

## Report to Corporate Services Committee

**To:** Chair and Members  
Corporate Services Committee

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

**Subject:** 2023 Portfolio Investments Report

**Date:** July 17, 2024

## Recommendation

That, on the recommendation of the Deputy City Manager, Finance Supports, the 2023 Portfolio Investments 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 portfolio investments (unconsolidated) in 2023 along with a summary of the prevailing market conditions. This report satisfies the legislative requirement for an annual investment report.

In 2023, the City's total portfolio investment income was approximately \$82 million on an all-in basis (inclusive of realized income and unrealized gains), of which \$78.5 million was from reserve fund investments and \$3.5 million was from operating fund investments. Of the total reserve funds income, \$29.3 million was realized income and \$49.2 million was from unrealized gains in the value of investments. Operating income of \$3.5 million was all realized investment income. It should be noted that these figures only include income from portfolio investments and exclude interest earnings on the City's bank accounts.

In 2023, interest rates rose further from the level experienced in the prior year. 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 provides a summary of the service review of the City's investment management function that was initiated in 2023. This review resulted in bringing the management of this function in-house and a change to the City's investment custodian service provider. This review resulted in net savings of approximately \$800K annually (operating and reserve funds combined), noting that direct operating budget savings of approximately \$120K per year will be brought forward as a budget amendment in the 2025 Annual Budget Update.

## 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 portfolio investments in line with the Council approved Investment Policy and its stated objectives 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 Portfolio Investments and Performance:

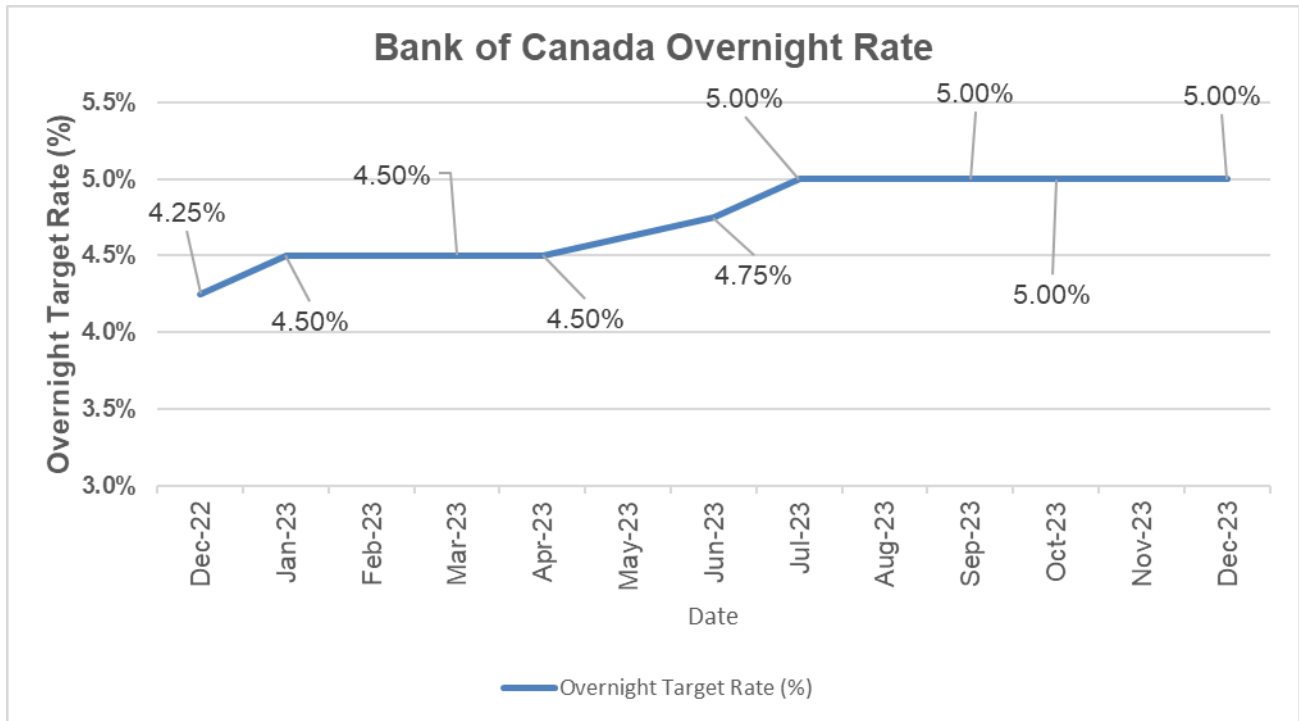
#### Portfolio Balance:

