
HALDIMAND COUNTY

Report FIN-07-2021 Investment Status Report – December 31, 2020

For Consideration by Council in Committee on May 11, 2021



OBJECTIVE:

To provide Council with information regarding the County's investment position, as at December 31, 2020, and to allocate any surplus or deficit exceeding \$100,000 to or from the Investment Income Stabilization Reserve, as well as to report on the Hydro Legacy Fund transactions for 2020, including accrued interest to be applied to that fund.

RECOMMENDATIONS:

1. THAT Report FIN-07-2021 Investment Status Report – December 31, 2020 be received;
2. AND THAT, in accordance with Section 8.0 of the Cash Management and Investments Policy #2001-11, as revised, \$1,834,275.85 of the 2020 investment income deficit be funded from the Investment Income Stabilization Reserve;
3. AND THAT, in accordance with Section 3(b)(i) of the Hydro Legacy Fund Policy #2018-01, the weighted average yield to maturity be set at 4.0% for the purpose of accruing investment interest earnings to the Hydro Legacy Reserve Fund for 2020;
4. AND THAT, in accordance with Section 3(c)(ii) of the Hydro Legacy Fund Policy, \$750,000 be allocated from the Hydro Legacy Reserve Fund to the Growing Communities Reserve.

Prepared by: Heather Love, CPA, CGA, Senior Financial Analyst

Reviewed by: Charmaine Corlis, Treasurer

Respectfully submitted: Mark Merritt, CPA, CA, General Manager of Financial & Data Services

Approved: Craig Manley, MCIP, RPP, Chief Administrative Officer

EXECUTIVE SUMMARY:

The Municipal Act requires that the Treasurer present a report to Council on an annual basis with respect to the performance of the County's investment portfolio, in addition to other specifics as noted below. This report addresses the performance of the County's investment portfolio for the period January 1, 2020 to December 31, 2020. The total unaudited book value of the County's investment portfolio, as at December 31, 2020, is approximately \$195.05 million, which is comprised of \$103.05 million in fixed income investments, and \$92.0 million in growth/equity investments.

The County is required to report the carrying value of its investments (and investment earnings) based on the lower of cost or market, which means any accrued market gains are not reported as income unless the underlying investment is liquidated. "Realized" earnings means actual cash income from the investment which has been deposited with the County. "Market" gains, on the other hand, relate to the growth in the investment portfolio, but the gain has not been received since the investment was not liquidated. The **realized** return on the fixed portion of the portfolio was **2.8%** for 2020, or approximately **\$3.0** million of actual cash interest received by the County, while realized returns on the growth portion

of the portfolio did not occur in 2020 as none of this portfolio reached maturity or was liquidated. The growth market experience gains of 3.52% in 2020, as displayed in Table 2 and compared to Benchmark returns in Chart 2 of this report.

The County's net investment interest income is allocated annually as follows:

- Apportioned to interest bearing reserves (including the Hydro Legacy Reserve Fund as outlined in the Hydro Legacy Policy and described in more detail below);
- Conversely, "funds" in a negative cash position (e.g. Community Vibrancy Fund (CVF) and some Development Charges) are charged "interfund" interest since we are internally borrowing from other "general fund" sources to cover that fund's expenses in advance of receipt of the related deposits;
- The remaining cash interest received in a calendar year is credited to the County's "general fund" and helps to reduce the annual tax levy. As approved in the 2020 Tax Supported Operating Budget, net revenue of \$1.6 million in interest income is allocated to the "general fund" resulting in reduced tax levy requirements of approximately 2.2%. Any annual surplus/deficit in the general fund's realized interest income, greater than \$100,000, is to be funded from the Investment Income Stabilization Reserve as outlined in the County's Cash Management and Investment Policy.

On March 27, 2018, staff presented report CS-GM-02-2018 Hydro Legacy Fund Policy & By-law. Through that report, Council approved that interest be accrued on an annual basis to the Hydro Legacy Reserve Fund based on a weighted average yield to maturity, which would then be reconciled as longer term investments matured or were liquidated. The County's Investment Committee recently met with our CIBC investment manager to determine what the appropriate weighted average yield to maturity would be based on 2020 performance, as well as to set a projection for 2021. As a result of this analysis and discussion, it is proposed that a rate of return of **4.0%** be allocated to the Hydro Legacy Reserve Fund for 2020. Though the portfolio did not perform as well as it has in prior years due to the impacts of the Covid-19 pandemic, the County's investment manager is confident that 4.0% is a realistic average return to maturity (currently projected to 2025). Using the 4.0% earnings figure results in total interest earnings of approximately **\$3.4 million** being allocated to the Hydro Legacy Reserve Fund for 2020 (\$2.4 million in realized income, and \$1.0 million in accrued income). The Investment Income Stabilization Reserve will be used to balance the accrual, as outlined in the Hydro Legacy Fund Policy. This accrual approach will avoid future "windfalls" due solely to timing of investment maturity/liquidation, and will allow utilization of some of the earnings from the Hydro sale proceeds while preserving the principal. The Hydro Legacy Fund started in 2015 with a net divestiture balance of \$72.6 million with substantial growth in the fund since that time due mainly to annual interest allocations less any approved expenditures. The unaudited balance at the end of 2020 is approximately **\$86.6 million**, of which **\$80.6 million** is principal protected/Litigation allowance, and the remaining **\$6 million** is accumulated uncommitted interest earnings (the 2020 Draft Hydro Legacy Fund Statement is included in Attachment 2).

