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Town of Aurora

# General Committee Report

No. FIN23-007

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**Subject:** Investment Policy Statement and Transition to Prudent Investment Regime

**Prepared by:** Laura Sheardown, Financial Management Advisor

**Department:** Finance

**Date:** March 7, 2023

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## Recommendation

1. That Report No. FIN23-007 be received; and
2. That the proposed Investment Policy Statement, attached as Attachment 1 be approved; and
3. That the Director, Finance – Treasurer be authorized to execute the ONE Joint Investment Board Agreement, substantially in the form attached as Attachment 2, subject to the final form and content being to the satisfaction of the Director, Finance – Treasurer and the Town Solicitor; and
4. That the Draft Investment Plan attached as Attachment 3 be received for information purposes; and
5. That a by-law be enacted to authorize the Town's investments under the Prudent Investor regime as required by Ontario Regulation 438/97 and authorize execution of the ONE Joint Investment Board Agreement delegating control and management of the Town's long-term investments to the ONE Joint Investment Board.

## Executive Summary

With the municipal investment structure being broadened, staff have explored the potential investment structures that are now available to the Town. Based upon its findings, staff have concluded that it would be advantageous for the Town to pursue the adoption of a prudent investor regime for its long-term investments. For the Town to proceed with a transition from a legal list to a Prudent Investor Regime for its longer-term investments, Council approval is required.

- The adoption of a prudent investor regime supports the Town's Fiscal Strategy
- Joining the Prudent Investor JIB provides more investment options than the Legal List and expands upon the Town's existing relationship with ONE Fund
- The Town's identification of funds that it does not require immediately for the PI's management will be governed by its fiscal strategy
- The administrative costs vary materially between Legal List, ONE Fund and ONE JIB Investments

## Background

Investing under the *Municipal Act, 2001* and O. Reg 438/97 is divided into the prescribed list of securities which is more commonly referred to as the Legal List and the Prudent Investor regime. The Prudent Investor regime gives the municipality access to a wider variety of investments, but also includes a new governance model.

The most cost-effective manner through which the town can access the Prudent Investor regime is through a Joint Investment Board (JIB) as establishing its own Investment Board is not financially feasible. There is currently one joint investment board in Ontario that the town can join if its transition to a Prudent Investor regime is approved.

To join a JIB, a municipality is required to relinquish its control and management of any money that it does not require immediately to the JIB who will invest on behalf of the municipality subject to the municipality's Investment Policy Statement and the overarching portfolio's investment plan.

Funds that are defined as being needed immediately by the Town continue to follow the investing rules and limitations as outlined through the Legal List.

On November 19, 2019, Council reviewed the benefits of the new Prudent Investor regime – FS19-033 Prudent Investor Option Analysis and directed staff to proceed with an in-depth review of the investment options and revised investment policy with FAC.

On January 28, 2020, the FAC completed its review of the Prudent Investor regime and directed staff to proceed to General Committee for their final approval of the Town's transition to the Prudent Investor regime as a founding member.

On February 25, 2020, staff presented report FIN20-006 to Council, however the report was referred back to staff as Council still had some concerns about joining the JIB as a founding member, requiring further clarity as to how exactly it would work. Staff agreed to wait until the approval of an overarching Fiscal Strategy document that would detail how the expansion of the current investment strategy would be supported by the implementation of the Prudent Investor regime for the town.

On May 9, 2022, staff presented to FAC an update on the prudent investor regime including a comparison of historical investment returns and administrative costs and received direction to proceed back to General Committee on this subject once the debt management policy was approved. The Town's debt management policy was approved by Council on January 31, 2023.

## **Analysis**

### **The adoption of a prudent investor regime supports the Town's Fiscal Strategy**

The new investment policy supports the long-term financial sustainability guiding principle of the fiscal strategy. Through its membership in the ONE Joint Investment Board, the Town is able to access the Municipal Act's Prudent Investor Standard. Moving forward as a Prudent Investor will enable the Town to optimize investment income, allowing for an overall reduction to the financial burden on tax and rate payers. All investment income generated from capital asset reserve holdings, of which are mostly funded through tax and user rates, must be maximized to offset the impact of inflation on reserves and ensure sufficient funding is available for the Town's aging infrastructure in the long-term.

