

City of Toronto Investment Report for the Six Month Period Ending June 30, 2020

Date: November 25, 2020

To: Executive Committee

From: Chief Financial Officer and Treasurer

Wards: All

SUMMARY

The purpose of this report is to provide the following information:

1. Performance of the Funds for the first six months of 2020
2. General Market Update and Benchmark Performance

The City's General Group of Funds ("General Fund") that holds the City's working capital and the amounts designated for the City's reserves and reserve funds earned:

- \$92.4 million in the first six months of 2020 (3.6% annualized rate of return)

The City's Sinking Fund portfolio that holds funds for future debt repayments earned:

- \$17.2 million in the first six months of 2020 (2.3% annualized rate of return)

Since January 1, 2018, the City's long-term investments have been managed by the Toronto Investment Board under a new Council adopted Investment Policy which is based on the prudent investor standard.

As at June 30, 2020, approximately 80 percent of both the Sinking Fund and the Long Term Fund were managed by external investment managers selected by the Toronto Investment Board. At the end of 2019, four external fixed income managers controlled approximately 70 percent of the assets while two global equity pooled fund managers oversaw 7 percent of these funds. A third global equity pooled fund manager started in February 2020 resulting in a total equity exposure of 10 percent at the fund level by June 30, 2020. The balance of these funds remain in cash and short-term securities until additional external fund managers can be funded. Selection and contract negotiations for an additional global equity pooled fund manager and real asset managers continues in 2020.

All funds managed are compliant with the Council-approved Investment Policy.

RECOMMENDATIONS

The Chief Financial Officer and Treasurer recommends that:

1. City Council receive this report for information.

FINANCIAL IMPACT

The City's General Group of Funds ("General Fund") earned \$92.4 million in the first six months of 2020.

The investment activities in the first six months of 2020 were compliant with the investment policies and goals adopted by City Council. The earnings for the first half of 2020 have met the forecasted income contribution to the 2019 Operating Budget.

The City's Sinking Funds portfolio earned \$17.2 million in the first six months of 2020. These earnings are retained within the Sinking Funds and must be used for the purpose of retiring debenture debt at maturity.

DECISION HISTORY

At its meetings held on July 28 and 29, 2020, City Council receive the report (July 7, 2020) from the Chief Financial Officer and Treasurer for information. This report provided the performance and compliance to year-end 2019 and the three months ending March 31, 2020.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.EX15.10>

At its meetings held on January 29, 2020, City Council referred the Investment Policy Update report to the Executive Committee for further consideration.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.CC14.4>

At its meetings held on December 17, 2019, City Council received for information the Investment Report for the Year 2018 and the Six Month Period Ending June 30, 2019

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.EX11.15>

At its meetings held on October 2 to 3, 2019, City Council considered amendments to the Investment Policy and passed a motion to refer items to the Chief Financial Officer and Treasurer related to additional improvements to the Investment Policy's ESG practices. Staff were asked to report back on the referred items to City Council at its meeting held on January 29 and 30, 2020.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.EX8.3>

City Council received for information the Investment Report for 2017 and the First Quarter of 2018 and adopted the updated Investment Policy at their meetings on June

26 to 29, 2018. A motion for staff to review the ESG sections with the focus on climate change after consultations with several stakeholders
<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.EX35.16>

City Council adopted the New City of Toronto Investment Policy at their meetings on December 5 to 8, 2017
<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2017.EX29.6>

COMMENTS

Working capital and the amounts designated for reserves and reserve funds are held for investment in the City's General Group of Funds ("General Fund"). The amounts necessary for working capital and amounts designated for reserves and reserves funds are held within the Short Term Fund and the Long Term Fund. Given the specific purpose of the Sinking Fund (debt retirement), it is managed separately from the General Fund but adheres to the same primary investment beliefs and objectives. Attachment 1 provides a short background on the City's investment funds.

In November 2015, the province changed the City of Toronto Act, 2006 which replaced the prescribed list of investments with what is known as the prudent investor standard. This change removed the previous limitations and allows the City to be responsible for its own investment decisions as a prudent investor. The change required the City to establish an independent local board that would have fiduciary duty over the City's funds not immediately required. This local board can hire agents (external investment managers) which would carry out the fiduciary duty of the board.

Although this new provincial regulation was announced in late 2015, the effective date for this new regulation was January 1, 2018. During this transition period the City created the Toronto Investment Board ("Board") and appointed six independent members. In addition, City Council had approved a new Investment Policy that allowed for allocations to fixed income as well as new asset classes which included global equities and real assets.

As at December 31, 2017, the City's investments were all managed internally by City staff and were limited to a prescribed list of eligible investments set by the province in the legislation. This prescribed list limited the City investments to primarily government bonds and some high quality bonds of financial institutions.

During 2018, the Board chose eight external investment managers to manage the fixed income (70%) and global equity (20%) allocations as outlined in their Investment Plan. The new investment policy and plan, in conjunction with the investment consultant and investment managers, are expected to result in improved investment returns over the longer-term while also reducing overall portfolio risk.