CIBC has a team of advisors which have been managing the majority of the County's investment portfolio since the later part of 2013. This relationship began with the management of the County's bond portfolio, but has grown to involve a more comprehensive and diversified portfolio built upon a relationship of communication and monitoring that is based on CIBC's proven track record in the municipal investment market. Finance staff have regular communication with the CIBC team. The County's investment committee (consisting of the Mayor, Chief Administrative Officer, Chief Financial Officer/General Manager of Financial and Data Services and the Treasurer) meet at least semi-annually with the CIBC team to review the portfolio's performance. In addition, monthly internal investment performance reports are produced for monitoring.

Though the market took a hit in early 2020 as a result of the global pandemic, there was a positive upswing in the last quarter of the year, which has continued in to 2021. A projected weighted average yield to maturity of **4.0%** is being proposed as a target for 2021. This 2021 rate will be what the County uses to benchmark actual performance during 2021. It is anticipated that stronger earnings will continue into 2021 and the County's investment manager is confident that strong yields will return within the next five years. Though the returns may fluctuate significantly over the next couple of years, it is anticipated that an average yield of **4.0%** over the term of the investments is a realistic and obtainable goal.

The County's investment policy and strategy is based on its current cash flow needs and future capital requirements. Any deviations to the current plan (i.e. the addition of projects not included in the current financial plan) could result in the premature liquidation of investments and result in the loss of potential investment income if other avenues are not explored or available (i.e. issuing debt).

BACKGROUND:

Legislated Investment Reporting

As provided for under the Municipal Act, the County can invest funds not required to meet current expenditures in accordance with prescribed restrictions and rules. Intended to preserve and protect the security of these public funds, Provincial regulations restrict the nature and term of eligible investments. These regulations require all municipalities to adopt a policy outlining its investment policies and goals. The County's "Cash Management and Investment Policy" (2001-11, amended in 2016) was enacted to meet the legislative requirements. The County's policy does the following:

- describes the eligible investments and restrictions;
- establishes priority objectives of adherence to the statutory requirements;
- balances liquidity and cash flow needs with a competitive return on the portfolio of investments; and
- delegates the authority of control and management of these investments to the Treasurer, with reporting oversight by senior staff, as well as input and advice from the external investment manager.

The County's Investment Policy, as well as legislation, requires the Treasurer to present an investment report to Council on an annual basis. The investment report is to provide the following information:

- a statement related to the performance of the securities held in the investment portfolio;
- estimated proportion of the total investments of a municipality that are invested in its own long-term and short-term securities to the total investment;
- a statement by the Treasurer as to whether or not, in his or her opinion, all investments are consistent with the investment policies and goals adopted by the County.

Staff also continue to indirectly communicate investment performance to Council on a semi-annual basis through the reporting of investment income in the Tax Supported Operating Budget Variance report and the Tax Supported Operating Budget document.

Furthermore, through CS-FI-08-2016 *RE: Investment Status Report and Investment Policy Update*, Council approved the establishment of an Investment Committee consisting of the Mayor, Chief Administrative Officer, Chief Financial Officer/General Manager of Financial and Data Services and the Treasurer. As per revised Policy No. 2001-11 *Cash Management and Investments*, the Investment Committee is mandated to meet *at least* semi-annually to review performance and obtain advice on future trends from the external investment manager. Finance staff also meet regularly with the investment manager to review trends and projected performance.

The intent of this report is to meet the formal reporting requirements of the County's investment policy, as well as to provide Council with an indication of the market value of the investment portfolio.

It should be noted that legislative amendments have been enacted by the Province that have changed some of the eligible investment regulations as well as provided a framework for a "Prudent Investor" status. These regulations came into effect January 2019, requiring a future report to Council which would outline the changes, a review of best practices, performance, options and any recommended amendments, if any, to the County's current investment policy.

There are also draft regulations coming out in 2021 that will significantly impact the way investments are recorded in the financial statements for municipalities. Staff are actively reviewing and monitoring these proposed changes and will be working with the County's auditor to ensure that the County's financial statements are in compliance with the new regulations once they come into effect. These changes are anticipated to impact the County's financial statements starting in 2022.

Hydro Legacy Reserve Fund

Staff Report CS-GM-02-2018 Hydro Legacy Fund & By-law was presented for Council's consideration on March 27th, 2018. In that report, it was recommended that the interest allocated to the Hydro Legacy Reserve Fund be based on the weighted average yield to maturity, not the realized income as is the practice for other interest bearing reserve fund accounts. As longer term investments mature or are liquidated, a reconciliation process will occur to ensure the interest allocated to the Hydro Legacy Reserve Fund is not materially over or understated due to timing. Based on the analysis of the 2020 returns, a weighted average interest earnings rate of 4.0% is recommended to be allocated to the Hydro Legacy Reserve Fund for 2020, as outlined in further detail below.

