HALIFAX
REGIONAL MUNICIPALITY

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Audit and Finance Standing Committee
October 17, 2012

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

SUBMITTED BY: ______________________________
Greg Keefe, Director of Finance and ICT / CFO

DATE: October 3, 2012

SUBJECT: Investment Activities – Quarter Ending June 30, 2012

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 June 30, 2012 has been reviewed by the Committee. A report from the Committee on staff's compliance with the HRM Investment Policy has also been sent to the Audit and Finance Committee for the October 17 meeting.

DISCUSSION

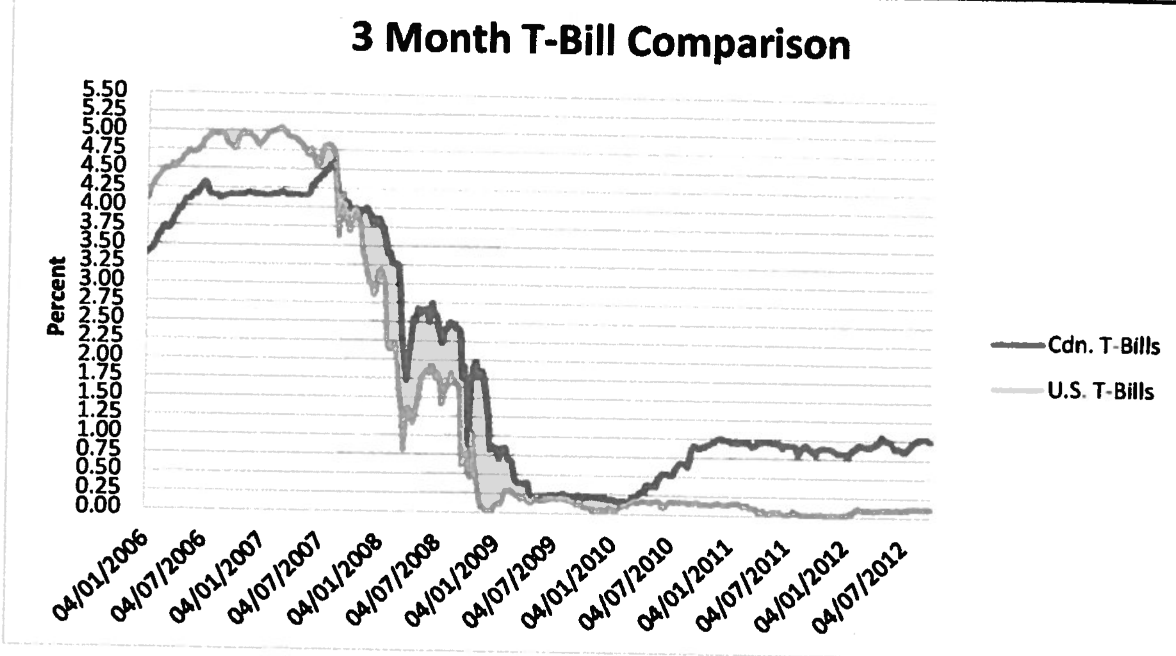
HRM Investment Activities

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, 2012:

Money Market Funds	3 Months (to June 30, 2012)	6 Months (to June 30, 2012)	1 Year (to June 30, 2012)
5th Percentile	0.37%	0.72%	1.44%
1st Quartile	0.30%	0.59%	1.19%
Mercer Median	0.29%	0.58%	1.17%
3rd Quartile	0.27%	0.52%	1.04%
95th Percentile	0.24%	0.46%	0.95%
Dec 91 Day T-Bills	0.27%	0.49%	0.96%
HRM	**0.29%**	**0.56%**	**1.14%**

HRM relative performance was at median for the reporting Quarter while somewhat below median for the 6 month and 1 year time frames on a before fee basis. After allowing for fees that would have been paid to an external management firm HRM performance would have exceeded median in all reported timeframes. The very high quality of the HRM investment portfolio was maintained.

