

Municipality of Chatham-Kent
Finance, Budget, Information Technology & Transformation
Information Report

To: Mayor and Members of Council
From: Matt Torrance, MBA, CPA, CGA
Director, Financial Services
Date: March 30, 2021
Subject: 2020 Annual Investment Report

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, Chatham-Kent had investments with a book value totalling \$39.2 million at the end of 2019. In 2020, one equity backed note with a book value of \$4,000,000 was sold for \$4,241,200 realizing a gain on investment of \$241,200. Also in 2020, a 6 month Guaranteed Investment Certificate was purchased and sold for \$25,000,000 recognizing \$178,767 in interest income.

Over the course of 2020, Chatham-Kent invested an additional \$22 million in cash and re-invested the \$4.24 million from the sale of an investment. \$16.24 million was invested in principally protected equity backed notes and \$10 million was invested in fixed income notes. \$33,306 in interest was earned on the fixed income notes in 2020. As of December 31, 2020 Chatham-Kent's investments have a total book value of \$54.2 million and a market value of \$56.8 million.

Comments and Financial Implications

Portfolio Balance

In 2020, Chatham-Kent retained a year ending investment portfolio balance of \$240 million (\$202 million in 2019), consisting of cash and investments in deposit notes prescribed under *Ontario Regulation 438/97*. As at December 31, 2020, Chatham-Kent's investment portfolio included 12 equity backed deposit notes, 2 fixed income notes and a high interest account with CIBC, where the Municipality receives interest income on its deposits.

A summary of Chatham-Kent's investment holdings and activities for 2020 is highlighted in the tables below:

Principal Protected Equity Backed Notes Held Greater Than 1 Year						
Name	Maturity	Participation Rate	Book Value	Market Value as of Dec 31, 2019	Market Value as of Dec 31, 2020	2020 Unrealized Gain / Loss
CIBC Volatility Control Cross Asset Momentum Index Deposit Notes Due September 7, 2022	07-Sep-22	95%	\$ 6,000,000.00	\$ 6,000,000.00	\$ 6,000,000.00	\$ -
CIBC Canadian Banks Index Growth Deposit Notes due September 7, 2023	07-Sep-23	105%	\$ 4,000,000.00	\$ 4,000,000.00	\$ 4,000,000.00	\$ -
CIBC U.S. Financials Growth Deposit Notes due September 8, 2025	08-Sep-25	50%	\$ 3,000,000.00	\$ 3,143,400.00	\$ 3,000,000.00	\$ (143,400.00)
CIBC Canadian Utilities Index Growth Deposit Notes Due September, 2026	23-Sep-26	115%	\$ 2,893,750.00	\$ 2,956,255.00	\$ 3,324,036.16	\$ 367,781.16
CIBC Canadian Infrastructure Growth Deposit Notes Due September 23 2026	23-Sep-26	115%	\$ 2,665,000.00	\$ 2,665,000.00	\$ 2,665,000.00	\$ -
CIBC Global Blue Chip Growth Deposit Notes Due October 15 2025	15-Oct-25	150%	\$ 4,211,627.00	\$ 4,335,448.00	\$ 4,211,627.00	\$ (123,821.00)
CIBC Canadian Large Cap Select Index Growth Deposit Notes Due October 15 2024	15-Oct-24	105%	\$ 4,200,000.00	\$ 4,326,000.00	\$ 4,200,000.00	\$ (126,000.00)
TOTAL			\$ 26,970,377.00	\$ 27,426,103.00	\$ 27,400,663.16	\$ (25,439.84)

Principal Protected Equity Backed Notes Purchased in 2020						
Name	Maturity	Participation Rate	Book Value	Market Value as of Dec 31, 2019	Market Value as of Dec 31, 2020	2020 Unrealized Gain / Loss
CIBC Canadian Blue Chip Growth Deposit Notes Due March 27 2026 (Series 79)	27-Mar-26	230%	\$ 4,000,000.00		\$ 5,545,600.00	\$ 1,545,600.00
CIBC Canadian Blue Chip Autocallable Deposit Notes Due March 11 2027 (Series 15)	11-Mar-27	5% Autocallable	\$ 4,241,400.00		\$ 4,453,470.00	\$ 212,070.00
CIBC Global Blue Chip Growth Deposit Notes Due March 15 2027 (Series 8) (USD) *	15-Mar-27	110%	\$ 4,003,500.00		\$ 4,277,737.44	\$ 274,237.44
CIBC Global Blue Chip Growth Deposit Notes, Series 9	31-Jul-26	70%	\$ 2,000,000.00		\$ 2,000,000.00	\$ -
CIBC Canadian Insurance Index (AR) Autocallable Coupon Deposit Notes, Series 1	20-Oct-27	2.54% yield	\$ 3,000,000.00		\$ 3,152,400.00	\$ 152,400.00
TOTAL			\$ 17,244,900.00	\$ -	\$ 19,429,207.44	\$ 2,184,307.44

* notes were purchased at an exchange rate of 1.3345 and the exchange rate as of Dec 31, 2020 was 1.2735

Fixed Income Notes Purchased in 2020						
Name	Maturity	Coupon Rate	Book Value	Market Value as of Dec 31, 2019	Market Value as of Dec 31, 2020	2020 Accrued Interest Earnings
CIBC Fixed Income 2025	06-Nov-25	2.17%	\$ 5,000,000.00	\$ -	\$ 4,975,000.00	\$ 16,729.17
CIBC Fixed Income 2027	06-Nov-27	1.87%	\$ 5,000,000.00	\$ -	\$ 4,965,000.00	\$ 16,576.39
CIBC GIC	28-Oct-20	1.45%	\$ 25,000,000.00	\$ -	\$ -	\$ -
TOTAL			\$ 35,000,000.00	\$ -	\$ 9,940,000.00	\$ 33,305.56

