



The Regional Municipality of Halton

Report To:	Chair and Members of the Administration and Finance Committee
From:	Mark Scinocca, Commissioner, Finance and Regional Treasurer
Date:	October 5, 2016
Report No. - Re:	FN-27-16 - Investment Performance to August 31, 2016

RECOMMENDATION

THAT Report No. FN-27-16 re: “Investment Performance to August 31, 2016” be received for information.

REPORT

Executive Summary

- The Region’s cash management and investment program generated \$45.7 million in revenue to August 31, 2016.
- The revenue consisted of \$35.1 million of interest earnings and \$10.6 million of realized capital gains.
- The realized average rate of return on invested funds for this period was 3.62% on an annualized basis.

Background

This report reviews Halton Region's year-to-date realized investment income earnings (consisting of interest income, realized capital gains/losses and amortized premiums/discounts) and provides a comparison of its total return (realized investment income plus unrealized capital gains/losses) with that of its performance benchmark.

Discussion

Investment Income

Investment income is available for distribution within Halton Region’s operating accounts and reserves. The following table summarizes the Region’s investment position and realized returns to August 31, 2016, and provides comparative data for the prior three years.

Halton Fund Portfolio
Year to Date August 31 (2013-2016)
(\$ millions)

	August 31-13	August 31-14	August 31-15	August 31-16
Portfolio (Adjusted Book Value)	\$1,579.707	\$1,706.768	\$1,802.999	\$1,947.955
Interest Earned	\$36.605	\$35.265	\$34.338	\$35.148
Realized Capital Gain/(Loss)	\$ 9.510	\$ 9.377	\$11.673	\$10.583

Note: Pooled investments held on behalf of Halton Hills are excluded from these figures.

As at August 31, 2016, the Regional investment portfolio had an adjusted book value of \$1.948 billion. The portfolio is currently composed of the following:

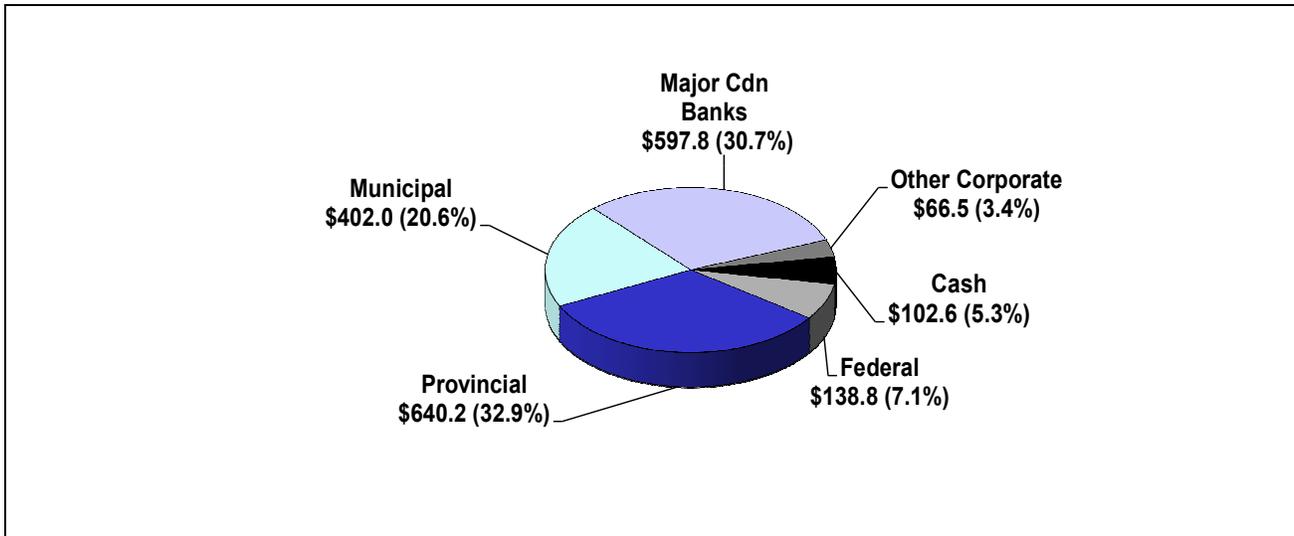
- 50% Regional reserves and reserve funds (including development charge reserves);
- 43% Capital WIP (capital funding approved in current/previous year's budgets); and,
- 7% current funds, deposits and other.