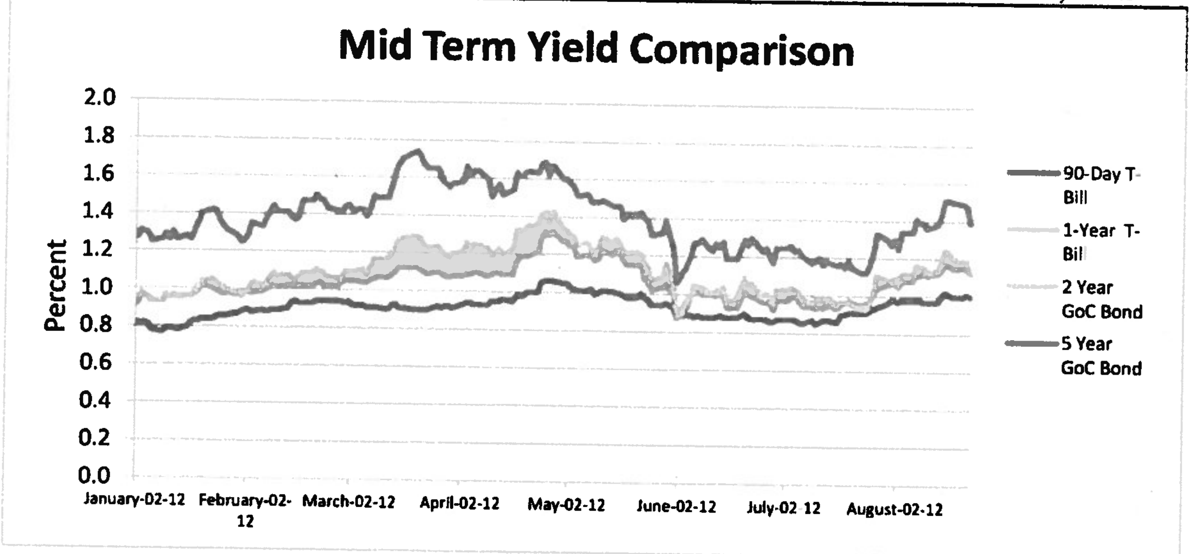
On a historical basis interest rates in Canada have been persistently low resulting in disappointing rates of return and investment income. However by comparison, as evidenced by the graph below, the recovery in Canadian rates has been stellar when compared to the U.S. The differences are even more striking when the various additional U.S. non-conventional monetary policy stimulus measures discussed briefly later in this report are taken into consideration.



The Quarter saw 85 money market investments made at a cost of $338,075,536 with an average term to maturity of 141 days. This compares to last year's 1st Quarter of 86 investments made at a cost of $370,594,000 with an average term of 83 days. The longer term to maturity this year was as a result of staff locking in relatively attractive rates early in the Quarter with Government instruments near the one year term as the market speculated that rates may be rising in Canada earlier than was previously anticipated. Other funds were placed to cover shorter term cash requirements. The bank account continued to provide an attractive rate of interest relative to other short term Financial Institution instruments and was used extensively.

