INFORMATION REPORT

TO:	Chair and Members Audit, Finance and Administration Committee
COMMITTEE DATE:	June 18, 2020
SUBJECT/REPORT NO:	Reserve / Revenue Fund Investment Performance Report – December 31, 2019 (FCS20048) (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 2.80% for the 12 months ending December 31, 2019 and had an average earnings rate of 2.81% 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 $32,592,757 in bond interest, net realized capital gains / losses, lending revenue and bank interest over the 12 months ending December 31, 2019. The average dollar amount generated over the last five years is $27.92 M. The return of $32,592,757 was realized on an average asset cost of $1,174,258,660 (made up of $988,385,886 for the investment portfolio plus $157,308,279 for the City's bank account balance plus $28,564,494 for the One Fund Equity and Universe Corporate Bond), giving a percentage return on cost of 2.78%. Bond lending revenues of $322,520 are included in the earnings rate of 2.80%. Net unrealized capital gains were $23,084,184 as at December 31, 2019.

OUR Vision: To be the best place to raise a child and age successfully.
OUR Mission: To provide high quality cost conscious public services that contribute to a healthy, safe and prosperous community, in a sustainable manner.
OUR Culture: Collective Ownership, Steadfast Integrity, Courageous Change, Sensational Service, Engaged Empowered Employees.

For the 12 months ending December 31, 2019, the overall return (includes bond interest, bond lending revenues, realized capital gains / losses and unrealized capital gains / losses) was 4.97% and the return on the benchmark was 3.42%, resulting in an out-performance of 155 basis points. Over the past five years, the overall return has averaged 2.63% per annum, out-performing the average return on the benchmark over the same five-year period of 1.77% by 86 basis points. For the one-year period ending December 31, 2019, 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 out-performing short-term bonds given the significant rate decrease into the fall of 2019.

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, 2019 were 2.61% for bonds and 1.68% 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 2.45% less than the actual return of 4.97%, or 2.52%. On an average portfolio market value of $1.02 B, (excluding One Fund Equity and bank account balances), the incremental return of 2.45% resulted in incremental revenue of approximately $2.55 M. 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 4.92% and the FTSE TMX Short Government Index returned 2.40%.

Table 1 summarizes the investment return indicators.

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

	12 Months ended 12/31/2019	12 Months ended 12/31/2018	12 Months ended 12/31/2017	12 Months ended 12/31/2016	12 Months ended 12/31/2015
Policy Target	3.42%	1.79%	0.42%	0.52%	2.72%
City's Portfolio	4.97%	1.82%	1.29%	1.49%	3.56%
One Fund – Bonds	2.61%	1.51%	-0.15%	0.68%	1.94%
One Fund – Money Market	1.68%	1.43%	0.60%	0.50%	0.67%
FTSE TMX – Short Government	2.40%	1.96%	-0.38%	0.35%	2.54%
FTSE TMX – Mid Government	4.92%	2.12%	0.46%	0.87%	5.11%
Bond Lending Revenue	$322,520	$284,474	$231,169	$155,754	$130,191
Earnings Rate (Excludes Capital Gains/Losses)	2.80%	2.85%	2.79%	2.78%	2.83%
City's Return One Fund Investment (Equity)	18.53%	2.24%	9.85%	14.18%	-0.11%

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, 2019, 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, 2019, the duration of the portfolio was 4.49 years compared with 4.72 years as at December 31, 2018.

On December 31, 2019, the market value of the investment portfolio was $1,000,783,402 (excluding One Fund Equity, Universe Corporate Bond and bank balances), an increase of $40,041,186 compared to $960,742,216 as at December 31, 2018.

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 plus accrued interest to maturity date. Reserves set aside under the Companies' Creditors Arrangement Act (CCAA) and held by the court appointed Monitor (Deloitte) totalled $4,838,001 net of expenses at December 31, 2018. The City's pro-rata share is estimated from the low distribution estimate of $1,547 and a high of $774,471. This item was settled in 2019 with the Deloitte making two final distributions through the year one of $530,000 and a late year final of $44,655. This total recovery of $574,655 closes the account out with a high side final recovery as per court instructions.

As at December 31, 2019, the One Fund equity holdings market value was $29.775 M (or 2.98% of the market value of the Reserve Fund including the One Fund but excluding bank balances). Over the 12-month period ending December 31, 2019 it returned 18.53%. Over the same period, The Universe Corporate Bond market value was $5.287 M and returned 0.175%.

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 2, 2020	Interest Rate January 2, 2019	Interest Rate January 2, 2018
One Month (T-Bill)	1.63%	1.63%	0.95%
2 year	1.66%	1.86%	1.68%
5 year	1.62%	1.85%	1.86%
10 year	1.62%	1.92%	2.05%

Through 2019, 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 $65 a barrel before closing 2019 at $61, 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 $0.770 US, having closed 2018 at $0.745 US. This was due to decreased projected global economic activity and a decrease in general commodities pricing, especially oil.

The portfolio of bonds, despite having a high proportion of near 10-year terms out-performed the One Fund and its benchmark.

The Canadian economy performed well. Growing 1.6 % overall, it lagged the projected year-end target growth rate of 2.0% by 0.4% which led to the short-term rate increases late in the year. The Bank of Canada had projected 1.8% growth in 2019. Going forward, the projected growth for 2020 is less than 1.6%. Some have speculated on a rate of much less than 1.0% which would be underperforming the target growth. This would indicate long-term slow growth with rates lower, awaiting a return to July 2018 levels or lower.

Global trade relationships have been strained by import and export tariffs in many countries. For example, the United States, Mexico and Canada agreement (USMCA) has been signed off and will be taking effect July 1, 2020. As well, the United States and China have been trading various tariffs with each other. The trade environment has served to slow economic activity and create an uncertain environment. Many Central Banks have lowered interest rates dramatically, in some cases, to negative levels in order to mitigate economic damage.

The potential exit of Britain from the European Union is contributing to overall economic uncertainty, slow growth and declining economic activity. The uncertainty of the negotiations has stopped the Bank of Canada from increasing rates further in the near term, even though oil recovered to $61 a barrel.

The Reserve Fund portfolio of bonds was maintained with significant holding of near 10-year terms of high-quality provincial, municipal and major banks. The portfolio out-performed its benchmark and the One Fund's estimated returns by a wide margin. The portfolio, as it stands, is in very good shape. However, at this writing going forward, there is significant re-investment risk in terms of lower rates, liquidity and debt issuance.

Maturing holdings, new investments and marketability risk with dramatically dropping interest rates will cause diminished investment returns. The global movement to financed deficits will cause some financial instability due to the worldwide suspension of global trade and internal economic trade coming to a standstill due to COVID-19 Pandemic. Results could be inflationary to a degree, however a return to near normal economic conditions is the goal.

APPENDICES AND SCHEDULES ATTACHED

None

GB/BT/dt