



The Corporation of the Town of Milton

Report To:	Council
From:	Glen Cowan, Chief Financial Officer/Treasurer
Date:	April 15, 2019
Report No:	CORS-020-19
Subject:	2018 Year End Report on Investments
Recommendation:	That report CORS-020-19 be received for information.

EXECUTIVE SUMMARY

This report has been prepared to provide an annual update to Council on the 2018 performance of the Town of Milton's investment portfolio as required by Ontario Regulation 438/97 (as amended) of the *Municipal Act, 2001* and the Town's policy No. 61 - Financial Cash Management and Investment.

The highlights for the twelve months ending December 31, 2018 are:

- The Town's cash management and investment program generated \$3.9 million in revenue;
- The average portfolio balance was \$192.8 million; and
- The overall portfolio average return was 2.01% on an annualized basis.

REPORT

Background

All investments made by the Town of Milton are in accordance with the approved Investment Policy which has the following basic objectives, in order of priority:

- i. Adherence to statutory requirements;
- ii. Preservation of principal;
- iii. Ensuring availability of cash to meet disbursements and other obligations;
- iv. Maintaining liquidity;
- v. Diversification of the investment portfolio, commensurate with constraints in (i) to (iv);
- vi. Earning a competitive rate of return, commensurate with constraints in (i) to (v);
- vii. Regular review of the effectiveness of the policy in meeting the above objectives;
- viii. Periodic audit of the investment program to ensure adherence to the policy.



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In addition, all investments must meet the eligibility requirements set out by Ontario Regulation 438/97 (as amended), which specifies specific limits for each type of investment that can be held.

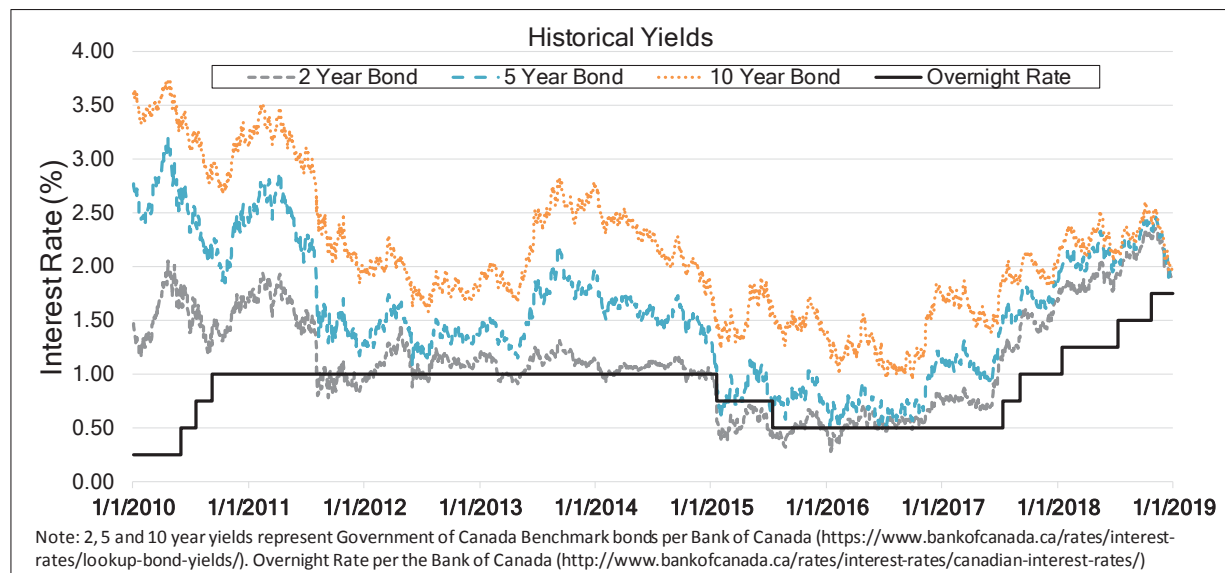
Discussion

Interest Rates

The Bank of Canada increased interest rates three times during 2018 in each of January, July and October. These increases brought the overnight rate to 1.75%, resulting in a higher rate of return on the Town's general bank account.

