



STAFF REPORT INFORMATION ONLY

City of Toronto 2008 Investment Report

Date:	May 12, 2009
To:	Executive Committee
From:	Deputy City Manager and Chief Financial Officer
Wards:	All
Reference Number:	P:\2009\Internal Services\Cf\Ec09012Cf – ET (AFS #10014)

SUMMARY

This report provides a review of the City of Toronto's annual bond fund and money market investment returns for all internally managed portfolios, i.e. those invested in respect of the City's reserve funds and operating budget. Moneys invested in other funds are reported separately, specifically, those in sinking funds, pension funds and trust funds.

Financial Impact

Investment earnings on the City's general funds in 2008 totalled \$171.6 million and averaged a 4.6% annual return. Investment earnings and Toronto District School Board net interest earnings result in total income earnings of \$172.0 million, which were allocated to the operating budget (\$97.0 million) and reserve funds (\$75.0 million).

The operating budget component exceeded the budgeted revenues in the Non-Program account by \$28.6 million and contributed to the 2008 operating surplus. This was due to a combination of higher than expected cash balances and a positive impact of a change in the allocation method for investment earnings between operating and reserve funds which was approved by Council in 2008.

2008 Budget	2008 Actual	Earnings in Excess of Budget
\$68.4 million	\$97.0 million	\$28.6 million

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 as cash when needed
3. Maximize Rate of Return while conforming to the other objectives

COMMENTS

Market Review

The financial crisis that negatively affected financial markets in 2008 has extended into 2009. All major world economies are in recession, despite sizeable global fiscal stimulus by governments around the world, rates cut to new lows, and aggressive actions by central banks. The continuing financial turmoil weighs heavily on all aspects of the Canadian economy - slowing business activity, rising unemployment levels, and eroding consumer confidence and spending. Inflation, at the moment, is not a central focus for the Bank of Canada. The net effect is that both short and long term interest rates declined during 2008.

Investment Portfolios

The City manages several investment portfolios, each which has specific objectives. 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.

When combined, these 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.

Credit Quality

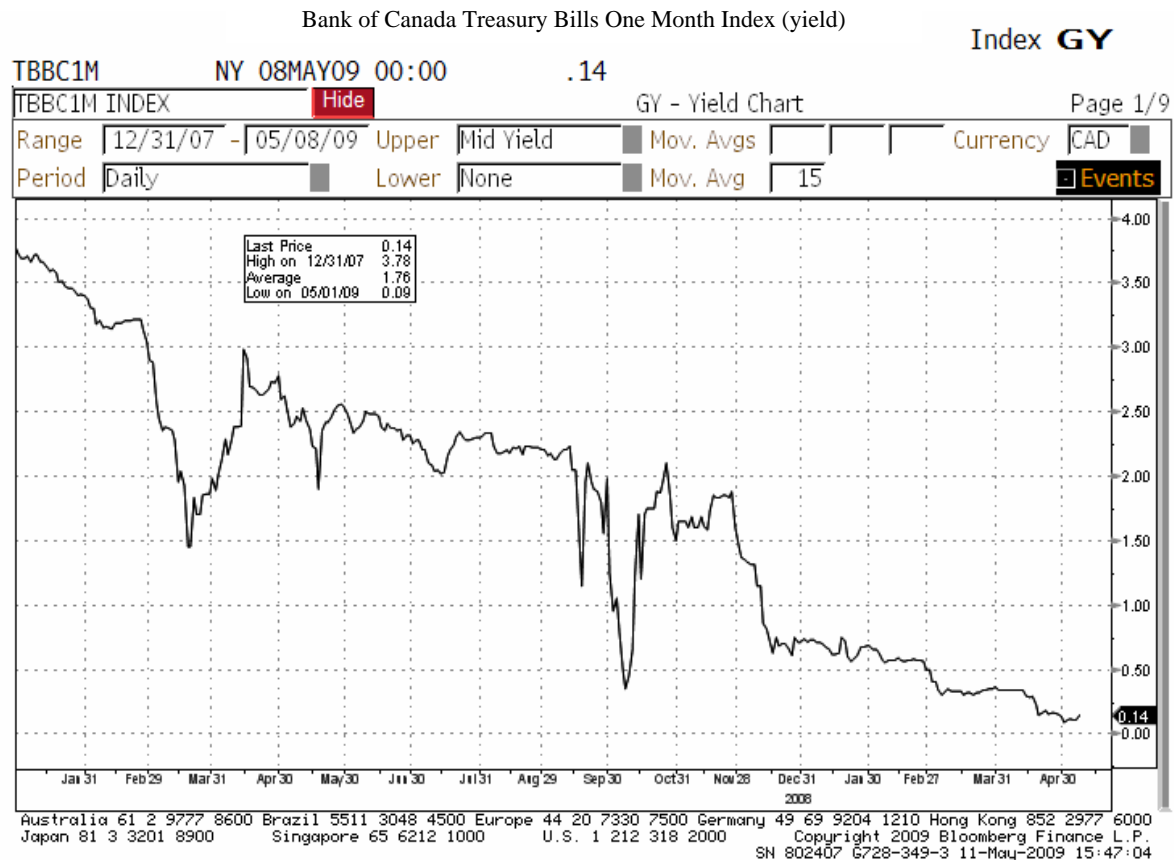
The City’s bond portfolio (Table 1 below) continued to exhibit high credit quality and liquidity as shown by the distribution of the credit ratings of investments. The City did not hold any bond portfolio investments with less than an A credit rating and the overall credit quality increased in 2008 compared with 2007.

