
For Information

DATE: May 15, 2019

REPORT TITLE: **2018 TREASURY REPORT**

FROM: Stephen VanOfwegen, Commissioner of Finance and Chief Financial Officer

OBJECTIVE

To provide the annual results of Treasury activities in accordance with the Region of Peel's Investment Goals and Policies (F20-05) and Debt Management Policy (F20-06); and, to provide the annual results of energy commodity hedging performance in accordance with the Energy Commodity Procurement Policy.

REPORT HIGHLIGHTS

- For the year ended December 31, 2018, the General Fund generated gross earnings of \$67.5 million, representing a yield of 2.9%.
- Earnings on cash and short-term holdings were improved through access to new deposit products.
- All investments were in accordance with the Region of Peel's Investment Goals and Policies and statutory requirements.
- All commodity price hedging agreements during 2018 were in accordance with the Energy Commodity Procurement Policy.

DISCUSSION

1. Background

In accordance with Ontario Regulation 438/97 (as amended) of the *Municipal Act, 2001*, and the Region of Peel's ("Region") Investment Goals and Policies, the Treasurer is required to report annually on the Region's investment portfolio, including the performance of the portfolio and its consistency with the Investment Goals and Policies set out by the Region.

Regional Council approved the adoption of the Energy Commodity Procurement Policy which outlines the framework and guidelines of the overarching strategy to manage and mitigate the risks associated with competitive energy markets.

In accordance with Ontario Regulation 653/05 (as amended) of the *Municipal Act, 2001*, and the Region's Energy Commodity Procurement Policy, the Treasurer is required to report annually on the Region's commodity hedging performance.

This report is provided in compliance with Ontario Regulation 438/97 (as amended) of the *Municipal Act, 2001*, Ontario Regulation 653/05 (as amended) of the *Municipal Act, 2001*,

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the Region of Peel's ("Region") Investment Goals and Policies and the Region's Energy Commodity Procurement Policy.

2. Treasurer's Discretionary Authority

Policy F20-05 Investment Goals and Policies provide the Treasurer with discretionary authority to temporarily exceed investment limitations within the Region's Investment Goals and Policies. Details are provided below:

A. Sinking Fund FX Portfolio:

During 2016, the Treasurer approved a strategic over allocation to Hydro Quebec holdings (58% versus 55%). In November 2018, the allocation reverted back to 55%.

B. Sinking Fund EB Portfolio:

In October 2018, the portfolio had an over allocation in the bank sector of 55% versus 50% limit within the policy. The Treasurer approved the Portfolio Manager's recommendation for a tactical over allocation to the bank sector given the attractive yield relative to the target return.

3. Market Summary

During 2018, the Bank of Canada raised the overnight policy rate three times, taking the rate to 1.75%. Longer term Government of Canada interest rates fell, ending 2018 marginally below the beginning of the year. The overall market tone was mixed throughout the year, with periods of sustained volatility, turning decidedly negative during November and December. Driven by the increased uncertainty in the latter part of 2018, Government of Canada bonds generally outperformed, with provincial, municipal, and bank bonds lagging, a theme that was more pronounced in terms beyond 5 years. Looking across asset classes, Canadian fixed income indices outperformed equity in 2018. Geopolitical events, such as trade negotiations, Brexit, and civil unrest in some emerging economies tended to have short term impacts on market direction. Central Banks (e.g. Bank of Canada, U.S. Federal Reserve, and European Central Bank) also influenced markets to a significant degree, as policy outlooks impacted investor decisions.

The outlook for 2019 is mixed, with markets and economists becoming more conservative in their growth forecasts as the economy moves into what appears to be the later stages of the business cycle. It is widely expected that the Bank of Canada will remain on the sidelines, especially in an election year, but will continue to monitor economic activity and core inflation. Economists are still calling for a moderate rise in longer dated rates; however, this has been pared back significantly from estimates made during 2018.

4. Cash Management

Treasury Staff are responsible for ensuring adequate liquidity to meet the Region's day-to-day operating needs. Collaboration with the Region's program areas to develop longer term cash flow forecasts assists the team in optimizing the Region's cash position over time.

