

Date: 2023-04-17

Subject: 2022 Year-End Investment Report

Contact: Nash Damer, Treasurer
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Report Number: Corporate Support Services-2023-357

Recommendations:

- 1) That the report titled: **2022 Year-End Investment Report**, to the Committee of Council meeting of May 24, 2023 be received.

Overview:

- The City's investment portfolio generated investment income of \$34.3 million or 2.4% return on an average book value of \$1,404.6 million, for the year ended December 31, 2022.
- Of the \$34.3 million in investment income, \$26.9 million was allocated to Reserves, while \$7.4 million was included in the 2022 Operating Budget to offset property tax requirements.
- For fiscal year 2022, the average book value of \$1,404.6 million was funded primarily from Reserve Funds in the amount of \$1,222.6 million, with the remaining \$182.1 million funded through the Operating Fund. The average allocation of these funds consisted of \$511.2 million in short-term Cash and GIC's, \$862.8 million in medium to long-term Bonds and \$30.6 million in Equities.
- In compliance with Provincial Regulation 438/97, it is the opinion of the Treasurer that all investments to December 31, 2022 were made in accordance with the City's Investment Policy.

Background:

In accordance with the requirements of Ontario Regulation 438/97 of the *Municipal Act, 2001* and Council approved Investment Policy, this report presents the results of the investment activities, interest earnings and investment yield for the year ended December 31, 2022.

The City's Investment Policy (FIN-210) directs staff to manage the City's investments with the goal of achieving the following outcomes:

- Adherence to legislative and regulatory requirements on eligible investments;
- Preservation of the City's capital funds while maximizing investment returns;
- Minimize the City's investment risk; and,
- Maintain liquidity of the City's funds.

Funding for the City's Investment Portfolio is provided from the following two sources:

Reserve Funds – the City maintains funding in reserve accounts to grow, enhance and maintain the City's infrastructure, protect against unforeseen events and providing financial flexibility to invest in strategic projects. These reserves include Development Charges, Infrastructure Repair and Replacement, Canada Community Building Fund, Strategic Reserves and the General Rate Stabilization Reserve. Approximately 70% of the funds are typically available for investment over longer periods and are allocated mainly to Government Bonds, Bank Bonds and similar securities permitted by the *Municipal Act, 2001, Ontario Regulation 438/97* with maturities extending beyond one year.

Operating Funds - consist of revenues collected primarily through property taxes and users fees, to fund day-to-day operations of the municipality. The priority of these funds are to ensure necessary liquidity is available to process expenditure payments, such as payroll and contractor payments. With this priority in mind, staff monitor timing differences between revenues and expenditures and prudently invest funds in short-term financial instruments to maximize investment revenue. These funds are typically available for investment over short periods and consist of cash deposits (i.e. bank accounts), GICs and eligible bond securities.

Current Situation:

Investment Performance

The City's investment portfolio generated investment income of \$34.3 million or 2.4% return on an average book value of \$1,404.6 million, for the year ended December 31, 2022. This compares to a return of \$28.9 million or 2.2% on an average book value of \$1,295.9 million in 2021.

The investment return increase of \$5.4 million or 0.2% is primarily due to an increase in the average book value of \$108.8 million, as average reserve balances in Development Charges and

the Stormwater Charge Fund were higher than 2021, in addition to higher return on Cash deposits, given the Bank of Canada's overnight interest rate increased from 0.25% to 4.25% during 2022.

Of the \$34.3 million in investment income for fiscal year 2022, \$26.9 million was allocated to Reserves, while \$7.4 million was included in the 2022 Operating Budget to offset property tax requirements.

With respect to the investment allocation throughout 2022, the \$1,404.6 million was on average allocated to \$511.2 million in short-term Cash and GIC's, \$862.8 million in medium to long-term Bonds and \$30.6 million in Equities.

The following tables provide a year-over-year comparison of the funding sources and allocation of the average book value and investment returns:

Table 1: Funding Source – Average Book Value and Investment Returns

Average Book Value (\$millions)	31-Dec-21	31-Dec-22	Change
Reserves & Reserve Funds Portfolio	\$1,113.6	\$1,222.6	\$109.0
Operating Fund Portfolio	\$182.3	\$182.1	(\$0.3)
Total Portfolio Funds (Average)	\$1,295.9	\$1,404.6	\$108.8

Funds	Investment income (\$m)*		Annualized return**	
	2021	2022	2021	2022
Reserves & Reserve Funds	\$25.2	\$29.6	2.3%	2.4%
Operating Fund	\$3.7	\$4.7	2.0%	2.6%
Total investment income	\$28.9	\$34.3	2.2%	2.4%
* Investment earnings include earned interest income and realized capital gain				
** Earned income divided by the monthly average portfolio balance at book value				

Table 2: Investment Allocation – Average Book Value and Investment Returns

Average Book Value (\$millions)	31-Dec-21	31-Dec-22	Change
Cash and GICs	\$495.1	\$511.2	\$16.1
Bond portfolio	\$776.7	\$862.8	\$86.0
Equity Portfolio	\$24.0	\$30.6	\$6.6
Total Portfolio Funds (Average)	\$1,295.9	\$1,404.6	\$108.8

