

Report to Corporate Services Committee

To: Chair and Members
Corporate Services Committee

From: Anna Lisa Barbon, CPA, CGA, Deputy City Manager, Finance Supports

Subject: 2022 Investment Portfolio Report

Date: July 17, 2023

Recommendation

That, on the recommendation of the Deputy City Manager, Finance Supports, the 2022 Investment Portfolio Report, providing a summary of the performance of the City of London's investments, **BE RECEIVED** for information.

Executive Summary

This report provides a summary of the performance of the City of London's investment portfolio (unconsolidated) in 2022 along with a summary of the prevailing market conditions and associated impacts on the investment assets held by the City. This report satisfies the legislative requirement for an annual investment report.

In 2022, the City earned total income of approximately \$35.8 million from investments (excluding unrealized gains/losses), of which \$24.8 million was earned from reserve fund investments and \$11 million was earned from Operating fund investments. The City's 2022 average monthly investment portfolio balance totaled approximately \$1.789 billion.

In 2022, interest rates rose from the low interest rate environment that prevailed during the COVID-19 pandemic. Given the City's heavy emphasis on fixed income securities (e.g. bonds, guaranteed investment certificates), the overall interest rate environment greatly influences the City's investment returns.

This report also outlines upcoming accounting standard changes related to its investments that will impact the City's 2023 fiscal year-end.

Linkage to the Corporate Strategic Plan

Council's 2023-2027 Strategic Plan for the City of London identifies 'Londoners experience good stewardship, exceptional and valued service' as an outcome of the strategic area of focus - "Well Run City". Management of the City of London's investment portfolio in line with its stated objectives and council approved investment policy supports this area of focus and links to the strategy to 'Review, update and implement the City's strategic financial principles, policies and practices'.

Analysis

1.0 Background Information

As outlined in Ontario Regulation 438/97, the City Treasurer is required to provide an annual investment report to Municipal Council. The report, at a minimum, shall contain the following;

- a) a statement about the performance of the portfolio of investments during the period covered by the report;
- b) a description of the estimated proportion of the total investments that are invested in its own long-term and short-term securities to the total investments 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 their opinion, all investments are consistent 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 Municipal Council may require or that, in the opinion of the treasurer, should be included;
- f) a statement by the treasurer as to whether any of the investments fall below the standard required for that investment during the period covered by the report; and,
- g) the details of the proposed use of funds realized in the disposition of an investment for which the City sold as a result of a decline in rating below the standard required by Ontario Regulation 438/97.

This report meets the above requirements.

