

# The Regional Municipality of York

Committee of the Whole  
Finance and Administration  
April 16, 2020

Report of the Commissioner of Finance

## 2019 Annual Investment Report

### 1. Recommendation

Council receive this report for information.

### 2. Summary

This report discusses the investment activities undertaken during 2019, as required by Ontario Regulation 438/97 (as amended) of the *Municipal Act, 2001* and the Region's Investment Policy.

Key Points:

- Realized investment returns for the General Fund totalled \$104.2 million (\$64.6 million in 2018) on an average investments of \$3,004 million (\$2,838 million in 2018), representing a return of 3.47% (2.28% in 2018)
- Realized investment returns on the Sinking Fund totalled \$30.8 million (\$18.4 million in 2018) on an average investments of \$699.5 million (\$645.8 million in 2018), representing a return of 4.41% (2.86% in 2018)
- All investments met the requirements of the investment policies approved by Council and the Sinking Fund Committee

### 3. Background

The Treasury Office manages both the General Fund and the Sinking Fund investment portfolios on behalf of the Region. As at December 31, 2019, these portfolios had a combined maturity value of approximately \$4.3 billion (\$4.1 billion in 2018).

#### **The General Fund investments adhere to the Region's Investment Policy**

The General Fund consists of investments held for the reserves and reserve funds, working capital and other funds of the corporation (Attachment 1). The maturity value of the investments at year end included fixed income securities of \$3,286 million (\$3,128 million in 2018) and equity investments of \$90 million (\$103 million in 2018), for a total of \$3,376 million (\$3,233 million in 2018).

General Fund investments adhere to the approved Investment Policy, which has the following objectives:

- Adherence to statutory requirements
- Preservation of capital
- Maintaining liquidity
- Earning a competitive rate of return

In addition, all investments must meet the eligibility requirements set out by Ontario Regulation 438/97 (as amended) of the Municipal Act, 2001, which specifies limits for each type of investment that can be held.

As at December 31, 2019, approximately 97% of the General Fund's portfolio consisted of fixed income or interest-producing investments. The remaining 3% represented equity investments that were managed by The ONE Investment Program, a fund sponsored by the Association of Municipalities of Ontario (AMO) and the Municipal Finance Officers' Association of Ontario (MFOA).

### **Sinking Funds will repay the principal amount of debentures at maturity**

The Sinking Fund portfolio is separately managed from the General Fund portfolio. It is funded from contributions set aside each year (as part of the annual Budget) to repay the principal amount of the sinking fund debentures at their maturity. In 2019, there were 11 sinking fund debentures which will mature between 2019 and 2043. The Sinking Fund portfolio held investments which had a maturity value of \$950 million (\$905 million in 2018) at year-end (Attachment 2). During the year, \$133.3 million of contributions were made to the Sinking Fund to meet the actuarial requirements for the retirement of those debentures. Investments within the Sinking Fund portfolio have been segregated to align with the maturity of their respective sinking fund debenture.

Sinking Fund investments are being held in trust on behalf of the Town of Newmarket, the Township of King, and York Region. All investments follow a policy established by the Sinking Fund Committee, which is similar to the Region's Investment Policy. An Annual Investment Report detailing the Sinking Fund investment activities is submitted to and approved by the Sinking Fund Committee, which is chaired by the Commissioner of Finance.

## **4. Analysis**

### **Short-term interest rates moved lower in 2019**

During 2019, U.S.-China trade issues dominated the market for much of the year, with new tariffs announced in May and August leading initially to declines in risk assets, and drawing responses from the U.S. Federal Reserve (the "Fed"). The back and forth between hope and fear about the U.S.-China trade conflict made for considerable volatility, driven as much by rumours and tweets as by substance.

