EX35.16

REPORT FOR ACTION

City of Toronto Investment Report for 2017 and the First Quarter of 2018 and Policy Update

Date: June 5, 2018
To: Executive Committee
From: Interim Chief Financial Officer
Wards: All

SUMMARY

This report was written to comply with the Council-approved Investment Policy and provides the following information:

1. Performance of the Funds – for the year of 2017 and for the first quarter of 2018
2. General Market Update and Benchmark Performance
3. Recommendations for Investment Policy Changes

During 2017, the City's investment portfolio that holds the City's working capital and the amounts designated for the City's reserves and reserve funds earned $130.9 million in 2017 and $36.5 million in the first quarter of 2018 (2.6% and 3.2% annualized respectively).

The City's sinking funds portfolio that holds funds for future debt repayments earned $59.7 million in 2017 and $13.5 million in the first quarter of 2018 (3.8% and 3.2% annualized respectively).

Effective January 1, 2018, the City's investments are now managed under a new Council adopted Investment Policy which is based on the prudent investor standard. Minor changes to the Investment Policy are recommended in order to improve the efficiency and effectiveness of the Toronto Investment Board's (the Board) Investment Plan.

This report also responds to Council direction to report on the selected investment manager's Environmental, Social and Governance (ESG) polices, and other developments related to ESG factors. ESG policies are an important part of the investment manager selection process currently underway. The City will recommend only those prospective fund managers who are UN Principles of Responsible Investing signatories, or equivalent, and use these principles in their investment decision process.

RECOMMENDATIONS

The Interim Chief Financial Officer recommends that:

1. City Council approve the following amendments to the City Council-approved Investment Policy (Policy) and adopt the amended Policy as set out in Attachment 2:

    (a) the Asset Mix for Equities for Long Term Fund and Sinking Fund be adjusted by combining all four equity categories into one category called "Global Equity" with a Targeted Asset Mix of 20-percent with a range from a Minimum of 0-percent to a Maximum of 30-percent.

    (b) the MSCI All-Country World Index (MSCI ACWI) be included as a benchmark to measure the performance of the equity portfolio in its entirety for the Long Term Fund and Sinking Fund;

    (c) the benchmark for the Fixed Income component of the Sinking Fund be changed to "Customized" based on the "Liability Driven Investments" approach;

    (d) the average credit rating of the fixed income portfolio for the Long Term Fund and Sinking Fund be lowered from "A" to "A-" (or equivalent) to be equal to the fixed income benchmark (Financial Times Securities Exchange (FTSE) TMX Universe Canada Bond Index);

    (e) the Asset Mix for the Trust Fund be adjusted by increasing the Maximum weight of Schedule 1 Bank from 50% to 100% which aligns with the current limit in the Investment Policy for the City's Short Term Fund;

    (f) the minimum credit rating requirements of the Schedule 1 Banks for the Trust Funds be lowered from "AA-" to "A" (or equivalent) to be the same as the requirements for the City's Short Term Fund.

2. City Council approve the establishment of a corporate reserve account named the Investment Stabilization Reserve in Schedule 3 – Stabilization Reserves of the City of Toronto Municipal Code Chapter 227, Reserves and Reserve Funds ("Chapter 227"), the purpose of which is to stabilize 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, with criteria as set out in Attachment 5 of this report.

FINANCIAL IMPACT

The City's General Group of Funds ("General Fund") earned $130.9 million in 2017 and $36.5 million in the first quarter of 2018. The investment activities conducted by staff in 2017 and the first quarter of 2018 were in compliance with the investment policies and goals adopted by City Council.

The 2017 earnings from the General Fund were allocated to the operating budget ($113.4 million) and reserve funds ($16.6 million) according to the Council approved interest allocation policy. The earnings for the first quarter of 2018 are in line with the forecasted income contribution to the 2018 Operating Budget.

The City's Sinking Funds portfolio earned $59.7 million in 2017 and $13.5 million in the first quarter of 2018. These earnings are retained within the Sinking Funds.

The recommended Investment Policy changes are expected to modestly improve the administration of the invested funds, reducing cost and increasing risk adjusted returns.

