

The Regional Municipality of York

Committee of the Whole
Finance and Administration
May 9, 2019

Report of the Commissioner of Finance

2018 Annual Investment Report

1. Recommendation

Council receive this report for information.

2. Summary

This report discusses the investment activities undertaken during 2018, 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 totaled \$64.6 million, representing a return of 2.28%
- Realized investment returns on the Sinking Fund totaled \$18.4 million
- 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, 2018, these portfolios had a combined maturity value of approximately \$4.1 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 (Attachment 1). The maturity value of the investments at year end included fixed income securities of \$3,128 million and equity investments of \$103 million, for a total of \$3,233 million.

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, 2018, 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 2018, 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 \$905 million 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 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 higher in 2018

During 2018, economic and political developments dominated the marketplace. Central banks around the world began talking about higher rates. In Canada, Governor Poloz suggested that maintaining a policy of negative real rates when the economy is near full employment and inflation is on target would not only heighten economic risk (via overheating) but also financial risk (via excessive debt). With the economy and employment continuing to make strong gains throughout 2018, both the Bank of Canada and the Federal Reserve raised overnight rates three and four times respectively, causing short-term rates to

increase. Long-term yields remained stable as the economy did not show signs of inflation which resulted in investors only requiring a lower premium to hold long-term bonds.

As depicted in Figure 1, the yield on five-year Government of Canada bond has remained at historic lows since 2015. Since the fall of 2016, yields have begun to move higher as central banks gradually withdrew stimulus from the economy as gains in employment and output began to make strides.

Figure 1
5 Year Government of Canada Benchmark Bond
(2015 – 2018)



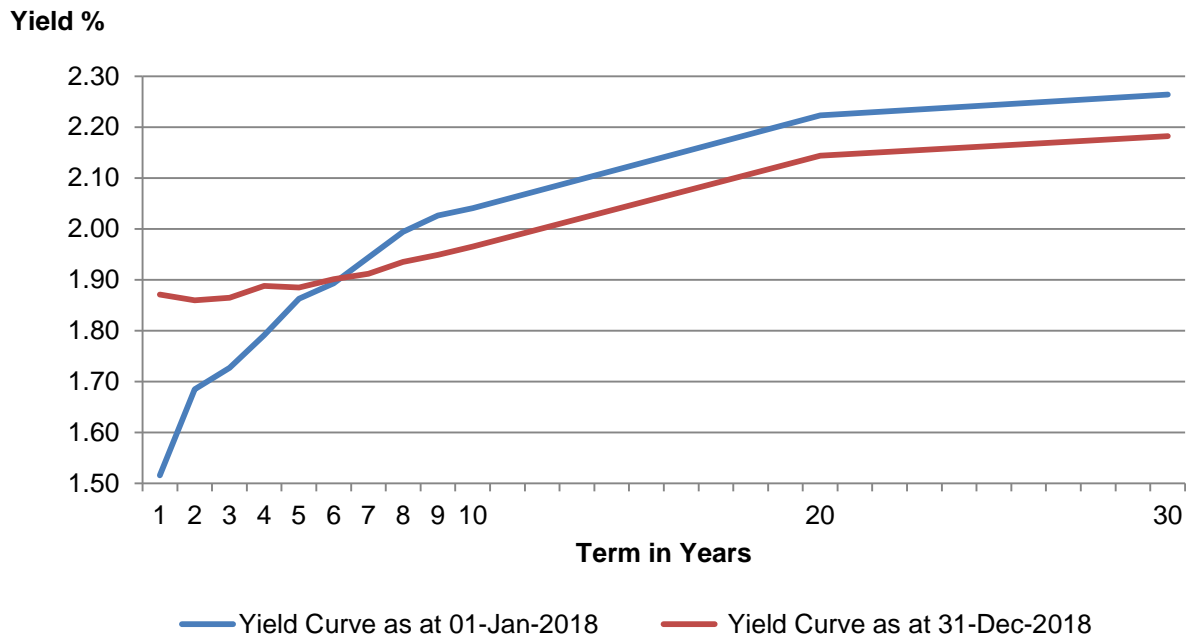
The focus of the 2018 investment strategy was to remain defensive

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

1. Portfolio to remain defensive in anticipation of higher interest rates
2. Maintain higher liquidity
3. Maintain discipline of investment program and be patient

As Figure 2 depicts, the level of interest rates diverged over the course of 2018. Short-term rates (1 to 4 years) rose significantly; whereas mid-term rates (5 to 8 years) did not rise as much; and long-term rates actually declined year-over-year.

