

TO: CITY MANAGER 2001 March 15
FROM: DIRECTOR FINANCE File: I56-1-2
SUBJECT: CITY INVESTMENTS - 2000 UPDATE
PURPOSE: To update Council on the City's current investment program.

RECOMMENDATION:

1. THAT this report be received for information purposes.

REPORT

BACKGROUND

Periodically, the Director Finance makes a stewardship report to Council regarding the City's investment portfolio. The report highlights any significant events that have occurred in the investment program, lists the institutions the City invests with, and states the investment limits that have been placed on those institutions.

The Local Government Act states that Council has the authority to invest the City's reserve (capital) funds and that the Municipal Treasurer has the authority to invest the revenue (operating) funds.

Due to the volume of transactions involved in the placement of investments, Council has assigned the responsibility for the management of the investment portfolio to the Director Finance.

Attached is an updated schedule summarizing the institutions and limits currently in place for the combined capital and operating investment portfolios (Schedule A). While maintaining dollar limits for each investment issuer, our desired overall investment portfolio contains a preferred mix by category of security.

Schedule A references a number of terms with which the reader may not be familiar. A brief definition of the terms follows:

Dominion Bond Rating Service (DBRS) is the leading Canadian institutional credit rating agency, the authority on the fiscal strength of financial and governmental bodies.

<u>Term</u>	<u>Meaning</u>
Schedule A Bank	Canadian-owned Bank
Schedule B Bank	Foreign-owned Bank
BDN	Bank Deposit Note (issued by all major banks)
DBRS investment quality categories for short-term securities:	
R-1	High (investment grade) credit quality
R-2	Medium (average grade) credit quality
R-3	Low (speculative) credit quality
High	The relative standing within each rating classification, e.g. R-1 High is, by definition the highest credit quality available.
Middle	
Low	
DBRS investment quality categories for bonds and long-term debt are:	
AAA	Highest quality credit
AA	Superior credit
A	Upper mid grade credit

Credit Unions of British Columbia

The Credit Unions of British Columbia are not currently rated by any of the Canadian institutional credit rating agencies. Credit Unions are regulated by the British Columbia Ministry of Finance and are under the Superintendent of Financial Institutions. The Superintendent monitors performance monthly and examines each credit union annually.

Credit Unions are required to meet regulatory, statutory capital and liquidity requirements, under the Financial Institutions Act of British Columbia and the Credit Union Incorporation Act of British Columbia.

The Province maintains, under the Credit Union Incorporation Act and in addition to the regulatory system, two credit union deposit insurance funds, of approximately \$91 million and \$94 million respectively, that are structured to support the liquidity of British Columbia credit unions. This infrastructure exists at the Provincial level to avoid concerns over default by individual credit unions in British Columbia.

Prior to placing any funds on deposit with a B. C. credit union the City obtains, from the Financial Institutions Commission, a certified copy of the business authorization and compliance record signed by the Superintendent of Financial Institutions Commission. A review and analysis of the audited financial statements of the credit union then determines the level of investment. The maximum term of an investment with any B. C. credit union does not exceed 367 days. The maximum amount of the portfolio invested with B. C. credit unions at any one time does not exceed 30% of the total investment portfolio.

SIGNIFICANT EVENTS DURING 2000

During 2000 short-term interest rates increased and decreased during the year as the prime interest rate, which governs the level of short-term rates, moved from its October 1999 low of 4.75% to a high of 6.00% in May 2000. The prime interest rate remained unchanged from May 2000 until the end of the year. However, other market conditions in 2000 put downward pressure on the short term interest rates in the 3rd and 4th quarters. The average yield for 90 day Treasury Bills for 2000 was 5.49% (for 1999 - 4.68%).

Long-term rates, maturities over 10 years, also climbed steadily in 1999 reaching 6.38% in October 1999. In January 2000 the long-term rate was at its highest for the year at 6.36%. By 2000 December 31, the long-term bond average yield was at 5.63%.

