

## **City of Toronto Investment Report for the Year 2019 and the Three Month Period Ending March 31, 2020**

**Date:** July 7, 2020

**To:** Executive Committee

**From:** Chief Financial Officer and Treasurer

**Wards:** All

### **SUMMARY**

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The purpose of this report is to provide the following information:

1. Performance of the Funds for 2019, and the first quarter of 2020
2. General Market Update and Benchmark Performance

The City's General Group of Funds (General Fund) that holds the City's working capital and the amounts designated for the City's reserves and reserve funds earned:

- \$267.3 million in 2019 (4.3% rate of return)
- \$41.5 million in the first quarter of 2020 (3.2% annualized rate of return)

The City's Sinking Fund portfolio that holds funds for future debt repayments earned:

- \$83.1 million in 2019 (4.9% rate of return)
- \$8.6 million in the first quarter of 2020 (2.3% annualized rate of return)

Since January 1, 2018, the City's long-term investments have been managed by the Toronto Investment Board under a new Council adopted Investment Policy which is based on the prudent investor standard.

As at December 31, 2019, approximately 77 percent of both the Sinking Fund and the Long Term Fund were managed by external investment managers selected by the Toronto Investment Board. Four external fixed income managers control approximately 70 percent of the assets while two global equity pooled fund managers oversee 7 percent of these funds. A third global equity pooled fund manager started in February 2020 resulting in a total equity exposure of 10 percent at the fund level. The balance of these funds remain in cash and short-term securities until additional external fund managers can be funded. Selection and contract negotiations for an additional global equity pooled fund manager and real asset managers continues in 2020.

All funds managed are compliant with the Council-approved Investment Policy.

## RECOMMENDATIONS

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The Chief Financial Officer and Treasurer recommends that:

1. City Council receive this report for information.

## FINANCIAL IMPACT

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The City's General Group of Funds ("General Fund") earned \$267.3 million in 2019, and \$41.5 million in the first quarter of 2020.

The 2019 earnings from the General Fund were allocated to the operating budget (\$185.5 million) and reserve funds (\$81.8 million) according to the Council approved interest allocation policy. The investment activities in 2019 and the first quarter of 2020 were compliant with the investment policies and goals adopted by City Council.

The City's Sinking Funds portfolio earned \$83.1 million in 2019, and \$8.6 million in the first quarter of 2020. These earnings are retained within the Sinking Funds and must be used for the purpose of retiring debenture debt at maturity.

## DECISION HISTORY

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At its meetings held on January 29, 2020, City Council referred the Investment Policy Update report to the Executive Committee for further consideration.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.CC14.4>

At its meetings held on December 17, 2019, City Council received for information the Investment Report for the Year 2018 and the Six Month Period Ending June 30, 2019

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.EX11.15>

At its meetings held on October 2 to 3, 2019, City Council considered amendments to the Investment Policy and passed a motion to refer items to the Chief Financial Officer and Treasurer related to additional improvements to the Investment Policy's ESG practices. Staff were asked to report back on the referred items to City Council at its meetings held on January 29 and 30, 2020.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.EX8.3>

City Council received for information the Investment Report for 2017 and the First Quarter of 2018 and adopted the updated Investment Policy at their meetings on June 26 to 29, 2018. A motion for staff to review the ESG sections with the focus on climate change after consultations with several stakeholders

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

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>

## **COMMENTS**

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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 and amounts designated for reserves and reserves funds are held within the Short Term Fund and the Long Term Fund. Given the specific purpose of the Sinking Fund (debt retirement), it is managed separately from the General Fund but adheres to the same primary investment beliefs and objectives. Attachment 1 provides a short background on the City's investment funds.

In November 2015, the province changed the City of Toronto Act, 2006 which replaced the prescribed list of investments with what is known as the prudent investor standard. This change removed the previous limitations and allows the City to be responsible for its own investment decisions as a prudent investor. The change required the City to establish an independent local board that would have fiduciary duty over the City's funds not immediately required. This local board can hire agents (external investment managers) which would carry out the fiduciary duty of the board.

Although this new provincial regulation was announced in late 2015, the effective date for this new regulation was January 1, 2018. During this transition period the City created the Toronto Investment Board ("Board") and appointed six independent members. In addition, City Council had approved a new Investment Policy that allowed for allocations to fixed income as well as new asset classes which included global equities and real assets.

