

The Regional Municipality of York

Committee of the Whole
Finance and Administration
May 13, 2021

Report of the Commissioner of Finance

2020 Annual Investment Report

1. Recommendations

Council receive this report for information.

2. Summary

This report discusses the investment activities undertaken during 2020, as required by Ontario Regulation 438/97 (as amended) of the *Municipal Act, 2001* and the *Investment Policy*.

Key Points:

- Realized investment returns for the General Fund totalled \$124.4 million (\$104.2 million in 2019) on an average investment of \$3,306 million (\$3,004 million in 2019), representing a return of 3.76% (3.47% in 2019)
- Realized investment returns on the Sinking Fund totalled \$35 million (\$30.8 million in 2019) on average investments of \$836.9 million (\$699.5 million in 2019), representing a return of 4.18% (4.41% in 2019)
- 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, 2020, these portfolios had a combined maturity value of approximately \$4,992 million (\$4,326 million in 2019).

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 \$3,798 million (\$3,286 million in 2019), and equity investments of \$136 million (\$90 million in 2019), for a total of \$3,934 million (\$3,376 million in 2019).

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, 2020, approximately 96% of the General Fund's portfolio consisted of fixed income or interest-producing investments. The remaining 4% 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). Attachments 2A and 2B provide a further breakdown of General Fund portfolio holdings by sector. In addition, Attachment 3 provides the maturity distribution of these holdings. The average term of the portfolio in 2020 was 3.7 years which is less than the benchmark term of 5 years.

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 the contributions set aside each year (as part of the budget) to repay the principal amount of the sinking fund debentures at their maturity. In 2020, there were 11 sinking fund debentures which will mature between 2020 and 2043. The Sinking Fund portfolio held investments which had a maturity value of \$1,058 million (\$950 million in 2019) at year-end (Attachment 4). During the year, \$152.5 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. Attachment 5 provides a breakdown of Sinking Fund portfolio holdings by sector.

Sinking Fund investments are being held in trust on behalf of the Town of Georgina, 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*.

4. Analysis

Financial markets were very volatile during 2020 with the global pandemic leading to significant economic issues

The past year was an extraordinary year for financial markets with the global pandemic leading to significant economic restrictions and the biggest recession since the 1930s. This was followed by major government and central bank intervention that drove a rapid recovery in many sectors of the economy, including a strong rebound in financial markets.

Federal government bond yields declined sharply in March 2020 in both the US and Canada (Figure 1) and remained near record lows throughout the balance of the year. The US Federal Reserve and Bank of Canada implemented a diverse basket of monetary stimulus measures similar to those used to deal with the 2008/09 financial crisis. These measures included establishing near-zero policy interest rates, substantial Quantitative Easing (central bank purchases of government bonds) and providing loans against a broad range of collateral including corporate bonds. All these measures proved to be effective in supporting financial systems and markets.

The Canadian federal government deficit reached 17.75% of GDP, the highest among G7 countries. Fiscal and monetary authorities also coordinated their interventions to a considerable degree, with the central bank introducing several programs like provincial bond-buying, in part because it recognized the risk that increased issuance could add to market disruptions. Concerns about elevated federal government debt issuance subsided quickly and have remained well contained so far, as the unprecedented auction sizes were well absorbed by the market, helped by the Bank of Canada's large-scale Quantitative Easing program.

Figure 1
5 Year Government of Canada Benchmark Bond
(2019 to 2020)



The focus of the 2020 investment strategy was to be defensive and maintain reasonable liquidity levels

Coming into 2020, the Region's investment program had taken on a much more conservative posture as interest rates were declining during the latter half of 2019 while equity markets continued to climb. The Region responded to these trends by reducing its equity position and raising the liquidity of the portfolio. As a result, the investment portfolio was in a very good position to weather the coming crisis that was to unfold during the first quarter of 2020.

The investment strategy set out in last year's annual report therefore, centered on the following two major themes:

1. Be defensive and protect York Region's investment assets
2. Maintain appropriate liquidity levels to cover capital and operating expenses

Liquidity is made up of cash on hand and short-term investments with a maturity typically under two years. 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 objectives as required. During 2020, the Region held on average, \$1,168 million in bank deposits and short-term investments (under two years), representing approximately 35% of the portfolio to adequately meet these obligations.

