TORONTO

# REPORT FOR ACTION

# Sinking Fund and Long Term Fund - Performance and Compliance Update for the Fourth Quarter and Full Year of 2021

Date: March 14, 2022
To: Toronto Investment Board
From: Randy LeClair, 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 the fourth quarter and full year of 2021.

2. Investment Policy and Plan Compliance certificates and reports for the fourth quarter of 2021.


## 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 17, 2022, City Council adopted the 2022 Capital and Operating Budgets:
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2021.EX21.2

At its meeting on December 15, 2021, City Council adopted the report City of Toronto Investment Report for the six month period ending June 30, 2021
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2021.EX28.4

At its meeting on December 13, 2021, the Toronto Investment Board adopted the report Sinking Fund and Long-Term Fund - Performance and Compliance Update for the Third Quarter of 2021.
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2021.IB14.3

At its meeting of June 29, 2020, City Council adopted the Investment Policy Update
http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2020.EX14.2

## COMMENTS

### Highlights

The performance of the Long Term Fund (LTF) and Sinking Fund (SF) as at December 31, 2021 is shown in Table 1 below:

**Table 1 - Summary of Performance**[1]

| | Long Term Fund (LTF) - (%) | Sinking Fund (SF) - (%) |
|---|---|---|
| **Q4 2021** | 3.0 | 5.0 |
| **1 Year** | 3.2 | 2.0 |
| **2 Year (Annual)** | 6.7 | 6.0 |
| **Since Inception (January 7, 2019)** | 5.6 | 5.1 |

[1] Performance Review and Investment - December 31, 2021 (Aon) - Attachment 1B

Detailed market value performance information with benchmarks and attribution can be found in the reports provided by the investment consultant (Aon) in Attachment 1A and 1B. These returns do not include cash and other short term holdings of the LTF and SF and reflect the performance of the external investment managers only.

Compliance to the Investment Policy is checked monthly and a report from custodian (RBC) is provided to staff in addition to a Compliance Statement from the four investment managers with segregated mandates. These monthly reports and statements for the three months ending December 31, 2021 can be found in Attachment 4.

The remainder of this report along with Attachments 2, 3, and 5 provide further information regarding the funding, re-balancing, breakdown of holdings by investment manager, quarterly realized income, flow-of-funds, and other details.

## Performance Overview and Cash Flows

### Sinking Fund (SF)

### Activities and Balances:

As of December 31, 2021, external investment managers held $1.7 billion of invested assets. Table 2, 3 and 4 below show the balances and asset mix of the Sinking Fund managed by these investment managers as at December 31, 2021. Details on 2021 funding to investment managers is contained in Attachment 2. Attachment 3 (Tables A3-1 and A3-2) provide quarterly balance information during 2021.

**Table 2 - Balances in Market Value managed by Investment Managers ($millions)**

| Date | Fiera LDI | Addenda | Oakmark | Pier 21 | Fiera CCF[4] | LGIM | Total |
|---|---|---|---|---|---|---|---|
| May 1, 2019 (initial funding) | $679.8 | $679.9 | - | - | - | - | $1,359.7 |
| Dec. 31, 2019[1] | $498.7 | $489.4 | $62.2 | $62.0 | - | - | $1,112.3 |
| Dec. 31, 2020[2] | $739.7 | $745.6 | $75.8 | $86.1 | $74.1 | - | $1,721.3 |
| Dec. 31, 2021[3] | $587.5 | $580.3 | $89.6 | $101.9 | $91.8 | $252.1 | $1,703.2 |

[1]The decline in externally managed assets was due to the debt repayment in 2019.

[2]Asset mix rebalancing: $145 million and 166 million were transferred to Fiera LDI and Addenda on September 8, 2020 respectively. $45 million was transferred to each of Addenda and Fiera, $15.5 million was transferred to Fiera Capital, and $8.5 million was transferred to Oakmark in December 2020.

[3] $210 million was transferred to LGIM on January 6, 2021; $170 million was transferred out of each of Fiera LDI and Addenda on Nov 29th, 2021 for sinking fund maturity payment.

