TORONTO

REPORT FOR ACTION

City of Toronto Investment Report for the six month period ending June 30, 2021

Date: November 16, 2021
To: Executive Committee
From: Chief Finance Officer and Treasurer
Wards: All

SUMMARY

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

1. Performance of the Funds for the six month period ending June 30, 2021
2. General Market Update and Benchmark Performance
3. City of Toronto Investment Policy and Procedures

Short-term volatility due to the pandemic and the economic outlook did create a reversal of some above average results experienced in 2020, especially those with exposures to interest rates. However, investors with a longer term view and investment horizon, like the City of Toronto, have solid returns over the combined 2-year period ending June 30, 2021. This 2-year period also marks the anniversary of a majority of the external investment managers that were funded under the purview of the Toronto Investment Board. Performance of these managers are viewed on a rolling 4-year annualized basis in accordance with the Council adopted Investment Policy.

The City's General Group of Funds ("General Fund") holds the City's working capital and amounts designated for the City's reserves and reserve funds. The Long Term Fund portion of this portfolio managed by external managers returned 5.4% on an annualized basis for the two year period ending on June 30, 2021. Overall, including the Short Term Fund, the fund had a total return of 0.4 percent for the six month period ending June 30, 2021, and a 2.7 percent total return on a 4-year annualized return basis. These results outperformed the weighted market benchmark by 0.4 percent and 0.3 percent respectively. When the unrealized gains and losses are excluded from the total return, the book return for the General Fund was 1.2 percent (earned $46.4 million) for the six month period ending June 30, 2021.

The City's Sinking Fund portfolio, which holds the investment funds for future debt repayments, saw external investment managers have a 4.1% annualized total return for the two year period ending June 30, 2021. On a shorter term basis, the fund had a total return of -2.4 percent for the six month period ending June 30, 2021,

underperforming the weighted market benchmark by 0.2 percent. When excluding the unrealized market gains and losses, the City's Sinking Fund portfolio earned 1.2% (earned $15.0 million) for the six month period ending June 30, 2021 on an earned income basis. The customized benchmark index used for this portfolio as required by the Investment Policy does not yet have enough history for the 4-year measurement.

Since January 1, 2018, the City's long-term investments have been managed by the Toronto Investment Board ("Board") under a new Council adopted Investment Policy which is based on the prudent investor standard. The investment portfolios have been progressively phased in to use of the broader range of investments that have become available. Although the overall portfolio risk has been reduced through asset mix diversification, the potential for volatility in total returns over the short term investment horizon still exist while the risk-adjusted total returns over the long term investment horizon are expected to be higher.

The Toronto Investment Board completed an asset mix review during the first six months of 2021 given the impact of the pandemic. The Board decided that neither the asset mix nor changes to the Investment Policy would be required at this time. It is a legislative requirement that the Investment Policy be provided to City Council, at least annually, for their review. A copy of the current Investment Policy is included as Attachment 1 to this report which was last adopted by Council in June 2020.

In total, there are now four fixed income managers and four global equity managers engaged in managing the long-term investments under the Toronto Investment Board. Both fixed income and equity investment classes are fully funded in accordance with the target asset mix in the Investment Policy with 70 percent allocated to fixed income and 20 percent to global equities. As at June 30, 2021, approximately 90 percent of both the Sinking Fund and the Long Term Fund were managed by external fund managers with the remaining 10 percent to be allocated to real assets. The Board continues to evaluate opportunities in the real asset category.

The City's auditor, KPMG LLP, found no exceptions with the compliance to the City's Investment Policy for 2020. For the first six months of 2021, all funds managed are compliant with the Investment Policy.

The Toronto Investment Board is in the process of hiring a third-party data provider in order to monitor and report on whether or not external investment firms hired are compliant with the terms of the Investment Policy governing Environmental, Social, and Governance Factors. While this process has taken longer than expected due to the pandemic and other unforeseen issues, contract negotiations are currently underway with a vendor for these services. It is expected this information and data regarding climate change risk from these reviews be available for the next investment report in mid-2022 and will continue to be reported to City Council on a semi-annual basis.

RECOMMENDATIONS

The Chief Finance 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 $46.4 million for the six month period ending June 30, 2021.

The investment activities in the six month period ending June 30, 2021 were compliant with the investment policies and goals adopted by City Council. The realized earned income (excluding unrealized gains and losses) for the six month period ending June 30, 2021 was below the 6-month prorated budgeted contribution to the Operating Budget by $27.9 million. However, there is over $200 million of unrealized gain available as of June 30, 2021, which if required, can be realized to meet budget.