There is a transition period before reaching the long-term target asset mix and realizing optimal long-term returns. During this time the investment portfolio will phase in greater use of the broader range of investments that become available. Although the portfolio

risk will be reduced, the potential for volatility in short-term returns will still exist. The new target asset mix will have a modest positive budget impact in the short term.

In June 2018, Council approved the creation of the Investment Income Stabilization Reserve. This reserve was established for the purpose of stabilizing investment income contributions to the operating budget by minimizing in-year variances through receiving funds in years when investment income is in excess of the amount expected in the operating budget and withdrawing funds in years when investment income is below budget.

During 2019, the Long Term Fund and Sinking Fund have been transitioned to four external fixed income investment managers (70%) and two global equity pooled fund managers (7%). During the first quarter of 2020, a third global equity fund manager was added resulting in a total equity exposure of approximately 10% at the fund level.

The four fixed income investment managers are Connor, Clark & Lunn Investment Management ("CC&L") and Leith Wheeler Investment Counsel Ltd ("LW") who provide asset management for the Long Term Fund, while Fiera Capital ("Fiera LDI") and Addenda Capital ("Addenda") focus on the Sinking Fund.

The three global equity pooled fund managers are Oakmark Global Pooled Fund II ("Oakmark"), Pier 21 WorldWide Equity Pool ("Pier 21"), and Fiera Capital Common Contractual Fund ("Fiera CCCF").

The contract negotiation for the fourth and last global equity pooled fund manager is near completion. The selection process for real asset managers is expected to potentially start in 2021.

Earned Investment Income of General and Sinking Fund – the Six Month Period Ending June 30, 2020

Earned Investment Income for the First Six Month of 2020

During the first six months of 2020, staff continued to manage the Short Term Fund to meet City's liquidity needs while maximizing investment return. To date, the Toronto Investment Board ("Board") had selected and entered into agreements with four fixed income investment managers and three global equity pooled fund managers to invest the Long Term and Sinking Funds.

As demonstrated in Table 1 below, the General Fund, composed of both the Short Term fund and the Long Term Fund, and the Sinking Fund had average fund balances of \$5.2 billion and \$1.5 billion respectively during the first six months of 2020. The General Fund earned \$92.4 million (3.6% annualized rate of return on capital) during the first six months of 2020. The Sinking Fund earned \$17.2 million (2.3% annualized rate of return on capital) during the first six months of 2020.

Table 1 - Investment Portfolio for the First Six months of 2020 (\$ millions)

Portfolio	Average Weighted Capital Balance (Book Value)	Earned Income	Earned Return on Capital (Annualized)
Total General Fund	\$5,194.3	92.4	3.6%
Short Term Fund	\$1,644.5	\$18.0	2.2%
Long Term Fund	\$3,549.8	\$74.4	4.2%
Sinking Fund	\$1,530.0	\$17.2	2.3%

Table 2a and 2b below show that the total investment income earned to date generally aligns with the forecasted income contribution to the operating budget, and as well as the historical table for reference. The Bank of Canada decreased short term rates three times from 1.75% to 0.25% in March 2020 due to the COVID situation. The deferred property tax collection amid the pandemic also significantly lowered the City's cash balance. The coupling of lower short term interest rates and cash balance, the earned investment income from the Short Term Fund fell sharply as a result.

Table 2a - Actual and Budget Gross Investment Earnings for the Operating Budget

Investment earnings (\$ millions & Annualized Rate of Return)	Actual YTD as at June 30, 2020	Estimated ¹ Gross income requirement for the year	% of full year Budget
Total General Fund	\$92.4 (3.6%)	\$191.0	48.4%
Short Term Fund	\$18.0 (2.2%)	\$48.0	37.5%
Long Term Fund	\$74.4 (4.2%)	\$143.0	52.0%

¹The estimate is based on the forecasted income allocation to the reserve fund in the year end depending on the reserve fund balances.

Table 2b - Historical Allocation of Gross Investment Earnings for 2015 to 2019

Investment Earnings (\$ millions)	2019	2018	2017	2016	2015
1. Operating Budget	\$185.5	\$109.4	\$114.3	\$114.1	\$121.3
2. Reserve Funds	\$81.8	\$47.1	\$16.6	\$16.3	\$16.5
Total General Fund	\$267.3¹	\$156.5	\$130.9	\$130.4	\$137.8
Return on Capital	4.3%	2.7%	2.6%	2.6%	2.7%

¹ The investment return was abnormally high due to one-time non-recurring capital gains realized during the transition period when fund was transferred to the external investment managers.

General Market Update and Portfolio Market Return –the Six Month Period Ending June 30, 2020

The positive economic scenario of 2019 came to a complete halt in the first quarter of 2020 with the arrival of a global pandemic in the form of the COVID 19 virus. This unprecedented situation resulted in a state of emergency in most countries with a shut-down of most global economic activity.

