The Corporation of the Town of Milton

Report To: Council

From: Glen Cowan, Chief Financial Officer / Treasurer

Date: June 23, 2025

Report No: ES-033-25

Subject: Income Reserve Fund

Recommendation: THAT staff be directed to proceed with a phased introduction of investments in the ONE Canadian Equity Portfolio beginning in 2025.

THAT the Head of Council be requested to consider increasing the amount of investment income that is used to fund the Operating Budget by $1 million as part of the 2026 Budget.

EXECUTIVE SUMMARY

- Milton's 2025 Budget included an estimated average annual portfolio balance of $330 million that is expected to generate $12.4 million in investment income that will be used to both reduce operating budget pressure and support the Town's reserves and capital program.
- The Town previously updated its treasury policy to allow for investment in the ONE Canadian Equity Portfolio ("Equity Fund"). This fund aims to provide superior long-term investment returns by investing in a diversified, conservatively managed portfolio of equity securities issued by Canadian corporations.
- An initial investment of approximately $20 million in this Equity Fund has the potential to generate the incremental $1 million in annual revenue to alleviate financial pressure on the Town's operating budget.
- Council could elect to create a segregated income reserve fund in order invest in the Equity Fund, or could leverage the existing investment management structure to achieve additional relief towards the pressures on the property tax rate. The benefits of each approach are outlined in the report below.
- Equity investment returns are not guaranteed and may fluctuate based on market conditions. The returns may fall short of the $1 million annual target and could potentially included net losses. The rates of return noted in this report are based on historical performance as reported by the Equity Fund.

REPORT

Background

During the 2024 Budget process, the potential to establish an Operating Budget Income Fund was raised through the question and answer process with Council. The topic was further discussed as a part of the February 2024 workshop with Council in relation to the multi-year financial strategy and the Town's current investment management strategies. In June 2024, Appendix D of report ES-016-24 was presented in order to summarize the concept, and although creation of the fund was not recommended, it was noted that should an external or one-time funding source become available, the concept could be revisited.

Through a Notice of Motion approved on April 28, 2025, staff were directed to come back to Council with a plan to create a reserve fund that generates an estimated $1 million annually to mitigate operating budget increases and provide additional fiscal relief for property taxpayers. As part of the related discussion, Council indicated that the source of the funding would be from the Town's reserves.

This report outlines the current Investment Portfolio framework for the Town of Milton and presents options for the creation of a new investment fund.

Discussion

Investment activities are governed by the Municipal Act, 2001. Section 418 of the Municipal Act, 2001 and the Eligible Investments Regulation O. Reg. 438/97 prescribe a specific set of municipal investment opportunities and related restrictions. The prescribed list of eligible investments under O. Reg. 438/97 includes low risk securities such as government bonds and certain financial institution bonds that are aimed at protecting public funds. Also included are shares in a corporation, so long as the municipality has entered into an agreement with the Local Authority Services and the CHUMS Financing Corporation to act as the agent for the investment in the security (i.e. that the municipality is participating in the ONE Canadian Equity Portfolio).

