

**To:** COUNCIL

**Meeting Date:** 07/27/21

**Subject:** 2020 Year End Report on Investments

**Submitted By:** Sheryl Ayres, Chief Financial Officer

**Prepared By:** Mirna Raponi, Supervisor of Accounting and Financial Reporting

**Report No.:** 21-138(CRS)

**File No.:** C1101

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## Recommendation(s)

THAT report 21-138(CRS) re: 2020 Year End Report on Investments be received for information.

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## Executive Summary

### Purpose

- To report on the 2020 investment portfolio performance and holdings as required by Ontario Regulation 438/97 of the Municipal Act.

### Key Findings

- The carrying value of the City's reserve fund and general fund investments was \$127.0 million as of December 31, 2020 plus cash holdings of \$57.8 million.
- The investment balance increased by \$8.6 million over the previous year. This is reflective of the City investing more of its cash holdings in 2020 compared to 2019 as the Bank of Canada reduced its overnight interest rate throughout 2020, which increased the need to invest more into investments with higher interest rates compared to the lower interest rates on cash held at the bank.
- Overall, investment income increased year-over-year in 2020 compared to 2019 by \$0.1 million, largely as a result of increased carrying value of reserve fund investments offset by the significant decreases in the Bank of Canada's overnight interest rate in 2020 which is a driver of the City's banking services provider's prime interest rate and investment options available to the City.

- The 2021 outlook for investment income is poor for the short to medium term as rates are expected to stay low throughout the remainder of the year. The economic recovery remains highly dependent on the evolution of the COVID-19 pandemic. The movement in the Bank of Canada's overnight interest rate is a primary driver in the City's investment income performance. The Bank of Canada's overnight interest rate is expected to remain at a low rate of 0.25% until the inflation target is under control, stable, and predictable, which is anticipated to take place in the second half of 2022. Staff continue to monitor the investment portfolio and diversify the holdings where possible in a very difficult/low market.

## Financial Implications

- Investment income reduces the amount otherwise required from property taxation and user fees to finance City services, as well as increasing the value of reserve funds used to finance future expenditures. The amount of investment income earned in 2020 was as follows:
  - General or tax-supported fund: \$1,645,698
  - Reserve fund: \$2,373,923

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## Background

Ontario Regulation 438/97 of the Municipal Act requires an investment report to be provided to Council at least annually. This report has been prepared in compliance with this regulation.

All investments made by the City are in accordance with Council approved policies.

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## Analysis

### Strategic Alignment

PEOPLE To actively engage, inform and create opportunities for people to participate in community building – making Cambridge a better place to live, work, play and learn for all.

Goal #2 - Governance and Leadership

Objective 2.5 Focus on the responsible management of financial resources, ensuring transparency and accountability.

Reporting on the City's 2020 investment performance and portfolio supports transparency in the City's financial management.

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## Comments

### Definitions

**Carrying Value:** The portion of an asset's value that is not depreciated. Carrying value is not market value, which is determined by market forces such as stock prices. Also called Book Value.

**Market Value:** The price at which a security currently can be sold.

**Callable Investment:** An investment that can be redeemed early by the issuer before its maturity at the issuer's discretion and pay the investor par plus accrued interest. Issuers reward investors with a higher interest rate in return for the right to call the investment.

**Inflation:** an economic term that refers to an environment of generally rising prices of goods and services within a particular economy.

