
For Information

REPORT TITLE: **2019 Treasury Report**

FROM: Stephen Van Ofwegen, Commissioner of Finance and Chief Financial Officer

OBJECTIVE

To provide the annual results of Treasury activities in accordance with the Region of Peel's Investment Goals and Policies (F20-05) and Debt Management Policy (F20-06); and, to provide the annual results of energy commodity hedging performance in accordance with the Energy Commodity Procurement Policy.

REPORT HIGHLIGHTS

- For the year ended December 31, 2019, the General Fund generated gross earnings of \$78.2 million, representing a yield of 3.2%, outperforming the portfolio's inflation target by 1.3%.
- Approximately 90% of earnings are allocated to Regional reserves and less than 10% allocated to operations and bank accounts related to PHC operations.
- All investments were in accordance with the Region of Peel's Investment Goals and Policies and statutory requirements.
- All commodity price hedging agreements during 2019 were in accordance with the Energy Commodity Procurement Policy.
- A task force has been formed to undertake a review of the Region's capital plan to ensure long term financial sustainability.

DISCUSSION

1. Background

In accordance with Ontario Regulation 438/97 (as amended) of the *Municipal Act, 2001*, as amended, and the Region of Peel's ("Region") Investment Goals and Policies, the Treasurer is required to report annually on the Region's investment portfolio, including the performance of the portfolio and its consistency with the Investment Goals and Policies set out by the Region of Peel.

On April 14, 2016, Regional Council approved the adoption of the Energy Commodity Procurement Policy which outlines the framework and guidelines of the overarching strategy to manage and mitigate the risks associated with competitive energy markets.

In accordance with Ontario Regulation 653/05 (as amended) of the *Municipal Act, 2001*, as amended, and the Region's Energy Commodity Procurement Policy, the Treasurer is required to report annually on the Region's commodity hedging performance.

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This report is provided in compliance with Ontario Regulation 438/97 (as amended) of the *Municipal Act, 2001*, Ontario Regulation 653/05 (as amended) of the *Municipal Act, 2001*, the Region of Peel's ("Region") Investment Goals and Policies and the Region's Energy Commodity Procurement Policy.

2. Treasurer's Discretionary Authority

Policy F20-05 Investment Goals and Policies provides the Treasurer with discretionary authority to temporarily exceed investment limitations within the Region's Investment Goals and Policies. Details are provided below:

Sinking Fund EB:

In October 2018, a tactical overallocation was approved by the Treasurer, increasing Bank sector holdings to 55% (50% standard limit). Upon receipt of the June 2019 provision payment, the allocation to the Bank sector moved back within standard limits.

Sinking Fund EQ:

In July 2019, the Province of Newfoundland was downgraded to A1 from Aa3; therefore, reducing the allowable exposure for the issuer to 30% from 55%. Series EQ holdings of Newfoundland bonds were 34% at the time of the downgrade. Following the rating change, the Treasurer approved Treasury's recommendation to maintain the existing exposure (i.e. 34%) as the December 2019 provision payment would bring the exposure down to ~20% and back within standard limits. This above action avoided the need to sell Province of Newfoundland bonds at an inopportune time and recognizes the long-term objective of the Sinking Fund.

3. Market Summary

Market conditions generally improved in 2019, following a volatile end to 2018. Improving investor sentiment through the course of the year led to strong performance across stocks and bonds. Global growth was approximately 3.0% in 2019, while Canada and the United States posted GDP of 1.6% and 2.3% respectively. Inflation remained well anchored around 2.0%.

The Bank of Canada held overnight rates steady at 1.75%, following three 0.25% rate increases in 2018. Government bonds with maturities of two to ten years trended lower, declining between ~0.2% and ~0.4%. Provincial, municipal, and corporate bonds were further supported by improving (i.e. tighter) spreads, driving a general outperformance vis-à-vis Government of Canada bonds. Overall, the broad Canadian fixed income market experienced a total return of 6.9% during 2019. Global equities, including the S&P/TSX also experienced very strong growth during 2019, with returns ranging between ~20% and 25%.

Initial forecasts for 2020 estimated global GDP to remain around the 3.0% level, while Canadian GDP was expected to remain stable at ~1.6%. Markets and economists were forecasting overnight policy rates to remain mostly unchanged, with most expecting longer term rates to move gradually higher, albeit by modest amounts. However, as the impact of COVID-19 increased dramatically during March 2020, initial forecasts became largely irrelevant.