The yield on 1-3 year Government of Canada bonds averaged 1.96% in 2018 (2017 average: 1.08%) and 10 year Government of Canada yields averaged 2.28% in 2018 (2017 average: 1.78%)¹.

Towards the end of 2018 the yield curve has flattened significantly. Between 2010 and the beginning of 2017 the spread between the overnight rate and the 10 year bond rate has averaged 1.50% and ranged between approximately 3.50% and 0.50%. Towards the end of 2018 the gap narrowed significantly to 0.20% reducing the financial benefits historically associated with long-term investment opportunities as compared to short-term.

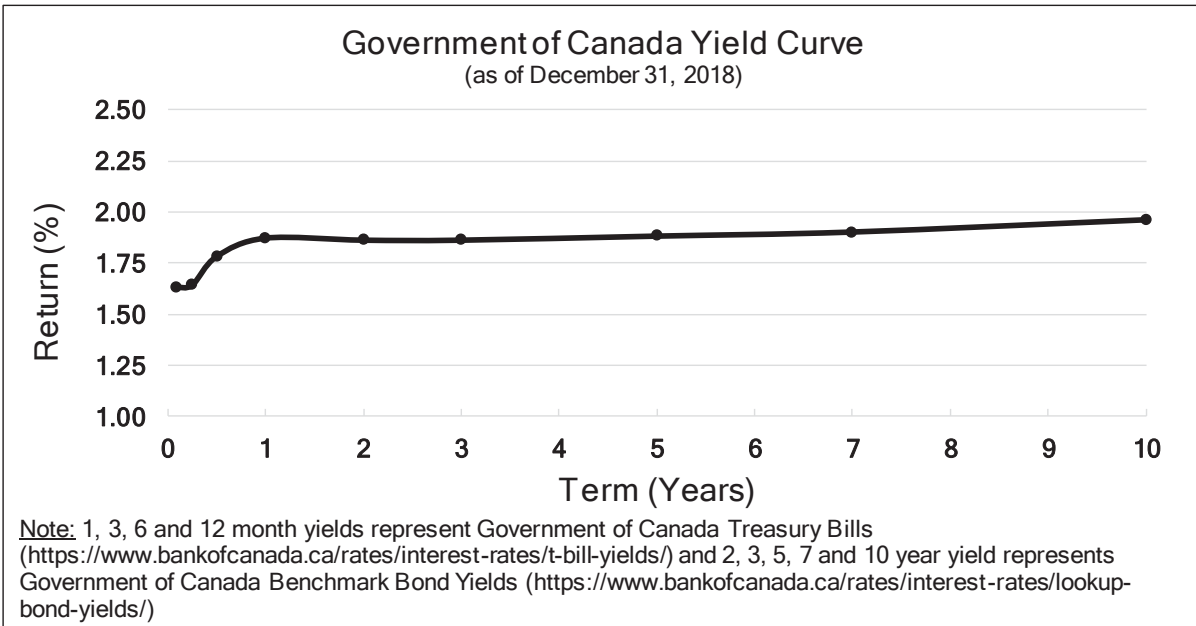


¹Bank of Canada. *Canadian Bond Yields: 10-Year Lookup table, V39059 Government of Canada Marketable Bonds - Average Yield - 1 to 3 Year and V39055 - Government of Canada Benchmark Bond Yields - 10 Year*. <http://www.bankofcanada.ca/rates/interest-rates/lookup-bond-yields/>. Accessed March 6, 2019.



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The chart below shows the flattening yield curve between short term and long term securities based on Government of Canada yields as of December 31, 2018.



