Cash management strategy
The Region of Peel’s ability to realize long-term positive financial impact

Audit and Risk Committee presentation
Part of the Cash Management Strategy Project • May 2017
Cash management strategy project

Project context and background

• The Region of Peel’s Treasury function currently operates its investment portfolio within the confines of the Ontario Municipality Act (“OMA”), which defines the way it can invest (e.g. invest in high rated fixed income assets). In a historically low interest rate environment the Treasury function is continuously looking for opportunities to increase the positive financial impact of its cash management strategy. A new legislation has been recently proposed, the Prudent Investor Standard (“PIS”), that potentially broadens the range of investment options for the Region in order to generate additional return.

• To continuously improve the Treasury function’s practices the Director of Corporate Finance & Treasurer and Executive Leadership Team (“ELT”) challenged whether the Treasury function can effectively capitalize on the new standards to generate additional return given its current practices and structure.

Project mandate

• The project mandate to assess the Region of Peel’s Treasury function revealed opportunities to improve and augment its current practices to potentially generate additional financial returns and reduce costs

Project outcomes

- Increase the potential to generate greater financial returns
- Enhance Treasury function practices
- Redefine the Treasury function’s mandate
Cash management strategy summary

Three key observations

**Investment strategy and practice revision**
Utilize the breadth of investment options available to generate additional financial returns and consider additional investment strategy

**Borrowing strategy implementation**
Implement additional borrowing options to potentially reduce financing costs incurred by the Region of Peel

**Treasury function evolution**
Make required changes to the structure, governance model, technology platform, and processes to evolve the overall capabilities of the Treasury function

Risk management implications
The above key observations can be implemented and executed within the Region’s current risk profile and risk tolerance levels
Investments

1. Opportunities exist to further expand current portfolio

Immediate opportunities:

- Expand the current investment profile of the Region’s current portfolio to cover the Region’s internal policies
- Update Region’s internal policies to allow for the full scope of investments permitted by OMA

2. Investment strategies

Current investment strategy – Buy and hold

Region of Peel buys investments (e.g. highly rated fixed income assets) and holds them until maturity.

Additional investment strategy – Active investment

Informed trading decisions by the Region of Peel to buy and sell its investments (e.g. highly rated fixed income assets) based on market events.
Borrowing program

Available to the Region of Peel are additional options to manage its borrowing program.

Bank debt warehousing

- Use a bank operating line of credit for temporary financing of capital projects before refinancing the bank line with a debt issuance
- Bank debt warehousing will allow the Region to match actual capital expenditures with debt issuance, thereby reducing its financing costs

Bond forward agreement

- An effective tool to lock-in favorable rates in an environment of rising interest rates. If the Region of Peel anticipates an increase in interest rates, it can lock-in the rate today and potentially save on financing costs
The Treasury function’s operating model can be improved within critical elements of treasury.
Implementation roadmap

A multi-stage roadmap has been developed to outline the necessary tactical steps to evolve the Region’s Treasury function to its desired state.

Benefits realized

- **Immediate**
- **Medium-term**
- **Long-term**

The purpose of the implementation plan is to guide the Treasury function to achieve its desired objectives.

The benefits will be realized throughout the evolution of the Treasury function.
Appendix
Investment strategies
Active investment management provides the Region another investment strategy to generate additional return by capitalizing on market opportunities.

A mock scenario – active investment vs. passive investment

Financial instrument: Government of Canada Bond / Bond price: $100* / Bond maturity: 365 days* (repayment of original sum) / Coupon rate: 0.50%* (annual interest rate paid on the issuer’s borrowed money)

1. Passive investment management ("Buy and hold")

1. Region purchases Government of Canada Bond

Regardless of value fluctuation – hold onto the bond until maturity

Benefits
- Very conservative
- Not dependent on market
- Access to immediate liquidity
- Minimal cost

Challenges
- Does not maximize potential returns

2. Active investment management

1. Region purchases Government of Canada Bond
2. Macro-economic event such as BREXIT drives up Government of Canada bond prices above Region’s purchase price
3. Region sells bond in the market to generate a profit
4. Bank of Canada increases interest rates which decreases bond prices so the Region purchases bonds in the market at a perceived discount
5. The bond value increases above the price purchased and the Region sells the bond in the market at a profit

Benefits
- Additional returns to the Region
- Access to liquidity

Challenges
- Skilled portfolio manager required
- Active analysis of market conditions

* Fictional values – this is for illustrative purposes only and is a very simplified scenario

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**Borrowing Program**

Bank debt warehousing is an immediate and simple alternative debt borrowing strategy that can be utilized as it can provide greater matching of debt and expenditures.

**Region’s current borrowing program** relies heavily on expenditure estimates provided by the project managers, which often times result in over-borrowing.

1. **Project Manager** estimates capital expenditures.
2. **Region** utilizes estimates to issue long-term debt.
3. **Region** repays obligation + interest payments.

**Challenges**
- Issuance of debt is based on estimated capital expenditures that have a tendency to be inaccurate.

**Alternative option - Bank debt warehousing** will allow the Region to match actual capital expenditures with debt issuance, thereby reducing its financing costs.

1. **Bank line** to pay actual capital expenditures.
2. **Max. limit** to pay actual capital expenditures.
3. **Region** issues long-term debt based on actual expenditures incurred.
4. **Region** repays obligation + interest payments.

**Benefits**
- Greater matching of debt with expenditures
- Easy to manage
- No prepayment penalties for the bank debt
- Easier access to cash for immediate needs
- Potential savings

<table>
<thead>
<tr>
<th></th>
<th>Debenture</th>
<th>Bank line + debenture</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of debt*</td>
<td>3.7%</td>
<td>3.6%</td>
</tr>
</tbody>
</table>

**Challenges**
- Very minimal

* Approximate
Borrowing Program
Available to the Region are options to manage its debt in a more cost effective manner

**Bond Forward Agreement** is an effective tool to lock-in favorable rates in an environment of rising interest rates. If the Region anticipates an increase in interest rates, it can lock-in the rate today.

1. Region will issue debt within the next 6 months
2. Region assesses likely interest rate increase over the next 6 months
3. Region decides to lock the rate at current interest rate
4. Region enters into agreement with Bank to guarantee interest rate

**Benefits**
- Mitigate interest rate exposure - locking in rate could potentially save on financing costs
- Enables the Region to better forecast costs

**Challenges**
- May result in securing an unfavourable rate relative to the current market interest rates

**Additional options available to Region are presented below:**

- **Commercial Paper Program** – An unsecured, short-term debt instrument to meet immediate cash flow requirements; however, susceptible to market volatility.
- **Public-private partnership (3P)** – A long-term performance based approach to procuring public infrastructure. The private partner assumes responsibility for development of capital project but this option can be time consuming to find appropriate partner and expensive to break contract.