As at December 31, 2018, the General Fund portfolio carrying value (amortized book value), including cash holdings was \$2,344 million and the Sinking Fund portfolio carrying value, including cash was \$270 million. Cash holdings for the General Fund totaled \$461 million

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as at December 31, 2018, down from \$734 million as at December 31, 2017. Additional details are provided in Appendix 1.A.

Earnings on cash holdings were enhanced as Staff were able to source more attractive short-term deposit rates.

5. Debt

Under the *Municipal Act, 2001 (section 401)*, the Region, as an upper-tier municipality, acts to issue debentures on behalf of its lower-tier municipalities, if/when required. A summary of 2018 activity and outstanding debt is as follows:

- In March 2018, a total of \$53.3 million in debt was issued for Mississauga (\$46.3 million) and Caledon (\$7.0 million).
- As at December 31, 2018, the Region of Peel had outstanding net own-purpose debt of \$1,359 million. This includes \$152 million in Peel Housing Corporation's social housing mortgages.
- In 2018, the Region did not issue external debt for its own purposes, resulting in an \$80.0 million decrease in net debt due to debenture and mortgage principal payments and Sinking Fund provision payments. Appendix 1.B contains additional details.

6. Investments

General Fund

The General Fund is comprised of cash and investments held for working capital, reserves and reserve funds, and other funds of the corporation. During 2018, the General Fund generated gross earnings of \$67.5 million, on a Weighted Average Portfolio Value of \$2,307.9 million, resulting in an investment yield of 2.9%.

The majority of earnings were allocated to reserves (\$63.2 million), and \$3.3 million was allocated to operations.

Performance

For the year ending December 31, 2018, the General Fund earned \$67.5 million, representing a gross yield of 2.9%. Fixed income holdings generated \$53.5 million of earnings with the remaining \$14.0 million from deposit interest earned on cash holdings. Included in the \$53.5 million of fixed income earnings, was \$1.7 million in realized gains on securities that were sold during the year – this represents a very small portion of total earnings (approximately 2.5%). The Region continues to take a long-term view of portfolio performance and balances the trade off between realizing capital gains in the short-term and the impact it may have on future earnings.

Additional performance and portfolio characteristics are provided in Appendix 1.C.

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Portfolio Costs

The Treasury Division's management expense ratio (MER) was approximately 3.8 basis points (0.038%) in 2018. The MER represents the direct operational cost of the investment portfolio relative to the size of the assets under management. This represents excellent value for money relative to alternative options.

By comparison, the ONE Fund charges a management fee of 40 basis points (0.40%) for their bond fund. If the Region were to invest the General Fund fixed income holdings into ONE Fund's portfolio, as opposed to managing internally, the additional cost is estimated to be approximately 35 basis points (0.35%) higher, equivalent to an additional annual budget outlay of \$6.0 million.

Sinking Funds

Sinking Funds are established upon issuance of sinking fund debentures, and managed separately, per *Municipal Act, 2001 (section 409)*, with an estimated amount contributed annually to the Sinking Fund which, with interest compounded annually, will be sufficient to pay the principal of the debentures at maturity.

During 2018, the six (6) Sinking Funds generated total gross earnings of \$8.2 million, with the total aggregate value of the Funds increasing from \$215 million to approximately \$270 million, inclusive of annual provision payments. The investment returns outperformed the target returns for four (4) Sinking Funds while two experienced shortfalls compared to the annual target return requirement. Sinking Fund EP has a deficit of \$21,515 at the end of 2018 as it continues to underperform the target return. Market interest rates have fallen significantly since the debenture issuance, making it difficult to invest contributed provision payments at yields equal to or greater than target. As required by the Act, the Region will contribute the shortfall during 2019. Further details for individual Sinking Funds are contained in Appendix 1.C.

7. Energy Procurement Performance

The objectives of the Energy Commodity Procurement Policy are to establish commodity price hedging agreements that ensures regulatory compliance, provide financial flexibility and maximize procurement opportunities.

Electricity: No hedge volumes were procured for 2018.

Natural Gas: The Region of Peel and the Housing Services Corporation hedged 53% of its approximately 15.65 million m3 of natural gas requirements for 2018. The total risk mitigated from volatility in the natural gas market for the year was approximately \$191,000.

Further details on energy procurement performance are in Appendix 1.E.

