TORONTO

REPORT FOR ACTION

Sinking Fund and Long Term Fund - Performance and Compliance Update for 2019 and First Quarter of 2020

Date: June 23, 2020
To: Toronto Investment Board
From: Director, Capital Markets
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 for 2019 and the first quarter of 2020.

2. Investment Policy and Plan Compliance certificates and reports for 2019 and the first quarter of 2020.

RECOMMENDATIONS

The Director, Capital Markets 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 February 19, 2020. City Council adopted the 2020 Capital and Operating Budgets:
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.EX13.2

At its meeting of December 4, 2019, the Toronto Investment Board adopted a report called the Sinking Fund and Long Term Fund - Performance and Compliance Update for the Third Quarter of 2019.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2019.IB5.4

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. The two fixed income investment managers are Fiera Capital ("Fiera LDI") and Addenda Capital ("Addenda"). During the fourth quarter of 2019, approximately seven percent of the Sinking Fund was transferred (cash) to two global equity pooled fund managers. A third global equity pooled fund manager also started in February 2020 resulting in a total equities exposure of 10% at the fund level.

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 CCF"). Table 1 below shows the value of the Sinking Fund managed by these 5 investment managers.

Table 1 - Size (market value) of Sinking Fund managed by Fiera LDI, Addenda, Oakmark, Pier 21 and Fiera CCF

($millions)	Fiera LDI	Addenda	Oakmark	Pier 21	Fiera CCF	Total
May 1, 2019	$679.8	$679.9	-	-	-	$1,359.7
June 30, 2019	$697.4	$688.2	-	-	-	$1,385.6
Sept. 30, 2019	$506.5	$494.0	-	-	-	$1,000.5
Dec. 31, 2019	$498.7	$489.4	$62.2*	$62.0*	-	$1,112.3
Mar. 31, 2020	$511.2	$479.8	$44.6	$58.0	$46.6*	$1,140.2

*$56 million was transferred to each of Oakmark and Pier21, and $54 million was transferred to Fiera CCF

The decline in externally managed assets as at September 30, 2019 was attributable to funds being transferred to the 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 - Historical Asset Mix of the Sinking Fund

Asset Class	Policy Target Allocation	May 1, 2019 (%)	June 30, 2019 (%)	Sept. 30, 2019 (%)	Dec. 31, 2019 (%)	Mar. 31, 2020 (%)
Segregated Sinking Fund Short Term Fund (Internal)	0.0%	23.2%	27.8%	34.1%*	31.1%	29.5%
Cash & Cash Equivalents (Investment Managers)	0.0%	0.0%	1.7%	0.1%	0.1%	0.1%
Government of Canada & Guarantees	30.0%	0.0%	6.7%	6.6%	8.0%	9.0%
Provincial, Provincial Guarantees, & Municipal Bonds	30.0%	76.6%	49.0%	44.2%	36.4%	35.7%
Corporate Bonds	10.0%	0.2 %	14.8%	15.0%	16.9%	15.8%

Asset Class	Policy Target Allocation	May 1, 2019 (%)	June 30, 2019 (%)	Sept. 30, 2019 (%)	Dec. 31, 2019 (%)	Mar. 31, 2020 (%)
Equities	20.0%	N/A	N/A	N/A	7.5%	9.9%
Total	10.0%	100.0%	100.0%	100.0%	100.0%	100.0%

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

The 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) at December 31, 2019 was $1.7 billion in market value. This balance was comprised of 31% segregated short term fund, 61% bonds (of which, 17% are Corporate Bonds), and 8% equities.

The ending fund balance (including segregated cash) for the first quarter of 2020 was $1.6 billion in market value. This balance was comprised of 30% segregated short term fund, 60% bonds (of which, 16% are Corporate Bonds), and 10% equities.

As demonstrated in Table 3 below, the fixed income portion of the Sinking Fund outperformed its market return benchmark (custom benchmark based on liabilities) by 80 basis points for the year of 2019. On the other hand, the global equities portion of the Sinking Fund underperformed it market return benchmark (MSCI ACWI (CAD)) by 250 basis points for the year of 2019. Further details of performance for each investment manager has been prepared by the investment consultant (Aon) in Attachment 2.

