Intelligence MEMOS

From: Andrew Kaufman

To: Ontario Municipalities

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Re: **POOLING PIGGYBANKS: ONTARIO MUNICIPALITIES CAN BETTER DEPLOY THEIR SPARE CHANGE**

There is a long – 103-year – history of investment managers supporting the supervision and investment of public funds in Ontario to provide increased revenue for public coffers while reducing the costs associated with the duplication of services. And it's a concept that Ontario's municipalities should embrace.

Under this pooling approach, different organizations' funds are comingled and overseen by an investment management firm that administers financial portfolios corresponding to each member's budgetary goals. In turn, each contributing agency owns a share of total portfolio assets and receives a return dependent on full portfolio returns.

In Ontario, public-sector pensions have been the principal target for pooling investment portfolios. By the summer of 2022, six major Ontario public pension plans managed approximately $500 billion in assets. *The Economist* magazine and *Financial Times* have hailed Canada's approach to public investment management as "Maple Revolutionaries," for its strong investment mandates, depoliticized governance, and adaptable investment strategies.

Applying a similar Maple Revolution approach to Ontario's local government reserves offers meaningful advantages, as I outlined in my recent C.D. Howe Institute **Working Paper**, allowing a more structured and strategic approach to managing scattered reserves and cash holdings.

Various public cash and revenue streams can be pooled to provide an investment return on government funds. These investments are typically linked to local governments' spending goals outlined in their operating and capital budgets. To be clear, these funds have different goals than pooled pensions. Unlike pensions, the demands of municipal funds require easy access for the cash-flow needs of local governments and public-sector agencies.

Local governments recognize the importance of effective asset management, as it is crucial for making timely investments that minimize costs and optimize the repair and rehabilitation of capital assets. Unlike pension funds, the investment strategies for these public funds must be carefully tailored to the unique circumstances of each situation.

Local government investment pools (LGIPs) are one vehicle that has successfully risen to the challenge. Compared to pensions that may hold assets with long maturities, LGIPs allow local governments and public agencies to combine their funds to invest in highly liquid financial instruments such as money-market funds and short-duration government bonds that allow quick access to cash.

As an added benefit, LGIPs enable local governments and public agencies to consolidate their resources and invest in a broader range of assets, potentially yielding increased returns and providing greater investment portfolio stability.

My paper asked two questions.

First, to what extent have Ontario's local government reserves and cash holdings grown over time? Second, could these reserves and cash holdings be better managed?

Ontario's local governments had some $39.7 billion in municipal reserves in 2020, I found using public data available through Ontario's Financial Information Return portal.

The report identifies the different pots of local government funds in Ontario comprising the $39.7 billion. By 2020, Ontario municipalities, counties, districts and cities held some $15.5 billion in discretionary reserve funds, $12.6 billion in other reserve funds and $11.7 billion in obligatory reserve funds associated with development charges. Primarily, excess municipal reserves are driven by population and housing growth within the Greater Toronto Area. By 2020, Ontario municipalities, counties, districts and cities held $20.1 billion in cash and temporary investments.

Over the past year, the reserves related to development charges have been the focus of increasing debate given last year's passing of Bill 23, the *More Homes Built Faster Act. It* removed housing services from development charges, providing exemptions for affordable and attainable housing, altered the method for determining development charges, and a requirement for municipalities to spend or allocate 60 percent of reserve funds annually for certain services.

Development charges are necessary, but, the goal should be to target them only where they are required. Associated investment returns can offset their continued growth, but collecting investment returns should not be an explicit goal of development charge policies. Accordingly, we caution against an overreliance on the investment returns associated with public-fund consolidation for generating municipal income.

Ontario's *Municipal Act* limits investment durations for these development-charge monies to short-term, fully liquid investments. Any approach to public-fund consolidation must recognize that local governments require a certain level of liquidity. Therefore, the entire $39.7 billion is not simply available for long-term investments.

Still, cities could be getting better investment returns than their current 2 percent. One potential solution is improving the coordination between local governments and Ontario's public-asset management institutions such as ONE Investment and the Investment Management Corporation of Ontario (IMCO). To be clear, the point is not that municipalities are mismanaging their reserves and cash holdings. Instead, I suggest that Ontario's local governments could collectively benefit from pooling these reserves and cash holdings.

To implement better pooling and higher-return investments for municipal government, the Ontario government should consider legislative changes to remove limits on investment durations and improve clarity on investment pooling.

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