



## STAFF REPORT ACTION REQUIRED

### City of Toronto 2012 Investment Report

<b>Date:</b>	June 18, 2013
<b>To:</b>	Executive Committee
<b>From:</b>	Deputy City Manager and Chief Financial Officer
<b>Wards:</b>	All
<b>Reference Number:</b>	P:\2013\Internal Services\Cf\Ec13014cf (AFS #17059)

#### **SUMMARY**

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This report provides a review of the annual returns realized in 2012 on the funds invested in the City's internally-managed investment portfolios. These portfolios hold the City's working capital and the amounts designated for the City's reserves and reserve funds. The investment results for other funds, such as sinking funds, pension funds and trust funds are reported on separately.

In compliance with Ontario Regulation 610/06 Financial Activities of the *City of Toronto Act, 2006*, a record of each transaction in the City's own securities is listed in this report.

#### **RECOMMENDATIONS**

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**The Deputy City Manager and Chief Financial Officer recommends that:**

1. Council receive this report for information.

#### **Financial Impact**

In 2012, investment earnings on the City's managed funds totalled \$154.2 million. A 3.80% average annual rate of return on capital was achieved, which was allocated to the operating budget (\$136.5 million) and reserve funds (\$17.7 million) according to the Council-approved interest allocation policy.

The operating budget component exceeded the budgeted revenues in the Non-Program account by \$22.1 million. The increase was primarily due to an unexpected 20% increase in the size of the investment portfolio as a result of a higher-than-anticipated budget

surplus, proceeds from the sale of Enwave Energy Corporation, and the realization of capital gains.

The Deputy City Manager & Chief Financial Officer has reviewed the investment activities conducted by staff in 2012 and confirmed that these were consistent with the investment policies and goals adopted by City Council.

## **DECISION HISTORY**

This investment report is required to be presented to Council annually under Ontario Regulation 610/06 Financial Activities of the *City of Toronto Act, 2006*. In October 2012, Council adopted a revised City of Toronto Investment Policy.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2012.EX23.13>

## **ISSUES BACKGROUND**

### **Sources of Investment Funds**

The principal categories of City funds that are internally managed by Corporate Finance Capital Markets staff are working capital, reserves and reserve funds.

#### Working Capital

The City retains substantial funds on hand to provide bridge financing between the time when expenditures, such as staff payroll and construction contractor payments, are required and the time when major cash inflows, such as tax and water payments and debenture issuance proceeds, are received. These funds are typically available for investment over short periods (typically less than a year) and are invested in the Money Market Portfolio which carried an average balance of \$1.7 billion during the year.

#### Reserves and Reserve Funds

Reserves and reserve funds have been established by the City to address the following types of long-term expenditure needs:

- Growth-related infrastructure expansion (funded by Development Charges paid by developers)
- Other major City infrastructure initiatives (e.g. the Move Ontario 2020 Reserve Fund which holds funds contributed by other levels of government for the Spadina Subway extension)
- Land acquisition
- Replacement of City vehicles
- Funding of unanticipated City and ABC operating budget shortfalls
- Funding of employee benefits

The majority of the amounts designated for these reserves and reserve funds are not required on a continual basis and can be invested over a longer term (greater than one year) in order to improve returns.

## **Investment Portfolios Managed by Corporate Finance**

Working capital and the amounts designated for reserves and reserve funds are held for investment in the City's General Investment Fund, which is managed by Capital Markets staff in the Corporate Finance Division. The amounts necessary for working capital are held within the Money Market sub-component of this General Fund and amounts being invested on a longer-term basis (amounts designated for reserves and reserve funds) are held within the Bond sub-component of this General Fund.

## **Investment Objectives and Policies**

The primary objectives, in priority order, for all City investment activities are:

- to ensure the safety of principal,
- maintain adequate liquidity and
- Earn the maximum investment income that is consistent with the above two objectives

The specific criteria and restrictions on the investments that can be acquired for each of the City's investment funds are set out in the City of Toronto Investment Policy. An Updated Investment Policy was adopted by Council in October, 2012. On an annual basis, and more frequently if required, a comprehensive review of the City's investment Policy and procedures is completed. The current review is underway and is expected to be submitted to Council for its consideration in 2013 if any update is required.