DECISION HISTORY

City Council adopted a plan to establish the Investment Board at its meeting of March 28, 2017
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2017.EX23.2

City Council appointed members to the Toronto Investment Board on October 2, 2017
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2017.CC32.4

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

The Toronto Investment Board adopted the Interim Investment Plan at their meeting on November 24, 2017
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2017.IB2.2

The Toronto Investment Board updated their Investment Plan at their meeting on April 5, 2018
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.IB4.5

On the May 31, 2018 meeting, The Toronto Investment Board requested, via the Chief Financial Officer's Office, City Council approval to amend the Council-approved Investment Policy.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.IB5.4

COMMENTS

Up until the end of 2017, administration of City investments was managed by staff under investment regulations dating back to amalgamation. Beginning January 1, 2018, new prudent investor rules took effect and the City began to transition to the new framework under the management of the Toronto Investment Board.

Earned Investment Income - 2017

During 2017, 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 are held within the Short Term Fund and amounts being invested on a longer-term basis (amounts designated for reserves and reserve funds) are held within the Long Term Fund.

Given the specific purpose of the Sinking Fund, it is managed separately from the General Group of Funds but adheres to the same primary objectives.

For the year of 2017 – General Fund

Investment earnings are composed of the annual earned interest income and capital gains/losses that are realized on the portfolio. The total earnings of $130.9 million for the General Fund in 2017 were distributed to the City’s operating budget ($114.3 million) and to the City’s reserve funds ($16.6 million) as shown in the following table:

Table 1 - Allocation of Investment Earnings for the Year 2017

Investment Earnings ($millions)	2017	2016	2015	2014	2013
1. Operating Budget	$114.3	$114.1	$121.3	$120.1	$120.2
2. Reserve Funds	$16.6	$16.3	$16.5	$23.6	$22.1
Total General Funds	$130.9	$130.4	$137.8	$143.7	$142.3

The investment earnings of $130.9 million in 2017 exceeded budget by $15.7 million. This variance was mainly due to two factors as follows:

- The introduction of higher-yielding investment products to the Short Term Fund during 2017.
- Lower than forecasted income allocation to reserve and reserve funds due to lower than projected Bank of Canada T-Bill rates used for allocation purpose.

The table below shows the historical budget and actual investment earnings for the operating budget.

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

Investment Earnings allocated to the Operating Budget ($millions)	**2017**	**2016**	**2015**	**2014**	**2013**
1. Operating Budget Investment Earnings	$98.6	$114.5	$121.8	$121.7	$121.7
2. Actual Investment Earnings	$114.3	$114.1	$121.3	$120.1	$120.2
Variance	$15.7	$-0.4	-$0.5	-$1.6	-$1.5

The distribution and historical investment earnings are summarized in the tables below:

Table 3 - Investment Portfolio Income for the Year 2017 ($millions)

Portfolio	**Average Fund Balance**	**Earned Income**	**Earned Return on Capital**
1. Long Term Fund	$2,724.6	$92.8	3.4%
2. Short Term Fund	$2,394.5	$38.1	1.6%
Total General Funds	$5,119.10	$130.9	2.6%

As demonstrated in the table below, the overall earned return on capital of 2.6% in 2017 was similar to the 2.6% and 2.7% return realized in 2016 and 2015 respectively.

Table 4 - Earned Return on Capital for 2012 - 2016 ($millions)

	Earned Income	**Earned Return on Capital**
2013	142.3	3.1%
2014	143.7	2.9%
2015	137.8	2.7%
2016	130.4	2.6%
2017	130.9	2.6%

For the year of 2017 – Sinking Fund

During 2017, the sinking funds portfolio of $1.6 billion earned $59.7 million yielding 3.8%. Earnings vary for each of the five separate Sinking Funds in relation to their respective balances and the average term to repayment of the underlying debentures. Sinking Funds are segregated so that the scheduled contributions plus reinvested earnings are dedicated to the repayment of debentures.

Earned Investment Income for the First Quarter of 2018

During the first quarter of 2018, staff continued to invest for the Long Term Fund (LTF) and Sinking Fund (SF) following the Council-approved Investment Policy and the Board's approved Interim Investment Plan.

