

To: ONE Joint Investment Board
From: Keith Taylor, Chief Investment Officer, ONE Investment
Date: July 14, 2021
Re: The District Municipality of Muskoka – Annual Investment Plan Review
Report: ONE JIB-007-21

1. RECOMMENDATIONS

It is recommended that the Board:

1. Approve The District Municipality of Muskoka’s Investment Plan (Attachment 1).

2. SUMMARY

Muskoka’s annual Investment Policy Statement review resulted in changes that more closely align it with the ONE JIB Outcomes Framework. The Municipality has \$135.3 million of MNRI available to invest and will neither contribute nor withdraw MNRI at this time. Muskoka’s updated Municipal Client Questionnaire indicates that changes are required to the Outcome mapping that involve larger allocations to the Contingency and Cash Outcomes, funded from drawdowns in the Target Date 3 to 5 Year Outcome. No changes will be made to the Target Date 5-to-10-Year Outcome.

The trading involved in implementing this Investment Plan should realize a modest amount of capital gains, but as no sales from equity-heavy Outcomes are required, the realized gains have been minimized.

The Pooled Fund allocations in the proposed Investment Plan differ from the actual allocations in Muskoka’s current portfolio primarily due to the proposed reallocation of MNRI between Outcomes. The Pooled Fund allocations within their assigned Outcomes are substantially aligned with target weights as a rebalance occurred in April 2021.

The average annual expected return in the proposed Investment Plan is 3.7%, which is 0.3% lower than in the June 2020 Investment Plan. The difference is primarily attributable to a larger allocation to the Cash Outcome and lower return assumptions on some of the fixed income Pooled Funds that ONE JIB approved in February 2021. This was partially offset by higher overall equity allocations resulting from the proposed changes in this Investment Plan.

3. BACKGROUND

Muskoka's Annual Investment Policy Statement review resulted in changes that more closely align it with the ONE JIB Outcomes Framework

The District Municipality of Muskoka completed its Annual Investment Policy Statement review on May 19, 2021. Council is required to review and, if necessary, update the Policy annually as per Ontario Regulation 438/97 (Regulation). Council amended its Investment Policy so that it more closely aligns with the ONE JIB Outcomes Framework. The objectives, risk tolerance and investment horizons now mirror those in the Framework.

Muskoka's investment objective is long-term growth and returns in excess of inflation

The Regulation requires municipalities to consider the following matters under the prudent investor regime:

- Preservation of capital
- Adequate liquidity that takes into account the needs of financial obligations and reasonably anticipated budgetary requirements
- Diversification by asset class, market, sector, issuer, credit quality and term to maturity
- Income and capital appreciation
- Macro risks, such as inflation, economic growth and interest rates.

Muskoka's Investment Policy Statement verifies that the Municipality has taken these considerations into account in setting its investment objectives. The Municipality's overall investment objective is moderate growth at moderate levels of risk, resulting in above-inflation returns based on the Consumer Price Index.

Muskoka's risk tolerance and investment horizon are defined by category and purpose of reserves, and they are aligned with the ONE JIB Outcome Framework

The ONE JIB uses an outcome-based approach to translate municipal needs and goals into investment allocations.

Table 1 below shows details of the ONE JIB approved Outcomes Framework, which classifies investments into four Outcome categories: Cash, Stable Return, Contingency, and Target Date Outcomes. The Outcomes are in alignment with Muskoka's investment objectives, risk profile and time frames. Muskoka's Investment Plan assigns investment allocations based on the outcome mapping in Table 1.

Table 1: ONE JIB Outcomes Framework

Outcome Category	Outcome Strategy	Objective	Risk Tolerance, Liquidity	Investment Horizon
Cash	Cash	Preservation of capital	Low risk; high liquidity	< 3 years
Stable Return	Stable Return	Income generation: To generate returns to fund recurring needs	Moderate risk with emphasis on growth and stable returns, regular liquidity	> 5 years (Perpetual)
Contingency	Contingency	Contributions for unexpected and infrequent events	Higher risk, emphasis on longer-term capital growth with some liquidity	> 5 years (Perpetual)
	Asset mgt reserves	Contributions to generate returns to fund asset management reserves	Higher risk, emphasis on longer-term capital growth; low liquidity	> 10 years (Perpetual)
Target Date	Target Date 3-5 yrs	Preservation of capital	Low risk; high liquidity	3 - 5 years
	Target Date 5-10 yrs	Contributions toward capital projects, mitigate inflation impacts and meet target funding requirements	Moderate risk, liquid	5 - 10 years
	Target Date 10+ yrs	Contributions toward capital projects, mitigate inflation impacts and meet target funding requirements	Higher risk, emphasis on long term inflation-adjusted growth	> 10 years