Figure 2
Government of Canada Shift in Yield Curve for 2018



During 2018 there were fewer opportunities to extend the overall term of the portfolio. The investment team did however add to portfolio holdings in bonds maturing between two and four years as these securities were deemed to provide the best returns with limited term risk.

Liquidity is made up of cash on hand and short-term investments with a maturity typically under one 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 2018 the Region held on average \$1,070 million in bank deposits and short-term investments (under two years) representing approximately 35% 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 2017. Credit quality of the portfolio was also maintained by holding a diverse range of securities with an overall average credit rating of AA.

The General Fund earned \$64.6 million for a return of 2.28%

In 2018, the General Fund generated realized returns of \$64.6 million on an average portfolio balance of \$2.838 billion. This equates to a rate of return of 2.28%. 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, 2018.

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 2 above, in 2018 short-term interest rates rose dramatically 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 decline in market value mark-to-market returns for 2018 totaled 1.96%.

As cited earlier, it is a policy objective and the practice of the investment program to maintain adequate liquidity such that investments do not need to be sold prior to maturity and thereby avoid realizing capital losses.

Table 1
York Region General Fund Portfolio
Comparison of Realized and Mark-to-Market Returns 2014 – 2018
(millions)

Year	Average Assets	Realized Income	Realized Return*	Mark-To-Market** Adjustments	Mark-to-Market Returns Income	Mark-to-Market Returns Return*
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%
2015	\$2,093.8	\$85.4	4.08%	-\$16.9	\$68.5	3.27%
2014	\$2,010.0	\$74.2	3.69%	\$58.8	\$133.0	6.62%

*These returns exclude program costs of approximately \$664,000 or 2 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 2.25%, a difference of three basis points. The three basis point cost compares favorably 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 \$18.4 million for a return of 2.86%

In 2018, the Sinking Fund generated realized returns of \$18.4 million on a portfolio averaging \$645.8 million. This equates to a realized rate of return of 2.86%. The returns were \$0.700 million higher than the \$17.7 million required to meet the Sinking Fund's actuarial requirement for 2018.

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 1.60% 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 is provided by The Financial Times Stock Exchange (FTSE) Capital Markets Group 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 2018 was 1.37%. York Region's portfolio return of 1.96% exceeded that benchmark by 0.59%.

The General Fund Portfolio has consistently outperformed its benchmarks

The 2018 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 Figurally depicted in Figure 3.

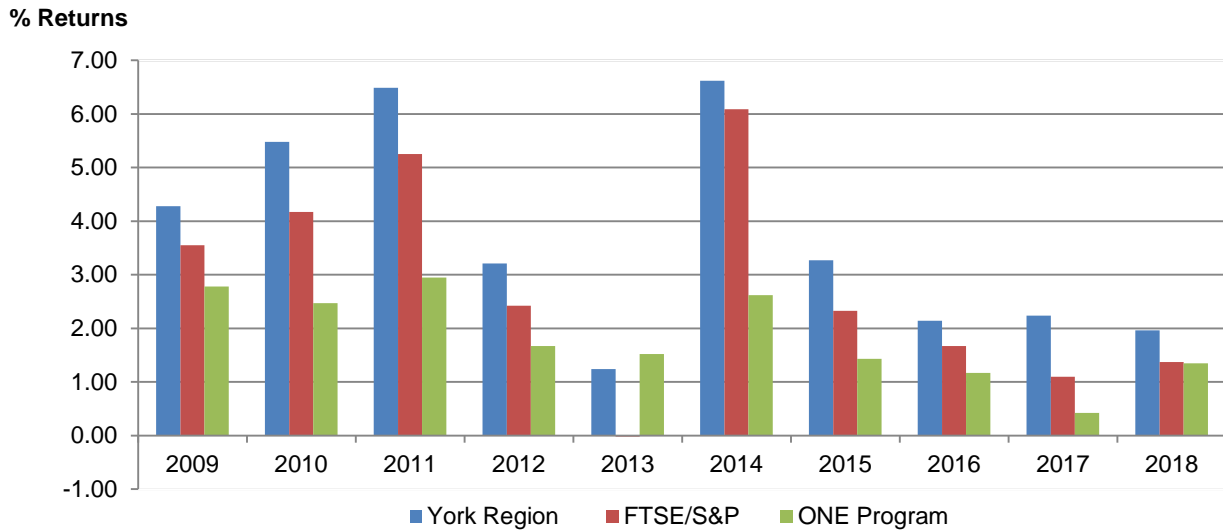
Table 2
Comparison of Mark-to-Market Returns
General Fund versus FTSE/S&P Composite Index and ONE Program