As demonstrated in the table below, the General Fund of $4.6 billion earned $36.5 million and a 3.2% rate of return on capital for the first quarter of 2018. The earnings are in-line with the forecasted income contribution to the 2018 Operating Budget ($36.5 million). The SF of $1.7 billion earned $13.5 million yielding 3.2%.

Table 6 - Earned Return on Capital for the First Quarter of 2018 ($millions)

Portfolio	Average Fund Balance	Earned Income	Earned Return on Capital (annualized)
Short Term Fund	1,814.1	8.5	1.9%
Long Term Fund	2,765.0	28.0	4.1%
Total General Fund	**4,579.1**	**36.5**	**3.2%**
Total Sinking Funds	**1,709.9**	**13.5**	**3.2%**

The results above also include one-time accounting adjustments due to changes in accounting methodology. These adjustments have positively affected the earned income ($5.2 million for the LTF and $0.1 million for the SF). Without the adjustment, the rate of return for the Long Term Fund and the total General Fund would be 3.5% and 3.1% respectively while the rate of return for the SF would remain at 3.2%.

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. The details pertaining to the 2017 transactions are documented in Attachment 1. In 2017, the City of Toronto purchased $19,500,000 and sold $10,300,000 of its own securities in the secondary bond market for the Bond Fund. The City did not make any purchase or sale of its own securities during the first quarter of 2018.

General Market Update and Portfolio Market Return

The positive performance of global economic activity of 2017 continued into the first quarter of 2018. Economic data in Canada and the United States were particularly strong with unemployment rates near cycle lows with Canada achieving levels not seen in four decades. Growth, as measured by GDP, remained positive while inflation stayed within the acceptable range of most central banks.

Given this economic scenario, central bankers in both Canada and the United States started to remove the very low and accommodative interest rates by moving short-term borrowing rates higher. The Federal Open Markets Committee (FOMC) in the U.S. increased short-term interest rates five times since December 2016 for a total of 125 basis points (a basis point is 1/100th of a percent). The most recent increase of 25 basis points occurred on March 21, 2018. Similarly, the Bank of Canada increased the overnight rate three times for a total of 75 basis points over the same time period with the most recent increase of 25 basis points on January 17, 2018.

Several central banks, including those in Canada and the United States, have indicated future increases to short-term interest rates are possible in 2018.

The increases to short-term interest rates have an impact on longer-term interest rates (yields) in the bond market. This results in negative returns in the bond market in the short term. Conversely, falling long-term interest rates are associated with positive total returns in the bond market.

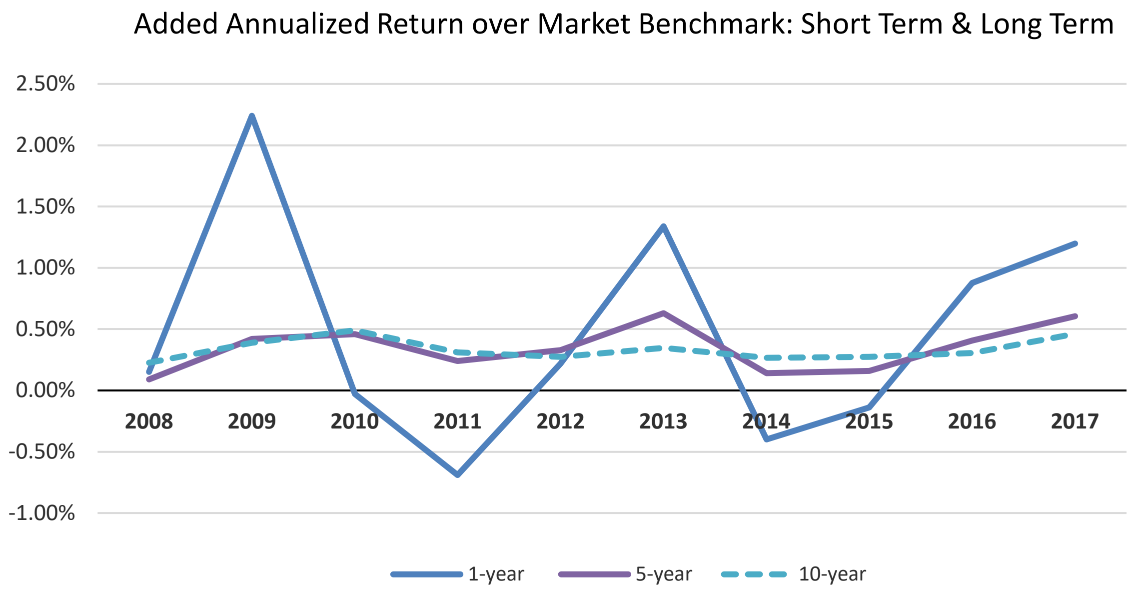
Global equity markets continued to increase in the first quarter of 2018, given the economic backdrop, although the Canadian equity market fell. Some analysts have become concerned with the valuations in addition to the higher costs associated with higher interest rates and the possible negative impact of trade agreements and tariffs (e.g. NAFTA).

