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2004 ANNUAL INVESTMENT REPORT

The Finance and Administration Committee recommends the adoption of the recommendations contained in the following report, January 6, 2005, 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 2004, 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 $988 million as of December 31, 2004 (*see Attachment 1*).

The General Fund, with a value of $986 million at year-end ($947 million in 2003), represents investments for the reserves and reserve funds, working capital and other funds of the Corporation. All investments in 2004 were made in accordance with the Region's Investment Policy approved by Council in October 2002. Consideration was given to the following objectives that are set out in the Investment Policy:

- Adherence to statutory requirements;
- Presentation of capital;
- Maintaining liquidity; and
- Earning a competitive rate of return.

As well, all investments met eligibility requirements set out by 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

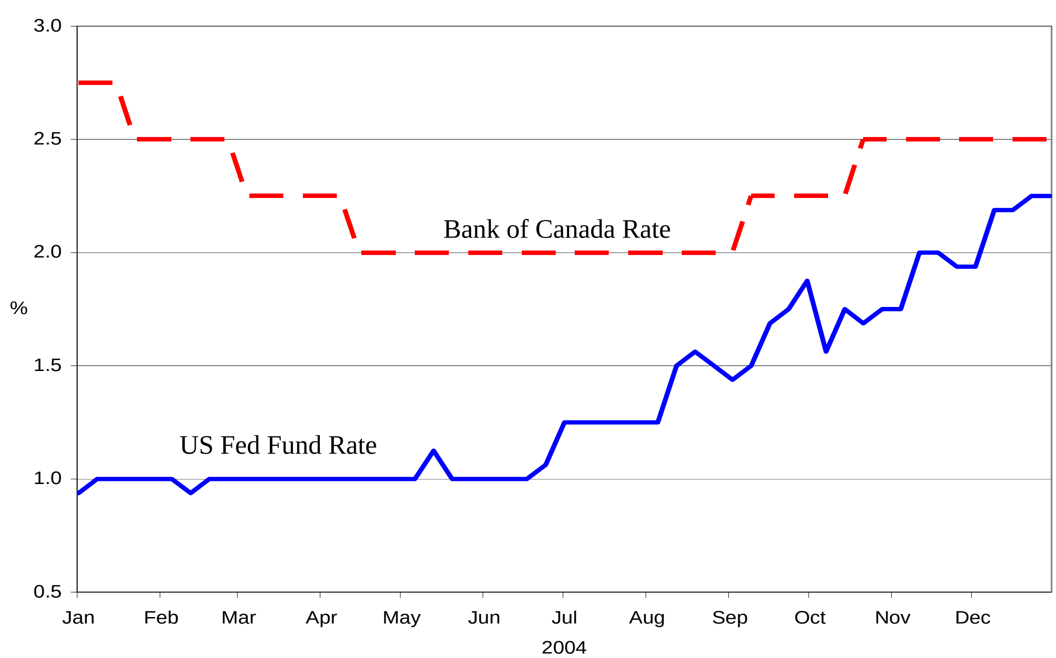
Similar to the experience in 2003, interest rates in Canada ended 2004 at levels approximately equal to where they began. Table 1 compares rates throughout the yield curve as at the end of 2003 and 2004.

Table 1
Year-end Interest Rates – 2003 and 2004

Year	Rates			
	1 yr	**2 yr**	**5 yr**	**10 yr**
2003	2.60%	3.00%	4.00%	4.65%
2004	2.65%	3.00%	3.80%	4.35%
Change	+0.05%	0.00%	-0.20%	-0.30%

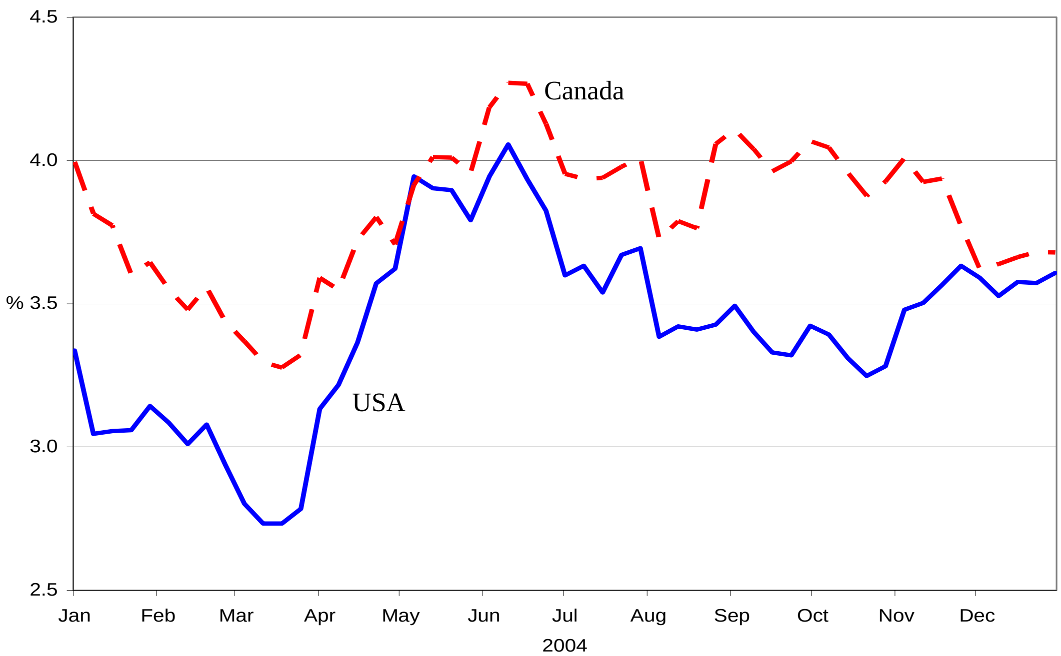
Despite the apparent tranquility, the bond market still experienced a significant amount of volatility over the course of 2004 especially in Canada. At the beginning of the year the Bank of Canada reduced short-term interest rates three times in order to offset the effects of a strong Canadian dollar (see Graph 1). These interest rate cuts, combined with the U.S. Federal Reserve keeping their short-term rates at an historic low of 1% sparked a significant bond rally in the spring of 2004 (see Graph 2).