[4] Fiera CCF (Contractual Common Fund) is also known as Fiera Global Focused Equity on Aon's report

## Table 3 - Historical Asset Mix of the Sinking Fund

| Asset Class - Sectors | Policy Range | Policy Target | 12/31/19 | 12/31/20 | 12/30/21 |
|---|---|---|---|---|---|
| Segregated Short Term Fund (Internal) | 0-100% | 0.0% | 31.1% | 20.0% | 13.6% |
| Cash & Cash Equivalents (Investment Managers) | 0-5% | 0.0% | 0.1% | 0.2% | 0.5% |
| Government of Canada & Guarantees | 0-100% | 30.0% | 8.0% | 13.7% | 13.2% |
| Provincial (and Guarantees) & Municipal Bonds | 0-100% | 30.0% | 36.4% | 40.6% | 32.2% |
| Corporate Bonds | 0-60% | 10.0% | 16.9% | 14.5% | 13.3% |
| Global Equity Pooled Funds | 0-30% | 20.0% | 7.5% | 11.0%[1] | 27.2%[2] |
| Real Assets | 0-15% | 10.0% | N/A | N/A | N/A |
| Total | | 100.0% | 100.0% | 100.0% | 100% |

[1] The increase was due to funding to a new investment manager, Fiera Capital CCF.
[2] The increase was due to funding to a new investment manager, Legal & General Investment Management.

## Table 4 - Sinking Fund Asset Mix by Investment Managers as at December 31, 2021 (Market Value $ millions)

| Asset Mix - Sectors | Internal | Fiera LDI | Addenda | Oakmark | Pier 21 | Fiera CCF | LGIM | Total |
|---|---|---|---|---|---|---|---|---|
| Segregated Short Term Fund (Internal) | 269.0 | - | - | - | - | - | | 269.0 (13.6%) |
| Cash & Cash Equivalents (Investment Managers) | - | 10.3 | 0.8 | - | - | - | - | 11.1 (0.5%) |
| Government of Canada & Guarantees | - | 191.7 | 67.9 | - | - | - | - | 259.6 (13.2%) |
| Provincial (and Guarantees) & Municipal Bonds | - | 280.3 | 354.0 | - | - | - | | 634.3 (32.2%) |
| Corporate Bonds | - | 105.2 | 157.6 | - | - | - | | 262.8 (13.3%) |
| Global Equity Pooled Funds | - | - | - | 89.6 | 101.9 | 91.8 | 252.1 | 535.4 (27.2%) |
| Total | 269.0 | 587.5 | 580.3 | 89.6 | 101.9 | 91.8 | 252.1 | 1,972.2 (100.0%) |

The total Sinking Fund balance (including segregated cash) at the end of the year 2021 was $2.0 billion on a market value basis. This balance was comprised of 14 percent segregated short term fund (cash and equivalents), 59 percent fixed income, and 27 percent global equities.

During the fourth quarter of 2021, a $500 million debenture repayment was partially funded from the externally managed funds (Addenda and Fiera, $170 million each), and the rest was funded from the internally managed segregated Short Term Fund for the Sinking Fund. The remaining cash balance is set aside for the upcoming investment in real assets.

**Market Return Performance:**

As demonstrated in Table 5 below, the externally managed Sinking Fund outperformed its market return benchmark by 60 basis points for the full year in 2021. For the 12 month period ending December 31, 2021, the fixed income portion and global equity portion of the Sinking Fund outperformed the benchmark by 70 basis points and 180 basis points respectively.

Attachment 3 (Table A3-3 and A3-4) provides a highlighted performance breakdown by each investment manager.

The investment consultant (Aon) has also provided a performance breakdown for the Sinking Fund in Attachment 1A and 1B.

