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REPORT TO FINANCE COMMITTEE
MEETING OF WEDNESDAY, MAY 2, 2018

SUBJECT Capital Regional District Investment Portfolio Annual Update

ISSUE

Provide an update on Capital Regional District (CRD) investments held and rates of return for the period ended December 31, 2017.

BACKGROUND

The CRD follows a policy of investing working capital and cash-on-hand according to guidelines set out in the *Local Government Act* and the CRD Investment Policy.

The CRD Investment Policy meets the statutory requirements under the *Local Government Act* and applies to investment activities for all funds maintained by the CRD including operating, capital and reserve funds. The types and terms of investments are structured to meet the goals of security and availability of funds when required, while balancing social responsibility with returns. The policy also defines minimum ratings for investment vehicles to be purchased; chartered banks or savings institutions holdings must be R-1 low or higher for short-term, while long-term facilities require a minimum rating of A-. As a number of investments are held through the Municipal Finance Authority (MFA), they are presently rated Aaa “Stable” by Moody’s and AAA “Stable” by both Fitch and Standard & Poor’s.

The CRD invests its net working capital, primarily the annual requisition, in a mix of vehicles including its general bank account and term deposits or bankers acceptances of various financial institutions. In practice, sufficient funds are maintained in the general bank account to meet immediate needs. At December 31, 2017, the general bank account had a balance of $17.4 million, along with $160.6 million invested in both short and long-term investments, as outlined in Table 1 below.

Table 1: Investment and Bank Balances

	Balance
General Bank Account	17,441,569
Chartered Bank GIC’s	40,171,161
Credit Union GIC’s	60,000,000
Total Short Term	**$ 117,612,730**
MFA Intermediate	21,007,820
MFA Term Bond	39,441,571
Total Intermediate and Long-Term	**$ 60,449,391**
Total Investments and Bank	**$178,062,121**

As per the CRD Investment Policy, the CRD generally invests longer term funds (primarily reserve funds, where the funds are not likely to be needed for a number of years) in MFA Bond Funds to minimize interest and credit risk and provide liquidity not otherwise available in the long-term investment market.

As part of the overall portfolio management process, staff regularly monitor market trends through Bank of Canada interest rate announcements and reports, Government of Canada bond rates and other key metrics. Additionally, staff communicate with the MFA on regular market developments and receive forward looking reports through Phillips, Hager & North Investment Management (PH&N). It is important to note that the MFA pooled investment funds are managed externally by PH&N, an organization recognized for an outstanding track record of long-term performance.

In addition, for 2017, all investment providers were advised of CRD Board-approved revisions to the investment policy in support of socially responsible investing (SRI) and green investing as qualifying investments within 5% of maximum available yield in the market. In 2017, there were no investments of this type evaluated.

FINANCIAL IMPLICATIONS

Portfolio Holdings

Table 1 summarizes the mix of the CRD investment portfolio at December 31, 2017. Total investments of $160.6 million were distributed 62% and 38% between short-term and long-term instruments respectively. Investments with maturities less than two years are classified as short-term. All short-term investments at December 31 were held in Superior rated Guaranteed Investment Certificates (GICs) yielding interest upon maturity and were issued by both chartered banks and credit unions. Long-term investments are held in the MFA intermediate and bond fund earning a 3 year blended compounded annual return of 1.29%.

Rates of Return

Placements of funds are made throughout the year in accordance with the CRD Investment Policy based on cash flow requirements, market rate analysis and portfolio constraints. The evaluation of short-term rates are inclusive of CRD's primary banking agreement with the Royal Bank of Canada (RBC), which provides a tiered rate of return based on balance. Rates are shown in Table 2 below.

Table 2: Banking Agreement Tiered Rates

RBC 2017 Deposit Rates		
Description	**2017 Rate Structure**	**2017 Rates at Dec 31/17**
Tier 1: $0-49,999,999.99	Prime less 1.65%	1.55%
Tier 2: > $50,000,000	Prime less 1.62%	1.58%