2.0 Discussion and Considerations

2.1 Investments and Performance:

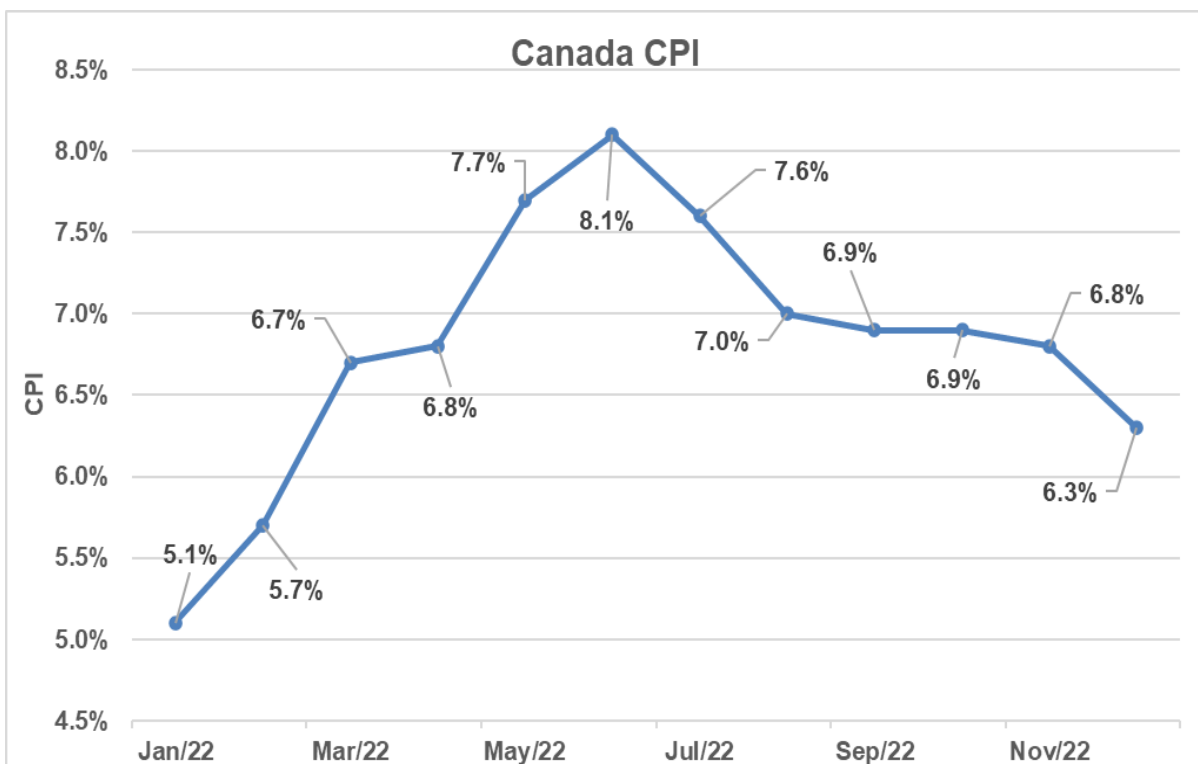
Portfolio Balance:

In 2022, the City of London (the "City") maintained a monthly average investment portfolio balance of \$1.789 billion (2021, \$1.572 billion), consisting of cash and investments in securities prescribed under Ontario Regulation 438/97. As at December 31, 2022, the City's investment portfolio included government bonds, treasury bills, corporate bonds, One Canadian equity portfolio, guaranteed investment certificates (GICs) and principal protected notes. A summary of the City's investment portfolio, including cash, at year-end is attached as Appendix "A". The City's investment portfolio contains over 400 securities.

Market Summary for 2022:

As the economy emerged from the impact of the pandemic and expanded at a rate exceeding the projections of the Bank of Canada (BOC), growth in demand, recovery in the labour market and continued supply chain bottlenecks all contributed to inflation surging beyond projections and remaining at an elevated level through 2022. Year-over-year inflation (as measured by the Consumer Price Index) rose from 5.1% at the beginning of the year to 8.1% mid-year before declining to 6.3% by the end of the year (see Figure 1).