Investment Portfolio

2018 year-end cash and investment holdings for the Town, excluding the Town's investment in Milton Hydro, were as follows:

Investment Type	Holdings (\$ Millions) (as of Dec 31, 2018)		Return in 2018
	Book Value	Market Value	%
Cash	\$76.3	\$76.3	1.98%
Short Term Investments	\$37.5	\$37.5	2.25%
Long Term Investments	\$65.8	\$65.1	1.89%
Total	\$179.6	\$178.9	2.01%

Cash

The Town's 2018 year-end cash balance was \$76.3 million, and had an average balance of \$77.5 million. The average yield on cash balances for 2018 was 1.98% generating \$1.5 million in interest. The cash balances remained high during 2018 due to market conditions along with cash requirements for major capital projects including the Sherwood Community Centre and Branch Library.



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Short Term Investments

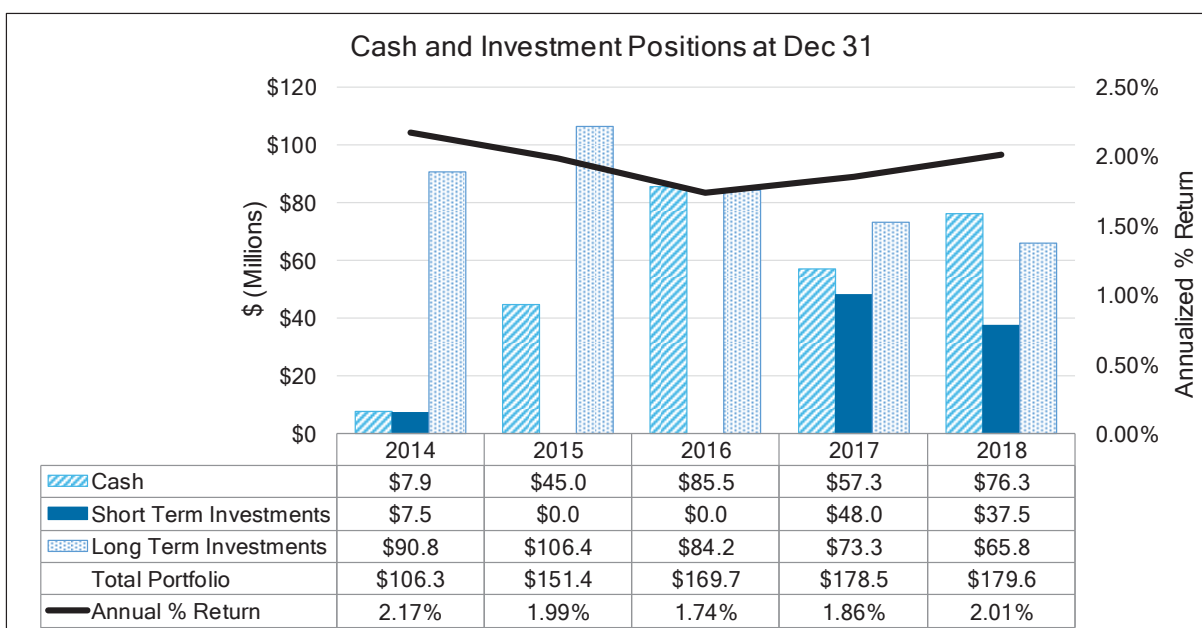
During 2018 short term investments (securities with a holding period of one year or less) were purchased as the yields were favourable to savings and high interest accounts and comparable to yields on five year provincial bonds while still providing liquidity options if the funds were required. Short term investments generated \$1.1 million in investment earnings and at the end of 2018 the Town held six short term securities with a value of \$37.5 million. The average balance through 2018 was \$47.3 million.

Long Term Investments

Long term investments had an average balance of \$68.0 million during 2018. At year-end, the Town held 28 securities with a book value of \$65.8 million and a market value of \$65.1 million. This translates into \$0.7 million in unrealized losses and consistent with prior years has not been included in the investment return figures. As the Town generally holds investments until maturity the unrealized book losses will have no impact on investment earnings.

