APPROVAL REPORT

Research on Equity Investments

ISSUE

The purpose of this report is to provide additional information regarding the City of Saskatoon (City) expanding its investment policy to include equities and the best process to proceed in that direction.

RECOMMENDATION

That the Standing Policy Committee on Finance recommend to City Council:

1. That the Administration hire a consultant to assist with researching equity investments by determining an optimal asset allocation to enhance return and minimize risk while supporting Environmental, Social and Governance investments; and
2. That the Administration initiate a capital project in the amount of $50,000, funded through the Asset Financial Management Capital Reserve

BACKGROUND

At its regular meeting on March 14, 2022 the Standing Policy Committee on Finance resolved:

> "That the Administration report back further on equities and Environmental, Social and Governance (ESG) investing including the benefits, challenges and experiences in other cities which have moved into these types of investments."

DISCUSSION/ANALYSIS

Introduction

The City's current Portfolio Management Policy allows the following fixed income investments:

- Bonds issued by the Government of Canada (GoC) or an agency of the GoC;
- Bonds issued by a Province of Canada or Crown corporation carrying the guarantee of its province;
- Bonds issued by a Canadian municipal government; and
- Bonds issued by a Canadian Corporation that hold an "A" rating or better.

The City's investments provide approximately $10 million to $12 million of investment revenue each year and has provided an average annual return of 2.73% over the last 10 years. The objectives for the City's investment portfolio are capital preservation, maintaining liquidity, and maximizing return potential.

In the long term, equities outperform bonds and have historically provided investors with favorable returns. Over the last 30 years, equities have generated an average annual return of 11%, whereas bonds have only averaged 5%. Equities do expose investors to more risk, but investors are also compensated for this extra risk with higher return potential. The City's current investment policy only allows investments in high quality bonds, but by updating the policy to allow equity investments the City will be able to improve the return potential of the portfolio. Appendix 1 – Business Case for Equities, gives additional detail on benefits and risks of investing in equities. Other Canadian municipalities have updated their investment policies to allow investment in equities and have succeeded in improving the return on invested funds. These municipalities have also been able to accomplish this by investing in a way that is ESG friendly.

Table 1 provides a summary of other municipalities in Canada that invest in equities. The table provides information on the year they began investing in equities, the most recent return from those equity investments, and what the municipality's investment policy says regarding ESG investments.

Table 1

Municipality	Invested in Equities Since	Latest Portfolio Return*	Investment Policy ESG Mandates
Edmonton	1995	14.10%	Policy requires all proxy proposals to be voted in a way that discourages the expansion of products which are harmful or destructive to human life, encourages expansion of gender and racial equality, must be environmentally responsible business practices, and progressive industrial relations with employees.
Toronto	2018	4.10%	The Investment Board is required to incorporate ESG factors into its investment decision-making through a due diligence processes when choosing Investment Managers. Prior to hiring any Investment Manager their ESG policies must be reviewed.
Calgary	2016	12.07%	Consideration of ESG factors enable investors to better understand and mitigate risks.
Medicine Hat	2016	6.21%	Unable to determine based on public information
Moose Jaw	2019	9.70%	Unable to determine based on public information

*The returns presented in this table are from the portfolios that allow equity investments. Many municipalities have multiple portfolios but not all allow for equities.

Recommendation

The main challenge with updating the investment policy to allow equities is determining the optimal asset allocation. Asset allocation is an investment strategy that balances risk with return by determining how much of the portfolio to allocate between the three asset classes—equities, fixed income, cash and cash equivalents. This is accomplished by setting up an investor's portfolio based on their goals, risk tolerance and investment time horizon. Other municipalities have hired a consultant to assist in determining this for their investment policy and in doing so were able to determine the optimal asset allocation required to enhance return potential while minimizing risk.

It is recommended that Administration initiate a capital project in the amount of $50,000 funded through the Asset Financial Management Reserve to hire a consultant to assist in further research of equity investments. A consultant will be able to setup different models of allocations using the City's investment goals, risk tolerance and time horizon. Using these models, the consultant will be able to perform simulations and tests to show the risk/return profile of each allocation. This information will help determine the optimal allocation for the City among the three asset classes as it will show the best option to enhance returns while minimizing risk.

Should the City decide to move forward with investing in equities the consultant will be able to further assist in drafting a new investment policy and developing a Request for Proposals (RFP) to select an external investment manager to oversee the equity portion of the City's portfolio. Fees for using an external manager usually range from 0.5%-1.5% and are paid out via returns generated from invested funds. Despite the added costs, municipalities that invest in equities have been able to improve the overall return potential of their portfolio.

FINANCIAL IMPLICATIONS

In addition to the financial implications outlined in this report, the City will need to determine a financial strategy on how to finance investment losses when returns are less than budget. Some initial options considered which will be further explored in future reports include:

- Interest/Investment Stabilization Reserve – This approach would utilize the existing Interest Stabilization Reserve to fund Interest Income budgetary shortfalls. This reserve would be funded by investment income surpluses that exceed budget up to a certain cap. Once the Interest Stabilization Reserve reaches a set cap, dividends could be declared to be utilized on municipal projects.
- Utilizing an investment portfolio strategy, whereby the portfolio would issue dividends/returns to the operating budget even in years of loss. These losses would be expected to be made up in future years as the portfolio experiences positive returns over the long term.
- Linking Investment Returns to Capital Programs – Capital programs are more able to grow or shrink based on the amount of funding received. An option to mitigate years which have interest income returns less than budget would be to link it to a program such as the $30 million road maintenance/rehabilitation

program to remove the risk from the operating budget. This approach would mean the road program would carry the risk and fluctuate from year to year based on investment returns. While the annual investment may vary based on investment income, the long-term service level would likely be able to be met as the longer-term return with equities have historically been reliable.

OTHER IMPLICATIONS

There are no privacy, legal, social or environmental implications identified.

NEXT STEPS

If approved a project will be setup and funded with $50,000 from the Asset Financial Management reserve. Next, a consultant will be hired to gather information to determine the optimal asset allocation for the City and to determine if the City would benefit from updating the investment policy to include equities. If the benefit of investing in equities is demonstrated and City Council approves the change, Administration will work with the consultant to update the policy to include equities and draft an RFP for the City to hire an external investment manager.

APPENDICES

1. Business Case for Equities

REPORT APPROVAL

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