Legislative Assembly of Alberta

The 29th Legislature
Fourth Session

Standing Committee
on the
Alberta Heritage Savings Trust Fund

Wednesday, January 16, 2019
1 p.m.

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Alberta Heritage Savings Trust Fund

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Standing Committee on the Alberta Heritage Savings Trust Fund

Participants

Ministry of Treasury Board and Finance
Lowell Epp, Assistant Deputy Minister, Treasury and Risk Management
Stephen J. Thompson, Executive Director, Capital Markets

Alberta Investment Management Corporation
Dale MacMaster, Chief Investment Officer
Mark Prefontaine, Chief Client and Stakeholder Relations Officer

1 p.m. Wednesday, January 16, 2019

[Mr. Coolahan in the chair]

The Chair: Good afternoon, everyone. I'd like to call this meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund to order.

My name is Craig Coolahan, the MLA for Calgary-Klein and chair of this committee. Now I'd like everyone at the table to introduce themselves, please, starting on my right.

Ms Woollard: Hello. I'm Denise Woollard, MLA for Edmonton-Mill Creek.

Mr. Cyr: My name is Scott Cyr, the MLA for Bonnyville-Cold Lake.

Mr. Ellis: Mike Ellis, MLA, Calgary-West.

Mr. Prefontaine: Mark Prefontaine, AIMCo.

Mr. MacMaster: Dale MacMaster, AIMCo.

Mr. Epp: Lowell Epp, Department of Treasury Board and Finance.

Mr. Thompson: Steve Thompson, Treasury Board and Finance.

Mr. Robe-From: Nelson Robe-From, principal with the office of the Auditor General.

Ms Antoniuk: Danielle Antoniuk with communications services for the Legislative Assembly Office.

Mr. Horne: Good afternoon. Trevor Horne, MLA for Spruce Grove-St. Albert.

Mr. Sucha: Graham Sucha, MLA for Calgary-Shaw.

Ms McKitrick: Bon après-midi. Annie McKitrick, MLA/Députée de Sherwood Park.

Mr. Koenig: Good afternoon. I'm Trafton Koenig, a lawyer with the Parliamentary Counsel office.

Dr. Massolin: Good afternoon. Philip Massolin, manager of research and committee services.

Mr. Roth: Good afternoon, and Happy New Year. Aaron Roth, committee clerk.

The Chair: Okay. It's official. We can still say Happy New Year. That's good. Well, Happy New Year, everyone.

We'll go to the phone. Member Drever, introduce yourself, please.

Drever: Good afternoon. Deborah Drever, MLA for Calgary-Bow.

The Chair: Member McPherson, are you on the phone?

Ms McPherson: Hello. Karen McPherson, MLA for Calgary-Mackay-Nose Hill.

The Chair: Thank you.

As per Standing Order 56(2.1) to (2.4) I'd like to note the following substitutions for the record. Ms Woollard is substituting for Mrs. Schreiner, Ms McKitrick for Dr. Turner, and Mr. Sucha for Mr. Dang.

A few operational items. Please note that the microphones are operated by *Hansard* and that the committee proceedings are being live streamed on the Internet and broadcast on Alberta Assembly TV. Please set your cellphones and other devices to silent for the duration of this meeting.

The first item on the agenda is to approve the agenda. Do we have anyone to move the approval of the agenda? Mr. Horne moves that the agenda for the January 16, 2019, meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund be adopted as circulated. All in favour, say aye. On the phone? Any objections? That motion is carried.

The next item is to approve the minutes from the September 25, 2018, meeting of this committee. Would anybody like to move that? Mr. Horne moves that the minutes of the September 25, 2018, meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund be adopted as circulated. All in favour? Any objections? That motion is carried.

The Alberta heritage savings trust fund's second-quarter report for 2018-2019 was released on November 30, 2018. Committee members were sent notification of its release, and the report was posted to the committee's internal website. The Alberta Heritage Savings Trust Fund Act mandates that one of the functions of the committee is to receive and review quarterly reports on the operation and results of the heritage fund. We are pleased today to have Mr. Dale MacMaster and Mr. Mark Prefontaine with AIMCo and Mr. Lowell Epp and Mr. Stephen Thompson from Treasury Board and Finance here to assist us with our review.

Now I'll turn the floor over to Mr. Epp and then to Mr. MacMaster.

Mr. Epp: Thank you, Mr. Chair. It is always a pleasure to be here in front of the committee. Minister Ceci is unable to attend today and sends his regrets.

I will spend a few minutes, and only a few, to highlight some important parts of the report. As of September 30 of last year the heritage fund had a market value of 17 and a half billion dollars. Through the end of the second quarter the heritage fund earned a return of 3.1 per cent and a net income of $702 million.

Returns on equity investments have led the way again over the past six months, with a return of 5.7 per cent over the period. Inflation-sensitive and alternative investments earned a return of 1.8 per cent during the past six months while fixed income earned a return of .3 per cent.

While the short-term returns are certainly important and interesting, the focus of the heritage fund, of course, is to maximize investment earnings over the long term. Over the past five years the heritage fund has earned an annual rate of return of 10.2 per cent while the return over the past 10 years is 8.9 per cent. These returns exceed the return objective for the heritage fund, which is to earn a return of 4 and a half per cent over the rate of inflation as measured by the consumer price index. Over the past five years inflation was 1.6 per cent, which implies that the target return for the heritage fund over that period was 6.1 per cent. Actual performance was 4.1 per cent higher than this target. Over the 10-year time frame heritage funds have exceeded the target return by 2.8 per cent.