2017 Portfolio Performance in Market Value

The City has used the FTSE (Financial Times Stock Exchange) TMX Canada bond indices as the market benchmark for the General Fund (the Sinking Funds Portfolio is not measured against a market benchmark). Figure 1 compares the City's General Fund performance relative to the benchmark over the one-year, five-year and ten-year investment horizons. As demonstrated below, one-year return shows the most volatility while the ten-year annualized return shows stable annual return over a ten-year investment period.

As at December 31, 2017, the City's investment program has out-performed the benchmark by 1.20% in one-year annualized return, 0.60% in the five-year annualized return and 0.46% in the ten-year annualized return.

Figure 1 - Added Annualized Return (Outperformance) over Market Benchmark: Short, Mid & Long Term



First Quarter of 2018 Portfolio Performance in Market Value

In anticipation of the transition to other asset classes, the LTF under the Board's management continues to build cash and short-term holdings as well as keeping bond holdings that were purchased under the previous eligible investment list. Market return for the LTF during the first quarter of 2018, as compared to the weighted benchmark of the FTSE TMX 30-day T-bill index and the FTSE TMX Canada Universe Bond Index, has underperformed by 8 basis points during the transition period.

Market return for the STF under staff's management during the first quarter of 2018, as compared to the benchmark of the FTSE TMX 30-day T-bill index, has outperformed by 21 basis points.

Compliance with the Investment Policy Guidelines

All the funds were within the Asset Mix requirements set out in the Council-approved Investment Policy. With regard to the Credit Rating Constraints, all the fund holdings are at a minimum of "A-" credit rating. The breakdown of each portfolio is shown in Attachment 3.

There were no exceptions to report for the year of 2017 and the first quarter of 2018.

Investment Objectives and Policies

The primary objectives, in priority order, for all City investment activities continue to be:

- ensure the safety of principal
- maintain adequate liquidity

- meet annual budgetary requirements for earnings
- maximize long-term market rate of return that is consistent with the above risk management objectives.

The specific criteria and restrictions on 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 December 2017 that became effective on January 1, 2018. On an annual basis, and more frequently if required, a comprehensive review of the City's Investment Policy is completed.

The year 2017 also marked the final year of older investment regulations whereby the City was limited to a prescribed list set by the Province of fixed income securities comprised of short-term money market securities and longer-term bonds.

Effective January 1, 2018, an Investment Board, established under subsection 46(2) of Ontario Regulation 610/06 under the City of Toronto Act, 2006, is responsible to oversee and manage the City's investments of funds not immediately required by the City pursuant to the prudent investment standard. City staff will continue to manage the Short Term Fund to maintain liquidity for daily working capital management.

Toronto Investment Board

The new investment regulations were filed in November 2015 and the City was given until January 1, 2018 to transition to the new standard. During this time a number of action items were implemented:

- Council established the Toronto Investment Board (the Board) in March 2017.

- Outreach to fill six independent seats on this new Board commenced immediately with the members appointed by Council in October 2017.

- The Board held its first two meetings in November 2017 and adopted an Interim Investment Plan.

- Council passed the new Investment Policy in December 2017.

With the Board fully functional by the effective date, the former Independent Investment Advisory Committee that was created in 2011 was dissolved.

Although still in the process of transitioning both the Long Term Fund (LTF) and the Sinking Fund (SF) to the target asset mix depicted in the new Investment Policy, the Board has taken several steps in the first quarter (Q1) of 2018.