The majority of Muskoka’s MNRI is very long term in nature

Muskoka’s MNRI can be categorized into the following types:

1. Other Obligatory Reserve Funds, which are legislated reserve funds under various Acts where money is collected and must be used for a specific purpose – target date capital projects.
2. Program Reserve Funds, which are used to fund capital infrastructure.
3. Debt Reduction Reserve Fund, which reflects funds set aside to retire the Municipality’s debentures as they mature.
4. Stabilization Reserves, which are a type of contingency reserve that is used to smooth out somewhat predictable annual volatility (e.g., winter maintenance costs, municipal election costs).
5. Contingency Reserves, which are intended to manage potential cost and revenue shocks (e.g. emergency management, legal expenses).

Table 2 below, adapted from the Municipal Client Questionnaire, shows the breakdown in dollar values by reserve type, category, and investment horizon. The stabilization reserves and contingency reserves have expected investment horizons mostly greater than five years, with a conservative estimate of about \$350,000 with a 3-year timeframe. The Municipality has significant capital reserves with investment horizons that exceed 5 years. More than half of the \$60.6 million of Program Reserve Funds identified as having an investment horizon greater than 5 years is from the Municipality’s Roads Capital Reserve Fund. The Municipality’s cashflow forecasts do not currently extend beyond 10 years, and Municipality staff were reluctant to assign

longer investment horizons to reserves that were not well supported by their forecasting. With two thirds of their MNRI allocated to time horizons exceeding 5 years, there was staff comfort that the investment horizon already reflects the Municipality's long investment horizon.

Table 2 below also includes adjustments that bridge the differences between accounting-based cashflow projections and a MNRI amount that is based on the current market value of investments.

Table 2: MNRI by Type, Category and Time Horizon from MCQ section 4.2 (rounded to \$ thousands)

Reserve Type	Category	Comments	MNRI Amount	Investment Horizon of MNRI		
				18 months to 3 years	3-5 years	5-10 years
Obligatory reserve funds	Target Date	Near term drawdowns	6,963.9	2,031.6	3,386.1	1,546.2
Program Reserve Funds	Target Date	Increasing after 2024	77,266.8	11,795.2	4,830.5	60,641.1
Debt Reduction Reserve Fund	Target Date	Well defined funding needs	23,562.0	5,217.1	7,677.1	10,667.8
Stabilization Reserves	Contingency Reserves	Stable balances	13,561.1	352.5	na	13,208.6
Contingency Reserves	Contingency Reserves	Modest growth expected	5,489.8	na	na	5,489.8
Unrealized Capital Gains not reflected in Cashflow forecasts	Adjustment		5,868.4			
Other Accounting related adjustments	Adjustment		2,590.1			
MNRI Total			135,302.1	19,396.4	15,893.7	91,553.5

Reserves identified as having a nearer term investment horizon reflect known spending needs and some level of cost uncertainty

A large portion of MNRI has been allocated to nearer term investment horizons as these funds will be required within the next 5 years to fund planned capital expenditures. Table 3 summarizes the estimated cashflows in the coming years. The Municipality has ongoing projects, most notably a wastewater treatment plant and a long-term care home, that will lead to funds being drawn down. Municipality staff noted that there is currently a great deal of uncertainty about the ultimate cost of these projects and other shorter-term spending priorities. The pandemic has significantly increased the cost of materials for these projects. The larger allocations to shorter investment horizons in this year's Municipal Client Questionnaire update are in part a reflection of these cost uncertainties.

Table 2: Forecasted changes to MNRI from MCQ section 4.3

Type	2022	2023	2024	2025	2026-2030
Anticipated MNRI Drawdowns	(5,000)	(5,800)	(9,700)	0	0
Anticipated MNRI Contributions	0	0	0	23,200	174,500
Net change in MNRI	(5,000)	(5,800)	(9,700)	23,200	174,500

Muskoka has indicated a willingness to accept higher risk for potentially higher long-term returns

Muskoka's Municipal Client Questionnaire indicates a willingness to accept higher risk for potentially higher returns in the long run. The Municipality is comfortable with a moderate chance of capital loss over a 5-year period and has indicated tolerance for a single year decline between 5-10%.

