

**Municipality of Chatham-Kent**  
**Finance, Budget and Information Technology Services**  
**Information Report**

**To:** Mayor and Members of Council  
**From:** Matt Torrance, MBA, CPA, CGA  
Director, Financial Services  
**Date:** April 28, 2020  
**Subject:** 2019 Annual Investment Report

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This report is for the information of Council.

**Background**

In October of 2015, Chatham-Kent instituted an investment policy with the following four primary objectives, in priority order:

1. Adherence to statutory requirements
2. Preservation of capital
3. Maintenance of liquidity
4. Competitive rate of return

**Adherence to Statutory Requirements**

All investment activities shall be governed by the Ontario Municipal Act, 2001 as amended. Investments, unless further limited by Council, shall be those eligible under Ontario Regulation 438/97 or as authorized by subsequent provincial regulations.

**Preservation of Capital (Minimization of Credit Risk)**

Meeting this objective requires the adoption of a defensive policy to minimize the risk of incurring a capital loss and of preserving the value of the invested principal. As such, this risk shall be mitigated by investing in properly rated financial instruments in accordance with applicable legislation, by limiting the types of investments to a maximum percentage of the total portfolio and being mindful of the amount invested within individual institutions.

**Maintenance of Liquidity**

The investment portfolio shall remain sufficiently liquid to meet daily operating cash flow requirements and limit temporary borrowing. The portfolio shall be structured to maintain a proportionate ratio of short, medium and long-term maturities to meet the funding requirements of the Municipality. The term 'liquidity' implies a high degree of marketability and a high level of price stability. Important liquidity considerations are a reliable forecast of the timing of the requirement of funds, a contingency to cover the possibility of unplanned requirement of funds, and an expectation of reliable secondary marketability prior to maturity.

### Competitive Rate of Return (Overall Yield)

Investment yields shall be sought within the boundaries set by the three foregoing objectives, and then consideration shall be given to the following guidance:

- Higher yields are best obtained by taking advantage of the interest rate curve of the capital market, which normally yields higher rates of return for longer term investments;
- Yields will also fluctuate by institution as per individual credit ratings (greater risk confirmed by a lower credit rating) and by the type of capital instrument. For example, an instrument of a small trust company would in many cases have a slightly higher yield than a major bank;
- A lower credit rating generally makes an investment more difficult to sell on the secondary market and therefore less liquid; and
- Capital instruments that are non-callable will have a lower yield than instruments which are callable, but the call feature does not necessarily compromise marketability.

Based upon this policy, in 2018 Chatham-Kent invested \$30 million of reserves into eligible investments under *Ontario Regulation 438/97*. In 2019, four deposit notes with a book value totalling \$13,000,000 were sold for \$13,970,377, recognizing a realized gain of \$970,377. This gain was immediately reinvested, increasing the book value of Chatham-Kent's investment portfolio to \$30.97 million. Subsequently, in early 2020 another fund with a book value of \$4,000,000 was sold for \$4,241,200, recognizing a realized gain of \$241,200. In addition to the realized gain, Chatham-Kent invested another \$8 million from its reserves, bringing the total book value of Chatham-Kent's investments to \$39.2 million.

### **Comments and Financial Implications**

#### **Portfolio Balance**

In 2019, the Municipality of Chatham-Kent retained a year ending investment portfolio balance of \$202 million (\$179 million in 2018), consisting of cash and investments in deposit notes prescribed under *Ontario Regulation 438/97*. As at December 31, 2019, the Municipality's investment portfolio included eight deposit notes and a high interest account with CIBC, where the Municipality receives interest income on its deposits.

A summary of the Municipality's investment portfolio at year-end and at April 27, 2020 is shown below.

#### **Investment Income**

For the purposes of this report, investment income includes interest income and realized gains and losses. In 2019, the Municipality earned a total income of approximately \$4.7 million (\$3.2 million in 2018) from investments of which \$3.7 million (\$3.2 million in 2018) was earned from cash investments in our high interest bearing bank account and \$1.0 million (\$0 million in 2018) from realized gains on the sale of investments.

The interest income represents 79 percent of Chatham-Kent's investment income in 2019. This income is earned on Chatham-Kent's bank balances with CIBC. The interest rate on

this account is variable and is dependent on the prime lending rate of the chartered banks less 1.45%. In 2019, the prime lending rate peaked at 3.95% so Chatham-Kent would have received 2.5% interest on all account balances. In 2020, the Bank of Canada has responded to the COVID-19 emergency by reducing lending rates as a means to stimulate the economy. As a result, the prime lending rate offered by banks has been reduced to 2.45%. The interest rate currently earned on Chatham-Kent's bank balances has been reduced from 2.5% to 1.0%. Chatham-Kent is forecasting interest income to be \$2.2 million for 2020 which is \$1.5 million less than 2019. The 2020 Base Budget for interest income is \$2.8 million which would result in a \$0.6 million negative variance.