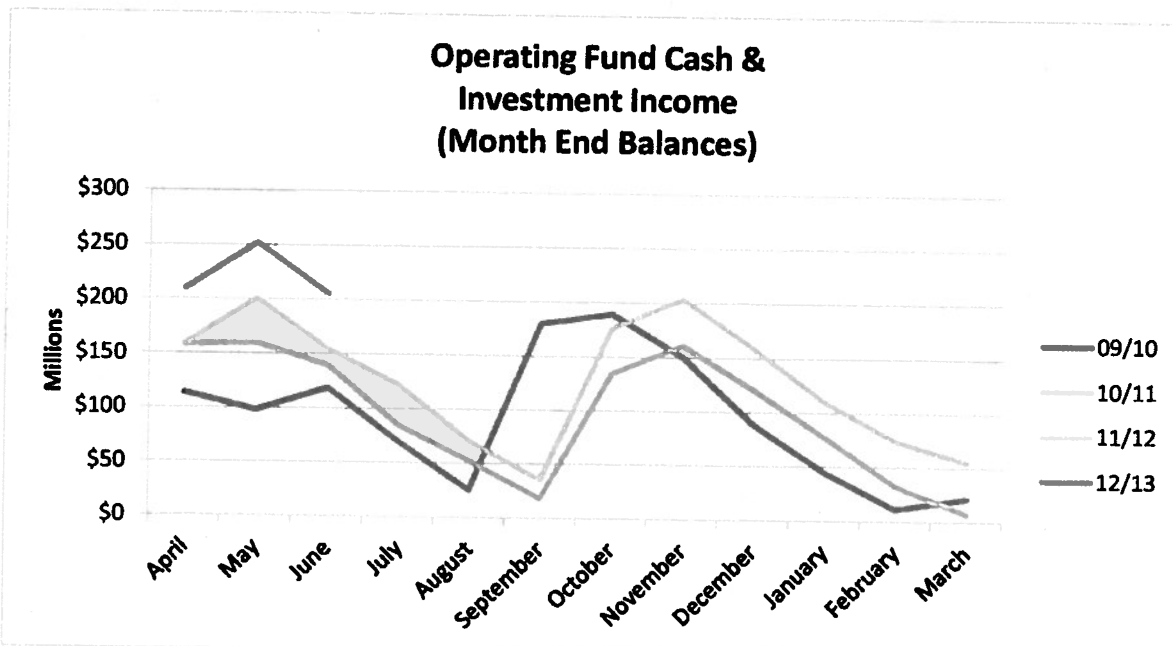
HRM Short Term Bond Pool

The Short Term Bond Pool holds bonds to a maximum term to maturity of approximately five years. The $5,000,000 of bonds currently held have yields ranging from 2.21% to 3.07%. 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

Operating Fund cash flows continue to show strength versus previous years. Contributing factors are less bridge financing for the Capital Fund, an Operating surplus in the previous fiscal year and payment of Federal disaster assistance for Hurricane Juan and White Juan.



The Sector Weight guidelines for the HRM banker were exceeded for a two day period during the Quarter. These instances were reviewed in detail with the Investment Committee and they agreed with staff's assessment that this temporary variance did not constitute a significant increase in risk to the portfolio.

The average level for the bank account for the Quarter was 93% of the maximum allowable under the Investment Policy.

Subsequent to End of Reporting Quarter

HRM entered into an agreement with Scotiabank to open a 'Notice Account'. This is a new product from Scotiabank that takes into consideration the new Basil III capital rules and offers a higher interest rate on balances held in this account in return for HRM agreeing to provide 30 days notice prior to withdrawing these funds. This account is part of the exposure to Scotiabank under the Sector Weight provisions of the Investment Policy and therefore reduces the amount of funds that can be held in the HRM operating bank accounts with Scotiabank. As a result of these reduced balances greater care will be required in managing HRM's liquidity position. It may also test the reliability of the cash flow forecast. Should staff be too aggressive in the amount put in the Notice Account and the total portfolio shrinks abruptly the entire allocation to Scotiabank could be used by the amount of funds on hold for 30 days. Although not anticipated, should this situation occur staff would likely sell investments to meet liquidity requirements rather than incur interest charges. This assumes that investments that meet our sale criteria are available which in the current interest rate environment would certainly be the case.

The Parti Quebecois unseated the Liberal Party in the September 4 Quebec provincial election but with a minority government and a relatively low share of the vote. At least in the short term there does not appear to be any risk of a renewed referendum that might rile financial markets. Staff were advised that after the election Quebec provincial bond spreads compared to Ontario actually contracted as markets showed relief over the minority status. Earlier in the summer staff added to the length of the term of Quebec exposure with a Floating Rate Note maturing December 2013. At this point staff certainly have no concerns with regards to investing in Quebec as even in the unlikely future event of separation a sovereign Quebec would require access to capital markets so any risk of default would be extremely low. However yields could be dramatically altered. Staff will continue to monitor the situation.

