Info Item 3

HALIFAX
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Audit and Finance Committee
September 21, 2011

TO: Chair and Members of the Audit and Finance Committee

SUBMITTED BY: Bruce Fisher, MPA, CMA, Acting Director of Finance and Chief Financial Officer

DATE: August 25, 2011

SUBJECT: **Investment Activities - Quarter Ending June 30, 2011**

INFORMATION REPORT

ORIGIN

Quarterly report of investment performance and adherence to approved Investment Policy.

BACKGROUND

The Investment Policy calls for quarterly reporting by the Treasurer to Council and the Investment Policy Advisory Committee (the Committee). The report for the Quarter ending June 30, 2011 has been reviewed by the Committee. An information report from the Committee on staff's compliance with the objectives of the HRM Investment Policy has also been sent to the Audit and Finance Committee for the September 21 meeting.

DISCUSSION

HRM Investment Activities

HRM Money Market investment performance is summarized below in comparison with the Mercer Investment Consulting Survey of Canadian Institutional Pooled Funds for periods ending June 30, 2011:

Money Market Funds	3 Months (to June 30, 2011)	6 Months (to June 30, 2011)	1 Year (to June 30, 2011)
5th Percentile	.38 %	.77%	1.36%
1st Quartile	.31 %	. 63%	1.12%
Mercer Median	. 29%	. 58%	1.03%
3rd Quartile	. 27%	. 54%	.97%
95th Percentile	.20 %	.42 %	.74%
Dec 91 Day T-Bills	. 24%	.52 %	.89%
HRM	.29%	.59%	1.08%

HRM relative performance was at median for the Quarter and slightly above median for the 6 month and 1 year time frames before any allowance for fees that would have been paid to an external management firm. The very high credit quality of the portfolio was maintained.

Relative to recent activity levels the Quarter was much busier with 86 investments made at a cost of approximately $370,594,000. For the comparable Quarter last year there were 62 investments at a cost of $238,945,000. The increased activity versus last year was largely due to a shorter average term to maturity for investments of 83 days versus 136 days in the previous year. In both years the bank account offered an attractive interest rate and was used extensively. The shorter term to maturity was motivated by the fact that the market did not appear to be offering appropriate compensation for the then reasonable prospect of Bank of Canada rate increases and by a desire to preserve the potential of meeting the budgeted rate of return for the year by not locking in rates below the budgeted rates.