### Market Summary for 2019

The Bank of Canada held its overnight target rate at 1.75% throughout 2019. Although it was filled with dramatic news events, 2019 was a great year for investors with the S&P/TSX Composite and S&P 500 Total Return Indices rallying roughly 23% and 31%. With global central banks suddenly turning very dovish to support business activity to progress in trade deals, many of the macro factors impacting markets last year were expected to continue into 2020.

Similar to the Bank of Canada overnight rate, the chartered banks held their prime rate at 3.95% throughout the year. Chatham-Kent receives the CKLAG (Chatham Kent Lambton Administrators Group) rate of prime less 1.45% in its general banking account. The increased investment income for 2019 was related to increased amounts available in the bank account and the increase in interest rates, relating to higher yields.

### Investment Strategy

As directed by the Municipality's Investment Policy, the Municipality's overall investment strategy is to invest public funds in a manner that prioritizes security and liquidity of principal over attaining higher investment returns. The investment strategy in 2018 and 2019 was focused on building a balanced and diversified portfolio relative to short-term, medium-term and long-term investment instruments.

Below is a comparison of the Municipality's portfolio as of December 31, 2019 to the policy targets.

Classification	Maturing In	2019	Policy Limits
Cash & Short-term	Less than 1 year	84.6%	Balance
Medium-term	1 – 5 years	6.9%	25%
Long-term	More than 5 years	8.4%	25%

CIBC Wood Gundy manages the Municipality's external portfolio. The management of this portfolio allows the Municipality to benefit from the services provided by sophisticated investment teams, which includes frequent monitoring and trading, diversifying funds, and

anticipating interest rate changes. \$30 million was purchased in the externally managed portfolio in 2018. An additional \$970,377 was invested in 2019 by selling and recognizing the gains on one of the investment funds and immediately reinvesting the funds.

## **Performance of Portfolio Investments**

### Cash & Short-Term

In 2019, the Municipality had an ending cash and short-term balance of \$171 million. The average yield on the Municipality's cash and investments with a maturity of less than 1 year was 2.5%. The cash & short-term target is at least 50% and aims to accommodate cash fluctuations during the year related to the timing and collection of property taxes along with disbursements for expenditures. Chatham-Kent is in the early stages of establishing a balanced and diversified portfolio and may move closer to 50% over time.

### Medium-Term

In 2019, the Municipality's medium-term investment portfolio had an ending balance of \$14 million, all externally managed. There was no realized yield on the investments as the maturity dates on the medium-term deposit notes are from Sept 2022 to Sept 2024. The long-term strategy would be to roll over investments, to have deposit notes maturing each year to help diversify our investments and maximize our returns, while maintaining security and liquidity.

The medium-term investments have no realized value until maturity date, however we are showing the current unrealized value, based upon a point in time (December 31, 2019 and April 27, 2020) to report performance to date.

Both the medium and long-term investments are principal protected notes, meaning that no matter what the value is at maturity, the notes have a minimum value of their investment amount. This is adhering to our second principle in our policy, security of capital. These combine key investment characteristics of both stocks and bonds, without the risk side of the investment. The original investment is 100% protected if the PPNs are held to maturity.

Table of current values at December 31, 2019 and April 27, 2020 are below.

### Long-Term

In 2018, the Municipality's long-term investment portfolio had an ending balance of \$17 million all externally managed. There was no realized yield on the investments as the maturity dates on the long term deposit notes are from Sept 2025 to Oct 2026. The long-term strategy would be to roll over investments, to have deposit notes maturing each year to help diversify the Municipality's investments and maximize the returns, while maintaining security and liquidity.

Table of current values at December 31, 2019 and April 27, 2020 are below.