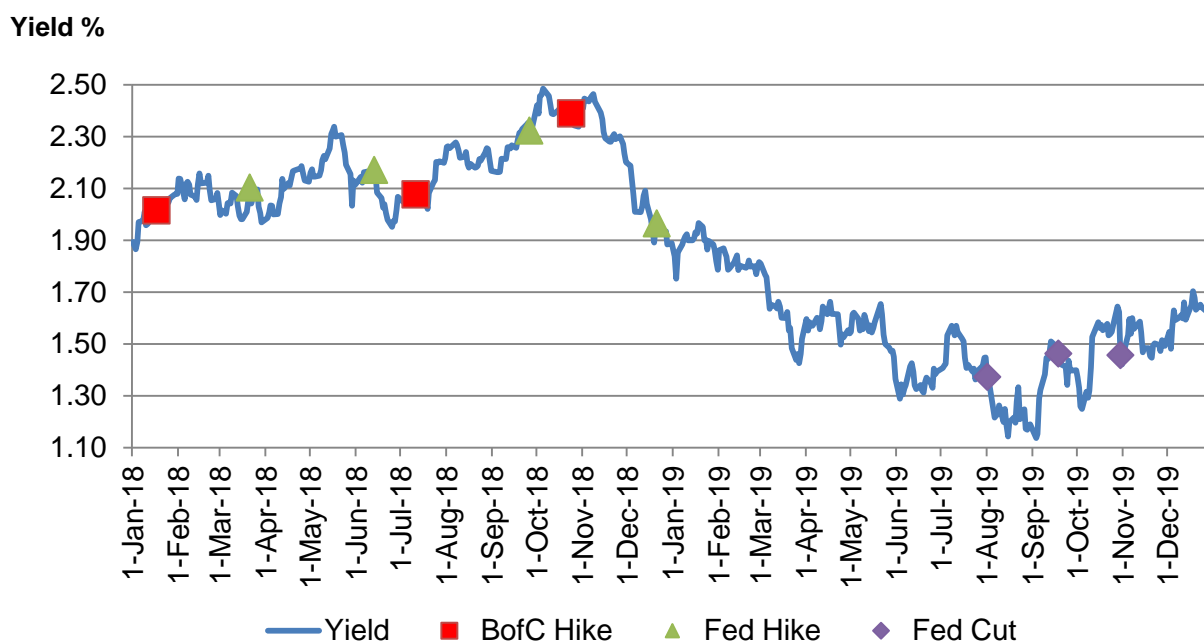
The Fed had raised rates 100 basis points (4 hikes) in 2018, in part on optimism about the recent tax cuts, and more fundamentally on the theory that tight labour markets would

eventually lead to inflation pressures. The Fed in 2019 shifted to emphasize the persistence of low inflation, and possible fallout of trade tensions and as a result lowered rates by 75 basis points during 2019.

The Bank of Canada (BoC) held rates steady at 1.75% throughout 2019, as inflation held steady at its 2% target, and by the fact its policy rate was already 50-75 bps below the US when the year began, lessening the need to follow the Fed in cutting. The BoC had been quite aggressive when it last raised rates in October 2018, but over the next few months it increasingly signaled a long pause was likely.

As depicted in Figure 1, the yield on five-year Government of Canada bond reached a peak near the end of the final quarter in 2018 as the Bank of Canada and the Fed ended their tightening cycle. Beginning in early 2019, the yield began to fall with the Fed cutting rates throughout the year as trade tension fueled recession fears.

**Figure 1**  
**5 Year Government of Canada Benchmark Bond**  
**(2018 to 2019)**



**The focus of the 2019 investment strategy was to be opportunistic and maintain reasonable liquidity levels**

The investment strategy set out in last year’s annual report centered on the following themes:

1. Maintain adequate liquidity levels to cover capital and operating expenses
2. Seek out opportunities to enhance portfolio return

Liquidity is made up of cash on hand and short-term investments with a maturity typically under two year. Maintaining adequate liquidity is an important objective of the Region’s Investment Policy. It is required to ensure the Region always has sufficient funds to meet its financial obligations as required. During 2019 the Region held on average \$1,137 million in bank deposits and short-term investments (under two years) representing approximately 34% of the portfolio to adequately meet these obligations.