### Investment Portfolio

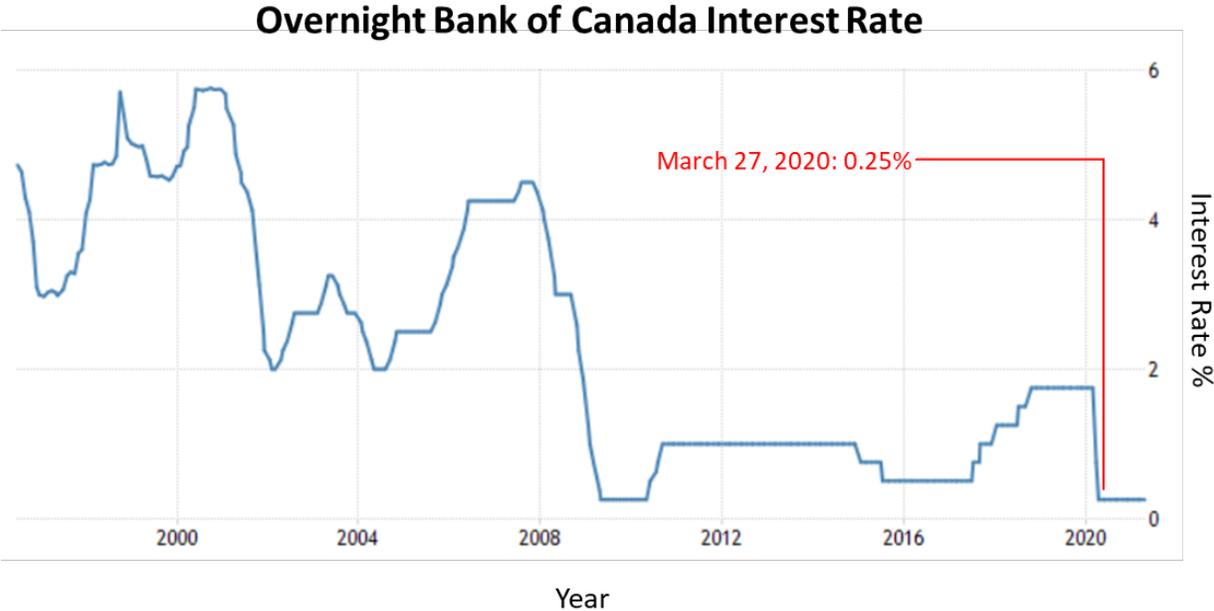
The investment and cash portfolio positions of the City are as follows:

Investment Type	December 31, 2020 Market Value	December 31, 2020 Carrying Value	December 31, 2019 Carrying Value
Short-term Investments	\$81,962,349	\$81,808,938	\$76,855,696
Long-term Investments	\$46,060,889	\$45,238,390	\$41,587,436
<b>Total Investments</b>	<b>\$128,023,238</b>	<b>\$127,047,328</b>	<b>\$118,443,132</b>
Cash	\$57,784,646	\$57,784,646	\$59,711,347
<b>Total Cash &amp; Investments</b>	<b>\$185,807,884</b>	<b>\$184,831,974</b>	<b>\$178,154,479</b>

The carrying value of the City's reserve fund and general fund investments was \$127.0 million as of December 31, 2020 plus cash holdings of \$57.8 million. The investment balance increased by \$8.6 million over the previous year, partially offset by a reduction in cash balance of \$1.9 million. This is reflective of the City investing more of its cash holdings in 2020 compared to 2019 as the Bank of Canada reduced its overnight interest rate throughout 2020, which increased the need to invest more into investments with higher interest rates compared to the lower interest rates on cash held at the bank.

From October 2018 until the first closures resulting from the COVID-19 pandemic in March 2020, the Bank of Canada had held its overnight interest rate flat at 1.75%. In its scheduled announcement on March 4, 2020, the rate was cut by 0.50%, catching many financial experts who had been expecting a cut of only 0.25% by surprise. Amidst

significant economic uncertainty, the Bank of Canada further announced emergency rate cuts of 0.50% on March 13, 2020 and again on March 27, 2020. Within a one-month timeframe, the overnight interest rate therefore dropped from 1.75% to 0.25%. The Bank of Canada held its overnight interest rate flat at 0.25% for the remainder of 2020.



