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HALIFAX
REGIONAL MUNICIPALITY

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Audit and Finance Standing Committee
December 14, 2011

TO: Councillor Russell Walker, Chair, and Members of the Audit and Finance Standing Committee

SUBMITTED BY: James Cooke, Director of Finance and Information Technology/CFO

DATE: November 23, 2011

SUBJECT: Investment Activities – Quarter Ending September 30, 2011

RECOMMENDATION REPORT

ORIGIN

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

RECOMMENDATION

It is recommended that the Audit and Finance Standing Committee forward this report to Halifax Regional Council as an information item.

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 September 30, 2011 has been reviewed by the Committee. A 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 December 14 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 September 30, 2011:

Money Market Funds	3 Months (to Sept. 30, 2011)	9 Months (to Sept. 30, 2011)	1 Year (to Sept. 30, 2011)
5th Percentile	.35%	1.10%	1.45%
1st Quartile	.31%	.93%	1.23%
Mercer Median	.29%	.87%	1.16%
3rd Quartile	.27%	.83%	1.05%
95th Percentile	.25%	.75%	.98%
Dec 91 Day T-Bills	.26%	.78%	1.02%
HRM	**.29%**	**.88%**	**1.16%**

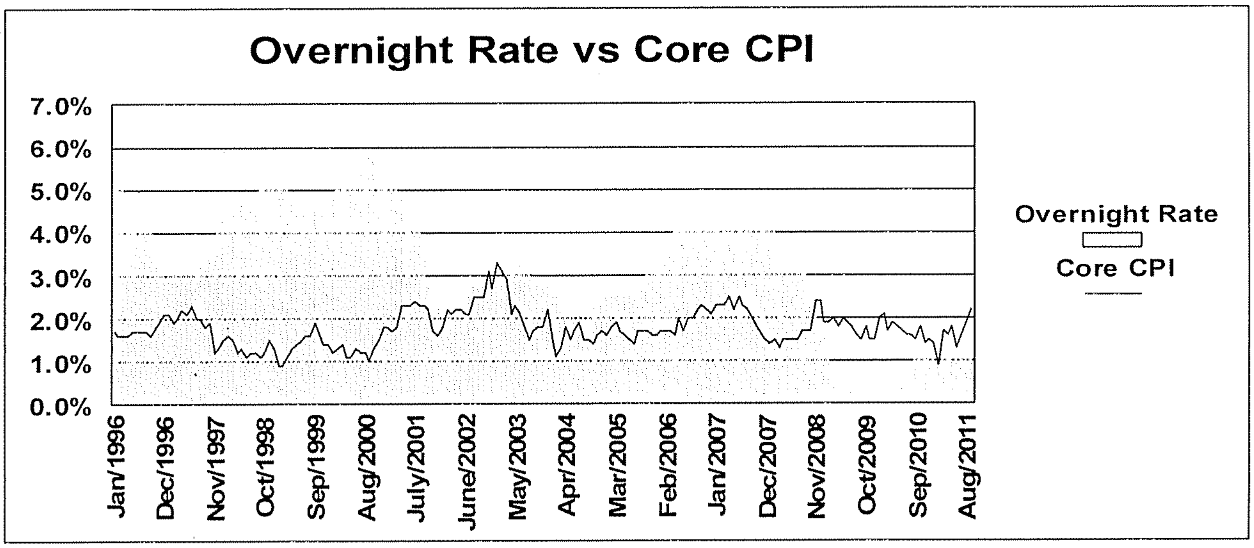
Relative performance was consistently Median across all reported timeframes. This rate of return was before any allowance for fees that would have been paid for external management. The very high quality of the portfolio was maintained.

The Quarter saw 28 money market investments made at a cost of $108,973,000 with an average term to maturity of 98 days. There were also 2 Floating Rate Notes (FRN's) purchased for a cost of $12,000,000 maturing in December 2011. This compares to last year's 2nd Quarter with 12 investments made at a cost of $41,726,900 with an average term of 108 days. The increase in investment activity was due to better than expected cash flows as well as an emphasis on shorter term investments. For much of the Quarter the market was not offering reasonable compensation for the then reasonable prospect of Bank of Canada rate increases. The bank account continued to provide an attractive rate of interest relative to other short term Financial Institution instruments and was used extensively.