Table 1. Credit Ratings of the Bond Portfolio Holdings

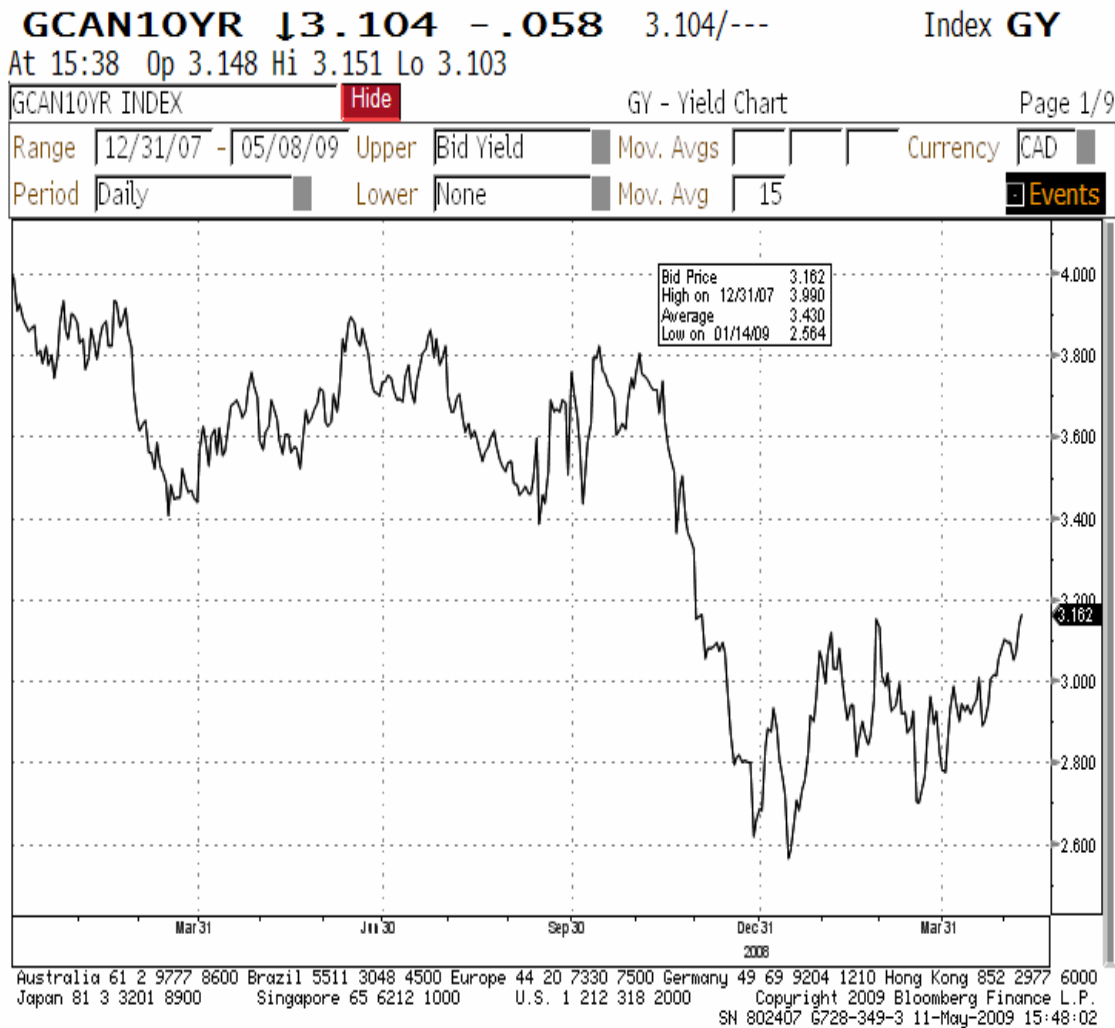
	AAA/AA	A	BBB	<BBB
1. Dec 31, 2008	84.4%	15.6%	0%	0%
2. Dec 31, 2007	83.1%	16.9%	0%	0%