Source: <https://tradingeconomics.com/canada/interest-rate>

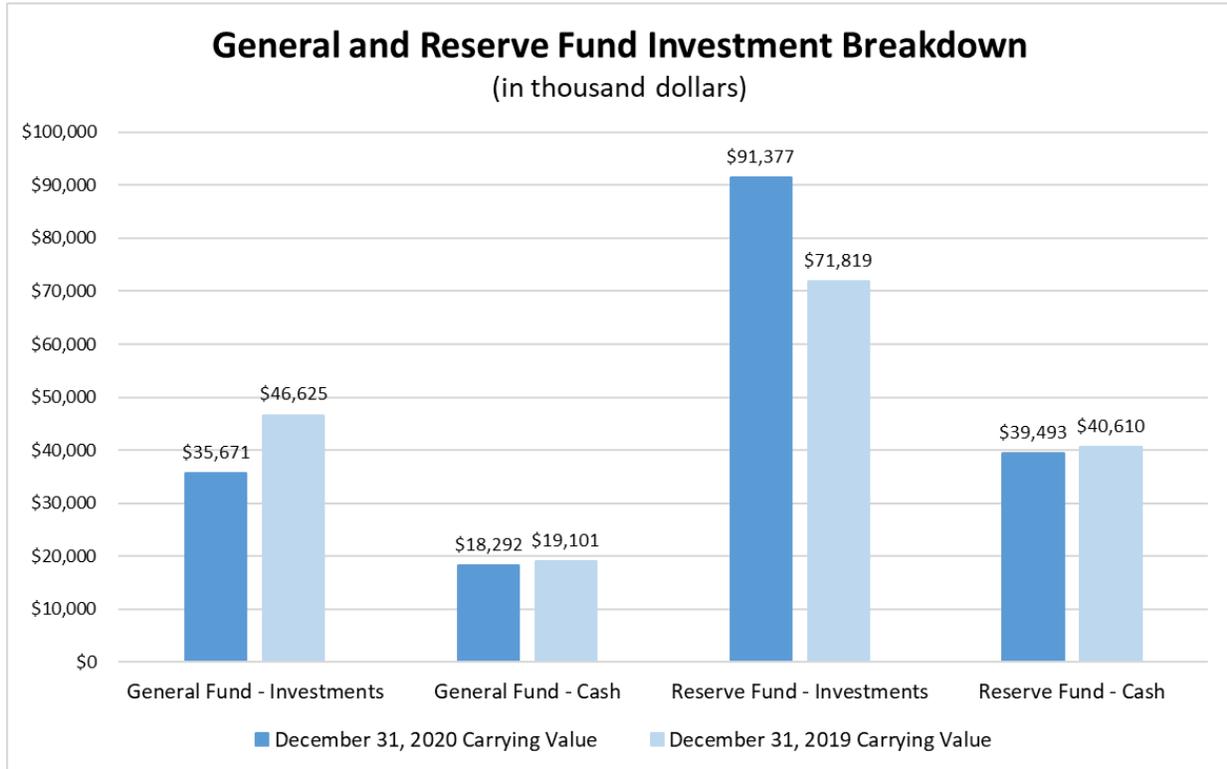
In March 2020, staff responded quickly to the impending pandemic and the announced rate cuts, by locking in available cash flows prior to the markets adjusting fully to the cuts. Earlier in the fiscal year, the investments secured had relatively higher interest rates ranging from 1.80% to 2.66%. Subsequent to March 2020, short-term investment opportunities became limited with much lower interest rates ranging from 0.85% to 1.13%. In addition, all investments held by the City that had callable features had been subsequently called by institutions as those investments previously held by the City were earning higher interest rates relative to the market.

The movement in the Bank of Canada’s overnight interest rate is a primary driver in the City’s investment income performance. The City’s investment strategy strives to maximize returns within certain risk tolerances and in accordance with the Municipal Act and related regulations, while ensuring sufficient cash flow to meet operational needs. The investment portfolio includes both short and medium to long-term investments. Throughout 2020, as these investments mature in the market of much lowered interest rates, the City has been unable to find investment products with the same level of returns.

The details of the City’s specific investment portfolio as at December 31, 2020 are attached in Appendix A.

