

The Regional Municipality of York

Committee of the Whole
Finance and Administration
May 5, 2022

Report of the Commissioner of Finance

2021 Annual Investment Report

1. Recommendations

Council receive this report for information.

2. Summary

This report discusses the investment activities that were undertaken during 2021, 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 totaled \$99.8 million on an average investment of \$3.838 billion, representing a return of 2.60%
- Total returns exceeded the FTSE/S&P Index and ONE Investment Program benchmarks by 1.98% and 1.48% respectively
- Realized investment returns for the Sinking Fund totaled \$25.9 million on average investments of \$860.4 million, representing a return of 3.01%
- All investments made during the year 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, 2021, these portfolios had a combined maturity value of approximately \$5.562 billion.

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 (Table 1). The maturity value of these investments

at year end included fixed income securities of \$4.300 billion, and equity investments of \$137 million, for a total of \$4.437 billion.

Table 1
General Fund Portfolio Holdings
As at December 31, 2021
(\$millions)

Category	Total	% Total
Cash*	1,636	37%
Fixed Income	2,664	60%
Equity	137	3%
Total	4,437	100%

* Cash is in the form of bank deposits and high interest savings accounts

General Fund investments were made in accordance with the Region's Investment Policy, which has the following objectives:

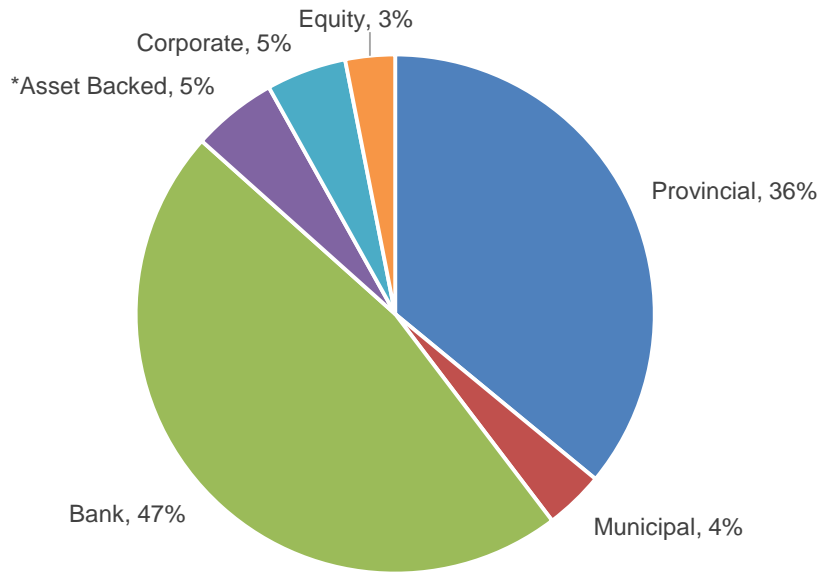
- Adherence to statutory requirements
- Preservation of capital
- Maintaining liquidity
- Earning a competitive rate of return

In addition, all investments met the eligibility requirements that are 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 shown on Table 1, on December 31, 2021, approximately 97% of the General Fund's portfolio consisted of fixed income or interest-producing investments. The remaining 3% were equity investments that are managed through the ONE Investment Program, a fund sponsored by the Association of Municipalities of Ontario (AMO) and the Municipal Finance Officers' Association of Ontario (MFOA). Figure 1 provides a breakdown of the investment held by sector categorization.

In addition, Attachment 1 provides the maturity distribution of the holdings. In 2021, the average term of the entire portfolio was 3.5 years, which was below the benchmark term of 5 years. The risk of a change in value of the portfolio holdings as a result of rising interest rates was mitigated by limiting its term exposure.