The discipline of the investment program was maintained as the term of the portfolio was held relatively constant at three and one half years, similar to that of 2018. Credit quality of the portfolio was also maintained by holding a diverse range of securities with an overall average credit rating of AA.

As Figure 1 depicts, the level of interest rates declined over the course of 2019. As yields decreased there were fewer opportunities to extend the overall term of the portfolio. The investment team did however take advantage of declining rates and falling credit spreads (Figure 2) to increase realized capital gains to enhance portfolio returns. During the first half of 2019, the investment program was focused on purchasing both provincial and corporate securities at higher relative yield spreads to Government of Canada bonds. As interest rates declined and credit spreads tightened later in 2019, the investment team capitalized on these trends thereby generating over \$33 million in capital gains in 2019.

**Figure 2**  
**Credit Spreads for Ontario 10 Year Benchmark Bond**  
**and 5 Year Bank Debt**  
**(2018 – 2019)**



## The General Fund earned \$104.2 million for a return of 3.47%

In 2019, the General Fund generated realized returns of \$104.2 million (\$64.6 million in 2018) on an average portfolio balance of \$3.0 billion (\$2.8 billion in 2018). This equates to a rate of return of 3.47% (2.28% in 2018). Realized returns include actual interest income, dividend earnings and realized capital gains from the sale of securities. These returns are referred to as “realized” as they represent all cash income realized and credited to the reserves, reserve funds and other accounts.

Another method of calculating investment returns is referred to as mark-to-market returns (also known as total returns). Mark-to-market investment returns include the same components as realized returns, but also take into account any change in the market value of securities held from one period to the next.

This change in market value (due to the change in interest rates and stock market values) is not realized in the form of cash income, but rather is a potential gain or loss if all the investments being held are liquidated on the date of the calculation which for the purpose of this report was December 31, 2019.

As noted above, mark-to-market adjustments include the period over period change in the market value of the securities held in the portfolio. Bond prices are inversely related to interest rates. When interest rates rise, bond prices decrease and conversely when interest rates fall, bond prices increase. As indicated in Figure 1 above, in 2019 interest rates fell throughout the year and as a result bond values increased which resulted in a favorable mark-to-market impact. After accounting for the impact of an increase in market value, mark-to-market returns for 2019 totalled 5.04% (1.96% in 2018).

**Table 1**  
**York Region General Fund Portfolio**  
**Comparison of Realized and Mark-to-Market Returns 2014 – 2019**  
**(millions)**

Year	Average Assets	Realized Income	Realized Return*	Mark-To-Market** Adjustments	Mark-to-Market Income	Mark-to-Market Return*
2019	\$3,003.9	<b>\$104.2</b>	<b>3.47%</b>	\$47.2	\$151.4	5.02%
2018	\$2,838.2	<b>\$64.6</b>	<b>2.28%</b>	-\$8.9	\$55.7	1.96%
2017	\$2,661.1	<b>\$66.9</b>	<b>2.51%</b>	-\$7.2	\$59.7	2.24%
2016	\$2,306.7	<b>\$72.1</b>	<b>3.13%</b>	-\$22.7	\$49.4	2.14%
2015	\$2,093.8	<b>\$85.4</b>	<b>4.08%</b>	-\$16.9	\$68.5	3.27%
2014	\$2,010.0	<b>\$74.2</b>	<b>3.69%</b>	\$58.8	\$133.0	6.62%

\*These returns exclude program costs of approximately \$702,000 or 2.5 basis points

\*\*Market value (mark-to-market) adjustments reflect the gain or loss in value of securities over the prior year end valuation

After factoring in approximately \$702,000 in costs to operate the investment program (staff, safekeeping, market monitoring services, transaction costs, etc.), the net rate for the General Fund was 3.445%, a difference of 2.5 basis points. The 2.5 basis point cost compares favourably to the management fee charged by The ONE Investment Program, which equates to a weighted average of approximately 35 basis points.