## Reserve Fund and General Fund Carrying Value

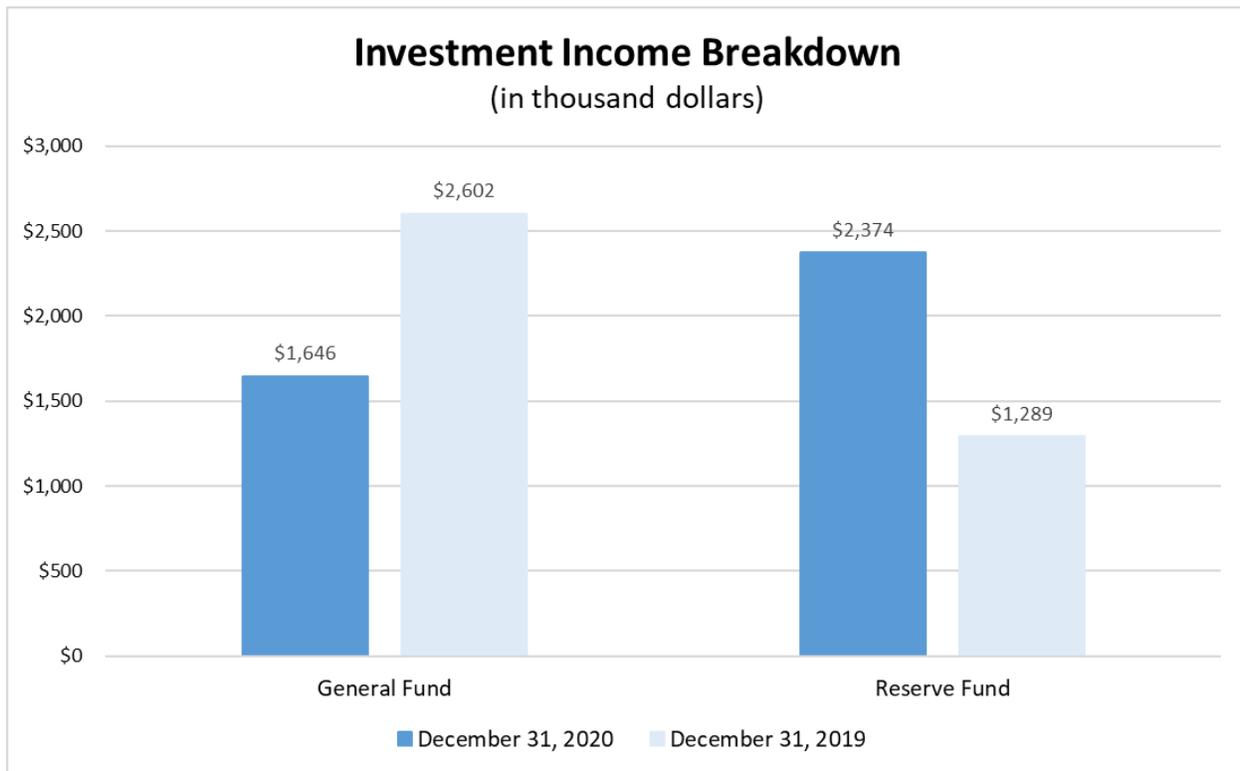
The graph below summarizes the general and reserve fund carrying values from 2019 to 2020:



Further discussion on the carrying values can be found under section “Investment Income” below.

## Investment Income

The graph below summarizes the general and reserve fund investment income in 2019 and 2020:



Overall, investment income increased year-over-year in 2020 compared to 2019 by \$0.1 million.

The income on the general fund decreased by \$1.0 million, largely as a result of the significant decreases in the Bank of Canada's overnight interest rate in 2020 which is a driver of the City's banking service provider's prime interest rate and investment options available to the City. In addition, the general fund carrying value of investments and cash totalled \$54.0 million in 2020, a reduction by \$11.8 million from 2019 of \$65.7 million due to decreased cash flow from the loss of revenues and timing of tax payments, and reduced investment opportunities with much lowered interest rates.

The income on the reserve fund totalled \$2.4 million, an increase of \$1.1 million from 2019 totalling \$1.3 million. This is due to an increased balance in the reserve fund investments, and due to 2019 investment income being lower than it otherwise would have following an accounting adjustment.