Figure 1
General Fund Holdings by Sector Categorization
As at December 31, 2021



*Asset Backed Securities (ABS) are a type of financial investment that is collateralized by an underlying pool of high quality assets and are all AAA rated

Sinking Funds are held to repay the principal amount of the debentures at their maturity

Most of the debentures issued by York Region are required under the *Municipal Act* to have a Sinking Fund that is used to repay the principal amount of the debenture at its maturity. In 2021, there were 11 of these “sinking fund” debentures outstanding that would mature between 2021 and 2043. The Sinking Fund portfolio are investments that are being held for this purpose and on December 31, 2021, they had a maturity value of \$1.125 billion (Table 2).

Table 2
York Region Sinking Fund Portfolio Holdings
As at December 31, 2021 (\$millions)

Category	Total	% Total
Cash*	62	6%
Fixed Income - Provincial	1,063	94%
Total	1,125	100%

* Cash is in the form of bank deposits and high interest savings accounts

During 2021, \$185 million was contributed into the Sinking Fund to meet the actuarial requirements needed for the retirement of those debentures. Also, during the year, a sinking fund debenture matured and \$180 million was drawn out of the portfolio to repay this debt obligation. Investments within the Sinking Fund portfolio are segregated to align with the maturity of their respective sinking fund debenture.

Sinking Fund investments in the portfolio are being held in trust on behalf the participants of the debentures which included the Town of Georgina, the Township of King and York Region. All investments follow a policy that was established by the Sinking Fund Committee¹, that is similar to the Region's own Investment Policy.

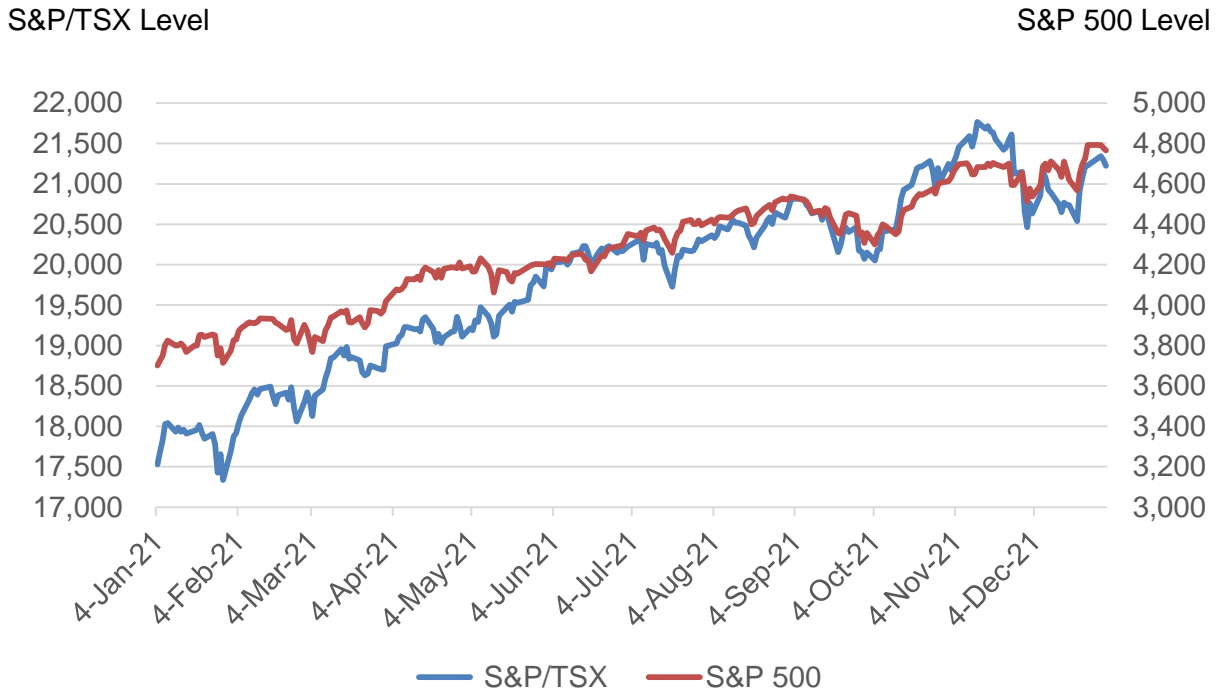
4. Analysis

Financial markets have started to recover from the impact of the pandemic which has led to higher interest rates

The dominant factor affecting financial markets during 2021 continued to be the COVID-19 pandemic. Although not as severe a market disrupter as it was in 2020, its influence was still substantial both in a positive and negative way.