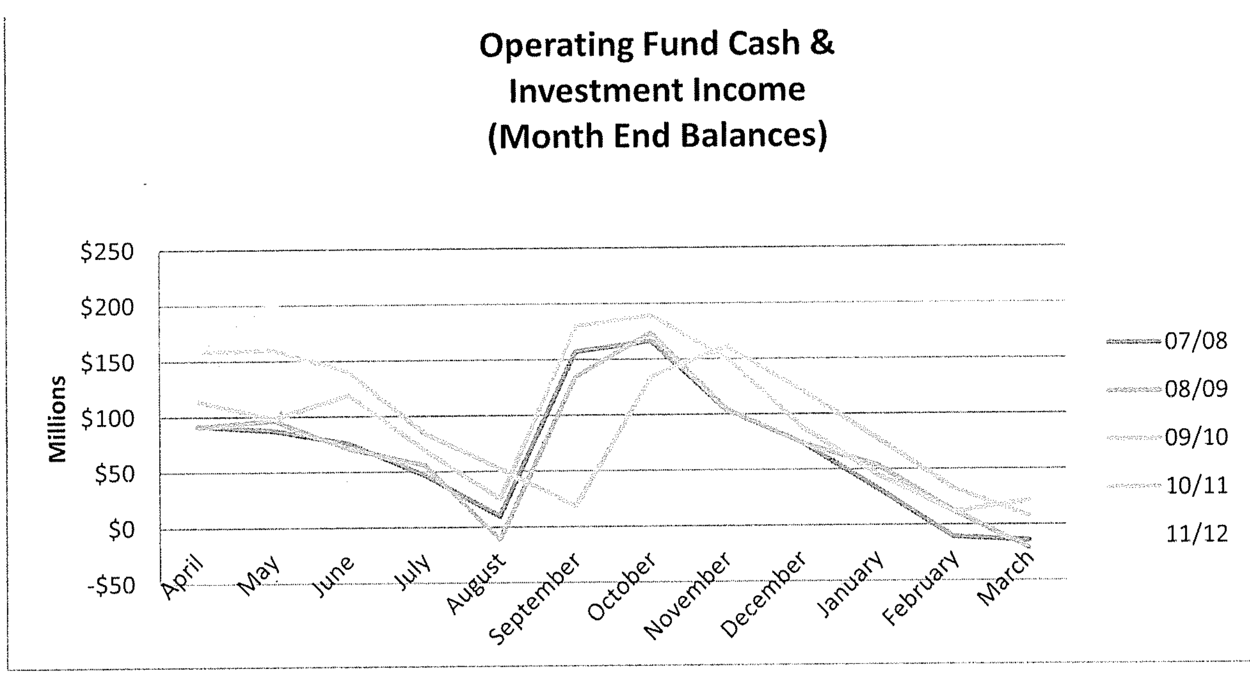
Operating Fund Investment Income for the Quarter was $436,000 versus a budget of $374,000. Better than anticipated cash flows were solely responsible as the actual rate of return was .29% versus a budgeted rate of .31%. Future Quarters will be challenging to say the least and will be discussed further below.
The cumulative incremental gross investment income from the 2007 Policy change that expanded the Non-Government Sector Weight was $737,594 or a $12,490 increase during the Quarter.

HRM Short Term Bond Pool

The Short Term Bond Pool holds bonds to a maximum term to maturity of approximately five years. The $6,000,000 of bonds currently held have yields ranging from 2.21% to 4.30%. These bonds are guaranteed by either the Government of Canada or highly rated Provinces. There were no additions to the Bond Pool during the Quarter. Staff continues to look for opportunities to add to the Bond Pool with the ever changing outlook for future interest rates over a potential five year holding period a key consideration.

Cash Flow

The unusual peek in Operating Fund Cash & Investments at the end of May shown below was due to the receipt of the Spring Debenture proceeds in May versus the usual month of June as well as higher cash receipts in a number of revenue categories. Expenditures were slightly below the previous year's levels. The recently redeveloped cash flow model will be used for variance analysis. The success of the effort to rebuild the cash flow model will be determined by its ability to adequately explain year over year differences in cash and investment balances.



The Non-Government Sector limit was slightly exceeded on June 15. Investments on June 16 brought the Sector Weights back in line. This variance was discussed with the Investment Policy Advisory Committee which agreed with staff's assessment that this temporary variance did not represent a material increase in risk to the portfolio.

Subsequent to End of Reporting Quarter

There has been a dramatic increase in volatility in markets and increased fears that developed economies may slip back into recession. By way of background, the financial crisis that began to unfold in 2007 has not ended but has merely migrated from banks and over-leveraged home buyers to governments. With the advantage of 20/20 hindsight, it now seems clear that the U.S. Federal Reserve in particular may have inadvertently taken actions that have made economic matters worse. Interest rates were reduced and kept at low rates in response to market events as well as the usual economic events.

In terms of specific events, the adoption of a slightly more hawkish tone by the Bank of Canada at its July 19 meeting was eclipsed by developments in Europe and the United States in late July and early August. Fears of debt contagion in Europe and the demonstration of a lack of political will to face the very real budget challenges created a crisis of confidence in markets. This also coincided with some weaker than expected economic numbers. The net results were dramatic selloffs in equity and bond markets with the newly downgraded U.S. debt still attracting safe haven flows. Canadian rates also saw dramatic moves with the yield on 1 year Government of Canada T-Bills dropping more than 20 bps in a single day. The implied moves in the Overnight Rate for the next 8 meetings of the Bank of Canada as expressed by the futures went from +44.5 July 28 to -41.25 August 8.

