

## City of Toronto Investment Report for the Year 2020

**Date:** June 18, 2021

**To:** Executive Committee

**From:** Chief Finance 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 the year 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:

- \$180.4 million for the year of 2020 (3.0% annualized rate of return)

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

- \$39.3 million for the year 2020 (2.4% 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.

In total, there are now four fixed income managers and four global equity managers engaged in managing the long-term investments under the Toronto Investment Board. The final two global equity investment managers were funded in 2020. Both fixed income and equity investment classes are fully funded in accordance with the target asset mix in the Investment Policy with 70 percent allocated to fixed income and 20 percent to global equities. As at December 31, 2020, approximately 90 percent of both the Sinking Fund and the Long Term Fund were managed by external fund managers with the remaining 10 percent to be allocated to Real Assets. The Toronto Investment Board continues to evaluate opportunities in the Real Asset category.

Performance of the long-term investment portfolios in 2020 were in line with expectations on an earned income basis and did exceptionally well on a market value basis. It should be noted that performance of these funds are measured on a four year moving average basis in accordance with the Investment Policy. Subsequent to year-end, the Toronto Investment Board was reviewing options for ways to enhance return in

this low-interest environment. More information on this review will be provided in the next semi-annual report to City Council.

Short term cash balances, which are part of the Short Term Fund managed by staff, finished 2020 at above average levels. This was primarily due to the COVID pandemic and the uncertainty around several revenue sources. A sharp decline in short term interest rates due to changes by the Bank of Canada resulted in returns below expectations in 2020. We expect these short term interest rates to return to pre-COVID levels once the pandemic nears an end.

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

The Toronto Investment Board is in the process of hiring a third-party data provider in order to monitor and report on whether or not external investment firms hired by the City are compliant with the terms of the Investment Policy governing Environmental, Social, and Governance Factors. It is expected this information and data regarding climate change risk from these reviews be available for the next investment report due in December, and will continue to be reported to City Council on a semi-annual basis.

## **RECOMMENDATIONS**

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The Chief Finance 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 \$180.4 million for the year 2020.

The investment activities in the year of 2020 were compliant with the investment policies and goals adopted by City Council. The earnings for 2020 was below budgeted contribution to the Operating Budget by \$28.3 million.

The City's Sinking Funds portfolio earned \$39.3 million in the year 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 December 16, 17, and 18, 2020, City Council receive the report (November 25, 2020) from the Chief Financial Officer and Treasurer for information. This report provided the performance and compliance to the six month period ending June 30, 2020.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.EX19.8>

At its meetings held on July 28 and 29, 2020, City Council receive the report (July 7, 2020) from the Chief Financial Officer and Treasurer for information. This report provided the performance and compliance to year-end 2019 and the three months ending March 31, 2020.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.EX15.10>

At its meetings held on June 29 and 30, 2020, City Council adopted the Investment Policy Update report with amendments.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.EX14.2>

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>

## 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, invested assets in both the Long Term Fund and the Sinking Fund are managed by four external fixed income investment managers (70%) and two global equity pooled fund managers (7%).

The third global equity pooled fund manager was added in February 2020 for both the Long Term Fund and the Sinking Fund. The fourth and final global equity pooled fund manager was added in December 2020 and January 2021 for the Long Term Fund and the Sinking Fund respectively.

Both Fixed Income and Equity asset classes are fully funded in accordance to the target asset mix in the investment policy. As at December 31, 2020, approximately 90 percent of both the Long Term Fund and the Sinking Fund were managed by external investment managers selected by the Toronto Investment Board.

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

The four global equity pooled fund managers are Oakmark Global Pooled Fund II ("Oakmark"), Pier 21 WorldWide Equity Pool ("Pier 21"), Fiera Capital Common Contractual Fund ("Fiera CCF"), and Legal & General Investment management ("LGIM") for both the Long Term Fund and the Sinking Fund.

The remaining cash holdings are for future investment in real assets and upcoming debt repayment. Toronto Investment Board continues to evaluate investment opportunities in real assets.

### **Earned Investment Income of the General and Sinking Fund in 2020**

During the year 2020, staff continued to manage the Short Term Fund to meet City's liquidity needs while maximizing investment return. To date, the Toronto Investment Board ("Board") had selected and entered into agreements with four fixed income

investment managers and four global equity pooled fund managers to invest the Long Term and Sinking Funds.

As demonstrated in Table 1 below, the General Fund, which is composed of both the Short Term Fund and the Long Term Fund, and the Sinking Fund had average fund balances of \$6.1 billion and \$1.6 billion respectively during the year. The General Fund earned \$180.4 million (3.0% annualized rate of return on capital) over the 12 month period. The Sinking Fund earned \$39.3 million (2.4% annualized rate of return on capital) over this same time.

