

Report to Corporate Services Committee

To: Chair and Members
Corporate Services Committee

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

Subject: 2021 Investment Report

Date: July 25, 2022

Recommendation

That, on the recommendation of the Deputy City Manager, Finance Supports, the 2021 Investment Report, providing a summary of the performance of the City of London's investment portfolio, **BE RECEIVED** for information.

Executive Summary

This report provides a summary of the performance of the City of London's investment portfolio in 2021 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 2021, the City earned total income of approximately \$27.9 million from investments (excluding unrealized gains/losses), of which \$24.1 million was earned from reserve fund investments and \$3.8 million was earned from general fund investments. The City's 2021 average monthly investment portfolio balance totaled approximately \$1.572 billion.

The prevailing low interest rate environment resulting from the COVID-19 pandemic persisted in 2021. 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. An update on the prudent investor standard is also provided.

Linkage to the Corporate Strategic Plan

Council's 2019-2023 Strategic Plan for the City of London identifies 'Leading in Public Service' as a strategic area of focus. Management of the City of London's investment portfolio in line with its stated objectives supports this area of focus and links to the strategy of maximizing investment returns while adhering to the City's Investment Policy.

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

Investments and Performance:

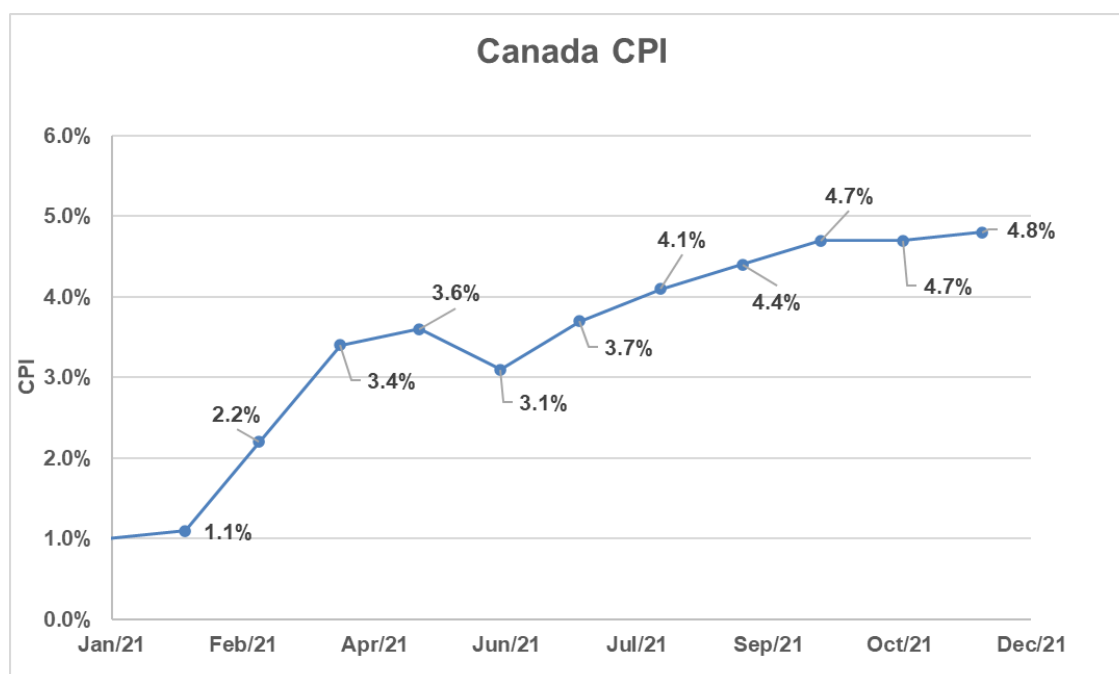
Portfolio Balance:

In 2021, the City of London (the “City”) maintained a monthly average investment portfolio balance of \$1.572 billion (2020, \$1.319 billion), consisting of cash and investments in securities prescribed under Ontario Regulation 438/97. As at December 31, 2021, the City’s investment portfolio included government bonds, corporate bonds, One Fund 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 500 securities.

Market Summary for 2021:

The Bank of Canada maintained its overnight target rate at 0.25% throughout 2021; COVID-19 remained the biggest risk to economic growth and the financial markets with several variants of the virus identified at different points in the year. Further supply chain disruptions added additional challenges to the economy and financial markets with year-over-year inflation (as measured by the Consumer Price Index) rising from 1% at the beginning of the year to 4.8% by the end of the year (see Figure 1).