The U.S. Federal Open Market Committee had a fairly gloomy statement August 9 and added a 'conditional commitment' type statement to keep their primary policy rate at the current level of between 0 and .25% until at least the middle of 2013. This is similar to what the Bank of Canada invoked in 2009 and then abandoned in April 2010. It is striking that in addition to all the other measures taken by the U.S. Federal Reserve that they felt the need to make such a pledge at this time and serves to underline the still sorry state of the U.S. economy. To put a more human face on this the USDA website now indicates the food stamps program is being used by over 40,000,000 Americans compared to 'just' over 35,000,000 when we last reported on this in early 2010.

As a result of the deteriorating economic situation and the commitment by the U.S. Federal Reserve to keep rates on hold until at least the middle of 2013, interest rates in Canada have dropped considerably. Most economists are projecting that the Bank of Canada will maintain its target rate at 1% well into 2012. This is in sharp contrast to projections of rising rates in Canada that were in place earlier in the year. In developing the budgeted rate of return for HRM investments for this fiscal year staff used the consensus forecasts of the Big 6 Canadian Bank economists for certain key rates adjusted for HRM asset mix. This resulted in a budgeted rate of return for the year of 1.75%. In the current environment this rate of return will be unattainable. Although cash flow trends have been better than anticipated resulting in an overachievement of Operating Fund Investment Income for the 1st Quarter it is anticipated that dramatically lower than anticipated interest rates will result in a shortfall in Operating Fund Investment Income for the year. The magnitude of this shortfall may be between $200,000 and $300,000 depending in future cash flow developments..

Outlook & Strategy

The economic outlook remains highly uncertain but with a negative bias being priced into most markets. However, the U.S. elections in 2012 may provide a powerful incentive for the adoption of policy measures to encourage economic growth, at least in the short term. On the other hand the election prospect may also serve to harden established positions and further reduce economic confidence.

We will continue to employ the strategy of locking in longer term rates when they appear attractive relative to what the Bank of Canada may do with interest rates and staying shorter term to cover cash needs when relatively attractive rates are not available.

Policy Compliance

Adherence to Legal Requirements – There were no legal issues identified during the Quarter with respect to investments.

Preservation of Capital - There was no loss of capital during the Quarter and no investments were sold during the Quarter.

Liquidity - No overdraft charges were incurred and sufficient cash was available to meet all requirements. The funded ratio of the Reserves at Quarter end was 100%.

Diversification of Investment Portfolio - Staff believe that the Diversification Objective of managing risk and return has been achieved.

Competitive Return on Investments - The rate of return was above median for the year ending June 30.

Regular Review of Performance - Performance data continues to be reported to the Investment Policy Advisory Committee.

BUDGET IMPLICATIONS

While Operating Fund Investment Income exceeded the budgeted amount of $371,000 in the 1st Quarter by some $62,000, it is anticipated that much lower than expected interest rates will result in a shortfall for the year. This shortfall may be between $200,000 and $300,000 on a total budget of $1,435,000. Staff will be in a better position to more accurately project this figure after tax billing in October.

FINANCIAL MANAGEMENT POLICIES / BUSINESS PLAN

This report complies with the Municipality's Multi-Year Financial Strategy, the approved Operating, Project and Reserve budgets, policies and procedures regarding withdrawals from the utilization of Project and Operating reserves, as well as any relevant legislation.

COMMUNITY ENGAGEMENT

Investment activities are reported Quarterly to the Investment Policy Advisory Committee. The majority of members of this Committee (4 of 6) are volunteers from the general public. The Committee reports to Council Quarterly on staff's compliance with the Investment Policy. In addition, the Committee conducts an annual review of the Investment Policy and makes recommendations to Council for any changes considered appropriate.