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The immediate impact on the economy appears significant, as it also is on financial markets. Expectations for growth have been dramatically reduced, with most forecasts now pointing to negative GDP for Q2, globally and in Canada. Significant policy responses on both fiscal and monetary fronts have been rolled out in order to combat the impacts of COVID-19. The Bank of Canada lowered the overnight policy rate from 1.50% to 0.25% through three rate cuts in March and has implemented a number of monetary stimulus programs to ease the impact of COVID-19.

It is expected that financial markets will remain volatile for at least the first half of 2020, while the full impact on business and individuals will likely not be known for some time. Given the nature of the COVID-19 health crisis, the ultimate range of outcomes appears very difficult to predict in terms of severity and length.

4. Cash Management

Treasury Staff are responsible for ensuring adequate liquidity to meet the Region's day-to-day operating needs. Collaboration with the Region's program areas to develop longer term cash flow forecasts assists the team in optimizing the Region's cash position over time.

As at December 31, 2019, the General Fund portfolio carrying value (amortized book value), including cash holdings was \$2,440 million and the Sinking Fund portfolio carrying value, including cash was \$327 million. Cash holdings for the General Fund totalled \$551 million as at December 31, 2019, up from \$461 million as at December 31, 2018. Additional details are provided in Appendix I.A.

Earnings on cash holdings were enhanced as Treasury staff were able to source more attractive short-term deposit rates.

In response to the COVID-19 pandemic, increased oversight of cash management activities has been implemented to ensure sufficient liquidity to meet key business needs. A task force has been formed to review the Region's current capital plan to ensure long term financial sustainability.

5. Debt

Under the *Municipal Act, 2001* sections 401 to 417, the Region has the authority to issue debt for its own municipal purposes, and also, as an upper-tier municipality, acts to issue debentures on behalf of its lower-tier municipalities, if/when required. A summary of 2019 activity and outstanding debt is as follows:

- On March 15, 2019, the Region re-opened the existing \$300 million 2042 debenture for an additional \$23 million on behalf of the City of Brampton.
- On October 15, 2019, the Region issued serial debentures in the amount of \$51.8 million (\$48.2 million for City of Mississauga & \$3.6 million for the Town of Caledon).
- In 2019, the Region did not issue external debt for its own purposes.

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- As at December 31, 2019, net Region own source debt totalled approximately \$1,288 million, including \$133 million in PHC related debt. Total Sinking Fund assets were approximately \$327 million. Appendix I.B contains additional details.

6. Investments

General Fund

The General Fund is comprised of cash and investments held for working capital, reserves and reserve funds, and other funds of the corporation. The fund targets a return greater than inflation. During 2019, the General Fund generated gross earnings of \$78.2 million, on a weighted average portfolio value of \$2,436.8 million, resulting in an investment yield of 3.2%.

The majority of earnings were allocated to reserves (\$71.1 million), and \$3.1 million was allocated to operations, with \$4.0 million to bank accounts related to PHC operations.

Performance

For the year ending December 31, 2019, the General Fund earned \$78.2 million, representing a gross yield of 3.2%, compared to the portfolio's inflation target of 1.9%. Fixed income holdings generated \$62.0 million of earnings with the remaining \$16.2 million from deposit interest earned on cash holdings. Included in the \$62.0 million of fixed income earnings, was \$6.1 million in realized gains on securities that were sold during the year. This represents 7.8% of total earnings. The Region continues to manage the portfolio with a long-term view and balances the trade off between realizing capital gains in the short-term and the impact it may have on future earnings.

Additional performance and portfolio characteristics are provided in Appendix I.C.

Portfolio Costs

The Treasury Division's management expense ratio (MER) was approximately 4.2 basis points (0.042%) in 2019, which was slightly higher than the five-year average of 3.9 basis points. The MER represents the direct operational cost of the investment portfolio relative to the size of the assets under management. This represents excellent value for money relative to alternative options.

By comparison, the ONE Fund charges a management fee of 40 basis points (0.40%) for their bond fund. If the Region were to invest the General Fund fixed income holdings into ONE Fund's portfolio, as opposed to managing internally, the additional cost is estimated to be approximately 25 basis points (0.25%) higher, equivalent to an additional annual budget outlay of \$6.5 million.