Finally, I would like to provide a brief update on the Alberta growth mandate. As of September 30, 2018, the heritage fund has made 31 different investments, for a total commitment of $386 million. Of these 31 investments, two have been exited, and a significant profit was earned on both of these transactions. As in the past, we will continue to provide the committee clerk with periodic reporting regarding investments made under this mandate.

Thank you, Mr. Chair. That concludes my remarks.

The Chair: Thank you, Mr. Epp.

Mr. MacMaster.

Mr. MacMaster: Thank you. The second-quarter return for the heritage fund was 1.12 per cent. That's 22 basis points above the benchmark return of .91 per cent. The year-to-date return of 3.14 was slightly below the benchmark of 3.3. That's all interesting, but as Mr. Epp pointed out, it's the long term that matters, and as you can see from the heritage fund report, the five-year, 10-year from inception returns are both strong from an absolute point of view and from a relative value point of view as well.

I'd like to inform you as well that the current year-to-date returns do not include up-to-date valuations for the illiquid assets in the portfolio, including real estate, infrastructure, and private equity, as they are valued only once a year, in December. Although these have not been finalized, it appears that the fund will get a nice lift from the strong performance of these assets that you will see in our upcoming meetings later on in 2019.

The net impact is that the heritage fund should show a modest but positive return as of the end of December despite the market turbulence, which I'm sure you all have read about. This positive outcome demonstrates the benefits of a portfolio that is widely diversified by asset type and geography.

In terms of the market environment I will say that the past year has been both challenging and unusual. Markets have been volatile and unpredictable while active managers, especially in equities, have struggled to add value. Usually it's the economic climate that is the main driver of markets, but this year politics and trade disputes have entered the environment, with a more impactful effect on markets and investment psychology than we've seen in prior years. The result was a very volatile year for markets, with two significant stock market corrections of 10 per cent or more. The second, which began in October, left major developed markets down almost 20 per cent from the high as we closed out the year on a very sour note, with equities, oil, and bond yields all caught in a tailspin. Just as one example, the S&P 500, the main U.S. benchmark, was down 9 per cent for the month, its worst single month since 2009 and the worst December since 1931.

The Canadian market was down 12 per cent on a price basis for the year, also marking its worst performance in a decade. In Europe things weren't much better as emerging markets dropped 15 per cent. The Chinese market was off 25 per cent.

So why all the panic? Well, some of the extreme volatility we saw in the last few weeks of the year was just due to year-end rebalancing and thin trading, but the main reason in the last quarter for this volatility was a surge in economic uncertainty. Three months ago the market appeared to be pricing in a strong, continuing growth in economies around the world, with solid earnings into 2019. That all changed near the end of September as the first signs of an economic slowdown started to emerge. As further evidence of a potential global economic recession began to emerge, stocks started pricing in that potential, and that led to the sell-off. We believe the market will continue to push and pull until more economic signs emerge that one or the other is going to be our fate in 2019.

In addition to the slowing economic theme, we've also seen nagging concerns around trade, in particular the U.S.-China trade showdown, steady Fed tightening, a variety of geopolitical hotspots, including Brexit, and the U.S. government shutdown.

1:10

The collapse in equity markets in December has pushed aside the fact – there were actually quite a few good things that emerged in 2018. After all, global growth had another above-average year, the jobless rates fell to multidecade lows in both Canada and the U.S. and other industrialized nations, and inflation was also mainly subdued. We believe that much of the current negativity in financial markets is overdone. It might be exaggerating things to the downside.

The following few points are just some of the supportive factors we would point to when considering this year's economic outlook that fall on the positive side of the equation. One, the slide in oil prices will trim inflation and leave more money in consumers' pockets. Income growth remains solid, especially in the U.S., where real disposable income is up almost 3 per cent in the past year, which should help support spending. Many businesses are operating near capacity and are still looking to hire and to invest. Trade uncertainty, at least in North America, is a little more subdued with the potential ratification of the USMCA, and any progress on the U.S.-China file should give the markets a lift. Fiscal policy on both sides of the border will add modestly to growth although not as much as it did in 2018 with the tax cuts we saw in the U.S. Investor sentiment has also turned much more bearish; at the same time, valuations have improved.

For these reasons, we're a little more positive than what you're potentially seeing in the market activity. The interest rate environment now looks much less threatening for growth, with expectations of further rate increases pulling back sharply in recent weeks from both the Fed and the Bank of Canada. While the consensus view is for two more rate increases in the coming year, it's clear that the risks for that scenario are to the downside.

The final conclusion, I guess, is that with inflation pressures cooling off and chilled further by a recent slide in oil prices, central banks have the flexibility to stop the rate hike campaign, especially if financial markets weaken further and/or if growth slows more than expected. Overall, there are clear reasons to believe that growth will cool in both Canada and the U.S. We still believe there are some supportive factors that should keep the markets intact.

That concludes my comments.

The Chair: Thank you.

I'll turn the floor over to committee members to ask questions of our guests about the second-quarter report. Mr. Ellis.

Mr. Ellis: Thank you, Chair. This is to Mr. MacMaster. In the last several hours there's been some development in regard to Brexit. My understanding, in just watching the news, is that the British Parliament rejected the Prime Minister's proposal. Can you maybe explain what possible impacts that might have on investments pertaining to the heritage trust fund?