In 2023, the City of London (the "City") investment portfolio consisted of investments in securities prescribed under Ontario Regulation 438/97. As at December 31, 2023, 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 at year-end is attached as Appendix "A". The City's investment portfolio contains over 300 securities.

#### Market Summary for 2023:

The overnight policy rate is the Bank of Canada's (BOC) primary monetary policy instrument. The BOC raised its overnight target rate three times in 2023 between January and July from 4.25% to 5%; where it held from July until December (see Figure 1).

Figure 1 – Change in BOC overnight target rate over 2023



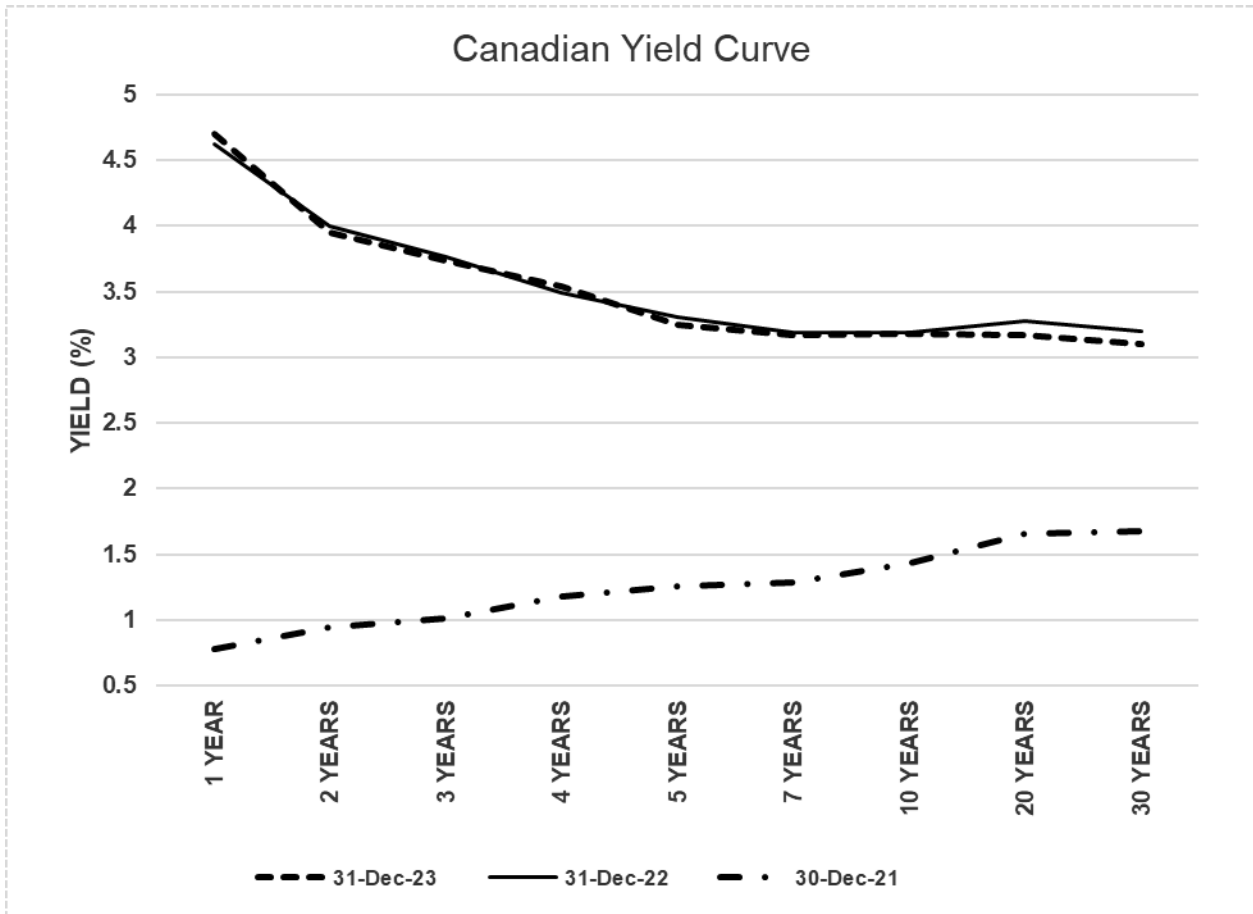
Source: BOC

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 remained high over the course of 2023, 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. However, the financial conditions of 2022 which 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, persisted in 2023.