- **Increased Reserve Fund Carrying Value:** in 2020, the carrying value of reserve fund investments and cash totalled \$130.9 million, an increase of \$18.5 million in comparison to 2019 totalling \$112.4 million. This increase is mainly due to two factors. The first factor is in 2020, Finance changed its accounting process to

only fund capital projects by development charges as capital expenditures are incurred. This is in comparison from the prior process where capital projects were funded by development charges once Council approved the capital project. As a result of this change in process, a total of \$14.2 million of excess funds from capital projects has been returned to the development charge reserve funds. The second factor is in 2020, wastewater rate stabilization and water rate stabilization reserve funds increased by \$1.6 million from 2019 mainly due to the 2019 year end surplus transferred to the rate stabilization reserve funds in 2020. These rate stabilization reserve funds are within the funding target of 5 to 15% of annual rate revenue requirements, which follows best practices for financial stability.

- **Prior Year Adjustment:** in 2019, an adjustment was made to one particular investment product that the City has held for many years. This investment product was associated with bonds, and therefore the market value varied over time from the book value due to changes in interest rates. Generally, investment products are not adjusted to their market values under Public Sector Accounting Standards (the standards that define how the City records and presents its financial statements) except when there is a sustained impairment. As staff planned to dispose of this investment product in 2020, its value was therefore adjusted down to its market value as of December 31, 2019 reflecting the impairment.

Although the carrying value of the reserve funds increased in 2020 in comparison to the prior year, the return on investment for the reserve fund for 2020 was 2.28%. In comparison, the 2019 return on investment would have been 2.42% had it not been for the prior year adjustment discussed above, which resulted in an actual return on investment of 0.75%.

The return on investment for the general fund for 2020 was 2.09%, compared to 2.72% in 2019.

Additionally, the City's return on its cash holdings was 1.11% in 2020, compared to 2.28% in 2019.

In conclusion, the COVID-19 pandemic has had a negative impact to the City's 2020 investment income as a result of the Bank of Canada cutting its key interest rate and the reduced investment options available to the City.

## **2021 Investment Income Outlook**

The COVID-19 pandemic has had an unprecedented impact to global and local economies. The continuing third wave of the pandemic demonstrates that while vaccination rates are rising and there are positive outlooks ahead, it will take time for the Ontario and the local economy in the Region of Waterloo to rebound fully to pre-pandemic levels.

Per the Bank of Canada's most recent Monetary Policy Report from April 2021<sup>1</sup>, the outlook has improved for both the global and Canadian economies. However, COVID-19 variants are leading to renewed lockdowns, dampening near-term activity. Achieving full recovery will take time, and the impacts of the pandemic remain uneven. Uncertainty remains elevated, particularly around the implications of variants of the virus. The recovery remains highly dependent on the evolution of the pandemic and the pace of vaccinations. The timing is more uncertain than usual, however, given the uncertainty around potential output and the highly uneven impacts of the pandemic. The Bank of Canada lowered its overnight interest rate at an effective lower bound of 0.25% since March 27, 2020, which has been held throughout 2021 to date. The Bank of Canada will hold its overnight interest rate until the inflation target is under control, stable, and predictable. Low, stable and predictable inflation is ideal for the economy as it helps money keep its value, makes it easier to plan future spending, and helps economies expand at a sustainable pace.<sup>2</sup> The Bank of Canada expects that inflation will return to this target some time in the second half of 2022.<sup>3</sup>

The movement in the Bank of Canada's overnight interest rate is a primary driver in the City's investment income performance. The City's investment strategy strives to maximize returns within certain risk tolerances and in accordance with the Municipal Act and related regulations, while ensuring sufficient cash flow to meet operational needs. The investment portfolio includes both short and medium to long-term investments. As these investments mature in today's markets of much lowered interest rates, the City will continue to be unable to find investment products with the same level of returns. Additionally, with decreased cash flow due to loss of revenues, the City may not be in a position to even have any excess cash to invest as products mature.