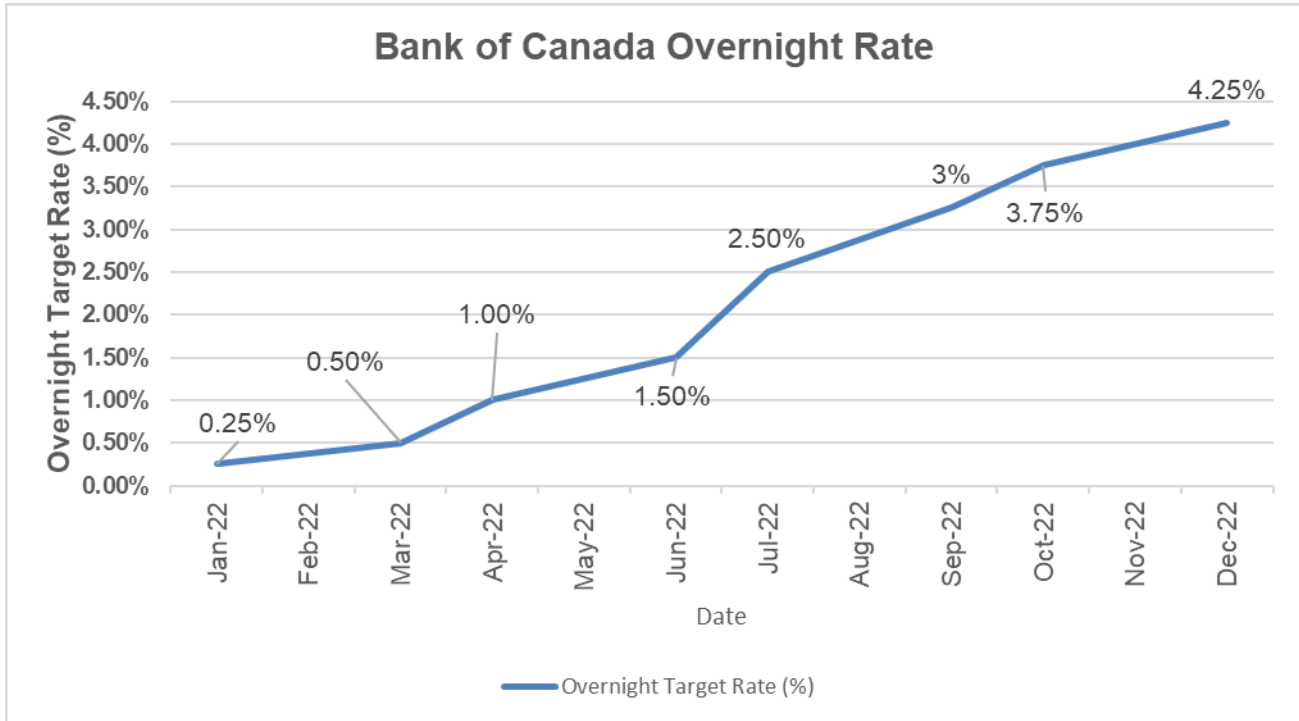
Figure 1 – Canada Consumer Price Index (CPI) – year-over-year



Source: Refinitiv

To curb inflation, the BOC began using its monetary policy tools with aim of returning inflation to the target rate of 2%. The overnight policy rate is the BOC’s primary monetary policy instrument. The BOC steadily raised its overnight target rate from 0.25% in March 2022 to 4.25% in December (see Figure 2).