Mr. MacMaster: Sure. For those of you who may have not seen the news, the U.K. Parliament voted down Theresa May's Brexit plan by about 230 votes, which was a substantial number, but this was no surprise to the markets or to anyone who has been paying attention. It was expected, and the market shrugged it off. Equity markets rallied, and the pound sterling was up significantly. Why? Well, this is seen as reducing, actually, the chance of a hard Brexit, which neither side has any interest in seeing happen. It does increase the chance that Brexit will be cancelled completely or transformed into an endless transition period or a watered-down version of Brexit in a Norway style. It increases the chance of a second referendum as well.

In the media there's been lots of reporting, and quite frankly in any trade negotiation, just like we saw with the U.S. trade negotiation last year, there's lots of huffing and puffing and positioning. But this is a negotiation. The magnitude of the defeat sends a message to the EU that significant concessions would have to be made to the plan to get Parliament to accept the deal, but reality says that there are probably no concessions great enough to reverse all of those 230 votes.

What's next? There's no clear path, but there are several options. Theresa May has three days to present a new plan. It's unlikely that there will be significant changes to the plan that she can negotiate with the EU to overcome those votes, but that's what she has. There's also a no-confidence vote. I believe it's tonight. They're expected to win that. She will get support. It's expected she'll get through that.

So option 1 is more discussion and a revised plan and then another vote if Brussels agrees. The more likely option is that Brussels agrees to extend the May 29 deadline well into July to allow more time for negotiation. They've already alluded to that option. That's article 50, that could get delayed. While this removes the immediate risk, it's not necessarily good for the economy or the uncertainty in the U.K. around this issue. We should expect to hear more talk of a referendum; that should get louder.

The next major event is that Parliament seizes control of the Brexit negotiations. This is fairly unprecedented, since Oliver Cromwell, probably, in the 17th century. But the Speaker there, John Bercow, has absolute authority over parliamentary procedures, and they would need an act of Parliament to repeal or amend the European Union (Withdrawal) Act 2018, which established March 29 as the hard deadline. Parliament could outlaw a no-deal Brexit, and this would probably receive support by all parties. Once a hard Brexit is out of the way, it does open up the door for hard-line Brexiteers to support May's plan in fear of an even softer plan that could come forward. And Parliament could vote on a new referendum.

So there are several options, more uncertainty, but the market views the chance of a hard Brexit on March 29 as less likely than it was 24 hours ago.

Mr. Ellis: Thank you very much. Those were excellent comments. Just for the record, just in watching the news prior to attending this meeting, she did survive the vote of no confidence. So, hopefully, that's good for them.

Mr. MacMaster: Great. Thank you.

Mr. Ellis: Thank you, Chair.

The Chair: Thank you.

Any other questions? Anyone on the phone have a question? Okay. Mr. Horne.

Mr. Horne: Thank you. And thank you for the summary of the past 48 hours of U.K. politics. I've been keeping an eye on it myself. But a little bit closer to Alberta, I was just looking at the last quarter, and there appear to not have been any significant changes to investments made under the Alberta growth mandate. I suppose that, first, I'm wondering if you could confirm whether or not I'm correct in that observation.

Mr. MacMaster: Yes. That's correct. The last investment I have here is Wolf Midstream, which would have been first quarter. We've continued to look for investments and have simply not found anything that meets the criteria for inclusion in the portfolio, but we continue to actively look for potential investments.

Mr. Horne: Okay. Are there any particular sectors or industries that you're keeping an eye on in particular?

Mr. MacMaster: Energy is the most interesting for a number of reasons that I've spoken about here before. One of them is the absence of capital investment from outside of Canada that we've seen in the last couple of years for all the reasons that have been well documented. The other reason is the extreme valuation that we're seeing, a valuation to the low side, that presents opportunities. There's a tremendous amount of uncertainty, as you're all well aware, around takeaway capacity and pipelines and through rail. So we're continuing to be actively involved in this sector, looking for opportunities.

Mr. Horne: I suppose there's definitely a lot more long-term expected growth with energy, for sure. Are there any particular industries, perhaps including but certainly not limited to energy, that you're looking at and expecting growth in in 2019?

1:20

Mr. MacMaster: There was an opportunity in financial services we looked at but couldn't come to an agreement. But given that it's Alberta, I would say that it's primarily energy and energy related.

Mr. Horne: Thanks.

The Chair: Thank you.

Mr. Cyr: Thank you for coming here today. It's definitely cold out there. My question revolves around China and the United States. They seem to be pretty much locked in a trade war right now. We're seeing tariffs being, I guess, levied at an astounding rate. How does this trade war with China impact the heritage fund, and are we making plans around it to deal with this for, say, other countries that are tied heavily with both of those countries?

Mr. MacMaster: Sure. Good question. The major impact on the portfolio and on investment generally is from more of a macro point of view, which is that it's created a lot of uncertainty and the reduction in investor confidence and business confidence that we saw in the last, you know, quarter of 2018. I think that was part and parcel of the correction we saw in the last quarter, you know, with a lot of rhetoric coming out of the White House around China and threats, much like we saw in the Canada-U.S. negotiations.

But it's not all bad. You know, no one has really taken on China before. China has some issues to work through in terms of opening up the country to foreign investment and to foreign companies operating there while many other countries have sort of welcomed China with open arms. This will hopefully strike a balance, so good things could come of this, actually. China will be forced, probably, to make some concessions but, just like Canada, only after a long, protracted negotiation, which could take months.

Should we get good news on that file, I think it would be a tremendous lift to confidence around the world and to markets. So that would be a good thing. I think that's possible.

Mr. Cyr: Are we looking at investing in China, then? Is that what I'm hearing?

Mr. MacMaster: Yes. In the equity portfolio primarily China has opened up what we call China A-shares to foreign investment. It has opened up that market, and our timing was actually reasonably good because we started looking at that in 2018 and started to deploy money, you know, after markets had tumbled there. We've hired some external managers that operate within China to select securities for us there. So that should be a good thing.