The City's Sinking Funds portfolio earned $15.0 million for the six month period ending June 30, 2021. 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 17, 2021, City Council received the report from the Chief Financial Officer and Treasurer for information. This report provided the performance and compliance for the year 2020.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2021.EX25.6

At its meetings held on December 16, 17, and 18, 2020, City Council received the report from the Chief Financial Officer and Treasurer for information. This report provided the performance and compliance to the six month period ending June 30, 2020.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.EX19.8

At its meetings held on July 28 and 29, 2020, City Council received the report 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 June 29 and 30, 2020, City Council adopted the Investment Policy Update report with amendments.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.EX14.2

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

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 General Fund is comprised of two sub-funds known as 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 2 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, invested assets in both the Long Term Fund and the Sinking Fund are managed by four external fixed income investment managers (70%) and two global equity pooled fund managers (7%).

The third global equity pooled fund manager was added in February 2020 for both the Long Term Fund and the Sinking Fund. The fourth and final global equity pooled fund manager was added in December 2020 and January 2021 for the Long Term Fund and the Sinking Fund respectively.

Both fixed income and equity asset classes are fully funded in accordance to the target asset mix in the Investment Policy. As at December 31, 2020, approximately 90 percent of both the Long Term Fund and the Sinking Fund were managed by external investment managers selected by the Toronto Investment Board.

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

The four global equity pooled fund managers are Oakmark Global Pooled Fund II ("Oakmark"), Pier 21 WorldWide Equity Pool ("Pier 21"), Fiera Capital Common Contractual Fund ("Fiera CCF"), and Legal & General Investment Management ("LGIM") for both the Long Term Fund and the Sinking Fund.

The remaining cash holdings are for future investment in real assets and upcoming debt repayment. Toronto Investment Board continues to evaluate investment opportunities in real assets.

General Fund Total Return Performance in the six month period ending June 30, 2021

As shown in Table 1 below, the General Fund (Short Term Fund and Long Term Fund) has outperformed the weighted market benchmark by 40 basis points (0.4 percent) during the six month period ending June 30, 2021. Also, from a longer investment horizon perspective, the General Fund has outperformed the market benchmark by 30 basis points (0.3 percent) on a 4-year annualized return basis.

Table 1 – 2021 - Total Returns vs. Market Benchmarks (%) for the General Fund[1]

	YTD (annualized) June 30, 2021			1 year (Year-over-Year)			4 year (annualized)		
	Short Term Funds[2]	Long Term Fund	General Fund	Short Term Funds[2]	Long Term Fund	General Fund	Short Term Funds[2]	Long Term Fund	General Fund
Portfolio Return (%)	0.8%	-0.1%	0.4%	0.8%	4.0%	2.2%	1.6%	4.5%	2.7%
Benchmark Return (%)	0.0%	-0.1%	0.0%	0.1%	4.1%	1.9%	1.1%	4.5%	2.4%
Value Added (%)	0.8%	0.0%	0.4%	0.7%	-0.1%	0.3%[3]	0.5%	0.0%	0.3%[3]

[1]Calculated from RBCIS Performance Analytics and Aon, Performance Review

[2]Including cash portion of the Long Term Fund

[3] For the year of 2020, the General Fund has outperformed the weighted market benchmark by 0.60%.It has outperformed the market benchmark by 0.30% on a 4-year annualized return basis.

Staff continued to manage the Short Term Fund to meet City's liquidity needs while maximizing investment return. To date, the Toronto Investment Board had selected and entered into agreements with two fixed income investment managers and four global equity pooled fund managers to invest the Long Term Fund.

As demonstrated in Table 2 below, the General Fund, which is composed of both the Short Term Fund and the Long Term Fund, had an average total fund balance of $7.9 billion during the year. When unrealized gains and losses are excluded from the total return, the General Fund earned $46.4 million (1.2% annualized rate of return on capital) over the six month period on a book return basis.

Table 2 - Investment Portfolio for the six month period ending June 30, 2021 ($millions)

Portfolio	Average Weighted Capital Balance (Book Value)	Earned Income	Earned Return on Capital (Annualized)
Total General Fund	**$7,877.9**	**$46.4**	**1.2%**
Short Term Fund	$4,197.9	$15.8	0.8%
Long Term Fund	$3,680.0	$30.6	1.7%

As shown in Table 3a and 3b below, the total book income (excluding unrealized gains and losses) in the six month period ending June 30, 2021 was $27.9 million lower than the prorated budgeted income contribution to the operating budget. However, there is over $200 million of unrealized gain available as of June 30, 2021, which if required, can be realized to meet budget. It should be noted that performance measured by book value is for the accounting and budget purposes only while the total return (market value) truly reflects the current value of the portfolio. The City is in the process of transitioning its valuation accounting methodology from book value to market value.