ANALYSIS:

Fixed Income Investment Performance – 2020

The fixed income investment earnings, comparing 2020 to 2019, are summarized as follows, and are limited to the County's external investment portfolio so do not include any inter-fund interest allocation (i.e. allocation between operating fund, capital funds or reserve funds):

Table 1 – Realized Fixed Income Performance

Investment Type	2020 Unaudited Realized Income Returns					2019 Audited Realized Income Returns			
	Year End Book Value (million)	Percent of Portfolio	Realized Earnings	Average Yield (%)		Year End Book Value (million)	Percent of Portfolio	Realized Earnings	Average Yield (%)
Fixed Income Investments	\$ 103.05	53%	\$ 2,974,877	2.80%		\$ 101.84	53%	\$ 3,391,984	3.45%

Note 1 – Yields for individual holdings within each category above vary based on the timing of purchase and the maturity date.

Note 2 – Annualized average yield to December 31

Note 3 – All earnings are net of investment fees

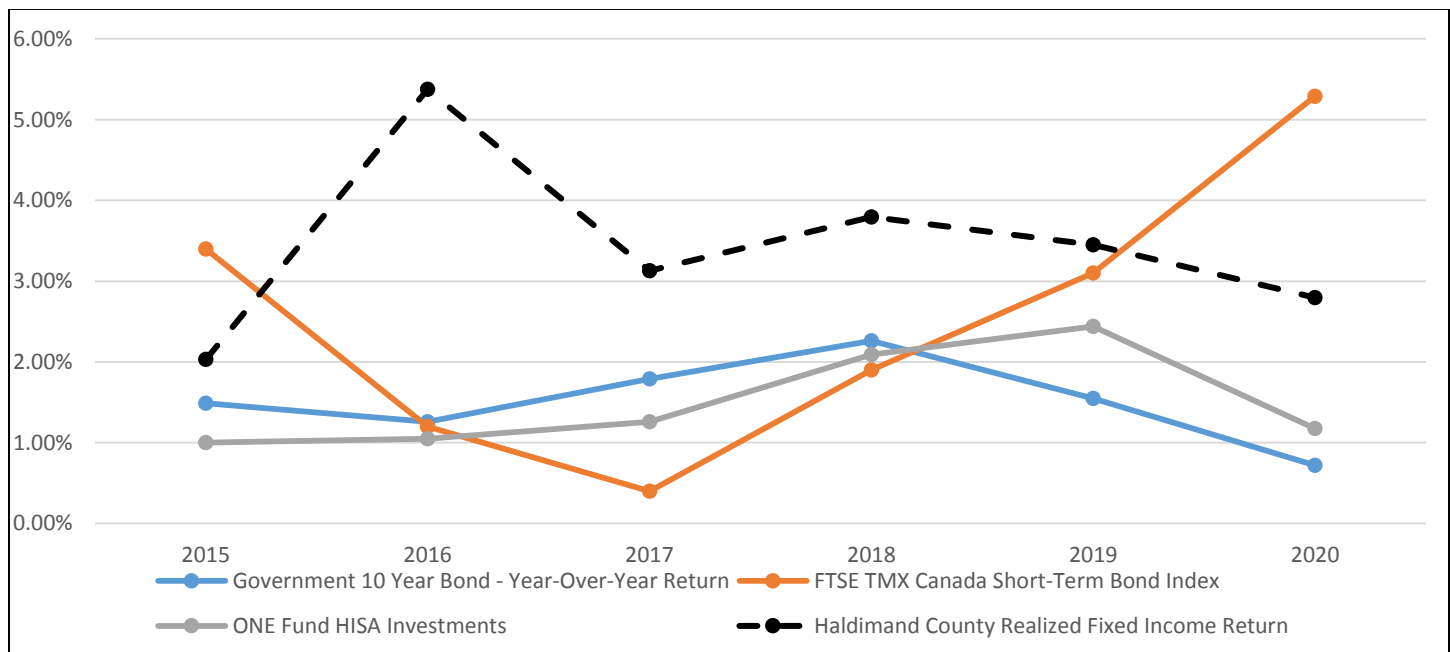
Short term investments included under Fixed Investments include cash. Cash is held under an interest bearing account that provides an interest rate of Monthly Average Prime (MAP) less 1.75% or 2.00% depending on the cash balance.

From Table 1 above, it can be seen that \$103.05 million or 53% of the entire investment portfolio was in fixed income investments in 2020, with actual cash realized earnings of approximately \$3.0 million, or 2.8%. The remainder of the County's \$195.05 million portfolio is held in growth income investments, as outlined in Table 2. It should be noted that the 2020 the average yield of 2.8% was strong, particularly compared to related benchmarks, as discussed below.