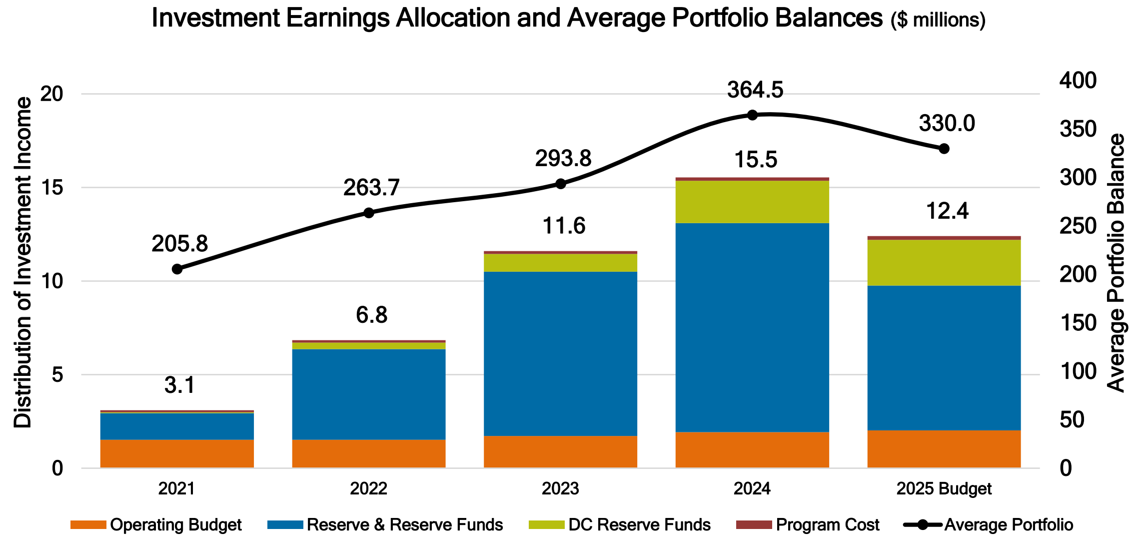
The Town's Treasury Policy No. 116, most recently updated in March 2025 through staff report ES-009-25, establishes individual issuer limits, term limits and minimum rating requirements to further manage exposure and risk. A full listing of the Town's authorized investments and limitations are outlined in Appendix A.

Current Investment Portfolio Strategy

While the Town maintains cash in its general bank account to meet ongoing operational and capital investment needs, surplus cash is also invested, depending on market conditions, as a means to generate additional income. As previously reported through staff report ES-010-25 the average portfolio balance including cash, short and long term investments was $364.5 million in 2024. The Town earned an average return of 4.26% on the overall portfolio in 2024, which resulted in $15.5 million in investment earnings.

Discussion

As shown in the graph below, earnings from the Town's investments are used to support the operating budget as well as reserve fund balances.

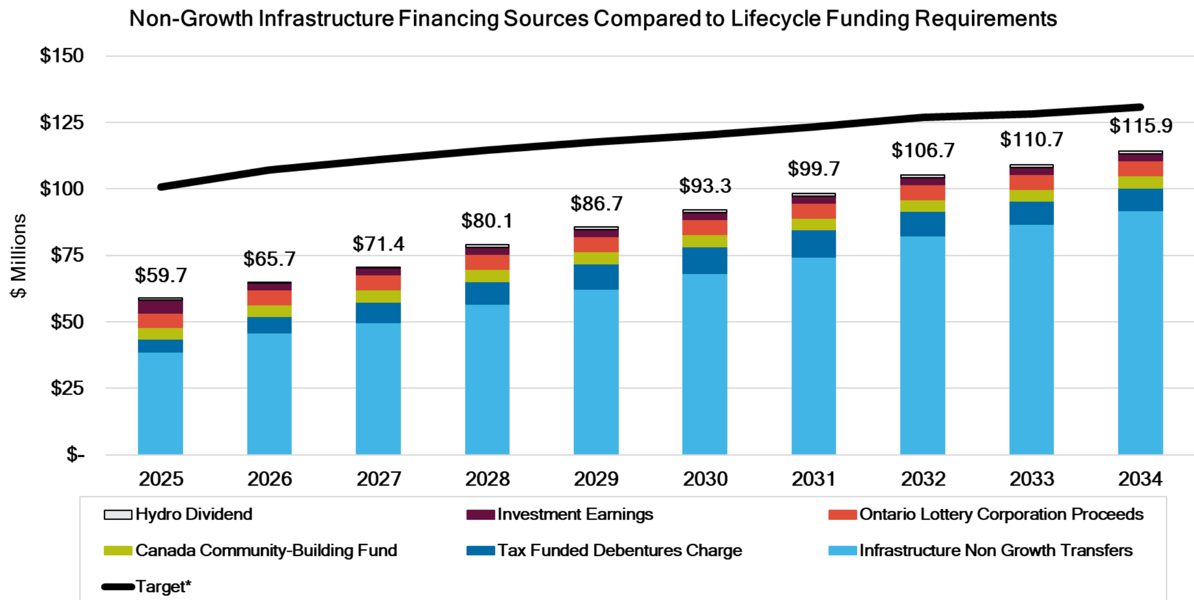


Of the total investment earnings that are budgeted in 2025 of $12.4 million, $2.0 million will be used to support the operating budget, offsetting what would otherwise have been an approximate 2% increase in tax rates. The amount of investment earnings supporting the operating budget has increased by $0.7 million over the past six years through the annual budget processes in order to mitigate budget pressures.