Furthermore, effective March 23, 2021, the City's bank adjusted the deposit credit interest arrangements on cash accounts held at the bank, causing even further reductions in interest earned on cash. This reduced return on cash holdings has resulted in staff seeking liquid to short-term investment opportunities while considering future cash outflow requirements.

Therefore, while current monitoring and forecasting shows that the City is likely to just barely reach the budgeted amount for investment income in 2021, the impact is anticipated to be felt through to the second half of 2022.

In conclusion, the outlook for investment income is poor for the short to medium term as rates are expected to stay low throughout 2021. Staff continue to monitor the investment portfolio and diversify the holdings where possible in a very difficult/low market. There are very few attractive options for short or long-term investments currently available in the market.

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<sup>1</sup> <https://www.bankofcanada.ca/wp-content/uploads/2021/04/mpr-2021-04-21.pdf>

<sup>2</sup> <https://www.bankofcanada.ca/2020/08/understanding-inflation/>

<sup>3</sup> <https://www.bankofcanada.ca/2021/04/fad-press-release-2021-04-21/>

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## Existing Policy/By-Law

Corporate policy CFO-210.010 reflects the City's statement of investment policies and goals, in accordance with requirements of Ontario Regulation 438/97 of the Municipal Act. The goal of this policy is to invest all available funds of the Corporation in a prudent manner so as to maximize the rate of return while minimizing the degree of risk and ensuring an adequate level of liquidity. In terms of eligible investments, all investment by the municipality will be subject to Section 167 of the Municipal Act and Ontario Regulation 438/97 made under the Municipal Act.

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## Financial Impact

Investment income reduces the amount otherwise required from property taxation and user fees to finance City services, as well as increasing the value of reserve funds used to finance future expenditures. The amount of investment income earned in 2020 was as follows:

- General or tax-supported fund: \$1,645,698
- Reserve fund: \$2,373,923

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## Public Input

Posted publicly as part of the report process.

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## Internal/External Consultation

There was no internal/external consultation undertaken.

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## Conclusion

This report has been prepared in compliance with Ontario Regulation 438/97 of the Municipal Act which requires an investment report to be provided to Council at least annually. Overall, investment income increased year-over-year in 2020 compared to 2019 by \$0.1 million, largely as a result of increased carrying value of reserve fund investments offset by the significant decreases in the Bank of Canada's overnight interest rate in 2020 which is a driver of the City's banking service provider's prime interest rate and investment options available to the City.

Looking ahead into 2021, the outlook for investment income is poor for the short to medium term as rates are expected to stay low throughout the remainder of the year. The economic recovery remains highly dependent on the evolution of the COVID-19 pandemic. The movement in the Bank of Canada's overnight interest rate is a primary driver in the City's investment income performance. The Bank of Canada's overnight interest rate is expected to remain at a low rate of 0.25% until the inflation target is

under control, stable, and predictable, which is anticipated to take place in the second half of 2022. Staff will continue to monitor the investment portfolio and diversify the holdings where possible in a very difficult/low market.

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## Signature

### Division Approval

Reviewed by Legal Services



**Name: Sheryl Ayres**  
**Title: Chief Financial Officer**

### Departmental Approval



**Name: Dave Bush**  
**Title: Deputy City Manager, Corporate Services**

### City Manager Approval



**Name: David Calder**  
**Title: City Manager**

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## Attachments

- Appendix A - City's Investment Portfolio as at December 31, 2020

Issuer	Location Held	Type of Investment	Maturity Date	Purchase Date	Current Interest Rate	Yield	Investment Book Value
<b>General Fund - Short Term Investments</b>							
Meridian	Meridian	Other	Liquid	27-Aug-18	0.900%		5,332,365
Meridian	Meridian	Other	Liquid	26-Feb-19	0.900%		6,329,140
BMO	BMO Commercial	GIC	28-Jan-21	28-Jan-20	2.400%	2.400%	10,000,000
BMO	BMO Commercial	GIC	23-Nov-21	23-Nov-20	0.860%	0.860%	3,400,000
							<b>25,061,505</b>