First, the Board signed a contract with an investment consultant (Aon) to develop an Investment Plan and search for investment managers. This was the result of a Request for Proposal process handled by City staff in late 2017. The Investment Plan was adopted by the Board at its meeting in April.

Recommendations for Investment Policy Changes

The prudent investor regulations require that Council review its Investment Policy each year. The Investment Board has identified and now proposes some changes to the Investment Policy adopted by Council at its meeting on December 5 to 8, 2017.

The proposed changes comprise i) consolidation of four geographically defined equity categories into a single global aggregate investment category; ii) amendments to the selected benchmarks for various funds; and iii) amending the average credit quality for the fixed income portfolio to A- from A to match the benchmark index. The recommendations do not change any of the basic principles, objectives, overall portfolio risk profiles or investment beliefs in the current Investment Policy, but are intended to lower costs, improve performance and better match the processes proposed in Investment Plan being developed by the Board.

The Board's investment consultant completed an analysis comparing the Target Asset Mix in the current Investment Policy with the recommended policy changes. As shown in the table below, the result shows that the risk level as measured by the average annual standard deviation is expected to stay the same at 5.0% while the 10-year average return is expected to increase by 20 basis points.

Asset Mix with Recommended Changes	Current Target Asset Mix (%)	Recommended Target Asset Mix (%)
10-Year Annualized Nominal Return	3.6%	3.8%
Average Annual Standard Deviation	5.0%	5.0%

In addition, the Interim Chief Financial Officer recommends housekeeping amendments to the policy as outlined in Amendment Item 4 for the external funds managed "in trust" by the City. The change would allow investments in Schedule 1 Banks to increase to up to 100% from up to 50% of the investment portfolio, and to lower the minimum issuer credit quality for Schedule 1 and 2 Banks to A from AA- to align with the requirements of the other internally managed investment fund.

Amendment Item 1. Combine Equity Categories into Single Category

Currently there are four equity categories based on geo-political boundaries in the equity section of the Asset Mix. Selecting investment managers for each of these categories with different styles and strategies would result in having approximately 8 to 12 mandates to administer with higher fee structures. In order to improve the efficiency of administration, monitoring, and reduce fees, it is recommended these be combined into a single category called "Global Equity". As recommended in section 2, the MSCI All Country World Index (MSCI ACWI) will be used as a benchmark for investment managers in this category.

The proposed change is expected to result in geo-political weightings in line with the MSCI All Countries Index (MSCI ACWI). Consequently, investments in Canadian and

Emerging Markets equities would be expected to have their weighting fall to below the previously assigned ranges, and investments in Europe, Australasia and Far East Asia (EAFE) would increase to a slightly higher share. These changes are reflective of the size and opportunity in the respective markets.

As shown in the table above, this change in the Investment Policy has no impact on the risk profile of the overall portfolio presented in a previous section of this report.

	Current Investment Policy			Recommended Benchmark
Asset Class	**Target Asset Mix (%)**	**Min (%)**	**Max (%)**	**MSCI ACWI (%)**
Canadian Equity	4	0	6	0.6
US Equity	10	0	15	10.4
EAFE Equity	3	0	5	6.6
Emerging Equity	3	0	5	2.4
Total Equity	20	0	30	20

Amendment Item 2. Performance Measurement

The current Investment Policy Section 5.2 (c) requires the use of four different equity index benchmarks for the four categories of equities allowed in the Asset Mix (see below).

Asset Class	Benchmark (1)
Canadian Equity	S&P/TSX Composite Index
US Equity	S&P 500 (CAD)
EAFE(1) Equity	MSCI EAFE (Net) (CAD)
Emerging Equity	MSCI Emerging Markets Index (CAD)

(1) EAFE is Europe, Australasia, and Far East Asia

In order to increase the efficiency of monitoring these asset classes, and to lower the cost of hiring additional investment managers for each of these categories, it is recommended that an additional equity index benchmark be used. This benchmark would cover all four equity categories and allow the equity portfolio to be measured in its entirety.