Figure 2 provides an overview of the Government of Canada bond yield for various durations, demonstrating how yields have remained elevated in the past two years and the yield curve inverted.

Figure 2 - Government of Canada Yield Curve

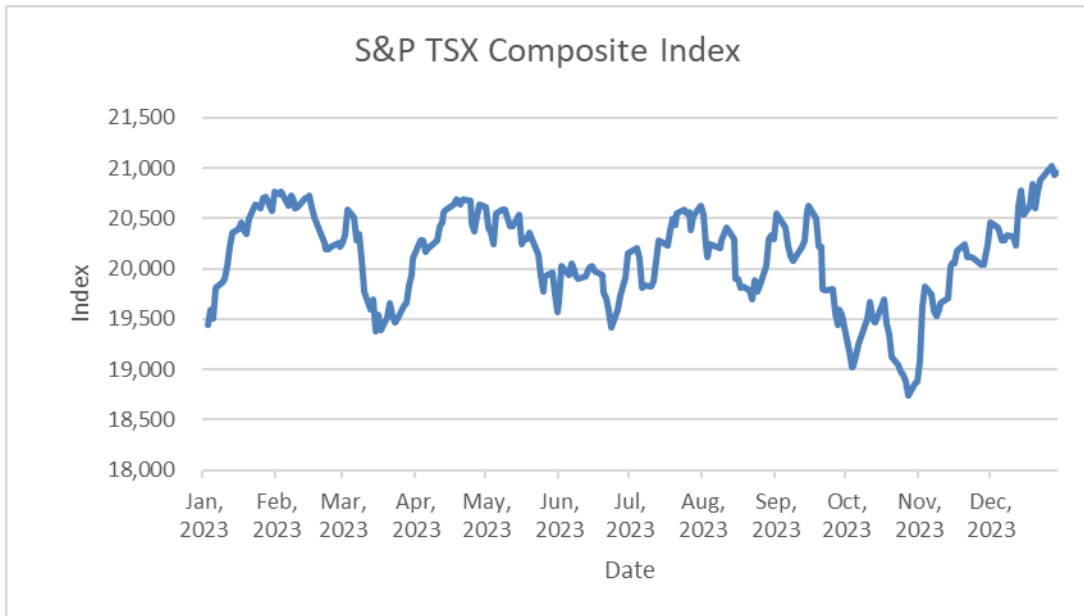


Source: Refinitiv

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.

The Canadian equity market (as measured by the S&P TSX Composite Index) was resilient in 2023, experiencing a major recovery from the prior year to close on a strong note with an 8.1% annual growth (see Figure 3). 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.

Figure 3 - S&P TSX Composite Index 2023 Chart



Source: Refinitiv

Economic and market conditions will continue to be monitored to inform investment decisions accordingly, within the parameters of the City's Investment Policy.