Mr. Cyr: Sorry, Mr. Chair. Can I have another?

The Chair: Sure.

Mr. Cyr: We've seen some pretty astounding drops in their markets, though. Is that not something that you're very worried about?

Mr. MacMaster: Yeah, but not for the long term. I mean, the reason why we like China so much is that it's one of the leading economies around the world in terms of its growth. At the end of the day, equity prices are somehow linked to GDP growth in the country, the domicile. Over the short term it's not always a hundred per cent correlated, but over the long run it tends to be. That's why we like emerging markets and particularly China, which is really growing at quite a clip despite what you've read in 2018. So that's what attracts us there.

The other thing is that the market is predominantly dominated by retail investors. Retail investors don't always bring the necessary rigour and investment discipline, which allows sophisticated institutional investors to pick up stocks when panic happens in the market. So the ability to add value over benchmark returns is much greater in China than it is, say, in the U.S., where you've got, you know, thousands of analysts staring at company reports, earnings every time they come out.

The Chair: Okay. Thank you.

On the phone, Member McPherson.

Ms McPherson: Hi. Thank you very much, Mr. Chair. I do also have a question about the Alberta growth mandate. I'm just wondering: are there any investments under consideration right now to use up the about $150 million that's remaining, and is there any consideration being given to purchasing railcars, similar to where we see the heritage trust fund grain cars on the rails right now?

Mr. MacMaster: For AIMCo, I can say that I do not believe we're looking at a railcar investment. We are looking at some investments, as we speak, in the energy sector, you know, so stand by. One of the biggest concerns we have, like other investors, is the takeaway capacity. We need to make headway on pipelines. It will offer a dramatic change to the landscape if we can get something going there. What we're waiting for is the consultation with First Nations and the evaluation of additional tanker capacity off the west coast. Once those hurdles are overcome, hopefully we'll see something there.

In the meantime, you know, things are pretty dire, especially for smaller companies in the energy sector. We have to balance our desire to put money to work with timing and concern over this major issue.

Ms McPherson: Thank you very much.

Mr. Prefontaine: If you don't mind, Mr. Chair, I'll also add that any conversation regarding the Alberta growth mandate also has to be married with a conversation about the asset allocation decisions that, on behalf of the minister, the department would lead. When Dale and his team are considering particular investments, the first step is to take guidance from that asset allocation. When you look at the asset allocation of the heritage fund as it stands today, it's got a heavy tilt towards the illiquid space. A key consideration in any discussion regarding an infrastructure asset, like railcars for example, would start with what's in the asset allocation decision-making powers that the department has on behalf of the minister.

As well, adding to this conversation is the fact that Dale and his team look at these opportunities not just through the lens of the heritage fund but also on behalf of all of our other clients. So when it comes to those kinds of decisions, there are multiple factors that feed into this. Just because a particular asset doesn't fit the characteristics of the Alberta growth mandate doesn't mean that there isn't that ongoing activity within the heritage fund itself, whether that be real estate, such as the Edmonton Tower, that AIMCo recently purchased on behalf of its clients, or other assets like that.

The Chair: Okay. Thank you.

Ms Woollard.

Ms Woollard: Thank you, Mr. Chair, and thank you, all, for the information you've presented, which is helping me understand what we're talking about. I appreciate that. I've got a couple of questions about the report, which I hope you'll be able to help me with. On page 12 of the report it talks about investment risk management. In previous committee meetings we asked you about what an appropriate level of risk is. Has how you define risk changed recently given the volatile economic situation globally?

Mr. Epp: I'll take that. The investment risk for the heritage fund: our assessment of that risk has not changed. We don't change it with market events.

Ms Woollard: All right. Thank you. Just a follow-up to that question: can you provide a little bit more detail about what safeguards are in place to ensure that this risk is responsible and in the best interests of the fund and Albertans, please?

Mr. MacMaster: Sure. Well, the first aspect of your question gets to the asset mix. The Finance team, you know, creates a desired asset mix for the objectives that are to be achieved by the heritage fund. So that's the first thing. That would involve investments in infrastructure and real estate and equities and fixed income. Then when AIMCo deploys or invests the portfolio, we have a number of risk management protections right across the organization. So we'll set a target for the fund, and we'll create a risk budget to achieve that to make sure that, you know, we're not taking undue risk in the portfolio but just enough risk to achieve the objectives that Finance and you would like us to see achieved.

I would also say that the volatility we've seen in the markets in the last few months is well, well within the norm that we would expect and within the allowed risk budget. You know, despite the discomfort that we feel sometimes when markets correct by 10 or 20 per cent, actually in the last 75 years there have been some – 34 – 10 per cent corrections, so they happen about every two years. This is to be expected. We're long-term investors, so just fasten your seat belt.

1:30

Ms Woollard: Thank you. That's very helpful.

I'll leave the next question for a while.

The Chair: Mr. Sucha.

Mr. Sucha: Thank you, Chair. Two questions pretty quick. The first one: how have WTI and WCS differentials affected the fund over the last year?

Mr. MacMaster: Well, for one thing, as you know, that differential widened to over $50, which was really negative for everyone operating in Alberta. Some companies were obviously affected more than others, but it really hurt the sentiment generally around investing in energy in Alberta. It seems like the restrictions put in place have narrowed that, and recently I saw that as narrow as $5. That's a good thing. WTI has also rebounded a little bit, so that's all a good thing.