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

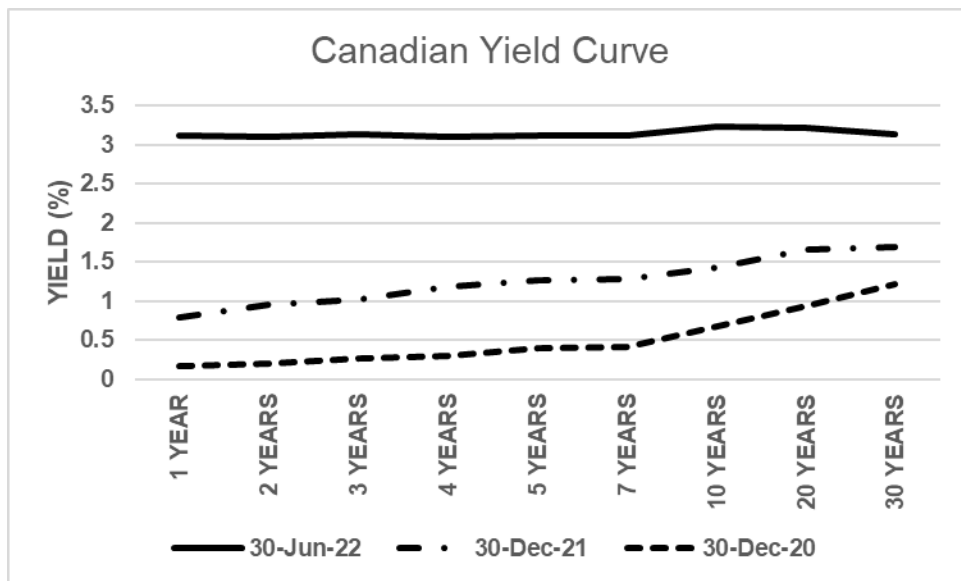


Source: Refinitiv

In 2020, as part of the measures put in place to stimulate the economy, the Bank of Canada (BOC) implemented the quantitative easing program (QE), which essentially involves the

BOC purchasing fixed income securities of various types and durations in the market, to maintain market liquidity and keep rates low for longer term borrowings. The low yield environment persisted until the BOC was confident of the improvement in the economy, at which point they announced their intention of winding down the QE program. As the economy continued to recover through 2021, reaching pre-pandemic GDP in November 2021 (with employment levels having fully recovered in Q3), the Bank of Canada continued winding down emergency stimulus to the economy, cutting its government bond purchases over the last year and completely ending programs that were no longer needed. This saw bond yields begin to move higher as the economy began to reopen. In the latter part of the year, the market began to price in rate hikes for 2022 on the back of continuous economic growth and rising inflation. Figure 2 provides an overview of the Government of Canada yield for various durations, demonstrating how yields have continued to rise.

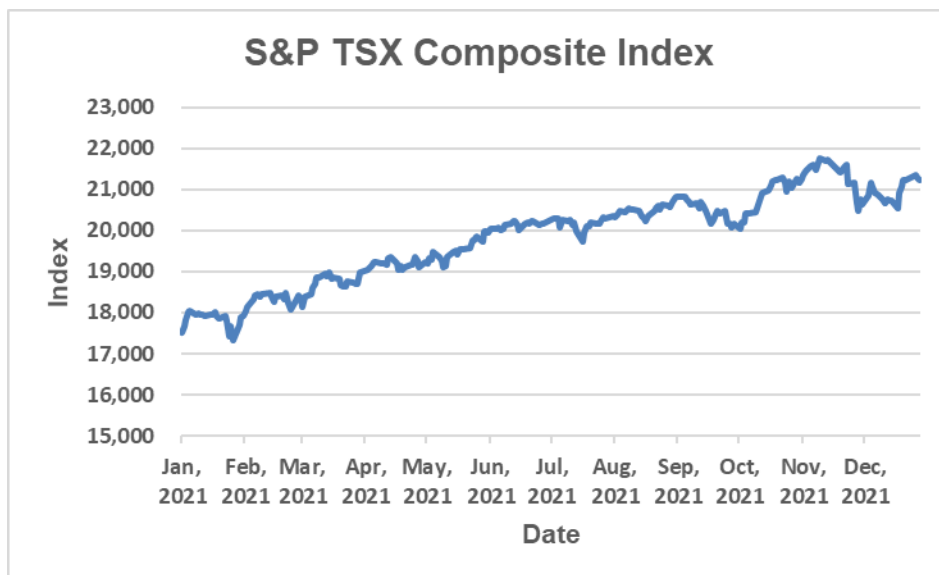
Figure 2 - Government of Canada Yield Curve



Source: Refinitiv

Canadian equity markets remained above pre-pandemic highs in 2021 closing above 2020 levels (see Figure 3).