**Table 5 - Sinking Fund Market Return (%)[1]**

| As at December 31, 2021 | Allocation | Performance (%) | |
|---|---|---|---|
| **($ million)** | **Market Value** | **Q4, 2021** | **1-year** |
| Total Sinking Fund | $1,703.2 (100%) | 5.0% | 2.0% |
| Blended Benchmark - Total Fund | | 4.2% | 1.4% |
| **Value Added - Total** | | **0.8%** | **0.6%** |
| Fixed Income | $1,167.8 (68.6%) | 4.0% | -3.5% |
| LDI Benchmark[2] | | 3.8% | -4.2% |
| **Value Added - Fixed Income** | | **0.2%** | **0.7%** |
| Global Equity | $535.4 (31.4%) | 7.0% | 20.0% |
| Market Benchmark (MSCI ACWI) | | 6.9% | 18.2% |
| **Value Added - Equity** | | **0.1%** | **1.8%** |

[1] Performance Review and Investment (Q4 2021 Performance) - Aon - Attachment 1B

[2] Liability Driven Investment (LDI) benchmark is customized based on the Sinking Fund liability

**Sinking Fund - Book Return Performance:**

On a book return basis (excluding unrealized gain and losses), the Sinking Fund earned $18.5 million yielding a return of 0.9 percent during in 2021 as shown in Table 6 below.

**Table 6 - Sinking Fund Earned Income ($millions)**

| Year | Average Fund Balance (Book Value) | Earned Income | Earned Return on Capital (Annualized) |
|---|---|---|---|
| **2021** | **2,172.8** | **18.5** | **0.9%** |
| 2020 | $1,648.0 | $39.3 | 2.4% |
| 2019 | $1,713.8 | $83.1 | 4.9% |

For quarterly earned income in 2021, please refer to Attachment 3 (Table A3-5).

**Flow of Funds - Sinking Fund**

The City of Toronto repaid $150 million of debt at maturity from its 5 percent Sinking Sub-Fund in July and $500 million of debt at maturity from its 3.5 percent Sinking Sub-Fund in December, totalling $650 million of debt repayment during 2021. There are no debt maturities in 2022. The next maturity will be in September 2023 for $300 million.

On the debt issuance side, the City of Toronto issued $1 billion of long-term debentures in 2021 as shown in Table 7 below.

**Table 7 - 2021 Sinking Fund Debenture Issuances ($millions)**

| Issuance Date (Settlement) | Maturity Date | Size ($ millions) |
|---|---|---|
| April 29, 2021 | April 29, 2051 | $350.0 |
| July 26, 2021 | August 25, 2040 | $200.0 |
| September 28, 2021 | December 2, 2030 | $100.0 |
| November 23, 2021 | November 23, 2041 | $200.0 |
| December 21, 2021 | December 21, 2031 | $150.0 |

## Long Term Fund (LTF)

### Activities and Balances:

As of December 31, 2021, external investment managers held $3.6 billion of invested assets for the Long Term Fund (LTF). There were no funding contributions or withdrawals for the LTF in 2021 (Attachment 2).

Table 8, 9 and 10 below show the balances and asset mix of the LTF managed by the six investment managers as at December 31, 2021. Attachment 3 contains quarterly balances of the LTF during 2021 (Table A3-6 and A3-7).

**Table 8 - Balances in Market Value managed by Investment Managers ($millions)**

| Date | CC&L[3] | LW[3] | Oakmark | Pier 21 | Fiera CCF | LGIM | Total |
|---|---|---|---|---|---|---|---|
| May 1, 2019 (initial funding) | $1,050.2 | $1,053.8 | - | - | - | - | $2,104.0 |
| Dec. 31, 2019 | $1,242.8 | $1,248.3 | $122.2[1] | $122.8[1] | - | - | $2,736.1 |
| Dec. 31, 2020 | $1,362.0 | $1,363.4 | $131.9 | $153.0 | $129.1 | $384.6[2] | $3,524.0 |
| Dec. 31, 2021 | $1,334.5 | $1330.6 | $156.0 | $181.0 | $160.0 | $459.6 | $3,621.7 |

[1]$360 million cash ($120 million each) was transferred to the management of Oakmark, Pier 21 and Fiera CCF on Nov 1, 2019, Nov 1, 2019, and Feb 24, 2020 respectively

[2]$376 million cash was transferred to the management of LGIM on December 16, 2020

[3]Connor, Clark & Lunn Investment Management ("CC&L") and Leith Wheeler Investment Council ("LW")

