IB4.2

TORONTO

REPORT FOR ACTION

# Sinking Fund and Long Term Fund - Performance and Compliance Update for the Second Quarter of 2019

**Date:** September 11, 2019
**To:** Toronto Investment Board
**From:** Executive Director, Corporate Finance
**Wards:** All

## SUMMARY


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

1. The performance of the Sinking Fund and Long Term Fund in the second quarter of 2019.

2. Investment Policy and Plan Compliance reports for the second quarter of 2019.


## RECOMMENDATIONS

The Executive Director, Corporate Finance recommends that:

1. Toronto Investment Board receive this report for information.

## FINANCIAL IMPACT

There are no financial impacts on the City's operating or capital budgets as a result of this report.

## DECISION HISTORY

At its meeting of June 12, 2019, the Toronto Investment Board adopted a report called the Sinking Fund and Long Term Fund - First Quarter Performance and Compliance Update.

http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.IB3.2

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

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

### Performance Overview and Cash Flows

### Sinking Fund (SF)

Seventy percent of Sinking Fund was transferred in-kind to two fixed income investment managers on May 1, 2019 as shown in Table 1 below. The two fixed income investment managers are Fiera Capital (Fiera) and Addenda Capital (Addenda).

Table 1 - Size (market value) of Sinking Fund managed by Fiera and Addenda

| ($millions) | Fiera | Addenda | Total |
|---|---|---|---|
| May 1, 2019 | $600.6 | $671.2 | $1,271.8 |
| June 30, 2019 | $695.7 | $685.9 | $1,381.6 |

During the transition period (May 1-June 30, 2019), the investment managers have sold a portion of the government bonds and replaced them with corporate bonds. The portfolios managed by Fiera and Addenda respectively both have average credit quality of "A+". Starting on July 1, 2019, the portfolio performance of Fiera and Addenda will be measured against the benchmark as outlined in the Investment Policy. Table 2 below demonstrates the change in asset mix after the transition to the investment managers.

Table 2 - Asset Mix under Fiera's and Addenda's Management (May 1 vs. June 30)

| Asset Class | May 1, 2019 (%) | June 30, 2019 (%) |
|---|---|---|
| Cash & Cash Equivalents | 0.0% | 3.3% |
| Government of Canada & Guarantees | 0.0% | 9.2% |
| Provincial, Provincial Guarantees, & Municipal Bonds | 99.7% | 66.3% |
| Corporate Bonds | 0.3% | 21.2% |
| Total | 100.0% | 100.0% |

*Does not include cash ($529M) that are held in a segregated Short Term sub-fund.

The total Sinking Fund continued to have large cash holdings for upcoming investments in equities and real assets. The cash holdings are held in a segregated Short Term sub-fund specifically for the Sinking Fund. The overall ending fund balance (including segregated cash) for the second quarter of 2019 was $1.8 billion in market value. This balance is comprised of 27% cash, and 73% bonds (of which, 16% Corporate Bonds).

On a market return basis, as at June 30, 2019, the SF underperformed its benchmark (FTSE TMX Canada Mid Term Overall Bond Index) by 169 basis points on an annualized one-year return basis (5.96% vs. 7.65%), and 38 basis points on an annualized four-year return basis (2.65% vs. 3.03%). This benchmark will be replaced after the transition period starting the third quarter of 2019.

On an earned return basis, the Sinking Fund earned $39.9 million yielding an annualized quarterly return of 9.4% during the second quarter of 2019, as shown in Table 3 below. The trading activities during the transition period have generated $27 million of one-time non-recurring realized capital gain.