¹ The Sinking Fund Committee is comprised of York Region's Commissioner of Finance (Chair), the Director of Corporate Services and Treasurer for the Town of Georgina, the Deputy City Manager, Corporate Services, City Treasurer and Chief Financial Officer for the City of Vaughan, and the Director of Finance and Treasurer for the Township of King

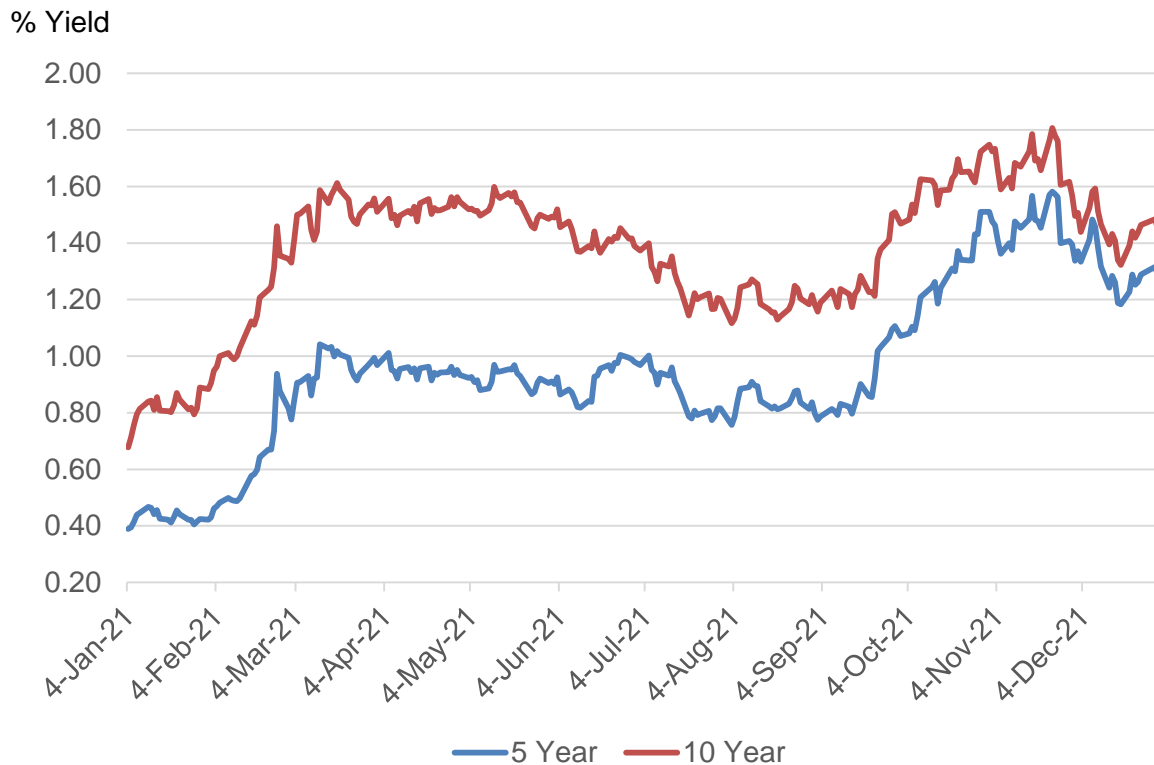
Figure 2
S&P/TSX Composite Index and S&P 500 Index



As shown on Figure 2, global economies continued their healing process and government stimulus both monetary and fiscal provided an uplift to equity markets that almost universally experienced healthy gains.