The cost of managing the overall portfolio is approximately 0.06% of the portfolio value and is funded from investment earnings, reflected as the program cost in the above graph.

The remaining $10.2 million in budgeted earnings is expected to be transferred to reserves and reserve funds in accordance with the 2025 budget allocations and the Town's Treasury Policy No. 116. These funds will then be used to support the Town's capital program, thereby alleviating pressure on other revenue sources (such as property taxes), and reducing the Town's annual infrastructure deficit. The following graph reflects the annual sustainable funding level for non-growth related infrastructure investment, including the amount generated from investment earnings, as was reported through the 2025 Budget process.

Discussion



It is important to note that the Town manages its current investment portfolio based on the following 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.

Strategy to Generate an Incremental $1 million to Support Operating Budget

Town Council could choose to simply re-allocate a larger portion of the overall return from existing investments to reduce pressure on the tax rate (via a transfer to the operating budget). Assuming no change in the composition of the Town's current portfolio, this approach would achieve the immediate tax relief, but would have an offsetting increase in the Town's annual infrastructure deficit. Instead, it is recommended that the additional $1 million in funding to offset annual operating costs be associated with the Town's planned introduction to equity market investments, as outlined below.

Discussion

Through staff report CORS-024-22 Council approved an expansion to the list of eligible investments for the Town that would allow for exposure to the equity market through the ONE Canadian Equity Fund for up to 10% of the Town's investment portfolio. This expansion provides for the opportunity for both enhanced returns, as well as the diversification of the Town's investments.

The ONE Canadian Equity Portfolio ("Equity Fund") mandate is to seek to provide superior long-term investment returns through capital growth and dividend yield. The Equity Fund achieves this by investing in a diversified, conservatively managed portfolio of equity securities issued by Canadian corporations. The Equity Fund's December 2024 Performance Report published an annualized 10 year return for the fund of 9.14%. Additional detail with respect to the Equity Fund has been provided in Appendix B.

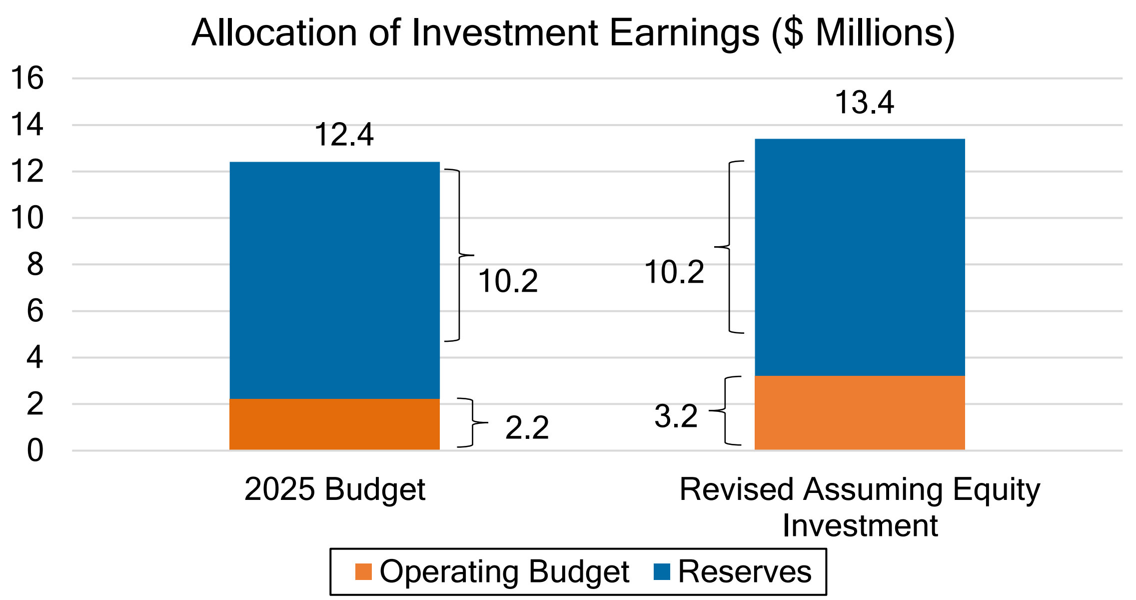
The Town is currently in a position to begin allocating a portion of the portfolio to the Equity Fund in 2025. Investments into the Equity Fund would be made on a phased basis to take advantage of the dollar cost averaging and reduce the risks associated with market timing and provide a more measured and disciplined entry into the fund.

