Intelligence MEMOS

From: Patrick Gill

To: Canadian Taxpayers

Date: January 30, 2020

Re: **JUMPSTARTING MUNICIPAL INVESTMENT RETURNS – THE PRUDENT THING TO DO**

All levels of government in Canada invest funds they don't immediately require. These investments are a significant source of revenue for public coffers. Without this revenue stream, taxes would be higher or service levels lower for Canadians.

Provincial rules have historically hindered municipal investment portfolios from maximizing returns and leveraging investment funds for local needs.

This changed in Ontario last January, when it became the third Canadian province to allow municipalities to manage investment funds like a mature order of government or a public-sector pension fund.

Ontario municipalities that (a) individually or collectively possessed more than $100 million in investment assets or (b) individually held a net financial position of at least $50 million could now begin managing portfolios using a prudent investor standard.

Unlike the old regime – which limited municipalities' investment options to domestic government securities – the new framework offers municipalities a broad range of investment options, including the option of investing in local infrastructure, such as purpose-built rentals.

One year later, however, Toronto alone of 444 Ontario municipalities is using the standard.

Confined to domestic government securities, a prolonged period of low interest rates since the Great Recession meant Ontario municipalities saw their rates of return decrease by 50 percent. This put Ontario municipalities, some more than others, in a difficult position. Legally required to balance their annual operating budget, municipalities must fill budgetary gaps by raising revenues, cutting expenditures, or drawing from reserves.

Collectively, Ontario municipalities have a significant sum invested. The total in 2016 was nearly $29 billion. These funds generated a total investment return of $514 million in 2016. (These funds are only a fraction of municipalities' total wealth – encompassing both financial and non-financial assets, a state of affairs recently described in a C.D. Howe Institute Intelligence Memo.)

While a $500 million investment return is significant, it could have been far greater.

Only half of Ontario's 444 municipalities were investing their reserved assets in 2016. If more municipalities were to put those reserved assets to work, the overall return would have been greater. Second, the investment options available to Ontario municipalities in 2016 were still restricted to domestic government securities. If investing Ontario municipalities had the ability to use a prudent investor standard at the time, the return would have been greater still. Simply splitting their investment assets on a 95 percent fixed income and 5 percent equities basis would have achieved this.

Considerable value is placed on preserving public assets in Canada. Unsurprisingly, the regulations introduced to govern the new Ontario investment standard were decidedly protective of municipal financial assets. This, however, has slowed adoption of the new standard itself. Ontario municipalities are seeking both more flexibility in establishing an independent investment board and with potential investment management partners.

Four policy changes would help jumpstart municipal investment returns in Ontario and Canada.

1) All provinces should allow municipalities, either individually or collectively, to use a prudent investor standard as do Alberta, Ontario and Nova Scotia.
2) The Ontario government should encourage municipalities to individually or collectively work with a reputable financial institution to manage their investment portfolio, and in so doing, also absolve municipalities from the requirement to establish independent investment boards. Municipalities would benefit by a) saving money on internal management; b) gaining better advice; c) saving significant time on establishing mediocre oversight; and d) helping shield investment decisions from political interference.
3) Ontario should also allow municipalities to partner with the Investment Management Corporation of Ontario (IMCO) – an independent corporation created to manage the assets of the province's public entities. Moreover, IMCO should consider collaborating with ONE Investment, a non-profit organization founded by the Association of Municipalities of Ontario and the Municipal Finance Officers' Association to provide municipal investment advice, on a unified and exemplary service offering.
4) All provincial governments, especially Ontario, should encourage their municipalities to invest their reserved funds in something – even if it's simply a low-yield government bond.

Size of Ontario Municipal Investment Portfolios

Number of municipalities	222	75	75	47	19	6
	No investments	<$1M	$1M - $10M	$10M - $100M	$100M - $1B	>$1B

Source: Ontario Ministry of Municipal Affairs and Housing, September 2018

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To send a comment or leave feedback, email us at blog@cdhowe.org.

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