### **The Sinking Fund earned \$30.8 million for a return of 4.41%**

In 2019, the Sinking Fund generated realized returns of \$30.8 million (\$18.4 million in 2018) on a portfolio averaging \$699.5 million (\$645.8 million in 2018). This equates to a realized rate of return of 4.41% (2.86% in 2018). The returns were \$12.4 million (\$0.7 million in 2018) higher than the \$18.4 million (\$17.7 million in 2018) required to meet the Sinking Fund's actuarial requirement for 2019.

The actuarial requirements of the Sinking Funds for the year are based on predetermined expected rates of return (set at time of the debenture issue) for each Sinking Fund. The expected rates of return range from 1.50% to 3.0% depending on the term characteristics (10 year, 20 year or 30 year) of the Sinking Fund. The Sinking Fund requirements are expected to accumulate to an amount sufficient to pay the related debentures face value on maturity. The excess of revenue over these requirements for the year is included in the fund balance.

### **The General Fund portfolio performance is compared to two benchmarks**

The investment performance of the General Fund Portfolio is compared to two different types of benchmarks: a managed fund benchmark and an index fund benchmark. Both benchmarks are considered fair references as they reflect the nature and scope of the mandate of the Region's investment program, as intended by the Investment Policy.

The managed fund benchmark is represented by the weighted composite returns of The ONE Investment Program's Money Market, Bond and Equity portfolios. Each of these funds is professionally managed by a different investment management firm selected and monitored by The ONE Investment Program.

The index fund benchmark the Region measures its performance against is provided by The Financial Times Stock Exchange (FTSE) Capital Markets Group which is a predominant provider of exchange-related indices throughout the world.

For the equity portion of the portfolio, the Region uses the S&P/TSX (Standard and Poor's/Toronto Stock Exchange) Composite Index, which is designed to measure the market activity of stocks listed on the Toronto Stock Exchange.

The Region's index-based benchmark, therefore, consists of the weighted composite returns of the FTSE Canadian Money Market, Short-Term Bond, Mid-Term Bond and Long-Term Bond indices and the S&P/TSX Composite Index. This benchmark reflects the returns earned on the passive investment of securities and can be easily tailored to reflect the changing nature of a portfolio over time. The FTSE/S&P Composite Index is used as the primary benchmark when assessing the Region's portfolio performance.

The composite mark-to-market return of this benchmark in 2019 was 4.27% (1.37% in 2018). York Region's portfolio return of 5.04% (1.96% in 2018) exceeded that benchmark by 0.77% (0.59% in 2018).

### **The General Fund Portfolio has consistently outperformed its benchmarks**

The 2019 results and comparisons for the last ten years for both The ONE Investment Program and the FTSE/S&P Composite Index are summarized in Table 2 and as also depicted in Figure 3.