Table 3 - Benchmark returns (%) for the Sinking Fund as at December 31, 2019*

Sinking Fund	Fixed Income	Global Equities
Portfolio (%)	0.9	2.1
Benchmark (%)	-0.3	4.6
Weighted Average Value Added (%)	1.2	-2.5

* From Aon Report - Performance Review and Investment (since inception each asset class)

Table 4 - Performance of the Sinking Fund managed by Fiera LDI and Addenda as at December 31, 2019

	Fiera Benchmark*	Fiera LDI	Addenda Benchmark*	Addenda
Total Fund Size (Market Value $millions)	N/A	$498.7	N/A	$489.4
Average yield (%)	2.3%	2.3%	2.1%	2.6%
Average term (years)	13.2	12.6	13.4	15.3
Average credit quality	N/A	A	N/A	AAL
December 31, 2019 (Since Inception) Investment Return (%)	0.1%	0.5%	-0.8%	0.4%
Investment Return (%) Value-added	N/A	0.4%	N/A	1.2%

* Addenda and Fiera LDI started the mandate using different methodology for managing their LDI mandate. Addenda matched the interest rate exposure of the sinking funds at the sub fund levels and Fiera matched it at an overall level by aggregating the sinking fund liabilities. Effective December 2019, Addenda reverted their methodology to match interest rate exposure of the sinking fund liabilities at an aggregate level.

As demonstrated in Table 5 below, the fixed income portion of the Sinking Fund underperformed its market return benchmark by 340 basis points on an annualized return basis. The global equities portion of the Sinking Fund underperformed its market return benchmark by 480 basis points on an annualized return basis. Further details of performance for each investment manager has been prepared by the investment consultant (Aon) in Attachment 2.

Table 5 - Benchmark returns (%) for the Sinking Fund as at March 31, 2020*

Sinking Fund	Fixed Income	Global Equities
Portfolio (%)	0.3	-18.7
Benchmark (%)	3.7	-13.9
Value Added (%)	-3.4	-4.8

* From Aon Report - Performance Review and Investment (Q1 Performance)

Table 6 - Performance of the Sinking Fund managed by Fiera LDI and Addenda as at March 31, 2020

Fixed Income - Q1, 2020	Fiera Benchmark	Fiera LDI	Addenda Benchmark	Addenda
Total Fund Size (Market Value $millions)	N/A	$511.2	N/A	$479.8
Average yield (%)	2.1%	2.1%	1.7%	2.6%
Average term (years)	12.8	12.5	13.2	15.1
Average credit quality	N/A	AA	N/A	AAL
March 31, 2020 - Investment Return (%)*	3.4%	2.5%	3.9%	-1.8%
Investment Return (%) - value added*	N/A	-0.9%	N/A	-5.8%

. * From Aon Report - Performance Review and Investment (Q1 Performance)

Table 7 - Performance of the Sinking Fund managed by Pier 21 and Oakmark as at March 31, 2020*

Equity - Q1, 2020 (1st full quarter)	Pier 21	Oakmark
Portfolio (%)	-6.5	-28.3
Benchmark (%) (MSCI ACWI)	-13.9	-13.9
Value Added (%)	7.4%	-14.4

. * From Aon Report - Performance Review and Investment (Q1 Performance)

On a book return basis (excluding unrealized gain and losses), the Sinking Fund earned $83.1 million yielding an annual return of 4.9% as at December 31, 2019, as shown in Table 8 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 full year of 2019 generated $36.6 million in realized capital gains.

During the first quarter of 2020, the Sinking Fund earned $8.6 million yielding an annualized return of 2.3%. Trading activities generated $0.1 million in realized capital gains.

Table 8 - Sinking Fund Income ($millions)

Year	Average Fund Balance (Book Value)	Earned Income	Earned Return on Capital (Annualized)
2020 - Q1	$1,513.6	$8.6	2.3%
Dec. 31, 2019	$1,713.8	$83.1	4.9%
2019 - Q4	$1,687.1	$14.2	3.4%
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%

Flow of Funds - Sinking Fund

The City of Toronto has no bond maturities in 2020. The City plans to issue $1 billion sinking fund debentures in 2020 depending on market conditions. As at the writing of this report, the City has completed $300 million of the $1 billion of the planned debenture issues for 2020 with maturities in 2029 ($200 million) and 2030 ($100 million).

The table below shows the upcoming debt maturities for 2020, 2021 and 2022.

Table 9 - Debt Maturities 2020-2022 ($millions)

Debt Maturity	2020	2021	2022
2% Sinking Fund	-	-	-
2.5% Sinking Fund	-	-	-
3.5% Sinking Fund	-	$500.0*	-
4% Sinking Fund	-	-	-
5% Sinking Fund	-	$150.0**	-
Total	-	$650.0	-

*$300.0M (By-law 686-2012) & $200.0M (By-law 1429-2011), both are maturing on December 6, 2021

**$150.0M (By-law 613-2001) maturing on July 26, 2021

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 Connor, Clark & Lunn Investment Management ("CC&L") and Leith Wheeler Investment Counsel Ltd ("LW").