Fixed income securities (bonds and money market), however, came under significant pressure as the year progressed due to rising interest rates (Figure 3). Interest rates began to rise during 2021 as the need for continued low rates to support economies to battle the impact of the pandemic had diminished. Additionally, markets became focused on inflationary pressures that had built up due to supply chain disruptions/bottlenecks and increased demand for goods and services.

Figure 3
Government of Canada 5 and 10 Year Benchmark Bond Yields



The focus of the investment strategy during 2021 was to be opportunistic while protecting the investment portfolio and maintaining adequate liquidity

When formulating the investment strategy for 2021, the following dominant factors were taken into consideration:

1. The impact of the pandemic would continue to diminish
2. Global economies would begin to recover
3. Central banks and governments would look to alter fiscal and monetary policies
4. Interest rates that were still at or near historic lows would need to rise

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

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

Protecting the Region's portfolio assets was carried out mainly through restricting term exposure

A significant portion of York Region's investments are held in fixed income securities in the form of bank debt, money market securities and marketable bonds (government and corporate).

The market value of these investments will tend to rise or fall as interest rates fluctuate. If interest rates rise, the market value of the securities would decline and conversely, if interest rates fall, the market value would rise – the difference between the market value and the purchase price paid by the Region is referred to as unrealized gains or losses. These gains or loss are only realized if and when the investments are sold. The longer the term of the Region's portfolio, the greater the impact these fluctuations have on the value of the portfolio. Therefore, to mitigate the impact of rising interest rates, an effective strategy is to restrict the term of the portfolio and add to the amount held in short-term securities or bank deposits. To this end, the term of the investment portfolio was reduced from an average of 3.7 years in 2020, to 3.5 years in 2021. Most of this term reduction was effected during the first part of the year when interest rates were lower.

Liquidity levels were increased during the year as well

Liquidity is defined as cash on hand and short-term investments with a maturity date which is typically under two years. Maintaining adequate liquidity is an important objective of the Investment Policy. It is required to ensure that sufficient funds are available to meet the Region's financial objectives when required. During 2021, the Region held on average, \$1.890 billion in bank deposits and short-term investments (under two years), representing approximately 43% of the portfolio. This was significantly higher than levels held during 2020 which averaged 35% of the portfolio.

Having additional liquidity during a volatile market also allows for more opportunities to take advantage of rising interest rates or a spike in rates during the year.

The General Fund earned \$99.8 million for a realized return of 2.60%

In 2021, the General Fund generated realized returns of \$99.8 million on an average portfolio balance of \$3.838 billion. This equates to a realized rate of return of 2.60%. Realized returns include actual interest income, dividend earnings and realized capital gains resulting from the sale of securities. These returns are referred to as "realized" as they represent all cash income realized and are credited to the reserves, reserve funds and other accounts.

Another method of calculating investment performance 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, 2021.

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. As previously cited, when interest rates rise, bond prices decrease and conversely when interest rates fall, bond prices increase. As indicated in Figure 1 above, 2021 interest rates rose throughout the year and as a result, bond values decreased which resulted in an unfavorable mark-to-market impact. After accounting for the impact of a decrease in market, value mark-to-market returns for 2021 totaled 1.19%.

Table 3
York Region General Fund Portfolio
Comparison of Realized and Mark-to-Market Returns 2017 – 2021
(millions)

Year	Average Assets	Realized Income	Realized Return*	Mark-to-Market Adjustments	Mark to Market Income	Mark to Market Return*
2021	\$3,837.7	\$99.8	2.60%	(\$54.0)	\$45.8	1.19%
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%

*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 \$850,000 of costs to operate the investment program (staff, safekeeping, market monitoring services, transaction costs, etc.), the net return for the General Fund was 2.58%, 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 cost 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 remain in each of the reserves or deferred revenue accounts will determine 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 \$26 million for a return of 3.01%

In 2021, the Sinking Fund generated realized returns of \$26 million on a portfolio averaging \$860 million. This equates to a realized rate of return of 3.01%. The returns were \$6 million higher than the \$19.9 million required to meet the Sinking Fund's actuarial requirement for 2021.

