

Staff Report



To	Committee of the Whole
Service Area	Corporate Services
Date	Monday, February 1, 2021
Subject	Prudent Investor Standard Analysis and Recommendations

Recommendation

1. That staff be directed to ready the City for the implementation of the Joint Investment Board option available under the Prudent Investor Standard while monitoring the legislative landscape for additional opportunities that may arise from an anticipated provincial review of municipal investment legislation; and
 2. That staff be directed to report back to Council with final Investment Policy recommendations within two years, subject to the anticipated provincial review; and
 3. That the proposed amendments to the current Investment Policy to expand access to professionally managed investments through ONE Investment be approved.
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Executive Summary

Purpose of Report

To provide Council with analysis and recommendations regarding the Prudent Investor Standard (PI) options available under the Municipal Act (the Act) and Regulations.

Key Findings

As the City grows, and implements sustainable, long-term financial management practices, the City's investment portfolio is increasing and therefore requires a review to understand the options available for managing these funds in the most effective model. In recent years, the province announced new PI legislation that would enhance a municipality's ability to diversify holdings subject to specific governance structures being implemented. Please refer to the December 2020 [Information Report](#) for background on the options available.

Staff sought professional expertise to review the options available, consider earnings potential and associated management costs and to ultimately provide future-looking advice on the City's investment management function. Staff also completed a municipal comparison and interviewed staff at specific municipalities regarding their investment management choice and experience to date.

Based on the analysis included in Attachment-1 to this report, and City staff investigation and assessment of readiness of internal practices, it is recommended

that in the short-term, the City should continue to invest funds not immediately required in accordance with Section 418 of the Act and Part I of Ontario Regulation 438/97 (O.Reg). For greater clarity, this means the City should continue to use the legal list legislation while staff ready the City to move to an enhanced standard in the future. The consultant's report shows however, that the City should amend its current Investment Policy to increase the externally managed portion of its investment portfolio.

The Investment Board (IB) option under PI has significant financial and operational risk associated with it, and would require additional staff resources as well as the creation of a paid, skilled oversight board to manage effectively. Staff have determined this is not a financially efficient model for Guelph and it should therefore be eliminated from further consideration. It would be more financially prudent to consider a joint model where municipalities share in the cost of professional management and governance.

Staff should continue to prepare the City to opt-in to PI through the Joint Investment Board (JIB) option by continuing to develop and refine long-term cash flow forecasting capabilities and investigating appropriate investment policy options under PI. The City should also monitor the landscape for amendments to investment options under the Municipal Act, consider any new options that may become available, and provide a report to Council comparing the PI JIB option with any new options that emerge within two years' time.

Financial Implications

The proposed amendment to the current Investment Policy to increase the amount of the portfolio that can be invested in the professionally managed funds through ONE Investment (ONE) should provide greater returns for the City based on the analysis. Caution however should be used as past historical performance does not guarantee future rate returns.

Report

This report is provided in follow-up to the December 11, 2020 [Information Report 2020-217 - Prudent Investor Standard for Municipal Investments](#).

Background

Sections 418 and 418.1 of the Act and the O.Reg set the parameters under which municipalities may invest funds not immediately required. Allowable investments under Section 418 and Part I of the O.Reg are referred to as the legal list. Legal list investments are limited to Canadian federal, provincial and municipal governments and associated entities, or government-guaranteed bonds, short-term fixed-income securities issued by Canadian chartered banks and credit unions, and Canadian equities accessed through the ONE Canadian Equity portfolio. Investing under the legal list is the default investment position for municipalities, and the City's current investment policy is built on the legal list.

On January 1, 2019, Section 418.1 of the Act and the associated changes to the O.Reg (Part II) came into effect, giving municipalities that meet the financial eligibility criteria outlined in the Act the option to opt-in to PI. Opting-in to PI will give municipalities the ability to invest in any security, and requires the municipality

to exercise the care, skill, diligence and judgement that a prudent investor would exercise in making an investment.