Figure 3 - S&P TSX Composite Index 2021 Chart



Source: Refinitiv

Economic and market conditions are continually monitored by the City and its team of professional portfolio managers to ensure the City's investment portfolio is adjusted to reflect changing conditions.

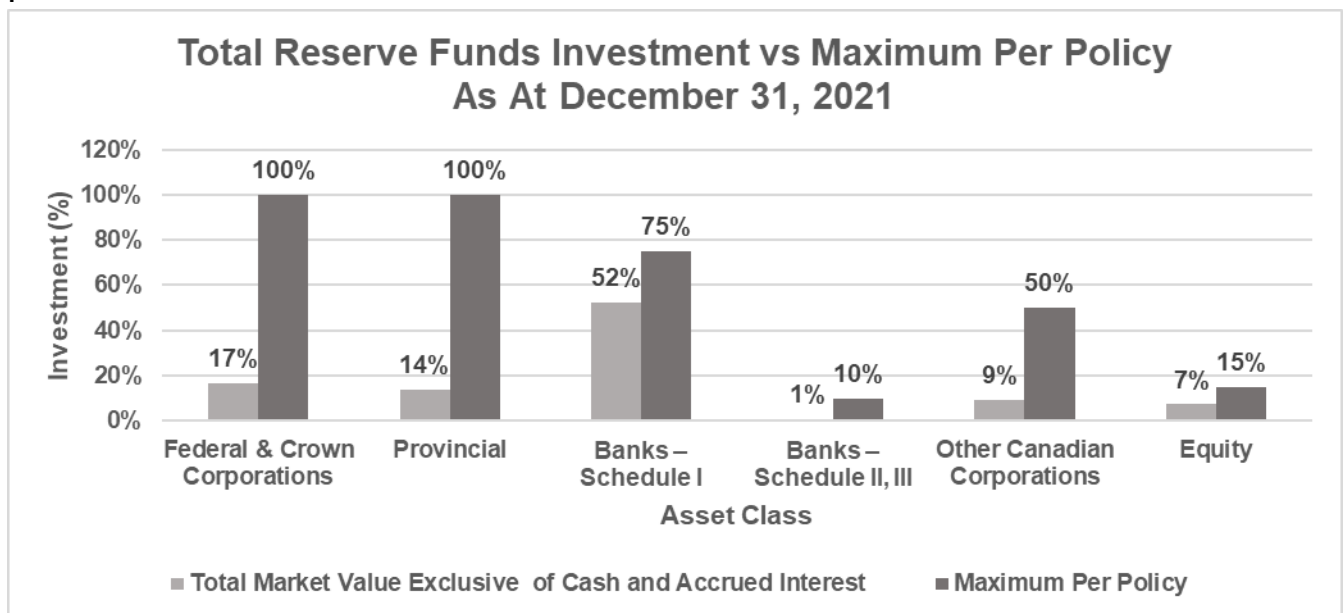
Investment Strategy:

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

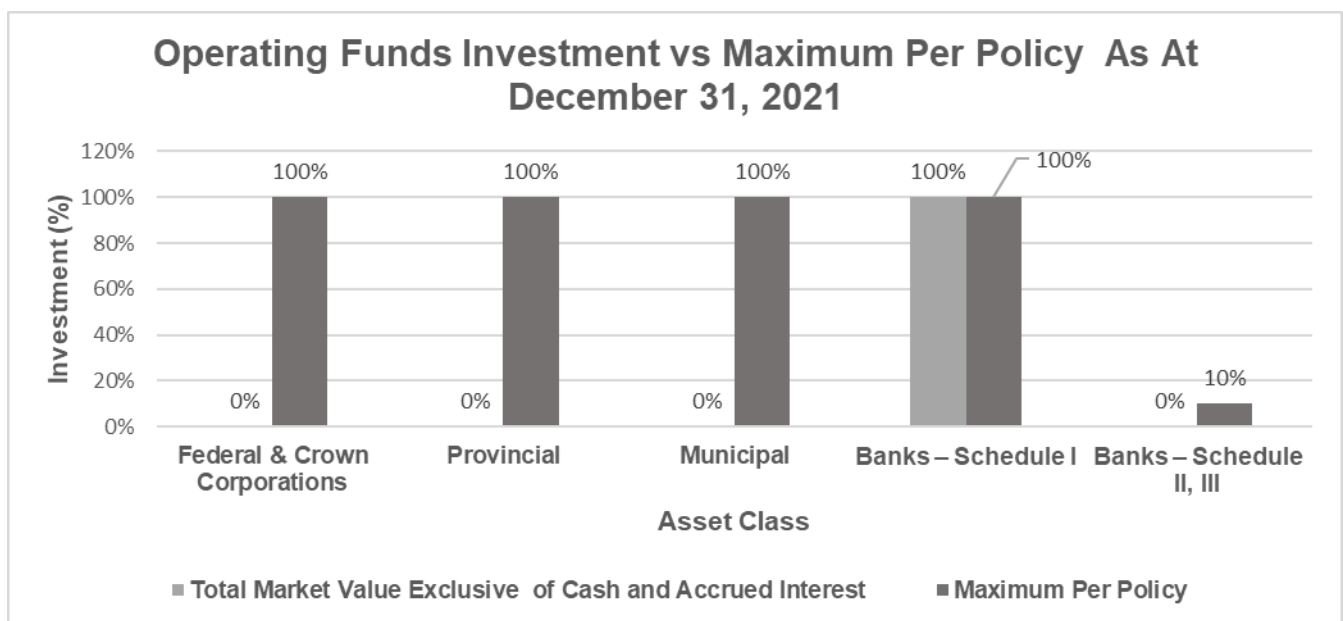
1. Adherence to statutory requirements
2. Preservation of capital
3. Maintenance of liquidity
4. Achieving a rate of return sufficient to maintain the purchasing power of invested funds

The City’s strategy includes building a liquid and diversified portfolio while being mindful of the limitations of the portfolio. In 2021, the City’s Investment Policy was updated to provide further flexibility with the aim of optimizing the City’s portfolio while adhering to long-standing investment objectives that have served the City well. Key changes included removal of term targets; segregation of specified assets; creating separate identification and investment type limitations for operating funds, reserves, reserve funds and trust funds; expansion and definition of fixed income investments to allow for more fixed income investment options and an increase to allowable equity holdings.

Below is the comparison of the City’s investments in each asset class and the maximum allowed for the asset class.



Note: The City’s holdings in Federal and Crown corporations, provincial, banks - schedules I, II, III and other Canadian corporations are all fixed income investments.



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Operating fund securities have a maximum term of two years per the City's Investment Policy. During 2021, one-year and two-year Canada bonds had a yield lower than 1% for most of the year. This low yield environment translated to lower yield across other fixed income securities. While being mindful of the policy objectives and priorities, there continued to be a focus on investing in bank securities to realize greater yields compared to government bonds.

Investment Income:

The table below shows a breakdown of the average annual yields for 2021, as well as the 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	1,155.7	24.1	2.1%
Operating Funds	416.3	3.8	0.9%

The City's portfolio performance is closely tied to the Bank of Canada's overnight rate and the 1–10-year yield curve given the type of securities and assets it holds. While the City's portfolio balances increased in 2021, the low interest rate environment and prevailing market conditions led to a slight increase in earnings with lower yields in comparison to 2020.

In 2021, the City earned total income of approximately \$27.9 million (\$27.3 million in 2020) from investments, of which \$24.1 million (\$23.9 million in 2020) was earned from reserve fund investments and \$3.8 million (\$3.4 million in 2020) was earned from general fund investments.

In accordance with the Municipal Act, 2001 (the "Act"), interest and capital gains 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 general fund is allocated to general revenues, which is included in the approved 2020-2023 Multi-Year Operating Budget and contributes to offsetting the amount of taxes levied. For 2021, investment income realized (\$3.8 million) was unfavourable when compared to budgeted income (\$5.1 million). General fund investment income, given the shorter-term nature of these investments, tends to be significantly impacted by changes in the Bank of Canada overnight rate. These impacts were included in the City of London's operating results as reported in the 2021 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 2021, 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.

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.

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. However, given the City’s typical buy-and-hold approach to investing, unrealized gains or losses are of limited relevance in most cases. The exception is when fixed income securities are required to be liquidated before they mature or when equity holdings are sold (both of which are historically rare occurrences).

Despite the limited relevance of unrealized gains or losses in the City’s normal investment activities, adoption of the PS 3450 standard is mandatory. The primary change resulting from this new accounting standard is the recognition of some unrealized gains and losses within the financial statements and recording investment balances at their fair value versus cost on the statement of financial position (balance sheet). The City’s investment portfolio’s cost and fair value is currently disclosed in the notes to financial statements – refer to Note 4 excerpt for the 2021 Consolidated Financial Statements (Appendix B). The difference in these values effectively represent the unrealized gain or loss position. These unrealized gains or losses will take greater prominence in the financial statements starting for the year ending December 31, 2023.

