

Report to Council



Date: March 18, 2024
To: Council
From: City Manager
Subject: Investment of Kelowna Funds 2023
Department: Financial Services

Recommendation:

THAT Council receives, for information, the Investment of Kelowna Funds for 2023 Report from the Financial Planning Manager as presented on March 18, 2024, in alignment with Council's strong financial management priority.

Purpose:

To provide Council with information summarizing the City of Kelowna's 2023 investment portfolio and an overview of the performance of the portfolio as a whole.

Background:

Economic Overview

The 2023 economic environment consisted of stubbornly sticky inflation, along with the highest interest rate in 20 years. The Consumer Price Index (CPI) for Canada decreased from 6.3% at the end of 2022 to a low of 2.8% in June 2023 and settling at 3.4 % at the end of December 2023. Interest rate increases by the Bank of Canada are used as a tool to cool inflation. The slow decrease in inflation was caused by several factors which include:

- continued strong population growth in Canada;
- a robust US economy with spillover affects to Canada; and
- geo-political conflicts in Eastern Europe and the Middle East.

The Bank of Canada increased the interest rate three times over 2023. The interest rate went from 4.25% in January 2023 to 5% in July 2023 where it has been maintained to present day. The Bank of Canada expects CPI to slowly recede into the 2 – 3% range, which is within the Bank of Canada's target CPI rate range. Bank of Canada interest rates have been historically difficult to predict, however, the current prevailing view by various economists is that interest rates will ease in the Summer of 2024.

Investment of Kelowna Funds

The Investment Policy contemplates a balance of investment return and risk mitigation. The City of Kelowna's investments have a market value of \$946.6 million as of Dec. 31, 2023. The funds are used

toward the City’s operating and capital programs and help offset taxation impact to residents. The portfolio is segregated into short term funds (26% or \$249.8 million) and long-term funds (74% or \$696.8 million).

The City of Kelowna continues to utilize a laddered 10-year bond strategy and balanced approach for investment holdings and duration. The laddered strategy ensures that the bonds mature at a smooth and predictable rate and that investment income and maturing investments provide ongoing liquidity. This balanced approach results in the City having sufficient levels of income and funding available to meet the municipality’s annual requirements.

Portfolio Performance

The City of Kelowna Investment Policy includes five market indicators as benchmarks to determine the investment portfolio’s performance. The benchmarks are compared to the City’s average rate of return earned on the entire investment portfolio as at December 31, 2023. These benchmarks are the CPI Index Average, the FTSE TMX Canada 91-Day T-Bill, the median money market return, the MFA Bond Fund, and the MFA Money Market Fund. In 2023, the City of Kelowna’s 3.9% average rate of return was greater than CPI Index Average, however less than the other benchmarks.

Benchmark	Rate	City of Kelowna Average Rate
CPI Index Average	3.40%	3.90%
FTSE TMX Canada 91-Day T-Bill	4.70%	
Median Money Market Return	4.93%	
MFA Bond Fund	5.22%	
MFA Money Market Fund	5.70%	

The City of Kelowna’s portfolio was not able to outperform these benchmarks, other than CPI Index Average, due to short duration benchmarks. One of the City’s investment strategies is to purchase investment vehicles with an average duration to maturity of approximately 3 years. This allows the City to smooth out investment returns during fast-changing interest rate environments, like we have recently experienced. Given our investment mix has long-term and short-term investments, as investments mature, the City is re-investing in higher yielding investment vehicles. This strategy provides smaller differences in our return on investment from year-to-year, and more predictable cashflows which provides more accurate budgeting by the City.

Given the City’s investment strategy to invest in maturities with longer durations, the City is able to beat the benchmark’s during a decreasing interest rate environment, however, it is difficult to beat benchmarks during a rapidly increasing interest rate environment.

Year	City of Kelowna Average Rate of Return
2019	2.51%
2020	1.89%
2021	1.67%
2022	2.49%
2023	3.90%

Legacy Endowment Fund

The City's Legacy Endowment Fund has been created with funds received from the sale of the City's Electrical Utility. The endowment funds are separated into three streams, a distributable, stabilization, and capital fund. This approach provides a stable, long-term financial avenue that balances wealth accumulation with a guaranteed payout, ensuring financial security for funding needs which will create generational wealth for the community. The Endowment fund strategy aligns with the Legacy Fund's objective to incrementally increase its overall investment's monetary value on an annual basis and maintain its value over time.

The distributable fund, which is expected to be a minimum annual amount of \$4 million, will provide a flexible annual income stream for City use. These investment returns soften the tax impact of debt servicing costs related to capital infrastructure.

The stabilization fund will be utilized to cushion the impact of market fluctuations on the fund's value. It will act as a reserve that will enable the City to smooth out fluctuations in the fund's income stream and minimize volatility of the distributable portion of the fund.

The capital fund will aim to generate long-term growth for the Legacy Fund. This growth will help the fund maintain its value over time and continue to support the City's initiatives in the future. 2023 ending balances of the Endowment Fund are noted in the table below.

Endowment Fund at December 31, 2023	Amount (FMV)
Capital Fund	\$ 153.5
Stabilization Fund	\$ 4.0
Distributable Fund	\$ 1.9
Total	\$ 159.4

(In Millions)

The Year Ahead

2024 investment objectives include continued monitoring of interest rate fluctuations and the timing of investment maturities with the future cash flow requirements of the City. There is an inverse yield curve on GIC rates over the next 5 years which is an indicator that the Canadian Financial Institutions believe

we are at the top of the Bank of Canada interest rate hikes and foresee a decrease in the Bank of Canada interest rate in the next few quarters. The City's Treasury department is extending the duration of its investment maturities to take advantage of the current interest rates. It will be a key focus of the Treasury department to balance the duration of the investment maturities with the major Capital requirements of the City.

Legal/Statutory Procedural Requirements:

The Treasury Supervisor will provide Council with an annual report on the performance of the Investment of City of Kelowna Funds portfolio in the first quarter of the following year.

Existing Policy:

Council Policy Number 316

Submitted by: Melanie Antunes CPA, Financial Planning Manager

Approved for inclusion:



Joe Sass CPA, CA, Divisional Director Financial Services