The recommended equity index benchmark is the MSCI All Country World Index (MSCI ACWI) which is comprised of large and mid-size companies across 23 Developed

Markets (DM) and 24 Emerging Markets (EM) countries. There are currently 2,495 constituents in this index and it comprises approximately 85% of the global investable equity opportunity set.

Staff will continue to provide information on the original four equity index benchmarks as it may prove useful for attribution purposes. However the MSCI ACWI index will be added to the Investment Policy under Section 5.2 as another index that will be used for performance measurement purposes.

Liability Driven Investments (LDI) - Customized Benchmark (Sinking Fund Only)

Due to the set maturity dates of the Sinking Fund, it is recommended by the investment consultant and approved by the Board to select fixed income investment managers that will have an approach to effectively "immunize" the portfolio. This approach is known as "Liability Driven Investing" (LDI) as the focus is on the specific liabilities (maturities) of the portfolio with fixed contributions and expected returns.

Since this approach is highly specific and not based on the broad market return as it is for the LTF, it is recommended the performance benchmark be customized to fit the mandate and measure how well the investment manager is performing. This customized benchmark will be developed by the investment consultant and approved by the Board and investment manager before funds are committed to this strategy.

This change in approach and benchmark does not change the Target Weight of the fixed income component which remains at 70%.

Amendment Item 3. Fixed Income Portfolio Constraints

The standardized benchmark used by Canadian fixed income portfolio managers for broad fixed income portfolios is the FTSE TMX Universe Canada Bond Index. It is also the benchmark previously adopted by Council to be used to measure fixed income manager performance.

The average credit rating of this index is currently "A-" and will continue to change with bond market developments. This move lower has been the result of several developments in the Canadian bond market. For example, Canadian banks were downgraded following changes to banking regulations which gave them the ability to issue debt with lower credit ratings. In addition, more corporations with lower credit ratings are coming into the bond market.

The current Investment Policy Section 3.2 (c) requires the average credit rating quality of both the government and the corporate categories of the fixed income portfolio to be "A" rated or above. Having a credit rating that is higher than the benchmark would constrain and limit a fixed income manager and potentially reduce expected returns from this asset class.

In order to fully participate in the broad Canadian bond market and take advantage of a larger set of opportunities, the Toronto Investment Board would prefer to engage external fixed income managers that will be measured with this benchmark. Therefore, it is recommended the average credit quality of the fixed income portfolio be adjusted from "A" to "A-" in the Investment Policy.

This change in the Investment Policy has no material impact on the risk profile of the overall portfolio.

Amendment Item 4. Trust Funds:

The responsibility and management of the Trust Funds rest with the Chief Financial Officer and is not delegated to the Board as these funds are not City's funds.

Carried over from the former Investment Policy, investments in the Schedule 1 Banks are limited to a maximum weigh of 50%. Currently, Schedule 1 Bank Guaranteed Investment Certificate (GIC) offers an interest rate of about 2.43% for a one-year term while Treasury Bills only offer about 1.65%. Staff recommends an amendment to the Investment Policy to increase the maximum limit for Schedule I bank to 100% which aligns with the policy limits on Banks for the City's Short Term Fund.

In the past decade since the financial crisis in 2007 the credit ratings of some Canadian banks have declined. For example, Bank of Nova Scotia and Bank of Montreal issuer credit ratings were downgraded to "A+" from "AA-". The Investment Policy that came into effect on January 1, 2018 reflects updated minimum credit rating for Schedule 1 and Schedule 2 Banks from "AA" to "A" for the City's Short Term Fund. As a housekeeping item, staff recommends to update the Investment Policy for the Trust Funds to lower the minimum credit rating requirement from "AA-" to "A" for Schedule 1 and Schedule 2 Banks.

Integration of an Environmental, Social, and Governance Policy (ESG)

When Council adopted the current Investment Policy, it directed the Interim Chief Financial Officer, in consultation with the Investment Board, to report to the Executive Committee in the second quarter of 2018 on selected investment manager's ESG policies, and other developments related to ESG factors.

The Board has directed the investment consultant and staff to recommend external investment managers for the Board's consideration. The process is currently at the stage of evaluating short-listed investment managers. The investment consultant and staff will recommend the preferred investment managers at a meeting of the Board scheduled for June 25, 2018.