**Table 1 - Investment Portfolio for the Year 2020 (\$ millions)**

Portfolio	Average Weighted Capital Balance (Book Value)	Earned Income	Earned Return on Capital (Annualized)
<b>Total General Fund</b>	<b>\$6,079.7</b>	<b>\$180.4</b>	<b>3.0%</b>
Short Term Fund	\$2,487.3	\$32.8	1.3%
Long Term Fund	\$3,592.4	\$147.6	4.1%
<b>Sinking Fund</b>	<b>\$1,648.0</b>	<b>\$39.3</b>	<b>2.4%</b>

As shown in Table 2a below, the total investment income earned in 2020 was \$11 million lower than the forecasted income contribution to the operating budget. Table 2b is the historical table for reference. Short term interest rates were moved substantially lower by the Bank of Canada due to the COVID situation. The deferred property tax collection amid the pandemic also significantly lowered the City's cash balance. The coupling of lower short term interest rates and cash balance, the earned investment income from the Short Term Fund fell sharply as a result.

**Table 2a - Actual and Budget Gross Investment Earnings (Operating Budget)**

Investment earnings (\$ millions & Annualized Rate of Return)	Actual 2020	Budget 2020	% 2020 Budget
<b>Total General Fund</b>	<b>\$180.4 (3.0%)</b>	<b>\$191.4</b>	<b>- \$11.0</b>
Short Term Fund	\$32.8 (1.3%)	\$48.1	- \$15.3
Long Term Fund <sup>1</sup>	\$147.6 (4.1%)	\$143.3	+ \$4.3

<sup>1</sup>Include income allocation to Reserve Fund, which was \$17.3M higher than budgeted due to higher than forecasted Reserve Fund balances.

**Table 2b - Historical Allocation of Gross Investment Earnings for 2015 to 2019**

Investment Earnings (\$ millions)	2020	2019	2018	2017	2016	2015
1. Operating Budget	\$95.2	\$187.0 <sup>2</sup>	\$109.4	\$114.3	\$114.1	\$121.3

<b>Investment Earnings (\$ millions)</b>	<b>2020</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
2. Reserve Funds	\$85.3	\$80.3 <sup>2</sup>	\$47.1	\$16.6	\$16.3	\$16.5
<b>Total General Fund</b>	<b>\$180.5</b>	<b>\$267.3<sup>1</sup></b>	<b>\$156.5</b>	<b>\$130.9</b>	<b>\$130.4</b>	<b>\$137.8</b>
<b>Return on Capital</b>	<b>3.0%</b>	<b>4.3%</b>	<b>2.7%</b>	<b>2.6%</b>	<b>2.6%</b>	<b>2.7%</b>

<sup>1</sup> The investment return was abnormally high due to one-time non-recurring capital gains realized during the transition period when fund was transferred to the external investment managers.

<sup>2</sup> Previously reported \$185.5 for income allocation to operating budget and \$81.8 for income allocation to Reserve Funds due to accounting adjustment.

## **General Market Update and Portfolio Market Return in 2020**

The global financial markets have never experienced a year like 2020 with the COVID-19 pandemic resulting in significant levels of volatility in interest rates, credit, equity, and energy markets. In addition to the COVID-19 pandemic, the world also experienced an oil price war which pushed oil prices to record lows during the first half of 2020.

Alongside the market shocks were also historic levels of monetary and fiscal supports from central banks and governments around the world. The Bank of Canada conducted three 50 basis point rate cuts in March 2020 moving the Overnight Rate from 1.75 percent to 0.25 percent (a basis point is 1/100th of a percent). They also announced a variety of programs supporting market functionality, including the Provincial Money Market Purchase Program, Provincial Bond Purchase Program, CMB Purchase Program, and Insurance Mortgage Purchase Program.

During the second half of 2020, global equities continued to perform well supported by the anticipated COVID-19 vaccine program and accommodative monetary and fiscal policies. After breaking the pre-pandemic all-time high in third quarter, the MSCI All Countries World Index continued its strong run despite uncertainties around the U.S. elections, and surging COVID-19 cases and deaths during the fourth quarter. Both the U.S. Federal Reserve and the Bank of Canada kept their interest rate policy unchanged during the second half of 2020. The Bank of Canada pledged to keep it at the current low level of 25 basis points (0.25 percent) until 2023 or when inflation reaches two percent.

While the Canadian economy rebounded at a historic pace as businesses resumed after the COVID-19 lockdown during the second half of 2020, the two consecutive quarters of recovery still left the measure for the country's economic growth (Gross Domestic Product) down 5.4 percent for 2020 as a whole. On a year-over-year basis, as of the fourth quarter of 2020, Gross Domestic Product was down 3.2 percent from the same period a year earlier. There is still significant slack in the Canadian economy, however things are moving higher but it will take some time to reach full potential.

