INFORMATION REPORT

TO: Chair and Members Audit, Finance and Administration Committee	**WARD(S) AFFECTED:** CITY WIDE
COMMITTEE DATE: March 2, 2011	
SUBJECT/REPORT NO: Reserve/Revenue Fund Investment Performance Report - December 31, 2010 (FCS10075(a)) (City Wide)	
SUBMITTED BY: Roberto Rossini General Manager Finance & Corporate Services Department **SIGNATURE:**	**PREPARED BY:** Gerald T. Boychuk 905-546-4321 Rosaria Morelli 905-546-2424 Ext. 1390

Council Direction:

Not Applicable.

Information:

The investment portfolio for the City's Reserve/Revenue Fund (comprised of reserves/revenue funds, capital account balances and unused operating funds) had an earnings rate of **3.57%** for the 12 months ending December 31, 2010, and an average earnings rate of **3.91%** over the past five years. Bond lending revenues of **$73,771** are included in the earnings rate of **3.57%.** The earnings rate includes interest and lending revenues but excludes realized and unrealized capital gains/losses.

The City's portfolio generated approximately **$35.8** million in bond interest, net realized capital gains, lending revenue and bank interest over the last 12 months ending December 31, 2010. The average dollar amount generated over the last five years is **$33.5** million. Earnings in 2010 were buoyed by a record **$10.3** million in net realized capital gains versus $9.8 million in 2009. The total return of **$35.8** million was realized on an average investment at a cost of **$681,614,068.** The percentage return on asset cost over this period was **5.25%.** Net unrealized capital gains totalled **$16.8** million as at December 31, 2010.

For the 12 months ending December 31, 2010, the overall return (which includes bond interest, bond lending revenues, realized and unrealized capital gains/losses) was **4.29%**; whereas the benchmark return was **3.89%**, resulting in an out-performance by **40** basis points. Over the past five years, the overall return has averaged **4.59%** per annum, underperforming the average benchmark return over the same five-year period of **4.64%** by **5** basis points.

By comparison, the overall returns for the ONE Funds portfolios (offered by the Association of Municipalities of Ontario and the Municipal Finance Officers' Association), over the 12 month period ending December 31, 2010 were 3.00% for bonds and 0.65% for money market. If the City's Policy had been used in these funds (i.e. 90% bonds and 10% money market), the overall return would have been **2.77%** or 152 basis points less than the actual return of **4.29%**. On an average portfolio market value of $715.7 million, an increase of 1.52% return translates into a revenue increase of approximately **$10.9** million.

The following Table 1 summarizes the investment return indicators.

Table 1

Investment Return Indicators (for information purposes only)

	12 Months ended 12/31/2010	**12 Months ended 12/31/2009**	**12 Months ended 12/31/2008**	**12 Months ended 12/31/2007**	**12 Months ended 12/31/2006**
Policy Target	3.89%	1.72%	9.17%	4.50%	3.91%
City's Portfolio	**4.29%**	**4.92%**	**6.73%**	**3.67%(1)**	**3.32%**
The One Fund – Bonds	3.00%	3.35%	8.08%	3.84%	2.62%
The One Fund – Money Market	0.65%	0.75%	4.00%	4.39%	3.83%
Dex - Short Government	3.29%	1.94%	10.16%	4.53%	3.88%
Dex – Mid Governments	6.51%	1.57%	11.66%	4.52%	3.91%
Bond Lending Revenue	$73,771	$97,365	$84,071	$61,220	$36,918
Earnings Rate (Excludes Capital Gains/Losses)	**3.57%**	**4.26%**	**3.61%**	**3.30%(1)**	**4.79%**
City's Return ONE Fund Investment (Equity)	**11.91%**	**31.18%**	**-19.04%**	**-0.15%**	

(1) The earnings rate in 2007 was adjusted for an allowance of $14.4 million due to ABCP holdings. This allowance is an estimate only and actual results may differ due to realization from these holdings.