8. Compliance

All investments were in accordance with the Region of Peel's Investment Goals and Policies and statutory requirements. All commodity price hedging agreements during 2018 were in accordance with the Energy Commodity Procurement Policy. Ontario Regulation 438/97 requires that a municipality report on investments held in its own securities. From time to time, the Region invests in its own securities no different than any other Portfolio

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investments where the Region sees value relative to other similar securities. Appendix 1.D contains details of holdings and transactions throughout 2018.

9. Cash Management Strategy - Update

The implementation of the Cash Management Strategy is underway. During 2018, Treasury Services continued to focus on the Strategy's three key outcomes:

- Redefine the Treasury function's mandate;
- Enhance the Treasury function's practices; and
- Increase the potential to generate greater financial returns.

In accordance with the Strategy, the Region completed all hiring with the exception of one position, expected in 2019. Governance process changes were implemented to ensure clear roles and responsibilities, strengthening internal controls. All material processes and procedures were documented and where appropriate automated and/or enhanced. Through the multi-year implementation plan, the Region will improve and augment the current Treasury practices, focusing on opportunities that will provide long term financial flexibility to the Region of Peel. The Treasury Oversight Committee, consisting of senior Regional management, was established. The purpose of this Committee is to enhance activities of the Region and PHC, thereby strengthening risk management practices. This Committee will provide advice and/or recommendations regarding the:

- Structure and strategy of the Region's investment portfolio and borrowing program.
- Potential amendments to the annual review of policies related to investment and debt activities.
- Review of the financial performance of debt and investment portfolios to enhance understanding and management of risks.
- Review of the funded status of sinking funds.
- Effectiveness of the policies and the achievement of the objectives of the Debt and Investment Programs.
- Other matters as determined by the CFO and Regional and PHC Treasurer(s).

The Region continues to seek opportunities to further expand the investment opportunities and borrowing strategies which is expected to reduce the Region's financial vulnerability as it strives to meet the needs of the community.

10. Prudent Investor Status – Update

In May 2017, Bill 68 *Modernizing Ontario's Municipal Legislation Act* received Royal Assent in the legislature. The Bill made a number of changes to the *Municipal Act, 2001* including the extension of the Prudent Investor Standard (the Standard) to municipalities, which became enabled in March 2018, through the amendment of *O. Reg. 438/97*.

Previously, municipal investment activities were regulated through a prescribed list under *O. Reg. 438/97: Eligible Investments and Related Financial Agreements*, which restricts municipal investments to highly rated Canadian bonds, money market instruments and other similar debt instruments.

The inclusion of the Standard, however, allows *municipalities* greater investment authority than what was previously prescribed under the *Municipal Act, 2001*. The *Trustee Act* stipulates the provisions for the Standard which can be generally viewed as a non-

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prescriptive, broad authority to invest as a 'prudent person' would. The *Trustee Act* outlines that a Prudent Investor must:

- view risk within the context of their total portfolio;
- make investments in view of the unique circumstances of the beneficiary;
- diversify portfolio investments across assets;
- make investments with a view toward the impact of inflation; and,
- consider total return of the investments.

Through the passing of the regulation, municipalities now have the option to continue to invest through the prescribed list or choose to expand their investment opportunities by participating in the Standard.

The Region, in collaboration with other large Ontario municipalities is undertaking thorough analysis and due diligence of the options available through the Standard. This analysis is expected to provide the consortium with the costs and benefits on the various options available. This will support the Region in determining its recommended approach going forward. The working group is in the process of engaging a 3RD party consultant to provide further independent analysis which will be used to evaluate the Region's position with respect to the Standard.

Some highlights of the work that has been done to date include:

- Costs and benefits of permissible governance/investment structures under the Standard;
- Organizational impacts, such as accounting, reserve budgeting, and cash flow forecasting are being investigated; and,
- Historical back-testing of risk/return metrics.

The Standard became effective January 1, 2019. To date, we are not aware of any municipality that has implemented the Standard, with the exception of City of Toronto that was granted the authority in 2018. The Municipal Finance Officers' Association, through ONE Investment is currently developing a product/service offering that would allow municipalities to access the Standard. As part of the Region's due diligence, Staff are in regular contact with ONE Investment to understand the offering. With the landscape still evolving, the Region continues to evaluate the options and is exercising patience as solutions evolve within the industry. Staff will continue to keep Council updated with findings/recommendations. As the Region has not implemented the Standard, all investments continue to be governed by the prescribed list under Ontario Regulation 438/97 and the Region's Investment Goals and Policies.

