REPORT

To: New Products Committee
From: Keith Taylor, Chief Investment Officer, ONE Investment
Date: October 1, 2024
Re: Model Portfolios and Allocation Process
Report: New Products Committee 2024-003

1. RECOMMENDATIONS

It is recommended that ONE JIB:

1. Rescind the Outcomes Framework Policy.

2. Approve the model portfolios comprised of PH&N Institutional funds to be used under the OCIO model as per Table 1:

Table 1 - OCIO Model Portfolios

Model Name	Fixed Income	Equity	Real Estate & Infrastructure	Model
Short Term / 0% Equity	100%	-	-	A
Short Term / 20% Equity	80%	20%	-	B
Mid Term / 30% Equity	70%	30%	-	C
Mid Term / 40% Equity	60%	40%	-	D
Mid Term / 40% Equity Plus	50%	40%	10%	D+
Mid Term / 50% Equity	50%	50%	-	E
Mid Term / 50% Equity Plus	40%	50%	10%	E+
Long Term / 60% Equity	40%	60%		F
Long Term / 60% Equity Plus	30%	60%	10%	F+
Long Term / 70% Equity	30%	70%	-	G
Long Term / 70% Equity Plus	20%	70%	10%	G+

2. SUMMARY

At its April 22, 2024, special meeting, ONE JIB directed that ONE Investment work with Philips, Hager & North (PH&N) Institutional, ONE's OCIO partner (and herein also referred to as "OCIO"), to develop model portfolios suitable for most municipalities and individually tailored solutions where appropriate, each comprised of allocations to PH&N Isntitutional funds, to meet the investment needs of Participating Municipalities investing under the OCIO model, and report back to the New Products Committee.

PH&N Institutional would make use of several model portfolios, built with various allocations to any of the eligible investment funds available under the OCIO model, to guide the investment allocations of Participating Municipalities. This report provides an overview of the proposed model portfolios that have been designed and may be used to implement the ONE JIB approved Investment Plans of the Participating Municipalities.

This report is recommending ONE JIB approval of model portfolios that would be used in client investment allocations as detailed in the attachment to this report. The allocations used in the models were guided by an optimization process conducted by PH&N Institutional, and it is intended that PH&N Institutional and ONE JIB would jointly review the model portfolios at least annually. This optimization process would only use the eligible investment funds identified in the Investment Management Agreement (IMA).

3. BACKGROUND

The OCIO model will use a new set of investment funds and allocations to build investment allocations of Participating Municipalities

The OCIO model will use any of the eligible investment funds provided by PH&N Institutional to construct portfolios for Participating Municipalities. As directed by ONE JIB, model portfolios have been constructed by PH&N Institutional that could be used to address the investment needs of most Participating Municipalities investing under the OCIO model.

Existing ONE Investment Pooled Funds will not be used under the OCIO model, and new asset allocation analysis has been conducted to support the construction of the model portfolios introduced in this report. Over 30 eligible investment funds are currently available for use which will allow the OCIO model to provide a wider range of investment exposures than are currently available under the Prudent Investment Offering.

Analysis of municipal reserves will continue to be a key input that influences client allocations under the OCIO model, along with other relevant factors

The OCIO model uses a different set of funds than currently used by Participating Municipalities, and it is contemplated that under the OCIO model, the Outcomes Framework could be used differently. Instead of direct mapping of reserves to allocations, as has traditionally been done under the Outcomes Framework, an understanding of reserves would inform allocation decisions in concert with other relevant factors. The expected cashflows affecting municipal reserves will continue to be a key item that influences the allocation process, and other factors can also be considered in the evaluation of Participating Municipality circumstances, including forecasting uncertainty, risk tolerances, the need for liquidity, expected returns, inflation expectations, and other macroeconomic or capital market factors. Other methods of communicating reserve details to ONE JIB could also be used, such as the short, medium, and long reserve groupings used in Durham's ONE JIB approved Investment Plan.

As directed by ONE JIB, PH&N Institutional has created a set of model portfolios for the OCIO model that are appropriate for the needs of most Participating Municipalities

A set of model portfolios has been developed by PH&N Institutional that is designed to be appropriate for a wide range of Participating Municipalities needs. The modelling, which includes eleven different allocations, each with unique risk and return attributes, has been included in Attachment 1 to this report. Pages eight throught 10 of the attachment provide provide more detailed information about the models.

More detail on the decision history related to this report is available in the following link:

Link 1: New Products Committee Report (2024-01) March 18, 2024

4. ANALYSIS

Client risk tolerances are relevant when assigning investment allocations.

To provide more consistent evaluations, client risk tolerances will be assessed by the CIO and OCIO instead of client self-evaluations. While the Municipal Client Questionnaire (MCQ) has always included questions that attempt to evaluate the risk profile of the municipality, the answers provided to these questions have typically been of limited value in understanding municipal circumstances. Asking a treasurer how much risk should be associated with MNRI will almost always result in an answer of “low’ or ‘moderate’ risk. If all treasurers are answering the question the same way, then their answers make it difficult to differentiate the risk appetite of each municipality.

The most recent version of the MCQ approved by ONE JIB on September 4, 2024, no longer solicits the treasurer’s evaluation of the municipality’s risk tolerance. The risk tolerance will instead be assessed by the CIO and PH&N Institutional based on their understanding of municipal circumstances, investment horizon, and feedback from municipal staff.