It is important to note that the Equity Fund will be more volatile in terms of returns than the other types of investments currently undertaken by the Town and is best suited for funds that are not required for an extended period, as the market volatility and fluctuations should be less of an issue over the long term.

An initial investment of approximately $20 million in the ONE Canadian Equity Fund, which represents approximately 6.1% of the Town's budgeted average investment portfolio, could generate a sufficient return in order to support the annual property tax relief. Staff could reallocate $20 million of the current portfolio balance into the Equity Fund on a phased basis. $1 million in new budgeted revenue would be added to the operating budget in 2026 which would assist in mitigating budget pressures and offset an otherwise local tax rate increase of approximately 1%.

The following graph uses the 2025 budget as an illustration on how the average annual return of the Equity Fund could potentially increase the returns by $1 million however it is dependant on portfolio size, portfolio weightings and market conditions.

Discussion



Note: Portfolio returns will vary based on portfolio size, portfolio weightings, market

<u>Creation of a Dedicated Income Reserve Fund</u>

The resolution passed by Council called for the creation of a reserve fund as part of the $1 million property tax relief strategy. In preparing this strategy, staff have identified an alternate approach to achieving the same degree of tax relief through an investment strategy without the creation of a new reserve fund, which may offer advantages to the Town. Each are described further below.

<u>Option 1 – Creation of a new Income Reserve Fund</u>

The establishment of a new Income Reserve Fund would require the identification of an initial funding source. As indicated by Council at the April meeting, a re-allocation from existing reserves is the anticipated source for the funding required.

Several of the Town's reserves are restricted based on their initial purpose, however there are certain reserves where Council could re-direct the funds should it chose to. The Town reserve with the most significant balance is the Infrastructure Renewal – Roads, Structures and Traffic Reserve. This reserve had a balance of $54.6 million at the end of 2024. Based on a review of the reserve forecast presented with the 2025 Budget, a redirection of approximately $20 million from the reserve could be managed without creating a funding deficit in the capital program over the next 10 years. The purpose of the Infrastructure Renewal reserves is to set aside funds for the future replacement of the Town's assets. As the Town's assets are relatively new, funds from these reserves are forecasted to be more heavily used outside of the 10 year forecast. Also to be considered is that this particular

Discussion

reserve's balance currently falls significantly short of the reserve target ($227 million deficit for this reserve at 2024 year end) and the Town continues to have an overall infrastructure funding deficit of $41 million per year as outlined in ES-031-25.

Should the funding that is invested to support the $1 million annual contribution be segregated, and assuming the strategy is reliant on the returns available from the Equity Fund, there are some potential logistical considerations in the implementation strategy. Specifically:

- The 9.14% average annual return on the Equity Fund that is noted above is not reflective of the cashflow that is returned to the Town each year. Instead it includes a combination of dividend yield, capital gains and other adjustments. Further, even with dividend yield, the Equity Fund retains the value of those gains for reinvestment rather than distribution to the investors.
- Investments in the Equity Fund are expected to have an investment horizon of at least 5 years, which does not align well with an investment strategy that would require annual withdrawal amounts.
- It should be noted that if the fund does not generate the full $1 million in a particular year, or if the fund incurs a net loss in a year, it would result in the principal being eroded to fund the shortfall and therefore reduce the ability to earn the expected income in future years.
- Additional administration would be required for the fund relative to the Town's current methodology for investment income distribution and reporting.
  An update will be required to the Town's Treasury Policy No. 116 (section 4.3.5 Investment of Reserves and Reserve Funds) to exclude the Income Fund from receiving monthly interest based on the Town's overall investment portfolio annual return and instead receiving the actual interest earned or lost at year end.