Figure 2 – Change in BOC overnight target rate over 2022



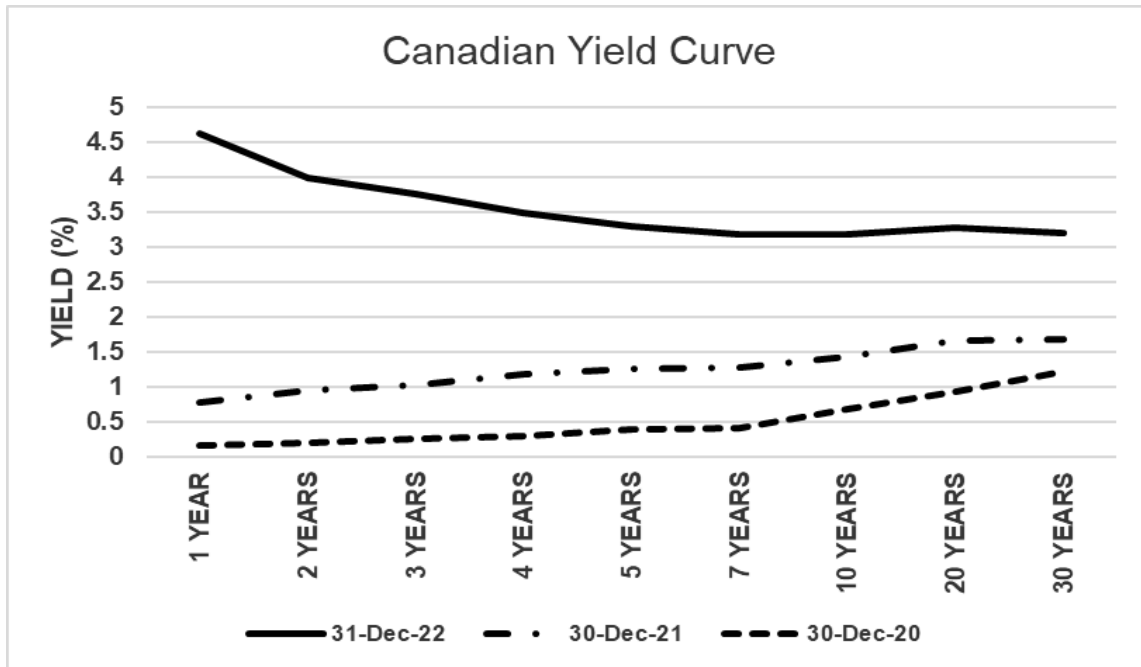
Source: BOC

The BOC overnight rate has a close relationship to the interest rates on various fixed income investments held by the City of London, including GICs, government bonds and corporate bonds. Financial market expectations regarding the future BOC overnight rate most directly influence the interest rates available on short-term bonds and GICs. As the overnight rate has trended higher over the course of 2022, so too have the rates on short-term bonds and GICs. Longer term interest rates are more influenced by longer-term market expectations regarding future economic conditions.

Generally, longer-term fixed income securities yield a higher rate of interest (“term premium”) compared to shorter-term products to compensate for the commitment and risks of holding the investment for a longer period. The financial conditions of the past year have resulted in an “inverted yield curve” whereby the rates on shorter-term bonds are equal to or greater than those available on long-term bonds.

Figure 3 provides an overview of the Government of Canada yield for various durations, demonstrating how yields have continued to rise and the yield curve inverted.

Figure 3 - Government of Canada Yield Curve

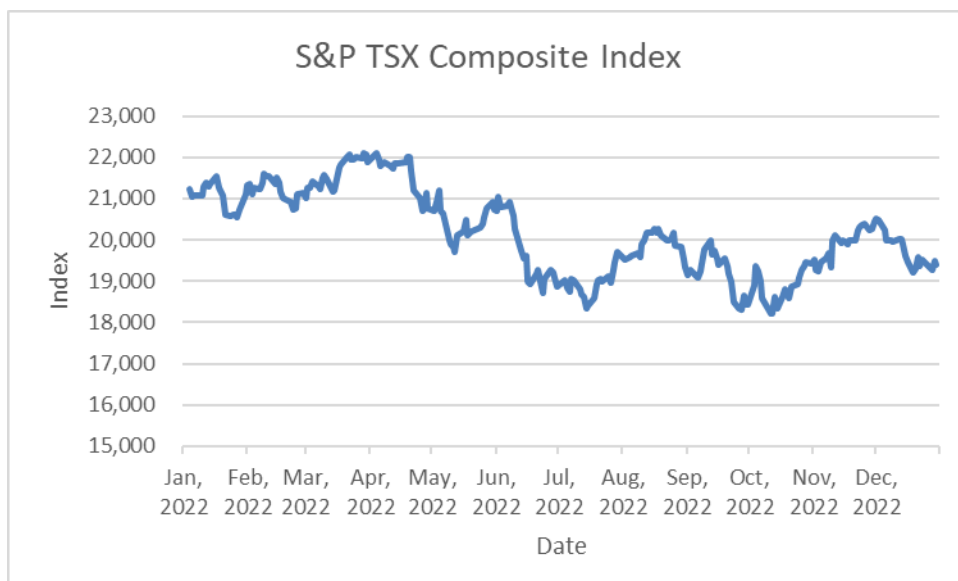


Source: Refinitiv

Historically the inversion of the yield curve has not persisted for an extended period, however it presents an added layer of complexity to investment decisions while it persists. While higher yields can often be achieved by investing in short-term products during an inverted yield curve period, the unknown re-investment risk (i.e. the rates that will be available when that investment matures in a year or two) needs to be balanced against the short-term benefits that can be realized.