## **Independent Investment Advisory Committee**

City Finance staff receive input on investment policies and strategies from the Independent Investment Advisory Committee. This Committee was created by City Council in April, 2011, replacing the former Investment Advisory and Sinking Fund Committees, and is composed of three volunteer citizen members and the Deputy City Manager and Chief Financial Officer (DCM/CFO) as Chair. The citizen appointees were approved by Council in October, 2011.

## **COMMENTS**

### **Factors That Affect Annual Investment Income**

#### Capital Market Conditions

One of the principal factors affecting the performance of the City's investment portfolios is the general level of interest rates that can be earned on fixed income investment instruments.

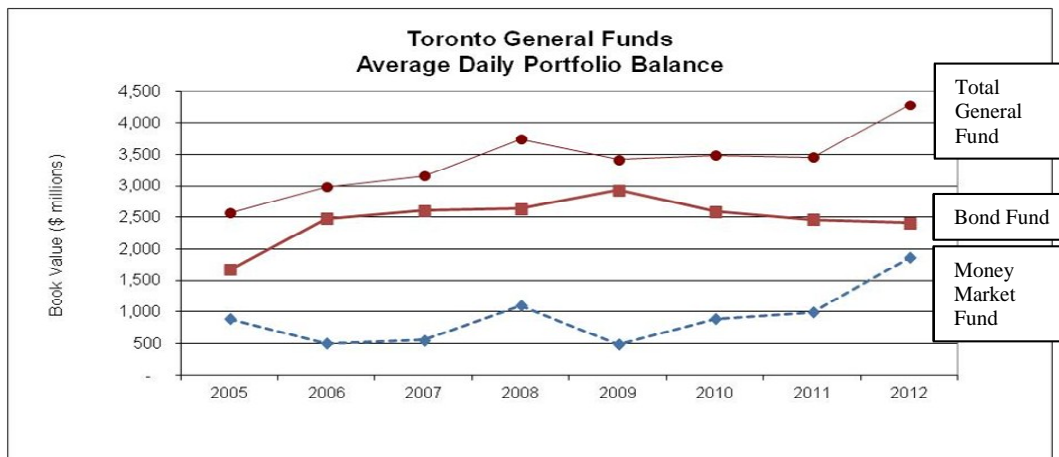
These interest rates have remained unusually low for an extended period following the 2008 financial crisis. Although 10-year Government of Canada bonds generated an average yield of 4.388% during the pre-crisis period in 2003-2007, these 10-year bonds only generated an average yield of 1.875% in 2012. Similarly, 1-year treasury bills generated an average yield of 4.388% during the 2003-07 pre-crisis period while the average yield in 2012 was only 1.061%. In 2012 the yield on 30-day treasury-bills reached a low of 0.896%.

### Amounts Available for Investment

Another factor that affects the total annual investment earnings is the total amount of City funds that are available for investment in that year. This amount will depend on the following:

- Major one-time events such as sales of large capital assets or inflows of senior government infrastructure funding
- Rate of development activity (e.g. development charge revenues)
- Operating surpluses
- Capital project surpluses
- Proceeds from debenture issuances

The foregoing factors have recently resulted in greater amounts of funds available for investment purposes. As shown in the following graph, the average daily balance on the Total General Fund rose by 21.4% in 2012.



### The Timing of the City's Future Expenditure Funding Needs (Current and Future Liquidity Requirements)

Borrowers will generally offer the highest interest rates for funds that are committed to them for the longest periods of time. Therefore, they will offer low interest rates on short-

term money market (<1-year term) investments and substantially higher rates of interest on long-term (20+ years) bonds. The City's ability to invest in long-term securities is limited by the future forecasted requirements (e.g. for capital expenditures).

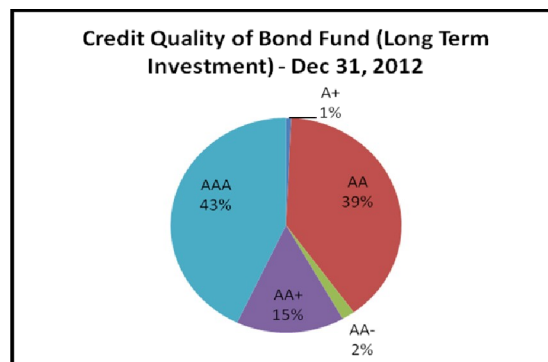
Recently, the average investment term of the investment portfolio has been reduced based on the expectation that more of these funds will be needed in the near future. This has had a negative impact on investment returns due to the lower level of short-term interest rates.