As at December 31, 2017, the City's investments were all managed internally by City staff and were limited to a prescribed list of eligible investments set by the province in the legislation. This prescribed list limited the City investments to primarily government bonds and some high quality bonds of financial institutions.

During 2018, the Board chose eight external investment managers to manage the fixed income (70%) and global equity (20%) allocations as outlined in their Investment Plan. The new investment policy and plan, in conjunction with the investment consultant and investment managers, are expected to result in improved investment returns over the longer-term while also reducing overall portfolio risk.

There is a transition period before reaching the long-term target asset mix and realizing optimal long-term returns. During this time the investment portfolio will phase in greater use of the broader range of investments that become available. Although the portfolio risk will be reduced, the potential for volatility in short-term returns will still exist. The new target asset mix will have a modest positive budget impact in the short term.

In June 2018, Council approved the creation of the Investment Income Stabilization Reserve. This reserve was established for the purpose of stabilizing 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.

During 2019, the Long Term Fund and Sinking Fund have been transitioned to four external fixed income investment managers (70%) and two global equity pooled fund managers (7%). During the first quarter of 2020, a third global equity fund manager was added resulting in a total equity exposure of approximately 10% at the fund level.

The four fixed income investment managers are Connor, Clark & Lunn Investment Management ("CC&L") and Leith Wheeler Investment Counsel Ltd ("LW") provide asset management for the Long Term Fund, while Fiera Capital ("Fiera LDI") and Addenda Capital ("Addenda") focus on the Sinking Fund.

The three global equity pooled fund managers are Oakmark Global Pooled Fund II ("Oakmark"), Pier 21 WorldWide Equity Pool ("Pier 21"), and Fiera Capital Common Contractual Fund ("Fiera CCCF").

The selection process and contract negotiations continue in 2020 to bring on board the fourth global equity pooled fund manager and real asset managers.

### **Earned Investment Income of General and Sinking Fund – 2019 and the Three Month Period Ending March 31, 2020**

#### **For the year of 2019 - General Fund and Sinking 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 \$267.3 million for the General Fund in 2019 were distributed to the City's operating budget (\$185.5 million) and to the City's reserve funds (\$81.8 million) as shown in the following table:

Table 1 - Allocation of Gross Investment Earnings for 2015 to 2019

<b>Investment Earnings (\$ millions)</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
1. Operating Budget	\$185.5	\$109.4	\$114.3	\$114.1	\$121.3
2. Reserve Funds	\$81.8	\$47.1	\$16.6	\$16.3	\$16.5
<b>Total General Fund</b>	<b>\$267.3</b>	<b>\$156.5</b>	<b>\$130.9</b>	<b>\$130.4</b>	<b>\$137.8</b>
<b>Return on Capital</b>	<b>4.3%</b>	<b>2.7%</b>	<b>2.6%</b>	<b>2.6%</b>	<b>2.7%</b>

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

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

<b>Investment Earnings (\$ million and Rate of Return) Allocated to the Operating Budget</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
1. Actual Investment Earnings allocated to Operating Budget	\$185.5 (3.0%)	\$109.4 (1.9%)	\$114.3 (2.2%)	\$114.1 (2.2%)	\$121.3 (2.4%)
2. Budget Investment Earnings allocated to Operating Budget	\$117.0 (1.9%)	\$108.0 (1.9%)	\$98.6 (1.9%)	\$114.5 (2.2%)	\$121.8 (2.4%)
Variance	\$68.5 (1.1%)	\$1.4 (0.0%)	\$15.7 (0.3%)	\$-0.4 (0.0%)	\$-0.5 (0.0%)

The investment earnings of \$267.3 million in 2019 exceeded budget by \$68.5 million. The excess return was mainly due to non-recurring capital gains realized during the fund transition period when assets in the fund were transferred to investment managers. The Short Term Fund also earned more interest income than forecasted due to higher than forecasted cash balances as a result of delayed contracts negotiation with the external investment managers, which was partially offset by lower than forecasted interest rates.