While equity investments comprise a relatively small portion of the City’s investment portfolio (maximum 15% per policy) compared to fixed income investments, they are closely monitored as well. The Canadian equity market (as measured by the S&P TSX Composite Index) was volatile in 2022, posting a negative return of 8.5 percent and reversing the upward trend experienced in the prior year. While the S&P TSX Composite closed below 2021 year-end levels (see Figure 4), it remains well above year-end 2020 levels.

Figure 4 - S&P TSX Composite Index 2022 Chart



Source: Refinitiv

The City’s treasury team and professional investment managers will continue to regularly monitor economic and market conditions and base investment decisions accordingly, within the parameters of the City’s Investment Policy.

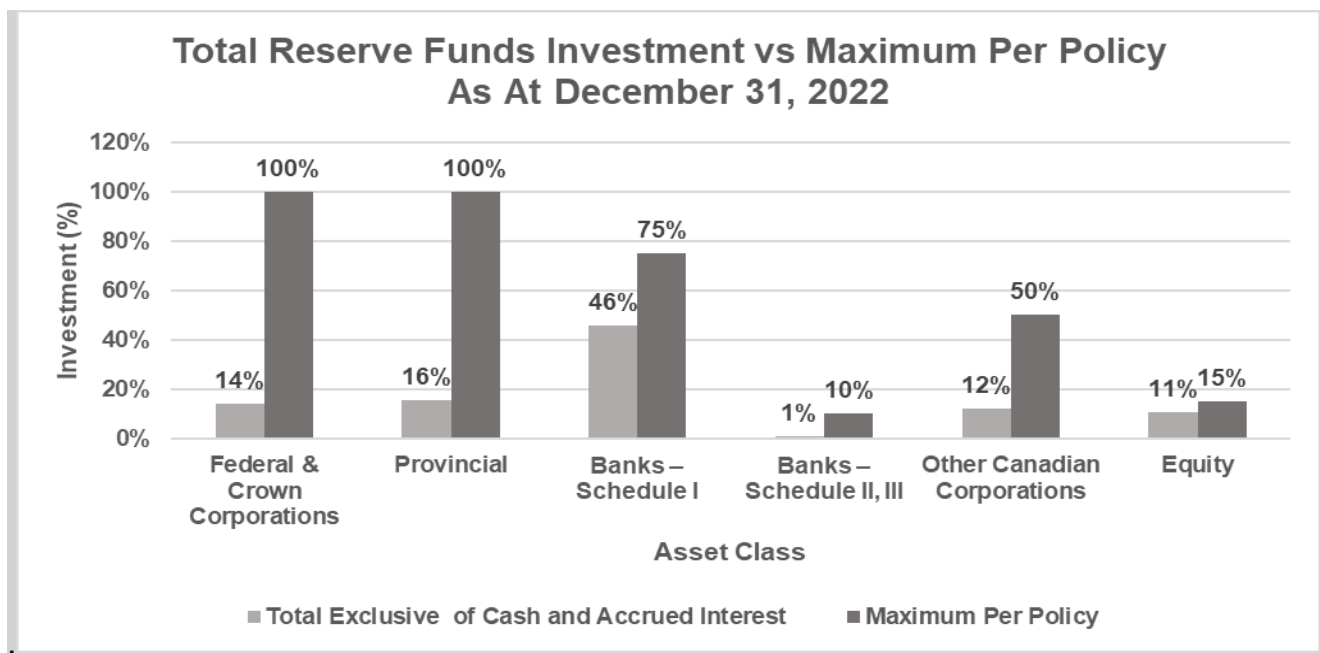
Investment Strategy:

As directed by the City’s Investment Policy, the City’s overall investment strategy is to invest public funds in a manner that prioritizes:

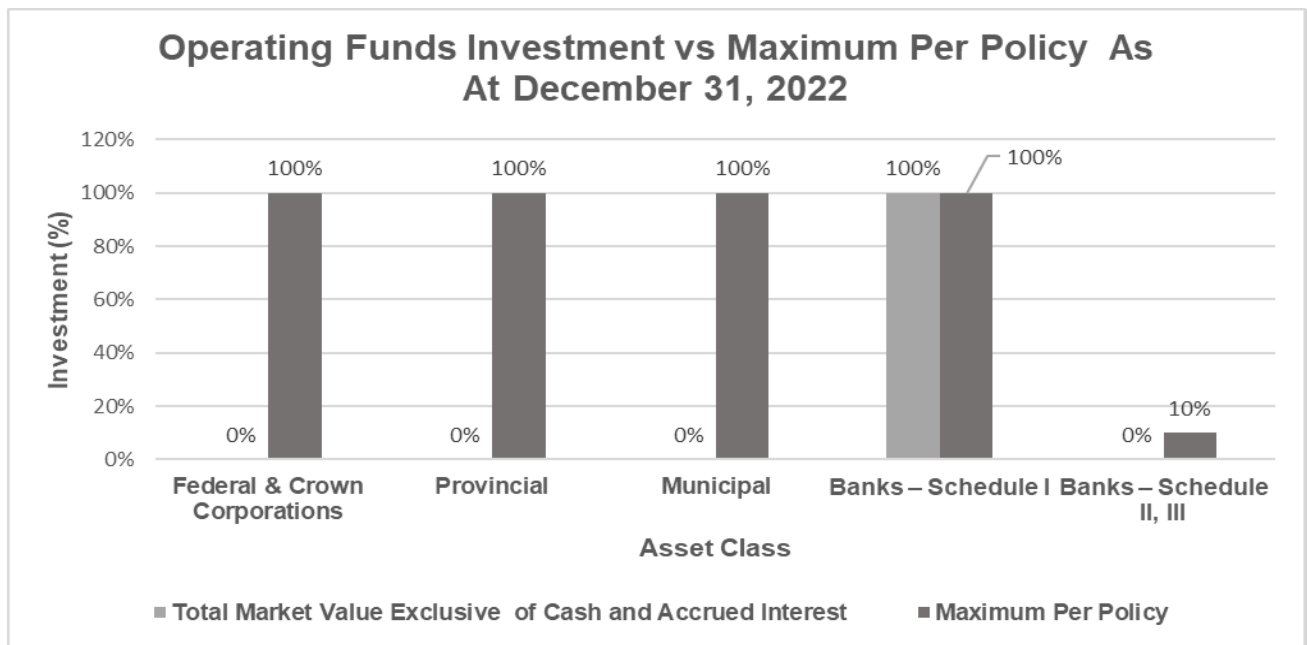
1. Adherence to statutory requirements
2. Preservation of capital
3. Maintenance of liquidity
4. Achieving a rate of return sufficient to maintain the purchasing power of invested funds

The City’s strategy includes building a liquid and diversified portfolio while being mindful of the limitations of the portfolio. No changes were made to the City’s Investment Policy in 2022.

Below is a comparison of the City’s investments in each asset class to the maximum allowed for each asset class, as set out in the City’s current Investment Policy:



Note: With the exception of the “Equity” category, all other categories are fixed income investments.



Note: With the exception of the “Equity” category, all other categories are fixed income investments.

Investment Income:

The table below shows a breakdown of the City's average annual yields for 2022, as well as the average investment portfolio balance. For the purposes of this report, yield includes interest income and realized gains and losses. Yield does not include unrealized gains and losses (i.e. market value appreciation/depreciation).