11. Treasurer's Comments

It is the opinion of the Treasurer and Director of Corporate Finance that all transactions and investments during 2018 were in compliance with the Region's Investment Goals and Policies and Ontario Regulation 438/97. Commodity hedging was also in compliance with the Region's Energy Commodity Procurement Policy and Ontario Regulation 653/05. This report satisfies the Treasurer's legislative requirements per Ontario Regulations 438/97 and 653/05.

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FINANCIAL IMPLICATIONS

The revenue generated through investment activities in 2018 was allocated to reserves (93%), operations (5%) and some non-program Regional bank accounts (2%).

CONCLUSION

The Region's Investment Goals and Policies provide the Region with an effective and efficient investment management operation which maximizes the rate of return on investment while ensuring safety of principal and liquidity.



Stephen VanOfwegen, Commissioner of Finance and Chief Financial Officer

Approved for Submission:



D. Szwarc, Chief Administrative Officer

APPENDICES

- Appendix 1.A – Cash Management
- Appendix 1.B – Debt
- Appendix 1.C – Investments
- Appendix 1.D – Investments Held in Region of Peel Securities
- Appendix 1.E – Energy Procurement

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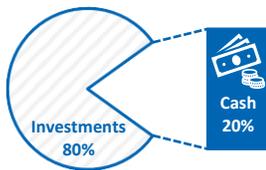
Appendix A: Cash Management

2018 General Fund cash holdings reduced from \$734M to \$461M



Portion of cash holdings invested into longer term fixed income securities as yield levels became more attractive

General Fund cash holdings down 14% from 2017



General fund cash levels remain higher than historical levels

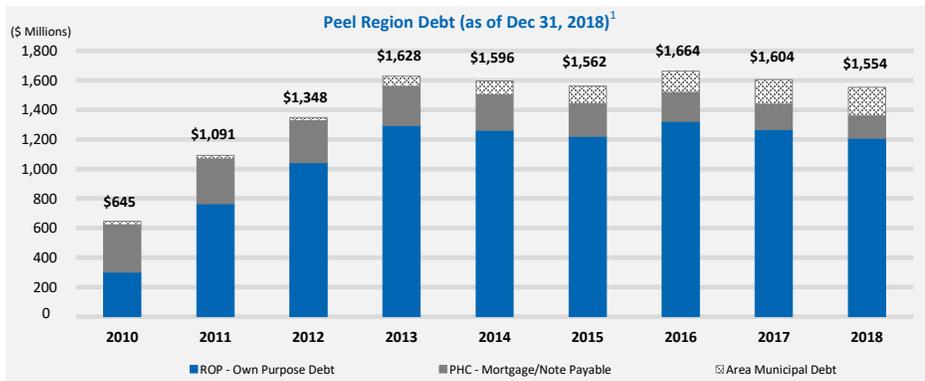
- Historically low rates on federal bonds previously used for liquidity have made cash holdings more attractive
- Deposit rates on cash were generally higher than rates on 2 to 3-year fixed income securities, resulting in an investment decision to hold higher levels of cash

Sinking Fund cash holdings were \$13M, down \$32M from 2017

- Cash levels were reduced as investments were made throughout 2018



Appendix B: Debt



In 2018, the Region had outstanding net own-purpose debt of \$1,359M



This includes \$152M in PHC's social housing mortgages

The Region had an \$80M decrease in net debt

\$1,440M 2017 **\$1,359M** 2018

Reductions due to debenture and mortgage principal payments and Sinking Fund provision payments

Appendix C: Investments – General Fund

The portfolio carrying value (amortized book value) was \$2,344M



The total market value of holdings was \$2,359M



- While the allocation to cash is higher than it has been historically, the extreme flattening of the yield curve where the spread between long and short-term yields decreased, has boosted the relative attractiveness of cash holdings vis-a-vis longer term fixed income holdings.

- More specifically, the Region was able to negotiate more favourable rates on cash deposits, which are comparable to 2 to 4-year investment options at various points throughout 2018.



¹ Maturities are expressed using par value.