### **Joining the Prudent Investor JIB provides more options than the Legal List and expands upon the Town's existing relationship with ONE Fund**

ONE Investment Prudent Investor offers a more diverse investment portfolio mix which may include its current Legal List investment options, plus two additional funds that are only available to its Prudent Investors – a Global Equity fund and a Global Bond fund. Additional details on these funds can be found in the ONE Investment Annual Performance Report and ONE Investment Annual Report.

Table 1 compares possible returns under the Legal list and the Prudent Investor Standard for a relatively conservative asset mix. The allocations in this table were designed to have the same amount of risk (same worst case return expectations).

**Table 1**  
**Comparison of Conservative Portfolio Mix Under Both Options<sup>1</sup>**

<b>Assumed Asset Allocation Weights</b>	<b>Legal</b>	<b>Prudent</b>
Money Market Portfolio	25%	
Bond Portfolio	20%	10%
Unconstrained Global Bonds		50%
Canadian Corporate Bonds	26%	11%
<b>Total Fixed Income</b>	<b>71%</b>	<b>71%</b>
Canadian Equity	29%	5%
Global Equity		24%
<b>Total Equity</b>	<b>29%</b>	<b>29%</b>
<b>Estimated Investment Portfolio Returns</b>		
<b>Expected return</b>	<b>3.11%</b>	<b>3.96%</b>
<b>Expected worst case annual return</b>	<b>-5.0%</b>	<b>-5.0%</b>
<b>Town's Actual 2022 Return</b>	<b>2.97%</b>	<b>n/a</b>

Under the Prudent Investor regime the returns are 0.85% higher than the Legal List, with the same downside risk and an identical overall allocation to equity investments. The increased return is achieved by shifting from purely Canadian bonds and equities to a portfolio that also holds global investments which improves the diversification benefits.

The two Prudent Investor global offerings are existing and established funds with an existing client investment base and track record – Global Bond Fund is managed by Manulife Asset Management and Global Equity is managed by Mawer Investment Management. Table 2 presents the historical rates of return for ONE Investment's portfolio offerings. This table provides a comparison of the actual past performance of

<sup>1</sup> Modelling conducted by AON Hewitt and data provided by ONE Investment

a Prudent Investor to a Legal List investment portfolio based upon the assumed asset allocation weights presented under Table 1.

**Table 2**  
**Historical Rates of Return for ONE Investments (2014-2022)<sup>2</sup>**

Year	Money Market	Equity Portfolio	Global Equity	Govt Bond Portfolio	Canadian Corporate Bond	Global Bond	Legal List Allocation	Prudent Investor Allocation
<b>2022</b>	1.8%	-7.1%	-10.1%	-3.5%	-7.9%	-8.2%	<b>-4.4%</b>	<b>-8.1%</b>
<b>2021</b>	0.3%	21.3%	22.9%	-1.0%	-1.9%	0.7%	<b>5.6%</b>	<b>6.6%</b>
<b>2020</b>	1.1%	8.2%	11.2%	5.7%	8.0%	8.7%	<b>5.9%</b>	<b>8.9%</b>
<b>2019</b>	1.9%	19.1%	22.3%	3.1%	5.6%	9.4%	<b>8.1%</b>	<b>12.0%</b>
<b>2018</b>	1.7%	-1.9%	5.7%	2.0%	1.6%	-0.6%	<b>0.7%</b>	<b>1.4%</b>
<b>2017</b>	0.8%	10.8%	19.1%	0.3%	2.6%	4.6%	<b>4.1%</b>	<b>7.8%</b>
<b>2016</b>	0.7%	15.3%	0.9%	1.2%	2.2%	5.2%	<b>5.4%</b>	<b>3.9%</b>
<b>2015</b>	0.9%	0.3%	23.1%	2.3%	3.7%	7.6%	<b>1.7%</b>	<b>10.0%</b>
<b>2014</b>	1.1%	20.2%	15.9%	3.4%	9.4%	10.3%	<b>9.3%</b>	<b>11.3%</b>

