REPORT TO GOVERNANCE AND FINANCE COMMITTEE
MEETING OF WEDNESDAY, MAY 01, 2019

SUBJECT **Capital Regional District Investment Portfolio Holdings and Performance Annual Update**

ISSUE

Provide an update on Capital Regional District (CRD) investments held and rates of return for the period ended December 31, 2018.

BACKGROUND

The CRD invests operating, capital and reserve funds in accordance with the *Local Government Act*, Community Charter, and Board approved Investment Policy. The Investment Policy applies to the investment activities for all funds maintained by the CRD, as well as the Capital Regional Hospital District and the Capital Region Housing Corporation. The types and terms of investments purchased are evaluated conservatively on four fundamental objectives: safety of principal, liquidity, responsible investing and return on investment.

The policy also provides the minimum ratings of investment vehicles that can be purchased. Currently, investments in chartered banks or savings institutions must be R-1 (low) or higher for short-term and a rating of A- for long-term. Both ratings achieve a superior market rating on all investments.

The Investment Policy followed by the CRD provides criteria to ensure the capital is preserved and rate of return maximized while maintaining sufficient liquidity. Investments are continuously monitored to ensure the appropriate strategy through known economic and financial conditions.

The CRD invests net working capital, primarily the annual requisition, in a mix of vehicles ranging from bank deposits to fixed term deposits. All funds in excess of immediate needs are invested to meet liquidity requirements.

The CRD invests reserve funds in longer term Guaranteed Investment Certificates (GICs) as well as the Municipal Finance Authority (MFA) Intermediate Fund and MFA Bond Fund. The placement or divestiture of long-term funds are timed based on the anticipated need for these funds.

In addition, for 2018, all investment providers were encouraged to include options for socially responsible investment (SRI) and green investment. With no investments meeting the minimum 5% of maximum available yield in the market, there were no investments of this type offered or evaluated in 2018.

Market Rate Analysis – Applies to the CRD, CRHD, CRHC
As part of overall portfolio management, staff regularly monitor market trends through Bank of Canada interest rate announcements and reports, Government of Canada bond rates and other key metrics and through market commentary issued by banks and investment brokers. Additionally, the MFA provides regular market commentary on developments in offerings and based on outlook reports provided by Phillips, Hager & North Investment Management (PH&N).

In 2018, the Bank of Canada (BoC) raised its key overnight rate three times, influencing the prime rate and the rate offered on deposits with the Royal Bank of Canada (RBC):

Date	Change	BoC Rate
Jan 2018	+ 0.25%	1.25%
Jul 2018	+ 0.25%	1.50%
Oct 2018	+ 0.25%	1.75%

In addition to the Bank of Canada overnight rates, investor expectations also influence the prevailing rates on investments in the market. Throughout 2018, investor expectations were for short-term rates to increase and longer term rates to remain steady. Rates of return on fixed term maturities between one and five years returned only marginal interest rate premiums for taking on more liquidity risk.

Investment Marketplace – Applies to the CRD, CRHD, CRHC
During 2018, high interest savings accounts (HISAs) became available through a limited number of institutions. A HISA operates like a regular bank deposit account except it pays an enhanced, institutional rate of interest. In fact, the HISA rates offered throughout 2018 were competing with short-term fixed GIC products. For example:

Canadian Imperial Bank of Commerce (CIBC): The Municipal Finance Authority of BC (MFABC) created a high interest savings account in partnership with CIBC in 2018. The purpose of this HISA is to provide BC local governments with additional deposit products at an interest rate which benefits from economies of scale. The interest rate paid on this account is based on the CIBC prime rate minus 1.49%. At December 31, 2018, the CIBC/MFABC HISA was yielding 2.46%.

Scotiabank: Scotiabank offers two HISAs. A regular HISA which acts like a normal deposit account and a Notice Plan, which requires 31 days' notice before funds can be withdrawn. The Notice Plan pays slightly higher interest than the HISA.

Overall, the CRD portfolio of investments reflects the four fundamental objectives of safety of principal, liquidity, responsible investing and return on investment. Investments have been made in keeping with requirements under the Investment Policy Statement and investment performance was in line with expectations for the year ended December 31, 2018, as described in the following sections of this report.

ALTERNATIVES

Alternative 1
That the Governance and Finance Committee recommend to the Capital Regional District Board: That the Capital Regional District Investment Portfolio Holdings and Performance Annual Update be received for information.