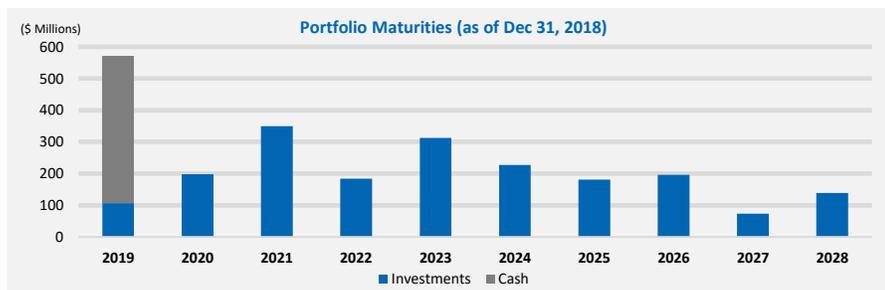
Duration of the General Fund portfolio as of Dec 31, 2018, was



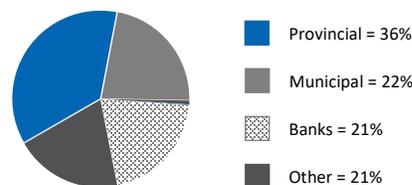
Maturities are structured to meet the timing of cash requirements

All investments continue to be held in highly rated securities

Only **1%** rated below **AA**



Sector Allocation



Other includes: Cash = 19.76%; Asset Backed Securities = 0.69%; Corporate Bonds = 0.21%; Federal = 0.04%

Portfolio returns exceeded the benchmark

+0.8%

Attributed to attractive rates on the Region's deposits and the Portfolio's municipal and provincial bond holdings in the 1 to 5-year terms

Increased earnings

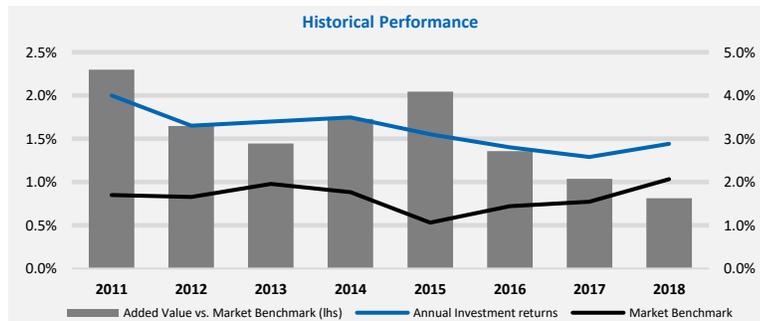
+\$9.8M

2017: \$57.7M
to
2018: \$67.5M

Investment Returns vs. Market Benchmark ²	2018	2017	2016
Annual Investment Earnings (\$ Millions)	\$67.5	\$57.7	\$56.0
Annual Investment Returns ³ (gross)	2.9%	2.6%	2.8%
Market Benchmark ⁴	2.1%	1.5%	1.4%
Value Add (returns – benchmark)	0.8%	1.0%	1.4%

- Staff were able to help generate additional earnings by deploying new investment opportunities and taking advantage of periods with higher rates

- Market yields bottomed in 2015/2016 and have since begun moving slightly higher.
- As the market benchmark is reflective of current yields, there tends to be a lagged effect on the portfolio yields. For example, as rates move higher, short term outperformance tends to be reduced, while the opposite tends to be true as yields move lower (e.g. 2015).



Long Term Target

Average Investment Returns vs. Average Inflation ²	2018	2017	2016
4-year Average Investment Returns ³ (gross)	2.8%	3.0%	3.2%
4-year Average Inflation ⁵	2.1%	2.1%	1.8%
Value Add (returns – inflation)	0.7%	0.9%	1.4%

A major goal of the General Fund is the preservation of purchasing power over the long-run. Inflation is used as a barometer of the Portfolio's long-term minimum return requirement.

Average return exceeded average inflation

+0.7%

² Values may not add due to rounding.

³ The gross fixed income investment yield is based on earned revenues (interest income, realized capital gains/losses, amortized premiums/discounts and securities lending income) as a percentage of the weighted average value net of expenses.

⁴ Blend of FTSE TMX Indices based on target term and sector exposures.

⁵ Toronto CPI.