Chart 1 below compares the County's actual annual return on the fixed income portfolio to a set of industry benchmarks. These benchmark indices are recommendations from our external investment manager to compare the performance of County's current investment returns to the following: the Government Bond 10 year-over-year average; the Financial Times Stock Exchange (FTSE) TMX Canada Short-Term Bond Index (this index is a broad measure of Canadian one to five year term bonds); and the One Fund High Interest Savings Account (HISA) offered to municipalities as provided under Provincial legislation. As can be seen in the chart below, the FTSE TMX Canada Short-Term Bond Index performed well in 2020, as the result of short term Government bonds yields hitting record lows in the first half of 2020. As the yields on these instruments plummeted the prices of the underlying bonds rose. It should also be noted that historically the ONE Fund HISA offering has been a strong short term performer. However, effective January 1, 2021 the interest rate earnings on this investment dropped drastically to 0.165%. The ONE Fund is currently investigating its options in order to ensure they are providing their customers the best rate they can. The investment committee, along with the County's investment manager, is also reviewing the options available to the County in order to ensure the maximization of the County's short term investments.

The chart below displays that Haldimand's realized investment income continues to out perform most comparable indices in 2020. It should be noted that in 2016 the County realized substantial income from liquidating a strip bond that it held for quite some time), thus resulting in a larger than average yield.

Chart 1 – Realized Fixed Income Performance Compared to Benchmarks



Growth Income Investment Performance – 2020

Growth income performance relates to growth in the value of the investment portfolio, but the gain has not been received since the investment was not liquidated or did not mature. The following table displays the market growth in the County's investment portfolio between December 31, 2019 and December 31, 2020:

Table 2 – Growth Income Investment Performance

Investment Type	2020 - Market Growth					2019 - Market Growth				
	Portfolio Balance (million)	Market Value Balance (million)	Market Growth (million)	Market Return at December 31, 2020	WAYM* Recorded	Portfolio Balance (million)	Market Value Balance (million)	Market Growth (million)	Market Return at December 31, 2019	WAYM** Recorded
Growth/Equity Investments	\$ 92.00	\$ 95.24	\$ 3.24	3.52%	4.00%	\$ 92.00	\$ 105.45	\$ 13.45	14.62%	5.83%

*WAYM=Weighted Average Yield to Maturity

**2019 Market Growth includes sale of PPN that result in \$12.9M return (32.5%)

Table 2 provides details regarding the 2020 and 2019 performance of Growth Income Investment portfolio. The table provides a comparison of Market Growth and the Weighted Average Yield to Maturity (WAYM). The growth portfolio can be affected positively and negatively from market conditions. As you can see above, though the market was significantly impacted by the Covid-19 pandemic, by the end of 2020 the market did experience a modest increase.

The Market Growth above reflects investment value increases as of December 31st. As previously mentioned, a substantial portion of the invested funds will not generate income until maturity or sold, it is important to recognize these changes in value over the life of the investment. Realized and unrealized gains or losses are based on the difference between the cost (book) and market value (current market price) of securities at any point in time.

As per the Hydro Legacy Fund Policy #2018-01, the Weighted Average Yield to Maturity (WAYM) is determined annually, by the Investment Committee, based on advice from the external Investment Manager on the performance to date of the overall investment portfolio and expected future market conditions. Establishing a benchmark rate for the purpose of accruing unrealized earnings for the Hydro Legacy Reserve Fund, will help avoid significant reconciliations in future years.

For 2020, included in Table 2, the Growth Income Investments resulted in a 4.0% WAYM, which will be recorded as a year-end accrual for the Hydro Legacy Reserve Fund. The 2020 projected WAYM benchmark was projected at 4.0%. The Investment Committee reviewed the investment portfolio for the period of 2020-2025, inclusive, and it was determined, with input and expertise from the investment manager, that though the next year or two may be volatile in the market, an overall average yield of 4.0% during the time frame is a realistic and attainable goal. The Investment Income Stabilization Reserve will be utilized to smooth out the fluctuations in the coming years.

It is critical to note that earnings are not realized on the growth market portfolio until the related investment matures or is liquidated. After consultation with our investment manager in 2020, it was determined that there were no opportunities to adjust the investment portfolio. It should be noted, however, that in April 2021 the Investment Committee met with our investment manager and it was determined to be a beneficial time to liquidate a growth principal protected note tied to the S&P/TSX 60 index, with a principal of \$10 million and a maturity date of February, 2022. This liquidation resulted in realized income of approximately \$3 million. The original principal and the realized income were then reinvested in a similar principal protected note. By liquidating this investment, the County was able to realize returns, while maintaining diversification. This sale also allowed the County to minimize the risk of losing any of the upside that may occur should there be a downside in the economy before the liquidation date in 2022. The County, with the input of the investment manager, will continue to monitor the market conditions in 2021 in order to ensure the County is maximizing its returns (in compliance with the Cash Management and Investment Policy).