The lowering of short-term interest rates has an impact on longer-term interest rates (yields) in the bond market. The longer-term interest rates dropped by about one

percent in the first half of the year and regained approximately 15 basis points by the end of the year. The lowered rates resulted in positive total returns in the bond market in the short term over 2020. Conversely, higher long-term interest rates are associated with negative total returns in the bond market which is expected for 2021 as economic recovery continues.

Table 3 below shows the total benchmark rate of returns in market value as of December 31, 2020.

**Table 3 - Benchmark Returns<sup>1</sup> - As of December 31, 2020**

Benchmark	1 year	4 years (annualized)
FTSE Canada Universe Bond Index	8.7%	4.8%
S&P/TSX Composite Index	5.6%	6.6%
S&P 500 Index (\$CAD)	16.3%	14.6%
MSCI ACWI (Net)	14.2%	11.9%

<sup>1</sup>RBCIS Investment Analytics Report for the period ending December 31, 2020

### Market Performance of General Fund and Sinking Fund for 2020

Performance over short time periods tend to exhibit higher volatility of returns.

As an example, a substantial rebound in global equity markets followed the first quarter selloff. Volatility in global fixed income markets dissipated compared to the first quarter as well. As shown in Table 4 below, the General Fund (Short Term Fund and Long Term Fund) has outperformed the weighted market benchmark by 60 basis points (0.60 percent) during 2020. Also, from a longer investment horizon perspective, the General Fund has outperformed the market benchmark by 30 basis points (0.30 percent) on a 4-year annualized return basis.

**Table 4 – 2020 - Market Returns vs. Market Benchmarks (%) for the General Fund<sup>1</sup>**

	For the year 2020			4 year (annualized)		
	Short Term Funds <sup>2</sup>	Long Term Fund	General Fund	Short Term Funds <sup>2</sup>	Long Term Fund	General Fund
Portfolio Return (%)	1.3%	10.3%	6.0%	1.8%	5.3%	3.9%
Benchmark Return (%)	0.6%	9.8%	5.4%	1.1%	5.2%	3.6%
Value Added (%)	0.7%	0.5%	0.6%	0.7%	0.1%	0.3%

<sup>1</sup>Calculated from RBCIS Performance Analytics and Aon, Performance Review

<sup>2</sup>Including cash portion of the Long Term Fund

As shown in Table 5 below, the market return for the Sinking Fund was 10.2 percent for the year of 2020, and it has underperformed the weighted market benchmark by 1.6 percent. The investment managers use a customized benchmark index that more appropriately reflects the updated fixed income strategy (LDI - Liability Driven Investment) based on the required cash flows to fund future liabilities. The customized benchmark index does not have enough history for the 4-year measurement. RBCIS Performance Analytics will be used for reporting while track record continues to build.

**Table 5 - As of December 31, 2020 - Market Returns vs. Market Benchmarks (%) for the Sinking Fund<sup>1</sup>**

Sinking Fund	For the year 2020	4 year (annualized)
Portfolio Return	10.2%	4.8%
Benchmark Return	11.8%	4.9%
Value Added	-1.6%	-0.1%

<sup>1</sup> From RBCIS Performance Analytics and Aon Performance Review

Table 6 below shows the duration of the invested assets closely matches the duration of the liabilities. Bond duration is measurement of interest rate risk. It is a way of measuring how much bond prices are likely to change if and when interest rates move. By matching the duration of the assets and liabilities, investment managers can substantially reduce and eliminate the risk in the portfolio.

**Table 6 - As of December 31, 2020 - Duration for the Sinking Fund<sup>1</sup>**

(Years)	Duration
Portfolio Duration	13.4
Liability Duration	13.3

<sup>1</sup>From Aon Performance Review

## 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. A listing of these transactions are found in 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 for the year ending December 31, 2020. The breakdown of each portfolio is shown in Attachment 3.



There were no exceptions to report for the year ending December 31, 2020.

## **Reporting on Environmental, Social, and Governance (ESG) Performance**

When reviewing the last update to the Investment Policy in June 2020, City Council had requested the Chief Financial Officer and Treasurer, and the Toronto Investment Board to consider and incorporate internationally-recognized best practices for Environmental, Social and Governance.

The Toronto Investment Board is currently in the process of hiring a third-party data provider in order to monitor and report on external investment firms hired by the City are compliant with the terms of the Investment Policy governing Environmental, Social, and Governance Factors. It is expected this information and data regarding climate change risk from these reviews be available for the next investment report due in December 2021, and will continue to be reported to City Council on a semi-annual basis.

## **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