Alternative 2
That the report be referred back to staff for additional information.

FINANCIAL IMPLICATIONS

At December 31, 2018, the CRD held $207.0 million invested in short-term and long-term investments, as outlined in Table 1 below.

Table 1: Investment Holdings – as at Dec 31, 2018

Investments	Balance ($millions)	% Share
Investments Short-Term (less than 2 years)		
Scotia Bank (< 1 year)	$36.0	17.4%
Coast Capital Savings (<1 year)	34.0	16.4%
MFABC CIBC High Interest Savings Account (Cash)	30.2	14.6%
First West Credit Union (< 1 year)	25.2	12.2%
Scotia Bank High Interest Savings Account (Cash)	10.1	4.9%
Total Short-Term:	**135.5**	**65.4%**
Investments Long-Term (more than 2 years)		
MFA Short-Term Bond Fund	40.1	19.4%
MFA Intermediate Fund	21.4	10.3%
National Bank (> 2 year)	10.0	4.8%
Total Long-Term:	**71.5**	**34.6%**
Total Investments:	**$207.0**	**100%**

As noted in Table 1 above, the CRD investment portfolio at December 31, 2018, was distributed between short-term and long-term investments by 65% and 35%, respectively. Investments with maturities less than two years are classified as short-term.

Table 2: Cash and Reserves Invested – as at Dec 31, 2018

Investments	Balance ($millions)	% Share
Capital Reserves	$83.4	40.3%
Operating Reserves	40.8	19.7%
Working Capital	82.8	40.0%
Total Investments:	**$207.0**	**100%**

Performance

While the Bank of Canada rate rose throughout 2018, liquidity requirements remained a key driver in the investment strategy with major capital projects underway such as the Core Area Wastwater Treatment Project, construction of the South Island Communications Centre and works on the E&N Rail Trail Phases 3 & 4.

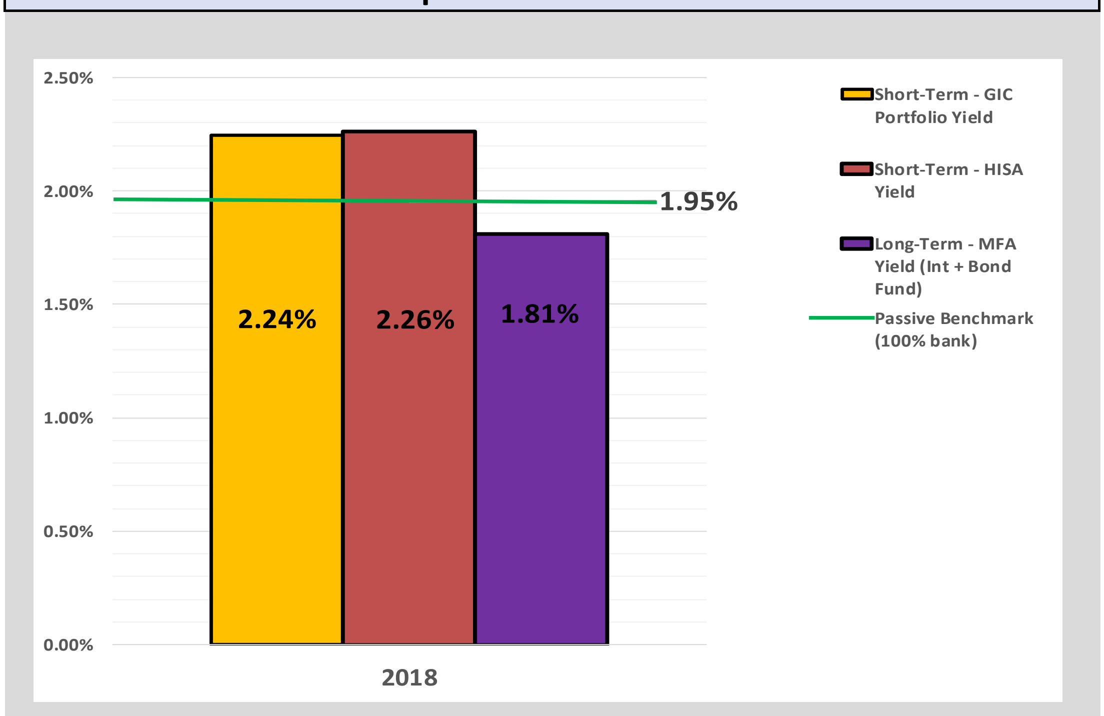
The magnitude of cash outflows increased in 2018, with average monthly cash outflows of $11.7 million, up from $6.0 million. Also in 2018, certainty around cash flow timing varied, as is the case with large capital expenditure projects. Although investment policy guidelines do not change, a more active investment strategy is required to achieve optimum performance of the net working capital portion of the investment portfolio. Matching the timing of investments with rate increases while meeting liquidity requirements requires a more dynamic investment management strategy.