**Investment Allocations**

<b>LL</b>	25.0%	29.0%	-	20.0%	26.0%	-
<b>PI</b>	-	5.0%	24.0%	10.0%	11.0%	50.0%

As can be seen from Table 2, the Prudent Investor investment portfolio returns have fared better over this historical time period, except for 2022. Table 3 summarizes a comparison of the historical rates of return for a Legal List and Prudent Investor strategy as presented in Table 2, as well as the Town’s long term investment portfolio results.

As can be seen from Table 3, a Prudent Investor strategy has performed well over the presented time period. Overall, a Prudent Investor strategy offered an average annual rate of return over this period that was 1.94% higher than the legal list investment portfolios.

<sup>2</sup> Historical data provided by ONE Investment

**Table 3**  
**Comparison of Investment Strategy Results (2014-2022)**

<b>Investment Strategy</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Legal List	9.3%	1.7%	5.4%	4.1%	0.7%	8.1%	5.9%	5.6%	-4.4%
Prudent Investor	11.3%	10.0%	3.9%	7.8%	1.4%	12.0%	8.9%	6.6%	-8.1%
ToA Long-term returns	n/a	n/a	n/a	2.48%	3.11%	2.92%	2.65%	3.18%	3.14%

Virtually all investment strategies carry some element of risk, the Prudent Investor Standard is no exception. There is no guarantee of better returns as a result of investing under the Prudent Investor regime. A broader array of investment possibilities exposes an investor to a broader array of risk. Further, past performance is not indicative of future results. Moreover, there is not a 100 percent guarantee that better performance will offset the initial or continuing costs of the Prudent Investor regime.

In 2022 stock markets around the world were down almost 20% in the worst year since the financial crisis. The main drivers have been the war in Ukraine, combined with rampant inflation as global economies broke out of the pandemic. Comparably, the S&P/TSX Composite Index has posted a negative return of 8.5% for 2022.

One other risk worth noting is once a municipality passes a by-law to adopt the Prudent Investor Standard it cannot be revoke this by-law and return to the Legal List unless the Lieutenant Governor in Council authorizes the municipality to do so as per the PI standard regulation. However, the municipality does have the ability to identify the funds that are required during the next 18 months. These funds are managed by the Town in short-term investments.

**The Town’s identification of funds that it does not require immediately for the PI’s management will be governed by its fiscal strategy**

The Town’s fiscal strategy, in particular its reserve management pillar will inform the identification of which funds will be deemed to be not required immediately. The Town’s recently updated long term reserve analysis enables more accurate identification of when funding needs will arise. To mitigate the risk of an unplanned immediate funding need arising, a funding contingency will be retained within the Town’s immediately

required funding balance. Also, the Town will have an ability to withdraw up to a maximum of 25 percent of the invested funds with the JIB at any time during the year should the need arise. On an annual basis, the Town's JIB holdings may be adjusted on a larger scale.

### **The administrative costs vary materially between Legal List, ONE Fund and ONE JIB Investments**

#### Legal List Investments:

Although the Town does not pay separate management fees, the Investment Brokers through which the Town accesses its legal list investments receive their compensation through the difference between the wholesale rates offered by the banks and credit unions and the institutional rates that are offered to the Town by the investment brokers. Although investment firms are required to disclose all fees paid to them by retail clients, they are not required to disclose similar details to their institutional clients, such as the Town. As a result, the Town is unable to provide specific details as to its historical investment portfolio administration costs; however, a legal list average administrative cost can be estimated.

#### ONE Joint Investment Board:

As a not-for-profit entity, the ONE Investment structures its fees to recover its operating costs and set aside appropriate reserves for future investment. Neither the ONE JIB nor ONE Investment will charge fees directly to a participating municipality.

