Council Direction:

N/A..

Information:

The City’s Reserve/Revenue Fund investment portfolio (comprised of reserves/reserve funds, capital account balances and unused operating funds) had an earning rate of 3.96% for the 12 months ending June 30, 2008. Bond lending revenues of $66,207 are included in the earnings rate. Over the past five (5) years, the earning rate on investments has averaged 4.28%. The overall return, which is impacted by increasing or decreasing asset prices, was 5.71% for the twelve (12) months ending June 30, 2008. This underperformed the City’s benchmark by 122 basis points. Over the past five (5) calendar years, this overall return has averaged 4.97% per annum, beating the average benchmark return of 4.81% by sixteen (16) basis points. The City’s portfolio has generated, on average over the past five years, approximately $26.3 million in interest, realized capital gains and lending income annually. The duration of the portfolio at June 30, 2008, was 2.99 years compared to 3.91 years at December 31, 2007. The total value of the portfolio was $797,314,464 at June 30, 2008, which included $97.6 million in Asset-Backed Commercial Paper (ABCP) at par value.

The One Fund (offered by the Association of Municipalities of Ontario and the Municipal Finance Officers’ Association) returns for the year ended June 30, 2008, was 6.09% for bonds, including unrealized gains and 4.44% for money markets. If the City’s policy had been used in these funds (i.e., 90.0% bonds and 10.0% money market), the overall
return would have been 5.93% or twenty-two (22) basis points more than the actual return of 5.71% for the past twelve (12) months, which translates into approximately $1.5 million revenue decrease on an average portfolio balance of $673 million.

**Investment Return Indicators (for information purposes only)**

(to June 30, 2008)

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Policy Target</td>
<td>6.93%</td>
<td>4.50%</td>
<td>3.91%</td>
<td>3.48%</td>
<td>5.23%</td>
</tr>
<tr>
<td>City’s Portfolio</td>
<td>5.71%</td>
<td>3.67% <em>(1)</em></td>
<td>3.32%</td>
<td>5.90%</td>
<td>6.27%</td>
</tr>
<tr>
<td>The One Fund – Bonds</td>
<td>6.09%</td>
<td>3.84%</td>
<td>2.62%</td>
<td>2.09%</td>
<td>4.93%</td>
</tr>
<tr>
<td>The One Fund – Money Market</td>
<td>4.44%</td>
<td>4.39%</td>
<td>3.83%</td>
<td>2.52%</td>
<td>2.20%</td>
</tr>
<tr>
<td>Dex – Short Government</td>
<td>6.97%</td>
<td>4.54%</td>
<td>3.88%</td>
<td>2.23%</td>
<td>4.89%</td>
</tr>
<tr>
<td>Dex – Mid Governments</td>
<td>8.99%</td>
<td>4.52%</td>
<td>3.91%</td>
<td>5.43%</td>
<td>7.62%</td>
</tr>
<tr>
<td>Lending Revenue</td>
<td>$66,207</td>
<td>$61,220</td>
<td>$36,918</td>
<td>$44,596</td>
<td>$17,318</td>
</tr>
<tr>
<td>Earning Rate (Excludes Capital Gains/Losses)</td>
<td>3.96%</td>
<td>3.30% <em>(1)</em></td>
<td>4.79%</td>
<td>4.71%</td>
<td>4.66%</td>
</tr>
<tr>
<td>City’s Return One Fund Investment (Equity)</td>
<td>-1.43%</td>
<td></td>
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<td></td>
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</tbody>
</table>

*(1)* The earning rate in 2007 was adjusted for an allowance of $14.4 million due to ABCP holdings. This allowance is an estimate only and actual results may differ due to actual cash realization from these holdings.

The performance of the City’s portfolio is explained by two primary factors. The Asset-Backed Commercial Paper held by the account has not been restructured and is non-performing. As well, the account is biased to a very short duration in anticipation of increasing rates. A very high proportion of the account is in money market securities which earn lower rates but meet the City’s liquidity requirements going forward.

The City subscribed to the “One Funds” equity account last year. A program of depositing $200,000 per month into this fund started in order to average into equity holdings. The City has deposited $2.6 million into the account over the past thirteen (13) months and the return for the past thirteen (13) months is -2.50%. The return over the past twelve (12) months is -1.43%.

Unrealized capital gains at June 30, 2008, totalled $2,626,400, resulting in a total portfolio value of $797,314,464. Capital gains of $5,777,955 were realized through the past twelve (12) months.
The City’s portfolio was 59.3% bonds and 40.7% money market securities at June 30, 2008, compared to 72.5% bonds and 27.5% money market at December 31, 2007. The portfolio’s money market holdings ranged from 21.8% to 42.6% through the past year, averaging 35.04%. The portfolio has increased from $651 million to $797 million with proceeds from tax levies, transfers and selected bond sales.

The following chart illustrates the changes in Canadian interest rates over the past eighteen (18) months:

<table>
<thead>
<tr>
<th>Maturity Term</th>
<th>Canada Benchmark</th>
<th>Interest Rate June 30, 2008</th>
<th>Interest Rate January 2, 2008</th>
<th>Interest Rate January 2, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>One Month (T-Bill)</td>
<td>2.27%</td>
<td>3.71%</td>
<td>3.17%</td>
<td></td>
</tr>
<tr>
<td>2 yr</td>
<td>3.25%</td>
<td>3.75%</td>
<td>3.81%</td>
<td></td>
</tr>
<tr>
<td>5 yr</td>
<td>3.46%</td>
<td>3.87%</td>
<td>3.89%</td>
<td></td>
</tr>
<tr>
<td>10 yr</td>
<td>3.83%</td>
<td>3.99%</td>
<td>3.97%</td>
<td></td>
</tr>
</tbody>
</table>

Current conditions in Canadian fixed income markets are dominated by the ongoing global credit crisis and growing concern over inflation expectations. Central Banks now face threats of weak growth and rising inflation.

Over the first half of 2008, Central Banks’ actions in the U.S. and Canada reflect their view of the balance of the risks. Concern over slower growth arising from the credit crisis dominated in the first quarter and concern over rising inflation expectations dominated in the second. Both the U.S. Federal Reserve and the Bank of Canada cut rates aggressively in the first four (4) months of this year. Through to April, rate cuts reduced the Canadian overnight rate to 3% and the U.S. Fed Funds rate to 2%. Since April, however, both the U.S. Federal Reserve and the Bank of Canada have left rates unchanged citing significant risks of higher inflation and of price expectations getting out of control. Inflation risk is perceived in continuing commodity price increases such as oil, raw materials and food products and the possibility of increasing wage demands to offset these price increases. Current market consensus is that the Federal Reserve and the Bank of Canada may raise rates a quarter point by year end.

Risks to the consensus outlook are that inflation expectations will remain contained. Some analysts point to a risk of deflation rather than inflation. For example, if reduced consumer demand in the U.S. tempers growth in the emerging countries, then it is believed that this may dampen demand for oil and result in a decline or correction in oil prices. Other analysts have argued that, without cost,push inflation, the wage price spiral may not take hold and, therefore, inflation expectations would remain contained.
The City’s investment portfolios are invested with a duration of less than the index due to the uncertainty and magnitude of a rate increase, if any. Investment has been in the highest credit quality bonds issued by governments or major Canadian banks. In addition, money market holdings and/or short bond equivalents have increased in order to remain flexible.

Peter A. Barkwell  
Acting General Manager  
Finance and Corporate Services