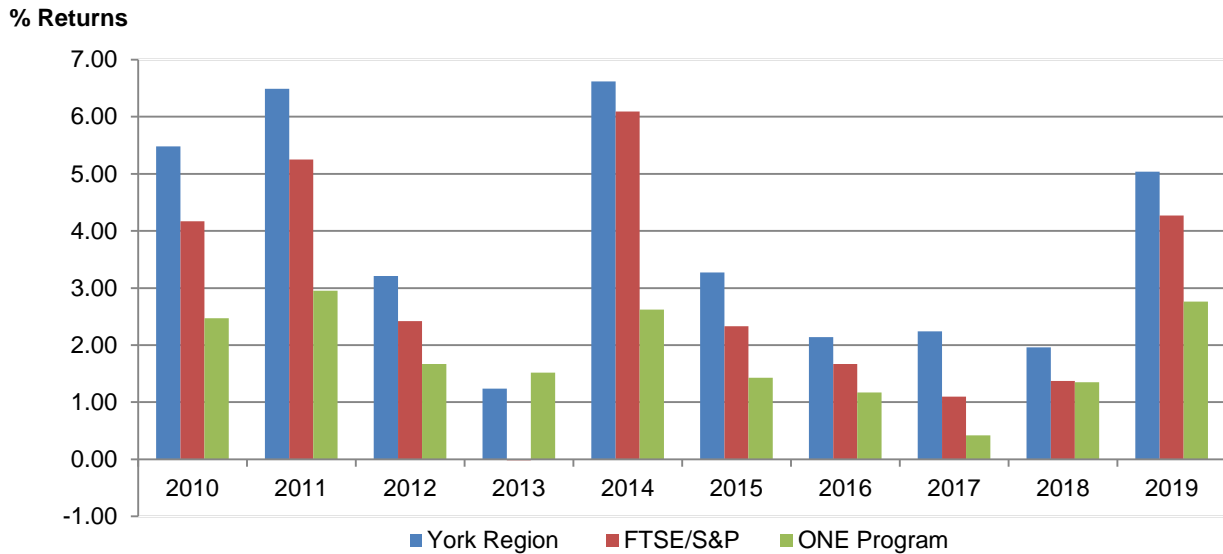
**Table 2**  
**Comparison of Mark-to-Market Returns**  
**General Fund versus FTSE/S&P Composite Index and ONE Program**

Year	York Region	FTSE TMX		ONE Program	
	Return %	Return %	Difference	Return %	Difference
2019	5.04	4.27	0.77	2.76	2.28
2018	1.96	1.37	0.59	1.35	0.61
2017	2.24	1.10	1.14	0.42	1.82
2016	2.14	1.67	0.47	1.17	0.97
2015	3.27	2.33	0.94	1.43	1.84
2014	6.62	6.09	0.53	2.62	4.00
2013	1.24	-0.02	1.26	1.52	-0.28
2012	3.21	2.42	0.79	1.67	1.54
2011	6.49	5.25	1.24	2.95	3.54
2010	5.48	4.17	1.31	2.47	3.01
<b>10 year average</b>	<b>3.77</b>	<b>2.87</b>	<b>0.90</b>	<b>1.84</b>	<b>1.93</b>

As Table 2 and Figure 3 indicates, the General Fund's investment returns have exceeded the FTSE/S&P Composite Index every year since 2010.