Chart 2 – Growth Income Investment Performance Compared to Benchmarks

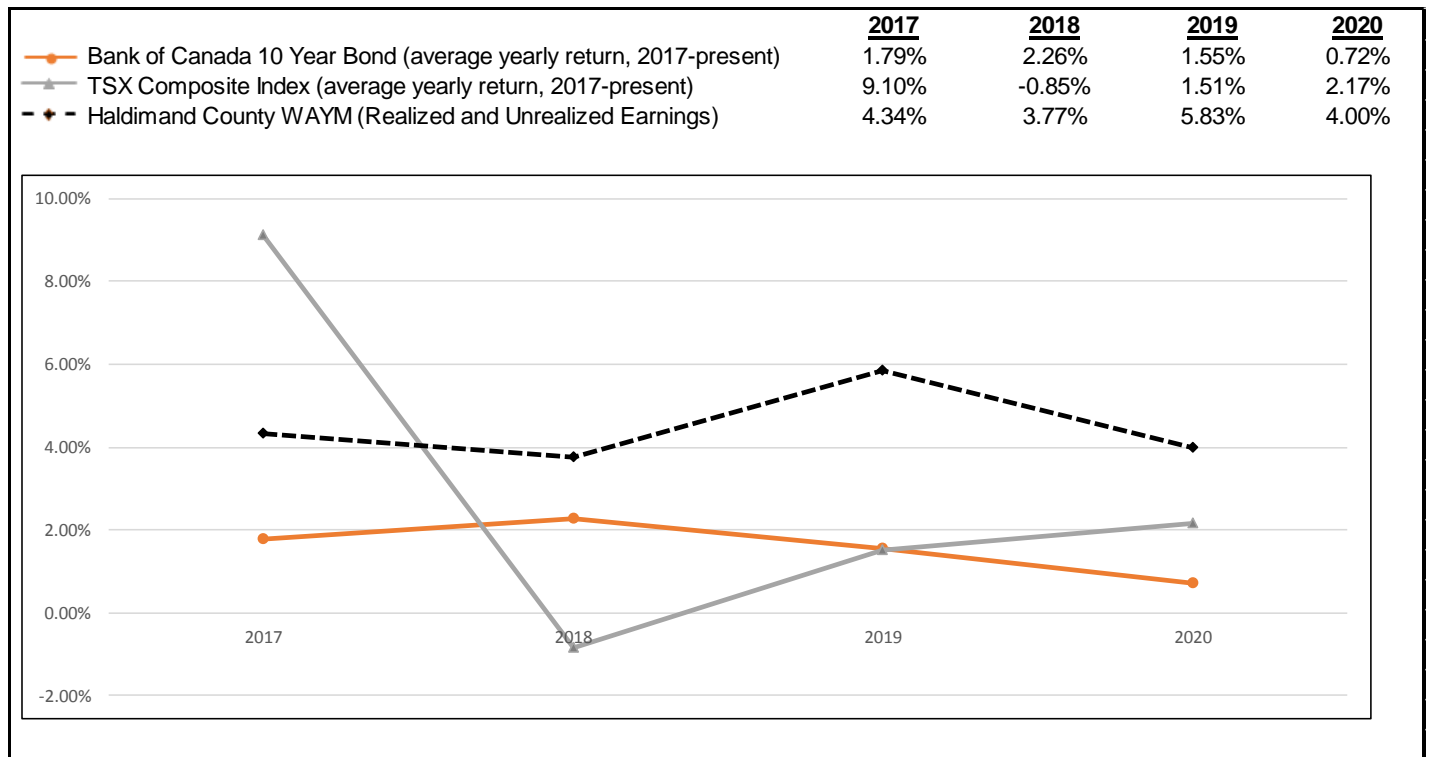


Chart 2 above compares the County's WAYM Growth Income of over the past four years to a set of selected industry benchmarks. These benchmarks were selected based on a review of industry standards and recommendations from our external investment Manager. These indices reflect performance of other available municipal investment options and comparison to a well established stock composite index. The Bank of Canada returns reflect the average yearly return on a 10 year Bank of Canada bond. In prior years performance of the ONE Fund has also been utilized as a benchmark. At the time of this report, the 2020 annual report was not available, and therefore has been omitted from this year's benchmarks. Historically, the ONE Fund has experienced an average return of 4.82% between 2017 and 2019.

External Investment Manager

In late 2013, the County obtained investment management services from CIBC. Given the size of the investment portfolio at the time, as well as the pending increase in available funds from the sale of Haldimand County Hydro, staff determined it was prudent to utilize an external investment management team as the County did not have the in-house resources and expertise to manage such a large investment portfolio. This allowed staff to deal directly with one broker and better manage cash flows and timing of transfers in and out of our investment portfolio.

When the County received the proceeds from the sale of Haldimand Hydro, the available investment portfolio nearly doubled to over \$145 million. This precipitated a review of the County's portfolio mix, eligible investments and use of external fund managers. County staff met with several investment fund managers (current CIBC manager, Association of Municipalities Ontario (AMO)/Local Authority Services (LAS's) One Investment Program, TD Wealth Private Investment, BMO Nesbitt Burns, Raymond James and Meridian Credit Union) to review their product mix offerings and projected market returns. Both CIBC and the One Investment Program made formal presentations to the now formally established "Investment Committee". Based on this review, available products and proposed portfolio mix, it was recommended to continue to utilize CIBC and to move to a more balanced investment mix,

which included making investments into Principal Protected Notes (PPNs) – both Fixed Income and Equity.