Portfolio Returns

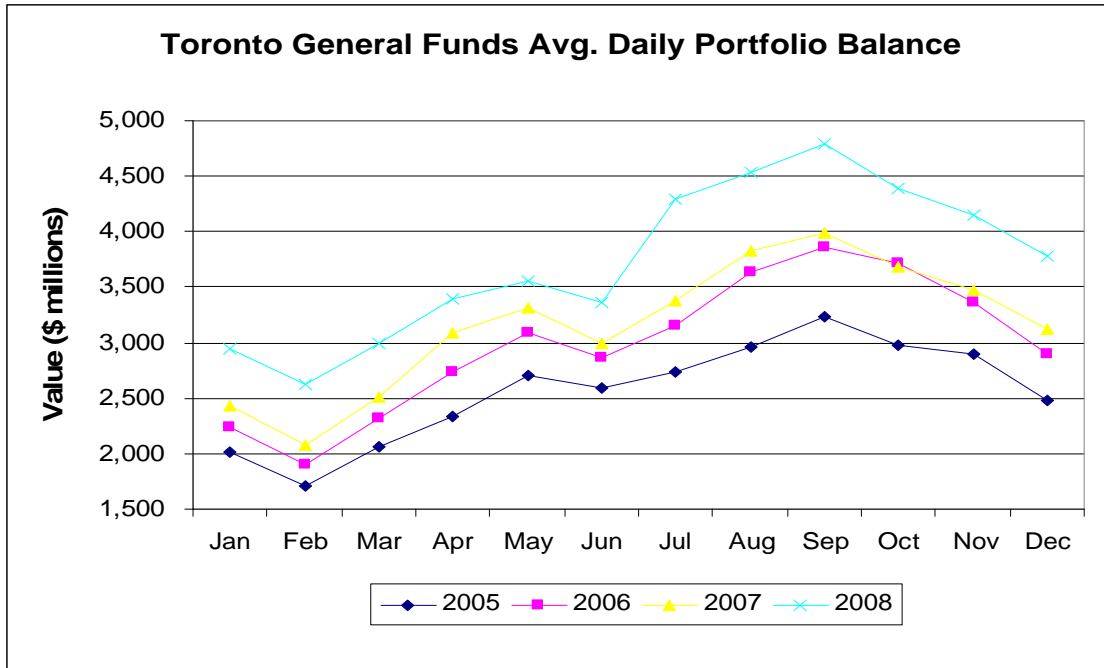
The following graphs demonstrate that the Canadian money market and bond yields have dramatically dropped to historical lows during 2008:



Canadian Government Bonds 10 Year Note Index (yield)



In 2008, the average value of all City investments under internal management, excluding sinking funds, was \$3.732 billion. As shown in the following chart, the portfolio balance peaked at approximately \$4.7 billion in September 2008. As well, the average daily balances have gradually increased over the past three years due to higher reserve and reserve fund balances, changes in the choice of tax payment dates by property taxpayers and other factors. This has helped the City earn higher overall investment returns, \$171.6 million in 2008 versus \$166.7 million in 2005, despite generally falling interest rates.



In 2008, the City’s money market and bond investment portfolios generated income in the amount of \$171.6 million. On a consolidated basis, this amount represents a 4.6% 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 2008 distribution of investment earnings and their respective annual investment return is summarized in the following chart:

Table 2. Investment Portfolio Income For the year 2008
(\$ 000’s)

Portfolio	Average Portfolio Book Value	Earned Income	Investment Return
1. Bond Fund	\$2,630,394	\$136,430	5.2%
2. Money Market	\$1,102,085	\$35,135	3.2%
3. General Funds	\$3,732,479	\$171,565	4.6%

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

	<u>Millions</u>
General Funds investment income	\$171.565
Toronto District School Board net interest earnings	<u>0.452</u>
Total Income Earnings	<u>\$172.017</u>

The net income earnings of \$172.0 million were distributed to the City's operating budget (\$97.0 million) and to the City's reserve funds (\$75.0 million). Net interest earnings as they pertain to the Toronto District School Board (TDSB) represent interest received from TDSB for capital advances and any interest applied against operating cash positions held on deposit with the City.