The capital program continues to be a large component of the total portfolio as it includes large water, waste water and road projects that are implemented over multiple years.

The Region's cash management and investment program generated \$45.7 million in revenue to August 31, 2016. The revenue consisted of \$35.1 million of interest earnings and \$10.6 million of realized capital gains. The realized average rate of return on invested funds during this period was 3.62% on an annualized basis.

The following chart illustrates the composition of the Region's portfolio holdings by major sector categories. The current position relative to the maximum allowable holdings under the approved Investment Policy as at August 31, 2016 is included on Attachment 1.

Halton Fund Portfolio Distribution
Adjusted Book Value as at August 31, 2016
(\$ millions)



Selected short-term investment holdings in Canadian banks, that have higher rates of return than cash in the Region's bank account, are used to enhance the yield on the cash portion of the Region's portfolio. The portfolio weighting in the municipal and provincial bond sectors, which have performed well during this period, are managed to enhance the overall yield of the Region's portfolio in an historically low rate environment while maintaining a high credit quality overall. Staff will continue to monitor closely all portfolio holdings for compliance with the Region's Investment Policy and Provincial regulations.

Investment Fund Performance

The total rate of return which includes the overall change in market value for the period January 1, 2016 to August 31, 2016 was 3.18% (annualized). Bond yields in Canada have dropped to historic lows as geo-political issues globally, as noted below, have caused some volatility. It is the total rate of return on the "mark-to-market" basis that is used to compare the Region's investment performance with external benchmarks. This total rate of return incorporates both realized and unrealized capital gains and/or losses along with realized and accrued interest income. Unrealized capital gains or losses represent potential funds that would be made available or relinquished if investments were liquidated as at the report date.

The Council approved benchmark for measuring the performance of the Region's investment portfolio is based on fixed income indices tabulated by TSX PC Bond Analytics group. These indices are recognized as an appropriate objective standard by Canadian portfolio and fund managers. The benchmark is a blend of four fixed income indices based on the following weightings:

Composition of Halton Region's Benchmark Index

TSX PC-Bond Analytics Index	% Weightings
91 day T-bills	10.0%
Short-term AAA/AA Corporate Bond	10.0%
Short-term Gov't Bond	30.0%
Universe All Gov't Bond	50.0%

The following table compares Halton's market value investment returns to the weighted blend of the above-referenced indices for the eight month period ending August 31, 2016 with comparative levels as of the same period in the previous two years.

Halton Region's Fund Performance vs. Market Indices

	August 31-14	August 31-15	August 31-16
Halton Fund	5.99%	2.86%	3.18%
Blended TSX PC Bond Indices	4.26%	2.49%	2.94%
Out(Under)performance	1.73%	0.37%	0.24%

Halton Region's investment fund performance is above that of the target benchmark for this reporting period. Bonds in both the provincial and municipal sectors have performed extremely well and as such, the significant weighting in these sectors in the Region's portfolio have contributed to the outperformance.

Additionally, these performance numbers do not reflect the comparative operating costs of managing the portfolio in-house with management fees typically charged by external managers. The cost of operating the Region's investment function in-house equates to approximately 3 basis points (0.03%) whereas fees charged by eligible external mutual funds and investment management firms range from 20 to 85 basis points.

Market Commentary

Global economies have continued to post sluggish growth so far in 2016 due to uncertainty driven by some geo-political issues. In particular, the surprise outcome of the Brexit vote in the United Kingdom has renewed global unease about growth going forward. Currency markets have also experienced significant volatility as they attempt to determine how trade will be affected as a result of eventual new trade agreements related to the Brexit outcome. Central banks in the developed world are either continuing with existing monetary stimulus or embarking on new programs as a result of the economic climate. For these reasons, bond yields have been pushed lower.