Overall Portfolio

The average rate of return for the year for the entire portfolio was 2.01%, generating \$3.9 million in investment income (includes interest income and amortized premiums or discounts). Holdings at year-end and historical returns are compared over the past five years in the following graph:



While the overall size of the portfolio has remained consistent since 2017 there has been a slight decrease in both short and long term investments offset by an increase in cash. This was due to maturities of both long and short term investments in 2018 that were held in savings accounts which offered similar yields to both short and long term



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investments but had the advantage of greater liquidity. Liquidity was important to consider through 2018 to manage cash outflows associated with some significant capital projects including the new Sherwood Community Centre and Branch Library.

In 2019 the cash balance is anticipated to decrease as construction continues on the Sherwood Community Centre and begins on Fire Station No. 5.

Policy Limits

The Town's Cash Management and Investment Policy outlines limitations on holdings, expressed as a percentage of the total portfolio. A comparison of holdings at December 31, 2018 to policy limitations are outlined in the following table:

Authorized Investments and Limitations (Dec 31, 2018)										
Category / Sector ⁽¹⁾	Holdings (\$ Millions)							Term Limit (Years)	Minimum DBRS Rating ⁽³⁾	
	Short Term	Long Term (based on original term)		Total	% of Portfolio	Portfolio Maximum	Individual Maximum ⁽²⁾		Short-term	Long-Term
	Less than 1 Year	1 to 5 Years	5 to 10 Years							
Cash	\$76.29	-	-	\$76.29	42%	100%	100%	20	N/A	A (low)
Federal and Federal Guaranteed⁽⁴⁾	-	-	-	\$0.00	0%	100%	100%	20	N/A	A (low)
Provincial and Provincial Guaranteed⁽⁴⁾	-	-	-	-	-	-	-	-	-	-
British Columbia	-	\$1.16	\$2.62	\$3.78	2%	-	20%	-	-	-
Manitoba	-	-	\$3.09	\$3.09	2%	-	20%	-	-	-
Nova Scotia	-	\$7.24	-	\$7.24	4%	-	20%	15	R-1 (low)	A (low)
Ontario	-	\$5.69	\$1.62	\$7.31	4%	-	20%	-	-	-
Prince Edward Island	-	\$1.31	-	\$1.31	1%	-	20%	-	-	-
Quebec	-	\$1.20	\$2.22	\$3.42	2%	-	20%	-	-	-
Provincial and Provincial Guaranteed Sub-total	\$0.00	\$16.61	\$9.56	\$26.16	15%	100%	-	-	-	-
Municipal and Municipal Guaranteed	-	-	-	-	-	-	-	-	-	-
BC Municipal Finance Authority	-	-	\$3.00	\$3.00	2%	-	10%	15	R-1 (low)	AA (low)
City of Toronto	-	-	\$0.96	\$0.96	1%	-	10%	-	-	-
Regional Municipality of York	-	-	\$6.72	\$6.72	4%	-	10%	-	-	-
Municipal and Municipal Guaranteed Sub-total	\$0.00	\$0.00	\$10.69	\$10.69	6%	50%	-	-	-	-
Boards / Schools⁽⁵⁾	\$0.00	\$0.00	\$0.00	\$0.00	0%	15%	-	10	R-1 (low)	AA(low)
Financial Institution	-	-	-	-	-	-	-	-	-	-
Schedule I Bank (Six Majors)⁽⁶⁾	-	-	-	-	-	-	-	-	-	-
Bank of Nova Scotia (The)	\$7.00	\$12.00	\$4.00	\$23.00	13%	-	20%	10	R-1 (low)	AA(low)
Royal Bank of Canada	-	\$8.00	\$5.00	\$13.00	7%	-	20%	-	-	-
Schedule I Bank (Six Majors) Sub-total	\$7.00	\$20.00	\$9.00	\$36.00	20%	60%	-	-	-	-
Other Sch I, Sch II, Trust Loan, Credit Union	-	-	-	-	-	-	-	-	-	-
First Ontario	\$15.00	-	-	\$15.00	8.4%	-	10%	2	R-1 (mid)	AA(low)
Meridian	\$15.50	-	-	\$15.50	8.6%	-	10%	-	-	-
Other Sch I/Sch II/Trust/Credit Union Sub-total	\$30.50	\$0.00	\$0.00	\$30.50	17%	20%	-	-	-	-
Financial Institution Sub-total⁽⁷⁾	\$37.50	\$20.00	\$9.00	\$66.50	37%	60%	-	-	-	-
ONE Investment Program⁽⁸⁾	-	-	-	\$0.00	0%	25%	-	N/A	N/A	N/A
Asset Backed Securities	-	-	-	\$0.00	0%	10%	5%	5	R-1 (high)	AAA
Commercial paper or promissory notes	-	-	-	\$0.00	0%	10%	5%	1	R-1 (mid)	N/A
Total	\$113.79	\$36.61	\$29.24	\$179.64	100%					