The breakdown of investment earnings by fund are summarized in the table below:

Table 3 - Investment Portfolio Income for the Year 2019 (\$ millions)

<b>Portfolio</b>	<b>Average Fund Balance</b>	<b>Earned Income</b>	<b>Earned Return on Capital*</b>
<b>Total General Fund</b>	<b>\$6,258.5</b>	<b>\$267.3</b>	<b>4.3%</b>
Short Term Fund	\$3,272.4	\$79.4	2.4%
Long Term Fund	\$2,986.1	\$187.9	6.3%
<b>Sinking Fund</b>	<b>\$1,709.7</b>	<b>\$83.1</b>	<b>4.9%</b>

\*Return on Capital represents return on fixed income investments.

The General Fund (Short Term Fund and Long Term Fund combined) of \$6.3 billion earned \$267.3 million in 2019. The earned return on capital of 4.3% in 2019 was higher than the 2.7% return realized in 2018. The Sinking Fund portfolio of \$1.7 billion earned \$83.1 million. The earned return on capital of 4.9% was higher than the 3.2% return realized in 2018. The increase in the General Fund and Sinking Fund was mainly due to broadened asset mix and non-recurring capital gains realized during the fund transition period when assets in the fund were transferred to investment managers.

Earnings vary for each of the five separate sub-funds of the overall Sinking Fund in relation to their respective balances and the average term to repayment of the underlying debentures. The Sinking Fund is segregated into sub-funds so that the scheduled contributions plus reinvested earnings are dedicated to the repayment of debentures.

### **Earned Investment Income for the First Quarter of 2020**

During the first quarter of 2020, staff continued to manage the Short Term Fund to meet City's liquidity needs while maximizing investment return. The Toronto Investment Board ("Board") had selected and entered into agreements with four fixed income investment managers and three global equity pooled fund managers to invest the Long Term and Sinking Funds.

As demonstrated in Table 4 below, the General Fund, composed of both the Short Term fund and the Long Term Fund, and the Sinking Fund had average fund balances of \$5.2 billion and \$1.7 billion respectively during the first quarter of 2020. The General Fund earned \$41.5 million (3.2% annualized rate of return on capital) during the first quarter of 2020. The Sinking Fund earned \$8.6 million (2.3% annualized rate of return on capital) during the first quarter of 2020.

Table 4 - Investment Portfolio for the First Quarter of 2020 (\$ millions)

<b>Portfolio</b>	<b>Average Fund Balance</b>	<b>Earned Income</b>	<b>Earned Return on Capital* (Annualized)</b>
<b>Total General Fund</b>	<b>\$5,189.1</b>	<b>\$41.5</b>	<b>3.2%</b>
Short Term Fund	\$1,657.3	\$10.5	2.6%
Long Term Fund	\$3,531.8	\$31.0	3.6%
<b>Sinking Fund</b>	<b>\$1,513.6</b>	<b>\$8.6</b>	<b>2.3%</b>

\*Return on Capital mainly represents return on fixed income investments managed by external investment managers.

Table 5 below shows that the investment income earned to date aligns with the income contribution forecast for the operating budget.

Table 5 - Actual and Budget Gross Investment Earnings for the Operating Budget

<b>Investment earnings (\$ millions &amp; Annualized Rate of Return)</b>	<b>Actual YTD as at March 31, 2020</b>	<b>Gross income requirement for the year</b>	<b>% of full year Budget</b>
<b>Total General Fund</b>	<b>\$41.5 (3.2%)</b>	<b>\$191.0</b>	21.7%
Short Term Fund	\$10.5 (2.6%)	\$48.0	21.8%
Long Term Fund	\$31.0 (3.6%)	\$143.0	21.7%

### **General Market Update and Portfolio Market Return – 2019 and the Three Month Period Ending March 31, 2020**

The positive performance of global economic activity continued throughout the year in 2019. Economic data in Canada and the United States were particularly strong with unemployment rates near cycle lows. Growth, as measured by GDP, remained positive while inflation stayed within the acceptable range of most central banks.

However, the positive economic scenario of 2019 came to a complete halt in the first quarter of 2020 with the arrival of a global pandemic in the form of the COVID 19 virus. This unprecedented situation resulted in a state of emergency in most countries with a shutdown of most economic activity globally.

Given this economic scenario, central bankers in both Canada and the United States started to move short-term interest rates aggressively lower in March 2020. Both the Bank of Canada and the Federal Open Market Committee (FOMC) in the U.S. dropped short-term interest rates by 150 basis points within a month in order to stimulate the economy.