The last quarter of 2018 was a very difficult one for energy and right across the board. In fact, 2018 was a really rough year for energy. It's probably the worst-performing sector in the Canadian index, that and material, and we're by no means out of the woods. I mean, this is a temporary thing. We still want to export more. The capacity is there. This is taking down some of the inventory, but we need a long-term solution, right? We need more pipe. Until that's resolved, this differential could indeed even widen.

Mr. Sucha: Okay. Thank you, through the chair. Obviously, you touched on the difficult decision around curtailment, but do you see it having any significant impact on the heritage savings trust fund's investments in 2019?

Mr. MacMaster: That particular aspect I can't speak to. You know, on the one hand, the price is up, but the volumes are down, and firms generally are cutting their production for 2019. You know, it's not a good thing. They're in a holding pattern; they're in survival. A lot of them are cutting dividends, reducing cap ex, and hunkering down for a difficult environment.

Mr. Sucha: Thank you.

The Chair: Thank you.
Mr. Ellis.

Mr. Ellis: Thank you, Chair. Mr. MacMaster, what effect, if any, has this American government shutdown had on the market or even, directly or indirectly, on the trust fund and its investments?

Mr. MacMaster: I mean, I think it's a small impact, but it's a negative thing just in terms of the overall sentiment, right? You know, a government shutdown on top of the U.S.-China negotiations, stock market corrections, concerns about growth: it just adds a little bit of fuel to the fire. But it's hard to pinpoint, hard to say whether that could impact on its own.

Mr. Ellis: If they can resolve their, quote, budgetary crisis or come to some sort of agreement, in your experience do you think that might have a positive impact?

Mr. MacMaster: I think it might be minor. I don't think it's the biggest issue facing the markets these days. I really do think it's Fed interest rate policy, growth, inflation, and trade. Those are the biggies. This is a minor factor, a factor but a small one.

Mr. Ellis: Thank you, Chair.

The Chair: Thank you.
Ms McKitrick.

Ms McKitrick: Thank you. I've often thought about the work that AIMCo has been doing over the last couple of months. Market and funds and investment income have been on everybody's mind. I know I have a lot of constituents, you know, who are concerned about how their RRSPs and retirement funds are doing. I'm sure it's been a challenging time for all of you, so I wanted to thank you for the care that you take in keeping the heritage fund with pretty good numbers, because I know it's not easy.

You know, I'm interested in that data around renewables, your investment around renewable energy funds, and also in how those investments have performed.

Mr. MacMaster: Yes. Well, that's another great question. As you all know, we have been investing in renewables. We made a large investment in a company called sPower in the southwest U.S. It's involved in solar and wind. As I alluded to earlier, our year-end valuations, that we got in December, are pointing to a pretty good lift on the illiquid portfolio, not only infrastructure but real estate and private equity, which is a good thing because equity, as you know, didn't do very well. So, again, it highlights the benefit of a diversified portfolio, which is great. It is great for the heritage fund to have that.

We also made another investment, similar to sPower, in Spain, in a company called Eolia, which is also in solar and wind. It will allow us the same type of platform investment, which is, you know, what we call it, which allows us to buy an operating company, which not only allows us to invest in the existing assets but participate in the growth of further renewables in that geography. This is the most recent one, and it was a fairly large investment and one we're quite excited about. So it continues.

Ms McKitrick: Good. Thank you.

Yesterday I listened to the gentleman, the chief economist, from the development bank of Canada. It was actually a very interesting presentation as he was doing an overview of the future and so on. Pierre Cléroux is his name. He's francophone, of course. I'm kind of still interested in the renewable energy, and, you know, I think there's expectation that investment in renewable energy and the use of renewable energy is going to rise over the next decade or so. I was wondering if you had any insight on how the fund can capitalize on this.

Mr. MacMaster: Well, yes, I think it will continue to grow. We are very much there, and we'll continue to do so. I think there's a long runway, and if we get developments in things like battery storage, which would be a tremendous lift, you know, that could be good as well. The cost of wind and solar continues to drop with technology improvements, so it's a positive area. As you all know, renewables are great, but it's not in the immediate future going to replace a tremendous need for hydrocarbons – and that's good for Alberta – oil and gas, for decades. It's great, it's part of the portfolio, but you can have both.

Ms McKitrick: Making sure we have a well-rounded fund for the future of Albertans.

Mr. MacMaster: Yes.

Ms McKitrick: Thank you.
Thank you, Mr. Chair.

The Chair: Thank you.
Anyone on the phone have any questions? Ms Drever, specifically? Okay.
Ms McPherson?

Ms McPherson: No. I'm good right now. Thanks.

The Chair: Okay. Thank you.
Anybody on the floor? I knew I could count on you, Mr. Cyr.

Mr. Cyr: Always can, sir. I see that we're sitting at $17.5 billion in our fair value of net assets. When I first got into office, in 2015, it was about $17 billion, $17.2 billion, something like that. I don't know the exact number. Do you have any idea if this fund will ever reach $20 billion, and if so, how long do you think that would take?

Mr. Epp: Under the current legislation the fund only retains an amount to keep its real value constant, so basically it matches what inflation did. I think we've been running – our allocation has been a couple hundred billion dollars for the last few years because inflation has been so low. You know, at $200 million a pop it's going to take us 12 years minimum.

Mr. Cyr: Okay. Thank you for that. It's nice to know that the fund is growing, at least covering inflation.

When we move this fund forward, have we leveraged the fund with the Alberta government with borrowing?

Mr. Epp: No.

Mr. Cyr: So we're not using this as collateral in any way?

Mr. Epp: No.