Notes:

- (1) Per definitions and regulations under Ontario Regulation 438/97.
- (2) Individual maximum applies to either an individual institution or in the case of the ONE Investment Program it applies to individual portfolios.
- (3) Equivalent ratings from Moody's Investor Services, Standard and Poor's or Fitch Ratings are also acceptable.
- (4) A minimum of 10% of the portfolio must be in the Federal or Provincial category.
- (5) Includes a University in Ontario that is authorized to engage in an activity described in section 3 of the Post-secondary Education Choice and Excellence Act, 2000 and a college established under the Ontario Colleges of Applied Arts and Technology Act, 2002.
- (6) Six major Schedule I Banks include: Bank of Montreal, Bank of Nova Scotia (The), Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada and Toronto-Dominion Bank (The).
- (7) The overall Financial Institution category shall not exceed 60% of the total portfolio, within this category:
 - i) Aggregate holdings of the Six major Schedule I Banks shall not exceed 60% of the total portfolio; and
 - ii) Aggregate holdings of Schedule II & Other Schedule I Banks not listed above and Trust Loan / Credit Union's shall not exceed 20% of the total portfolio.
- (8) The ONE Investment Program provides recommended investment timelines for each fund however funds can be withdrawn with one day's notice and investments in each pool meet eligibility criteria as defined by regulations under the Municipal Act. Town policy currently allows for investments in the Money Market, Bond and Universe Corporate Bond portfolios.



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Town policy also identifies the minimum credit rating for securities based on the classification of the issuing organization and the form of investment. All securities held in 2018 satisfied the credit rating requirement.

None of the investments held by the Town in 2018 were in its own long-term or short term securities.

Comparison to Benchmark

Direct comparator information is not easily available due to differing calculation methods for investment returns, different portfolio compositions, term structures and investment strategies. The One Investment Program is a municipal investment pool that is used by municipalities. The following chart compares the Town's performance to this benchmark.

2018 Returns Comparison: Town of Milton to One Investment Program			
Type of Investment	Town of Milton	One Investment Program ⁽¹⁾	Difference
Cash	1.98%	2.09% ⁽²⁾	-0.11%
Short Term Investments	2.25%	1.41% ⁽³⁾	0.84%
Long Term Investments	1.89%	2.00% ⁽⁴⁾	-0.11%

Notes:

- (1) One Investment Program data taken from the December 2018 Performance Report and the 2018 Annual Report.
- (2) One Investment Program annualized HISA rate, net of fees.
- (3) One Investment Program Money Market Portfolio annualized 1 year return, net of fees (0.19%) and excludes 0.02% Market Impact.
- (4) One Investment Program Bond Portfolio annualized 1 year return, net of fees (0.40%) and excludes -0.49% Market Impact.

It should be noted that due to the classification of investment categories, composition of investments and differences in reporting rates of return, a direct comparison cannot be made. The benchmark comparison does provide some assurance that Milton's investment performance is reasonable when considering the current low rate environment.