During the fourth quarter of 2019, approximately seven percent of the Long Term Fund was transferred (cash) to two global equity pooled fund managers. A third global equity pooled manager started in February 2020 resulting in a total equity exposure of over 9% at the fund level. 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 CCF").

On November 1, 2019, an additional $336 million was transferred to CC&L and LW from the excess liquidity in Short Term Fund ($168 million to each manager).

Table 10 - Size (market value) of Long Term Fund managed by CC&L, LW, Oakmark, Pier 21 & Fiera Capital

($millions)	CC&L	LW	Oakmark	Pier 21	Fiera CCF	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
Sept. 30, 2019	$1,082.8	$1,087.2	-	-	-	$2,170.0
Dec. 31, 2019*	$1,242.8	$1,248.3	$122.2*	$122.8*	-	$2,736.1
Mar. 31, 2020	$1,262.0	$1,262.0	$87.7	$114.8	$103.6*	$2,830.1

*$360 million cash was transferred to the management of Oakmark, Pier 21 and Fiera CCF ($120 million each)

Table 11 - Historical Asset Mix Long-Term Fund

Asset Class	Policy Target Allocation	May 1 2019 (%)	June 30 2019 (%)	Sept. 30 2019 (%)	Dec. 31 2019 (%)	Mar. 31 2020 (%)
Segregated Short Term Fund (Internal)*	0.0%	25.0%	26.1%	29.7%	23.7%	20.4%
Cash & Cash Equivalents (Investment Managers)	0.0%	0.0%	0.3%	0.4%	0.8%	0.6%
Government of Canada & Guarantees	30.0%	2.7%	12.5%	8.4%	7.4%	10.1%
Provincial, Provincial Guarantees & Municipal Bonds	30.0%	63.8%	36.6%	36.3%	35.6%	34.9%
Corporate Bonds	10.0%	8.5%	24.5%	25.2%	25.8%	24.7%
Equities	20.0%	N/A	N/A	N/A	6.7%	9.3%
Real Assets	10.0%	N/A	N/A	N/A	N/A	N/A
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

*Segregated Short Term Fund includes cash and short-term investments that will be allocated to investment managers of the Long Term Fund. .

The Long Term Fund continued to have large cash and short-term investment holdings in anticipation of the upcoming investments in equities and real assets. The ending fund balance (including all cash) of $3.0 billion on a market value basis and is comprised of approximately 24% short term funds and 69% bonds, and 7% equities, as of December 31, 2019.

The ending fund balance (including segregated cash) as at March 31 2020 was $3.6 billion (market value). This balance is comprised of 21% segregated short term fund and cash, 70% bonds (of which, 25% are Corporate Bonds), and 9% equities.

As shown in Table 12 below, the fixed income portion of the LTF outperformed its benchmark (FTSE Canada Universe Bond Index) by 20 basis points as at December 31, 2019. On the other hand, the global equity portion of the LTF underperformed the benchmark by 250 basis points. Further details of performance for each investment manager has been prepared by the investment consultant (Aon) in Attachment 2.

Table 12 - Benchmark returns (%) for the Long Term Fund as at December 31, 2019*

Long Term Fund	Fixed Income	Global Equity
Portfolio (%)	0.5	2.1
Benchmark (%)	0.3	4.6
Weighted Average Value Added (%)	0.2	-2.5

. * From Aon Report - Performance Review and Investment (Since Inception Performance)

The fixed income portion of the Long Term Fund is under the management of CC&L and LW, of which each are 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 manager. 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 13 - Portfolio Characteristics of the Long-Term Fund managed by CC&L and LW as at December 31, 2019

	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	$1,019.7	$228.6	$1,015.2	$227.6
Average yield (%)	2.3	2.4	2.4	2.3	2.4
Average term (years)	10.9	10.6	8.2	10.9	8.2
Average credit quality	AA	AA	A	AA	AA

	Benchmark* (for Active subfund)	LW - Active subfund	LW - Inactive subfund	CC&L Active subfund	CC&L - Inactive subfund
December 31, 2019 (Since Inception) Investment Return (%)**	0.3%	0.5%	0.3%	0.4%	0.4%
December 31, 2019 Value Added Investment Return (%)**	N/A	0.2%	N/A	0.1%	N/A

*FTSE Canada Universe Bond Index
**.From Aon Report - Performance Review and Investment (Since Inception Performance)

As shown in Table 14 below, the fixed income portion of the LTF underperformed its benchmark (FTSE Canada Universe Bond Index) by 30 basis points for the quarter ending March 31, 2020. The global equity portion of the LTF underperformed the benchmark by 490 basis points. Further details of performance for each investment manager has been prepared by the investment consultant (Aon) in Attachment 2.