Being in a defensive position allowed the Region to capitalize on market volatility

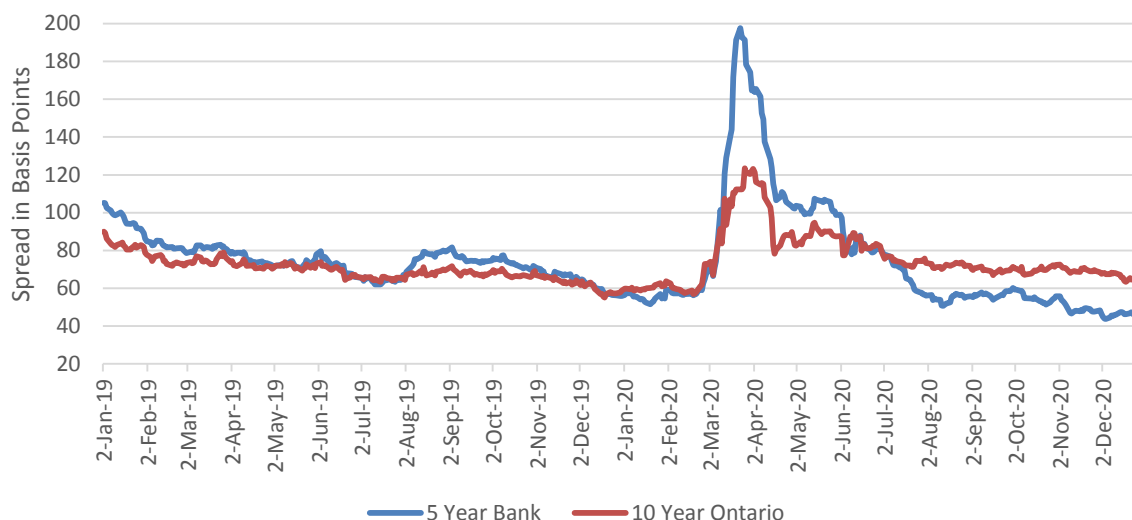
With the onset of the COVID-19 pandemic, capital markets became quite volatile. Investor uncertainty in the early days of the pandemic led to impulse selling. Equity markets fell and credit spreads for corporate, provincial and municipal securities widened considerably. Preservation of capital became the focus of government, corporations, and institutional investors.

Although the value of the Region's equity portion of the portfolio initially decreased in the early days of the crisis, the increase in the value of the fixed income portion (as interest rates declined) of the portfolio more than compensated. The discipline of the Region's investment program and its focus on term and credit risk management proved beneficial throughout the crisis.

This discipline was maintained as the term of the portfolio was held relatively constant at three and one half years, similar to that of 2019. Liquidity levels were kept elevated first to protect the Region's capital, and also to provide the opportunity to capitalize on market fluctuations. Credit quality of the portfolio was also maintained by holding a diverse range of securities with and overall average credit rating of AA.

As Figure 1 depicts, the level of interest rates declined over the course of 2020. As yields decreased there were few opportunities to extend the overall term of the portfolio. The investment team did however take advantage of declining rates and volatile credit spreads to increase realized capital gains to enhance portfolio returns. During the first half of 2020, 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 2020, the investment team capitalized on these trends, thereby generating over \$52 million in fixed income capital gains in 2020.

Figure 2
Credit Spreads for Ontario 10 Year Benchmark Bond and 5 Year Bank Debt
(2019 – 2020)



In addition, as equity markets sold off in the first half of 2020 (Figure 3), the Region was able to reinvest funds raised from equity sales in 2019 at much lower levels. Again, as equity values rose late in 2020, some of these positions were sold to realize equity capital gains of \$9.5 million.

Figure 3
S&P/TSX Composite Index
(2019 – 2020)



The General Fund earned \$124.4 million for a return of 3.76%

In 2020, the General Fund generated realized returns of \$124.4 million (\$104.2 million in 2019) on an average portfolio balance of \$3.03 billion (\$3.0 billion in 2019). This equates to a rate or return of 3.76% (3.47% in 2019). 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 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, 2020.

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, 2020 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 2020 totalled 5.72% (5.04% in 2019).