Fund	Average Balance (Million \$)	Earnings (Million \$)	Yield
Reserve Funds	1,360.4	24.8	1.82%
Operating Funds	428.4	11.0	2.57%

It should be noted that the City's fixed income investments are fixed coupon paying or zero-coupon securities and therefore the rates do not "float" according to overall market rates. The City's reserve fund investments are generally longer-term in nature and reflect a mix of securities purchased over an extended period, many during a much lower yield environment. The City's operating funds, with a shorter-term time horizon, have been able to take advantage of the rising interest rate environment to a greater extent as re-investment of maturities occur. Furthermore, as bond prices are inversely related to interest rates, reserve funds did experience realized capital losses in 2022 where our external managers deemed it beneficial for overall total returns to realize losses in order to take advantage of higher yielding opportunities. Overall, there was an increase in the total portfolio yield compared to 2021.

In 2022, the City earned total income of approximately \$35.8 million (\$27.9 million in 2021) from investments, of which \$24.8 million (\$24.1 million in 2021) was earned from reserve fund investments and \$11 million (\$3.8 million in 2021) was earned from operating fund investments.

In accordance with the Municipal Act, 2001 (the "Act"), interest and net capital gains/losses earned on reserve fund investments are allocated to all reserve funds on a prorated basis and are used for the purpose for which the reserve fund was created.

Investment income earned from the operating fund is allocated to operating revenues, which is included in the approved 2020-2023 Multi-Year Operating Budget and contributes to offsetting the amount of taxes levied. For 2022, investment income realized (\$11 million) was favourable when compared to budgeted income (\$5.1 million). These impacts were included in the City of London's operating results as reported in the 2022 Year-end Operating Budget Monitoring report.

Eligible Investments (Statement of Compliance):

The Act stipulates that a municipality may invest in securities prescribed under Ontario Regulation 438/97. All investments meet the eligibility requirements as prescribed by Ontario Regulation 438/97 and were made in accordance with the investment policies and goals adopted by the City.

Investment in Own-Securities:

Ontario Regulation 438/97 requires that the City report the estimated proportion of total investments that are invested in its own long-term and short-term securities to the total investments held by the municipality. In 2022, the City did not hold or purchase any of its own securities, reflecting no change in proportion of own securities to total investments from the previous year's report.

Investment Standards:

All investments were done within the standards required by the Ontario Regulation 438/97 and the Council approved Investment Policy. None of the investments fell below the standards during the period covered by this report.

Investment Ratings:

Ontario Regulation 438/97 requires that the City invest in eligible fixed income investment securities that are rated and the credit rating falls within prescribed levels by the credit rating agencies as stated within the Act. The minimum credit rating required is stipulated in the Council approved Investment Policy. All investments met the credit rating requirement as prescribed by Ontario Regulation 438/97; the City did not dispose of any investment due to decline in credit rating within the period covered under this report.

3.0 Key Issues and Considerations

3.1. Upcoming Accounting and Reporting Changes related to Investments

New Public Sector Accounting Standards impacting investment reporting are forthcoming and required for adoption for fiscal years beginning on or after April 1, 2022. For the City, this will be fiscal 2023 beginning January 1, 2023. Specifically, the main standard impacting investments is PS 3450 Financial Instruments. The standard outlines various requirements for recognition, measurement, presentation and disclosure of financial instruments, which includes investments. The changes are anticipated to include (among others) the requirement to recognize unrealized gains and losses (“mark to market”) for certain securities and the ability to elect to do so for other securities. As a result, adoption of these new standards may impact future investment reports as unrealized gains and losses will be recorded and be reported on the City’s financial statements. Furthermore, starting with the 2023 investment report in summer 2024, Civic Administration will be providing investment performance on a realized and market value basis as part of this annual report.

