INFORMATION REPORT

TO: Chair and Members Audit, Finance and Administration Committee	**WARD(S) AFFECTED:** CITY WIDE
COMMITTEE DATE: September 10, 2012	
SUBJECT/REPORT NO: Reserve/Revenue Fund Investment Performance Report - June 30, 2012 (FCS12067) (City Wide)	
SUBMITTED BY: Roberto Rossini General Manager Finance & Corporate Services Department	**PREPARED BY:** Gerald T. Boychuk 905-546-4321
SIGNATURE:	

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 **3.09%** for the 12 months ending June 30, 2012, and had an average earnings rate of **3.57%** over the past five years. Bond lending revenues of **$74,046** are included in the earnings rate of **3.09%.**

The City's portfolio generated approximately **$32.9** million in bond interest, net realized capital gains, lending revenue and bank interest over the 12 months ending June 30, 2012. The average dollar amount generated over the last five years is approximately **$35.5** million. Earnings were supplemented by **$9.1** million in net realized capital gains for the 12 months ending June 30, 2012. The total return of **$32.9** million was realized on an average asset cost of **$820,266,562** ($679,426,441 for the investment portfolio plus $140,840,121 for the City's bank account balance). The percentage return on this asset cost over this period was **4.01%**. Net unrealized capital gains totalled **$30.9** million as at June 30, 2012.

For the 12 months ending June 30, 2012, the overall return (which includes bond interest, bond lending revenues, realized and unrealized capital gains/losses) was **6.78%**; whereas the return on the benchmark was **4.97%**, resulting in an out-performance of **181** basis points. Over the past five years, the overall return has averaged **5.91%** per annum, outperforming the average return on the benchmark over the same five-year period of **5.10%** by **81** 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 June 30, 2012 were **3.31%** for bonds and **1.03%** 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 **3.08%** or **370** basis points less than the actual return of **6.78%**. On an average portfolio market value of **$709.9** million, an increase of **3.70%** in return translates into a revenue increase of approximately **$26.3** million.

Table 1 below summarizes the investment return indicators:

Table 1

Investment Return Indicators (for information purposes only)

	12 Months ended 06/30/2012	**12 Months ended 12/31/2011**	**12 Months ended 12/31/2010**	**12 Months ended 12/31/2009**	**12 Months ended 12/31/2008**
Policy Target	4.97%	5.76%	3.89%	1.72%	9.17%
City's Portfolio	**6.78%**	**6.83%**	**4.29%**	**4.92%**	**6.73%**
The One Fund – Bonds	3.31%	4.19%	3.00%	3.35%	8.08%
The One Fund – Money Market	1.03%	1.19%	0.65%	0.75%	4.00%
Dex - Short Government	3.55%	4.62%	3.29%	1.94%	10.16%
Dex – Mid Governments	11.38%	10.20%	6.51%	1.57%	11.66%
Bond Lending Revenue	$74,046	$64,847	$69,350	$97,365	$84,071
Earnings Rate (Excludes Capital Gains/Losses)	**3.09%**	**3.33%**	**3.57%**	**4.26%**	**3.61%**
City's Return ONE Fund Investment (Equity)	**-0.60%**	**-7.71%**	**11.91%**	**31.18%**	**-19.04%**

The investments in the portfolio consist of 100% bonds and 0% money market. During the year ending June 30, 2012, the rate earned in the City's bank account was higher than the rate earned on Treasury Bills and Banker's Acceptances (with terms less than 6 months) and therefore, funds that are 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 June 30, 2012, the duration of the portfolio was **4.3** years compared to **4.2** years as at December 31, 2011. The market value of the investment portfolio was **$737,527,248**, an increase of **$31.37** million compared to December 31, 2011. Significant cash flows in the first half of 2012 included the City borrowing a total of $94.74 million in three separate loans. On February 17, 2012, a $42 million loan was undertaken by effectively issuing a 15 year serial debenture through Infrastructure Ontario. Then on May 4, 2012, the City undertook two Swapped Variable Rate loans, one for $38 million over 15 years and another for $14.74 million over 5 years, both structured as serial debentures.