Operating Fund Investment Income for the first 6 months of the fiscal year was $752,000 versus a budget of $650,000. All of this positive variance was due to better than anticipated cash flows as the rate of return for the period was .59% versus a budgeted rate of .71%. As the anticipated increases in interest rates for the second half of the year included in the budgeted rate of return are not expected to occur, a shortfall in Operating Fund Investment Income for the year was originally anticipated to be between $200,000 and $300,000. However, initial indications of cash levels after the final tax billing are encouraging resulting in a current projected shortfall of approximately $100,000 for the fiscal year.

The cumulative incremental gross investment income from the 2007 Policy change that expanded the Non-Government Sector Weight was $748,490 or a $10,594 increase during the Quarter.

As demonstrated below the unusual situation of core inflation exceeding the Bank of Canada overnight target interest rate has persisted.

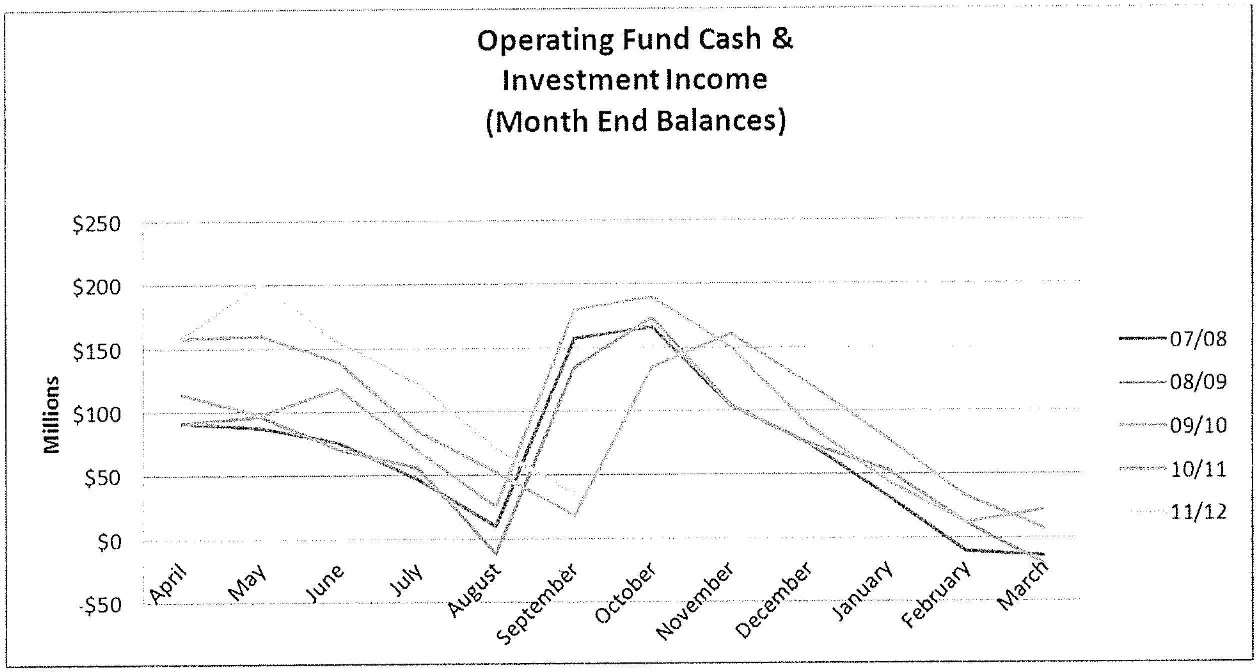


<u>HRM Short Term Bond Pool</u>

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 Flows

Positive Operating Fund cash flow trends continue. Analysis suggests a lower level of Capital expenditures relative to last year is an important contributing factor as this reduces the demand on the Operating Fund to provide bridge financing. Where last year there were a number of large projects such as the Canada Games Centre, the Ragged Lake Transit Facility and the 4 Pad Arena, there have not been projects collectively of a similar magnitude this year. This second year of the change in the property tax due date to the end of October is well illustrated in the graph below:



The Royal Bank Sector Weight exceeded the Policy guidelines by some $1,300,000 for one day on July 18. Investments on July 19 brought the Sector Weights back on side. 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.