One potential solution to partially mitigate these challenges may be to alter the initial composition of the investment in order to allow some combination of cash and fixed income investments to be utilized as part of the Income Reserve Fund. The value of the cash / fixed income portion could be drawn upon to fund the annual $1 million in cash flow requirements, with broader portfolio re-balancing occurring in a longer time horizon (example – every five years). For example, the initial investment of $20 million could include a $15 million investment in the Equity Fund, along with $5 million being invested in more liquid alternatives (i.e. cash and fixed income).

Option 2 – Leverage the Town's existing Investment Management Strategy

Although the Town considers the allocation and cash flow requirements of its current financial assets when creating investment strategies, there is no direct correlation between individual investments and individual reserves in the Town's current investment policy or strategy.

Discussion

Rather than deviating from this practice, and in order to avoid the challenges noted with Option 1 above, the Town could choose to increase the budgeted allocation of investment earnings to the Operating Budget by $1 million as part of the 2026 Budget, while at the same time introducing the Equity Fund investment as outlined above. This approach would achieve the same degree of taxpayer relief (in the form of reduced pressure on the property tax rates). Should the overall portfolio grow in size (as Equity Fund returns may exceed the annual $1 million allocation), there will still be opportunity for Council to grow the degree of annual taxpayer relief in future budgets as well.

This approach would allow for the initial balance of $20 million to be fully invested in the Equity Investment to maximize the overall return (as the cash flow concerns noted above in Option 1 would no longer apply). Should the Equity Fund incur losses or returns that fall short of the $1 million annual target in any particular year, this approach would also better support the sustainability of the annual taxpayer relief, as the $1 million required would be associated with the Town's entire portfolio, not just the segregated income fund. It would also create efficiencies in administration and reporting for the Town.

Recommendation

Staff recommend Option 2 of expanding the investment portfolio to have increased exposure to the equity markets to generate potential increased overall returns and allocating an additional $1 million in investment earning to the operating budget beginning in 2026 to mitigate tax pressures. This approach will result in the same result as the establishment of a segregated Income Fund but without the additional administration that would be involved with the establishment and tracking of a separate Income Fund.

In order to implement this strategy, the following resolutions could be considered for approval by Council (and are recommended in this report):

1) THAT staff be directed to proceed with a phased introduction of investments in the ONE Canadian Equity Portfolio beginning in 2025.
2) THAT the Head of Council be requested to consider increasing the amount of investment income that is used to fund the Operating Budget by $1 million as part of the 2026 Budget.

Should Council prefer to create a segregated Income Reserve Fund, the following additional resolutions could be considered for approval by Council:

3) THAT a new Income Reserve Fund be created in order to provide annual property tax relief, and that $20 million in funding be transferred to the new Income Reserve Fund from the Infrastructure Renewal – Roads, Structures and Traffic Reserve.
4) THAT staff be directed to update Treasury Policy No. 116 to reflect the creation of the Income Reserve Fund as described herein.

Discussion

Next Steps

Subject to direction received from Council, a phased approach to initiating an investment in the ONE Canadian Equity Fund will proceed with incremental investments on a predetermined schedule (example – monthly). This dollar cost averaging approach is intended to help mitigate the impact of market volatility and reduce the risks associated with market timing, providing a more measured and disciplined entry into the fund until the target allocation is reached.

Annually the ONE Canadian Equity Fund provides a year end distribution representing dividends and gains earned throughout the year which is reinvested to the holdings of investors. Reporting will be provided back to Council on the performance of the investment as part of the annual Investment Report.

Staff will monitor the results of the investment relative to the intended outcomes as well as the Town's treasury policy. Should the expected benefits be realized, further investment in the Equity Fund may be considered (within the limits established through Council approved policy) for the purpose of either creating further immediate property tax relief or reducing the Town's annual infrastructure funding deficit.

