TORONTO

REPORT FOR ACTION

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

Date: November 15, 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 third quarter of 2019.

2. Investment Policy and Plan Compliance reports for the third 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 September 25, 2019, the Toronto Investment Board adopted a report called the Sinking Fund and Long Term Fund - Performance and Compliance Update for the Second Quarter of 2019.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.IB4.2

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	$679.8*	$679.9	$1,359.7
June 30, 2019	$697.4	$688.2	$1,385.6
September 30, 2019	$506.5	$494.0	$1,000.5

*Figures were revised from the previous report due to custodian delay with securities lending program.

The drop in assets as at September 30, 2019 is attributable to amounts being transferred to a segregated short-term fund to meet a debt maturity obligation of $400 million on December 2, 2019. The contract with the investment managers requires the funds to be available at least one month before maturity.

Table 2 - Credit Quality of the Sinking Funds managed by Fiera and Addenda

	Benchmark*	Fiera	Addenda
Average yield (%)	2.1	2.1	2.5
Average term (years)	13.0	12.3	10.9
Average quality	A+	A+	AA-
Q3-2019 (Since Inception) Investment Return (%)	2.7	2.6	2.5

*FTSE Canada Universe Bond Index

Table 3 - Asset Mix of the Sinking Funds (May 1 vs. June 30 vs. Sept 30)

Asset Class	May 1, 2019 (%)	June 30, 2019 (%)	Sept. 30, 2019 (%)
Segregated Sinking Fund Short Term Fund (Internal)	23.2%	27.8%	34.1%*
Cash & Cash Equivalents (Investment Managers)	0.0%	1.7%	0.1%
Government of Canada & Guarantees	0.0%	6.7%	6.6%
Provincial, Provincial Guarantees, & Municipal Bonds	76.6%	49.0%	44.2%
Corporate Bonds	0.2 %	14.8%	15.0%
Total	100.0%	100.0%	100.0%

*The increase is due to an upcoming debt repayment in 2019.

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 fund specifically for the Sinking Fund. The overall ending fund balance (including segregated cash) for the third quarter of 2019 was $1.9 billion in market value. This balance is comprised of 34% segregated short term fund, and 66% bonds (of which, 15% are Corporate Bonds).

On a market return basis, as at September 30, 2019, the SF underperformed its benchmark (FTSE TMX Canada Mid Term Overall Bond Index) by 145 basis points on an annualized one-year return basis (8.05% vs. 9.50%), and 5 basis points on an annualized four-year return basis (3.02% vs. 3.07%). This benchmark is only a proxy and will be replaced by a customized version in the coming quarters. Further details of performance for each investment manager has been prepared by the investment consultant (Aon) in Attachment 2.

On an earned return basis, the Sinking Fund earned $16.7 million yielding an annualized quarterly return of 3.6% during the third quarter of 2019, as shown in Table 4 below. The trading activities during the transition period of May and June have generated $27 million of one-time non-recurring realized capital gains. Trading activities during the third quarter generated $2.6 million in realized capital gains.

Table 4 - Sinking Fund Income ($millions)

Year	Average Fund Balance (Book Value)	Earned Income	Earned Return on Capital (Annualized)
YTD - Sept. 30, 2019	$1,742.0	$68.9	5.3%
2019 - Q3	$1,875.2	$16.7	3.6%
2019 – Q2	$1,755.2	$39.9	9.4%
2019 – Q1	$1,595.5	$12.3	3.1%

Long Term Fund (LTF)

Seventy percent of Long Term Fund was transferred in-kind to two fixed income investment managers on May 1, 2019. The two fixed income investment managers are Conner, Clark & Lunn Investment Management (CC&L) and Leith Wheeler Investment Counsel Ltd (LW), as shown in Table 5 below.

Table 5 - Size (market value) of Long Term Fund managed by CC&L and LW

($millions)	CC&L	LW	Total
May 1, 2019*	$1,050.2	$1,053.8	$2,104.0
June 30, 2019*	$1,070.7	$1,074.2	$2,144.9
September 30, 2019	$1,082.8	$1,087.2	$2,170.0

*Figures were revised from previous report.