Civic Administration is currently in the process of reviewing and evaluating requirements of the standard in preparation for implementation in accordance with the required timeline. Civic Administration has engaged with its external auditors in obtaining technical clarity on certain matters and preparing its accounting elections. PS 3450 Financial Instruments implementation as it relates to investments is on track for the required adoption in fiscal year 2023. Formal accounting standard updates and elections will be provided to Council through the appropriate committees.

3.2. Prudent Investor Update

On March 1, 2018, amendments were made to the Municipal Act, 2001 and Ontario Regulation 438/97, granting eligible municipalities access to invest in any security in accordance with the prudent investor standard and other requirements set out in the regulation.

Amendments were also made to the prescribed list of eligible investment securities for municipalities that do not wish to invest or are not eligible to invest under the new prudent

investor standard. The prescribed list of eligible securities consists primarily of government bonds, bank-issued debt, and corporate bonds. The regulation also permits investment in Canadian corporate shares if the investment is made through the One Investment Program. Effective January 1, 2019, eligible municipalities have the option to continue under the updated prescribed list or move to the prudent investor standard.

Civic Administration has continued to perform due diligence and evaluation of implications and requirements of this standard. As reported in the 2019 Investment Report, Civic Administration participates in a treasury and investments working group with other Ontario municipalities, exploring other potential future investment options for municipalities. While this peer municipal group was engaging with representatives from the Municipal Finance Branch of the Ministry of Municipal Affairs and Housing and the Ontario Financing Authority to discuss potential changes to the Act prior to the COVID-19 pandemic, at this time the formal Provincial Debt and Investment group has not been re-established and no changes to the Act are expected in the near term.

Adoption of the prudent investor standard as currently written is irrevocable. Civic Administration continues to recommend not adopting the prudent investor standard at this time. Civic Administration continues focus on optimizing the investment portfolio under the current framework (the prescribed list framework) and is focusing efforts on cash forecasting and liquidity optimization as a first and fundamental step to potential prudent investor adoption if deemed appropriate in the future.

Conclusion

This report provides an overview of the City of London's investment portfolio in the context of the markets during COVID-19. Investment income increased in 2021 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.

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

Attachment: Appendix A and B

Appendix “A” - Investment Portfolio As Of December 31, 2021

Product	Avg. Term To Maturity (Years)	Internally/Externally Managed	Total Book Value (General + Reserve Fund) (thousands)	% of Portfolio	General Fund Book Value (thousands)	% of Portfolio	Reserve Fund Book Value (thousands)	% of Portfolio
Cash (Note A)	0.0	Internal	389,518	23.8%	176,861	10.8%	212,657	12.9%
High Interest Savings Account	0.1	Internal	200,000	12.2%	200,000	12.2%	0	0
Investment Clearing Balance	0.0	Internal	6,037	0.4%	0	0%	6,037	0.4%
Fixed Income - Pooled Funds	1.7	Internal	239,650	14.6%	10,000	0.6%	229,650	14%
Fixed Income – Pooled Funds	4.1	External	656,177	40.1%	0	0%	656,177	40.1%
Fixed Income - Horton Street Environmental Fund	4.4	External	79,761	4.9%	0	0%	79,761	4.9%
Canadian Equity - Pooled Funds	N/A	External	66,760	4.1%	0	0%	66,760	4.1%
Total Portfolio			1,637,903	100%	386,861	23.6%	1,251,042	76.4%
Total Internally Managed	N/A	Internal	835,204	51%	386,861	23.6%	448,344	27.4 %
Total Externally Managed	N/A	External	802,698	49%	0	0%	802,698	49.0%
Total Portfolio			1,637,903	100%	386,861	23.6%	1,251,042	76.4%

Note A: Cash balances as per bank accounts as at December 31, 2021. Excludes Trust Funds.

Appendix “B” - Note 4 excerpt from the 2021 Consolidated Financial Statements

	2021 Cost (thousands)	2021 Market Value (thousands)	2020 Cost (thousands)	2020 Market Value (thousands)
Pooled investment funds	74,833	84,222	42,634	45,865
Government fixed income	246,338	245,050	166,274	172,693
Corporate fixed income	664,877	662,874	599,258	605,296
Asset backed securities	64,884	65,586	71,022	76,086
Other investments	0	0	96	96
Total	1,050,932	1,057,732	879,284	900,036