**Figure 3**

**Comparison of General Fund Mark-to-Market Investment Returns\***

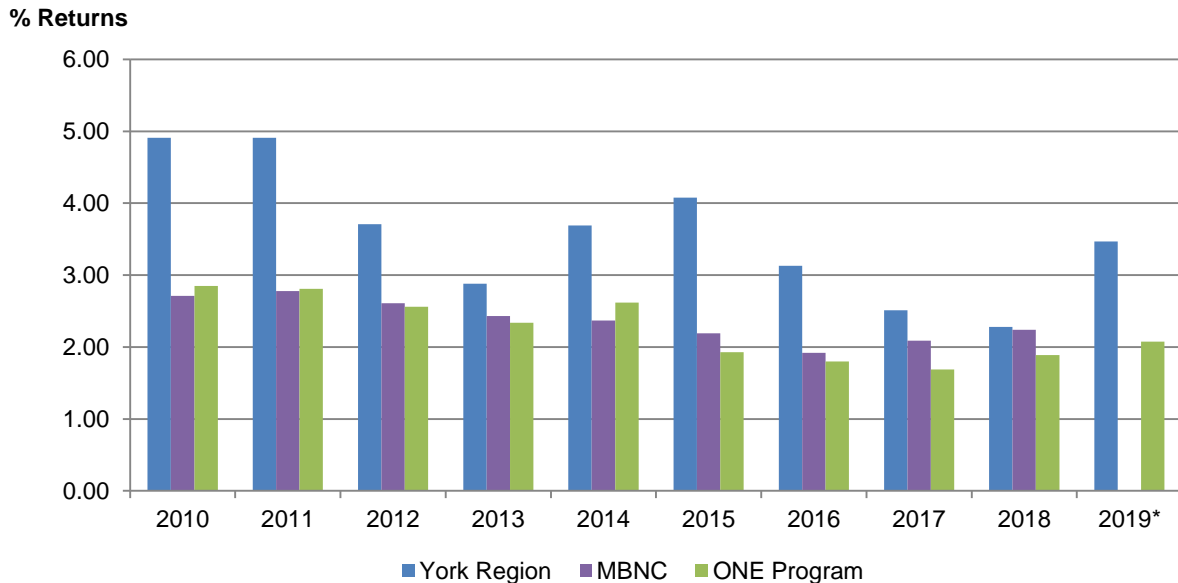


\*The 2013 FTSE/S&P return of -0.02% is not perceptible on graph

Figure 4 below compares the General Fund’s realized returns with those of the Municipal Benchmarking Network Canada (MBNC) and The ONE Program. As depicted York Region’s investment returns have significantly exceeded these respective returns every year since 2010. The MBNC comparison is a good measurement of how York Region’s investment program has performed compared to its peers both within Ontario and across Canada.

**Figure 4**

**Comparison of General Fund Realized Investment Returns**



\*MBNC 2019 data not available until June/July 2020

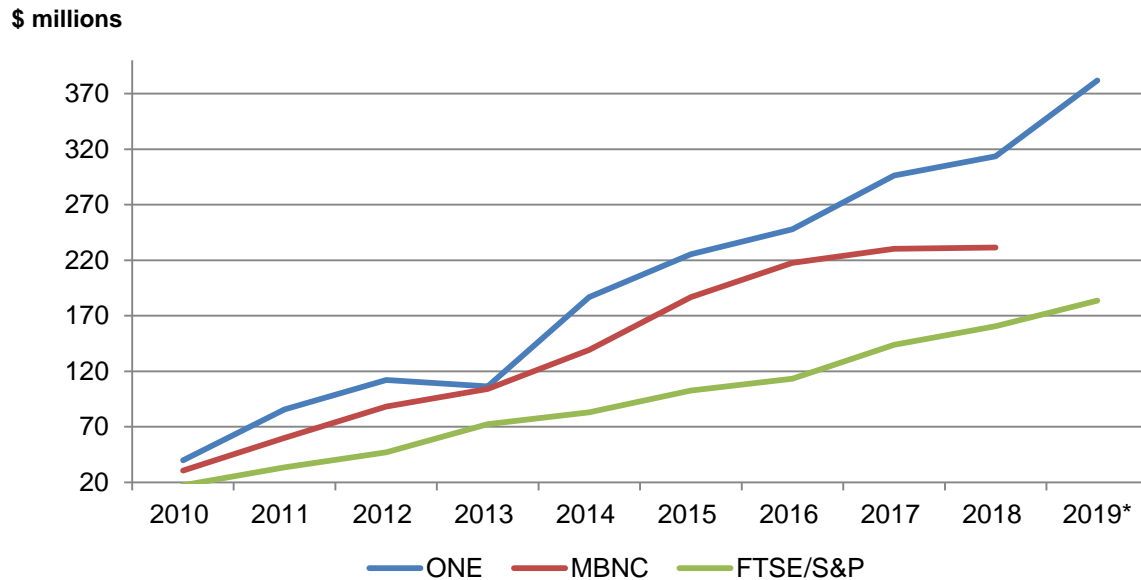


Figure 5 illustrates the amount of additional investment earnings York Region’s investment program has generated compared to its respective benchmarks and peer municipalities over the period from 2010 to 2019.

As depicted the General Fund portfolio earned \$184 million more compared to the FTSE/S&P, \$231 million more than the average return of the MBNC member municipalities and \$382 million more compared to The ONE Program.