Muskoka's MNRI includes debentures held in-kind

Muskoka has approximately \$2.3 million of debentures that are defined as MNRI and held in-kind to reflect MNRI under the control of the ONE JIB. The Municipality of Muskoka issued the debentures and subsequently repurchased them. They will be held to maturity and then used to offset the retirement cost of the debentures. A portion of the debentures has fallen below 18 months to maturity and technically should be reclassified as MRI. The Municipality has received coupon payments on these debentures, which are interest payments by the Municipality. The coupon interest received since July 2, 2020, along with \$325,000 of 4.75% debentures maturing May 2022, will be reclassified as MRI. This will not result in any impact on allocations to the Investment Outcomes because the debentures are in-kind holdings.

4. ANALYSIS

The ONE JIB Outcomes Framework was used to allocate MNRI in a manner consistent with Muskoka's Investment Policy Statement

The allocations in the proposed investment plan reflect the Municipality's objectives, investment horizon and risk tolerance, as expressed in its Investment Policy Statement. The characteristics of the Municipality's reserves were considered when building the Investment Plan.

The proposed mapping to Outcomes and resulting asset allocation are consistent with the time horizon and level of certainty in the Municipality's cash flow forecasts

Muskoka has a significant number of planned capital projects over the next 10 years, most of which are within the 5-to 10-year time horizon. The Municipality has several nearer-term projects, including work on their wastewater treatment plant and the construction of a long-term care home. The pandemic has increased the cost of materials for these projects, creating uncertainty about the ultimate cost of these projects. The Investment Plan allocates approximately \$20 million to the Cash Outcome for near-term expenditures and an additional \$16 million to the Target Date 3-5 Year Outcome. This should accommodate the near-term spending commitments. An additional \$19 million is allocated to the Contingency Outcome providing flexibility in the event that the near-term projects require additional funding. The majority of MNRI (\$79.5 million) is allocated to the Target Date 5-10 Year Outcome.

Tables 4 and 5 show the asset allocations and fund allocations in the investment plan, which were determined using the ONE JIB Outcomes Framework.

Table 3: Proposed Asset Allocation

Outcome	Total Invested (\$ millions)	Portfolio Weight (%)	HISA (%)	Fixed Income (%)	Equities (%)	Total (%)
Cash	\$ 19.9	14.7	100	-	-	100
Contingency	19.4	14.4	-	40	60	100
Target Date 3-5 Years	16.4	12.1	20	70	10	100
Target Date 5-10 Years	79.5	58.8	-	50	50	100
Total	\$ 135.3	100.0				

Table 4: Proposed Pooled Fund Allocations by Outcome (\$ millions)

Outcome	ONE HISA	ONE Canadian Equity Fund	ONE Global Equity Fund	ONE Canadian Govt Bond Fund	ONE Canadian Corporate Bond Fund	ONE Global Bond Fund	Total
Cash	\$ 19.9	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 19.9
Contingency	-	3.50	8.16	1.17	1.17	5.4	19.4
Target Date 3-5 Years	3.28	0.49	1.15	1.72	1.72	8.0	16.4
Target Date 5-10 Years	-	11.93	27.83	5.96	5.96	27.8	79.5
Target Date 10+ Years	-	-	-	-	-	-	-
Total \$	\$ 23.2	\$ 15.9	\$ 37.1	\$ 8.9	\$ 8.9	\$ 41.3	\$ 135.3

Table 6 provides the same information in percentage, showing how the fund holdings are held within each of the Outcomes.

Table 5: Fund Allocations as a Percentage of Total by Outcome

Outcome	ONE HISA	ONE Canadian Equity Fund	ONE Global Equity Fund	ONE Canadian Govt Bond Fund	ONE Canadian Corporate Bond Fund	ONE Global Bond Fund	Total
Cash	14.7%	0.0%	0.0%	0.0%	0.0%	0.0%	14.7%
Contingency	0.0%	2.6%	6.0%	0.9%	0.9%	4.0%	14.4%
Target Date 3-5 Years	2.4%	0.4%	0.8%	1.3%	1.3%	5.9%	12.1%
Target Date 5-10 Years	0.0%	8.8%	20.6%	4.4%	4.4%	20.6%	58.8%
Total	17.2%	11.8%	27.4%	6.5%	6.5%	30.5%	100.0%

The proposed change to the mapping of MNRI, reallocating it between Outcomes

The updated Municipal Client Questionnaire does not change the amount of MNRI to be invested in the Outcomes, but the changes in this Investment Plan reflect a remapping of MNRI between the Outcomes. The mapping to the Target Date 3-5 Year Outcome will be reduced, with the proceeds redeployed to the Cash Outcome and Contingency Outcome. This remapping partially reflects planned funding needs drawing nearer and the need for additional allocations for contingencies. There will be no changes to the remapping for MNRI in the Target Date 5-10 Year Outcome. Table 7 below summarizes these changes.

