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2003 ANNUAL INVESTMENT REPORT

The Finance and Administration Committee recommends the adoption of the recommendations contained in the following report, January 12, 2004, from the Commissioner of Finance:

1. RECOMMENDATIONS

It is recommended that:

1. This report be received for information.

2. PURPOSE

This report is to provide information regarding investment portfolio activities undertaken during the year 2003, as required by Ontario Regulation 438/97 (as amended by Ontario Regulation 265/02) of the *Municipal Act* and the Region's Investment Policy.

3. BACKGROUND

The Policy, Risk and Treasury Branch of the Finance Department manages two investment portfolios for the Region which had a combined maturity value of approximately $949 million as of December 31, 2003 (*see Attachment 1*).

The General Fund, with a value of $947 million at year-end ($819 million in 2002), represents investments for the reserves and reserve funds, working capital and other funds of the Corporation. All investments transacted in 2003 were in compliance with the Region's Investment Policy approved by Council in October 2002, as well as Ontario Regulation 438/97 (as amended by Ontario Regulation 265/02) of the *Municipal Act*.

The Sinking Fund, with a par value of $2 million at year end consists of investments held in trust on behalf of the Town of East Gwillimbury for the repayment of Sinking Fund debentures. Sinking Fund investments are made in accordance with a policy established by the Sinking Fund Committee which is similar to that of the Region's Investment Policy.

4. ANALYSIS AND OPTIONS

Although interest rates ended 2003 at approximately the same level they began, the year was far from uneventful. Concerns over inflation and a relatively strong domestic market prompted the Bank of Canada to initially raise short-term interest rates in the early part of 2003. However, the central bank was forced to retrench later in the year as the Federal Reserve continued to lower rates to spur economic growth and counter deflationary pressures in the U.S. The wide interest rate differential between U.S. and Canada helped support a 22% rise in the value of the Canadian dollar putting more pressure on the Bank of Canada to reduce interest rates in the second half of the year.

4.1 Investment Strategy - 2003

In October 2002, Council approved an update to the Investment Policy which broadened the parameters of the Region's investment program. These enhanced investment powers allowed the Region to diversify its portfolio holdings in terms of both credit and term exposure thereby providing greater opportunities to increase investment returns.

For the General Fund the investment strategy focused on prudently extending term to take advantage of higher long term rates while emphasizing preservation of capital and maintaining liquidity. Emphasis was also placed on improving the overall credit quality of the portfolio by diversifying credit exposures and by increasing holdings of government debt.

With respect to the Sinking Fund, the Region's strategy has been to mainly purchase investments with a maturity date approximating the term of the related sinking fund debenture and thus fully hedging the future obligation.

4.2 Investment Results 2003

During 2003, the interest earned by the General Fund was $27.7 million, which equates to a gross rate of return of 3.39%. After factoring in the cost of operating the Region's investment program of approximately $368,000 (i.e. staff, transaction costs, market monitoring services, safekeeping, etc.), the net rate of return for the General Fund was 3.34%, a difference of less than five basis points. During 2003 a more proactive investment program was introduced in line with guidelines set out in the Region's Investment Policy. Benefits from this program resulted in trading gains of over $1.6 million and improved the overall performance of the portfolio by approximately 20 basis points.

Table 1
York Region Investment Portfolios – 2002/2003

Year	Fund	Assets ($million)	Income ($million)	Returns
2003	General	$818.2	$27.3	3.34%
	Sinking	$1.2	$0.1	6.01%
2002	General	$716.7	$19.8	2.76%
	Sinking	$10.6	$0.3	2.56%

Over the same period, Sinking Fund investments earned about $0.1 million for a return of approximately 6.01% (compared to $0.3 million and 2.56% in 2002). The higher return was the result of the maturity in 2002 of lower yielding investments used to fund debt maturing on June 17, 2002.