Sinking Funds

Sinking Funds are established upon issuance of sinking fund debentures, and managed separately, per *Municipal Act, 2001 (section 409)*, with an estimated amount contributed annually to the Sinking Fund which, with interest compounded annually, will be sufficient to pay the principal of the debentures at maturity.

During 2019, the six Sinking Funds generated total gross earnings of \$9.9 million, with the total aggregate value of the Funds increasing from \$270 million to approximately

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\$327 million, inclusive of annual provision payments. The investment returns outperformed the target returns for four Sinking Funds while two generated returns less than their respective targets during 2019. Sinking Fund EP has a deficit of \$17,871 at the end of 2019 as it continues to underperform the target return. Market interest rates have fallen significantly since the debenture issuance, making it difficult to invest contributed provision payments at yields equal to or greater than target. As required by *Municipal Act, 2001*, the Region will contribute the shortfall during 2020. Further details for individual Sinking Funds are contained in Appendix I.C.

7. Energy Procurement Performance

The objectives of the Energy Commodity Procurement Policy are to establish commodity price hedging agreements that ensures regulatory compliance, provide financial flexibility and maximize procurement opportunities. In accordance with Ontario Regulation 653/05 (as amended) of the *Municipal Act, 2001*, and the Energy Commodity Procurement Policy, the Treasurer is required to annually apprise Council of the hedging performance.

Electricity

No hedge volumes were procured for 2019 because projections showed that 2019 market conditions would be relatively stable and the Region's exposure to the spot market is minimal (approximately 14% of total annual energy bill). This strategy allowed the Region to take advantage of the low spot market prices that averaged \$0.01672/kWh in 2019, which was approximately 16% lower than the most competitive forward market price for 2019 and 49% less than the Region's 2017 transaction price (the Region has remained unhedged since January 1, 2018).

Natural Gas

The Region of Peel and Housing Services Corporation hedged 58% of its approximately 16.10 million m³ of natural gas requirements for 2019. The hedged volume of 9.28 million m³ and index volume of 6.82 million m³ was purchased from both the Region of Peel's gas supplier and the Housing Services Corporation at various delivery points at an average price of \$0.1902/m³ inclusive of transaction fees, or a total hedge cost of approximately \$1.74 million and a total index cost of approximately \$1.32 million. The total risk mitigated from volatility in the natural gas market for the year was approximately \$621,593.

The fixed price hedged volumes for energy that were purchased for 2019 were consistent with the Region of Peel's policies and goals to address risks on commodity price volatility and were in alignment with the Region's level of risk tolerance.

Further details on energy procurement performance are in Appendix I.E.

8. Compliance

All investments were in accordance with the Region's Investment Goals and Policies and statutory requirements. All commodity price hedging agreements during 2019 were in accordance with the Energy Commodity Procurement Policy. Ontario Regulation 438/97 requires that a municipality report on investments held in its own securities. From time to time, the Region invests in its own securities no different than any other Portfolio investments where the Region sees value relative to other similar securities. Appendix I.D contains details of holdings and transactions throughout 2019.

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9. Cash Management Strategy – Update

During 2019, Treasury Services continued to focus on the multi-year implementation of the Cash Management Strategy. The implementation focused on three critical work streams:

- (1) Risk Management
- (2) People
- (3) Processes

Key initiatives completed in 2019 are:

Risk Management (foundational)

- Established Treasury Risk Oversight Committee to strengthen governance and risk management practices;
- Enhanced internal controls over banking activities;
- Improved analytics for the investment portfolio to support investment decisions; and,
- Pursuing debt and investment risk management strategies to hedge the volatility of interest rates.

People (foundational)

- Defined Treasury Services' mandate and its roles and responsibilities;
- Eliminated key person risk and succession planning through a structural organizational change and addition of four team members; and,
- Segregated duties through clearly defined front office, middle office and back office roles.

Processes (outcomes)

- Improved investment research increasing diversification of investment instruments held;
- Implemented a more strategic approach to the investment decision making process, helping optimize portfolio positioning, improving monitoring and management of risk exposure within the portfolio, and capture relative value opportunities where available;
- More efficient liquidity management, generating additional returns on cash;
- Cost savings of approximately \$8,000 by year end through operational efficiencies; and,
- Issuance of RFP for Custodial Services (August) and a Treasury Management System (December) to enhance automation and realize process efficiencies.

The Region continues to seek opportunities to further expand the investment opportunities and borrowing strategies which is expected to reduce the Region's financial vulnerability as it strives to meet the needs of the community.