The size of the HRM investment portfolio varies considerably throughout the fiscal year. As a result occasionally investments that were purchased when Sector Weight limit room was available can appear to be off side when the portfolio contracts and then move back on side as the portfolio expands again from new cash inflows. There were several instances of this at the end of the Quarter. As the portfolio grew again with the October property tax billing the limits for these entities expanded again to accommodate these previous purchases.

The average level for the bank account for the Quarter was 88.9% of the maximum allowed under the Investment Policy.

Subsequent to End of Reporting Quarter

The Bank of Canada in its October 25 rate announcement and October 26 Monetary Policy Report downgraded its assumptions for future economic growth but also cited the considerable monetary policy stimulus that target interest rates at near historic lows promotes. While very cognizant of potential downside risks they, for now, offer no hints of seeing a need to reduce interest rates further.

Canada saw a rather surprising drop in employment in October losing 54,000 jobs with a drop of 71,700 full time jobs being only partly offset by a gain of 17,700 part time jobs. U.S. employment for the same month was up 80,000 jobs but the two previous months were also revised upward to 158,000 and 104,000 for net revisions of 102,000. The fact that this report was interpreted as positive and somewhat better than anticipated demonstrates how low expectations have become. Because of labour force growth the U.S. needs to create 100,000 jobs a month to just breakeven and only job numbers in excess of this amount can begin to reduce the ranks of the unemployed and under employed.

The market moving twists and turns in Europe have been too numerous to try to list. The net result for the pessimists are that issues will not be resolved soon enough and that a major market crisis will result. The optimists see this process inching towards a resolution, although admittedly in an erratic manner.

Outlook & Strategy

In Europe the challenges may be more political than financial and the financial challenges are enormous. An orderly resolution to the sovereign debt and bank solvency issues will likely at best result in a Recession in Europe. A disorderly resolution would likely bring on a global financial freeze up perhaps of a magnitude greater than the post- Lehman Brothers situation. While Europe has captured most of the headlines, the U.S. Super Committee recently announced that they were unable to reach a consensus on U.S. budget cuts and or revenue enhancements. It is anticipated that this will trigger previously agreed budget cuts as well as demonstrate again the inability of the two political parties to work together. This stalemate may continue until after the November 2012 elections leaving the U.S. Federal Reserve as the only active economic policy agent. As they use more and more largely untested monetary policy measures the potential for dramatic unintended consequences grows.

With such a fluid outlook staff will continue the strategy of locking in longer term when rates are relatively attractive and covering shorter term cash requirements when the longer rates are less appealing. This strategy is also subject to the need to manage the Policy Sector Weights.

BUDGET IMPLICATIONS

While Operating Fund Investment Income exceeded the budgeted amount of $650,000 in the 1st half of the fiscal year by some $102,000, it is anticipated that much lower than expected interest rates will result in a shortfall for the full year. This shortfall is currently projected to be approximately $100,000 on a total budget of $1,435,000.

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 Audit and Finance Committee of 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 for any changes considered appropriate.

ALTERNATIVES

N/A

ATTACHMENTS

Sector Weight Schedules @ September 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	Jul 7.2% Aug 7.3%, Sep 7.1%	Jul 9.1% Aug 9.1%, Sep 9.1%
Jobs Created / (Lost) ('000's)	Jul 7.1, Aug -5.5, Sep 61	Jul 117, Aug 104, Sep 158
CPI (year over year)	Jul 2.7% Aug 3.1%, Sep 3.2%	Jul 3.6% Aug 3.8%, Sep 3.9%
CPI-X (Core) (year over year)	Jul 1.6% Aug 1.9%, Sep 2.2%	Jul 1.8% Aug 2.1%, Sep 2.0%
Q3 GDP	N/A	2.5%A

Central Bank Activities

- July 19 Bank of Canada Maintains overnight rate at 1.0%
- August 9 U.S. Federal Open Market Committee maintains Target Range of 0% to .25%
- September 7 Bank of Canada Maintains overnight rate at 1.0%
- September 21 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.