Chatham-Kent Investment Policy

Investment Policy

1.0 POLICY STATEMENT AND PURPOSE

The Municipality of Chatham-Kent (the Municipality) shall invest public funds in a manner that maximizes investment return and minimizes investment risk while meeting the daily cash requirements of the Municipality and conforming to legislation governing the investment of public funds.

The purpose of this investment policy is to ensure integrity of the investment management process. The objective of this investment policy is to maximize investment income at minimal risk to capital. Accordingly, emphasis on investments is placed on compliance first, security second, liquidity third and overall yields fourth.

2.0 SCOPE

This investment policy shall govern the investment activities of the Municipality's General account and its Reserves. This policy applies to all investments made by the Municipality on its own behalf and on behalf of its agencies, boards and commissions (if applicable) and any new funds created by the Municipality. (Excludes Trust Funds held for Cemetery Funds)

3.0 STANDARD OF CARE

Prudence

Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable safety of their capital as well as the probable income to be derived.

Delegation of Authority and Authorization

The Treasurer or Deputy Treasurer shall have overall responsibility for the prudent investment of the Municipality's investment portfolio. The Treasurer or Deputy Treasurer shall have the authority to implement the investment program and establish procedures consistent with this policy. Such procedures shall include the explicit delegation of the authority needed to complete investment transactions however the Treasurer or Deputy Treasurer shall remain responsible for ensuring that the investments are compliant with regulations and this policy. No person may engage in an investment transaction except as provided under the terms of this policy.

The Treasurer or Deputy Treasurer shall be authorized to enter into arrangements with banks, investment dealers and brokers, and other financial institutions for the purchase, sale, redemption, issuance, transfer and safekeeping of securities in a manner that conforms to the *Municipal Act, 2001* and the Municipality's policy manual.

Transfer of funds for investment transactions shall be authorized by two of the individuals listed below, one of whom must be Treasurer or Deputy Treasurer.

1. Treasurer
2. Deputy Treasurer
3. Supervisor, Accounting Operations

4.0 OBJECTIVES

The primary objectives of this investment policy, in priority order, are as follows:

1. Adherence to statutory requirements;
2. Preservation of capital;
3. Maintenance of liquidity; and
4. Competitive rate of return.

The investment portfolio is comprised of:

- Operating (General) cash flow balances; and
- Reserves;

1. Adherence to Statutory Requirements

All investment activities shall be governed by the Ontario Municipal Act, 2001 as amended. Investments, unless further limited by Council, shall be those eligible under Ontario Regulation 438/97 or as authorized by subsequent provincial regulations.

2. Preservation of Capital (Minimization of Credit Risk)

Meeting this objective requires the adoption of a defensive policy to minimize the risk of incurring a capital loss and of preserving the value of the invested principal. As such, this risk shall be mitigated by investing in properly rated financial instruments in accordance with applicable legislation, by limiting the types of investments to a maximum percentage of the total portfolio and being mindful of the amount invested within individual institutions.

3. Maintenance of Liquidity

The investment portfolio shall remain sufficiently liquid to meet daily operating cash flow requirements and limit temporary borrowing. The portfolio shall be structured to maintain a proportionate ratio of short, medium and long-term maturities to meet the funding requirements of the Municipality. The term liquidity implies a high degree of marketability and a high level of price stability. Important liquidity considerations are a reliable forecast of the timing of the requirement of funds, a contingency to cover the possibility of unplanned requirement of funds and an expectation of reliable secondary marketability prior to maturity.

4. Competitive Rate of Return (Overall Yield)

Investment yields shall be sought within the boundaries set by the three foregoing objectives and then consideration shall be given to the following guidance;

- Higher yields are best obtained by taking advantage of the interest rate curve of the capital market, which normally yields higher rates of return for longer term investments;
- Yields will also fluctuate by institution as per individual credit ratings (greater risk confirmed by a lower credit rating) and by the type of capital instrument. For example, an instrument of a small trust company would in many cases have a slightly higher yield than a major bank;
- A lower credit rating generally makes an investment more difficult to sell on the secondary market and therefore less liquid; and
- Capital instruments that are non-callable will have a lower yield than instruments which are callable, but the call feature does not necessarily compromise marketability.