Table 3a - Actual and Budget Gross Investment Earnings (Operating Budget) for the six month period ending June 30, 2021

Investment earnings (Book Return - $ millions & Annualized Rate of Return)	Actual	Budget	Over/Under Budget
Total General Fund	**$46.4 (1.2%)**	**$74.3**	**- $27.9**
Short Term Fund	$15.8 (0.8%)	$8.5	$7.3
Long Term Fund[1]	$30.6 (1.7%)	$65.8	-$35.2

[1]Includes income allocation to Reserve Fund, which was $5.8M higher than budgeted for the year 2021 due to higher than forecasted Reserve Fund balances.

Table 3b - Historical Allocation of Gross Investment Earnings for 2015 to 2021

Book Return - Investment Earnings ($ millions)	2021 (budgeted)	2020	2019	2018	2017	2016	2015
1. Operating Budget	$132.2	$95.2	$187.0	$109.4	$114.3	$114.1	$121.3
2. Reserve Funds	$15.0[3]	$85.3	$80.3	$47.1	$16.6	$16.3	$16.5
Total General Fund	**$147.2**	**$180.5**	**$267.3[1]**	**$156.5**	**$130.9**	**$130.4**	**$137.8**
Book Return on Capital	**1.6%[2]**	**3.0%**	**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.
[2]Budgeted return, prorated by estimated balance between Long Term and Short Term funds.
[3] The decline from 2020 is due to the significant drop in the 3-month T-Bill rate as a result of the pandemic.

The sharp drop in interest rates in 2020 resulted in some unusually large market returns (including unrealized gains) for fixed income. However, this trend was reversed in the first quarter of 2021 which had an adverse effect on the portfolio. While the recent increase in yields did not totally erase the gains seen in 2020, the reversal was significant during the first three months of 2021. The low interest rate environment also resulted in lower interest income for the City's funds as fixed income investments (new and reinvestment) are purchased at lower yields. On a positive note, the low interest rate levels allowed the City to take advantage with new debt issuance rates which have been at historical lows. Compared to 2019, the 2020 borrowing cost savings were approximately $6.1 million per year, or more than $100 million over the next 20 years (nominal basis over a 19 year weighted average term).

Since January 1, 2018, the City's long-term investments in the General Fund have been managed by the Toronto Investment Board under a Council adopted Investment Policy which is based on the prudent investor standard. The investment portfolios have progressively phased into greater use of the broader range of investments that become available. Although the overall portfolio risk has been reduced through asset mix diversification, the potential for volatility in total return over the short term investment horizon still exist while the risk-adjusted total return over the long term investment horizon are expected to be higher.

In addition, the City's Short Term Fund that mainly holds City's working capital is currently at a higher level to ensure sufficient liquidity especially during the pandemic. We expect the short term balance to return to pre-COVID levels once the pandemic is over and post-pandemic impact is assessed.

Sinking Fund Total Return Performance in the six month period ending June 30, 2021

The City's Sinking Fund portfolio, which holds the investment funds for future debt repayments, saw external investment managers have a 4.1% annualized total return for the two year period ending June 30, 2021 as shown in Table 4. On a shorter term basis, the fund had a total return of -2.4 percent for the six month period ending June 30, 2021, underperforming the weighted market benchmark by 0.2 percent (also shown in Table 4).

To date, the Toronto Investment Board ("Board") had selected and entered into agreements with two fixed income investment managers and four global equity pooled fund managers to invest the Sinking Fund. The investment managers use a customized benchmark index that more appropriately reflects the updated fixed income strategy (LDI - Liability Driven Investment) based on the required cash flows to fund future liabilities. The customized benchmark index does not have enough history for the 4-year measurement.

Table 4 - As of June 30, 2021 - Total Returns vs. Market Benchmarks (%) for the Sinking Fund[1]

Sinking Fund	**YTD (annualized) June 30, 2021**	**1 year (Year-over-Year)**	**2-year (annual)**
Portfolio Return	-2.4%	0.2%	4.1%
Benchmark Return	-2.2%	1.1%	5.4%
Value Added	-0.2%	-0.9%[2]	-1.3%[2]

[1] Aon Performance Review

[2] For 2020, the total return was 10.2%, underperforming the benchmark by 1.6%.

When excluding the unrealized market gains and losses, the City's Sinking Fund portfolio earned 1.2% ($15.0 million) for the six month period ending June 30, 2021 on a book income basis as shown in Table 5 below. Similar to the General Fund, the Sinking Fund also has an unrealized gain of approximately $90 million as at June 30, 2021. These funds will be used to pay the City's long-term debt obligations at maturity and the shorter term performance volatility should not affect the longer term purpose of these funds.