The City’s elections for the reporting of various investment categories are outlined below, as at the time of writing this report:

Category	Elections
Guaranteed Investment Certificates - GICs	Cost method
Equity	Fair Value
Notes with embedded derivatives	Fair Value
Fixed Income & Other	Fair Value

Unrealized gains or losses represent a change in the value of a security from the cost (or what was paid) for that security initially. These represent the changes in value before a security is sold or matures. The value of securities can fluctuate over the holding period and can swing between an unrealized gain or loss position. In the City of London’s investment portfolio, holdings in equity and fixed income securities can have unrealized gains or losses. With equity holdings, this is generated by the difference between its cost versus the prevailing equity market prices. For fixed income securities, such as a bond, its price is inversely related to interest rates. As interest rates fall, bond prices rise and vice versa. Similar to equity securities, the unrealized gain or loss of a fixed income security is the difference between the current value of the security when compared to the cost of the security when acquired. It is important to note that unrealized gains and losses currently exist within the City’s investment portfolio. To provide a sense of magnitude, the following represents the City’s portfolio investments unrealized gains and losses (excluding accrued income) as at December 31, 2022:

Category	Fair Value (Million \$)	Cost/Book Value (Million \$)	Unrealized Gains (Loss) (Million \$)
Guaranteed Investment Certificates - GICs	Not applicable	382.7	Not applicable
Equity	130.8	134.8	(4.0)
Fixed Income & Other (Including Notes with embedded derivatives)	807.3	864.4	(57.1)

It is important to emphasize that the City of London generally employs a passive, “buy and hold” investment approach for most of its investment portfolio (although one external investment manager does utilize an active management investment approach). Under a “buy and hold” investment approach, unrealized gains or losses are less relevant unless investments are required to be sold prior to maturity which would trigger the realization of the associated gain or loss. However, for fixed income investments that are held to maturity (a key element of the “buy and hold” strategy), they will mature at par (face) value. The City’s treasury team closely manages the City’s cash flow forecasts to minimize the need to unexpectedly sell a security for liquidity purposes prior to maturity. Therefore, it is very unlikely that an unrealized loss would become realized through the City’s investment policy.

Conclusion

This report provides an overview of the City of London’s investment portfolio in the context of the financial markets. Investment income increased in 2022 with the City maintaining adequate liquidity and preserving its capital. Furthermore, this report satisfies the various reporting requirements as outlined in the Municipal Act, confirming investments remained compliant with legislative requirements and the applicable Investment Policy.

Prepared by: **Folakemi Ajibola, CTP, ACMA, CGMA Manager, Financial Modelling, Forecasting and Systems Control (Treasury) and Martin Galczynski, CPA, CA, CIM, Manager, Financial Planning and Policy**

Submitted by: **Kyle Murray, CPA, CA, Director, Financial Planning and Business Support**

Recommended by: **Anna Lisa Barbon, CPA, CGA, Deputy City Manager, Finance Supports**

Attachment: Appendix A

Appendix “A” – Investment Portfolio (including Cash and Cash Equivalents) As Of December 31, 2022

Category	Internally/ Externally Managed	Total Book Value (Operating + Reserve Fund) (thousands)	% of Portfolio	Operating Fund Book Value (thousands)	% of Portfolio	Reserve Fund Book Value (thousands)	% of Portfolio
Cash (Note A)	Internal	288,731	16.25%	124,744	7.02%	163,987	9.23%
High Interest Savings Account	Internal	100,000	5.63%	100,000	5.63%	0	0
Investment Clearing Balance	Internal	2,641	0.15%	2,219	0.13%	422	0.02%
Fixed Income	Internal and External	1,250,706	70.39%	109,500	6.16%	1,141,206	64.23%
Canadian Equity	External	134,755	7.58%	0	0%	134,755	7.58%
Total Portfolio		1,776,833	100%	336,463	18.94%	1,440,370	81.06%
Total Internally Managed	Internal	730,042	41.09%	336,463	18.94%	393,579	22.15 %
Total Externally Managed	External	1,046,791	58.91%	0	0%	1,046,791	58.91%
Total Portfolio		1,776,833	100%	336,463	18.94%	1,440,370	81.06%

Note A: Cash balances as per bank accounts as at December 31, 2022. Excludes Trust Funds.