**Investment Strategy:**

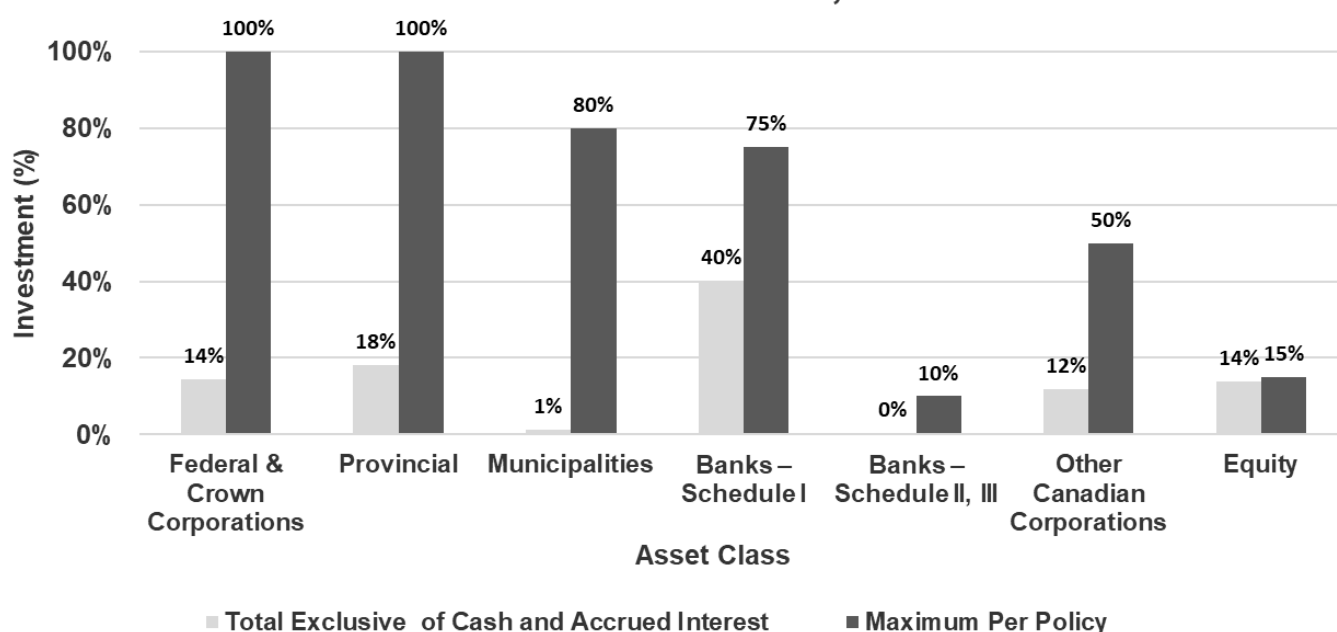
As outlined in the City's Investment Policy, the City's overall investment strategy is to invest funds in a manner that prioritizes:

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

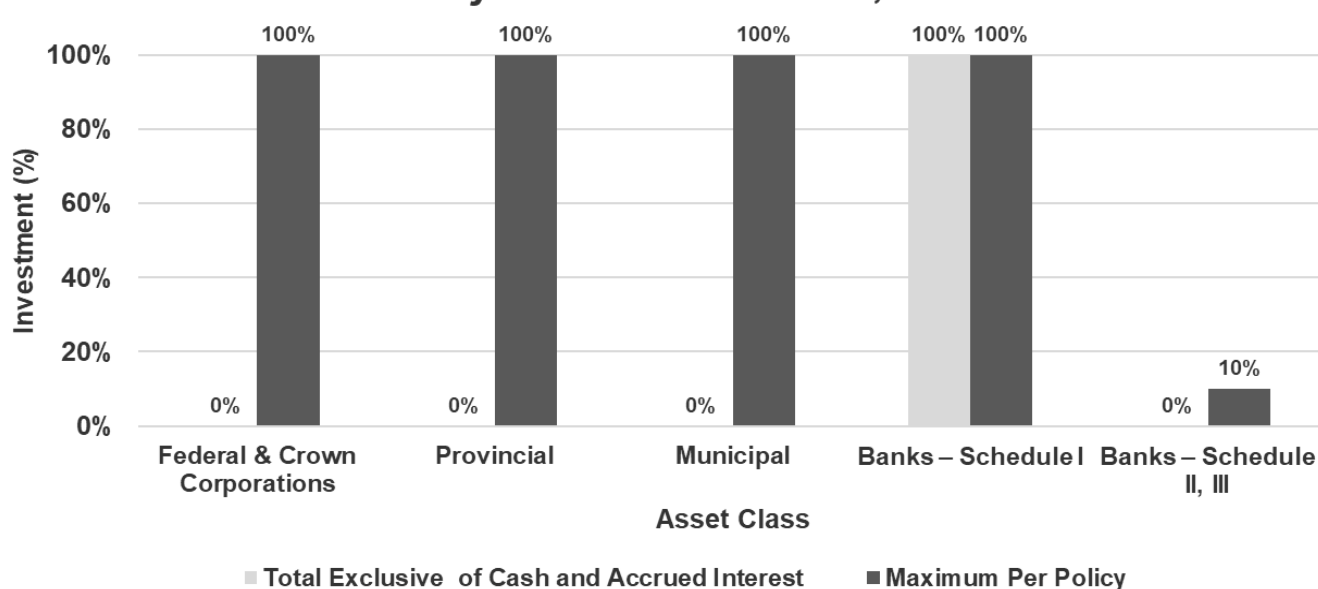
The City's strategy includes building a liquid and diversified portfolio while being mindful of the limitations of the portfolio. No significant changes were made to the City's Investment Policy in 2023.

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:

### Total Reserve Funds Investment vs Maximum Per Policy As At December 31, 2023



### Total Operating Funds Investment vs Maximum Per Policy As At December 31, 2023



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 yield for 2023 and components of portfolio investment income.

Fund	Realized Income (Million \$)	Unrealized Income (Million \$)	All-In Income (Million \$)	All-In Yield %
Reserve Funds	29.3	49.2	78.5	6.3
Operating Funds	3.5	0	3.5	4.1

For comparative purposes, 2022 realized income was \$19.2 million for reserve funds and \$1.2 million for operating funds, representing a realized yield of 1.7% for reserve funds and 2.7% for operating funds. Due to the implementation of new accounting standards,

comparative information will be reported on an all-in basis (realized and unrealized income) going forward.

These figures include income from portfolio investments only and exclude interest earnings on the City's bank accounts (see section 2.2). It should be noted that the City's fixed income investments are predominately 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, some 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. Overall, there was an increase in the total portfolio yield compared to 2022.

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.

### **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 2023, 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.

## **2.2 Non-Portfolio Investments Interest Earned**

In addition to portfolio investments, the City of London earns interest on cash and cash equivalents (e.g. the City's bank accounts). Interest on non-portfolio investments is grouped and included as investment income as part of the City's Multi-Year Budget and Financial Statements. In 2023, operating funds interest earned on non-portfolio investments amounted to \$19.4 million (2022 - \$10 million) and reserve funds non-portfolio investments interest earned amounted to \$9.6 million (2022 - \$5.5 million). The increased earnings on operating funds contributed to the investment income surplus reported in the 2023 Year-end Operating Budget Monitoring Report, noting that adjustments were made to the investment income budget as part of the 2024-2027 Multi-Year Budget and that the investment income budget is being further reviewed as part of 2025 Budget development.

In 2023, the Trust Fund interest earned on non-portfolio investments amounted to \$135 thousand (2022 - \$72 thousand).

### **3.0 Key Issues and Considerations**

#### **3.1. Investment Management Service Review**

In 2023, Civic Administration began a service review on the City's investment management function. Civic Administration focused its review on two major areas of the investment management function: custodial and reporting services and use of external investment managers related to fixed income securities. This review was aligned and linked with the introduction and implementation of new accounting standards that impacted portfolio investments in fiscal year 2023. Changes to the City's Investment Policy were not part of the scope of this service review.