Criteria for Opting-In to PI

The financial eligibility criteria are:

- In the opinion of the treasurer, the municipality has at least \$100,000,000 in money and investments it does not require immediately; or
- The municipality has \$50,000,000 in net financial assets as reported in Schedule 70 of the most recent Financial Information Return (FIR).

The Act provides an interpretation of money not immediately required, which includes money in a sinking, retirement or reserve fund, money raised or received for the payment of a debt of the municipality or interest on the debit, and proceeds from the sale, loan or investment of any debentures.

The City has reserves and reserve funds well in excess of the minimum of \$100,000,000 required under the legislation. City reserves reported on the December 31, 2019 audited financial statements totaled \$43,901,000, and City reserve funds totaled \$206,217,000.

The City reported net financial assets of \$167,154,000 on the 2019 FIR, and therefore exceeds the minimum threshold of \$50,000,000 required by the legislation.

How to Opt-In to PI

In order to opt-in to PI, Council must pass a by-law and in that by-law set out the effective date of the by-law (eligibility criteria must be met on the day the by-law is passed).

How to Opt Out Of PI

According to sub-section 418.1(5) of the Act, a by-law passed to opt-in to PI cannot be revoked, and PI continues to be in effect whether or not the municipality continues to meet the financial eligibility criteria.

A municipality may only withdraw from PI through a regulation of the Lieutenant Governor in Council (an amendment to the O.Reg), and in that case the regulation will prescribe transitional rules that apply to the municipality.

For this reason, the municipal sector as a whole is being very cautious about opting-in to PI as there is no ability to reverse this decision easily and the cost to maintain the PI model is significant.

Governance Structure under the Legal List

Municipalities investing funds not immediately required under the legal list do so in accordance with an investment policy approved by Council. Funds can be self-managed by the municipality or by an investment manager or managers who can be retained to manage the funds on behalf of the municipality. Whether self-managed or externally managed, it is the treasurer's responsibility to ensure compliance with Council's approved investment policy, and to report any inconsistency to Council within 30 days after becoming aware of it.

Governance Structure under PI

Municipalities that opt-in to PI have two governance options available to them:

- i. Form an IB for the municipality; or
- ii. Join an existing JIB.

There is only one JIB in existence at this time, and that is the ONE JIB, of which six municipalities are members. There are only two municipalities that have opted-in to PI using the IB model – Toronto and Barrie.

Under PI, Council would still be responsible for approving the investment policy for the municipality, and the IB or JIB is responsible for developing an investment plan in alignment with that policy, and for implementing it.

The IB or JIB has control of investment decisions in alignment with Council's approved policy, and is responsible for ensuring policy compliance.

The analysis in the attached consultant's report sets out the estimated costs of forming and operating an IB and of participating in the ONE JIB, as well as some of the potential benefits and pitfalls associated with either option.

Municipal Consultations

City staff connected with staff at the City of Barrie, which has opted-in to PI and formed their own IB, and the Region of Peel who is still considering its options.

Through this consultation, staff learned that the province has committed to re-convening a committee to review the sections of the Act and regulations that prescribe municipal investment powers to determine if there are other options that may be added that allow municipalities access to an expanded selection of investments without the more costly governance requirements of an IB or JIB.

One such option may be the outsourced chief investment officer (OCIO) model. An OCIO takes an organization's approved investment policy which establishes the needs, goals, and risk tolerances of the organization, builds a plan reflective of those policy goals decisions, and then selects and monitors the investment managers who manage the portfolio.

ONE

ONE was formed in 1993 as ONE – The Public Sector Group of Funds by Local Authority Services (LAS) and CHUMS Financing Corporation (a subsidiary of the Municipal Finance Officers' Association of Ontario) to provide investment options for Ontario municipalities. ONE provides several options for municipalities investing under the legal list, as follows:

Short term

- High Interest Savings Account (for 1+ month investments)
- Money Market Portfolio (for 1 to 18 months investments)

Medium term

- Canadian Government Bond Portfolio (18 months to 3 years investments)
- Canadian Corporate Bond Portfolio (4+ years investments)

Long term

- Canadian Equity Portfolio (5+ years investments)

Municipalities in the ONE JIB have access to the above medium and long-term portfolios (short-term cash flow management is outside of the scope of the JIB), in

addition a Global Equity Portfolio which is only available to municipalities who have opted-in to PI.