The European Central Bank announced its much anticipated bond buying program on September 6. It had immediate positive impacts on the yields of the needy countries and on most equity markets. On September 12 a German court ruled favourably on the constitutionality of the European Stability Mechanism. Should this ruling had gone the other way much of the repair work to the European financial structure may have been undone.

In a case of 'bad is good' weaker than expected job numbers in the U.S. announced September 7 failed to reverse the equity rally, at least in the short term, as it was seen as raising the odds of another round of Quantitative Easing (QE3) by the U.S. Federal Reserve sooner rather than later. Reported on the same day, Canada saw better than expected headline job growth but the details were weak with most of the jobs being part-time. Earlier in the week the Bank of Canada announced rates on hold again and maintained a very weak tightening bias with the statement that "some modest withdrawal of the present considerable monetary policy stimulus may become appropriate, consistent with achieving the 2% inflation target over the medium term".

The U.S Federal Reserve delivered on QE3 in a big way September 13 committing to buy $40 billion of agency mortgage-backed securities a month indefinitely. It continued 'Operation Twist' to at least the end of the year and provided guidance that the federal funds rate was likely to remain between 0 and .25% until the middle of 2015. Maturing holdings of mortgage-backed securities will continue to be reinvested in other mortgage-backed securities. It also committed to do more if all these efforts don't succeed in bringing down the unemployment rate. With the U.S. Federal Reserve almost exclusively targeting the mortgage market, yields on U.S. Treasuries and Canadian bonds rose somewhat in the immediate aftermath of the announcement. Equity markets also responded positively. It remains to be seen if this is another 'sugar rush' from quantitative easing that will fade or whether these actions will be the catalyst to finally heal the housing and job markets.

Predictably the U.S. Federal Reserve actions put upward pressure on the Canadian dollar. This may lead the Bank of Canada to counter with a removal of any hint of a tightening bias at its next rate setting meeting on October 23. Should this come to pass the timing will be particularly unfortunate with the property tax due of October 31.

Outlook & Strategy

Despite the aggressive actions by Central Bank in the U.S, and Europe many challenges remain. These include the 'fiscal cliff' and other budget issues in the U.S., the politics of Europe and hard or soft landings of emerging markets such as China. The opposing paths of debt inspired deflation or debt inspired inflation both remain open. While it can be argued that recent actions favour an inflationary outcome, the counter argument that these unprecedented measures would not have been taken without a fear of deflation and that past unprecedented actions have been ineffective are also credible. With this heightened degree of uncertainty staff will continue the strategy to lock in yield through longer term Government instruments when these yields are relatively attractive and focus on covering shorter term cash needs when they are not.

BUDGET IMPLICATIONS

Based on somewhat better than anticipated interest rates and strong Operating Fund cash flows staff are projecting that actual Operating Fund Investment Income for the fiscal year will be $1,900,000 exceeding the budget of $1,100,000 by $800,000.

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 at June 30, 2012 (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	Apr 7.3%, May 7.2%, Jun 7.2%	Apr 8.1%, May 8.2%, Jun 8.2%
Jobs Created / (Lost) ('000's)	Apr 58.2, May 7.7, Jun 7.3	Apr 115, May 87, Jun 64
CPI (year over year)	Apr 1.2%, May 1.5%, Jun 1.3%	Apr 2.3%, May 1.7%, Jun 1.7%
CPI-X (Core) (year over year)	Apr 2.1%, May 1.8% , Jun 2.0%	Apr 2.3%, May 2.3%, Jun 2.2%
Q2 GDP	2.4%	1.5%

Central Bank Activities

- April 17 Bank of Canada Maintains overnight rate at 1.0%
- April 28 U.S. Federal Open Market Committee maintains Target Range of 0% to .25%
- June 5 Bank of Canada Maintains overnight rate at 1.0%
- June 23 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.