Table 1
York Region General Fund Portfolio
Comparison of Realized and Mark-to-Market Returns 2016 – 2020
(millions)

Year	Average Assets	Realized Income	Realized Return*	Mark-To-Market** Adjustments	Mark-to-Market Income	Mark-to-Market Return*
2020	\$3,305.7	\$124.4	3.76%	\$53.5	\$177.9	5.38%
2019	\$3,003.9	\$104.2	3.47%	\$47.2	\$151.4	5.04%
2018	\$2,838.2	\$64.6	2.28%	-\$8.9	\$55.7	1.96%
2017	\$2,661.1	\$66.9	2.51%	-\$7.2	\$59.7	2.24%
2016	\$2,306.7	\$72.1	3.13%	-\$22.7	\$49.4	2.14%

*These returns exclude program costs of approximately 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 \$800,000 in costs to operate the investment program (staff, safekeeping, market monitoring services, transaction costs, etc.), the net return for the General Fund was 3.735%, 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.

Investment income earned during the year is allocated back to the source of the funds that have been invested. The sources are comprised of reserves, reserve funds as well as various deferred revenue accounts (e.g. development charges) that are held by the Region. In accordance with the *Investment Policy*, the anticipated length of time that funds are expected to be held in each of the reserves or deferred revenue accounts determines whether those funds will receive the short, medium or long term interest rate that the Region earns on its investment portfolio.

The Sinking Fund earned \$35 million for a return of 4.18%

In 2020, the Sinking Fund generated realized returns of \$35 million (\$30.8 million in 2019) on a portfolio averaging \$836.9 million (\$699.5 million in 2019). This equates to a realized rate of return of 4.18% (4.41% in 2019). The returns were \$15.4 million (\$12.4 million in 2019) higher than the \$19.6 million (\$18.4 million in 2019) required to meet the Sinking Fund's actuarial requirement for 2020.

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, 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 2020 was 4.98% (4.27% in 2019). York Region's portfolio return of 5.38% (5.04% in 2019) exceeded that benchmark by 0.40% (0.77% in 2019).

The General Fund Portfolio has consistently outperformed its benchmarks

The 2020 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 Return %	FTSE TMX Return %	Difference	ONE Program Return %	Difference
2020	5.38	4.98	0.40	3.77	1.61
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
5 year average	3.35	2.68	0.67	1.89	1.46

As Table 2 and Figure 4 indicates, the General Fund's investment returns have exceeded the FTSE/S&P Composite Index every year since 2016. The returns have been achieved while consistently keeping both credit and term risk exposures at prudently low levels. The average credit rating of securities held in the portfolio is maintained at AA and the average term under four years.

