its own securities in the secondary market and sold \$20.057 million for a net purchase of \$1.912 million. The City maintains a record of each transaction in its own securities, including a statement of the date and the purchase or sale price of each security transaction. The details pertaining to the 2006 transactions are documented in the attached Appendix A.

Investment Policies

In developing investment policies and goals for funds under management, primary consideration must be given to the objectives of each portfolio. Although the rate of return on assets is the principal measure of performance, the achievable rate of return is constrained by the parameters of the investment policy. This has important implications for performance measurement and, in particular, the choice of a suitable benchmark with which to compare the rate of return.

The City of Toronto's investment policies and procedures are continuously monitored to ensure that the guidelines approved by Council are sufficient to achieve the objectives of the respective investment portfolios. At least once annually a comprehensive review is completed at which time adjustments deemed appropriate are incorporated into the investment policies for approval.

There are no policy changes being recommended in this report. Any amendments deemed necessary upon completion of this year's investment policies review will be forwarded for approval in a separate report.

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ATTACHMENTS

Appendix A: City of Toronto Investment Portfolios
Record of 2006 Transactions in City of Toronto Debentures

City of Toronto Investment Portfolios
Record of 2006 Transactions in City of Toronto Debentures

Portfolio	Issuer	Transaction Date	Maturity	Coupon	Principal	Price
Purchases						
4% Sinking Fund	City of Toronto	09-Jan-06	18-Dec-18	5.600%	\$ 300,000	110.634
4% Sinking Fund	City of Toronto	09-Jan-06	20-May-15	4.550%	\$ 271,000	101.475
Bond Fund	City of Toronto	23-Feb-06	20-May-15	4.550%	\$ 4,400,000	100.518
Bond Fund	City of Toronto	21-Aug-06	25-Sep-13	5.125%	\$ 2,258,000	104.110
Bond Fund	City of Toronto	24-Aug-06	12-Dec-17	6.100%	\$ 2,740,000	112.140
Bond Fund	City of Toronto	13-Oct-06	12-Dec-17	6.100%	\$ 7,000,000	112.311
Bond Fund	City of Toronto	08-Dec-06	25-Sep-13	5.125%	\$ 5,000,000	105.706
Total Purchases:					<u>\$ 21,969,000</u>	
Sales						
Bond Fund	City of Toronto	20-Feb-06	27-Sep-06	7.400%	\$ 5,000,000	101.971
Bond Fund	City of Toronto	11-Mar-06	18-Dec-08	5.150%	\$ 2,225,000	101.870
Bond Fund	City of Toronto	10-Mar-06	26-Jul-11	6.400%	\$ 4,272,000	109.747
Bond Fund	City of Toronto	11-Mar-06	26-Jul-11	6.400%	\$ 1,448,000	109.163
Bond Fund	City of Toronto	11-Mar-06	26-Jul-11	6.400%	\$ 3,792,000	109.163
Bond Fund	City of Toronto	11-Mar-06	25-Sep-08	4.250%	\$ 3,320,000	100.080
Total Sales:					<u>\$ 20,057,000</u>	

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