The General Revenue Fund is directly impacted by any movement in short-term interest rates during the year, particularly in July when the investment fund reaches a high of over \$200 million upon receipt of tax revenue and then decreases again to approximately \$65 million at year end.

In order to offset the impact of declining short-term interest rates on investment income in 1999, the General Revenue fund invested a portion of its surplus fund in longer term, higher yield government bonds. These bonds were maintained within the portfolio in 2000. In 2000, the General Revenue Fund generated \$5.2 million (6.04%) in investment income (1999 - \$4.9 million) (6.26%).

During 2000 a portion of the Capital Fund reserves remained invested in longer term high yield government bonds to realize higher income and safeguard the City's Capital Reserves income from the negative impact of declining short-term rates. The Capital Fund which represented \$155 million at 2000 December 31 (\$172 million 1999), generated income of \$10.8 million (6.16%) (\$10.9 million 1999) (6.17%).

In 2000, the City continued its business relationships with Vancouver City Savings Credit Union. VanCity does not have a credit rating from DBRS, however they fall under the umbrella coverage of the B. C. Credit Union Act.

The City's investment banking relationships remained consistent with 1999. RBC Dominion Securities (the Royal Bank) and the Toronto-Dominion Bank Treasury Group remained the City's lead investment bankers for 2000.

In 2000 the City improved its ability to access and research financial markets, communicate with investment bankers and obtain competitive bids on-line through the use of Bloomberg, creating an environment of real-time information.

In December 2000, the City was notified by Deutsche Bank Canada that they had applied to the Office of the Superintendent of Financial Institutions Canada to establish a foreign bank branch in Canada. The new Investment Limits for 2001 does not include Deutsche Bank (Canada) for investments as the newly formed bank does not meet the Local Government Act investment requirements.

Also in 2000, Banque Nationale de Paris amalgamated with BNP Paribas (Paris). The Dominion Bond Rating for BNP Paribas (Canada) is R-1 Middle. The new Investment Limits for 2001 shows the rating and name change.

In addition to the noted institutional changes, the Province of Saskatchewan and the Bank of America Canada have been added to the Investment Limits for 2001 list. The Dominion Bond Rating is R-1 Low and R-1 Middle respectively.

OUTLOOK FOR 2001

Current economic forecasts for interest rates are at best uncertain. The events that have transpired in North America since 2001 January 01 have signaled concern for economic growth in both Canada and the United States. The 2000 interest rate increases to control inflation and slowdown fast expanding economies have been lowered as sectors of the economy show weakness. The inability of United States equity markets to rebound from 2000 lows and a general slowing of the U.S. economy resulted in the Reserve Board lowering interest rates a full 1% since 2001 January 01.

On 2001 March 06, the Bank of Canada lowered the overnight rate by 50 Basis Points, thus indicating that the Canadian Economy will indeed be affected by the United States slowdown. The effect of cumulative interest rate reductions in 2001 will have a greater impact on the General Revenue Fund where money market instruments are invested for short periods of time prior to expenditure needs.

	<u>March</u> <u>2001</u>	<u>March</u> <u>2000</u>
30 day Treasury Bills	4.70%	4.92%
60 day Treasury Bills	4.67%	5.03%
90 day Treasury Bills	4.54%	5.35%
180 day Treasury Bills	4.45%	5.44%
One year Treasury Bills	4.44%	5.88%

In 2001 the City will continue to invest in both the money and bond Markets for both the Capital and General Revenue Funds taking positions along the yield curve that will generate the highest yields, while maintaining liquidity and safety at all times. When an investment is placed or an investment strategy is entered into it must satisfy the criteria that it can be held until maturity. If these investments are in a capital gain position they may be sold prior to maturity.

Generally the portions of the Capital and General Revenue Funds that are not scheduled to be drawn on in the near future are invested in longer term investments with higher yields.