The Long Term Fund under the management of CC&L and LW are each separated into an Active sub-fund and an Inactive sub-fund. The Inactive portion is less than 20% of the total assets under management for each. The managers are only measured and compensated for the Active sub-funds. The Inactive sub-fund holds the inherited illiquid bonds (mostly municipal bonds). The manager will progressively incorporate the Inactive sub-fund into the Active sub-fund either through bond maturities or liquidation when market conditions are appropriate. The Inactive sub-funds are expected to be fully incorporated into the Active sub-funds by 2021.

Table 6 - Credit Quality of the Long-Term Fund managed by CC&L and LW

	Benchmark* (for Active subfund)	LW - Active subfund	LW - Inactive subfund	CC&L Active subfund	CC&L - Inactive subfund
Total Fund Size (Market Value $millions)	N/A	$855.4	$231.8	$852.6	$230.2
Average yield (%)	2.1	2.3	2.3	2.1	2.3
Average term (years)	10.9	10.7	8.5	11.1	8.5
Average quality	AA	AA	AA	AA	AA
Q3-2019 (Since Inception) Investment Return (%)	1.19	1.19	N/A	1.11	N/A

*FTSE Canada Universe Bond Index

Table 7 - Asset Mix Long-Term Fund (May 1 vs. June 30 vs. Sept 30)

Asset Class	May 1, 2019 (%)	June 30, 2019 (%)	Sept. 30, 2019 (%)
Segregated Short Term Fund (Internal)*	25.0%	26.1%	29.7%
Cash & Cash Equivalents (Investment Managers)	0.0%	0.3%	0.4%
Government of Canada & Guarantees	2.7%	12.5%	8.4%
Provincial, Provincial Guarantees & Municipal Bonds	63.8%	36.6%	36.3%
Corporate Bonds	8.5%	24.5%	25.2%
Total	100.0%	100.0%	100.0%

*In addition to cash, the Short Term Fund also includes $153M of securities that are maturing in 2019 and were not allocated to fixed income investment managers as proceeds from maturities of these securities will be used to fund other asset classes.

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 $3.0 billion in market value is comprised of approximately 30% short term fund and 70% bonds as of September 30, 2019.

On a market return basis as at September 30, 2019, the LTF, including short term fund portion that has not been allocated to investment managers, outperformed its benchmark (FTSE TMX Canada Universe Bond Index and FTSE Canada 30 day T-Bill) by 13 basis points for one-year return (7.41% vs. 7.28%) and outperformed the benchmark by 66 basis points for the average four-year return (3.43% vs. 2.77%). Further details of performance for each investment manager has been prepared by the investment consultant (Aon) in Attachment 2.

On an earned return basis, the Long Term Fund earned $38.2 million yielding an annualized quarterly return of 5.2% during the third quarter of 2019, as shown in the table 8 below. The trading activities during the transition of period between May and June have generated $84.9 million of one-time non-recurring realized capital gain. The trading activities during the third quarter of 2019 generated $8.8 million of realized capitals gains.

Table 8 - Long Term Fund Income ($millions)

Year	Average Fund Balance (Book Value)	Earned Income	Earned Return on Capital (Annualized)
YTD - Sept. 30, 2019	$2,899.2	$164.7	7.6%
2019 - Q3	$2,973.1	$38.2	5.2%
2019 – Q2	$2,889.3	$104.3	15.2%
2019 - Q1	$2,835.2	$22.2	3.2%

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 $164.7 million. It is recommended that a portion of this surplus be allocated to the Investment Stabilization Reserve.

Flow of Funds

There was an excess of $500 million that is not required for the Short Term Fund, which was transferred to the Long Term Fund on November 1, 2019 for investment in the asset mix as outlined in the Board approved Investment Plan. Further details of this allocation is presented in the Investment Manager Update report.

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 July to September of 2019 (Attachment 1).

CONTACT

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SIGNATURE

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ATTACHMENTS

Attachment 1 - Compliance Reports (July - September 2019)
Attachment 2 - Performance Attribution by Investment Manager (Aon)