**Figure 5**

**Cumulative Surplus Over Benchmarks and Municipal Peers**



\*MBNC 2019 data not available until June/July 2020

**General Fund holdings of the Region’s own debt did not change significantly in 2019**

As at December 31, 2019, approximately 1.67% of the General Fund portfolio was invested in York Region securities, compared to 1.11% a year ago. York Region’s securities are treated in the same way as any other securities in the portfolio. That is, these securities are bought when returns are promising and sold when funds are needed or other opportunities arise. Information regarding these transactions is presented in Attachment 3 as required by Ontario Regulation 438/97 (as amended) of the Municipal Act, 2001.

## **Investment themes for 2020 are to be defensive by focusing on preservation of principle and maintaining appropriate liquidity levels**

As recently as February 2020 equity markets in North America were reaching all-time highs and interest rates were continuing to hold at near historic lows. Risk assets, including equity and long term bonds reflected elevated valuations and as such represented more risk than reward.

With the onset of the coronavirus outbreak all asset classes have come under significant selling pressure and global capital markets have come under substantial strain. Market swings and volatility have seen historic extremes. The timing for the resolution of this crisis is, at time of writing, still unknown as is the final impact on the global economy and capital markets. Consequently, the strategy for the investment program during 2020 is to be more defensive with the goal to preserve capital rather than reach for marginal extra return at the risk of potentially large capital losses.

With that in mind, the following themes will guide the 2020 investment program:

1. Protection of York Region's investment assets
2. Maintain appropriate liquidity levels to cover capital and operating expenses

## **5. Financial**

### **The Region generated a realized investment return of \$104.2 million on the General Fund in 2019**

The Region generated a realized investment return of \$104.2 million (\$64.6 million in 2018) on the General Fund in 2019. After costs, the total return was \$23.1 million (\$16.7 million in 2018) higher than the principal benchmark, the FTSE/S&P Composite Index, and \$68.5 million (\$17.3 million) higher than The ONE Investment Program. These returns augment reserve and reserve fund balances over the longer term potentially reducing future levels of required contributions to these funds.

### **Realized investment returns on the Sinking Fund totalled \$30.8 million**

In 2019, the Sinking Fund generated realized returns of \$30.8 million (\$18.4 million in 2018) on a fixed income portfolio averaging \$699.5 million (645.8 million in 2018). This equates to a realized rate of return of 4.41% (2.86% in 2018). The returns were \$12.4 million (\$0.7 million in 2018) higher than the \$18.4 million (\$17.7 million) required to meet the Sinking Fund actuarial requirement for 2019.

## **6. Local Impact**

Returns generated from the General Fund portfolio have no direct impact on area municipalities. However, higher returns realized by the Sinking Fund portfolio help defray costs of borrowing for those municipalities participating in these Sinking Funds.

## 7. Conclusion

In 2019 the General Fund investment portfolio generated \$104.2 million (\$64.6 million in 2018), for a realized return of 3.47% (2.28% in 2018). This exceeded the FTSE/S&P and ONE Investment Program benchmarks by 77 basis points (59 basis points in 2018) and 2.28 basis points (61 basis points in 2018) respectively.

The Sinking Fund investment portfolio generated realized returns totaling \$30.8 million (\$18.4 million in 2018), which was \$12.4 million (\$0.7 million in 2018) higher than the actuarial requirement for the year.

It is the opinion of the Commissioner of Finance that all investments were made in accordance with the investment policies and goals approved by Council and the Sinking Fund Committee.

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For more information on this report, please contact Edward Hankins, Director, Treasury Office and Deputy Treasurer at 1-877-464-9675 ext. 71644. Accessible formats or communication supports are available upon request.

Recommended by: **Laura Mirabella, FCPA, FCA**  
Commissioner of Finance and Regional Treasurer

Approved for Submission: **Bruce Macgregor**  
Chief Administrative Officer

March 6, 2020  
Attachments (8)  
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