### Risk Profile of Investment Portfolio

The final factor that impacts investor returns is the amount of risk that an investor is willing to bear. This is because borrowers will offer higher returns on instruments that carry a higher risk of default.

However, safety of principal is a primary City investment objective so overall risk exposure on the City's investment portfolios has been kept very low. As shown below in Figure 1, the City does not hold any bonds with less than an “A” credit rating.

**Figure 1 - Credit Ratings of the Bond Portfolio Holdings**



The lowest risk and the lowest returns will be realized on Government of Canada bonds. However, the Bond Fund has recently invested more heavily in Provincial and Municipal bonds in order to maintain income targets in generally low-yield market conditions.

### **2012 Investment Portfolio Performance**

Capital Markets staff and the Investment Advisory Committee annually assess the performance of the managed portfolios on both a Revenue and Market Value basis.

#### Revenue Performance

The Revenue approach towards measuring performance is based on the annual earned interest income and capital gains/losses that are realized on each portfolio. This approach is used to determine the allocation of investment earnings to the operating budget.

The 2012 distribution of investment earnings is summarized in the following chart:

**Table 2 - Investment Portfolio Income For the year 2012 (\$ 000's)**

Portfolio	Average Capital Balance	Earned Income	Return on Capital
1. Bond Fund	\$2,293,921	\$133,399	5.82%
2. Money Market	\$1,767,808	\$20,815	1.18%
Total General Funds	\$4,061,730	\$154,213	3.80%

The \$154.2 million in investment revenue generated in 2012 was substantially higher than the \$143.6 million generated in 2011. However, the overall return on capital of 3.80% in 2012 was lower than the 4.18% return realized in 2011.

The lower return in 2012 was primarily the result of a lower allocation of funds to the Bond Fund due to the need to maintain additional liquidity to fund forecasted capital expenditures to occur during the year.

The total earnings of \$154.2 million were distributed to the City's operating budget (\$136.5 million) and to the City's reserve funds (\$17.7 million) as shown in the following table:

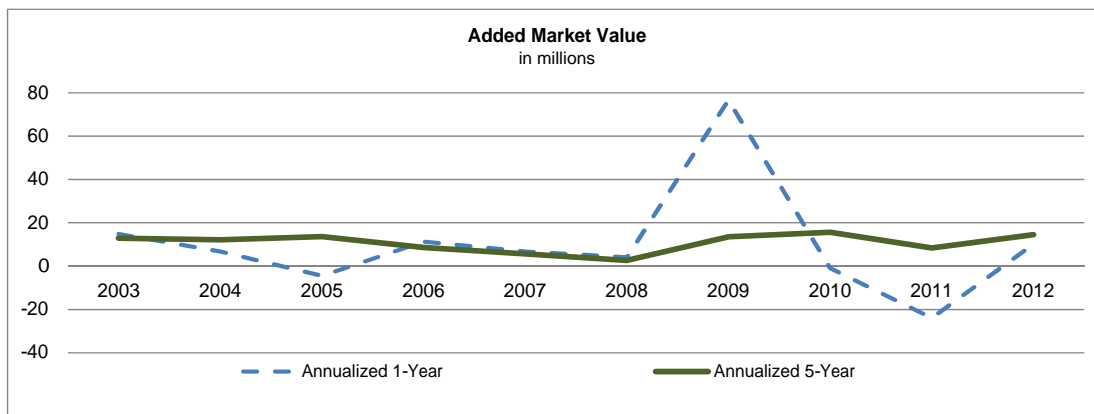
Millions	2012	2011
Operating Budget	\$136.5	\$121.7
Reserve Fund	\$17.7	\$21.9
General Funds investment and interest income	\$154.2	\$143.6

### Market Value Performance

Another approach towards measuring portfolio performance is to compare the total market value return to an established industry index. Since 2003, the City has used the RBC Investor Services' benchmark which tracks the performance of a portfolio which is similar in security holdings as compared to the City and provides the City with a means to assess the effectiveness of its investment decisions.