Economic data in the U.S. has been somewhat mixed this year. While there has been some reason for optimism about an economic recovery through stronger employment

growth, there has also been some weaker growth data that has caused concern. Overall strength in job numbers have led some investors to consider that the Federal Reserve may raise rates this year after pausing after its initial hike in December of 2015.

The Canadian economy has been growing slower than expected this year. There has been significant volatility from month to month, especially in employment data. Weak energy prices have led to major cutbacks in capital spending by oil companies. Alberta is recovering from the Fort McMurray forest fires from earlier this year which will continue to result in slower growth. As a result, the Bank of Canada will likely remain on hold, leaving overnight interest rates unchanged throughout 2016. Inflation numbers are forecast to remain within the Bank's targeted zone.

Economic conditions are continuously monitored to ensure the Region's investment portfolio is adjusted to reflect the changing market environment as deemed necessary. Higher bond prices (lower bond yields) due to global economic and geopolitical uncertainty, has enabled the Region's portfolio to generate capital gains. As directed by the Region's Cash Management and Investment Policy, the management of the investment portfolio will continue to focus on the preservation of capital and the maintenance of liquidity.

Investment Results

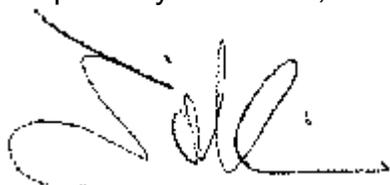
As market valuations reflect a single point in time, a more relevant measurement of return is the yield of investments actually held in the Region's portfolio. The Region's portfolio is managed to ensure that investment returns achieve, at a minimum, current operating budget targets. Active management provides an additional level of earning potential as the portfolio manager will realize capital gains throughout the year by recognizing opportunities and selling securities when market conditions are favourable. Interest income earnings are currently forecast to be \$52.75 million in 2016, \$2.25 million lower than the \$55 million budget as a result of continued low yields in the market. However, through active management of the portfolio, the Region has realized \$10.6 million of capital gains to date. Capital gains and losses are more difficult to forecast as they are generated as a result of changing market conditions and therefore create a variance when realized.

FINANCIAL/PROGRAM IMPLICATIONS

Revenue earned by the investment portfolio is applied to the appropriate reserves and operating accounts in accordance with the interest allocation policy. Investment earnings are budgeted on a conservative basis to provide a sustainable source of revenue to reduce tax impact. The Region's tax and ratepayers benefit to the extent that investment earnings can be maximized while maintaining an investment portfolio comprised of very liquid, high quality assets.

The cost of managing the Region's cash management and investment program is included in the 2016 Budget and Business Plan.

Respectfully submitted,



Jinsun Kim
Director, Financial Planning and Budgets



Mark Scinocca
Commissioner, Finance and Regional
Treasurer

Approved by



Jane MacCaskill
Chief Administrative Officer

If you have any questions on the content of this report,
please contact:

Jinsun Kim

Tel. # 7050

Attachments: Attachment #1 – Investment Portfolio by Sector

**Attachment 1
to Report No. FN-27-16**

**REGIONAL MUNICIPALITY OF HALTON
INVESTMENT PORTFOLIO BY SECTOR
(WITH COMPARATIVE FIGURES FOR PERMITTED LIMITS UNDER
APPROVED POLICY)**

as at August 31, 2016

SECTOR	PORTFOLIO ADJUSTED BOOK VALUE (000's)	% HOLDINGS	% POLICY LIMIT
GOVERNMENT OF CANADA *	\$138,824	7.1%	100.0%
PROVINCIAL GOVERNMENTS *	\$640,239	32.9%	100.0%
HALTON REGION *	\$ 10,484	0.5%	100.0%
OTHER MUNICIPALITIES	\$391,497	20.1%	40.0%
ELIGIBLE FINANCIAL INSTITUTIONS	\$597,795	30.7%	50.0%
CORPORATES	\$ 0	0.0%	15.0%
ASSET BACKED SECURITIES	\$ 66,473	3.4%	10.0%
CASH HOLDINGS	\$ 102,643	5.3%	100.0%
TOTAL	\$1,947,955	100.0%	

* A minimum of 30% of the portfolio must be comprised of investments within these three categories

Note: The portfolio value excludes investments managed on behalf of the Town of Halton Hills