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 debenture. 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 and on market conditions at time of issuance. 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 kept in the fund balance until the maturity of the debenture.

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 compares against 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 2021 was -0.79%. York Region's portfolio return of 1.19% exceeded that benchmark by 1.98%.

The General Fund Portfolio has consistently outperformed

The 2021 results and comparisons for the last five years for both the ONE Investment Program and the FTSE/S&P Composite Index are summarized in Table 4 and as also depicted in Figure 3.

Table 4
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
2021	1.19%	-0.79%	1.98%	-0.26%	1.45%
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%
5 Year Average	3.16%	2.19%	0.98%	1.61%	1.55%

As Table 4 and Figure 4 indicate, the General Fund's investment returns have consistently exceeded both the FTSE/S&P Composite Index and ONE Investment Program returns every year since 2017. In fact, York Region's investment returns have exceeded those benchmarks every year since 2010, except once, in the case of the ONE Investment Program in 2013. York Region's portfolio has generated excess returns (as captured in Figure 5) totaling \$273 million compared to the FTSE/S&P Index, and \$491 million compared to the ONE Investment Program since 2010. These 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
General Fund Mark-to-Market Investment Returns
Compared to Benchmarks

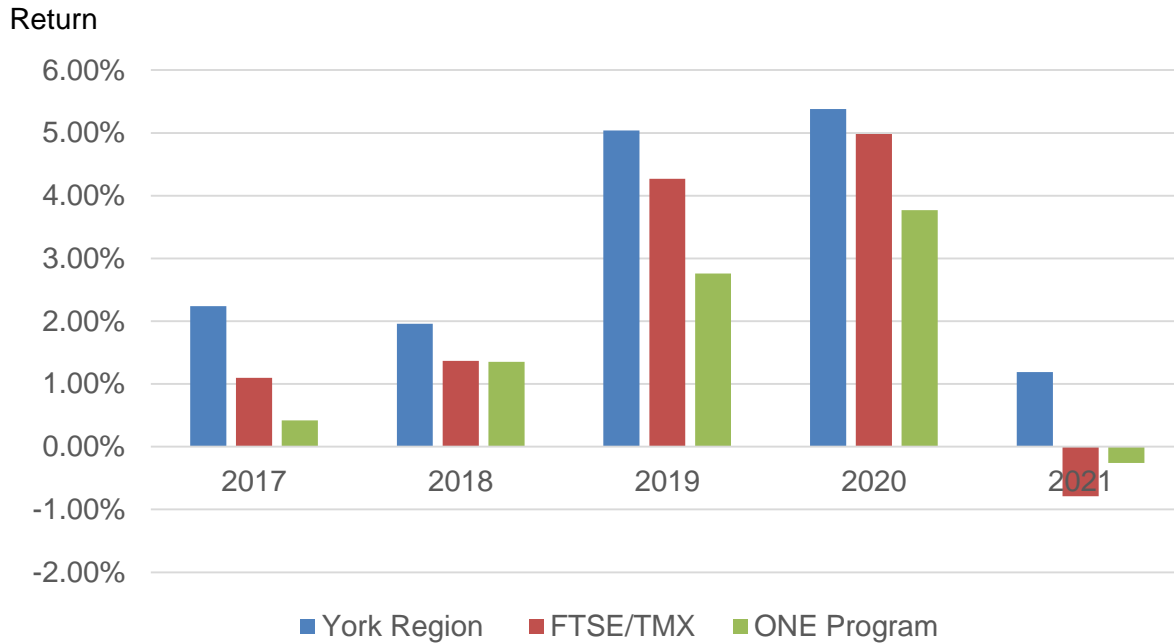
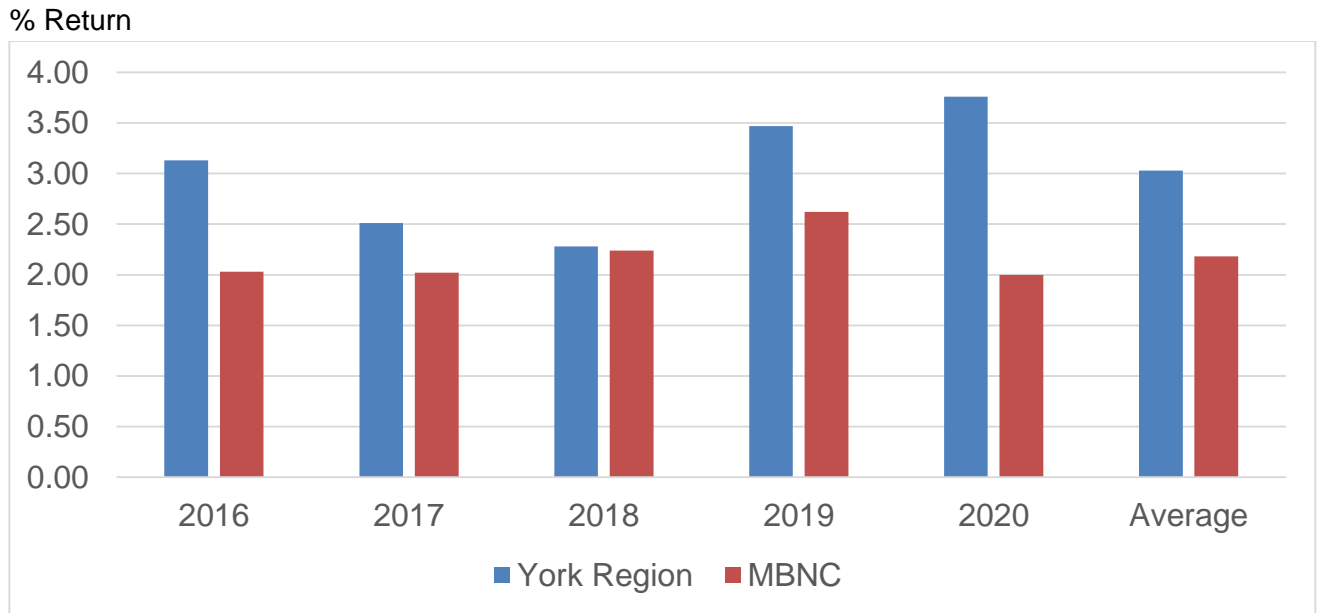


Figure 5 below compares the General Fund’s realized returns with those of the Municipal Benchmarking Network Canada (MBNC). The MBNC comparison is a good measurement of how York Region’s investment program has performed compared to municipal peers both within Ontario and across Canada. As depicted, York Region’s investment returns have significantly exceeded these respective returns every year since 2016. It should be noted that 2021 comparisons are not provided as investment results for the MBNC municipalities are not available until June/July 2022.