Portfolio	Investment income (\$m) *		Annualized return**	
	2021	2022	2021	2022
Cash and GICs	\$4.2	\$12.7	0.8%	2.5%
Bond portfolio	\$22.6	\$20.3	2.9%	2.4%
Equity Portfolio	\$2.1	\$1.3	8.8%	4.4%
Total investment income	\$28.9	\$34.3	2.2%	2.4%
* Investment earnings include earned interest income and realized capital gain				
** Earned income divided by the monthly average portfolio balance at book value				

Investment Environment

In 2022, Canada's Gross Domestic Product (GDP) grew by 3.4% vs an expected growth rate of 4.7%, which is 1.9% lower than the 2021 fiscal year growth rate of 6.6%.

In addition to this lower-than-expected growth rate, inflation became a significant concern during 2022, with CPI rising to a concerning 6.7%, on the basis of record low interest rates, global supply chain constraints, the war in Ukraine and trade protectionism.

In order to counteract these inflationary pressures, the Bank of Canada increased interest rates 7 times during 2022, raising the bank rate from 0.25% at the beginning of 2022 to a year-end rate of 4.25%. These increases led to bond yields peaking in the middle of 2022, with an expectation that the Bank of Canada will pause future rate increases in early 2023.

With respect to the equity market, unfavorable economic conditions negatively affected equities with the TSX index experienced a year-over-year decline of 8.7% decline, compared to an increase of 20% 2021.

Investment Benchmark

The City uses FTSE (Financial Times Stock Exchange) index as a benchmark to measure the market performance of its bond portfolio. The benchmark is comprised of 65% FTSE Short Composite; 32.5% All Gov't Mid Term; 2.5% All Gov't Long Term.

In 2022, the market return for the City's bond portfolio was lower by 253 basis points compared to the benchmark. The main driver for this short-fall is due to the sharp hikes in interest rates which negatively affected longer-term Bonds. For reference the inverse of this situation occurred in 2020, when sharp cuts to interest rates, resulted in the City's bond portfolio outperforming the benchmark by 261 basis points and highlights the challenges in managing financial assets in a rapidly changing and uncertain economic environment.

Appendix A - Market Benchmarking for the Bond Portfolio provides a performance summary of the Investment Portfolio's returns against the benchmark index.

Year-End Book Value

As of December 31st 2022, the year-end book value of the City's investment portfolio was \$1,322.4 million, which is an increase of \$21.5 million from the 2021 year-end book value of \$1,300.8 million.

The following tables provide a year-over-year comparison of the funding sources and allocation of the year-end book value:

Table 3: Funding Source – Year-End Book Value

Year-end Book Value (\$millions)	31-Dec-21	31-Dec-22	Change
Reserves & Reserve Funds Portfolio	\$1,193.3	\$1,245.4	\$52.1
Operating Fund Portfolio	\$107.6	\$77.0	(\$30.6)
Total Portfolio Funds (Book Value)	\$1,300.8	\$1,322.4	\$21.5

Table 4: Investment Allocation – Year-End Book Value

Year-end Book Value (\$millions)	31-Dec-21	31-Dec-22	Change
Cash and GICs	\$459.8	\$419.1	(\$40.7)
Bond portfolio	\$812.1	\$870.7	\$58.6
Equity Portfolio	\$28.9	\$32.6	\$3.6
Total Portfolio Funds (Book Value)	\$1,300.8	\$1,322.4	\$21.5

Appendix B - List of Securities in Operating and Reserve Bond Portfolio itemizes the holdings and values of the securities maintained in the Investment Portfolio, at December 31st 2022.

Compliance

In compliance with Provincial Regulation 438/97, it is the opinion of the Treasurer that all investments to December 31, 2022 were made in accordance with the City’s Investment Policy.

Corporate Implications:

None

Financial Implications:

In 2022, total investment income of \$ 7.4 million has been contributed to the operating budget and \$26.9 million contributed to Reserve Funds. The table below shows the breakdown of the investment income allocation to the Reserve funds and operating budget.

Funds	Total income (\$m)	Contributed to Reserve Funds	Contributed to Operating Budget
Reserves & Reserve Funds	\$29.6	\$26.9	\$2.7
Operating Fund	\$4.7	\$0.0	\$4.7
Total investment income	\$34.3	\$26.9	\$7.4

Term of Council Priorities:

This report fulfils the Council Priority of a Well-Run City through strict adherence to effective financial management policies and ensuring sustainable financial operations.

Conclusion:

In accordance with the requirements of Regulation 438/97 of the Municipal Act, 2001 and Council approved Investment Policy, this report presents the results of the investment activities, interest earnings and investment yield for the year ended December 31, 2022.

As per Provincial Regulation 438/97, it is the opinion of the Treasurer that all investments, to December 31, 2022, were made in accordance with the City's Investment Policy.

Authored by:

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Reviewed by:

Nash Damer, Treasurer

Approved by:

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Attachments:

Appendix A: Market Benchmarking for the Bond Portfolio

Appendix B: List of Securities in Operating and Reserve Bond Portfolio