Principal Protected Equity Backed Notes Sold in 2020						
Name	Maturity	Participation Rate	Book Value	Market Value as of Dec 31, 2019	Market Value as of Feb 19, 2020	2020 Realized Gain on Investment
CIBC European Index Growth Deposit Notes Due September 9, 2024	09-Sep-24	115%	\$ 4,000,000.00	\$ 4,698,400.00	\$ 4,241,200.00	\$ 241,200.00

Fixed Income Notes Sold in 2020						
Name	Maturity	Participation Rate	Book Value	Market Value as of Dec 31, 2019	Market Value as of Oct 28, 2020	2020 Interest Earnings
CIBC GIC	28-Oct-20	100%	\$ 25,000,000.00		\$ 25,000,000.00	\$ 178,767.12

Investment Income

For the purpose of this report, investment income includes interest income and realized gains and losses. In 2020, the Municipality earned a total income of approximately \$2.9 million (\$4.7 million in 2019) from investments of which \$2.4 million (\$3.7 million in 2019) was earned from cash investments in our high interest bearing bank account, \$178,767 (\$0 in 2019) in interest on a 6 month GIC, \$33,305 (\$0 in 2019) in interest on fixed income notes and \$241,200 (\$1.0 million in 2019) from realized gains on the sale of investments.

Summary of Investment Income	
Interest on Bank Deposits	2,411,386
Interest on GIC	178,767
Interest on Fixed Income	33,306
Realized Gains on Sale of Investments	241,200
	2,864,659

The interest income on bank deposits represents 84 percent of Chatham-Kent's investment income in 2020. 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 2020, the prime lending rate peaked at 3.95% so Chatham-Kent would have received 2.5% interest on all account balances up to March 2020. In March 2020, the Bank of Canada 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% which has had a significant effect on interest revenue.

Market Summary for 2020

Although it was filled with dramatic news events, 2020 was a great year for investors with the S&P/TSX Composite and S&P 500 Total Return Indices rallying to increased levels after the Covid-19 downfall. 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 2021.

In reaction to the COVID-19 pandemic, the Bank of Canada lowered its overnight target rate three times in March 2020 from 1.75% to 0.25%. The Bank of Canada has held this rate through 2020 and to date in 2021. Similar to the Bank of Canada overnight rate, the chartered banks reduced their prime rate from 3.95% in early 2020 to 2.45% through the balance of 2020. Chatham-Kent receives the CKLAG (Chatham Kent Lambton Administrators Group) rate of prime less 1.45% in its general banking account. This drop in interest rates had a significant effect in Chatham-Kent's year over year interest earnings on its bank deposits with CIBC.

Global markets had a strong start to 2020 and began a significant decline at the end of February early March as the pandemic was declared and swept across the globe. March 23, 2020 was the low with the S&P/TSX down 34.2% YTD, Dow Jones Industrial Average (US Market) down 34.85% and the MSCI World Index down 32.1%. Governments and Central Banks around the world began an aggressive campaign to support individuals, businesses

and economies in an unprecedented way. This led to a stabilization of the markets and significant turn around by year end with the S&P/TSX up 2.2%, Dow Jones Industrial Average up 7.2% and the MSCI World Index up 14.1%.

Investment Strategy

As directed by Chatham-Kent'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 for 2018 through 2020 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 Chatham-Kent's portfolio as of December 31, 2020 to the policy targets.

Classification	Maturing In	2020	Policy Limits
Cash & Short-term	Less than 1 year	76.3%	Balance
Medium-term	1 – 5 years	11.0%	25%
Long-term	More than 5 years	12.7%	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.

Performance of Portfolio Investments

Cash & Short-Term

In 2020, the Municipality had an ending cash and short-term balance of \$183 million. The average yield on the Municipality's cash deposits with CIBC was 1.33%. The Municipality was also able to take advantage of a unique opportunity in the GIC market, purchasing a \$25 million 6 month GIC with an interest rate of 1.45%. 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 2020, the Municipality's medium-term investment portfolio had an ending balance of \$26.4 million, all externally managed. One principally protected equity backed note was sold in 2020 recognizing a realized gain on investment of \$241,200.

The remaining medium-term investments have no realized earnings until they mature or until they are sold, however we are showing the current unrealized value as of Dec 31, 2020.

Long-Term

In 2020, the Municipality's long-term investment portfolio had an ending balance of \$30.4 million all externally managed. There was no realized yield on the investments and no investments were sold or matured during 2020. 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.

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 the 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 notes is held to maturity.

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 2020, 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

2021 has continued the strong performance from 2020 with returns solidifying in non-technology based sectors such as banks, insurance companies, energy, etc. Interest rates have begun to increase as the prospect of continued stimulus, economic expansion and overall recovery has given rise to inflation concerns. However, as the vaccine rollout continues to gain traction around the world, the global markets and economies are expected to benefit.

As directed by Chatham-Kent'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 2021 strategy will focus on managing Chatham-Kent's portfolio to the Municipality's policy term targets.

Conclusion

During 2020 we saw nice progress in the unrealized value of the notes and were also able to take advantage of the realized growth of \$241,200, interest income of \$178,767 from a 6 month GIC and \$33,306 in interest revenue from fixed income investments. In addition, the Municipality was able to take advantage of the markets in March 2020 with the purchase of

two notes with very favourable terms. Unrealized gains on investments totalled \$2.2 million in 2020.

Administration 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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