The lowering of short-term interest rates has an impact on longer-term interest rates (yields) in the bond market. It results in positive returns in the bond market in the short term. Conversely, higher long-term interest rates are associated with negative total returns in the bond market. Holding corporate bonds proved difficult during March 2020 as the economic scenario favored government bonds.

Global equity markets had a strong performance throughout 2019 with valuations considered high and index benchmarks hitting new record highs. The unknown impact to business of the pandemic resulted in some large negative performance in the global equity markets in first three months of 2020. It should be noted this may only be a temporary situation and that over the long run equity markets will outperform the bond market on a risk-adjusted basis. Many investors with cash are viewing this sudden drop in the stock market as an opportunity to buy from panic sellers.

Table 6 below shows the total benchmark rate of returns in market value for 2019 and Q1 of 2020\*.

Table 6 - Major Capital Market Returns - 2019 and Q1 2020

Benchmark	Q1 2020	2019 Full Year
FTSE Canada Universe Bond Index	1.6%	6.9%
S&P/TSX Composite Index	-20.9%	22.9%
S&P 500 Index (\$CAD)	-12.1%	25.0%
MSCI ACWI (Net)	-13.7%	20.2%

\* Aon, Performance Review and Investment (December 2019 and March 2020)

### Market Performance of General Fund and Sinking Fund – 2019

The market benchmarks for the City's Short Term Fund and Long Term Fund are FTSE Canada 30-day T-bill Index and FTSE Canada Universe Bond Index respectively for bonds and MSCI ACWI index for global equities. As shown in Table 7 below, the City's General Fund (Short Term Fund and Long Term Fund) has underperformed the weighted market benchmark by 0.1% for the one-year return. The underperformance was mainly due to underperformance of the global equity pooled funds which were funded in November 2019. When looking at a longer-term investment horizon, the General Fund has outperformed the benchmark by 0.6% for the annualized four-year return as at December 31, 2019.

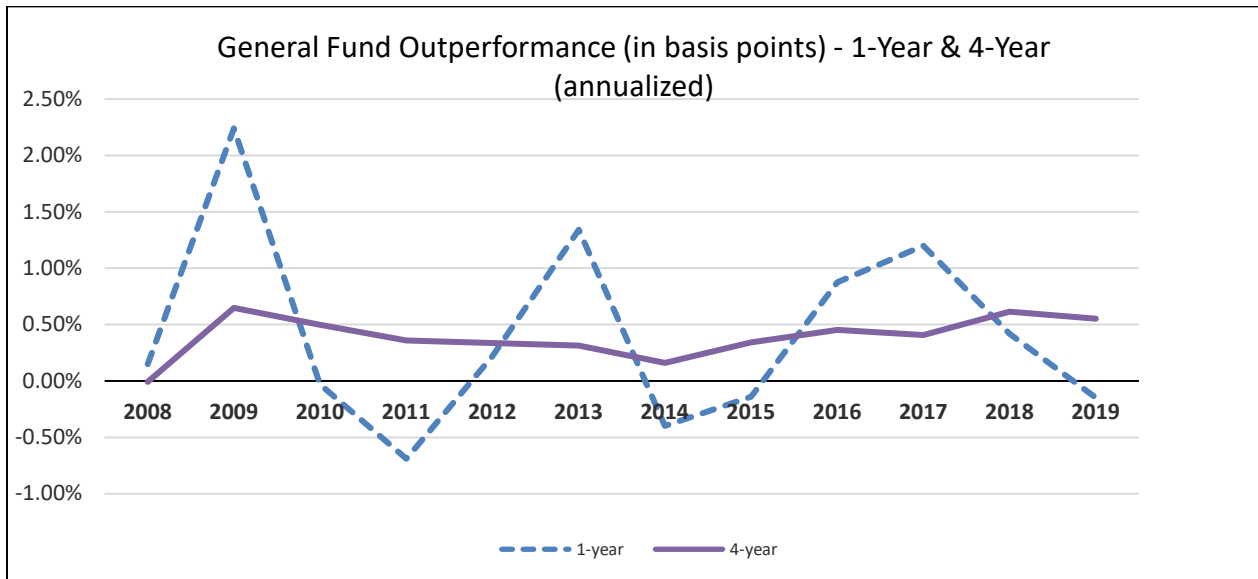
Table 7 – General Fund Market Returns vs. Market Benchmarks (%) for 2019

