



Report to: General Committee

Report Date: Feb 5, 2018

---

**SUBJECT:** 2017 Investment Performance Review  
**PREPARED BY:** Mark Visser, Senior Manager of Financial Strategy & Investments x.4260

---

**RECOMMENDATION:**

- 1) THAT the report dated February 5, 2018 entitled “2017 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

**FINANCIAL CONSIDERATIONS:**

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:**

For the year ending December 31, 2017, the City of Markham's Income Earned on Investments was \$11.508 million, compared to a budget of \$10.350 million, representing a \$1.158 million favourable variance.

The 2017 budget assumed an average general fund portfolio balance of \$375.0 million to be invested at an average rate of return of 2.76%. Both the actual average portfolio balance and the average rate of return were higher than the budgeted levels. The details of these two factors will be discussed below.

**Interest Rate**

At the beginning of the year, the Prime Rate was at 2.70%. In the third quarter, the Bank of Canada increased interest rates for the first time since 2010 with 25 basis point increases in both July and September. Although these increases helped Markham's returns in the money market, there was very little sustained impact on long term bond rates. Equity markets saw bigger gains in the latter part of 2017 which helped to increase the market value of the City's Principal Protected Notes (PPN) holdings.

In 2017, the City's investments had an average rate of return of 2.82%, 6 basis points higher than the forecast. Furthermore, through bond trading, the City realized \$0.479 million of Capital Gains, thereby increasing the actual rate of return to 2.95%; 19 points higher than the 2.76% forecasted rate. The difference in the rate of return accounts for a favourable variance of \$0.730 million.

**Portfolio Balance**

The budgeted average portfolio balance for 2017 was \$375.0 million. The actual average general fund portfolio balance (including cash balances) for 2017 was \$390.5 million. The higher portfolio balance accounts for a favourable variance of \$0.428 million.

**Variance Summary**

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Portfolio Balance	\$375.0m	\$390.5m	\$15.5m
Interest Rate	2.76%	2.95%	0.19%
Investment Income	\$10.350m	\$11.508m	<b>\$1.158m</b>
Portfolio Balance Variance Impact			<b>\$0.428m</b>
Interest Rate Variance Impact			<b>\$0.730m</b>

### Portfolio Composition

All investments made in 2017 adhered to the City of Markham Investment Policy. At December 31, 2017, 38% of the City's marketable securities portfolio was comprised of government issued securities and 62% of the portfolio was made up of instruments issued by Schedule A Banks. All of these levels are within the targets established in the City's Investment Policy. (Exhibit 1).

The December 31, 2017 marketable securities portfolio was comprised of the following instruments: Bonds 53%; GICs 25%; and Principal Protected Notes 22%. (Exhibit 2)

At December 31, 2017, the City's general portfolio balance was \$289.9 million (including bank balances and loan to the Development Charges reserve) and was broken down into the following investment terms (Exhibit 3):

	<u>2017</u>	<u>2016</u>
Under 1 month	6.6%	19.9%
1 month to 3 months	20.1%	17.9%
3 months to 1 year	19.4%	17.7%
Over 1 year	53.8%	44.4%
Weighted average investment term	2,337.1 days	1,850.3 days
Weighted average days to maturity	1,310.1 days	953.8 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 2017 was 0.69% (source: Bank of Canada). Non-DCA Fund money market investments held by the City of Markham in 2017 (including bank balances) had an average return of 1.41%. Therefore, the City's money market investments outperformed 3-month T-Bills by 72 basis points. See Exhibit 4 for all Money Market securities held by the City of Markham in 2017.

### Bond Market Performance

The 2017 highlights of the bond portfolio are as follows:

- 9 bonds/PPNs were purchased with a face value of \$54.7 million
- 8 bonds matured with a face value of \$32.8 million
- 5 bonds/PPNs were sold with a combined face value of \$24.8 million
- \$479,000 of Capital Gains were realized

At December 31, 2017, the City held 39 bonds in the general fund portfolio. The amortized value of these bonds at year-end was \$149.8 million. The market value of these bonds at December 31, 2017 was \$152.6 million. This translates into \$2.8 million of unrealized gains at year end.

---

In early 2017, longer term interest rates were once again at extremely low levels. This created a good selling opportunity, where Markham was able to sell 5 bonds in 2017 (with a combined face value of \$24.8 million) and earn \$479,000 of capital gains.

#### Principal Protected Notes (PPNs)

Principal Protect Notes are a relatively new form of investment and are a safe way for municipalities to participate in the stock 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 that if the underlying index increased by 50% over the duration of the investment, the holder would receive \$6.5 million upon maturity [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 350%.

At December 31, 2017, the City owned 10 PPNs with a combined face value of \$56.0 million. The market value of these PPNs at December 31, 2017 was \$58.8 million. This translates into \$2.8 million of unrealized gains at year end.

See Exhibit 5 for all 2017 Bond/PPN transaction 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	\$390,500,000	\$11,508,000	2.95%
Reserve Funds	\$34,700,000	(\$1,461,000)	(4.21%)
Trust Funds	\$2,400,000	\$69,000	2.89%
Powerstream Promissory Note	\$67,900,000	\$2,994,000	4.41%
MEC/District Energy Loans	\$16,800,000	\$872,000	5.19%
Development Charge Reserves	\$4,800,000	(\$139,000)	(1.56%)

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 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 \$34.7 million net average reserve balance was comprised of \$166.2 million of reserves that have a positive balance that earned \$2.375 million in interest (average interest rate of 1.43%), and \$131.5 million of reserves with a negative balance that were charged \$3.836 million of interest (average interest rate of 2.92%). Therefore the net interest allocated to the reserves was approximately (\$1.461) million. 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.

The average rate earned for the Development Charge Reserves is also negative as the general portfolio "loaned" \$20 million to the DC Reserves at a rate of prime since the reserves would have been in a negative position in 2017 otherwise.

---

**OPTIONS/ DISCUSSION:****Outlook**

While there was another 25 basis point increase to short term rates on January 17, 2018, long term bond rates actually declined as the commentary from the Bank of Canada surrounding the increase provided a not very favourable economic outlook.

The City has over \$158 million in bonds and PPNs locked in past 2019 at generally favourable interest rates, and will continue to search for opportunities to buy and sell when deemed in the best interests of the Markham.

**FINANCIAL TEMPLATE (Separate Attachment):**

Not applicable

**ENVIRONMENTAL CONSIDERATIONS:**

Not applicable

**ACCESSIBILITY CONSIDERATIONS:**

Not applicable

**ENGAGE 21<sup>ST</sup> CONSIDERATIONS:**

Not applicable

**BUSINESS UNITS CONSULTED AND AFFECTED:**

[Insert text here]

**RECOMMENDED BY:**

2018-01-30

  
X

Joel Lustig  
Treasurer  
Signed by: cxa

2018-01-30

  
X

Trinela Cane  
Commissioner, Corporate Services  
Signed by: cxa

**ATTACHMENTS:**[Attachment 1:](#)

- Exhibit 1 – Investment Portfolio by Issuer
- Exhibit 2 – Investment Portfolio by Instrument
- Exhibit 3 – Investment Terms
- Exhibit 4 – 2017 Money Market Investments
- Exhibit 5 – 2017 Bond Market Investments
- Exhibit 6 – 2017 DCA Fund Investments