The market value of the portfolio includes **$76.3** million (attributed cost) of restructured MAV Notes, and **$9.9** million of Devonshire Trust Asset Backed Commercial Paper which was not restructured. The MAV Notes were received in exchange for the previously held Asset Backed Commercial Paper (ABCP). In 2007 and 2008, the City took a reserve loss position of **$12.9** million against all the restructured MAV Notes. Currently, the Devonshire Trust ABCP is the subject of litigation between the Investment Industry Regulatory Organization of Canada and the Ontario Securities Commission. Barclays Bank and Metcalfe & Mansfield Alternative Investments are involved in an independent litigation which may ultimately result in a significant distribution to Note holders. 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 61 months ending June 30, 2012, the City has deposited a total of **$6.0** million with the ONE Funds Equity Account. As at June 30, 2012, the market value of the City's investment in the ONE Funds Equity Account is **$6.52** million, which corresponds to **0.9%** of the market value of the City's investment portfolio. Over the past twelve months ending June 30, 2012, the City's one-year return on its investment in the ONE Funds Equity Account was **-0.60%**.

The out-performance of the Reserve/Revenue investment portfolio relative to the benchmark is attributed mostly to its longer duration and its holdings in Schedule I Canadian Bank Deposit Note and Provincial bonds, primarily in the five and ten year terms.

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

Table 2

CANADIAN INTEREST RATES			
Canada Benchmark	**Interest Rate June 29, 2012**	**Interest Rate January 3, 2012**	**Interest Rate January 4, 2011**
One Month (T-Bill)	0.86%	0.90%	0.91%
2 year	1.03 %	0.98%	1.70%
5 year	1.25%	1.31%	2.46%
10 year	1.74%	1.99%	3.17%

As at June 30, 2012, compared with December 31, 2011, yields on Government of Canada bonds were lower for those with a yield-to-maturity greater than 5 years and were slightly higher for those with a yield-to-maturity less than five years. Credit spreads were moderately wider on Provincial, Canadian Schedule I Bank Deposit Note and Canada Housing Trust Agency bonds with yield-to-maturity greater than five years; and were either narrower or unchanged with yield-to-maturity less than five years. Commodities were down by 6.9%; crude oil was down 13.6%; gold was up 2.2%; and the Canadian dollar relative to the U.S. dollar appreciated by 0.5% to USD98.37 on June 29, 2012. In the first half of 2012, the European debt crisis and global growth concerns were key themes in the bond market and, like last year, continued to drive yields lower as investors moved into safe havens. In the first half of 2012, the Bank of Canada kept the policy interest rate at 1%, unchanged, citing external downside risks.

Recently, on August 1, 2012, the Federal Reserve reiterated that low levels (near zero) for the policy rate can be expected through late 2014. On July 17, 2012, as expected, the Bank of Canada maintained the policy rate at 1% saying the global economy has weakened since April 2012 which is expected to restrain Canadian growth. Market expectations are that the Bank of Canada will raise the policy rate ahead of the Federal Reserve and possibly in 2013.

The Bank of Canada, in July 2012, downgraded its 2012 growth forecast for the Canadian economy to 2.1% from 2.4%. Recently, on July 16, 2012, citing downside risks from the euro zone debt crisis, the International Monetary Fund (IMF) reduced its estimate for 2013 global growth to 3.9 per cent from 4.1 per cent just three months ago, and projects global growth to be 3.5% for 2012.

Some downside risks to the global economic outlook in 2012 include a hard economic landing in China as the momentum slows in its economy; slower-than-expected growth in the U.S., and the risk that policymakers in the euro-zone do not do enough to contain the region's on-going debt crisis.