*December 31, 2019*

Note	Book Value	Maturity Date	Underlying Performance	Participation Rate	Current Unrealized Value
CIBC Volatility Control Cross Asset Momentum Index	\$ 6,000,000.00	7-Sep-22	-10.63%	95%	\$ 6,000,000.00
CIBC Canadian Banks Index	\$ 4,000,000.00	7-Sep-23	-4.29%	105%	\$ 4,000,000.00
CIBC European Index	\$ 4,000,000.00	9-Sep-24	14.58%	115%	\$ 4,670,800.00
CIBC US Financial Growth Index	\$ 3,000,000.00	8-Sep-25	9.56%	50%	\$ 3,143,400.00
CIBC Canadian Utilities Index	\$ 2,893,750.00	23-Sep-26	1.88%	115%	\$ 2,956,255.00
CIBC Canadian Infrastructure Growth Index	\$ 2,665,000.00	23-Sep-26	-0.14%	115%	\$ 2,665,000.00
CIBC Global Blue Chip Growth Index	\$ 4,211,627.00	15-Oct-25	1.96%	150%	\$ 4,335,448.83
CIBC Canadian Large Cap Select Index Growth	\$ 4,200,000.00	15-Oct-24	2.86%	105%	\$ 4,326,000.00
<b>Totals / Weighted Average</b>	<b>\$ 30,970,377.00</b>				<b>\$ 32,096,903.83</b>

*April 27, 2020*

Note	Book Value	Maturity Date	Underlying Performance	Participation Rate	Current Unrealized Value
CIBC Volatility Control Cross Asset Momentum Index	\$ 6,000,000.00	7-Sep-22	-22.34%	95%	\$ 6,000,000.00
CIBC Canadian Banks Index	\$ 4,000,000.00	7-Sep-23	-26.22%	105%	\$ 4,000,000.00
CIBC US Financial Growth Index	\$ 3,000,000.00	8-Sep-25	-28.66%	50%	\$ 3,000,000.00
CIBC Canadian Utilities Index	\$ 2,893,750.00	23-Sep-26	-0.09%	115%	\$ 2,893,750.00
CIBC Canadian Infrastructure Growth Index	\$ 2,665,000.00	23-Sep-26	-29.12%	115%	\$ 2,665,000.00
CIBC Global Blue Chip Growth Index	\$ 4,211,627.00	15-Oct-25	-15.73%	150%	\$ 4,211,627.00
CIBC Canadian Large Cap Select Index Growth	\$ 4,200,000.00	15-Oct-24	-12.48%	105%	\$ 4,200,000.00
CIBC Blue Chip Growth Index	\$ 4,000,000.00	27-Mar-26	7.94%	230%	\$ 4,730,480.00
CIBC Canadian Blue Chip Autocallable	\$ 4,241,400.00	11-Mar-27	-10.68%	5% Autocallable	\$ 4,241,400.00
CIBC Global Blue Chip Growth Index (USD) *	\$ 4,003,500.00	15-Mar-27	0.37%	110%	\$ 4,226,130.63
<b>Totals / Weighted Average</b>	<b>\$ 39,215,277.00</b>				<b>\$ 40,168,387.63</b>

\* funds are converted to CAD from USD at a rate of 1.3345 at time of purchase and 1.403 as of April 27/20

**Eligible Investments (Statement of Compliance)**

The Act stipulates that a municipality may invest in securities prescribed under *Ontario Regulation 438/97*. All investments meet the eligibility requirements as prescribed by *Ontario Regulation 438/97* and were made in accordance with the investment policies and

goals adopted by the Municipality.

### **Investment in Own-Securities**

*Ontario Regulation 438/97* requires that the municipality report the estimated proportion of total investments that are invested in its own long-term and short-term securities to the total investments held by the municipality. In 2019, the Municipality did not hold or purchase any of its own securities, reflecting no change in proportion of own securities to total investments from the previous year.

### **Looking Ahead**

As little as a few months ago we would have expected continued growth in the markets. Unfortunately the economic impacts of the COVID-19 emergency have changed that dramatically. Policy makers around the world have coordinated strong and aggressive monetary and fiscal policy to support business. Growth in the near term is expected to be weak, and medium to long-term government bond yields may remain low for some time. The path to recovery from the outbreak will take time and could also cause longer term changes in behavior. This in turn could create new opportunities in the technology sector that could be taken advantage of.

As directed by the Municipality's Investment Policy, the Municipality's overall investment strategy will continue to focus on maximizing investment returns in a manner that first prioritizes security and liquidity. The 2020 strategy will focus on managing the Municipality's portfolio to the Municipality's policy term targets.

### **Conclusion**

During 2019 we saw nice progress in the unrealized value of the notes and were also able to take advantage of the realized growth of \$970,377. These gains were locked in and reinvested in new diversified notes with improved participation rates, therefore strengthening the portfolio further going forward. Overall gain in realized and unrealized value increased by 6.98% in 2019.

We will continue to monitor cash balances, cash requirements, global economy and monitor trends in investment policies to ensure we are providing the Municipality with the best opportunity for maximizing returns, while maintaining secure and compliant investments.

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