The earning results for the General Fund compare favourably to other industry benchmarks. For instance, the General Fund earned 52 basis points more than the return achieved by the ONE Fund, a pooled investment fund sponsored by AMO and MFOA for Ontario municipalities, and the primary benchmark used by the Region. Furthermore, these results significantly exceeded returns earned by private sector money market mutual funds. A survey of approximately 200 Canadian money market mutual funds conducted by the Globe and Mail indicated that the average return after costs was 2.22%. Furthermore, only seven of these funds had a return that exceeded 3.0%.

Table 2
Comparison of General Fund
Investment Returns

		ONE Fund		Private Sector	
Year	**General Fund**	**Returns**	**Difference**	**Returns**	**Difference**
2003	3.34%	2.82%	.52%	2.22%	1.12%
2002	2.76%	2.39%	.37%	1.55%	1.21%

As at December 31, 2003, approximately 3.7% of the total portfolio was invested in Region of York securities compared to 2.96% as at December 31, 2002. This change was the result of an investment of $18.4 million in Region of York debentures during the year for the General Fund. Information regarding these transactions is presented in *Attachment 3*.

The Region's portfolio as at December 31, 2003 consisted of securities issued by the Federal and Provincial governments (52%), Canadian financial institutions (36%), as well as securities issued by Ontario municipal governments and other approved institutions (12%). (see *Attachment 4)*. Furthermore, these investments had an average remaining term to maturity of approximately 475 days. The maturity distribution of these investments is shown in *Attachment 5*.

4.3 Investment Strategy – Outlook 2004

The updated Investment Policy approved by Council in October 2002 laid the foundation for the investment strategies that were implemented in 2003 and will continue in 2004. The enhanced investment powers allowed the Region to begin to diversify its portfolio holdings which provided opportunities to increase investment returns. However, to build much more upon these initial successes will require the addition of specialized resources to monitor the financial markets and to do in depth analysis on potential investment opportunities. This will be the subject of a future report to Finance and Administration Committee. The Region's investment strategy will continue to focus on diversifying its portfolio and extending term in a timely and prudent manner while maintaining an awareness of where interest rates are in the economic cycle.

The monetary and fiscal stimulus provided over the past three years have finally kick-started a global economic recovery and stock market rally. Despite this renewed vitality in the economy as a whole, both the U.S. Federal Reserve and Bank of Canada are holding short term interest rates at historic low levels. The Federal Reserve has indicated preference to keep rates low for a "considerable period" as inflation expectations and capacity utilization levels are low. The Bank of Canada is concerned about the impact of a strong Canadian dollar on its own economy and has suggested that short term rates could actually decline from current levels over the next several quarters.

Short term rates are currently around 2.5% whereas rates at 5 and 10 years are approximately 4% and 4.75% respectively. These rates reflect expectations that interest rates will rise over the course of the year and the Region's portfolio is in position to capitalize on any increases in interest rates.

5. FINANCIAL IMPLICATIONS

The careful management of the General Fund generated approximately $4.3 million (net of costs) in additional return versus a similar-sized investment with the ONE Fund and $9.2 million versus the average return of private sector mutual funds. Although these incremental returns have little immediate impact on the Region's operating budget, investment revenues contribute to reserves and help in defraying York Region's service costs over the longer-term.

6. LOCAL MUNICIPAL IMPACT

While returns on the Region's investments have no direct impact on area municipalities, the extra revenue earned contributes to the Region's reserves and decreases the longer-term need for taxes and development charges.

7. CONCLUSION

The Region's General Fund investment portfolio performed well in 2003 with a return of 52 basis points, or $4.3 million (net of costs), above the Region's principal benchmark, the ONE Fund. The additional income reduces the need for tax or development charge revenues. All investments met the requirements of the Region's Investment Policy.

The Senior Management Group has reviewed this report.

(A copy of the attachment referred to in the foregoing is included with this report and is also on file in the Office of the Regional Clerk.)