1:40

Mr. Cyr: Okay. If we were using this as collateral, you could see where that could be dangerous if our province is depending on this. Thank you.

Now, if we're looking at this and we've got approximately $200 million per year going into this fund, mandated by legislation, are we expecting that with the new law that came out that's more or less moving the pension funds away from AIMCo, we're going to start to see a lower rate of return from the Alberta heritage savings trust fund? It comes down to the fact we're not going to be able to invest as much as we were before, that we don't have the buying power, if you will.

Mr. Epp: I think the department is quite confident that the returns will not change. AIMCo, for the next five years at least, will retain those clients, and I know that they're working hard to retain them for a much longer period. So there's no doubt that costs would go up a little bit as they're allocated if AIMCo's assets under management were lower. But we've got time to assess that risk, and as I said, AIMCo is working hard to do what it can to retain those clients.

The Chair: Thank you.

Ms McKitrick.

Ms McKitrick: Thank you. I think I want to move a little bit to international interest rates. I think it was probably something that sparked my interest in the presentation I heard yesterday. Actually, it was something which the gentleman from the development bank mentioned. He mentioned that there might be more interest rate hikes from the United States Federal Reserve and, you know, in the U.K., too, and possibly with the European Central Bank ending its asset purchase program and raising interest rates. So if other communities or countries are expected to raise their interest rates, I'm wondering what that does to your foreign currency exposure and to your foreign assets.

Mr. MacMaster: Just so I understand the question, you're asking me about the potential for higher rates and the impact on currencies?

Ms McKitrick: Yes, because in the fund we do have foreign currency holdings.

Mr. MacMaster: Yes. Just on the topic of foreign currencies, having foreign currency exposure in a broadly diversified portfolio is seen as a good thing. It's a diversifier. If you look at hedged portfolios versus unhedged, unhedged ones tend to offer a higher risk-adjusted return and reduce your hedging costs as well. So having that exposure is a good thing, but it's a long-term thing. In other words, you need to have a long-term view because, as you know, currencies can move around over the short run and can be quite volatile, if you look at the U.K. pound over the last two years, for example. That's one aspect.

On the interest rates themselves, the potential increase in central bank rates, you know, around the world – Canada, the U.S., and the eurozone – and the reduction of monetary stimulus were a key factor in the stock market correction of last year. But it's pretty clear at this point that they've stepped back from that and are easing up on the path to higher rates. The objective in the first place was to try and normalize rates coming out of the credit crisis, where they had extreme monetary measures in place. The objective was to try and get back to normal, which is a good thing, and to the extent that they could get there, it would be a sign that the global economy is in good shape.

So it shouldn't be viewed as a negative, but it seems like the neutral rate, as the central banks like to call it, may be lower than they thought because the markets and economies reacted in a fairly sensitive way to the increases that we've seen already. My prediction is that they will adjust and that they will take a pause here, and if things settle down and growth looks like it's picking up again and, certainly, if inflation picks up, they will continue on the course of higher rates.

Typically what you see in terms of a reaction to currencies is that those economies that are raising rates faster and greater tend to attract capital, so their currency goes up, and this is one of the reasons why the U.S. dollar has been so strong over the last five or six years: they were ahead of everybody in terms of raising rates.

Ms McKitrick: So there's opportunity for the heritage fund to capitalize on this?

Mr. MacMaster: Well, we monitor currencies, and we have what we call a Tactical Risk Allocation Committee, which I chair, which looks not only at currency exposures and managing those and taking tactical positions to add value but also sector and country bets as well.

Ms McKitrick: Thank you. That's very interesting.

The Chair: Great. Member Drever, on the phone, you have a question?

Drever: Yes. Hi there. On page 1 it says that the net income of the fund was $702 million, and we see that there were expenses of $67 million. I was just wondering if you could give us a rough sense of what these expenses are and what you are doing to help limit those expenses.

Mr. Epp: From the report on page 1, under Investment Income, you can see that investment expenses were $67 million so far this year. That would be year to date, so that's where it sits.

Mr. MacMaster: Yeah. I mean, what we try to do at AIMCo is aim for a top quartile return, value-add, over long periods of time, doing that in a proper risk-adjusted framework, so high risk-adjusted returns adding value, and doing that in a low-cost way. So we measure our costs against peers like ourselves from all over the world. Every year we look at that, and we come out below the median. In other words, our costs to deploy the assets, to invest the assets, are lower than the median manager of similar size all around the world. That's something that we monitor, and that's an objective that we like to achieve.

So, you know, that's typically under 50 basis points. For the heritage fund it's a little higher, but that's because you have more illiquid assets, which are expensive to manage. But, by any measure, you can probably tell that that's a pretty reasonable cost. If you compare that, say, to the retail investor in mutual funds at 2 or 3 per cent, 50 basis points is a very low cost for the deployment of the asset mix that you have in real estate and infrastructure and private equity, fixed income and equities.

Drever: Thank you so much.
I have a follow-up question if that's okay, Chair?

The Chair: Yes.

Drever: Thank you. It appears from page 13 that since March 31 there has been an increase in unrated debt securities that are held by the fund. I was just wondering if you could walk us through why this increase, though marginal, is happening and how much risk the fund is exposed to with these unrated debt securities.
Thanks so much.

Mr. MacMaster: Unrated debt for the most part would include mortgages which are unrated. Mortgages on the total fund are about 3 and a half billion dollars of our $105 billion in assets. For the heritage fund, I can't say off the top of my head, but that would be where a large part of that is. We've been investing in mortgages for, you know, greater than the 20 years that I've been with AIMCo, never had a default. These are highly rated, low loan to value, very high cash-flow coverage commercial mortgages for the most part in Canada. We've been doing it for years. It offers a spread over domestic bonds, usually 125 to 200 basis points over investment grade bonds. It's been a terrific vehicle for adding value for the heritage fund. As I said, it's quite secure, and that's my story.