The market value return, which is often different from the earned investment income rate of return (Table 2), is based on the change in the market prices of the investments held in the portfolio (unrealized gains and losses included) on an annual basis.

The following graph shows the total added market value of the City's General Fund Money Market and Bond portfolios relative to their respective benchmark indices over investment horizons of 1-year and 5-years:



\*Benchmarks for the Bond fund and Money Market fund are DEX All Governments and DEX 30 Day T-Bill respectively.

Relative to the City's benchmark indices, the portfolio added an annual average incremental \$14.5 million in market value over the past five years.

The appreciation in the portfolio market value relative to the benchmark indices was attributable to several factors:

- strategic asset mix targets and investment term positioning (selection of portfolio term structure),
- active bond trading programs,
- maximizing investment terms through active cash management, and
- strategic selection of issuers and bonds.

### Outlook for 2013

As a result of continuing weakness in the global economy and limited price inflation, it appears likely that the Bank of Canada will continue its current policies that aim to stimulate growth by setting overnight interest rates low and signalling to market participants that these low overnight rates will be maintained.

However, many forecasts indicate that Canadian economic growth will gradually accelerate and interest rates will increase to more historically typical levels over the next few years.

While maintaining safety of principle and sufficient liquidity, the City's investment strategy for 2013 is to gradually extend portfolio term to align with updated reserve fund balance forecasts while enhancing return on invested capital if and when interest rates move higher. The City's investment strategy is expected to outperform in the long-term horizon in spite of short term fluctuations during economic cycles.

## **Record of Transactions in City of Toronto Debentures**

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 2012 transactions are documented in the attached Appendix A.

In 2012, the City of Toronto purchased a principal value of \$39,205,000 of its own securities in the secondary bond market for the Sinking Fund, the General Fund and the Long Term Care Homes and Services Trust Fund.

### **CONTACT**

Martin Willschick, Manager, Capital Markets; Phone number: 416-392-8072;  
Fax number: 416-397-4555; E-mail: [mwillsch@toronto.ca](mailto:mwillsch@toronto.ca)

Joe Farag, Director, Corporate Finance; Phone number: 416-392-8108;  
Fax number: 416-397-4555; E mail: [jfarag@toronto.ca](mailto:jfarag@toronto.ca)

### **SIGNATURE**

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Roberto Rossini  
Deputy City Manager and Chief Financial Officer

### **ATTACHMENT**

Appendix A – Purchases and Sales of City of Toronto Debentures during 2012



## Appendix A

### Purchases and Sales of City of Toronto Debentures during 2012 From Jan 01, 2011 To Dec 31, 2012

#### 1. Purchases

<u>Portfolio</u>	<u>Maturity</u>	<u>Coupon</u>	<u>Principal</u>	<u>Price \$</u>
Bond Fund	2/12/2019	4.500%	4,800,000.00	111.170
Bond Fund	2/12/2019	4.500%	2,300,000.00	111.725
Bond Fund	27/06/2018	4.950%	5,000,000.00	113.642
Bond Fund	2/12/2019	4.500%	5,000,000.00	111.900
4% Sinking Fund	10/6/2041	4.700%	4,000,000.00	110.988
4% Sinking Fund	25/09/2012	5.000%	888,000.00	102.360
4% Sinking Fund	10/6/2041	4.700%	2,112,000.00	111.731
4% Sinking Fund	10/6/2041	4.700%	4,442,000.00	110.955
4% Sinking Fund	18/07/2017	5.050%	2,000,000.00	113.678
4% Sinking Fund	27/06/2018	4.950%	4,936,000.00	113.936
5% Sinking Fund	25/09/2013	5.125%	1,490,000.00	105.900
6% Sinking Fund	8/6/2015	8.650%	889,000.00	122.189
Long-Term Care Homes & Services Trust Fund	28/10/2015	4.375%	1,348,000.00	107.429
			<u>39,205,000.00</u>	

#### 2. Sales

<u>Portfolio</u>	<u>Maturity</u>	<u>Coupon</u>	<u>Principal</u>	<u>Price \$</u>
No Sales for the Period				