The ONE Investment Pool offerings are subject to management fees and other expenses, which are described below. Except for taxes, ONE Investment bundles its fees and expenses into a single fee, where the rate of such fee will differ depending on the ONE Investment Pool. One Investment fees are approved by the ONE Investment Board and are reviewed, at least annually.

A summary of the estimated administrative costs for each of these modes of investment are presented below.

**Table 4**  
**Administrative Costs Charged by Investment**

Broker/Investment Fund	Basis Points Charged
Legal List - Other Town Investment Brokers (charged on rate of return)	3-15
<b>ONE Investment (charged on assets under management)</b>	
Money Market Portfolio	19
Canadian Government Bond Portfolio	35
Corporate Bond	40
Global Bond	45
Global Equity	75
Canadian Equity	45

There are discounts available at the discretion of the ONE Investment Board of Directors which are paid directly by ONE Investment to the participating municipality starting at 6 basis points and increasing, dependant on the value of assets being managed within the JIB (starting at a Managed Asset Tier of \$50M).

### Advisory Committee Review

Finance Advisory Committee review on May 9, 2022.

### Legal Considerations

Subsection 418.1 of the *Municipal Act, 2001* and Ontario Regulation 438/97 provide eligible municipalities the option to invest money that it does not require immediately. Subsection 418.1(8) imposes a duty on the Town to exercise the care, skill, diligence and judgement that a prudent investor would exercise in making the investment (i.e. the Prudent Investor Standard). The attached Investment Policy Statement provides further detail on this standard.

### Financial Implications

The Prudent Investor regime provides municipalities with a new and very different framework through which it may manage the investment of funds that are not required

in the short term. Should a municipality meet the eligibility requirements allowing it to implement a prudent investor regime, it is able to access higher risk-adjusted returns over the long-term. In the case of the Town of Aurora, the only feasible way to adopt a PI regime is through participation in a joint investment board. Through this membership in a JIB, the Town will share both the associated PI risk and operating costs with all participating JIB members.

As noted previously, any Town funding invested under a Prudent Investor regime will be invested in a prudent manner by professionals who will take great care in projecting the original investment value while maximizing the possible returns that can be made on these monies in an environment where there are many more investment options.

### **Communications Considerations**

The Town will inform residents of the information contained in this report by posting it to the Town's website.

### **Climate Change Considerations**

The recommendations from this report do not directly impact greenhouse gas emissions or climate change adaptation.

### **Link to Strategic Plan**

Investment of the surplus and reserve funds of the Town, contributes to achieving the Strategic Plan guiding principle of 'Leadership in Corporate Management' and improves transparency and accountability to the community.

### **Alternative(s) to the Recommendation**

1. Council may choose to accept, amend or reject any or all of the recommendations of this report.

### **Conclusions**

Given the opportunity for risk reduction and greater returns, the Prudent Investor regime offers an advantageous opportunity that the Town of Aurora should pursue. ONE Investment has established a ONE JIB which will allow the Town of Aurora to share on an on-going basis access to the expert investment and municipal financial advice that is required both by legislation and the overall JIB's success.

## **Attachments**

Attachment #1: Town of Aurora's Draft Investment Policy Statement

Attachment #2: ONE Joint Investment Board Agreement

Attachment #3: Draft Investment Plan

Attachment #4: ONE Investment Interim Financial Statements – June 30, 2022

Attachment #5: ONE Investment Annual Report – 2021

Attachment #6: ONE Investment Annual Report - 2020

Attachment #7: ONE Investment Annual Performance Report - 2020

## **Previous Reports**

FS19-029 Prudent Investor, October 1, 2019

FS19-033 Prudent Investor Option Analysis, November 19, 2019

FAC20-001 FAC Review of Prudent Investor Regime, January 28, 2020

FIN20-006 Prudent Investor Transition, February 18, 2020

Memo to FAC 2022 Prudent Investor Regime Review, May 9, 2022

## **Pre-submission Review**

Agenda Management Team review on February 16, 2023

## **Approvals**

Approved by Rachel Wainwright-van Kessel, CPA, CMA Director, Finance - Treasurer

Approved by Doug Nadorozny, Chief Administrative Officer