In an effort to integrate ESG policies into the City's protocols , all the short-listed investment managers are, or are in the process of becoming, signatories to the United Nations Principles for Responsible Investment (UNPRI) protocol.

The UNPRI protocol is recognized around the world for the inclusion of environmental, social and corporate governance issues in investment decisions. Signatories to the protocol commit to applying the following principles:

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5: We will work together to enhance our effectiveness in implementing the Principles.

Principle 6: We will each report on our activities and progress towards implementing the Principles.

The Principles for Responsible Investment were developed by an international group of institutional investors reflecting the increasing relevance of environmental, social and corporate governance issues to investment practices. The process was convened by the United Nations Secretary-General.

In addition to ensuring short-listed investment managers are UNPRI signatories, the Board is looking for investment managers that employ other tools and processes to assess investment options and insure adherence to ESG principles. As an example, one short listed manager is a subscriber to the MSCI ESG Research Tool and MSCI ESG Manager services, which provides ongoing monitoring of ESG issues of portfolio holdings. ESG factors are not allowed to be filtered out of the risk analysis model. Companies that post a poor rating, based on the external scoring system, are identified. Also, investment managers may employ credit reviews and approval procedures related to investment targets that incorporate a qualitative assessment of ESG practices. If an area of concern is identified, the investment manager's Credit Committee will discuss the materiality of the issue before making an investment decision. The manager incorporates all these discussions and identified concerns in their formal credit review documentation.

After the fund manager selection process is complete, the Board will periodically review each selected manager's ESG policy in conjunction with its performance track record on the City's funds.

Recommendation to Establish an Investment Income Stabilization Reserve

The City's Investment Policy will result in the City's funds being invested in a more diversified asset mix, including equities. The change is expected to increase risk-adjusted investment return over time, but could also result in higher short-term volatility in investment income. Investment income is an important source of the City's operating budget revenue.

In order to be prepared for and effectively manage potential investment income volatility, staff recommends that Council establish a corporate reserve account named the Investment Stabilization Reserve ("Reserve") in Schedule 3 – Stabilization Reserves of the City of Toronto Municipal Code Chapter 227, Reserves and Reserve Funds ("Chapter 227"). The purpose of the Reserve would be to stabilize investment income operating budget variances by contributing surplus income to the reserve and withdrawing funds in years when investment income is below budget. Once the reserve reaches a targeted maximum balance equal to the current year investment income budget, further contributions would be curtailed. The details on the criteria are set out in Attachment 5 of this report.

The Corporate Finance Division shall have the primary responsibility for the Reserve.

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SIGNATURE

Joe Farag
Interim Chief Financial Officer

ATTACHMENTS

Attachment 1 – Purchases and Sales of City of Toronto Debentures in 2017
Attachment 2 – Statement of Investment Policy and Procedures
Attachment 3 – Breakdown of the Portfolios by Sectors and by Credit Ratings
Attachment 4 – Investment Stabilization Reserve
Attachment 5 – Background on the Funds

ATTACHMENT 1

Purchases and Sales of City of Toronto Debentures in 2017

Purchases

Portfolio	Settle Date	Maturity Date	Coupon Rate	Principal	Price $
Bond Fund	02-Nov-17	28-Apr-35	2.950%	3,000,000.00	96.411
Bond Fund	06-Nov-17	07-Jun-27	2.400%	7,000,000.00	96.859
Bond Fund	03-Nov-17	07-Jun-27	2.400%	4,000,000.00	96.551
Bond Fund	06-Nov-17	07-Jun-27	2.400%	5,500,000.00	96.780
				19,500,000.00	

Sales

Portfolio	Settle Date	Maturity Date	Coupon Rate	Principal	Price $
Bond Fund	06-Nov-17	10-Mar-44	4.150%	6,000,000.00	115.058
Bond Fund	06-Nov-17	10-Jun-41	4.700%	4,300,000.00	123.063
				10,300,000.00	

ATTACHMENT 2

Under Separate Cover

ATTACHMENT 3

Breakdown of the Portfolios by Sectors (Excluding Cash)