Year	York Region	FTSE TMX		ONE Program	
	Return %	Return %	Difference	Return %	Difference
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
2009	4.28	3.55	0.73	2.78	1.50
10 year average	3.693	2.793	0.9	1.838	1.855

As Table 2 and Figure 3 indicates, the General Fund's investment returns have exceeded the FTSE/S&P Composite Index every year since 2009. Over that period, the Region has generated approximately \$210 million in additional earnings over the FTSE/S&P Composite Index. Compared to the ONE Investment Program returns, the Region's portfolio generated \$349.7 million in additional earnings over the same 10-year period.

Figure 3

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

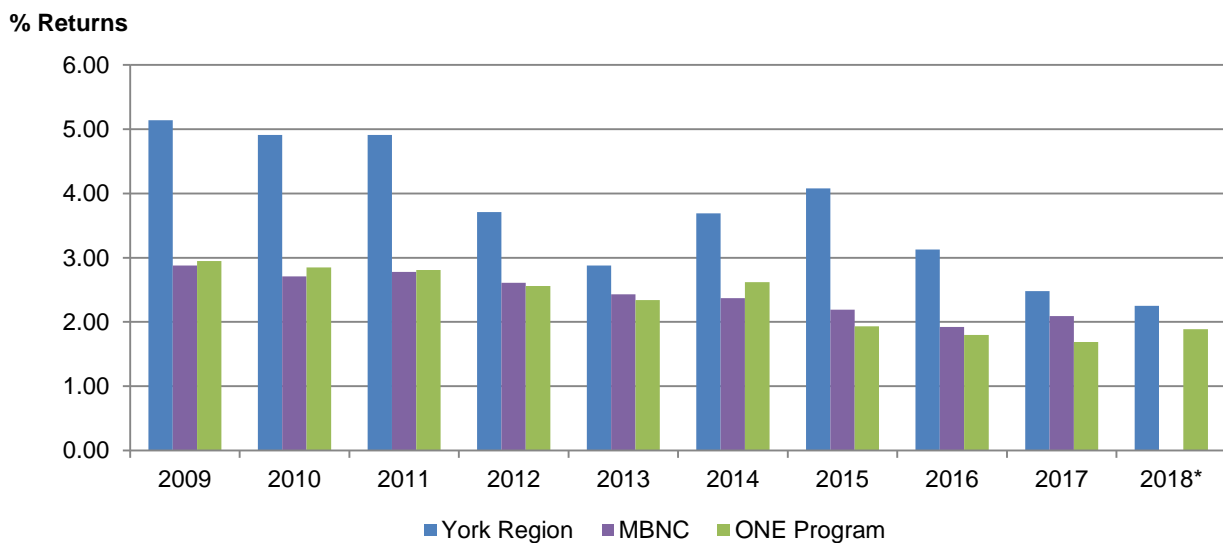


*The 2013 FTSE/S&P return of -0.02% is not perceptible on graph

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 2009. 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