The investments in the portfolio consist of 100% bonds and 0% money market. Over 2010, rather than invest in money market securities for the City's short term cash flow requirements, the City chose to retain higher balances in the bank account because the rate earned in the bank account was higher than the rate earned on short-term (less than 6 months) money market securities such as Treasury Bills and Banker's Acceptances. Additionally, in place of money market investments, the City invested in a modest amount of floating rate notes.

As at December 31, 2010, the duration of the portfolio was 4.0 years compared to 3.8 years as at December 31, 2009. The total market value of the portfolio was $667,174,704, a decrease of $37.7 million compared to December 31, 2009, mostly due to keeping higher balances in the City's bank accounts. Inflows to the portfolio included a $25 million loan issued under the Municipal Infrastructure Lending Program administered by the Canada Mortgage & Housing Corporation and a $100 million one-time Provincial Grant for the Woodward Wastewater Plant Upgrades, both received in June 2010.

The total market value of the portfolio included $76.3 million (attributed cost) of remaining restructured Notes, received in exchange for the previously held Asset Backed Commercial Paper (ABCP), as well as $9.9 million in Devonshire Trust ABCP, which was not restructured. In 2007 and 2008 the City took a reserve loss position of $12.9 million against all the restructured Notes. An update on the restructured Notes is given in report FCS11006. The Devonshire Trust ABCP is currently the subject of litigation between the Investment Industry Regulatory Organization of Canada and the Ontario Securities Commission, and between the City and Deutsche Bank in an independent litigation. The Devonshire Trust ABCP has an allowance for loss of $5.5 million.

In June 2007, the City began subscribing to the ONE Funds Equity Account. Over a period of 43 months ending December 2010, the City had deposited a total of $5.2 million with the ONE Funds Equity Account. As at December 31, 2010 the market value of the City's holdings in the Account is $5.8 million (less than one percent of the market value of the City's Reserve/Revenue investment portfolio). Over the past twelve months ending December 31, 2010, the City's return on the ONE Funds Equity Account was **11.91%.**

The performance of the City's portfolio relative to its benchmark is mostly attributed to its slightly longer duration and holdings of Schedule I Canadian bank deposit Notes and Provincial bonds, both in the five and ten year term.

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

Table 2

CANADIAN INTEREST RATES			
Maturity Term: Canada Benchmark	**Interest Rate January 3, 2011**	**Interest Rate January 2, 2010**	**Interest Rate January 2, 2009**
One Month (T-Bill)	0.90%	0.14%	0.83%
2 yr	1.67%	1.45%	1.10%
5 yr	2.42%	2.76%	1.70%
10 yr	3.12%	3.61%	2.69%

As at December 31, 2010, Canadian federal bond yields (with a maturity greater than three years) were lower versus December 31, 2009. In the third quarter of 2010, it became clear that the U.S. and Canadian economies were deteriorating. But, by the end of the fourth quarter, after further monetary and fiscal stimulus in the U.S., the outlook for growth had significantly improved. As at December 31, 2010, compared to December 31, 2009, credit spreads on Provincial, Canadian Schedule I deposit Notes and Canadian agency bonds were moderately wider. Commodities were up 17.4%; crude oil was up 15.1%; gold was up 29.5%; and the Canadian dollar relative to the U.S. dollar strengthened to parity. The Bank of Canada raised the policy interest rate by a quarter percentage point at three of its policy meetings in mid-year, resulting in a current policy interest rate of 1%.

Market expectations are that the Bank of Canada will begin again to raise the policy interest rate in the near future – forecasts range from as soon as April 2011 to as late as the end of 2011 (given the recent strength of the Canadian dollar and the Federal Reserve still on hold).

The Bank of Canada's forecast for Canadian GDP in 2011 is 2.4%. The World Bank forecasts global growth in 2011 to be 3.3% while the International Monetary Fund (IMF) forecasts global growth in 2011 to be 4.4%. Neither the World Bank nor the IMF believes growth would be strong enough to significantly reduce unemployment. Risks which may threaten the nascent economic revival globally include China's recent measures to rein-in inflation, a significant decline in prices in U.S. housing, the sovereign debt crisis in Europe, and the lack of a plan by the U.S. to tackle their fiscal deficit.