Historically, the investment strategy has been to evaluate cash flow timing and place investments into terms maturing along that timeline. This is called an investment ladder. The ladder approach, however, does not always result in the optimum rate of investments. With liquidity as a top priority, rates are evaluated only secondarily and only within each term to maturity.

An active investment strategy considers the rate environment as well as maturity, driving the turnover of investments to take advantage of the prevailing rate environment. This approach increases investment activity but helps to reduce liquidity risk and interest rate risk.

To take advantage of rate premiums being paid on short-term investments, cash was placed in facilities yielding optimum interest while still meeting liquidity targets. Graph 1 below provides a detailed report on portfolio yields for 2018:

Graph 1: Portfolio Yields



During 2018, the GIC investments returned 2.24%, with the HISA returns yielding 2.26%. The MFA Intermediate Fund and Bond Fund returned 1.81%, indicative of long-term rates prevailing on marketable securities.

A passive benchmark has been included in the table above. This benchmark assumes funds are deposited at the beginning of the year with one hundred percent allocated to the RBC bank account. The benchmark calculation assumes no funds movement throughout the year. This passive benchmark represents the theoretical return experienced from a deposit and hold strategy with no active management strategy and no flows of funds in or out of the accounts during the year.

Table 3 below shows the three-year trend on investment interest income (excludes bank account interest). Interest income is distributed annually on a pro-rata basis to reserve accounts and monies held in trust if applicable.

Table 3: Investment Income 3-Year Trend ($ Millions)

	2016	2017	2018
Interest Income (*)	$ 2.2	$ 2.3	$ 3.9
Effective Rate	1.42%	1.53%	2.09% (**)

(*) Excludes unrealized losses on MFA pooled funds
(**) Effective rate is calculated using an internal rate of return calculation, reflecting the annual growth rate of investments during the period

The total effective rate of return on investments, during 2018, was 2.09%. The return margin against the benchmark of a passive investment strategy was 0.14%, which is approximately $0.26 million.

Total interest income for 2018 was $3.9 million, excluding unrealized losses on MFA pooled funds. The overall increase in investment income is due to increasing rate environment, higher average monthly cash on hand and an active investment management strategy. The change in investment income by investment vehicle is shown below, in Table 4.

Table 4: Investment Income – Year over Year ($ Millions)

Type	2017	2018	Diff
GIC and HISA Portfolio Interest	$ 1.0	$ 2.4	$ 1.4
MFA Pooled Fund Interest (gross)	$ 1.3	$ 1.5	$ 0.2
Total	**$ 2.3**	**$ 3.9**	**$ 1.6**

The primary driver behind the increase in interest income was from returns on GICs and HISA investments. Total income on these vehicles was $2.4 million, an increase of $1.4 million over 2017. An increase in cash contributed to the overall investment income increase by approximately $0.90 million, while rate increases contributed an additional $0.25 million, with the remaining $0.26 million attributable to an active investment management strategy.

CONCLUSION

Overall, the Capital Regional District portfolio of investments reflects the four fundamental objectives of safety of principal, liquidity, responsible investing and return on investment. Investments have been made in keeping with requirements under the Investment Policy Statement and investment performance was in line with expectations for the year ended December 31, 2018.

RECOMMENDATION

That the Governance and Finance Committee recommend to the Capital Regional District Board:
That the Capital Regional District Investment Portfolio Holdings and Performance Annual Update be received for information.

Submitted by:	Rianna Lachance, CPA, CA, Senior Manager, Financial Services
Concurrence:	Nelson Chan, MBA, CPA, CMA, Chief Financial Officer
Concurrence:	Robert Lapham, MCIP, RPP, Chief Administrative Officer

AH:nm

Appendix 1: Investment Policy