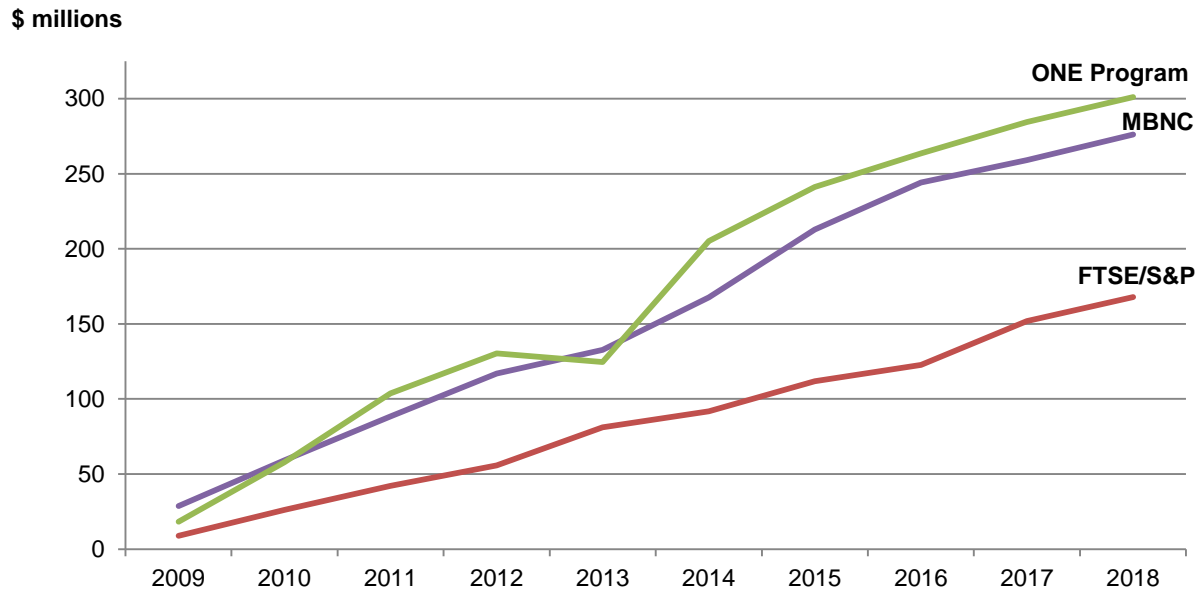
*MBNC 2018 data not available until June/July 2019

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 2009 to 2018.

As depicted the General Fund portfolio earned \$168 million more compared to the FTSE/S&P, \$276 million more than the average return of the MBNC member municipalities and \$301 million more compared to the ONE Program.

Figure 5

Cumulative Surplus Over Benchmarks and Municipal Peers



General Fund holdings of the Region’s own debt did not change significantly in 2018

As at December 31, 2018, approximately 1.11% of the General Fund portfolio was invested in York Region securities, compared to 1.19% 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 2019 are to be opportunistic and maintain reasonable liquidity levels

The US continues to make steady progress in employment and other economic factors, and the Federal Reserve has signaled to the market that it is prepared to raise rates either two or three times this year. Many feel the current policy proposals around protectionism and economic stimulus will lead to higher inflation and consequently higher interest rates.

When or if long-term interest rates rise meaningfully, staff will extend term to lock-in higher returns for the Region. In the meantime, any short-term gyrations in rates will be viewed as opportunities to enhance investment returns.

With that in mind, the following themes will guide the 2019 investment program:

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

5. Financial

The Region generated a realized investment return of \$64.6 million on the General Fund in 2018

The Region generated a realized investment return of \$64.6 million on the General Fund in 2018. After costs, the total return was \$16.7 million higher than the principal benchmark, the FTSE/S&P Composite Index, and \$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 totaled \$18.4 million

In 2018, the Sinking Fund generated realized returns of \$18.4 million on a fixed income portfolio averaging \$645.8 million. This equates to a realized rate of return of 2.86%. The returns were \$.700 million higher than the \$17.7 million required to meet the Sinking Fund actuarial requirement for 2018.

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 2018 the General Fund investment portfolio generated \$64.6 million, for a realized return of 2.28%. This exceeded the FTSE/S&P and ONE Investment Program benchmarks by 91 basis points and 39 basis points respectively.

The Sinking Fund investment portfolio generated realized returns totaling \$18.4 million, which was \$.700 million 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.

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

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Attachments (8)
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