Figure 4

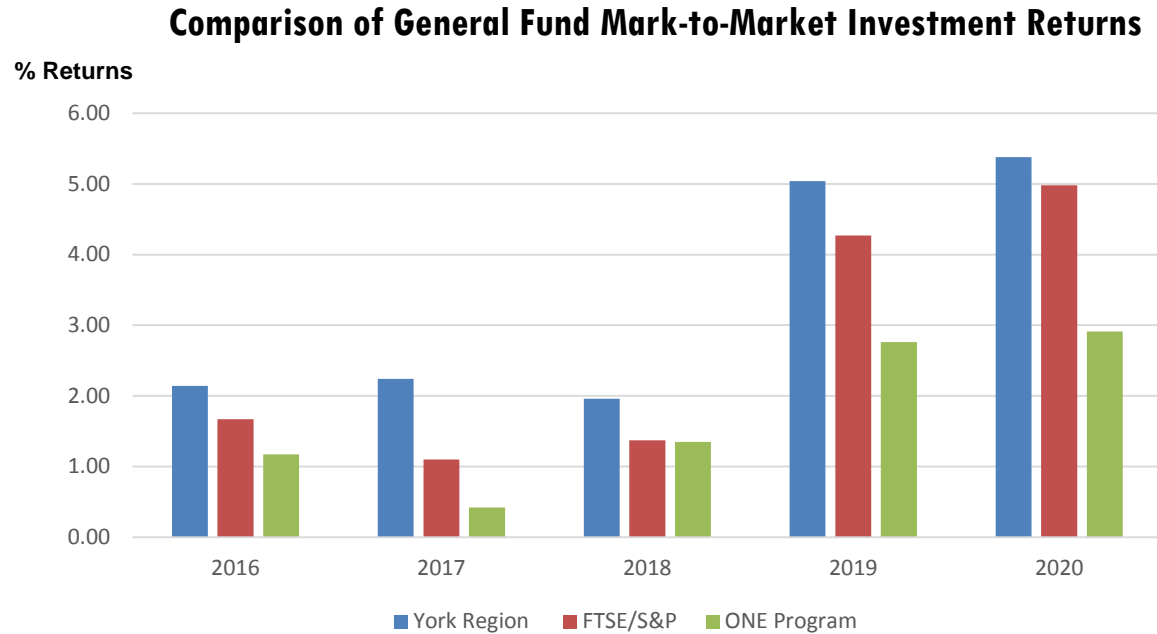
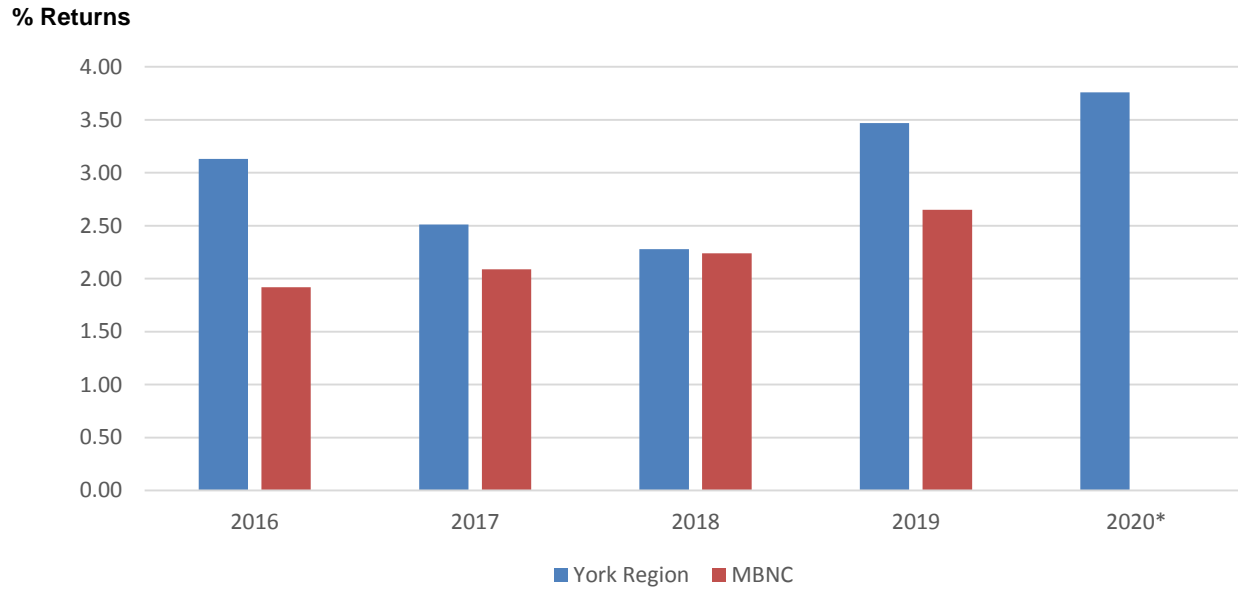


Figure 5 below compares the General Fund's realized returns with those of the Municipal Benchmarking Network Canada (MBNC). The MBNC comparison is a good measurement of how York Region's investment program has performed compared to municipal peers both within Ontario and across Canada. As depicted, York Region's investment returns have significantly exceeded these respective returns every year since 2016.