Table 14 - Benchmark returns (%) for the Long Term Fund as at March 31, 2020*

Long Term Fund	Fixed Income	Global Equity
Portfolio (%)	1.0	-18.8
Benchmark (%)	1.6	-13.9
Value Added (%)	-0.3	-4.9

. * From Aon Report - Performance Review and Investment (Q1 Performance)

Table 15 - Performance of the Long-Term Fund managed by CC&L and LW as at March 31, 2020

	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	$1,028.4	$233.6	$1,029.2	$232.8
Average yield (%)	1.9%	2.3%	1.9%	2.1%	1.9%
Average term (years)	10.6	10.7	7.9	11.0	7.9
Average credit quality	AA	AA	A	AA	AA

	Benchmark* (for Active subfund)	LW - Active subfund	LW - Inactive subfund	CC&L Active subfund	CC&L - Inactive subfund
March 31, 2020 Investment Return (%)*	1.6%	0.7%	2.8%	1.3%	2.8%
March 31, 2020 Value Added Investment Return (%)*	N/A	-0.9%	N/A	-0.3%	N/A

. * From Aon Report - Performance Review and Investment (Q1 Performance)

Table 16 - Performance of the Long-Term Fund managed by Pier 21 and Oakmark as at March 31, 2020*

Equity - Q1, 2020 (1st full quarter)	Pier 21	Oakmark
Portfolio (%)	-6.5	-28.3
Benchmark (%) (MSCI ACWI)	-13.9	-13.9
Value Added (%)	7.4%	-14.4

* From Aon Report - Performance Review and Investment (Q1 Performance)

On a book return basis, the Long Term Fund earned $187.9 million yielding an annual return of 6.3% as at December 31, 2019, as shown in the Table 17 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 full year of 2019 generated $106.4 million of realized capitals gains.

The LTF earned $31 million yielding an annualized return of 3.6% during the first quarter of 2020. The trading activities during this period generated $13.6 million in realized capital gains.

Table 17 - Long Term Fund Income ($millions)

Year	Average Fund Balance (Book Value)	Earned Income	Earned Return on Capital (Annualized)
2020 - Q1	$3,531.8	$31.0	3.6%
YTD - Dec. 31, 2019	$2,986.1	$187.9	6.3%
2019 - Q4	$3,246.5	$23.2	2.9%

Year	Average Fund Balance (Book Value)	Earned Income	Earned Return on Capital (Annualized)
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 $128.8 million (equivalent to approximately 3.7% rate of earned return net of Board expenses). The actual Board expenses for 2019 (include the fees for investment managers) were $2.1 million which was $5.3 million lower than forecasted. The underspending was mainly due to delays in completing contracts with investment managers as a result of various tax and insurance issues. The earned investment income in the LTF for 2019 was $187.9 million. Thus, the total investment income less Board expenses exceeded the budget by about $57.0 million.

Looking Ahead - 2020

The amount of forecasted earned investment income from the LTF required by the operating budget for 2020 is estimated at $143.0 million (equivalent to approximately 3.8% rate of earned return net of Board expenses). The $143.0 million is projected to be allocated between the operating budget ($75.0 million) and the Reserve Funds ($68.0 million). Similar to previous years, allocations will be finalized in 2021 after actual results are tabulated and confirmed by the Accounting Services Division. Table 17 shows the remaining investment income to be allocated from the $143.0 million.

Table 17 - Remaining Investment Income to be allocated in 2020

Required Income for 2020	Q1 Earned	Remaining 2020 Requirement
$143.0	$31.0	$112.0

Flow of Funds - Long Term Fund

As reported in December 2019, there was an excess of $500 million that was not required for the Short Term Fund. Subsequently, it 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.

There was an additional $500 million of projected excess available for transfer from the Short Term Fund to the Long Term Fund planned for April 2020. However, due to the current COVID-19 situation, this amount is no longer considered as excess liquidity and, as a result, was not transferred to Long Term Fund. Staff will continue to re-assess the City's liquidity position and advise accordingly.

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 fourth quarter of 2019 and the first quarter of March of 2020 (Attachment 1).

CONTACT

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SIGNATURE

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ATTACHMENTS

Attachment 1A – Compliance Certificates and Reports (October 2019 - December 2019)
Attachment 1B – Compliance Certificates and Reports (January 2020 - March 2020)
Attachment 2A – Performance Review and Investment (Aon) for the period ending December 31, 2019
Attachment 2B – Performance Review and Investment (Aon) for the period ending March 31, 2020