



Report to: General Committee

Report Date: Feb 1, 2016

SUBJECT: 2015 Investment Performance Review
PREPARED BY: Mark Visser, Senior Manager of Financial Strategy & Investments x.4260

RECOMMENDATION:

- 1) THAT the report dated February 1, 2016 entitled “2015 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 74/97 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, 2015, the City of Markham's Income Earned on Investments was \$10.484 million, compared to a budget of \$10.350 million, representing a \$0.134 million favourable variance.

The 2015 budget assumed an average general fund portfolio balance of \$258.8 million to be invested at an average rate of return of 4.00%. The actual average portfolio balance was higher than the budgeted level, however, the average rate of return was lower than the budgeted level. The details of these two factors will be discussed below.

Interest Rate

2015 began with the Bank of Canada Prime Rate at 3.00%. After two mid-year reductions, the Prime Rate was lowered to 2.70% and stayed there for the remainder of the year. This resulted in short-term money market rates being in the 1.00-1.40% range for most of the year. As well, bond rates continued to be near historically low levels. The City was able to take advantage of these low rates by selling some of its bond holdings and realizing Capital Gains.

In 2015, the City's investments had an average rate of return of 3.38%, 62 basis points lower than the forecast. However, through bond trading, the City realized \$0.698 million of Capital Gains, thereby increasing the actual rate of return to 3.62%; 38 points lower than the 4.00% forecasted rate. The difference in the rate of return accounts for an unfavourable variance of \$1.104 million.

Portfolio Balance

The budgeted average portfolio balance for 2015 was \$258.8 million. The actual average general fund portfolio balance (including cash balances) for 2015 was \$289.7 million. The higher portfolio balance accounts for a favourable variance of \$1.238 million.

Variance Summary

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
Portfolio Balance	\$258.8m	\$289.7m	\$40.9m
Interest Rate	4.00%	3.62%	(0.38%)
Investment Income	\$10.350m	\$10.484m	\$0.134m
Portfolio Balance Variance Impact			\$1.238m
Interest Rate Variance Impact			(\$1.104m)

Portfolio Composition

All investments made in 2015 adhered to the City of Markham Investment Policy. At December 31, 2015, 50% of the City's portfolio was comprised of government issued securities and 50% 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, 2015 investment portfolio was comprised of the following instruments: Bonds 92%; GICs 8% (Exhibit 2).

At December 31, 2015, the City's portfolio balance for all funds was \$323.0 million (including bank balances). DCA investments represented \$20.8 million of this amount. The City's portfolio (all funds excluding DCA) of \$302.2 million was broken down into the following investment terms (Exhibit 3):

	<u>2015</u>	<u>2014</u>
Under 1 month	29.0%	17.8%
1 month to 3 months	2.6%	2.2%
3 months to 1 year	8.4%	16.6%
Over 1 year	59.9%	65.5%
Weighted average investment term	2,003.9 days	2,153.7 days
Weighted average days to maturity	1,090.5 days	1,179.5 days

Since December 31, 2013, the weighted average days to maturity has decreased from 1,445.2 days to 1,090.5 days. This reflects the strategy of the City selling some of its longer duration bonds and reinvesting in shorter duration instruments until long term rates start to increase.

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 2015 was 0.53% (source: Bank of Canada). Non-DCA Fund money market investments held by the City of Markham in 2014 (including bank balances) had an average return of 1.21%. Therefore, the City's money market investments outperformed 3-month T-Bills by 68 basis points. See Exhibit 4 for all Money Market securities held by the City of Markham in 2015.

Bond Market Performance

The 2015 highlights of the bond portfolio are as follows:

- 8 bonds were purchased with a face value of \$39.2 million
- 11 bonds matured with a face value of \$38.2 million
- 7 bonds were sold with a combined face value of \$14.0 million
- \$698,000 of Capital Gains were realized

At December 31, 2015, the City held 58 bonds in the general fund portfolio. The amortized value of these bonds at year-end was \$213.5 million. The market value of these bonds at December 31, 2015 was \$223.8 million. This translates into \$10.3 million of unrealized gains at year end.

For much of 2015, bond rates were once again at extremely low levels. This created a good selling opportunity, where Markham was able to sell 7 bonds (with a combined face value of \$14.0 million) and earn \$698,000 of capital gains. At the end of 2015, bond rates continued to be near historical lows which should represent continued selling opportunities for Markham. See Appendix 5 for all 2015 bond transactions.

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	\$289,700,000	\$10,484,000	3.62%
Reserve Funds	\$79,000,000	\$292,000	0.37%
Trust Funds	\$2,300,000	\$80,000	3.48%
Powerstream Promissory Note	\$67,900,000	\$3,787,000	5.58%
MEC/District Energy Loans	\$16,800,000	\$872,000	5.19%
Development Charge Reserves	\$33,400,000	\$180,000	0.52%

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 low average 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 \$79 million net reserve balance (as noted in the table above) is comprised of \$126.2 million of reserves that have a positive balance that earned \$1.6 million in interest (average interest rate of 1.27%), and \$47.2 million of reserves with a negative balance that were charged \$1.3 million of interest (average interest rate of 2.77%). Therefore the net interest allocated to the reserves was approximately \$0.3 million.

The average rate earned for the Development Charge Reserves is also low as a) the majority of investments need to be kept short term, as it is forecasted that the reserves will be depleted in early 2016 and b) component reserves that are in a negative position are charged interest at the prime rate.

OPTIONS/ DISCUSSION:**Outlook**

Although the City does have over \$150 million of investments locked in past 2017 at relatively attractive rates, it is no longer possible to achieve an average rate of return of 4% given the sustained low interest environment. However, the increase to the general portfolio balance should offset the reduction in interest rates. The 2016 budget is based off a forecast of a \$300 million average general portfolio balance at an average rate of return of 3.45%. Therefore, the 2016 budget will remain unchanged from the 2015 budget of \$10.35 million.

FINANCIAL TEMPLATE (Separate Attachment):

Not applicable

ENVIRONMENTAL CONSIDERATIONS:

Not applicable

ACCESSIBILITY CONSIDERATIONS:

Not applicable

ENGAGE 21ST CONSIDERATIONS:

Not applicable

BUSINESS UNITS CONSULTED AND AFFECTED:

[Insert text here]

RECOMMENDED BY:

28/01/2016

X 

Joel Lustig
Treasurer

28/01/2016

X 

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 – 2015 Money Market Investments
- Exhibit 5 – 2015 Bond Market Investments
- Exhibit 6 – 2015 DCA Fund Investments