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Appendix C: Investments – Sinking Funds

Series	Issue Date	Maturity Date	(Millions)		Holdings (Millions)			Earnings Surplus / (Deficit)	
			Annual Provision Payments	Total Provision Payments (Cumulative)	Investments (Amortized Book Value)	Cash	Total	Region of Peel	Town of Caledon
DQ	Jun 29/10	Jun 29/40	\$8.9	\$71.4	\$72.3	\$11.7	\$84.0	\$307,333	\$3,343
EB	Oct 06/11	Dec 01/21	\$7.8	\$54.8	\$60.1	\$0.6	\$60.7	\$860,917	\$2,770
EC	Oct 30/12	Oct 30/42	\$6.8	\$41.0	\$46.1	\$0.1	\$46.3	\$2,560,091	n/a
EP	Jun 20/13	Jun 20/53	\$0.3	\$1.8	\$0.9	\$1.0	\$1.9	(\$21,515)	n/a
EQ	Aug 23/13	Dec 02/33	\$9.1	\$45.4	\$48.9	\$0.0	\$48.9	\$428,375	n/a
FX	Nov 02/16	Nov 02/26	\$13.7	\$27.4	\$27.8	\$0.0	\$27.8	\$187,638	n/a
TOTALS			\$46.7	\$241.7	\$256.1	\$13.4	\$269.5		

Objective of each Sinking Fund is to meet or exceed target return



The target return is the estimated return requirement necessary to ensure that each Sinking Fund is fully funded at maturity to repay its obligation

- For Series DQ, the 2018 return was only 3 basis points (0.03%) below the target return and the series continues to be in a surplus position due to surpluses accumulated in prior years.
- Series EP continues to underperform the target return as market interest rates have fallen significantly since the debenture issuance, making it more difficult to invest contributed provision payments at yields equal to or greater than target. The Region will contribute the shortfall for Series EP which was in a small deficit position (\$21,515) at the end of 2018.

Investment returns on the Sinking Funds were greater than the target return

4 of **6** exceed target

Exceptions are Sinking Fund Series DQ and Series EP

Appendix D: Investments Held in Region of Peel Securities

Region of Peel Bonds – Holdings

Date	Par Value		% of Portfolio
	Portfolio ⁶	RoP Bonds ⁷	
Dec. 31/18	\$2,752,357,130	\$70,711,000	2.6%
Dec. 31/17	\$2,579,877,871	\$55,811,000	2.2%
Yr. over Yr. Change	\$172,479,260	\$14,900,000	

Region of Peel Bonds – Transactions

Portfolio	Transaction	Date	Coupon	Par Value	Price		Yield
					Purchase	Sale	
GF	Sale	Jun. 21/18	5.10%	\$6,855,000	124.86	129.60	3.21%
GF	Maturity	Jun 29/18	4.20%	\$510,000	99.76	100.00	4.24%
GF	Maturity	Dec. 14/18	6.65%	\$2,320,000	99.57	100.00	6.69%
Series DQ				None			
Series EB	Purchase	Apr. 27/18	3.5%	\$1,672,000.00	103.24		2.55%
Series EC	Purchase	Nov. 05/18	3.85%	\$8,399,000.00	103.99		3.60%
Series EC	Purchase	Jan. 12/18	3.85%	\$655,000.00	108.73		3.33%
Series EC	Purchase	Jan. 02/18	3.85%	\$582,000.00	111.85		3.16%
Series EP				None			
Series EQ	Purchase	Apr. 30/18	4.25%	\$4,602,000	110.86		3.35%
Series EQ	Purchase	Dec. 06/18	4.25%	\$8,675,000	110.14		3.38%

Appendix E: Energy Procurement

No electricity hedge volumes were procured for 2018



Projections showed that 2018 market conditions would be relatively stable and the Region's exposure to the spot market is minimal (approximately 12% of total annual energy bill). This strategy allowed the Region to take advantage of the low spot market prices that averaged \$0.02244/kWh in 2018, which was 33% less than the 2017 transaction price.

Total hedge cost of approximately \$1.2M and total index cost of approximately \$0.99M spent on gas



Natural gas hedge volume of 8.32 million m³ and index volume of 7.33 million m³ was purchased from both the Region of Peel's gas supplier and the Housing Services Corporation at various delivery points at an average price of \$0.1389/m³ inclusive of transaction fees.

⁶Total of General Fund and six Sinking Fund portfolios.
⁷RoP bonds held in portfolios.