Given this economic scenario, central bankers in both Canada and the United States started to move short-term interest rates aggressively lower in March 2020. Both the Bank of Canada and the Federal Open Market Committee (FOMC) in the U.S. dropped short-term interest rates by 150 basis points within a month in order to stimulate the economy. The pandemic accelerated into the second quarter, leading to widespread non-essential business closures and unemployment surged. The International Monetary Fund (IMF) downgraded its estimate for global economic growth to -5% in 2020 and commenting that all regions are likely to contract in 2020.

During the latter half of the second quarter, as economies reopened, market tone improved. With the enormous response from policymakers, financial conditions eased and markets stabilized. Investors also looked past the current downturn and focused on optimism around re-opening economies and easing lockdown restrictions. Global equity markets rebounded sharply recovering the bulk of losses sustained during the previous quarter. However, the economic environment remained fragile.

The lowering of short-term interest rates has an impact on longer-term interest rates (yields) in the bond market. It results in positive total returns in the bond market in the short term. Conversely, higher long-term interest rates are associated with negative total returns in the bond market. Holding corporate bonds proved difficult during March 2020 as the economic scenario favored government bonds. While bond yields remained near all-time lows, Canadian corporate and provincial bonds return improved in the second quarter following a sharp deterioration during the first quarter.

Table 3 below shows the total benchmark rate of returns in market value as of June 30, 2020.

Table 3 - Major Capital Market Returns¹ - As of 30 June 2020

Benchmark	Q2 - 3 months ending June 30	For the first six months in 2020	1 year
FTSE Canada Universe Bond Index	5.9%	7.5%	7.9%
S&P/TSX Composite Index	17%	-7.5%	-2.2%
S&P 500 Index (\$CAD)	15.7%	1.6%	11.8%
MSCI ACWI (Net)	14.1%	-1.5%	6.4%

¹Aon, Performance Review and Investment for the period ending June 30, 2020

Market Performance of General Fund and Sinking Fund – First Six Months of 2020

Performance over short time periods tend to exhibit higher volatility of returns.

A remarkable rebound in global equity markets followed the first quarter selloff. Volatility in global fixed income markets dissipated compared to the first quarter as well. As shown in Table 4 below, the City's General Fund (Short Term Fund and Long Term Fund) has outperformed the weighted market benchmark by 0.4% during the first six months of 2020. And looking in the longer investment horizon, the General Fund has outperformed the market benchmark by 1.2% on a 4-year annualized return basis.

Table 4 – First Six Months in 2020 - Market Returns vs. Market Benchmarks (%) for the General Fund¹

	For the first six months in 2020			4 year (annualized)		
	Short Term Funds ³	Long Term Fund	General Fund	Short Term Funds ³	Long Term Fund	General Fund
Portfolio Return (%)	1.0%	5.9%	3.6%	1.6%	5.5%	3.6% ²
Benchmark Return (%)	0.5%	5.4%	3.2%	1.1%	3.6%	2.4%
Value Added (%)	0.5%	0.5%	0.4%	0.5%	1.9%	1.2%

¹Calculated from RBCIS Performance Analytics and Aon, Performance Review

²Year 2020 return is annualized based on first six months

³Including cash portion of the Long Term Fund

As shown in Table 5 below, the first six months market return for the Sinking Fund was 7.2%, and it has underperformed the weighted market benchmark by -1% during the first six months of 2020. The investment consultant to the Toronto Investment Board has developed a customized benchmark index that more appropriately reflects the updated fixed income strategy (LDI - Liability Driven Investment) based on cash flows to fund future liabilities. The customized benchmark index does not have enough history for the 4-year measurement. RBCIS Performance Analytics will be used for reporting while track record continues to build.

Table 5 - As of June 30, 2020 - Market Returns vs. Market Benchmarks (%) for the Sinking Fund¹

<i>Sinking Fund</i>	For the first six months in 2020	4 year (annualized)
Portfolio Return	7.2%	3.8%
Benchmark Return	8.2%	3.4%
Value Added	-1.0%	0.4%

¹Calculated from RBCIS Performance Analytics and Aon, Performance Review

Record of Transactions in City of Toronto Debentures

To comply 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. Please see Attachment 2.

Compliance with the Investment Policy Guidelines

All the City's funds were within the Asset Mix requirements set out in the Council-approved Investment Policy in the first six months of 2020. The breakdown of each portfolio is shown in Attachment 3.

There were no exceptions to report for the first six months of 2020.

CONTACT

Randy LeClair, Director, Capital Markets Division
Tel: 416-397-4054; E-mail: Randy.LeClair@toronto.ca

Betsy Yeung, Manager, Investments, Capital Markets Division
Tel: 416-392-6302; E-mail: Betsy.Yeung@toronto.ca

SIGNATURE

Heather Taylor
Chief Financial Officer and Treasurer

ATTACHMENTS

Attachment 1 - Background on the Funds

Attachment 2 - Record of Transactions in City of Toronto Debentures

Attachment 3 - Breakdown of the Portfolios by Sectors and by Credit Ratings