10. Prudent Investor Status – Update

Effective January 1, 2018, amendments to *Municipal Act, 2001* and O. Reg. 438/97 came into force, allowing Ontario municipalities to 'opt-in', at the earliest, January 1, 2019, to the Prudent Investment framework. Prior to this change, the only option for municipal investment activities were through a prescribed list under O. Reg. 438/97: Eligible Investments and Related Financial Agreements, which restricts municipal investments to highly rated Canadian bonds, money market instruments and other similar debt instruments, and equity exposure through the ONE Investment Fund.

The inclusion of Prudent Investment would allow municipalities greater investment authority than what was previously prescribed under the *Municipal Act, 2001*. Municipalities now have the option to continue to invest through the prescribed list or choose to expand their investment opportunities under the Prudent Investment framework.

Through the course of 2019, the Region has engaged in several initiatives related to existing investment guidelines and policy, as well as further researching the Prudent Investment alternative.

- Staff completed a comprehensive review of the Region's Investment Goals and Policies, allowing for additional investment flexibility consistent with the prescribed list and the Region's Treasury Risk Appetite Framework approved by Council on October 10, 2019.
- Process improvements were made on data analysis, reporting, and governance, including the establishment of the Treasury Oversight Committee.
- A municipal working group collaborated to undertake a comprehensive analysis of available options under Prudent Investment, industry best practices, and governance options.
- Analysis and advocacy for additional implementation options with respect to Prudent Investment, with the objective of reducing barriers to entry, and providing municipalities with more flexibility.
- Consultations with ONE Investment on their potential solution/offering for Prudent Investment.
- Ongoing discussions and research with investment industry experts to identify best practices across the investment industry.

To date, we are not aware of any municipality that has implemented Prudent Investment, with the exception of City of Toronto. With the landscape still evolving, the Region continues to evaluate the options. Staff will continue to keep Council updated with findings/recommendations. As the Region has not implemented Prudent Investment, all investments continue to be governed by the prescribed list under Ontario Regulation 438/97 and the Region's Investment Goals and Policies.

11. Treasurer's Comments

It is the opinion of the Treasurer and Director of Corporate Finance that all transactions and investments during 2019 were in compliance with the Region's Investment Goals and Policies and Ontario Regulation 438/97. Commodity hedging was also in compliance with the Region's Energy Commodity Procurement Policy and Ontario

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Regulation 653/05. This report satisfies the Treasurer's legislative requirements per Ontario Regulations 438/97 and 653/05.

FINANCIAL IMPLICATIONS

The revenue generated through investment activities in 2019 was allocated to reserves (91%), operations (4%) and bank accounts related to PHC operations (5%).

CONCLUSION

The Region's Investment Goals and Policies provide the Region with an effective and efficient investment management operation which maximizes the rate of return on investment while ensuring safety of principal and liquidity.

APPENDICES

Appendix I.A – Cash Management

Appendix I.B – Debt

Appendix I.C – Investments

Appendix I.D – Investments Held in Region of Peel Securities

Appendix I.E – Energy Procurement

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Reviewed and/or approved in workflow by:

Department Commissioner and Division Director.

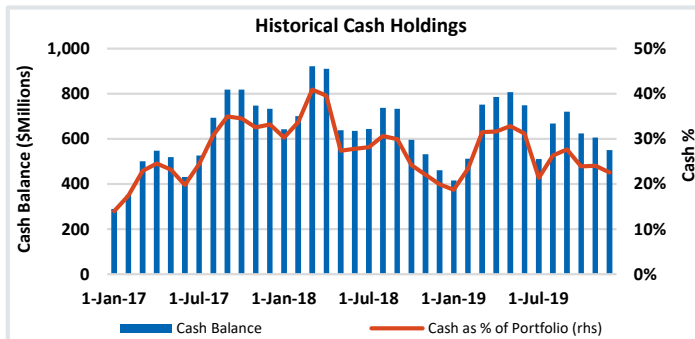
Final approval is by the Chief Administrative Officer.