<b>Reserve Fund - Short Term Investments</b>							
One Fund - High Interest Savings Account	CIBC	HISA	Liquid	16-Jun-20	0.915%		25,105,463
HSBC	CIBC - Wood Gundy	GIC	21-Feb-21	21-Feb-18	2.500%	2.500%	1,000,000
Meridian	Meridian	GIC	10-Mar-21	10-Sep-20	1.130%	1.130%	5,276,540
RBC	Royal Bank	GIC	16-Mar-21	16-Mar-20	1.950%	1.950%	5,000,000
BMO	BMO Commercial	GIC	18-Aug-21	18-Aug-20	1.000%	1.000%	5,103,996
BMO	BMO Commercial	GIC	18-Aug-21	18-Aug-20	1.000%	1.000%	15,105,534
Waterloo Region	Royal Bank	Serial	17-Nov-21	17-Nov-17	2.050%	2.067%	155,899
							<b>56,747,432</b>

<b>General Fund - Long Term Investments</b>							
Meridian	Meridian	GIC	26-Feb-22	26-Feb-20	2.660%	2.660%	10,609,000
							<b>10,609,000</b>

<b>Reserve Fund - Long Term Investments</b>							
HSBC	CIBC - Wood Gundy	GIC	21-Feb-22	21-Feb-18	2.600%	2.600%	1,000,000
CIBC	CIBC - Wood Gundy	GIC	14-Mar-22	13-Mar-20	1.800%	1.800%	5,000,000
BMO	BMO Nesbitt Burns	GIC	25-Jul-22	23-Jul-20	1.000%	1.000%	2,000,000
Waterloo Region	Royal Bank	Serial	17-Nov-22	17-Nov-17	2.200%	2.207%	207,931
CIBC	CIBC - Wood Gundy	GIC	07-Dec-22	07-Dec-20	0.850%	0.850%	500,000
Waterloo Region	Royal Bank	Serial	17-Nov-23	17-Nov-17	2.300%	2.335%	212,585
Waterloo Region	Royal Bank	Serial	17-Nov-24	17-Nov-17	2.400%	2.440%	217,442
BMO	BMO Nesbitt Burns	Step	12-Nov-25	12-Nov-20	1.000%	1.000%	2,098,000
Waterloo Region	Royal Bank	Serial	17-Nov-25	17-Nov-17	2.500%	2.548%	222,231
NFLD Hydro	BMO Nesbitt Burns	Bond	27-Feb-26	22-Feb-17		2.950%	3,384,132
Waterloo Region	Royal Bank	Serial	17-Nov-26	17-Nov-17	2.600%	2.630%	228,453
BMO	BMO Nesbitt Burns	PPN	06-Jan-27	20-Dec-19	5.000%		1,000,000
Waterloo Region	Royal Bank	Serial	17-Nov-27	17-Nov-17	2.700%	2.716%	234,673
Waterloo Region	Royal Bank	Serial	17-Nov-28	17-Nov-17	2.800%	2.811%	288,702
Waterloo Region	Royal Bank	Serial	17-Nov-29	17-Nov-17	2.850%	2.874%	247,400
CIBC	CIBC - Wood Gundy	Step	30-Jul-30	30-Jul-20	1.600%	1.970%	1,000,000
CIBC	CIBC - Wood Gundy	Step	13-Aug-30	12-Aug-20	1.350%	1.580%	1,000,000
CIBC	CIBC - Wood Gundy	Accrual	21-Sep-30	21-Sep-20	1.750%		5,000,000
Waterloo Region	Royal Bank	Serial	17-Nov-30	17-Nov-17	2.900%	2.924%	255,340
CIBC	CIBC - Wood Gundy	Accrual	23-Nov-30	23-Nov-20	1.820%		10,000,000
Waterloo Region	Royal Bank	Serial	17-Nov-31	17-Nov-17	2.950%	2.974%	262,282
Waterloo Region	Royal Bank	Serial	17-Nov-32	17-Nov-17	3.000%	3.024%	270,220
							<b>34,629,390</b>