5.0 INVESTMENT STRATEGY

Diversification

To minimize credit risk and to maintain liquidity of the investment portfolio, investment diversification shall be guided by the following:

1. Limiting investments to avoid over-concentration in securities from a specific issuer or sector (excluding Government of Canada securities);

2. Limiting investment in securities to those that have higher credit ratings;

3. Investing in securities with varying maturities; and

4. Investing in securities which have an active secondary market.

Investment Type Limitations

Cash held in the bank, i.e. one day maturity, shall be no less than what is deemed necessary to meet daily operating and capital requirements of the Municipality. The current guideline is approximately $25 million in general funds and $25 million in reserves. The general funds cover the fact that taxes are due 4 times a year but many expenses are constant and there are large draws when school board payments are due and in the summer construction period. This guideline shall be evaluated on an annual basis and this policy shall be updated as necessary to reflect any changes.

The total investment in securities issued by governments (federal, provincial or municipal) and Schedule I banks shall be no less than 65% of the total investment portfolio (excluding cash held in the bank).

The remaining portfolio may be invested in any other securities which are deemed eligible under O.Reg 438/97 however no more than 15% of the total investment portfolio (excluding cash held in the bank) shall be invested in eligible asset-backed securities and eligible commercial paper. Also, no more than 20% of the total investment portfolio (excluding cash held in the bank) shall be invested in eligible pooled equity funds (i.e. One Investment Program Equity Portfolio).

These portfolio percentage limitations apply at the time an investment is made and exclude trust fund investments, which are predominantly cemetery care and maintenance funds and are subject to the Cemetery Act investment requirements.

For the purpose of this policy, a short-term investment is defined as maturing in less than one year, medium-term as maturing between one and five years and long-term as maturing in greater than five years. In general, professionally managed portfolios are deemed to be long-term investments, as it is likely that the intention of administration is to invest funds that are not required for the next five years. For the purposes of this section, professionally managed portfolios shall be considered long-term investments, unless it is specifically known otherwise. The total investment portfolio in calculating term limitations shall exclude trust funds. The term limitations for the portfolio are as follows:

- Short-term – minimum 50% of total investment portfolio;
- Medium-term – maximum 25% of total investment portfolio; and
- Long-term - maximum 25% of total investment portfolio.

The portfolio percentage limitations shall apply at the time the investment is made. At specific times the portfolio limitations may not be compliant to the policy for a short time for various reasons, for example the timing of maturities. Prior to any changes to the portfolio based on term limitations, The Treasurer or Deputy Treasurer may, at his or her discretion, retain the investment(s), that contravenes the portfolio limitations provided that such action is not contrary to the Municipal Act, 2001.

Type and term limitations shall be reviewed annually by the Treasurer or Deputy Treasurer and this policy shall be amended as necessary to minimize the Municipality's exposure to changes in the financial marketplace after giving consideration to the available financial information.

Trust fund portfolio limitations are subject to the terms and conditions of the agreement to which the fund applies. Absent specific wording, compliance with the stated portfolio limitations is required, and should be considered separately from the Municipality of Chatham-Kent funds.

Buy and Hold

To achieve the objectives noted in section four, internally managed funds shall, for the most part, follow the buy and hold strategy. As noted above, higher yields are best obtained by taking advantage of the interest rate curve of the capital market which normally yields higher rates of return for longer term investments. By purchasing securities at varying maturity dates and holding the investments to term the interest rate risk is minimized, liquidity is maintained and capital is preserved. To be successful with the buy and hold strategy, matching cash requirements to investment terms is a key element and requires a solid cash flow forecast.

Some municipalities actively trade investments rather than holding to term. This 'active' investment strategy can produce a modest improvement in yield, but to be successful a large amount of excess cash, sophisticated investment expertise and resources are required. Professionally managed funds charge a fee (usually basis points deducted from the yield) but it is anticipated the performance of the funds provided will exceed the cost of administration. Nevertheless, performance of professionally managed funds shall be regularly compared to industry benchmarks and to the result that might be achieved using the internally managed approach.

Performance Standards

The investment portfolio shall be managed in accordance with parameters specified within this policy. The portfolio should obtain a market average rate of return throughout budgetary and economic cycles proportionate with investment risk constraints and the cash flow needs of the Municipality.

The performances of investments shall be measured using multiple benchmarks and performance indicators. The baseline yield for investments is the interest rate earned by the Municipality on cash held in its bank account. Then, investment yields can be compared to Government of Canada Treasury Bills and Benchmark Bond Yields. Furthermore, prime interest rates and other applicable market rates, such as Banker’s Acceptance can be used to provide useful benchmarks with consideration to limitations attributable to the Municipal Act, 2001.

Internal Borrowing

In developing the cash requirements for the year, sufficient cash shall be available to fund capital expenses. The main cash elements of the operating budget are stable and predictable, e.g. tax revenue and operating expenses which is established in the budget process. The primary variable in forecasting cash demands is capital spending. Capital spending is supported (temporarily financed) by the General fund prior to securing long-term financing, which could be reserves or if required long-term debentures.