As of December 31, 2017

	Short Term Fund ($ million)	Short Term Fund	Long Term Fund ($ million)	Long Term Fund	Sinking Fund ($ million)	Sinking Fund
Government of Canada & Guarantees			86	3%	0	0%
Provinces & Guarantees			787	29%	1,187	70%
Municipal Bonds (including School Boards)			1,204	44%	340	20%
Corporate Bonds*	888	100%	656	24%	157	10%
Total	888	100%	2,733	100%	1,684	100%

*Schedule 1 banks Senior Deposit Notes, GIC and "AAA" Asset Back Securities

Breakdown of the Portfolios by Credit Ratings (Excluding Cash)

As of December 31, 2017

	Short Term Fund (%)	Long Term Fund (%)	Sinking Funds (%)
AAA/AA	100%	100%	100%
A+/A/A-	0%	0%	0%
BBB	0%	0%	0%
Total	100%	100%	100%

Breakdown of the Portfolios by Sectors (Excluding Cash)

As of March 31, 2018

	Short Term Fund ($ million)	Short Term Fund	Long Term Fund ($ million)	Long Term Fund	Sinking Fund ($ million)	Sinking Fund
Government of Canada & Guarantees			80	3%	0	0%
Provinces & Guarantees			753	31%	1,156	71%
Municipal Bonds (including School Boards)			1,204	49%	339	21%
Corporate Bonds*	519	100%	407	17%	139	8%
Total	519	100%	2,444	100%	1,634	100%

*Schedule 1 banks Senior Deposit Notes, GIC and "AAA" Asset Back Securities

Breakdown of the Portfolios by Credit Ratings (Excluding Cash)

As of March 31, 2018

	Short Term Fund (%)	Long Term Fund (%)*	Sinking Funds (%)
AAA/AA	100%	100%	100%
A+/A/A-	0%	0%	0%
BBB	0%	0%	0%
Total	100%	100%	100%

ATTACHMENT 4

Investment Stabilization Reserve

1. *Location within the Consolidated Reserves/ Reserve Funds Schedule*

   Schedule No. 3 – Stabilization Reserve

2. *Statement of Purpose*

   The account will be used to stabilize investment income contribution 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, with criteria as set out in Attachment 3 of this report..

3. *Service Area or Beneficiary Program*

   Corporate Finance Division shall have primary responsibility for the account.

4. *Initial Contribution*

   The initial financial contribution is amount of investment income from 2017 in excess of the amount budgeted in 2017 for investment income.

5. *Contribution Policy*

   The funds will be provided in the year when investment income from the General Fund (including Short Term Fund and Long Term Fund) is in excess of the budgeted amount expected for investment income. The excess above the operating budget expectation will be contributed to the reserve. The maximum balance to be held in the Reserve will be equal to the expected investment income contribution amount to the Council-approved operating budget of the same year.

6. *Withdrawal Policy*

   The funds will be withdrawn in the year when investment income is below budget in accordance with the Operating Budget process. The amount to be withdrawn will be determined by the Chief Financial Officer.

7. *Review Cycle*

   The account will be reviewed on annual basis.

ATTACHMENT 5

Background on the Funds

Sources of Investment Funds

Sources of investment funds managed by staff include working capital for cash management purposes as well as reserves and reserve funds.

Working Capital (Short Term Fund)

The City retains necessary 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.

Reserves and Reserve Funds (Long Term Fund)

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)
- Land acquisition
- Replacement of City vehicles
- Capital financing
- Unanticipated City and ABC's operating budget shortfalls
- Employee benefits

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

Sinking Funds

The City of Toronto established the Sinking Fund under the City of Toronto Act, 2006. The sole purpose of this money is to be used for debt repayment.

Debt can only be issued for long-term capital projects approved by City Council and cannot be issued to fund operating budget items. Each new debenture issue is completed in either a 10, 20, or 30 year term to maturity with an accompanying by-law that provides a schedule of payments (contributions) to the Sinking Fund. There is an assumed rate of investment return that is built in to the schedule of payments on each issue. Higher assumed rates of investment return would result in lower contributions. The opposite would be true for lower assumed rates of return.

At maturity, the contributions plus the earnings should pay the full amount (par value) of the debenture. Any shortfall would require an additional payment by the City. Surpluses are kept within the Sinking Fund unless otherwise approved by Council to offset any potential future deficits.