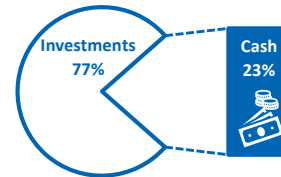
N. Polsinelli, Interim Chief Administrative Officer

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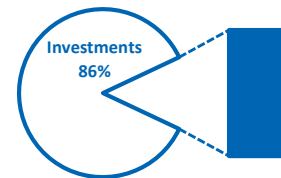
Appendix I.A: Cash Management



2019 General Fund cash holdings totaled \$551M, up from \$461M at the end of 2018



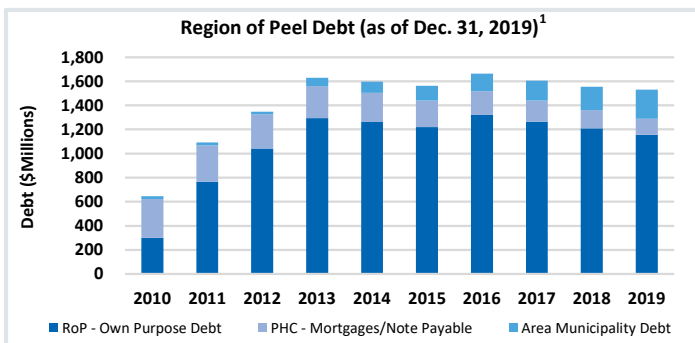
2019 Sinking Fund cash holdings were \$46M, up from \$13M at the end of 2018



General Fund average cash balances have trended lower since 2017

- Cash levels are closely monitored to optimize earnings on short-term investments
- Treasury staff continue to collaborate with the Region's program areas to develop longer term cash flow forecasts to optimize the Region's cash position over time.

Appendix I.B: Debt



In 2019, the Region had own source net debt of \$1,288M



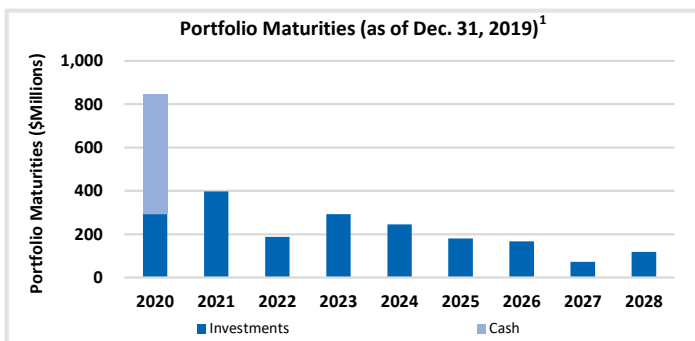
This includes \$133M in PHC related debt.

The Region had a \$71M decrease in net debt



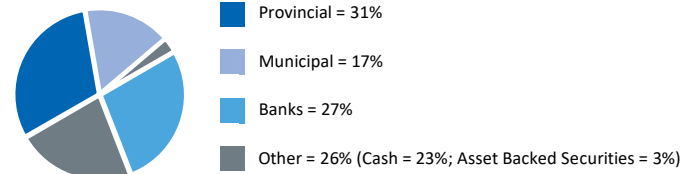
Debt is split by the Region of Peel "own purpose debt", Peel Housing Corporation (PHC) debt, and area municipality debt.

Appendix I.C: Investments – General Fund



- The Region continues to structure the portfolio using a laddered approach (i.e. similar level of maturities in all years) where possible, to match the timing of maturities to the Region's cash requirements.

Sector Distribution²



Investment Returns vs. Market Benchmark ²	2019	2018	2017	2016
Annual Investment Earnings (\$Millions)	\$78.2	\$67.5	\$57.7	\$56.0
Annual Investment Returns ³ (gross)	3.2%	2.9%	2.6%	2.8%
Market Benchmark ⁴	1.8%	2.1%	1.5%	1.4%
Value Add (returns – benchmark)	1.4%	0.8%	1.0%	1.4%

➔ Portfolio returns exceeded the benchmark by +1.4%

➔ Increased earnings by +\$10.7M

¹ Maturities are expressed using par value.

² Values may not add due to rounding.

³ The gross fixed income investment yield is based on earned revenues (interest income, realized capital gains/losses, amortized premiums/discounts and securities lending income) as a percentage of the weighted average value net of expenses.

⁴ Blend of FTSE TMX Indices based on target term and sector exposures.

Appendix I.C: Investments – General Fund (cont.)

Investment Returns vs. Inflation ²	2019	2018	2017	2016
4-year Average Investment Returns ³ (gross)	2.9%	2.8%	3.0%	3.2%
4-year Average Inflation ⁵	2.1%	2.1%	2.1%	1.8%
Value Add (returns – inflation)	0.8%	0.7%	0.9%	1.4%

➔ Portfolio returns exceeded inflation by **+0.8%**

➔ A major goal of the General Fund is the preservation of purchasing power over the long run. Inflation is used as a barometer of the Portfolio's long-term minimum return requirement.