Analysis of client cashflow helps describe the investment horizon, which informs investment allocations

Understanding when the MNRI invested will be needed is one of the most important factors to consider when assigning investment allocations. ONE Investment’s expertise in municipal finance allows staff to interpret the reserve details and use them to inform investment allocations, regardless of the format of how the reserves are presented or organized. This also provides insight relevant to the risk profile of the municipality.

The Outcomes Framework maps municipal reserve forecasts directly into multiple outcome accounts, but under the OCIO model it may be more practical to have a single consolidated account for each municipality

Participating Municipalities' MNRI is currently evaluated using the Outcomes Framework, with reserves being grouped by outcome and each investment outcome invested in a unique account. Participating Municipalities typically have multiple investment accounts that correspond to the mapping of municipal reserves. This direct mapping might not be used under the OCIO model.

An understanding of the reserve forecasts and anticipated drawdowns of MNRI is clearly very important when determining how to invest the MNRI, but the mapping of the Participating Municipality's individual investment accounts does not need to conform to the same groupings of municipal reserves. All investments could be held in a single account rather than being held in multiple outcome accounts. Using a single consolidated account to hold all investments would create operational efficiencies and simplify reporting. Unless there is a structural reason to segregate MNRI into separate accounts, each Participating Municipality's MNRI could be managed based on a single consolidated account.

Under the OCIO model municipalities may wish to continue using the Outcomes Framework to describe circumstances

Under the Outcomes Framework, investment allocations are directly linked to reserves and cashflow forecasts. This provides an understanding of when monies will be required, which is the starting point for any understanding of how the MNRI should be invested. As appropriate, the Outcome Framework could continue to be used to help communicate municipal circumstances in a way that informs allocation decisions, but it should not continue as policy for ONE JIB on allocation decisions.

Other ways of organizing municipal reserves could be used, such as the short, medium, and long-term mapping of reserves, as was used with Durham's ONE JIB approved Investment Plan.

PH&N Institutional has developed a set of model portfolios designed to address a wide range of client needs while retaining flexibility in how it could be implemented

PH&N Institutional has created a set of model portfolios that should address a wide range of needs for Participating Municipalities. This includes eleven separate models, each with unique risk-return attributes. The lowest-risk model has a 100% allocation to fixed income. The model portfolio with the highest risk profile has only a 20% allocation to fixed income.

Some of the models presented have allocations to alternative investments, which may not be suitable for all Participating Municipalities. Allocations to alternative investments are only available in models where fixed income allocations are less than 50% of investments. As alternative investments may not be appropriate for all Participating Municipalities, they may only be used for Participating Municipalities that have elected to use them and have documented this choice in a council approved IPS.

The PH&N Institutional may need to make selection choices when implementing client allocations

Currently, ONE JIB's external portfolio managers select securities based on guidance provided by ONE JIB, as detailed in an Investment Management Agreement (IMA). Likewise, the OCIO may need to select funds to fulfill allocations detailed in ONE JIB approved Investment Plans. This may involve substituting funds to address specific client requests/needs or in certain cases, operational constraints may require funds to be substituted by the OCIO when allocations are implemented.

When the first Participating Municipality's MNRI was deployed into the OCIO model, the implementation required the use of substitute funds and included a temporary allocation to Treasuries, neither of which was anticipated in Durham's Investment Plan. These adjustments were required to facilitate an efficient implementation of the MNRI. The OCIO may need to make similar adjustments with ONE JIB approved Investment Plans of other Participating Municipaliteis in the future that will be monitored by ONE JIB's Chair and Vice Chair and reported to ONE JIB through the Investment Plan Implementation report.

For allocations that include access to alternative investments, liquidity and costs become more important considerations

Alternative investment funds are available under the OCIO model that provide liquidity on a quarterly basis, but as the underlying investments may not be fully liquid, there are circumstances where redemptions in these funds may be curtailed. This can create problems if municipalities need to make a drawdown. Furthermore, one of the alternative investment funds included in the model portfolios has penalties for shorter-term redemptions and drawdowns within the first five years, which would involve additional fees.

If the MNRI of a Participating Municipality is stable over time and there is no expected need for drawdowns over the short to intermediate term, then models that include alternative investments are appropriate. If the MNRI is not 'sticky' and drawdowns are expected or balances invested in the allocations are revised frequently, then investing in allocations with alternative investments could be problematic. Because of these issues, Participating Municipalities will need to make an election in the council approved IPS that explicitly allows the use of alternative investments before they could be used. Even with this election, the ONE JIB approved Investment Plans may not necessarily include alternative investments if they are deemed inappropriate considering the municipal circumstances.

5. CONCLUSION

A set of model portfolios has been developed by PH&N Institutional that is designed to be appropriate for a wide range of Participating Municipalities needs under the OCIO model. These model portfolios were built with the eligible investment funds available under the offering based on a portfolio optimization process that evaluates both risk and return characteristics. Eleven models have been designed to provide great flexibility, with each providing different levels of risk. Fixed income allocations in these models range from 100% of investments down to only 20%, which should address the investment needs of most Participating Municipalities investing in the OCIO Offering. Tailored models would also be available as needed.

The evaluation of municipal reserves remains a key factor that informs how the investment allocations of Participating Municipalities are determined with time horizons of reserves and the characteristics of the reserve providing relevant contex. The process will continue to use municipal reserves and associated cashflows as a starting point in the analysis, with other factors that are relevant to determining investment allocations also being considered.

ATTACHMENTS

Attachment 1: OCIO Portfolios Modeling & Analysis

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