Graph 1
Central Bank Rates



However, in June, the Federal Reserve determined it was time to remove some of the economic stimulus it has provided over the past three and a half years and proceeded to raise rates from an historic low of 1% to 2.25% by year-end. This precipitated a significant increase in interest rates generally in both Canada and the U.S. through the summer as concerns mounted over potential inflationary pressures.

Graph 2
Fixed Income: 5-year Rates



Initially, the Bank of Canada responded by increasing its bank rate by 50 basis points but quickly went on hold as concerns of a strengthening dollar and its impact on the Canadian economy took precedence. In spite of rates rising in the U.S.(Graphs 1 and 2), Canadian rates (especially long-term rates) actually started to decrease over the fall and into year-end (Graph 2) as the market projected the Bank of Canada holding interest rates at least until the middle of 2005.

4.1 Investment Strategy - 2004

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.

In 2003 the investment strategy for the General Fund 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.

For 2004 the investment program continued to pursue an active management policy building on the successes achieved in 2003. Over the course of 2004 several opportunities to reduce as well as extend term were identified which provided the means to significantly enhance returns. In comparison to 2003 for instance where the average term of the portfolio was approximately 300 days, the average term in 2004 was extended to 475 days. As interest rates rose in the summer, the average term peaked at approximately 550 days and declined to 430 days by year-end as a result of securities sold in order to capitalize on a late year bond rally.

4.2 Investment Results 2004

During 2004, the interest earned by the General Fund was $28.8 million which equates to a gross rate of return of 3.33%. After factoring in the cost of operating the Region's investment progress of approximately $572,000 (ie. staff, safekeeping, market monitoring services, transaction costs, etc.) the net rate of return for the General Fund was 3.27%, a net difference of approximately 6 basis points (Table 2).

Over the same period, Sinking Fund investments earned about $0.1 million for a return of approximately 5.96% (compared to $0.1 million and 6.01% in 2003).

Table 2
York Region Investment Portfolios – 2003/2004

Year	Fund	Assets (million)	Income (million)	Net Rate of Return
2004	General	$867.4	$28.2	3.27%
	Sinking	$1.4	$0.1	5.96%
2003	General	$818.2	$27.3	3.34%
	Sinking	$1.2	$0.1	6.01%

The earning results for the General Fund compare favourably to other industry benchmarks. As Table 3 depicts, the General Fund earned 107 basis points (compared to 52 basis points in 2003) more than the return achieved by the ONE Fund, a pooled fund of eligible investments sponsored by AMO and MFOA for Ontario municipalities, and the primary benchmark used by the Region.

In addition, these results significantly exceeded returns earned by private sector money market mutual funds. A survey of approximately 220 Canadian money market mutual funds conducted by the Globe and Mail indicated that the average returns after costs were 1.39%. Furthermore, only two of the funds had a return that exceeded 3.0% in Canadian dollar terms. Therefore compared to these funds, the Region's portfolio earned 188 basis points (112 basis points in 2003) in additional interest.

Table 3
Comparison of General Fund Investment Returns

Year	General Fund	ONE Fund		Private Sector	
		Returns	Difference	Returns	Difference
2004	3.27%	2.22%	1.07%	1.39%	1.88%
2003	3.34%	2.82%	.52%	2.22%	1.12%

Included in the overall performance were benefits derived from continuation of the proactive style of investment management which provided over $4 million in trading gains and improved portfolio returns by approximately 46 basis points.

4.3 Portfolio Structure

As at December 31, 2004, approximately 4.8% of the total portfolio was invested in Region of York securities compared to 3.7% as at December 31, 2003. This change was the result of net investments of $37.2 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, 2004 consisted of securities issued by the Federal and Provincial governments (51%), Canadian financial institutions (36%), as well as securities issued by Ontario municipal governments and other approved institutions (13%). (*see Attachment 4).* Furthermore, these investments had an average remaining term to maturity of approximately 430 days. The maturity distribution of these investments is shown in *Attachment 5.*

4.4 Investment Strategy – Outlook 2005

The monetary and fiscal stimulus which began in January 2001 has apparently rekindled the North American economies. The U.S. Federal Reserve is now focused back on containing inflationary pressures and will likely continue to increase interest rates in "measured steps" throughout 2005.

The Bank of Canada however, will continue to monitor the impact of the Canadian dollar on the economy and will most probably not increase rates to the same extent as the U.S. Short-term interest rates are currently around 2.5% whereas 5 and 10 year rates are approximately 3.8% and 4.35% respectively. These rates continue to reflect expectations that interest rates will rise over the course of the year. In 2005 the Region's investment program will again look to extend term on a risk adjusted basis when market conditions warrant.

5. FINANCIAL IMPLICATIONS

Management of the General Fund investment portfolio generated net interest income of $28.2 million in 2004 which represented approximately $9.3 million in additional return versus a similar-sized investment with the ONE Fund and $16.3 million versus the average return of private sector mutual funds. 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 user rates.

7. CONCLUSION

The Region's General Fund investment portfolio performed well in 2004 with a return of 107 basis points, or $9.3 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.

(The attachments referred to in this clause are attached to this report.)