Table 6: Percentage of MNRI by Outcome (2020 Plan vs. Current vs. Proposed)

Outcome	31-May-21 Weight	Proposed Plan Weight
Cash	0.0%	14.7%
Contingency	4.2%	14.4%
Target Date 3-5 Years	42.6%	12.1%
Target Date 5-10 Years	41.2%	58.8%
Overall	100.0%	100.0%

When compared to the June 2020 Plan, most of the changes to the proposed plan can be explained by a remapping of MNRI to different Outcomes and market value changes

After mapping MNRI to Outcomes, the Framework suggests the portfolio-level Pooled Fund allocations in tables 8a (in dollars) and 8b (percentage). Comparable numbers are provided for the initial June 2020 Plan allocations and actual allocations as of May 31, 2021. The difference between the 2020 Plan figures and the Proposed Plan figures in both tables can be explained by market value change and the remapping of MNRI. The May Actual figures provide a reference point that incorporates market value change and transactions since the 2020 Plan. As part of the semi-annual rebalancing process, significant deviation from target weights in the Investment Outcomes was eliminated in April 2021 for the Target Date 5-10 Year Outcome and the Contingency Outcome. The differences are primarily a result of remapping MNRI from the Target Date 3-5 Year Outcome to the Cash and Contingency Outcomes.

Table 7a: Portfolio-level Allocations between ONE JIB Pooled Funds

Fund	2020 Plan \$ millions	Actual (May) \$ millions	Proposed Plan \$ millions
ONE HISA	\$ 11.2	\$ 11.1	\$ 23.2
ONE Canadian Equity Fund	13.1	15.7	15.9
ONE Global Equity Fund	30.7	34.4	37.1
ONE Canadian Government Bond Fund	10.6	11.0	8.9
ONE Canadian Corporate Bond Fund	10.6	10.9	8.9
ONE Global Bond Fund	49.4	52.1	41.3
Total \$	\$ 125.5	\$ 135.3	\$ 135.3

Table 8b: Portfolio-level Allocation Weights between ONE JIB Pooled Funds

Fund	2020 Plan Weight	Actual (May) Weight	Proposed Plan Weight
ONE HISA	8.9%	8.2%	17.2%
ONE Canadian Equity Fund	10.5%	11.6%	11.8%
ONE Global Equity Fund	24.4%	25.4%	27.4%
ONE Canadian Government Bond Fund	8.4%	8.2%	6.5%
ONE Canadian Corporate Bond Fund	8.4%	8.1%	6.5%
ONE Global Bond Fund	39.3%	38.5%	30.5%
Total \$	100.0%	100.0%	100.0%

The average expected return on the proposed Investment Plan is 0.3% lower than the June 2020 Investment plan due to revised return assumptions and allocation weights

The average return expectation (i.e., Annual 10-yr Compound Return Assumptions) in the investment plan is 3.7%. This is 0.3% lower than the return expectations in the June 2020 Investment Plan. The reduction is partially attributable to the revised return assumptions established at the February 17, 2021 ONE JIB meeting, which lowered the return assumptions on some of the fixed income Pooled Funds. The remapping between Outcomes also affected the projected returns. While a 5.3% higher allocation to equity investments tends to increase the projected returns, the 8.3% increase in Cash allocations more than offsets this. The overall risk level associated with the proposed 2021 Investment Plan is marginally higher than the June 2020 Investment Plan. The standard deviation, which is a statistical measure that helps reflect the amount of risk, is 4.7% in the proposed Plan, 0.2% higher vs the 2020 Investment Plan. The higher cash allocation in this year's plan has the added effect of helping offset the risk associated with higher equity allocations.

Table 9: Risk and Return Comparison to Last Plan

Plan version	Average Expected Returns	Standard Deviation
July 2021 Proposed Investment Plan	3.7%	4.7%
June 2020 Investment Plan	4.0%	4.5%
Difference	-0.3%	+0.2%

5. CONCLUSION

Muskoka's Council completed its annual Investment Policy Statement review and updated the policy. The proposed Investment Plan is consistent with the Municipality's Investment Policy Statement. The proposed asset mix and fund allocations reflect the Municipality's investment objectives and risk preferences expressed in its Investment Policy Statement and Municipal Client Questionnaire. As a result, the Investment Plan is appropriate for the Municipality's objectives, risk tolerance, time horizons and available MNRI.

Prepared by: Colin Macdonald, Manager of Investments and Keith Taylor Chief Investment Officer

Approved for submission by: Judy Dezell and Donna Herridge, Co-President/CEO