The Chair: Well, thanks for that.

Drever: Thank you very much.

The Chair: Ms Woollard.

Ms Woollard: Thank you, Chair. I'm really hoping that I'm not going to be going over already covered ground, but I've got a question having to do with Brexit. With both the U.K. Treasury and the Bank of England indicating that Brexit, whatever road is gone down, will leave the nation worse off and with the United Kingdom being scheduled to leave the European Union on March 29, we're wondering: have there been any discussions as to what consequences this could have for the heritage fund?

1:50

Mr. MacMaster: Sure. There have been lots of discussions about this and our investments. We have real estate investments. We have infrastructure investments in the U.K. But the punchline here, you know, is that we think that we won't have a hard Brexit because it's in no one's interest. This is a negotiation. It will happen, and it's quite desirable for EU countries to be trading with the U.K. because it's a large, developed economy and they have a trade surplus with them. So this is a trade deal that will get done one way or another. But along the way, as I pointed out earlier, as we saw with renegotiating NAFTA, it's a rocky road with lots of huffing and puffing and positioning and brinksmanship, and they usually only get done at the last hour.
I think we're ready for more volatility. It's unfortunate. It's probably unfortunate for, you know, the poor folks in the U.K. who are stockpiling food, but I think that's a dire scenario that we don't have as our base case.

Ms Woollard: Thank you very much. So you really don't see any major adverse consequences on the horizon?

Mr. MacMaster: Well, the adverse consequences have been experienced already – and we'll continue to experience them – which are, again, a lack of confidence, businesses withholding investment, transactions being delayed or put off, you know, until this is resolved. So it's having an impact on the economy there. It's probably running a little slower than it should be. It's certainly having an effect on consumer confidence. Again, these impacts are more macro.
But, for us, you know, we own part of the London City Airport. Well, planes will fly. There are steps that have been put in place to make sure that the space is open, and negotiations have already taken place to make sure the skies stay open. We also have an investment in a company called Porterbrook, a train car leasing company, and trains will continue to run. So that's our base case.

Ms Woollard: Okay. So, really, there's not a lot of mitigating, you know, eventualities that would have to be taken on our end, then? You've got things pretty covered, it sounds like, hopefully.

Mr. MacMaster: Well, investment is a risky business, you know, and you can't cover it all. But if you think about it, it would be foolish for us to take action now to try and mitigate something which we think is a low probability.

Ms Woollard: Exactly. Thank you very much. So, really, it's long term. Short term we're just going to have to wait and see, to some extent?

Mr. MacMaster: To some extent, yes.

Ms Woollard: Yeah. Thank you very much.

The Chair: Thank you.
Any other questions on the floor or on the phone? We have Mr. Cyr.

Mr. Cyr: Thank you very much. It's my understanding that AIMCo owns the podium to a new high-rise tower in downtown Edmonton. Is that correct?

Mr. MacMaster: Do you have a name? We've got $14 billion in real estate investments.

Mr. Cyr: The one with DynaLife. Is DynaLife in one of your buildings?

Mr. MacMaster: Yes, I believe so. Yeah.

Mr. Cyr: Okay. DynaLife is now moving their operations. How much rent does DynaLife pay to AIMCo?

Mr. MacMaster: I can't answer that.

Mr. Cyr: Is the reason you can't answer that because they're moving out and . . .

Mr. MacMaster: No. I just don't know. As you can imagine, with thousands of securities in the portfolio, I just don't have that level of detail on every security in the portfolio. I just don't. But we could always get back to you with that information, you know.

Mr. Cyr: It's safe to say, then, that it's likely this is going to be an empty building for you?

Mr. MacMaster: I can't even comment on that. I just don't know what the plans are at this moment in time. I've had discussions on this property with the head of real estate over the last couple of years, but I couldn't give you an update on where we are today on that. I just don't have the info at my fingertips.

Mr. Cyr: It seems to be a significant asset in Edmonton to not have any answers for, sir.

Mr. MacMaster: Well, I just don't want to, you know, give you false information; I want to make sure. Like, asking me about the rent: that is just not something where – we have a portfolio of hundreds of properties. I just don't have that, and I don't want to mislead you. So I think it would be best if we got back to you with something that's accurate.

Mr. Cyr: Okay. Are we going to be seeing a significant potential decrease in revenues now that we potentially are not going to be making money on this asset? We're actually going to probably be losing money being as it's going to be sitting there empty, paying property taxes and repairs and maintenance.

Mr. MacMaster: No. I'm not going to, you know, comment on that without having up-to-date information. But I can tell you that on all our retail estate properties we always have a plan, and on this particular one I know we've been working on this for years. We'll always have a plan. But, at the same time, in any portfolio, you know, you have your ups and downs. If we had – and I don't want to say that we have – any investment and the odd one does go south on you, this is why you have a diversified portfolio by geography, by type, by location, by everything.

As I said, we can get back to you with more details on this. I hope you can appreciate that I just don't have, you know, that level of detail on the thousands of securities we have when I come here.

Mr. Cyr: I do appreciate that, and I do recognize that this is definitely a very specific question.

Going back to Alberta-wide, though, how many buildings in Alberta are sitting empty right now that AIMCo owns?