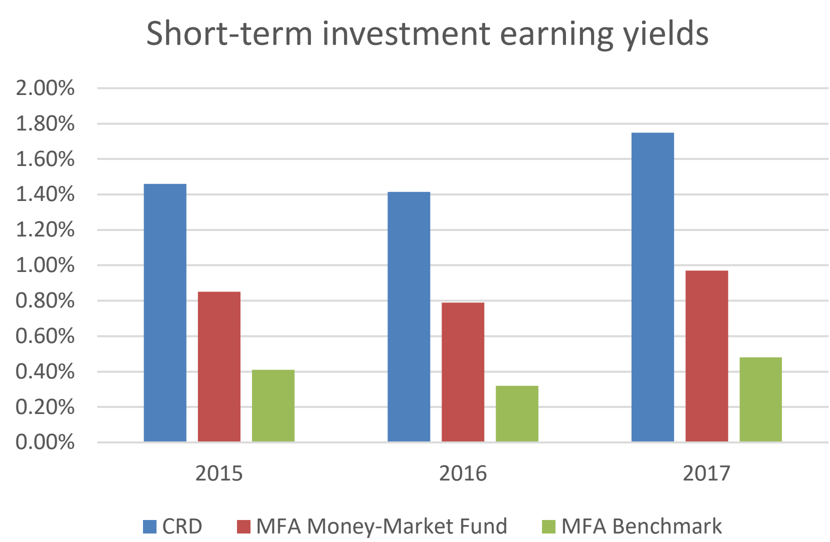
As the Bank of Canada issued multiple rate increases in 2017, the fixed interest rate structure in our banking agreement was renegotiated to a variable discounted prime rate, resulting in a net increase in interest earnings. As prime lending rate is forecasted to increase through 2018, interest yield will rise accordingly.

There were no significant re-investments of long-term funds in 2017 due to the prevailing, flatter yield curve. MFA rates fell significantly from prior years due mainly to the 13-year lows related to commodity prices for oil, uncertainty in domestic petroleum transportation, softwood lumber, NAFTA negotiations with the US, and political uncertainty in European markets.

2017 Performance

In line with the Bank of Canada rate increases in 2017, short-term GICs returned higher rates vs 2016. CRD earnings increased from 1.42% to 1.53% in 2017 on short-term investments, and combined with improved cash flow forecasting controls, resulted in higher interest income.

The summary charts below demonstrate short-term and long-term investment earnings for the past three years. The charts indicate the rates earned by the CRD, the bond and money market rates in MFA BC pooled investment funds and the benchmark FTSE TMX indices for treasury bills and bonds. The CRD rate of return outpaces both the benchmark and MFA returns. As long-term rates have declined in 2017, low or even negative returns are not unexpected with long term bonds, given the current market of international political uncertainty and low commodity pricing. All long-term placements are currently placed in the MFA Bond Funds; as a result, the posted MFA rates are equal to the return for the CRD. Notable negative return experienced in the bond market reflects the flattening of the yield curve in 2017 and the strength of MFA bond fund to still return positive interest return. The long-term rate graph also shows the spread between the MFA rate and the benchmark rate decreased from 0.62% in 2016 to 0.37% in 2017.



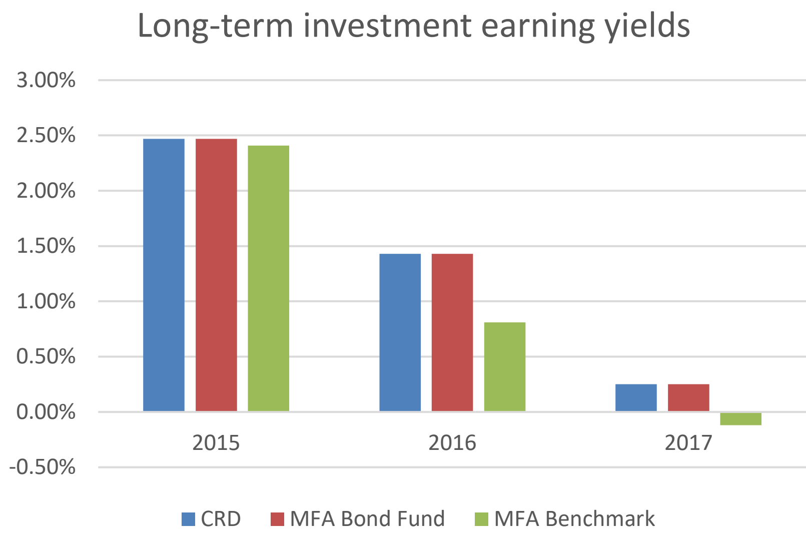


Table 3 shows the three year trend on interest income from 2015–2017. Interest income gains in the short-term market offset reduced earnings in long-term investments. Interest income is distributed annually on a pro-rata basis to reserve accounts.

Table 3: Investment Income 3-Year Trend

	2015	2016	2017
Interest Income	$ 2,112,187	$ 2,238,393	$ 2,309,995
Effective Rate	1.46%	1.42%	1.53%

CONCLUSION

Overall, the portfolio of investments reflects the CRD investment principles requiring security, liquidity and return. Investments have been made in keeping with statutory requirements under the *Local Government Act* and investment returns were in line with expectations for the year ended December 31, 2017.

RECOMMENDATION

That the Finance Committee recommend to the Capital Regional District Board:
That this report be received for information.

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