Figure 5

**Comparison of General Fund Realized Investment Returns
with Municipal Peers**



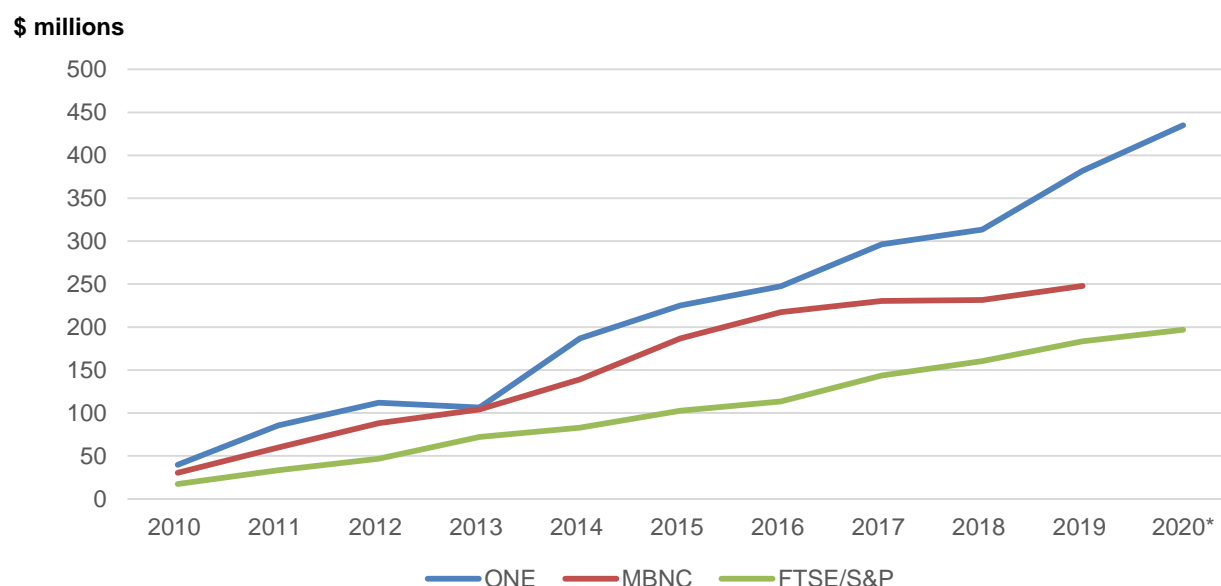
*MBNC 2020 data not available until June/July 2021

Figure 6 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 2020.

As depicted, the General Fund portfolio earned \$197 million more compared to the FTSE/S&P, \$248 million more than the average return of the MBNC member municipalities and \$435 million more compared to The ONE Program.

Figure 6

Cumulative Surplus Over Benchmarks and Municipal Peers



*MBNC 2020 data not available until June/July 2021

General Fund holdings of the Region's own debt did not change significantly in 2020

As at December 31, 2020, approximately 1.49% of the General Fund portfolio was invested in York Region securities, compared to 1.67% 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 6 as required by Ontario Regulation 438/97 (as amended) of the *Municipal Act, 2001*.

Investment themes for 2021 are similar to 2020 and remain to be defensive and maintaining adequate liquidity levels

Investment themes for 2021 are similar to last year which focus on conservative asset allocation and maintaining elevated liquidity.

During 2020 government initiatives globally helped support individuals, corporations and economies. These measures helped to avoid what would certainly have been worse financial and social outcomes. These initiatives were both fiscal and monetary in nature and included trillions of dollars of subsidies and support programs, as well as coordinated programs meant to reduce interest rates to historic low levels.

Economies have rebounded as have global equity markets, with most reaching new highs beyond pre-COVID-19 levels. Fixed income markets that reflect money market and bond yields still near record lows are exhibiting signs of excessive exuberance. Risk levels and risk

tolerance in both of these market sectors are now much higher than they were one year ago pre-COVID-19.

The strategy for the investment program during 2021 will continue to be defensive with the objective to preserve capital and await better market opportunities.

With that in mind, the following themes will guide the 2021 investment program:

1. Protection of York Region's portfolio assets through conservative asset allocation.
2. Continue to maintain adequate liquidity levels to cover capital and operating expenses and to provide readily accessible funds to invest when opportunities arise.

5. Financial Impact

The Region generated a realized investment return of \$124.4 million on the General Fund in 2020

The Region generated realized record investment returns of \$124.4 million (\$104.2 million in 2019) on the General Fund in 2020. After costs, the total return was \$13.2 million (\$23.1 million in 2019) higher than the principal benchmark, the FTSE/S&P Composite Index, and \$53.2 million (\$68.5 million in 2019) 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 \$35 million

In 2020, the Sinking Fund generated realized returns of \$35 million (\$30.8 million in 2019) on a fixed income portfolio averaging \$836.9 million (699.5 million in 2019). This equates to a realized rate of return of 4.18% (4.41% in 2019). The returns were \$15.4 million (\$12.4 million in 2019) higher than the \$19.6 million (\$18.4 million in 2020) required to meet the Sinking Fund actuarial requirement for 2020.

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 2020 the General Fund investment portfolio generated \$124.4 million (\$104.2 million in 2019), for a realized return of 3.76% (3.47% in 2019). This exceeded the FTSE/S&P and ONE Investment Program benchmarks by 40 basis points (77 basis points in 2019) and 161 basis points (228 basis points in 2019) respectively.

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

Approved for Submission: 
Bruce Macgregor
Chief Administrative Officer

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Attachments (7)
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