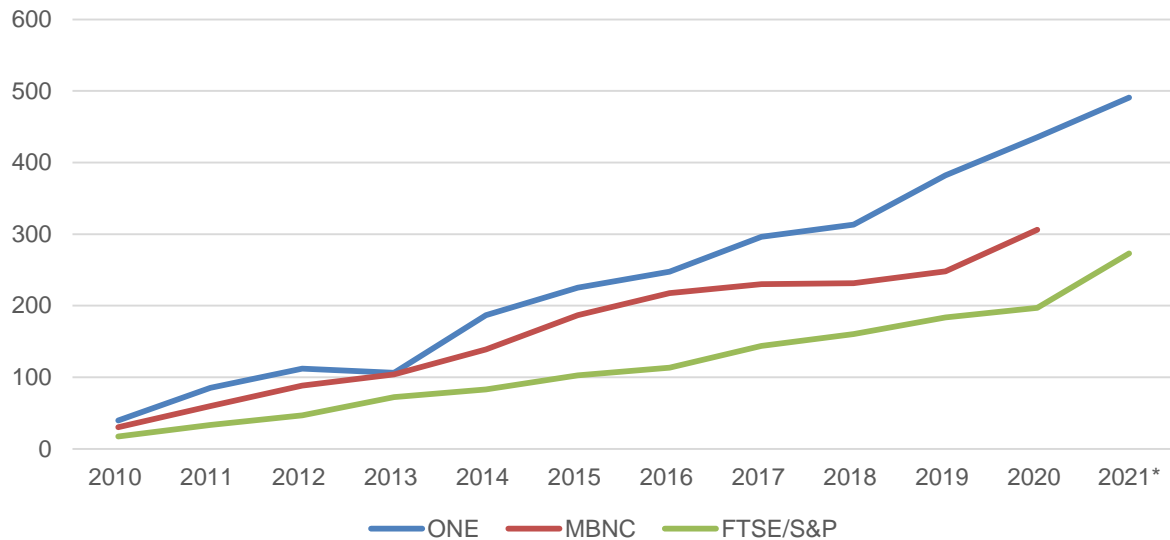
Figure 5
Comparison of General Fund Realized Investment Returns
with Municipal Peers



*MBNC 2021 data not available until June/July 2022

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 2021. As depicted, the General Fund earned \$273 million more compared to the FTSE/S&P, \$306 million more than the average return of the MBNC member municipalities and \$491 million more compared to the ONE Program.

Figure 6
Cumulative Surplus Over Benchmarks and Municipal Peers



*MBNC 2021 data not available until June/July 2022

Holdings of the Region's own debt did not change significantly during 2021

As of December 31, 2021, approximately 0.68% of the General Fund portfolio was invested in York Region's own securities, compared to 1.49% 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 2022 will be similar to those used in 2021

In formulating the investment strategy for 2022, the following market themes will be considered:

1. Global economies will continue to open up as COVID-19 concerns diminish
2. Inflation pressures will remain a primary focus for central bank policy
3. Political-economic fallout from Ukraine crisis will create market uncertainty

All these factors represent challenges for global capital markets during 2022 as supply chain issues will continue to prevail; inflation concerns build and interest rates are expected to rise. Maintaining a portfolio profile that is both defensive and flexible is considered to be the prudent strategy for 2022.

With these factors in mind, the investment strategy will continue to focus on:

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 fund to invest when opportunities arise

5. Financial

The General Fund generated realized investment returns of \$99.8 million for reserves and reserve funds during 2021

The Region generated realized investment returns of \$99.8 million on the General Fund in 2021. After costs, the total return was 1.98% higher than the FTSE/S&P Composite Index and 1.45% higher than the ONE Investment Program. These returns are contributed to and augment reserve and reserve fund balances over the longer term, reducing future levels of required contributions to these funds.

Realized investment returns on the Sinking Fund totaled \$25.9 million which will be used towards the retirement of outstanding debt

In 2021, the Sinking Fund generated realized returns of \$25.9 million on a fixed income portfolio averaging \$860.4 million. This equates to a realized rate of return of 3.01%. The returns were \$6 million higher than the \$19.9 million required to meet the Sinking Fund actuarial requirement for 2021.

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 2021 the General Fund investment portfolio generated \$99.8 million, for a realized return of 2.60%. Total returns exceeded the FTSE/S&P and ONE Investment Program benchmarks by 1.98% and 1.45% 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:

Kelly Strueby

Acting Commissioner of Finance and Regional Treasurer



Approved for Submission:

Bruce Macgregor

Chief Administrative Officer

April 13, 2022

Attachments (3)

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