



Report to: General Committee

Meeting Date: February 4, 2025

SUBJECT: 2024 Investment Performance Review
PREPARED BY: Mark Visser, Senior Manager, Financial Strategy & Investments x.4260

RECOMMENDATION:

- 1) THAT the report dated February 4, 2025 entitled “2024 Investment Performance Review” be received;
- 2) AND THAT staff be authorized and directed to do all things necessary to give effect to this resolution.

EXECUTIVE SUMMARY:

Not applicable

PURPOSE:

Pursuant to Regulation 438/97 Section 8, the Municipal Act requires the Treasurer to “prepare and provide to the Council, each year or more frequently as specified by Council, an investment report”.

The investment report shall contain,

- (a) a statement about the performance of the portfolio of investments of the municipality during the period covered by the report;
- (b) a description of the estimated portion of the total investments of a municipality that are invested in its own long-term and short-term securities to the total investment of the municipality and a description of the change, if any, in that estimated proportion since the previous year’s report;
- (c) a statement by the Treasurer as to whether or not, in his opinion, all investments were made in accordance with the investment policies and goals adopted by the municipality;
- (d) a record of the date of each transaction in or disposal of its own securities, including a statement of the purchase and sale price of each security;
- (e) such other information that the Council may require or that, in the opinion of the Treasurer, should be included.

BACKGROUND:

The 2024 budget for Income Earned on Investments was \$17.479 million based on an estimated average general portfolio balance of \$500.0M invested at an average rate of 3.50%. The 2024 budget was increased by \$3 million over the 2023 budget amount, and was set based on what was deemed to be sustainable over the next several years. As discussed during past budget processes, any 2024 interest earned in excess of \$17.479 million will be transferred to reserves.

For the year ending December 31, 2024, the City of Markham's Income Earned on Investments was \$43.571 million, representing a \$26.092 million favourable variance to budget.

Both the average rate of return and the actual average portfolio balance were higher than budgeted. The details of these two factors will be discussed below.

Interest Rate

Starting in June of 2024, the Bank of Canada began cutting interest rates. Through a series of 5 rate cuts over a six month span, the Prime Rate dropped from 7.20% to 5.45% by the end of 2024.

In 2024, the City's investments had an average rate of return of 5.86%, 236 basis points higher than the budgeted rate. Furthermore, the City earned \$9.860 million in capital gains, thereby increasing the annual rate of return to 7.57%, 407 basis points higher than the budgeted rate.

The difference in the rate of return accounts for a favourable variance of \$23.458 million.

Portfolio Balance

The forecasted average portfolio balance for 2024 was \$500.0 million. The actual average general fund portfolio balance (including cash balances) for 2024 was \$575.4 million. The higher portfolio balance accounts for a favourable variance of \$2.634 million.

Variance Summary

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Portfolio Balance	\$500.0m	\$575.4m	\$75.4m
Interest Rate	3.50%	7.57%	4.07%
Investment Income	\$17.479m	\$43.571m	\$26.092m
Portfolio Balance Variance Impact			\$2.634m
Interest Rate Variance Impact			\$23.458m

Portfolio Composition

All investments made in 2024 adhered to the City of Markham Investment Policy. At December 31, 2024, 41% of the City's marketable securities portfolio was comprised of government issued securities and 59% of the portfolio was made up of instruments issued

by Schedule A Banks. These levels are within the targets established in the City's Investment Policy. (Exhibit 1).

The December 31, 2024 marketable securities portfolio was comprised of the following instruments: Bonds 48%; GICs 14%; and Principal Protected Notes 38%. (Exhibit 2)

At December 31, 2024, the City's portfolio balance (all funds excluding Development Charges) of \$378.7 million was broken down into the following investment terms (Exhibit 3):

	<u>2024</u>	<u>2023</u>
Under 1 month	26.3%	37.8%
1 month to 3 months	1.0%	2.7%
3 months to 1 year	3.1%	4.6%
Over 1 year	69.5%	54.8%
Weighted average investment term	2,457 days	2,143 days
Weighted average days to maturity	1,687 days	1,265 days

Money Market Performance

The City of Markham uses the 3-month T-bill rates to gauge the performance of investments in the money market. The average 3-month T-bill rate for 2024 was 4.38% (source: Bank of Canada). Non-DCA Fund money market investments held by the City of Markham in 2024 (including bank balances) had an average return of 4.85%. Therefore, the City's money market investments outperformed 3-month T-Bills by 47 basis points. See Exhibit 4 for all Money Market securities held by the City of Markham in 2024.

Bond/Principal Protected Notes Market Performance

At December 31, 2024, the City held 32 bonds and 29 Principal Protect Notes in the general fund portfolio. The amortized value of these investments at year-end was \$294.5 million. The market value of these investments at December 31, 2024 was \$325.1 million. This translates into \$30.6 million of unrealized gains at year end.

