INFORMATION REPORT

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	April 23, 2018
SUBJECT/REPORT NO:	Reserve / Revenue Fund Investment Performance Report – December 31, 2017 (FCS18043) (City Wide)
WARD(S) AFFECTED:	City Wide
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Council Direction:

Not Applicable.

Information:

The investment portfolio for the City of Hamilton's (City's) Reserve / Revenue Fund (comprised of reserve / revenue funds, capital account balances and unused operating funds) had an earnings rate of 2.79% for the 12 months ending December 31, 2017 and had an average earnings rate of 2.82% over the past five years. The earnings rate includes interest and lending revenues, but excludes realized and unrealized capital gains / losses.

The City's portfolio generated $27,350,421 in bond interest, net realized capital gains / losses, lending revenue and bank interest over the 12 months ending December 31, 2017. The average dollar amount generated over the last five years is $24.01M. The return of $27,350,421 was realized on an average asset cost of $1,065,014,998 (made up of $870,987,271 for the investment portfolio plus $168,503,494 for the City's bank account balance plus $25,524,233 for the One Fund Equity and Universe Corporate Bond), giving a percentage return on cost of 2.57%. Bond lending revenues of $231,169 are included in the earnings rate of 2.79%. Net unrealized capital gains / losses were $10,486,872 as at December 31, 2017.

For the 12 months ending December 31, 2017, the overall return (includes bond interest, bond lending revenues, realized capital gains / losses and unrealized capital gains / losses) was 1.29% and the return on the benchmark was 0.42%, resulting in an out-performance of 87 basis points. Over the past five years, the overall return has averaged 2.40% per annum, out-performing the average return on the benchmark over the same five-year period of 1.68% by 72 basis points. For the one-year period ending December 31, 2017, the out-performance of the investment portfolio relative to the benchmark is attributed to its longer duration, resulting in mid-term and long-term bonds outperforming short-term bonds given the significant decrease into the fall of 2017.

By comparison, the overall returns for the One Fund portfolios (offered by the Association of Municipalities of Ontario and the Municipal Finance Officers' Association), over the 12 month period ending December 31, 2017 were -0.15% for bonds and 0.60% for money market. If the City's Policy had been used in these funds (i.e. 90% bonds and 10% money market), then the overall return would have been 137 basis points less than the actual return of 1.29% or -0.08%. On an average portfolio market value of $897M, (excluding One Fund Equity and bank account balances), the incremental return of 1.37% resulted in incremental revenue of approximately $12.29M. The One Fund's under-performance is attributed to its policy of investing in short-term bonds. The FTSE TMX All-Government Mid Index returned 0.46% and the FTSE TMX Short Government Index returned -0.38%.

Table 1 summarizes the investment return indicators.

Table 1 - Investment Return Indicators (*for information purposes only*)

	12 Months ended 12/31/2017	12 Months ended 12/31/2016	12 Months ended 12/31/2015	12 Months ended 12/31/2014	12 Months ended 12/31/2013
Policy Target	0.42%	0.52%	2.72%	4.34%	0.42%
City's Portfolio	1.29%	1.49%	3.56%	6.39%	-0.73%
One Fund – Bonds	-0.15%	0.68%	1.94%	2.91%	1.14%
One Fund – Money Market	0.60%	0.50%	0.67%	0.86%	0.95%
FTSE TMX – Short Government	-0.38%	0.35%	2.54%	2.76%	1.40%
FTSE TMX – Mid Government	0.46%	0.87%	5.11%	9.11%	-1.20%
Bond Lending Revenue	$231,169	$155,754	$130,191	$115,803	$129,097
Earnings Rate (Excludes Capital Gains/Losses)	2.79%	2.78%	2.83%	2.91%	2.81%
City's Return One Fund Investment (Equity)	9.85%	14.18%	-0.11%	25.09%	22.74%

The investments in the portfolio, excluding the One Fund Equity investment, consist of 100% bonds and 0% money market. During the year ending December 31, 2017, the interest rate earned in the City's bank account was greater than the interest rate earned on Treasury Bills and Banker's Acceptances (with term to maturity less than six months) and therefore, funds that were earmarked for short-term expenses were held in the City's bank account. The City also continued to hold a modest amount of Floating Rate Notes, which continued to be a favourable alternative to money market securities. As at December 31, 2017, the duration of the portfolio was 5.14 years compared with 4.62 years as at December 31, 2016.

On December 31, 2017, the market value of the investment portfolio was $878,295,958 (excluding One Fund Equity and bank balances), an increase of $18,916,801 compared to $859,379,157 as at December 31, 2016.

The restructured Asset Backed Commercial Paper (Master Asset Vehicles) was sold in 2013 and all the remaining $10,000,000 of Devonshire notes were redeemed in 2014 at par. Reserves set aside under the Companies' Creditors Arrangement Act (CCAA) and held by the court appointed Monitor (Deloitte) totalled $54,969,946 net of expenses at December 31, 2017. The City of Hamilton's pro-rata share is estimated from the low distribution estimate of $1,547 and a high of $774,471 depending upon expenses over the next two years.

As at December 31, 2017, the One Fund equity holdings market value was $34.343M (or 3.91% of the market value of the Reserve Fund including the One Fund but excluding bank balances). Over the 12-month period ending December 31, 2017, the City's investment returned 9.85%. We expect to increase the City's investment in the One Fund's Equity Fund and possibly the Universe Bond Fund in 2018.

Table 2 shows the changes in Canadian interest rates over the past 24 months.

Table 2

CANADIAN INTEREST RATES			
Canada Benchmark Bond	Interest Rate January 3, 2018	Interest Rate January 3, 2017	Interest Rate January 4, 2016
One Month (T-Bill)	0.95%	0.40%	0.46%
2 year	1.68%	0.77%	0.47%
5 year	1.86%	1.14%	0.73%
10 year	2.05%	1.74%	1.40%

Through 2017, short-term rates increased as the Bank of Canada's bank rate moved up to 1.0% by year end. Longer term rates tended to move progressively lower led by the 10 year and 30 year bonds. The decline was based on reduced inflation fears and reduced concerns of a rate increase by the Bank of Canada. As well, commodity prices, particularly oil which opened the year at $54 a barrel before closing 2017 at $60, were moving higher. This, in turn, led to increasing upward pressure on the Canadian dollar with an increase in its value year end. The Canadian dollar ended the year at $0.797 US, having closed 2016 at $0.745 US. This was due to increased projected global economic activity and an increase in general commodities pricing, especially oil. The portfolio of bonds, in spite of having a high proportion of very short securities to fund delayed projects, out-performed the One Fund and the benchmark.

The Canadian economy performed well over 2017. Growing 3.2% overall, it eclipsed the projected year-end growth rate of 2.0% by an additional 1.2%, which led to the short-term rate increases late in the year. The Bank of Canada had projected 3.1% growth in 2016 for 2017. Going forward, the projected growth for 2018 is 1.8%, which would be under-performing the target growth of 2.0% per year.

Concerns and trade relations in North America and globally rose, specifically, trade war fears due to tariff threats by the United States. The United States have proceeded to place tariffs on steel imports at different levels with all countries, with some short-term relief for Canada. As well, Canada and the United States are in negotiations on the North American Free Trade Agreement (NAFTA). The uncertainty of the negotiations has stopped the Bank of Canada from increasing rates further in the near term.

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