Appendix I.C: Investments – Sinking Funds

Sinking Fund Holdings and Surplus/Deficit (as of Dec. 31, 2019)

Series	Issue Date	Maturity Date	(Millions)		Holdings (Millions)			Earnings Surplus / (Deficit)		
			Annual Provision Payments	Total Provision Payments (Cumulative)	Investments (Amortized Book Value)	Cash	Total	Region of Peel	City of Brampton	Town of Caledon
DQ	Jun 29/10	Jun 29/40	\$8.9	\$80.2	\$73.4	\$22.9	\$96.3	\$113,535	n/a	\$1,234
EB	Oct 06/11	Dec 01/21	\$7.8	\$70.5	\$60.5	\$9.8	\$70.3	\$1,063,929	n/a	\$2,652
EC (RoP)	Oct 30/12	Oct 30/42	\$6.8	\$47.8	\$54.9	\$0.1	\$55.0	\$3,362,457	n/a	n/a
EC (Brampton)	Apr 15/19	Oct 30/42	\$0.7	\$0.7	\$0.7	\$0.0	\$0.7	n/a	\$521	n/a
EP	Jun 20/13	Jun 20/53	\$0.3	\$2.1	\$0.9	\$1.4	\$2.3	(\$17,871)	n/a	n/a
EQ	Aug 23/13	Dec 02/33	\$9.1	\$54.5	\$49.8	\$9.9	\$59.7	\$614,054	n/a	n/a
FX	Nov 02/16	Nov 02/26	\$13.7	\$41.1	\$42.2	\$0.0	\$42.2	\$510,268	n/a	n/a
TOTALS			\$47.4	\$296.8	\$282.4	\$44.1	\$326.5			

➔ 4 of 6 Sinking Funds had investment returns exceeding the target in 2019.

➔ The objective of each Sinking Fund is to meet or exceed the target return. The target return is the estimated return requirement necessary to ensure that each Sinking Fund is fully funded at maturity to repay its obligation.

Appendix I.D: Investments Held in Region of Peel Securities

Region of Peel Bonds – Holdings

Date	Par Value		% of Portfolio
	Portfolio ⁶	RoP Bonds ⁷	
Dec. 31/19	\$2,880,347,215	\$71,189,000	2.5%
Dec. 31/18	\$2,752,357,130	\$70,711,000	2.6%
Yr. over Yr. Change	\$127,990,085	\$478,000	

Region of Peel Bonds – Transactions

Portfolio	Transaction	Date	Coupon	Par Value	Price		Yield
					Purchase	Sale	
GF	Buy	Oct. 15/19	2.05%	\$5,361,000	99.94		2.06%
GF	Sell	Nov. 04/19	2.05%	\$5,361,000	99.94	99.34	2.17%
GF	Maturity	Jun. 29/19	4.35%	\$510,000	99.71	100.00	4.39%
GF	Maturity	Dec. 14/19	6.65%	\$2,473,000	99.45	100.00	6.70%
DQ				none			
EC				none			
EP				none			
EQ				none			
FX	Purchase	Nov. 04/19	2.05%	\$5,361,000	99.34		2.17%

Appendix I.E: Energy Procurement Performance

No electricity hedge volumes were procured for 2019



Projections showed that 2019 market conditions would be relatively stable and the Region's exposure to the spot market is minimal. This strategy allowed the Region to take advantage of low market prices which were 16% lower than the most competitive forward market price for 2019 and 49% less than the Region's 2017 transaction price.

The total risk mitigated from volatility in the natural gas market in 2019 was \$621,593



The Region of Peel and Housing Services Corporation hedged 58% of its natural gas requirements for 2019. The fixed price hedge volumes for energy that were purchased for 2019 were consistent with the Region of Peel's policies and goals to address risks on commodity price volatility and were in alignment with the Region's level of risk tolerance.

⁴ Values may not add due to rounding.

⁵ The gross fixed income investment yield is based on earned revenues (interest income, realized capital gains/losses, amortized premiums/discounts and securities lending income) as a percentage of the weighted average value net of expenses.

⁶ Toronto CPI

⁷ Total of General Fund and six Sinking Fund portfolios.

⁸ RoP bonds held in portfolios.