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REPORT TO CAPITAL REGIONAL DISTRICT BOARD MEETING OF WEDNESDAY, APRIL 22, 2020

SUBJECT **CRD Investment Portfolio Holdings and Annual Performance Update**

ISSUE SUMMARY

Provide an update on Capital Regional District (CRD) investment holdings and performance for the period ended December 31, 2019.

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. The types and terms of investments purchased are evaluated conservatively on four fundamental objectives: safety of principal, liquidity, responsible investing, and return on investment in alignment with the policy.

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

Investments are continuously monitored to ensure the appropriate strategy through known economic and financial conditions. The CRD invests net working capital, operating reserves and capital reserves in a mix of vehicles including high-interest savings accounts (HISA), fixed term guaranteed investment certificates (GIC's) and Municipal Finance Authority (MFA) investment funds. The placement or divestiture of investments are timed with the forecasted need.

Market Rate Analysis – Applies to the CRD, CRHD, CRHC

As part of overall portfolio management, staff regularly monitor market trends and key metrics such as the Bank of Canada overnight interest rate, the Government of Canada bond rates and other 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 2019, the Bank of Canada (BoC) held its key overnight rate steady at 1.75% maintaining stability in the prime rate and the rate offered on cash on deposit with the Royal Bank of Canada (RBC). Both the short term high-interest savings accounts and short term GIC's were offering competitive returns when compared to long-term GIC's. The table below presents key indicator rates at December 31 for both 2019 and 2018:

Table 1: Indicative Market Rates 2019 and 2018

Rate	2019	2018
Bank Of Canada – Overnight Rate	1.75%	1.25% - 1.75%
HISA	2.46%	1.96% - 2.46%
RBC – Bank Rate	2.30%	1.70% - 2.30%
Fixed GIC – 180 day /1 Year (sample)	1.68% / 2.30%	1.57% / 2.68%

Investment Marketplace – Applies to the CRD, CRHD and CRHC

Throughout 2019, HISA rates were highly competitive compared to fixed term GIC products. In many cases, HISA returns were higher than maturities up to terms as long as four (4) years.

Late in 2019, market place offerings were extended by MFA introducing a Fossil Fuel-Free Bond Fund (FFF) and a Pooled Mortgage Fund. Both offerings are responses to demand from local government and both offer the same liquidity and pooled structure as the existing MFA investment offerings.

The FFF Bond Fund invests in securities similar to the existing bond fund except that the FFF option excludes those holdings directly related to non-renewable energy extraction, processing, and transportation. This additional screening is estimated to exclude approximately 4% of the population of investible securities compared to the existing bond fund. The MFA expects to launch this product in late spring 2020.

The Pooled Mortgage Fund invests in existing PH&N pooled fund products, providing investment exposure to commercial investment grade mortgages. This new mortgage pooled fund was opened for investment in late 2019.

ALTERNATIVES

Alternative 1

That the CRD Investment Portfolio Holdings and Annual Performance Update be received for information.

IMPLICATIONS

Financial Implications

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. Investment performance was in line with expectations for the year ended December 31, 2019, as described in the following sections of this report.

Portfolio Holdings

At December 31, 2019, the CRD held \$248.7 million invested in short-term and long-term investments, as outlined in Table 2 below.

Table 2: Investment Holdings – as at Dec 31, 2019

Investments	Balance (\$millions)	% Share
Investments Short-Term (less than 2 years)		
National Bank GIC	\$10.0	4.0%
Canada Western Bank GIC	12.0	2.4%
Coast Capital Savings GIC	13.5	1.2%
VanCity Credit Union GIC	18.0	7.2%
MFABC CIBC High Interest Savings Account	51.1	20.5%
Scotia Bank High Interest Savings Account	63.0	25.3%
National Bank High Interest Savings Account	23.2	9.3%
Total Short-Term	190.8	76.7%
Investments Long-Term (more than 2 years)		
MFA Bond Fund	41.4	16.6%
Coast Capital Savings GIC	10.5	4.2%
Canada Western Bank GIC	6.0	2.4%
Total Long-Term	57.9	23.3%
Total Investments	\$248.7	100%

As noted in Table 2 above, the CRD investment portfolio at December 31, 2019, was distributed between short-term and long-term investments by 77% and 23%, respectively. Investments with maturities less than two years are classified as short-term. While the MFA Bond Fund is a liquid investment, investments placed in the fund are recommended for longer term holdings only.

Table 3: Cash and Reserves Invested – as at Dec 31, 2019

Investments	Balance (\$millions)	% Share
Capital Reserves	\$82.7	33.3%
Operating Reserves	47.8	19.2%
Working Capital	118.1	45.5%
Total Investments:	\$248.7	100%

Performance

While the BoC rate remained steady throughout 2019, liquidity requirements remained a key driver in the investment strategy with major capital projects underway such as the Core Area Wastewater Treatment Project, construction of the South Island Communications Centre, and works on the E&N Rail Trail Phases 3 & 4.