The recommended portfolio mix required the current Investment Policy to be updated and approved by Council in the spring of 2016. The main revisions to the County's policy were as follows:

- Authorized Investment Limits/Mix and Individual Issuer Limitations
- Ability to Invest in the *One Investment Program* to allow for investment in Canadian Bonds and Equities
- Provision for establishment of an Investment Income Stabilization Reserve
- Establishment of an internal investment committee, consisting of the Mayor, Chief Administrative Officer, Chief Financial Officer/General Manager of Financial and Data Services and Treasurer
- Requirement to report annual investment returns in comparison to selected benchmarks

When considering the need for a secure, yet attractive return, from the investment of public funds, some of the key features of CIBC deposit notes (PPNS) include:

- Capital Preservation – 100% principal protection at maturity with CIBC issuer guarantee
- Diversification – Can be linked to a variety of asset classes including equities
- Enhanced Income and/or Growth Potential – can be designed to generate minimum guaranteed returns, enhanced income or long-term growth potential
- Asset/Liability Matching – Ensure the availability of sufficient capital to meet future funding obligations over defined time horizons
- Liquidity – Daily secondary market (which could result in a value above or below par if the Deposit Notes are liquidated prior to maturity.)

Some additional factors that led to the selection of CIBC as the portfolio manager were:

- a) CIBC has a track record of investment expertise including:
 - they have the longest running secondary market for Structured Notes in Canada and their secondary market has been open every day since the notes program began, with the exception of September 11, 2001;
 - they issued their first Structured Note in 1994 and have originated more than \$20 billion in notes to date;
 - they were named Canada Derivative House of the Year (the 2014 & 2015 Global Capital Derivatives Awards);
 - #1 in Structure Products Market Share (Brendan Wood International 2015 Investment & Corporate Banking World Watch).
- b) The team at CIBC offers a number of key services that prove them to be the best fit with the County, at this time:
 - Specialization in the development of municipal investment products that are tailored to specific market views and risk tolerances;
 - The ability to invest in principal protected notes (PPNS) that not only improve portfolio diversification, they provide full principal protection at maturity. They may also generate higher potential return than traditional fixed income investments;
 - CIBC Deposit Notes combine key fixed income and equity investments. They rank equal to CIBC bank deposit and qualify as eligible investments under the Municipal Act.

Staff are very satisfied with both the performance to date and the services provided by CIBC. Regular internal reporting and meetings with the external advisors will continue to ensure that the investment portfolio is meeting the County's objectives.

Hydro Legacy Reserve Fund Reporting:

Section 3(e) of the Hydro Legacy Fund Policy #2018-01 outlines the reporting requirements related to the Hydro Legacy Reserve Fund.

Under this section of the Policy, the Treasurer is required to report to Council, at least annually, on the financial position of the Hydro Legacy Fund. This report must:

- Review the investment performance and earnings related to this Fund, including market versus realized gains/losses, as well as a reconciliation of actual to accrued earnings from prior periods;
- Outline the recommended benchmark interest rate for accruing of investment income to this Fund for the coming year;
- Provide an accounting of all transactions, with specific details, affecting this Fund;
- Outline any transactions affecting the litigation allowance (originally set at \$7 million);
- Outline the projected maximum amount of investment earnings that could be considered for use in the upcoming budget, based on the priorities and parameters stipulated in the Policy; and
- Include any other information pertinent to the Hydro Legacy Fund as deemed appropriate.

Section 3(e) also stipulates that Haldimand County's website will contain a section devoted to the Hydro Legacy Fund where the public may access:

- Information regarding the Hydro Legacy Fund Policy;
- Any associated reports, including the above-noted Treasurer's financial reports;
- Notice of projects funded by the Hydro Legacy Fund, with a focus on promotion and awareness of such benefit;
- Public notice of any meeting whereby users of the Hydro Legacy Fund or changes to the Hydro Legacy Fund Policy will be considered; and
- Any other relevant information.

The information noted above will also be publicized through the County's social media network, as well as in local newspapers, and specific signage at capital project locations, as deemed appropriate.

The County's Investment Committee, along with our CIBC investment manager, determined that a proposed rate of return of **4.0%** be allocated to the Hydro Legacy Reserve Fund for 2020. Even though the portfolio did not perform as well as in prior years due to the impacts of the Covid-19 pandemic, the County's investment manager is confident that 4.0% is a realistic average return to maturity (currently projects to 2025). Using the 4.0% earnings figure results in total interest earnings of approximately **\$3.4 million** being allocated to the Hydro Legacy Reserve Fund for 2020 (\$2.4 million in realized income, and \$1.0 million in accrued income). The Investment Income Stabilization Reserve will be used to balance the accrual, as outlined in the Hydro Legacy Fund Policy. The unaudited balance at the end of 2020 is approximately **\$86.6 million**, of which **\$80.6 million** is principal protected/Litigation allowance, and the remaining **\$6 million** is uncommitted interest earning (the 2020 Draft Hydro Legacy Fund Statement is included in Attachment 2).