	For the Year of 2019	
	1-Year Return	4-Year Return
Short Term Fund	2.4	1.8
Benchmark	1.7	1.0
<b>Value-Added</b>	<b>0.7</b>	<b>0.8</b>
Long Term Fund	6.2	3.3
Benchmark (Blended)	7.3	2.9
<b>Value-Added</b>	<b>-1.1</b>	<b>0.4</b>
Overall General Fund	4.3	2.5
Weighted Benchmark	4.4	1.9
<b>Value-Added</b>	<b>-0.1</b>	<b>0.6</b>



Figure 1 below compares the City's General Fund performance relative to the benchmark over the one-year and four-year investment horizons. As demonstrated below, one-year return shows the more volatility than the four-year annualized return.

**Figure 1 – Value-Added over Benchmark: 1-Year and 4-Year (annualized)**



As at the year end 2019, the Sinking Fund had a market return of 5.5% and an annualized four-year return of 2.6%. The investment consultant (Aon) to the Board has developed a customized benchmark index that more appropriately reflects the updated fixed income strategy (LDI - Liability Driven Investment) based on cash flows to fund future liabilities. The fund managed by the external investment managers has exceeded the weighted market benchmark by approximately 0.5%.

**Market Performance of General Fund and Sinking Fund – First Quarter of 2020**

It should be stressed that performance over short time periods like three months can show quite a bit of volatility of returns especially when single events occur that will cause capital markets to move abruptly.

As shown in Table 8 below, the City's General Fund (Short Term Fund and Long Term Fund) has underperformed the weighted market benchmark by 0.4% (annualized) during the first quarter of 2020. The underperformance in the first quarter was mainly due to the COVID-19 induced flight to quality and lower inflation expectation impact on the corporate, provincial and real return bonds, as well as the under-performance of certain sectors of the equity markets relative to the broader benchmark markets. When looking in the longer investment horizon, the General Fund has outperformed the market benchmark by 0.6% on a 4-year annualized return basis.

Table 8 – General Fund - Market Returns vs. Benchmarks (%) - Q1 2020\*

<b>Fund (%)</b>	<b>1-year return (annualized)</b>	<b>4-year return (annualized)</b>
Short Term Fund	2.6	2.2
Benchmark	1.8	1.1
<b>Value-Added</b>	0.8	1.1
Long Term Fund	1.3	2.7
Benchmark (Blended)	3.2	2.5
<b>Value-Added</b>	<b>-1.9</b>	0.2
Overall General Fund	2.0	2.4
Weighted Benchmark*	2.4	1.8
<b>Value-Added</b>	<b>-0.4</b>	<b>0.6</b>

\* Calculated from RBCIS Performance Analytics and Aon, Performance Review

As at March 31, 2020, the one-year and four-year annualized market return for the Sinking Fund was 0.51% and 1.86% respectively. The Investment Consultant has developed a customized benchmark index that more appropriately reflects the updated fixed income strategy (LDI - Liability Driven Investment) based on cash flows to fund future liabilities. The customized benchmark index does not have enough history for 1-year and 4-year measurement. Quarterly return will be used for reporting while track record continues to build. The fund managed by the external investment managers has underperformed the benchmark by 2% during the first quarter of 2020.

Table 9 –Sinking Fund - Market Returns for Q1 2020\*

<b>Sinking Fund (%)</b>	<b>March 31, 2020</b>
Q1 Return	-2.1%
Benchmark	-0.1%
<b>Value-Added</b>	<b>-2.0%</b>

\*Aon, Performance Review and Investment (March 31 2020)

## **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. Please see Attachment 2.

## **Compliance with the Investment Policy Guidelines**

All the City's funds were within the Asset Mix requirements set out in the Council-approved Investment Policy in the year 2019 and the first quarter of 2020. The breakdown of each portfolio is shown in Attachment 3.

There were no exceptions to report for the year 2019 and the first quarter of 2020.

## **CONTACT**

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## **SIGNATURE**

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Heather Taylor  
Chief Financial Officer and Treasurer

## **ATTACHMENTS**

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Attachment 1 - Background on the Funds  
Attachment 2 - Record of Transactions in City of Toronto Debentures  
Attachment 3 - Breakdown of the Portfolios by Sectors and by Credit Ratings