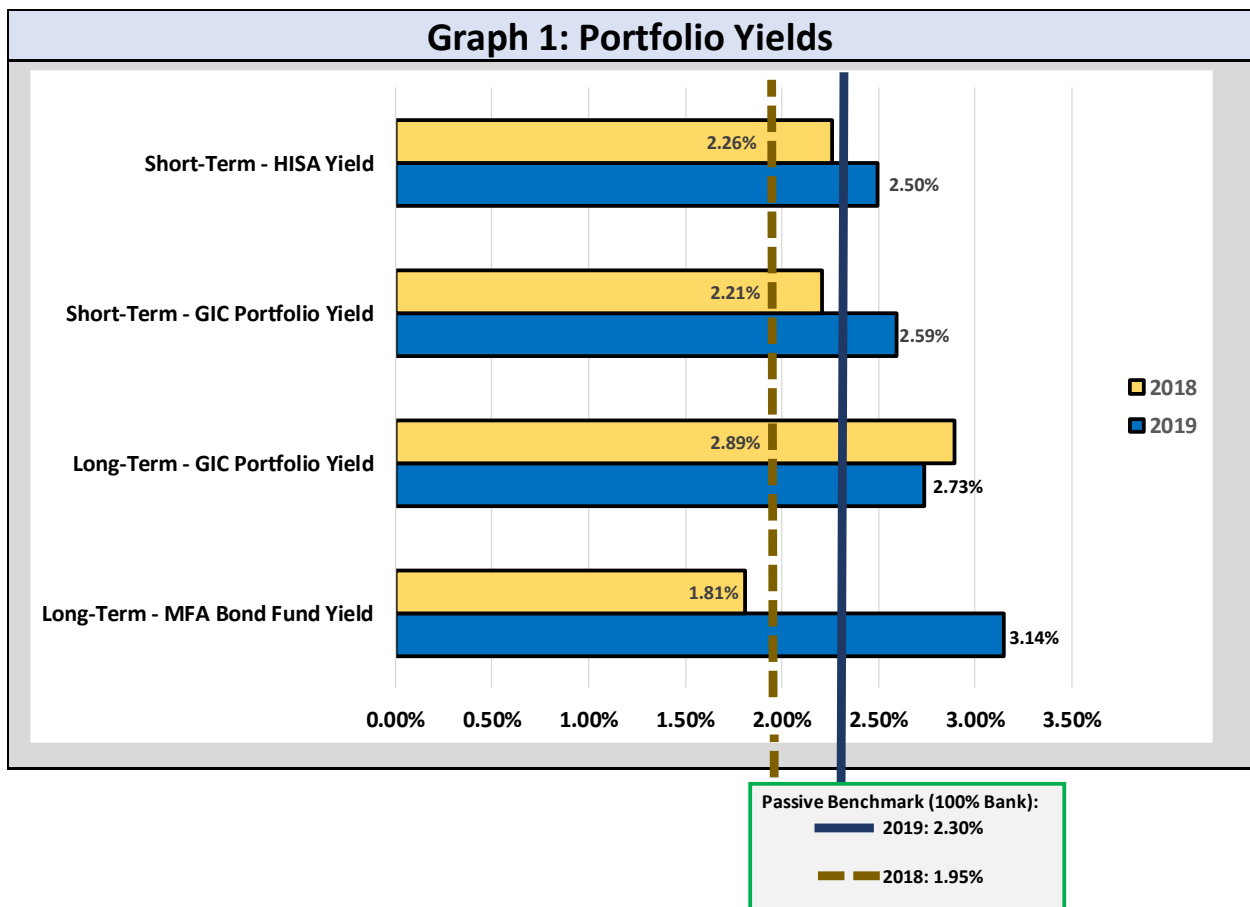
The magnitude of cash outflows increased in 2019, with average monthly cash outflows of \$13.6 million. Also in 2019, certainty around cash flow timing varied, as is the case with large capital

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 2019:



During 2019, short-term GIC investments returned 2.59%, long-term GICs returned 2.73%, with the HISA returns yielding 2.50%. The MFA Bond Fund returned 3.14%, driven by higher bond prices resulting from investor demand in the market.

The passive benchmark, included in graph 1, 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 4 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 4: Investment Income 3-Year Trend (\$ Millions)

	2017	2018	2019
Interest Income	\$ 2.3	\$ 3.9	\$ 5.4
Change in Unrealized Gain/(Loss)	(0.703)	(0.280)	0.224
Effective Rate (IRR)	1.53%	2.09%	2.67%

The total effective rate of return on investments, during 2019, was 2.67%. The return margin against the benchmark of a passive investment strategy was 0.37%.

Total interest income for 2019 was \$5.4 million, excluding unrealized gains on the MFA Bond Fund. The overall increase in investment income is due to higher average monthly cash on hand, utilization of the high-interest savings accounts, positive MFA Bond fund performance due to falling general market rates, and an active investment management strategy. The change in investment income by investment vehicle is shown below, in Table 5.

Table 5: Investment Income – Year over Year (\$ Millions)

Type	2019	2018	Diff
GIC and HISA Portfolio Interest	\$ 4.4	\$ 2.4	\$ 2.0
MFA Pooled Fund Interest (gross)	\$ 1.0	\$ 1.5	(\$ 0.5)
Total	\$ 5.4	\$ 3.9	\$ 1.5

The primary driver behind the increase in interest income was returns on GICs and HISA investments. Total income on these investment vehicles was \$4.4 million, an increase of \$2.0 million over 2018. An increase in cash contributed to the overall investment income increase by approximately \$1.11 million, while the rate increases achieved contributed an additional \$0.62 million, with the remaining \$0.22 million attributable to an active investment management strategy.

While the MFA Bond Fund posted a performance of 3.14% in 2019, the MFA total income was lower than previous years due to the disposition of the MFA Intermediate Bond Fund in early January 2019.

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, 2019.

RECOMMENDATION

That the Capital Regional District Investment Portfolio Holdings and Annual Performance Update be received for information.

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ATTACHMENT(S)

Appendix A: CRD & CRHD Investment Policy