FINANCIAL/LEGAL IMPLICATIONS:

As noted in Table 1, actual cash investment earnings realized in 2020 amounted to **\$2,974,877** (unaudited.) The allocation of this cash income is as follows:

Interest bearing reserve funds (excluding Hydro Legacy Reserve Fund)	\$ 1.54 million
Hydro Legacy Reserve Fund interest (earned)	\$ 2.35 million
Interest expense charged on Community Vibrancy Fund timing deficit	\$ (0.55 million)
Miscellaneous interest expense	\$(0.04 million)
General Tax Supported Interest Income (remaining balance)	\$(0.33 million)

It should be noted that, although some of the Reserve Funds are in negative balances (i.e. internally borrowed from other sources), the internal interest rate achieved is greater than interest earnings that could have been achieved from available benchmark investment options. In fact, in most cases, the interest returns exceed the underlying borrowing rates if the County had borrowed the funds externally.

Some of the significant factors affecting the above include:

- Strong results in the County's fixed income portfolio
- The allocation of interest earnings to various interest-bearing reserve funds

It should be noted that historically the interest rate allocated to interest-bearing reserve funds has been equivalent to the average yield of the County's investment portfolio for the year. Starting in 2019, however, it was determined that a more appropriate approach is to use the lower of the average fixed income return for the year, or the weighted average yield to maturity. This allows for a more fair and equitable distribution of interest earnings and smooths out the allocation in years when there is no realized growth income.

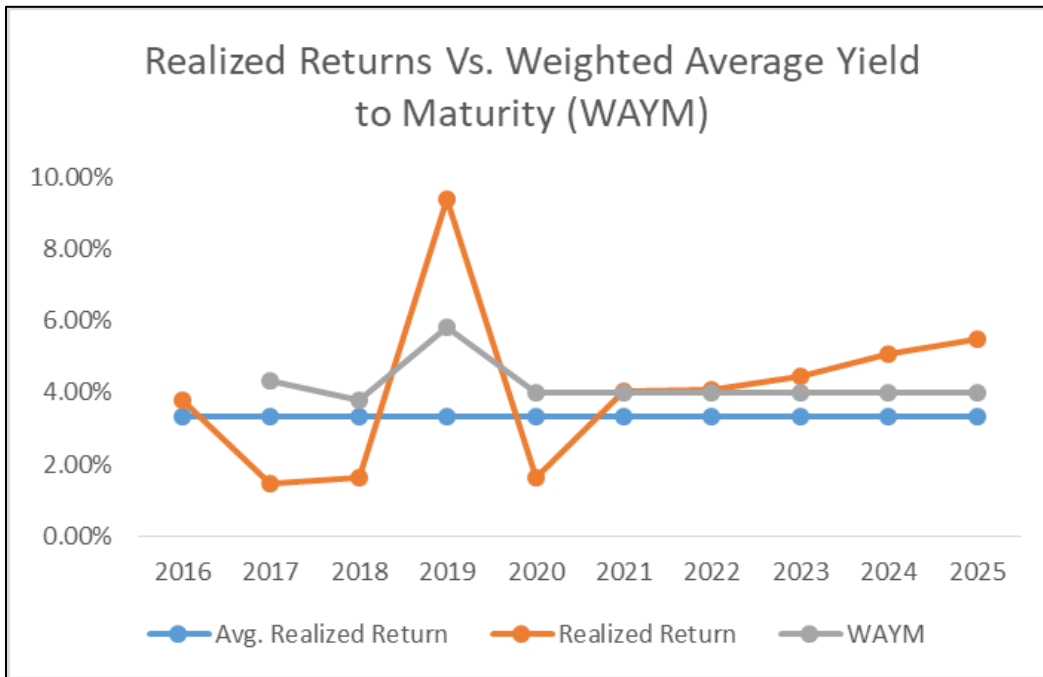
An amendment was also made to the County's debt financing principles in 2020. Historically the issuance of debentures did not occur until a project reached substantial completion. Going forward, debt will be issued upon tendering of construction. As a result, projects will no longer be subject to internal financing charges. This change in process will be discussed further in the 2021 debt issuance report, which is planned for June CIC.

The County's investment policy and strategy is based on its current cash flow and future capital requirements. Any deviations to the current plan (i.e. the addition of projects not included in the current financial plan) could result in the premature liquidation of investments and result in the loss of potential investment income if other avenues are not explored or available (i.e. issuing debt).

Historical Investment Returns

The investment committee has set a target return of 4.00% for the investment portfolio. As can be seen below, the actual returns achieved annually vary greatly. As returns are only realized when they are earned, the growth income returns are not realized until the underlying investment matures or is liquidated. Chart 3 below displays the County's historical realized returns compared to the weighted average yield to maturity as well as the projected returns to 2025.

Chart 3 – Investment Fluctuations



General Tax Supported Interest Income

The 2020 interest income related to the County's general fund (unallocated) was budgeted at \$1,600,000 (including inter-funding). After funds are allocated to the applicable sources as noted above (i.e. interest bearing reserve funds, unfinanced capital, etc.), an overall projected deficit of \$1,934,276 remains.

The Investment Policy requires variances in investment earnings, greater than \$100,000, to be transferred to or from the Investment Income Stabilization Reserve. Therefore a transfer of approximately \$1,834,276 will be made in 2020 to fund the investment income deficit in 2020. The purpose of this reserve is to mitigate the impact of annual fluctuations in investment returns, particularly due to the timing of liquidating the growth/equity investments. The summary of impacts on the Investment Income Stabilization Reserve are included in the chart below.