**Table 9 - Historical Asset Mix Long Term Fund**

| Asset Class - Sectors | Policy Range | Policy Target | 12/31/19 (%) | 12/31/20 (%) | 12/31/21 (%) |
|---|---|---|---|---|---|
| Segregated Short Term Fund (Internal)* | 0-100% | 0.0% | 23.7% | 9.3% | 9.1% |
| Cash & Cash Equivalents (Investment Managers) | 0-5% | 0.0% | 0.8% | 0.3% | 0.8% |
| Government of Canada & Guarantees | 0-100% | 30.0% | 7.4% | 8.6% | 11.8% |
| Provincial (and Guarantees) & Municipal Bonds | 0-100% | 30.0% | 35.6% | 34.1% | 29.8% |
| Corporate Bonds | 0-60% | 10.0% | 25.8% | 27.1% | 24.5% |
| Global Equity Pooled Funds | 0-30% | 20.0% | 6.7% | 20.6% | 24.0% |
| Real Assets | 0-15% | 10.0% | N/A | N/A | N/A |
| **Total** | | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

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

**Table 10 - Long Term Fund Asset Mix by Investment Managers as at December 31, 2021 (Market Value $ millions)**

| Asset Mix - Sectors | Internal | CC&L | Leith Wheeler | Oakmark | Pier 21 | Fiera CCF | LGIM | Total |
|---|---|---|---|---|---|---|---|---|
| Short Term Fund (Internally Managed) | 364.9 | - | - | - | - | - | - | 364.9 (9.1%) |
| Cash & Cash Equivalents (Investment Managers) | - | 30.7 | 1.2 | - | - | - | - | 31.9 (0.8%) |
| Government of Canada & Guarantees | - | 282.0 | 187.8 | - | - | - | - | 469.8 (11.8%) |
| Provincial (and Guarantees) & Municipal Bonds | - | 586.4 | 601.8 | - | - | - | - | 1,188.2 (29.8%) |
| Corporate Bonds | - | 435.4 | 539.8 | - | - | - | - | 975.2 (24.5%) |
| Global Pooled Fund Equities | - | - | - | 156.0 | 181.0 | 160.0 | 459.6 | 956.6 (24.0%) |
| **Total** | **364.9** | **1,334.5** | **1,330.6** | **156.0** | **181.0** | **160.0** | **459.6** | **3,986.6 (100.0%)** |

Cash and short-term investment holdings in the LTF was reduced significantly from 24 percent to 9 percent after funding LGIM in December 2020. The current outstanding cash balance is primarily set aside for the upcoming investment in real assets. The total fund balance (including segregated short term fund) as at December 31, 2021 was $4.0 billion in market value. This balance is comprised of 9 percent segregated short term (cash) fund, 66 percent fixed income, and 25 percent global equities.

## Market Return Performance:

As shown in Table 11 below, the total externally managed LTF outperformed its blended benchmark by 60 basis points for the full year 2021. For the 12 month period ending December 31, 2021, the fixed income portion and global equity portion of the LTF outperformed their respective benchmarks by 50 basis points and 160 basis points respectively.

The blended benchmark for the total fund is calculated based on the weighted average return of the target asset mix including real assets, the plan is currently transitioning towards the target asset mix and is not yet fully allocated at this point.

Further details of performance for each investment manager has been prepared by the investment consultant (Aon) in Attachment 1A and 1B. Attachment 3 provides a summary of performance by investment manager (Table A3-8 and A3-9).

### Table 11 - Market Return (%) for the Long Term Fund (Actively Managed)[1]

| As at December 31, 2021 | Allocation | Performance (%) | |
|---|---|---|---|
| **($ million)** | **Market Value** | **Q4, 2021** | **1-year** |
| Total Fund Size | $3,421.1 (100%) | 3.0% | 3.2% |
| Blended Benchmark - Total Fund | | 2.5% | 2.6% |
| **Value Added - Total** | | **0.5%** | **0.6%** |
| Fixed Income | $2,464.5 (72.0%) | 1.5% | -2.0% |
| Benchmark Return[2] | | 1.5% | -2.5% |
| **Value Added - Fixed Income** | | **0.0%** | **0.5%** |
| Global Equity | $956.5 (28.0%) | 7.0% | 19.8% |
| Benchmark Return[3] | | 6.9% | 18.2% |
| **Value Added - Equity** | | **0.1%** | **1.6%** |

[1] From Aon Report - Performance Review and Investment (Q4 2021 Performance). In addition, there is $200.6 million under passive management in transition to active management over time.