ATTACHMENTS

Sector Weight Schedules @ June 30, 2011 (Schedules A, B, C, D & E)
Appendix A - Economic Statistics and Central Bank Actions
Appendix B - List of Eligible Investments
Appendix C - DBRS Rating Scale

A copy of this report can be obtained online at http://www.halifax.ca/commcoun/cc.html then choose the appropriate Community Council and meeting date, or by contacting the Office of the Municipal Clerk at 490-4210, or Fax 490-4208.

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Appendix A

Economic Statistics

	Canada	US
Unemployment Rate	April 7.6%, May 7.4%, June 7.4%	April 9.0%, May 9.1%, June 9.2%
Jobs Created / (Lost) ('000's)	April 58.3, May 22.3, June 28.4	April 217, May 53, June 46
CPI (year over year)	April 3.3%, May 3.7%, June 3.1%	April 3.2%, May 3.6%, June 3.6%
CPI-X (Core) (year over year)	April 1.6%, May 1.8%, June 1.3%	April 1.3% , May 1.5%, June 1.6%
Q2 GDP	N/A	1.3%A

Central Bank Activities

- April 12 Bank of Canada Maintains overnight rate at 1.0%
- April 27 U.S. Federal Open Market Committee maintains Target Range of 0% to .25%
- May 31 Bank of Canada Maintains overnight rate at 1.0%
- June 22 U.S. Federal Open Market Committee maintains Target Range of 0% to .25%

Appendix B

List of Eligible Investments

The Government of Canada & Its Guarantees:
Federal Government
Business Development Bank
Canada Mortgage & Housing Corporation
Canadian Wheat Board
Export Development Canada
Farm Credit Corporation
Provincial Governments & Their Guarantees:
The Province of Alberta & Its Guarantees
The Province of British Columbia & Its Guarantees
The Province of Manitoba & Its Guarantees
The Province of New Brunswick & Its Guarantees
The Province of Ontario & Its Guarantees
The Province of Quebec & Its Guarantees
The Province of Saskatchewan & Its Guarantees
Municipal Governments & Their Guarantees:
The Municipality of Calgary & Its Guarantees
The Municipality of Edmonton & Its Guarantees
Financial Institutions & Their Guarantees (Tier 1):
The Bank of Montreal & Its Guarantees
The Bank of Nova Scotia & Its Guarantees
Canadian Imperial Bank of Commerce & Its Guarantees
Royal Bank of Canada & Its Guarantees
Toronto Dominion Bank & Its Guarantees

Financial Institutions & Corporations (Tier 2):
Desjardins Group
Caisse Centrale Desjardins
CDP Financial Inc
National Bank of Canada
Ontario Infrastructure and Lands Corporation
OMERS Finance Trust

Appendix C

Dominion Bond Rating Service (DBRS) Rating Scale

R-1 (high)

Short-term debt rated R-1 (high) is of the highest credit quality, and indicates an entity possessing unquestioned ability to repay current liabilities as they fall due. Entities rated in this category normally maintain strong liquidity positions, conservative debt levels, and profitability that is both stable and above average. Companies achieving an R-1 (high) rating are normally leaders in structurally sound industry segments with proven track records, sustainable positive future results, and no substantial qualifying negative factors. Given the extremely tough definition DBRS has established for an R-1 (high), few entities are strong enough to achieve this rating.

R-1 (middle)

Short-term debt rated R-1 (middle) is of superior credit quality and, in most cases, ratings in this category differ from R-1 (high) credits by only a small degree. Given the extremely tough definition DBRS has established for the R-1 (high) category, entities rated R-1 (middle) are also considered strong credits, and typically exemplify above average strength in key areas of consideration for the timely repayment of short-term liabilities.

R-1 (low)

Short-term debt rated R-1 (low) is of satisfactory credit quality. The overall strength and outlook for key liquidity, debt, and profitability ratios is not normally as favourable as with higher rating categories, but these considerations are still respectable. Any qualifying negative factors that exist are considered manageable, and the entity is normally of sufficient size to have some influence in its industry.