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 annualized market value performance of the City's General Fund Money Market and Bond portfolios to their respective benchmark indices as of March 31, 2009 in order to present the most recent markets returns that are generated by Royal Trust Dexia, the City's custodian, that were available when this report was prepared:

**Table 3. Market Value Performance
Annualized One-Year Return ('000)
As at March 31, 2009**

General Funds	Book Value Mar 31, 2009	Market Value Mar 31, 2009	Market Value Returns	Benchmark Returns	Benchmark
Bond Fund	\$2,822,353	\$3,022,985	6.82%	6.39%	DEX All Governments
Money Market	\$242,918	\$243,309	2.62%	1.85%	DEX 30 Day T-Bill

The bond portfolio of the General Funds is measured against the DEX Governments Index. As of March 31, 2009, the market value of the City's Bond Portfolio reflected a year-over-year return of 6.82% compared to the index return of 6.39%, or 43 basis points above the benchmark. In comparison to the benchmark index, based on the portfolio's average book value during the period of \$2.7 billion, the impact of a 43 basis point translates into an incremental \$11.5 million in market value. The appreciation in the portfolio market value and the outperformed returns were attributable to primarily several factors:

1. a general rally in the high credit-quality fixed income market (flight-to-quality environment)
2. strategic asset mix targets and duration positioning, and

3. active bond trading programs.

The money market component of the General Funds produced an annualized market value return of 2.62% as of March 31, 2009, compared to the DEX 30 Day T-bill Index return of 1.85%, or 77 basis points above the benchmark. Based on an average book value in this portfolio of \$1.1 billion during the period, the 77 basis points translates into an additional \$8.5 million in investment income generated by this portfolio. The appreciation in the portfolio market value and the outperformed returns were attributable to factors including:

1. maximize investment term through active cash management and
2. strategic selection of issuers.

The City's General Funds returns exceeded independent benchmarks by \$20 million. This market value return represents a value-added by the Capital Markets section of 52 basis points.

Looking forward, although this recession is far from over, this flight-to-quality phenomenon in 2008 and early 2009 will begin to reverse once there are early signs of economic recovery. When the economy recovers in late 2009 or in 2010, rising supply should push yields higher yet again. This trend is expected to benefit the earned yield and return but hinder the market value returns.

Record of Transactions in City of Toronto Debentures

In 2008, the City of Toronto purchased a principal value of \$52,446,000 of its own Securities in the secondary market for the Sinking Fund and the General Fund.

In compliance with Ontario Regulation 610/06 Financial Activities of the *City of Toronto Act, 2006*, 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 2008 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. The primary objectives, in priority order, for all City investment activities are to ensure the safety of principal, maintain adequate liquidity and maximize rate of return within constraints. Although the rate of return on assets is the principal quantitative measure of performance, the achievable rate of return is constrained by the parameters of the investment policy. The portfolio objectives and constraints have important implications on the portfolio's performance measurement.

The City's investment policies and procedures are monitored by the staff and the Investment Advisory Committees to ensure that the policies approved by Council are sufficient to achieve the objectives of the respective investment portfolios. On an annual basis, and more frequently if required, a comprehensive review is completed by the above

Committee and appropriate adjustments are incorporated into the investment policies which are forwarded for Council for approval.

In February 2009, Council adopted a revised City of Toronto Investment Policy. The revisions primarily respond to changes in the Financial Activities Regulations under the City of Toronto Act, the Audit Recommendations Report from the Auditor-General's Office (Nov 4, 2008) as well as the 2007 Investment Policy Compliance Report from Ernst & Young LLP.

CONTACT

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SIGNATURE

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ATTACHMENT

Appendix A – City of Toronto Debenture Purchases and Sales during 2008

Appendix A

City of Toronto Debenture Purchases and Sales during 2008

1. Purchases

<u>Portfolio</u>	<u>From Jan 01, 2008 To Dec 31, 2008</u>			
	<u>Maturity</u>	<u>Coupon</u> %	<u>Principal</u> \$	<u>Price</u>
4%SF	8/3/2010	6.25	9,746,000	106.187
4%SF	9/27/2016	8.00	3,100,000	121.465
5%SF	5/21/2014	5.30	4,000,000	106.725
BOND Fund	5/20/2015	4.55	1,535,000	100.902
BOND Fund	5/21/2014	5.30	1,000,000	106.725
BOND Fund	9/27/2016	8.00	2,100,000	125.058
BOND Fund	10/28/2012	4.05	9,530,000	100.667
BOND Fund	10/29/2014	4.90	1,440,000	105.35
BOND Fund	6/8/2015	8.65	2,125,000	127.95
BOND Fund	11/29/2009	5.00	2,400,000	102.263
BOND Fund	7/28/2016	4.85	4,325,000	101.74
BOND Fund	7/18/2017	5.05	5,000,000	103.56
BOND Fund	11/29/2009	5.00	2,000,000	102.15
BOND Fund	9/27/2016	8.00	1,000,000	123.788
BOND Fund	7/18/2017	5.05	2,100,000	101.492
BOND Fund	6/27/2018	4.95	<u>1,045,000</u>	96.954
Total			<u>52,446,000</u>	

2. Sales

There were no sales of City of Toronto debentures during 2008