REPORT FOR ACTION

Sinking Fund and Long Term Fund - Portfolio Update

Date: March 28, 2019
To: Toronto Investment Board
From: Executive Director, Corporate Finance
Wards: All

SUMMARY

As required by the City of Toronto's Investment Policy, the purpose of this report is to provide the Toronto Investment Board ("Board") with the following:

1. A schedule of Sinking Fund deposits as well as debt maturity dates and amounts for 2019.

2. The performance of the Sinking Fund and Long Term Fund during 2018.

3. The actual earned investment income in 2018 to be transferred to the City for operating purposes.

4. The expected earned investment income in 2019 to be transferred to the City for operating purposes based on the City's operating budget approved by City Council.

5. Investment Policy and Plan Compliance reports for 2018 and the first two months of 2019.

RECOMMENDATIONS

The Executive Director, Corporate Finance recommends that:

1. The Toronto Investment Board receive this report for information.

FINANCIAL IMPACT

There is no financial impact to the City's operating or capital budgets as a result of this report.

DECISION HISTORY

At its meeting of March 7, 2019, City Council adopted the 2019 Capital and Operating Budgets

http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.EX2.5

At its meeting of June 28, 2018, City Council adopted the report City of Toronto Investment Policy for 2017 and the First Quarter of 2018 and Policy Update, which set the guidelines for investment of the Sinking Fund and Long Term Fund.

http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.EX35.16

At its meeting of April 5, 2018, the Toronto Investment Board adopted an Investment Plan.

http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.IB4.5

In 2008, the City adopted a new Investment Earnings Policy that prioritizes the order of allocation of investment earnings:

https://www.toronto.ca/legdocs/mmis/2008/ex/bgrd/backgroundfile-10354.pdf

COMMENTS

Background

Sinking Fund (SF)

The City of Toronto established the Sinking Fund under the City of Toronto Act, 2006. The sole purpose of this fund is for the use of debt repayment.

As at December 31, 2018, the City of Toronto has total (gross) public debt outstanding of $6.55 billion. There are 16 maturity dates which range from December 2, 2019 to August 1, 2048. These outstanding public debt issues are listed in Attachment 1.

Each new debt issue has been completed in either a 10, 20, or 30 year term to maturity with an accompanying by-law that provides a schedule of payments to be deposited 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 annual contributions to the Sinking Fund. The Sinking Fund is a consolidation of "sub"-funds which are set up and based on the assumed rate of investment return. Currently there are five sub-funds: 2%, 2.5%, 3.5%, 4%, and the 5%.

At maturity, the sinking fund deposits plus the investment earnings are estimated to pay the full amount (par value) of the bond. Any shortfall would require an additional payment by the City. Surpluses are kept within the Sinking Fund unless otherwise approved by City Council.

Long Term Fund (LTF)

The Long Term Fund are defined as funds not immediately required and are primarily the reserves and reserve funds of the City of Toronto.

According to the Investment Earnings Policy established in 2008, investment earnings are allocated in the priority order to a) cost of the investment function, b) reserve funds (at the 3-month T-Bill rate), with the balance allocated to c) the Operating Budget. Investment earnings are actual "earned investment income" which includes interest (coupon) income, realized capital gains/losses, and amortization of the premium/discount of the fixed income holdings.

As part of the annual budget process, the City of Toronto estimates the amount of earned investment income from the LTF.

Performance Overview and Cash Flows

Sinking Fund (SF)

The Sinking Fund is currently in a transitional period with large cash holdings and the balance in conservative fixed income securities under passive management. The cash holdings are held in a segregated Short Term sub-Fund specifically for the Sinking Fund. The 2018 average balance of $2.8 billion comprising 9% cash and 91% bonds.