Principal Protected Notes (PPNs)

Principal Protect Notes are a safe way for municipalities to participate in the equity market. PPNs are notes of indebtedness issued by a bank, which provide a return profile based on an index (i.e. the TSX Low-Volatility index) or basket of equities without requiring direct ownership in the underlying indexes or equities (the underlying holdings are owned by the issuing bank). PPNs are fixed-income securities that guarantee a minimum return equal to the investor's initial investment if held to maturity. In other words, the principal is protected and the City can never lose its initial investment amount.

PPNs often have a low (or no) annual interest component. However, the upside can be quite significant depending on the "participation rate". The participation rate is percentage that the PPN holder receives compared to the overall increase of the

underlying indexes or equities. For example, if a \$5 million PPN has a 60% participation rate, that means if the underlying index increased by 50% over the duration of the investment, the holder would receive \$6.5 million upon maturity, for a \$1.5 million net gain [calculated as: \$5 million * (1+ (50% increase * 60% participation rate))].

The participation rate is often determined based on a function of duration and annual coupon payments (i.e. the guaranteed interest amount). The lower the coupon and longer the duration of the note, the higher the participation rate. The highest participation rate of a PPN owned by Markham is 625%.

At December 31, 2024, the City owned 29 PPNs with a combined face value of \$124.0 million. The market value of these PPNs at December 31, 2024 was \$159.7 million. This translates into \$35.7 million of unrealized gains at year end.

See Exhibit 5 for all 2024 Bond/PPN transactions and holdings.

Reserve Funds and Other Interest

The following table outlines the interest earned on investments for all major City funds and reserves.

	<u>Average Balance</u>	<u>Interest Earned</u>	<u>Average Rate</u>
General Portfolio	\$575,400,000	\$43,571,000	7.57%
Reserve Funds (+ve balances)	\$407,600,000	\$19,943,000	4.89%
Reserve Funds (-ve balances)	(\$483,100,000)	(\$33,086,000)	6.85%
Trust Funds	\$2,470,000	\$72,500	2.93%
Alectra Promissory Note	\$27,891,000	\$1,230,000	4.41%
MEC/District Energy Loans	\$16,800,000	\$872,000	5.19%
Development Charge Reserves	\$144,300,000	\$7,210,000	5.00%

Because of the large swing in portfolio balances throughout the year (due to the timing of the collection and disbursement of taxes), there will always need to be a significant portion of the City’s funds invested in the money market.

The net negative rate of return on the reserve funds is a combination of two factors:

- 1) The City’s Interest Allocation Policy (as approved by Council) stipulates that money market rates be allocated to the interest bearing reserves and bond interest be allocated to the general portfolio. The reasons for this are 1) over the long term, bond rates generally outperform money market rates, therefore the City is able to achieve higher rates of return in its general portfolio and thereby reducing the immediate need for tax increases; 2) bond market rates are more stable which allows for smoother budgeting; and 3) reserves and reserve funds can more easily absorb these money market rate fluctuations as the requirements for these funds are longer term in nature.
- 2) The Interest Allocation Policy also stipulates that “any reserves or reserve funds with negative balances will be charged at a rate of prime.”

The \$483.1 million of interest bearing reserves with a negative balance were charged \$33.086 million of interest (average interest rate of 6.85%). Note: a negative rate of return simply means that the general portfolio is earning a return by “lending” funds to reserves in a negative balance.

OPTIONS/ DISCUSSION:**Outlook**

It is expected that the Bank of Canada will continue cutting interest rates in 2025. The City does have \$260 million of investments locked in until at least 2028 at relatively favourable terms. As was the case in 2024, a large portion of investment income will likely come from interest on internal borrowing.

FINANCIAL CONSIDERATIONS

The 2025 budget is set at \$23 million (an increase of \$4.5 million over 2024) as that is considered to be a minimum level that will be sustainable in the long term. Any interest income earned over the \$23 million budget in 2025 will be transferred to reserves at the end of the year.

HUMAN RESOURCES CONSIDERATIONS

Not applicable

ALIGNMENT WITH STRATEGIC PRIORITIES:

Not applicable

BUSINESS UNITS CONSULTED AND AFFECTED:

Not applicable

RECOMMENDED BY:

Joseph Silva, Treasurer

Trinela Cane, Commissioner, Corporate
Services

ATTACHMENTS:

Attachment 1:

- Exhibit 1 – Investment Portfolio by Issuer
- Exhibit 2 – Investment Portfolio by Instrument
- Exhibit 3 – Investment Terms
- Exhibit 4 – 2024 Money Market Investments
- Exhibit 5 – 2024 Bond Market Investments
- Exhibit 6 – 2024 DCA Fund Investments