Table 3 - Sinking Fund Income ($millions)

| Year | Average Fund Balance (Book Value) | Earned Income | Earned Return on Capital (Annualized) |
|---|---|---|---|
| YTD - June 30, 2019 | $1,675.5 | $52.2 | 6.3% |
| 2019 – Q2 | $1,755.2 | $39.9 | 9.4% |
| 2019 – Q1 | $1,595.5 | $12.3 | 3.1% |
| 2018 | $1,681.6 | $54.1 | 3.2% |

**Long Term Fund (LTF)**

Seventy percent of Long Term Fund was transferred in-kind to two fixed income investment managers on May 1, 2019 as shown in Table 4 below. The two fixed income investment managers are Conner, Clark & Lunn Investment Management (CC&L) and Leith Wheeler Investment Counsel Ltd (LW).

Table 4 - Size (market value) of Long Term Fund managed by CC&L and LW

| ($millions) | CC&L | LW | Total |
|---|---|---|---|
| May 1, 2019 | $1,233.3 | $1,011.6 | $2,244.9 |
| June 30, 2019 | $1,263.4 | $1,073.8 | $2,337.2 |

During the transition period (May 1-June 30, 2019), the investment managers have sold a portion of the government bonds and replaced them with corporate bonds. The portfolios managed by CC&L and LW respectively both have average credit quality of "AA". Table 5 below demonstrates the change in asset mix after the transition to the investment managers. Starting on July 1, 2019, the portfolio performance of CC&L and LW will be measured against the benchmark as outlined in the Investment Policy.

Table 5 - Asset Mix under CC&L's and LW's Management (May 1 vs. June 30)

| Asset Class | May 1, 2019 (%) | June 30, 2019 (%) |
|---|---|---|
| Cash & Cash Equivalents | 0.0% | 1.5% |
| Government of Canada & Guarantees | 3.5% | 16.0% |
| Provincial, Provincial Guarantees, & Municipal Bonds | 84.5% | 49.4% |
| Corporate Bonds | 12.0% | 33.1% |
| Total | 100.0% | 100.0% |

*Does not include $807M cash that are held in a segregated Short Term Fund

The Long Term Fund continued to have large cash holdings in anticipation of the upcoming investments in equities and real assets. The ending fund balance (including all cash) of $3.1 billion in market value is comprised of 26% cash and 74% bonds as of June 30, 2019.

On a market return basis as at June 30, 2019, the LTF underperformed its benchmark (FTSE TMX Canada Universe Bond Index) by 14 basis points for one-year return (7.23% vs. 7.37%) and outperformed the benchmark by 46 basis points for the average four-year return (3.54% vs. 3.08%).

On an earned return basis, the Long Term Fund earned $104.3 million yielding an annualized quarterly return of 15.2% during the second quarter of 2019, as shown in the table 6 below. The trading activities during the transition period have generated $84.9 million of one-time non-recurring realized capital gain.

Table 6 - Long Term Fund Income ($millions)

| Year | Average Fund Balance (Book Value) | Earned Income | Earned Return on Capital (Annualized) |
|---|---|---|---|
| YTD - June 30, 2019 | $2,862.3 | $126.5 | 9.0% |
| 2019 – Q2 | $2,889.3 | $104.3 | 15.2% |
| 2019 - Q1 | $2,835.2 | $22.2 | 3.2% |
| 2018 | $2,819.3 | $93.8 | 3.3% |

**Earned Income Requirement Update**

The amount of forecasted earned investment income from the LTF required by the operating budget for 2019 was originally estimated at $128.8 million (equivalent to approximately 3.7% rate of earned return net of Board expense). Due to the later than expected hiring of investment managers, the Board expense for 2019 is expected to be approximately $2.8 million lower than originally budgeted. Thus, $126 million is estimated to be required from LTF for the year of 2019 which LTF has already met with its year-to-date earnings of $126.5 million.

**Flow of Funds**

There is an excess of $500 million that is not required for the Short Term Fund and can be made available for longer term investments. This amount will be transferred to the Long Term Fund in October 2019 for investment in the asset mix as outlined in the Board approved Investment Plan.

**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 for the three months April to June of 2019 (Attachment 1).

## CONTACT

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## SIGNATURE

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## ATTACHMENTS

Attachment 1 - Compliance Reports (April - June 2019)