[2] FTSE Canada Universe Bond Index

[3] Both LGIM and Fiera CCF use the MSCI World Index as the performance benchmark because they do not invest in emerging markets that are included in the MSCI ACWI Index. The Long Term Fund global equity composite, as an aggregate, is still benchmarked against the MSCI ACWI Index

The fixed income portion of the LTF is under the management of Connor, Clark & Lunn Investment Management (CC&L) and Leith Wheeler Investment Counsel Ltd (LW). Both managers have separated their portfolios into an Active sub-fund and an Inactive sub-fund. The proceeds from sales or maturities in the Inactive sub-funds have been reinvested and moved to the Active sub-fund. The remaining Inactive sub-fund balances are now about 11 percent and 4 percent of the assets under the management of LW and CCL respectively. 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 continue to progressively incorporate the Inactive sub-fund into the Active sub-fund either through bond maturities or liquidation when market conditions are appropriate.

**Book Return Performance:**

The book return performance only considers actual earned income from interest, dividends, capital gains/losses and other realized income. It does not include any unrealized capital gains which are taken into account for market value performance. The book value methodology is currently being calculated for accounting and budget purposes however will eventually be phased out.

On a book return basis, investment managers earned $69.3 million in the LTF yielding a return of 1.9 percent in 2021 as shown in Table 12 below. Quarterly earned income can be found in Attachment 3 (Table A3-10).

**Table 12 - Long Term Fund Earned Income ($millions)**

| Year | Average Fund Balance (Book Value) | Earned Income | Earned Return on Capital |
|---|---|---|---|
| **2021** | **$3,695.7** | **$69.3** | **1.9%** |
| 2020 | $3,592.4 | $147.6 | 4.1% |
| 2019 | $2,986.1 | $187.9 | 6.3% |

**Earned Income Requirement Update**

As of December 31, 2021, the LTF earned $69.3 million (unaudited), representing 52 percent of the targeted investment income contribution ($132.2 million) to the City's operating budget. The gross investment income from the LTF will be allocated to the Reserve Funds and the operating budget after deducting the Board expenses. Allocations will be finalized in 2021 after actual results are tabulated and confirmed by the Accounting Services Division. Similar to previous years, as the City has sufficient liquidity, cash will not be withdrawn from the LTF but instead will be remain and be reinvested.

The estimated amount of earned investment income contribution from the LTF required to the City's operating budget for 2022 is $94 million.

**Flow of Funds - Long Term Fund**

As reported in December 2019, $500 million of deemed excess liquidity was transferred to the LTF on November 1, 2019 from the Short Term Fund. The $500 million was allocated as per asset mix outlined in the Board approved Investment Plan.

In 2020, $496 million an internal transfer was completed within the LTF to fund new equity managers: Fiera Capital ($120 million) and LGIM ($376 million).

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

**Investment Policy and Plan Compliance**

According to provincial regulations, the Investment Policy must be reviewed by City Council at least annually. Council received the Investment Policy in December 2021 with the semi-annual performance report. There were no recommendations to update or change at that time. Previous to this, Council adopted the updated Investment Policy on June 29, 2020.

All investments in the Sinking Fund and Long Term Fund are consistent with the Investment Policy and the Investment Plan for the third quarter as of December 31, 2021 (Attachment 4).

## CONTACT

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## SIGNATURE

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## ATTACHMENTS

Attachment 1A - Toronto Investment Board - Discussion Guide Q4 2021 (Aon)
Attachment 1B - Performance Review and Investment - December 31, 2021 (Aon)
Attachment 2 - Historical Funding to Investment Managers (Contributions/Withdrawals)
Attachment 3 - 2021 Quarterly Fund Information
Attachment 4 - Compliance Certificates and Reports (October 2021 - December 2021)
Attachment 5 - Flow of Funds (Sinking Fund)