Throughout 2023, Civic Administration performed due diligence by piloting a new custodian for a short-term fixed income portfolio. This portfolio was managed directly by Civic Administration through established relationships developed with fixed income desks at the City's various financial institution partners. It was concluded that the piloted custodian provided enhanced reporting and monitoring capabilities and was more aligned with institutional requirements. Furthermore, due diligence confirmed that the City of London could successfully manage fixed income portfolios without the use of an external investment manager. The City of London was one of only a few similarly sized municipalities across Canada utilizing external managers for portfolio management, resulting in above average investment management expense ratios.

In the first half of 2024, Civic Administration initiated the transfer of custodial services as well as in-sourcing of the investment management function for the remainder of the City's investment portfolio (excluding the equity portion, which is legislatively restricted to the ONE Canadian Equity program). Previous external investment management services and custodial services were ceased in Q2 2024. Securities were moved in-kind avoiding any adverse transactions and preserving invested positions. This transition also provided the opportunity for the consolidation of multiple accounts for ease of administration. These changes have now been fully completed as of the writing of this report.

While evaluating the costs, savings and resourcing requirements to initiate this change, Civic Administration has determined that there are net direct and indirect savings of approximately \$800K annually. Included in this amount is approximately \$120K of direct annual operating budget savings, which will be included in a 2025 Annual Budget Update Amendment to provide a permanent reduction to the property tax levy. The remainder reflects net annual savings to reserve funds when assessing the savings from reduced custodial fees and external management fees net of the additional costs of in-sourcing. This will result in the City's suite of reserve funds retaining more net investment income, which may allow future contributions to certain reserve funds to be adjusted accordingly over time to achieve and maintain the respective target balances, which in turn may result in future tax levy savings. It should be noted that the Municipal Act requires that investment income earned on reserve funds be credited to those respective funds, so additional investment income earned on reserve funds cannot be utilized as a direct reduction to the tax levy.

In Q3 and Q4 of 2024, the final phase of this service review will be completed. This last phase is an evaluation of existing retail brokerage relationships versus institutional money market/deposit accounts. There are no additional budget amendments expected from this phase. The focus of this portion of the review is on operational efficiencies from possible institutional reporting capabilities. A secondary consideration is potential savings in commissions and potentially increased yields. Any yield increases realized would be considered when evaluating the City's total investment income budget in future years.



## **Conclusion**

This report provides an overview of the City of London's portfolio investments in the context of financial market conditions in 2023. Investment income increased in 2023 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)**  
**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” – Portfolio Investments (Unconsolidated) (As of December 31, 2023)**

Category	Internally/ Externally Managed	Total Amount (Operating + Reserve Fund) (thousands)	% of Portfolio	Operating Fund Amount (thousands)	% of Portfolio	Reserve Fund Amount (thousands)	% of Portfolio
Guaranteed Investment Certificates	Internal	231,102	16.81%	28,230	2.05%	202,872	14.76%
Fixed Income	Internal and External	958,587	69.76%	0	0%	958,587	69.76%
Canadian Equity Pooled Funds	External	184,559	13.43%	0	0%	184,559	13.43%
<b>Total Portfolio</b>		<b>1,374,248</b>	<b>100%</b>	<b>28,230</b>	<b>2.05%</b>	<b>1,346,018</b>	<b>97.95%</b>
Total Internally Managed	Internal	307,498	22.38%	28,230	2.05%	279,268	20.32 %
Total Externally Managed	External	1,066,750	77.62%	0	0%	1,066,750	77.62%
<b>Total Portfolio</b>		<b>1,374,248</b>	<b>100%</b>	<b>28,230</b>	<b>2.05%</b>	<b>1,346,018</b>	<b>97.95%</b>

Note: Fixed Income and Canadian Equity Pooled Funds are measured at fair value and Guaranteed Investment Certificates (GICs) are measured at cost.