During 2018, the Sinking Fund of $1.7 billion earned $54.1 million yielding 3.2%, as shown in the table follow:

Table 1- Sinking Fund Income ($millions)

Year	Average Fund Balance	Earned Income	Earned Return on Capital
2018	$1,681.6	$54.1	3.2%
2017	$1,563.0	$59.7	3.8%

In anticipation of the transition to other asset classes, the Sinking Fund continues to build cash and short-term holdings as well as keeping bond holdings that were purchased under the previous eligible investment list. The 2018 average fund balance was $1.7 billion. The market return, as compared to the benchmark of FTSE TMX Canada Mid Term Overall Bond Index, has underperformed by 11 basis points for the one-year return (1.80% vs. 1.91%).

As required by the City's Investment Policy, Attachment 2 of this report provides the Board with a schedule of Sinking Fund deposits as well as a schedule of debt maturity dates and amounts.

Cash (including sinking fund contributions, maturing investments and coupon payments) accumulates in each of these sub-fund custodial accounts that are setup to hold cash and short-term investments. City staff will handle the movement of cash in and out of these funds as they are required by the Toronto Investment Board for longer term investments in accordance to the Board-approved Investment Plan and Council-approved Investment Policy.

There is one debt maturity in 2019 that will be paid from the 4% sub-fund as follows:

Table 2 - Debt Maturity in 2019

By-Law	Maturity Date	Amount ($mil.)	Coupon (%)	Sinking Fund (Sub)
886-2009	Dec 2, 2019	$400	4.5%	4%

Funds for the debt repayment from the Sinking sub-Fund (managed by investment managers) should be transferred to the corresponding Short Term sub-Fund (managed by staff) about two weeks prior to the debt maturity date. On the debenture maturity date, funds will be transferred from the Short Term sub-Fund to CDS for payment to investors.

Long Term Fund (LTF)

Similar to the SF, the LTF is also in transition and has large cash holdings with the balance in fixed income securities under passive management.

The LTF earned $93.8 million of gross investment income during 2018. The LTF's earned investment income was allocated to the City's Reserve Funds ($47.1 million) and the City's operating budget ($46.7 million). The allocation is based upon Council approved policy which provides interest (at the 3-Month T-Bill rate) to the City's Reserve Funds, with the balance allocated to the City's operating budget.

Table 3 – Long Term Fund Income ($millions)

Year	Average Fund Balance	Earned Income	Earned Return on Capital
2018	$2,819.3	$93.8	3.3%
2017	$2,724.6	$92.8	3.4%

The $46.7 million of gross investment income required for operations will be transferred to the Short Term Fund after the official closing of the City's accounting system (SAP) for the year-end process. Since the Reserve Funds are a part of the LTF, the $47.1 million of investment earnings allocated to these funds will be retained in the LTF.

In anticipation of the transition to other asset classes, the LTF continues to build cash and short-term holdings as well as keeping bond holdings that were purchased under the previous eligible investment list. The 2018 average balance of $2.8 billion is comprised of 20% cash and 80% bonds. The cash holdings are mainly held in a segregated Short Term Fund. Market return for the LTF during 2018, as compared to the benchmark of FTSE TMX Canada Universe Bond Index, has outperformed by 1 basis points for one-year return (1.42% vs. 1.41%) and 51 basis points for the average four-year return (2.59% vs. 2.08%).

Looking Ahead - 2019

The amount of forecasted earned investment income from the LTF required by the operating budget for 2019 is estimated at $120.0 million (equivalent to approximately 3.7% rate of earned return net of Board expense). The $120.0 million will be allocated between the operating budget ($53.0 million) and the Reserve Funds ($67.0 million). Similar to previous years, allocations will be finalized in 2020 after actual results are tabulated and confirmed by the Accounting Services Division.

Investment Policy and Plan Compliance

All investments in the Sinking Fund and Long Term Fund are consistent with the Investment Policy and the Investment Plan during 2018 and the first two months of 2019 (Attachment 3).

CONTACT

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SIGNATURE

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Executive Director, Corporate Finance

ATTACHMENTS

Attachment 1 - City of Toronto Outstanding Public Debt Issues - Maturity Schedules as at December 31, 2018
Attachment 2 - City of Toronto Sinking Funds Cash Flows from Deposits and Repayments as at December 31, 2018 (in millions of dollars)
Attachment 3 - Compliance Reports