Table 5 - Sinking Fund Book Return as of June 30, 2021

Portfolio	Average Weighted Capital Balance (Book Value)	Book Income	Book Return on Capital (Annualized)
Sinking Fund	$2,545.8	$15.0	1.2%

Since January 1, 2018, the City's long-term investments in the Sinking Fund have been managed by the Toronto Investment Board under a new Council adopted Investment Policy which is based on the prudent investor standard. The investment portfolios have progressively phased into greater use of the broader range of investments that become available. Although the overall portfolio risk has been reduced through asset mix diversification, the potential for volatility in total return over the short term investment horizon still exist while the risk-adjusted total return over the long term investment horizon are expected to be higher and sufficient to meet the debt repayments.

Table 6 below shows the duration of the invested assets closely matches the duration of the liabilities. Bond duration is measurement of interest rate risk. It is a way of measuring how much bond prices are likely to change if and when interest rates move. By matching the duration of the assets and liabilities, investment managers can substantially reduce and eliminate the risk in the portfolio. In effect, the external managers are working to "immunize" the portfolio to ensure the fund with have cash available when the obligation comes due.

Table 6 - As of June 30, 2021 - Duration for the Sinking Fund[1]

(Years)	Duration
Portfolio Duration	12.8
Liability Duration	12.7

[1]From Aon Performance Review

General Market Update and Portfolio Market Return in the six month period ending June 30, 2021

The global economic recovery continued during the first half of 2021 as the COVID vaccination rollout continued to improve and become more widespread. Canada's vaccination rate has become one of the best in the world and the economy has found support from further fiscal stimulus along with a strengthening U.S. economy and robust commodity markets.

Global equity markets reached all-time highs during the second quarter of 2021 while emerging markets equities underperformed their developed markets peers. Solid corporate earnings reaffirmed the robust economic backdrop and bolstered investor sentiment. In Canada, the S&P/TSX Composite Index gained 8.5% and broke through the 20,000 level for the first time ever. Similarly, several U.S. equity index benchmarks reached new all-time highs.

Sustained economic optimism and improving fundamentals drove up interest rates over the first quarter. While investor sentiment remained generally upbeat and optimistic and the global economic recovery continued, a new strain of the virus called the Delta Variant has created uncertainty in equity and bond markets across the globe. Canadian economic activity (as measured by GDP) posted an unexpected decline of 1.1% (annualized rate) mainly due to supply chain disruptions and slowing housing markets. Spending and price increases continued to build in the first quarter along with concerns over inflation. Although there is still significant slack in the Canadian economy, and it will take some time to reach full potential, some economists and market analysts are asking at what point will we see central banks move to raise rates and dampen inflationary expectations.

Interest rates have declined later in the second quarter as a result of receding inflation fears and investor's concerns over how the Delta Variant will impact the global recovery. Underwhelming economic data releases, as well as the U.S. Federal Reserve's pivot toward a less accommodative tone, drove longer-term yields lower. Both the U.S. Federal Reserve and the Bank of Canada kept their interest rate policy unchanged during the first six months of 2021. Investors believed central banks would likely be more responsive and successful in containing inflationary pressure going forward.

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. A listing of these transactions are found in Attachment 3.

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 for the six month period ending June 30, 2021. The breakdown of each portfolio is shown in Attachment 4.

There were no exceptions to report for the six month period ending June 30, 2021.

The City's auditors, KPMG LLP, completed the annual investment policy compliance audit procedures and found no compliance exceptions for 2020.

Reporting on Environmental, Social, and Governance (ESG) Performance

When reviewing the last update to the Investment Policy in June 2020, City Council had requested the Chief Financial Officer and Treasurer, and the Toronto Investment Board to consider and incorporate internationally-recognized best practices for Environmental, Social and Governance.

The Toronto Investment Board is currently in the process of hiring a third-party data provider in order to monitor and report on external investment firms hired are compliant with the terms of the Investment Policy governing Environmental, Social, and Governance Factors. While this process has taken longer than expected due to the pandemic and other unforeseen issues, contract negotiations are currently underway with a vendor for these services. It is expected this information and data regarding climate change risk from these reviews will be available for the next investment report and will continue to be reported to City Council on a semi-annual basis.

CONTACT

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

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

SIGNATURE

Heather Taylor
Chief Financial Officer and Treasurer

ATTACHMENTS

Attachment 1 - City of Toronto Statement of Investment Policy and Procedures
Attachment 2 - Background on the Funds
Attachment 3 - Record of Transactions in City of Toronto Debentures
Attachment 4 - Breakdown of the Portfolios by Sectors and by Credit Ratings