In the Capital Fund approximately \$116 million is invested in long-term investments (five year and longer). The balance of the Capital Fund is invested in shorter term investments that mature within five years. Within the General Revenue Fund approximately \$38 million is invested in long-term higher yield investments (five year and longer). The balance of the General Revenue Fund investments have maturities of less than one year.

In 2000, after extensive review, the City invested in products called equity linked notes. These notes are issued by the Government of Canada or a Canadian Financial Institution for terms of approximately five years. These products typically have a zero coupon and a yield determined by certain equity indexes such as the TSE 300, Dow, S&P 500, or the NASDAQ 100. The notes may contain a basket of blue chip and other stocks and a secondary market is created in Canada by the brokers. The advantage to the City is that the investments have principal guarantees while also allowing for greater investment return possibilities. In 2000, the investment portfolio earned 7.62% on investment equity linked products. Currently the City maintains investments in equity linked notes and is looking for additional investment opportunities that fit the City's criteria and needs.

The current forecasts for year 2001 investment incomes are estimated at \$10 million for the Capital Fund and \$4.92 million for the General Revenue Fund.

Staff will continue to research and develop investment strategies that allow the City to increase its investment income, while maintaining strict controls and guidelines outlined under the Local Government Act to safeguard the City's capital and ensure liquidity of the portfolio.



Rick Earle
DIRECTOR FINANCE

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Attach.

INVESTMENT LIMITS FOR 2001
Schedule A

SECURITIES CATEGORY	<i>Short-term Investments</i> DBRS Ratings	<i>Long-term Investments</i> DBRS Ratings	Investment Limits	Portfolio % Mix
Federal & Federal Guaranteed	R1 - High	AAA	No Limit	No Limit
Total Federal & Federal Guaranteed			No Limit	No Limit
British Columbia	R1 - Middle	AA LOW	\$ 60,000,000	
Total Province of B.C.			\$ 60,000,000	30% Max.
Alberta	R1 - High	AA HIGH	\$ 40,000,000	
Saskatchewan	R1 - Low	A	\$ 40,000,000	
Manitoba	R1 - Low	A	\$ 40,000,000	
Ontario	R1 - Middle	AA LOW	\$ 40,000,000	
Quebec	R1 - Low	A	\$ 45,000,000	
Total Provinces Other (Excluding B.C.)			\$ 205,000,000	40% Max.
Bank of Montreal	R1 - Middle	AA LOW	\$ 40,000,000	
CIBC	R1 - Middle	AA LOW	\$ 40,000,000	
Royal Bank	R1 - Middle	AA LOW	\$ 40,000,000	
ScotiaBank	R1 - Middle	AA LOW	\$ 40,000,000	
Toronto Dominion Bank	R1 - Middle	AA LOW	\$ 40,000,000	
National Bank of Canada	R1 - Low	A	\$ 10,000,000	
Total Schedule 'A' Banks			\$ 210,000,000	50% Max.
ABN Amro Bank Canada	R1 - High		\$ 40,000,000	
UBS Bank (Canada)	R1 - High		\$ 40,000,000	
HSBC Bank Canada	R1 - Middle		\$ 40,000,000	
Bank of America	R1 - Middle		\$ 20,000,000	
BNP Paribas (Canada)	R1 - Middle		\$ 10,000,000	
Chase Manhattan Bank of Canada	R1 - Middle		\$ 10,000,000	
Citibank Canada	R1 - Middle		\$ 10,000,000	
Credit Suisse First Boston Canada	R1 - Middle		\$ 20,000,000	
J. P. Morgan Bank Canada	R1 - Middle		\$ 20,000,000	
Total Schedule 'B' Banks			\$ 210,000,000	30% Max.
VanCity Savings Credit Union	Not Rated	NOT RATED	\$ 50,000,000	
Surrey Metro Savings Credit Union	Not Rated	NOT RATED	\$ 5,000,000	
Gulf & Fraser Credit Union	Not Rated	NOT RATED	\$ 5,000,000	
Total B.C. Credit Unions / Non Rated Investments			\$ 60,000,000	30% Max.