Financial Impact

It is important to note that investment returns are not guaranteed and may fluctuate based on market conditions. The returns may fall short of the $1 million annual target and could potentially included net losses. The rates of return noted in this report are based on historical performance as reported by the Equity Fund.

The introduction of an investment in the equity fund as outlined herein has the potential to generate the $1 million in annual income to provide taxpayer relief as sought in Council's resolution. If supported by Council, this will result in a one-time reduction of approximately 1% in the tax rate pressure in the year that it is introduced in the Operating Budget, after which it would become an annual funding source for on-going operating costs.

Respectfully submitted,

Glen Cowan
Chief Financial Officer / Treasurer

For questions, please contact: Brad Schultz, Supervisor, Treasury & Long Term Financial Planning Phone: Ext. 2248

Attachments

Appendix A – Town Authorized Investments and Limitations

Appendix B – ONE Canadian Equity Fund Supplementary Information

Approved by CAO
Andrew M. Siltala
Chief Administrative Officer

Recognition of Traditional Lands

The Town of Milton resides on the Treaty Lands and Territory of the Mississaugas of the Credit First Nation. We also recognize the traditional territory of the Huron-Wendat and Haudenosaunee people. The Town of Milton shares this land and the responsibility for the water, food and resources. We stand as allies with the First Nations as stewards of these lands.

Appendix 1 – ES-0XX-25
Investment Portfolio Authorized Investments and Limitations

Authorized Investments and Limitations

Category	Sector[1]	Portfolio Maximum		Individual Maximum[2]	Term Limitation (Years)	Minimum DBRS Rating[3]	
						Short-term	Long-Term
Federal	Federal and Federal Guaranteed[4]	100%		100%	20	N/A	A (low)
Provincial	Provincial and Provincial Guaranteed[4] (example: Provincial Hydro Authority)	100%		20%	15	R-1 (low)	A (low)
Municipal	Municipal and Municipal Guaranteed	50%		10%	15	R-1 (low)	A (low)
Boards / Schools	School Board	15%		5%	10	R-1 (low)	AA(low)
	University and College[5]						
	Local Board or Conservation Authority						
	Public Hospital Board						
	Non-profit Housing Corporation						
Financial Institution [6]	Schedule I Bank (BMO, BNS, CIBC, NBC, RBC, TD)	60%[7]	60%	20%	10	R-1 (low)	A (low) [8]
	Schedule II & Other Schedule I Banks not listed above		20%	10%	2		
	Trust Loan / Credit Union						
ONE Investment Program[9]	Canadian Government Bond Portfolio	25%		10%	N/A	N/A	N/A
	Canadian Corporate Bond Portfolio			10%			
	Canadian Equity Portfolio			10%			
Other	Asset Backed Securities	10%		5%	5	R-1 (high)	AAA
	Commercial paper or promissory notes	10%		5%	1	R-1 (mid)	N/A

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) Includes bonds, debentures or other evidence of indebtedness issued or guaranteed by the Government of Canada, or a Province of Canada. 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) Includes bonds, debentures, deposit receipts, deposit notes, certificates of deposit or similar instruments issued, accepted, guaranteed or endorsed by a bank in Schedule I or II or a Credit Union, including bail-in. 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). Credit Unions require financial statements or certification in writing that various financial criteria has been met as outlined in O. Reg. 438/97.

(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) For securities of bonds, debentures, promissory notes or other evidence of indebtedness, issued or guaranteed by a bank listed in Schedule I, II or III to the *Bank Act* (Canada) with a term-to-maturity less than or equal to 2 years on the day the investment is made, the prescribed minimum credit rating is AA(low).

(9) 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.