If the General or Board or Commission fund does not have sufficient cash to support capital expenses and operating expenses during the year, the best option is to borrow from the Reserves on a short-term basis, rather than obtaining external financing. In order for this to occur, the Reserves must have sufficient cash available (i.e. not locked into long-term investments) to support the General or Board or Commission Fund through this period. A fair rate of interest shall be applied based on the interest rate paid on funds in the Municipality's consolidated bank account. For the most part the interest charged is going 'from one Municipal pocket to another', but given that some reserves are non-rate funded, there is a requirement to pay a fair rate to the reserves for 'investing' in the General fund.

Trust Funds

Trust funds by nature must be maintained in a separate account and invested separately. The investment strategy will be dictated by the terms of the trust agreement and the restrictions in the Cemetery Act. A separate Trust Fund Investment Policy will be brought forward in 2016.

Given the variability of capital spending, interest rates, and non-tax revenues, the investment strategy shall be reviewed, at a minimum, on an annual basis. Any changes in the investment strategy shall be reported to Council in the annual investment report and the investment policy shall be amended for the change in strategy.

6.0 REPORTING

The Treasurer or Deputy Treasurer shall provide an annual investment report to Council which includes, at a minimum, the requirements set forth in O. Reg. 438/97. Under the current regulations the investment report shall contain the following:

1. a statement about the performance or the portfolio of investments of the municipality during the period covered by the report;

2. a description of the estimated proportion of the total investments of a municipality that are invested in its own long-term and short-term securities to the total investment of the municipality and a description of the change, if any, in that estimated proportion since the previous year’s report;

3. a statement by the Treasurer as to whether or not, in his or her opinion, all investments are consistent with the investment policies and goals adopted by the municipality;

4. a record of the date of each transaction in or disposal of its own securities, including a statement of the purchase and sale price of each security;

5. such other information that the Council may require or that in the opinion of the Treasurer, should be included;

6. a statement by the Treasurer as to whether any of the investments fall below the standard required for that investment during the period covered by the report; and

7. the details of the proposed use of funds realized in the disposition of an investment for which the Municipality sold as a result of a decline in rating below the standard required by O.Reg. 438/97.

In addition to the annual report, the Treasurer or Deputy Treasurer shall report to Council any investment that is made that is not, in his opinion, consistent with investment policy adopted by the Municipality within thirty days after becoming aware of it.

GLOSSARY OF TERMS

Asset Backed Securities: fixed income securities (other than a government security) issued by a Special Purpose Entity, substantially all of the assets of which consist of Qualifying Assets.

Basis Point (BPS): a unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security.

Credit Risk: is the risk to an investor that an issuer will default in the payment of interest and/or principal on a security.

Diversification: a process of investing assets among a range of security types by sector, maturity, and quality rating.

Interest Rate Risk: the risk associated with declines or rises in interest rates that cause an investment in a fixed income security to increase or decrease in value

Liquidity: a measure of an asset's convertibility to cash.

Market Risk: the risk that the value of a security will rise or decline as a result of changes in market conditions.

Market Value: current market price of a security.

Maturity: the date on which payment of a financial obligation is due. The final stated maturity is the date on which the issuer must retire a bond and pay the face value to the bondholder.

One Investment Program: a professionally managed group of investment funds composed of pooled investments that meet the eligibility criteria defined by O.Reg 438/97. The program consists of Money Market Funds, Bond Funds and Equity Funds. The ONE Investment Program is operated by LAS (Local Authority Services Ltd., a subsidiary of the Association of Municipalities of Ontario) and the CHUMS Financing Corporation (a subsidiary of the Municipal Finance Officers' Association of Ontario).

Qualifying Assets: financial assets, either fixed or revolving, that, by their terms converts into cash, within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders.

Schedule I Banks: domestic banks that are authorized under the *Bank Act* to accept deposits, which may be eligible for deposit insurance provided by the Canadian Deposit Insurance Corporation.

Schedule II Banks: are foreign bank subsidiaries authorized under the *Bank Act* to accept deposits, which may be eligible for deposit insurance provided by the Canada Deposit and Insurance Corporation. Foreign bank subsidiaries are controlled by eligible foreign institutions.

Special Purpose Entity: a trust, corporation, partnership or other entity organized for the sole purpose of issuing securities that entitle the holders to receive payments that depend primarily on the cash flow from Qualifying Assets, but does not include a registered investment company.