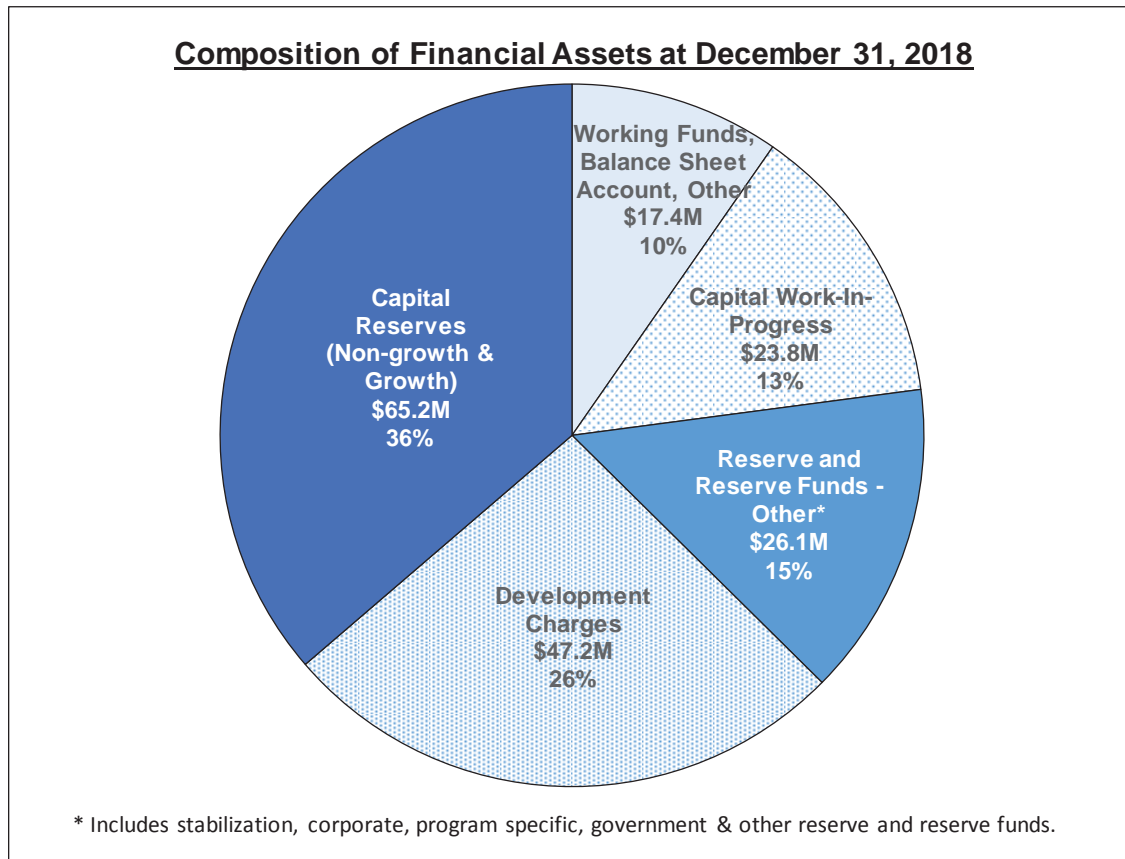


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Sources of Funds

The Town’s portfolio is comprised of funds held for a variety of purposes, each with its own investment horizon and liquidity needs. As the third priority in Milton’s investment policy involves ensuring sufficient cash is available to satisfy the disbursements and obligations of the Town, it is important to remain cognizant of the underlying needs when determining the Town’s investment strategy.

The following table summarizes the primary sources of the Town’s funds at 2018 year end. Although no individual category should be viewed as being entirely correlated to one specific investment timeframe, they have been presented in order of liquidity with the working funds / balance sheet amounts requiring the greatest liquidity (shortest time frame) and the capital reserves generally having a longer investment horizon.