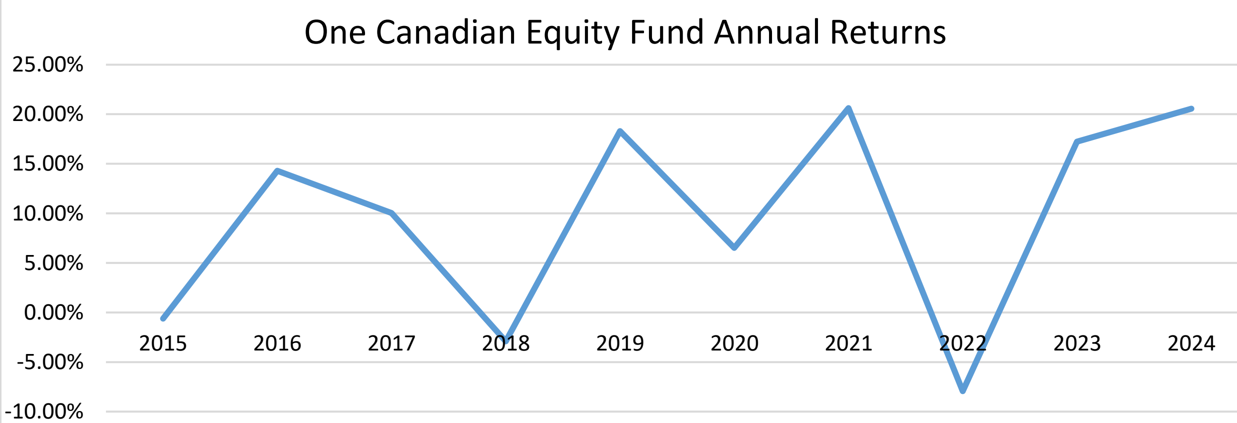
Appendix B
ONE Canadian Equity Fund Supplementary Information

The ONE Investment Portfolio guidelines indicate that the objective of the Equity Portfolio is to provide superior long-term investment returns by investing in a diversified, conservatively managed portfolio of equity securities issued by corporations, as permitted by applicable regulation from time to time.

All investments will comply with 0. Reg 438/97 as amended from time to time. A minimum of seven industry sectors must be represented in the portfolio. Maximum exposure to any single issuer is 7% based on the market value of the portfolio at the time of purchase and 10% of the market value of the portfolio. Up to 10% of the portfolio may be held in cash and cash equivalents that comply with the regulations.

The performance benchmark will be constructed based on a portfolio of 3% Money Market and 97% Canadian equity. The Canadian equity Benchmark will be based on the S&P/TSX Composite Total Return Index.

The following graph represents the historical annual returns as presented by the ONE Equity Fund in their December[1] and Year End Reports[2]. Over the previous ten years the average return is 8.79% and the annual returns have experienced some volatility where the highest annual return since 2015 was 20.62% (in 2021) and the lowest annual return was 7.94% (in 2022).



Annual returns per ONE Fund December (https://www.oneinvestment.ca/investment-reporting/one-monthly-performance-reports) and Year End Reports (https://www.oneinvestment.ca/investment-reporting/quarterly-and-year-end-reports)

[1] https://www.oneinvestment.ca/investment-reporting/one-monthly-performance-reports. Accessed May 28, 2025

[2] https://www.oneinvestment.ca/investment-reporting/quarterly-and-year-end-reports. Accessed May 28, 2025.

Appendix B
ONE Canadian Equity Fund Supplementary Information

As per the 2024 ONE Investment Audited Financial Statements for their Legal List Portfolio[3], note 10 illustrates the concentration of the Equity Portfolio. For example, in 2024 approximately 28% of the portfolio is allocated towards Canadian Financials and 16% is allocated towards Industrials.

Canadian Equity Portfolio	**December 31, 2024 %**	**December 31, 2023 %** (unaudited)
Canadian Equities		
Communication Services	**3.19**	3.32
Consumer Discretionary	**8.88**	7.36
Consumer Staples	**13.77**	11.03
Energy	**4.24**	5.79
Financials	**27.88**	28.58
Industrials	**16.17**	14.59
Information Technology	**12.73**	15.40
Materials	**6.18**	6.78
Utilities	**3.96**	3.36
Short-Term Investments	**2.79**	2.83
Cash	**0.02**	0.05
Other Assets, less Liabilities	**0.19**	0.91
Total	**100.00**	**100.00**

[3] https://www.oneinvestment.ca/system/files/documents/One%20Investment%20Legal%20Funds%20Final%20Signed%20Financial%20Statements_FINAL-%20Accessible%20and%20secured.pdf. Accessed May 28, 2025