There are a number of factors that come in to play when analyzing the performance on the County's investment portfolio. These factors include:

- **liquidation**: In order for the County to meet its short term cash obligations, a critical characteristic of the investment portfolio is the existence of liquidity. This limits the County's ability to invest more of its portfolio in longer term, higher yielding instruments;
- **market conditions**: Similar to all investors, the County's investment portfolio may be affected, either positively or negatively, by the market conditions at any given point in time;
- **timing**: An important aspect to take into account when examining the performance of the County's investment portfolio is timing. Given the magnitude of the portfolio, particularly since the sale of Haldimand County Hydro, the County relies heavily on its external investment manager, CIBC, to keep abreast of the market conditions. County staff are in regular contact with the external investment manager and the County's Investment Committee meets with CIBC to ensure the County's resources are being managed effectively and that the portfolio is achieving the best returns possible.

Hydro Investment Earnings

Through CS-GM-02-2018, Council approved the Hydro Legacy Fund Policy. Contained in this Policy is the requirement for market earnings to be accrued to the Hydro Legacy Reserve Fund based on an average weighted yield to maturity, starting in 2017.

The annual market yield to be accrued to the Hydro Legacy Reserve Fund is to be determined by the Investment Committee, with advice from the external investment manager. Based on these requirements, the Investment Committee met with the external investment manager and determined that a weighted average yield to maturity of **4.0%** should be accrued to the Hydro Legacy Reserve Fund for 2020. This results in a total interest allocation of \$3,359,109 for 2020 – of which \$2,351,376 is Hydro's share of the realized fixed income and \$1,007,733 is to be accrued and later reconciled as the related growth income matures or is liquidated (as per the terms of the Hydro Legacy Fund Policy). The unaudited balance of the Hydro Legacy Reserve Fund is approximately **\$87 million** - of which **\$81 million** is principal protected/Litigation allowance, and **\$6 million** is uncommitted interest earnings. The 2020 draft Hydro Legacy Fund Statement can be found in Attachment 2.

The accrued income allocated to this Fund will be offset by the Investment Income Stabilization Reserve as per the Hydro Legacy Fund Policy. As per the policy, it can be expected that there will be a difference between the accrued and realized gains and accrued market growth on these investments from the initial purchase which will be recognized in future years when these investments are either liquidated or they mature - the recording of which will be part of the annual interest reconciliation process.

Investment Income Stabilization Reserve

Currently, the Investment Income Stabilization Reserve is utilized for two key functions: to smooth out any annual surplus/deficit in the realized investment income in excess of +/- \$100,000, and to allow for the allocation of accrued interest to the Hydro Legacy Reserve Fund, which is then reconciled as longer-term income is realized, as per the terms of the Hydro Legacy Fund Policy.

As at December 31, 2019, there was a positive balance in the Investment Income Stabilization Reserve of \$5,559,712. Based on the information presented within this report, the estimated balance of this reserve at December 31, 2020 is anticipated to be approximately \$2,717,703 as outlined below:

Table 3 - 2020 Unaudited Investment Income Stabilization Reserve Balance

Opening balance, January 1, 2020	<u>\$5,559,712</u>
Less: Operating Investment income deficit in excess of \$100,000	(\$1,834,276)
Less: Accrued income allocated to Hydro Legacy Fund	(\$1,007,733)
<u>Ending Balance, December 31, 2020</u>	<u>\$2,717,703</u>

Under the terms of the Hydro Legacy Fund Policy, as the County's longer term investments mature or are liquidated, the annual accruals associated with the Hydro Legacy Fund are to be reviewed and reconciled. It is anticipated that over the near future (based on current analysis to 2025), that the Investment Income Stabilization Reserve will maintain a positive balance over this time period. Staff will continue to work closely with the County's investment manager to ensure that the County is earning the best returns possible, while still complying with other requirements of the Cash Management and Investment Policy (i.e. preservation of principle, maintenance of liquidity, etc.).

Growing Communities Fund

Council approved a maximum annual transfer of \$750,000 from the Hydro Legacy Fund's investment earnings to the Growing Communities Fund, conditional on being compliant with Section 3(c) (ii) of the Hydro Legacy Fund Policy, which states that any contributed amount towards the cost of major assets/infrastructure that benefit Haldimand County cannot exceed 60% of the year's net investment earnings (realized and unrealized), after deducting the sum first needed for inflation/annual indexing protection.

After deducting the interest allocated to the annual indexing of the principal balance, totaling \$1.6 million, the amount eligible to be transferred to the Growing Communities fund for 2020 is \$750,000. The 2020 unaudited balance of this reserve fund is approximately \$1.5 million.

STAKEHOLDER IMPACTS:

Not applicable.

REPORT IMPACTS:

Agreement: No

By-law: No

Budget Amendment: No

Policy: No

ATTACHMENTS:

1. Summary of Investment Holdings as of December 31, 2020
2. Draft Hydro Legacy Reserve Fund Statement