Sinking Fund

In 2015 the Town approved a \$15 million 30 year sinking fund for a portion of the Town’s contribution to the Hospital. The Hospital sinking fund is held and managed by the Region of Halton, for the purposes of retiring the debt at maturity. As a result, the Town’s



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portfolio balances exclude the sinking fund and the overall investment income excludes any interest income earned on the sinking fund investments.

For 2018, Milton's contribution to the sinking fund equaled \$302,726 and \$31,228 in return on investment was achieved by the Region of Halton. As such, the year-end value of the fund was \$968,188, which exceeds the originally projected year-end balance.

Legislative Updates

As previously reported through CORS-023-18, the Ontario Regulation 438/97: Eligible Investments and Related Financial Agreements was amended in March 2018. One of these changes allowed for municipalities to adopt a prudent investor regime, starting in January 2019.

Historically, municipalities have been restricted to investing in a prescribed list of securities, subject to minimum rating requirements, that include:

- Government issued or guaranteed debt (bonds, debentures, etc.)
- Bank and financial institution debt, deposit receipts and notes
- Certain corporate debt (bonds)
- Certain asset backed securities and corporate paper

Under the prudent investor standard, municipalities have the opportunity to invest in a wider array of securities. The prudent investor standard requires a municipality to exercise the care, skill, diligence and judgement that a prudent investor would exercise in making such an investment.

However, in order for a municipality to take advantage of these new powers, it will have to:

- Meet specific financial criteria including a minimum long-term investment balance of \$100 million and have a net financial asset balance of \$50 million
- Establish a new bylaw to invest in the prudent investor standard
- Develop new investment policies identifying objectives, risk tolerance, etc,
- Establish an investment board that cannot include members of Council or municipal staff, with the exception of the Treasurer and delegate to the board the control and management of the municipality's investing
- Implement a compliance monitoring system to ensure that the money is invested under the direction and supervision of the investment board in compliance with the investment policy and the investment plan



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- Put in place a mechanism for regular reviews and reports (at least annually), including updates of the municipality's investment policy and investment plan.

A municipality is able to qualify to invest under the prudent investor standard independently or as part of a group. However, once a municipality has opted into the prudent investor standard it cannot opt out without a regulation from the Province.

While the prudent investor standard offers opportunities for increased returns or greater diversity due to its expanded range of allowable investment vehicles, the requirement for a governing municipal investment board requires further study to ensure the costs do not outweigh the benefit. The potential alignment of the investment options available to the Town's investment objectives and portfolio composition also requires further review. Finally, as the ability for municipalities to pass by-laws related to the new prudent investor regime began only in 2019, results from any potential early adopters would prove beneficial in informing the Town's decisions related to this matter.

At this time the Town will continue to invest under the prescribed list of eligible investments contained in the regulation. Along with the area municipalities, staff will continue to evaluate the new legislation and any potential recommended opportunities will be proposed through future reports to Council.

2019 Outlook

Through continuous improvement practices staff will be further reviewing and implementing software enhancements for the purposes of creating efficiencies, reducing risk, augmenting returns and managing the overall portfolio. An updated treasury policy is also planned for 2019.

With respect to market conditions, leading up to the end of 2018 analysts were anticipating multiple increases to the overnight rate in 2019. Due to recent slowdowns in the global economy, the current expectations are that the overnight rate will remain stable until late in the year. Staff will continue to monitor market conditions for the purposes of making investment decisions for the Town.

Financial Impact

The Town earned \$3.9 million in investment income in 2018, of which \$1.5 million was allocated to the Operating budget and the remaining funds of \$2.4 million to reserves



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and reserve funds. The cost of managing the overall portfolio is in order of 0.03% of the portfolio value and has been included in the 2019 budget.

Respectfully submitted,

Troy McHarg
Interim Commissioner, Corporate Services

For questions, please contact: Brad Schultz, CMA, CPA 905-878-7252 x 2248

Attachments
None.

CAO Approval
William Mann, MCIP, RPP, OALA, CSLA, MCIF, RPF
Chief Administrative Officer