Analysis

The City engaged Rodgers Investment Consulting (RIC) to undertake a preliminary analysis of the options available under the legislation. RIC's report is attached as Attachment-1.

Four options were considered in this analysis:

- i. Continue to invest under Section 418 of the Act (legal list), and continue to self-manage a significant portion of the City's portfolio;
- ii. Continue to invest under Section 418 of the Act (legal list), and expand the managed portion of the City's portfolio;
- iii. Opt-in to PI and form an IB for the City; or
- iv. Opt-in to PI and join the ONE JIB.

The analysis is based on historical returns and actual costs (when known) or estimated costs (when not known). RIC points out that a limitation of the cost analysis is that the City does not have a dedicated investment professional(s) managing the City's portfolio. This task is part of the jobs of multiple staff in the Finance department, and the City does not have staff with specialized investment expertise managing the portfolio. The internal management costs have not been estimated.

RIC concluded that the City would be well served by opting-in to PI, while the financial decision as to whether or not to form its own IB or join the ONE JIB is less clear; however, given the significant financial and operational risks involved with setting up and operating an IB as outlined in the report, and the fact that the City would most likely need to hire a dedicated senior investment specialist if the IB option is pursued, staff recommend that the IB option is not the most effective for Guelph.

Based on the historical analysis, RIC also concluded that the City would have been better served utilizing the professional management of ONE for the management of the long-term portfolio in accordance with the O.Reg's (legal list).

The City's Readiness for PI

The City meets both of the financial eligibility criteria under the legislation for opting into PI (meeting only one of the two is required).

Staff have done significant foundational work that will contribute to readiness to implement PI, including implementation of the reserve and reserve fund strategy and capital funding strategies which have increased confidence in long-term planning and have increased the size of the long-term investment portfolio. The City is now at a point where a review of the investment portfolio structure and the new options available under the Act is important for future sustainability including integrating debt and investment planning to access longer-term financing options.

In addition to the work already done, staff are continuing to develop and refine long-term cash flow forecasting capabilities. Having a reliable long-term model for forecasting cash needs in place is an essential foundation for investment planning under PI.

In addition to long-term cash flow forecasting capability, a new investment policy will be required for the City under PI.

For this reason, the City is not currently in a position to implement PI through the ONE JIB.

Current Investment Policy Amendments

While staff continue to work on the foundational structures needed for participation in PI through the ONE JIB, an interim step of amending the City’s current Investment Policy to increase access to the ONE legal list professionally managed funds is recommended. The revised draft Investment Policy included in Attachment-2 (presented with changes tracked) contains the following amendments:

Investment Policy Classification	Portfolios Included	Current Portfolio Limit	Proposed Portfolio Limit
Joint Municipal Investment Pools – Bonds	Canadian Government Bond Portfolio	0%	40%
Joint Municipal Investment Pools - Bonds	Canadian Corporate Bond Portfolio	15%	40%
Joint Municipal Investment Pools - Equity	Canadian Equity Portfolio	5%	20%

The Investment policy has also been formatted in alignment with the City’s current corporate policy template to comply with Accessibility for Ontarians with Disabilities standards resulting in other minor changes.

Financial Implications

The proposed amendment to the current Investment Policy to increase the amount of the portfolio that can be invested in the professionally managed funds through ONE should provide greater returns for the City based on the analysis. Caution however should be used as past historical performance does not guarantee future rate returns.

Consultations

None noted.

Strategic Plan Alignment

This report supports the Working Together for Our Future Priority of exploring service delivery models and partnerships to ease taxes for residents and businesses.

Attachments

Attachment-1 Analysis of Long-Term Investment Options

Attachment-2 Proposed Investment Policy

Departmental Approval

N/A

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