Mr. MacMaster: Well, I can't give you that information, but the exposure which has been most troubled in Alberta real estate is probably Calgary office. You know, in that one we were 100 per cent full in our Eighth Avenue Place. What we've done in Calgary is try to keep our investments in the best of the best. What tends to happen when you have high vacancy rates is, you know, businesses will move into the best properties and leave the secondary properties, B and C types, vacant. So we're well positioned there. But there's no getting around the fact that Alberta and the Calgary office have probably been the laggards in the portfolio. As I said earlier, our overall portfolio results are very strong for a real estate portfolio, again highlighting the benefits of diversification both across Canada and around the world.

Mr. Prefontaine: Dale, if you don't mind, I'll just add that when we look at the total real estate portfolio, both domestic and foreign, we're talking billions of dollars.

Going back to an earlier question about risk management, I know that part of the risk management in that particular portfolio is looking at what the lease terms are, not just within specific securities or buildings but also across the entire portfolio. AIMCo has continued to demonstrate confidence in Alberta with recent real estate investments such as the Edmonton Tower, that I talked about, as well as many others.

The Chair: Are you finished, Mr. Cyr?

Mr. Cyr: I do have a follow-up here.

The Chair: Go ahead.

Mr. Cyr: Well, it's my understanding that the goal of AIMCo was to diversify our investment globally, not just focusing on Alberta. So when we see that you guys have poured quite a bit of money into Alberta real estate, it would be nice to know how much money actually is, I guess, tied to Alberta. What happens here is that when Alberta goes down, it's not supposed to see AIMCo significantly seeing a massive reduction in value, too. How much exposure do you have to Alberta, and how much of that real estate right now is sitting empty? Can I find that out?

Mr. MacMaster: We have about 8 and a half billion dollars in Alberta investments across the portfolio, not just in real estate but right across the portfolio, and I think there's about a billion and a half dollars in the heritage fund. Let's not forget, too, that Alberta until recently was Canada's leader in growth and a fabulous place to invest because you had, you know, great incentives, low taxation, a well-educated workforce, a young workforce, an entrepreneurial spirit, all the great things that attract capital. So we've invested in Alberta in a reasonable amount because it's been very successful, and we've had tremendous success here.

Certainly, the last couple of years have shown a downturn in the Alberta economy, and we've shifted the portfolio, mostly by virtue of investing more broadly, more internationally. You know, a few years ago we didn't have anything in real estate internationally, and now we have $4 billion across the portfolio and are diversifying across Canada. But there still is opportunity for real estate investment in Alberta, and in the past year we have made investments in apartments and multifamily. Again, you know, because foreign capital has evacuated Alberta, valuations are reflecting that. We're long-term investors, so we are picking away where we see value and will continue to do that.

2:00

But, again, I can't highlight enough the benefits of a diversified portfolio. Despite what we've suffered in Alberta both in energy and in real estate, our returns are, I think, quite good, and we are adding value over benchmark returns. I think that speaks to our approach, and I think it's been good.

Mr. Prefontaine: I'll just add to that conversation as well. When we talk to our clients on their expectations of their specific portfolios, as you identified, we have a number of clients that are public-sector pension plans whose liabilities are tracked to or indexed to Alberta inflation, which means when we look at that from the perspective of how they build their portfolios and the thoughts that they have, assets like Alberta real estate contribute to helping manage the risks associated with that kind of liability structure. There is an expectation from our clients that we continue to look at Alberta assets through that particular lens as well.

The Chair: Great. Thank you.

Any other questions on the floor or on the phone? Okay.

Seeing none, would a member like to move that the committee receive the report? Moved by Mr. Sucha that

> the Standing Committee on the Alberta Heritage Savings Trust Fund receive the 2018-2019 second-quarter report on the Alberta heritage savings trust fund.

All in favour? On the phone? Any opposed? Hearing none,

> that is carried.

We'll move on to the review of the 2018 public meeting. Hon. members, as you will recall, the committee held a public meeting on October 25, 2018, to provide information and answer questions from Albertans on the activities and state of the Alberta heritage savings trust fund. There were 21 members of the public here at the Federal Building. It was live streamed on YouTube as well as Assembly Online. This was also the first public meeting broadcast on Alberta Assembly TV.

I would like to invite Danielle Antoniuk from the Legislative Assembly Office, communications, to provide additional information regarding the broadcast and public response to the meeting. Ms Antoniuk.

Ms Antoniuk: Thank you, Mr. Chair. The communications goal for the public meeting was to notify Albertans and to encourage participation either in person at the meeting or online. The public meeting, as you guys may recall, back in October saw a full room with a pretty engaged audience.

We did survey as many of the respondents as we could, both online and during the meeting, and 100 per cent of the survey respondents felt they were more informed about the fund after than before the meeting began. A large majority of the respondents also reported that the meeting was engaging.

The age demographics for those that responded varied between 36 and 65 years old, which actually helps us a lot in terms of future advertising, specifically on social media. Most people reported hearing about the meeting through social media, newspaper, radio, and the Assembly website, which is really great information that we can use for future communications as well.

In terms of expenses the final costs were estimated at $21,255.15, which was well within the budget the committee provided for the public meeting.

This year we did increase our investment in social media. A few quick highlights for the committee. Our Facebook posts, which included both organic and paid posts, reached 445,446 impressions, for a total of 354,199 people. Our Twitter posts saw 74,274 impressions. Instagram reached 981. YouTube – as the chair mentioned, this was the first time a committee meeting had been live streamed on YouTube – saw 11,396 impressions. Specifically, that live broadcast saw 25 views.

That's a brief summary. We're happy, of course, if . . .

The Chair: Just a quick question for you. What's an impression?

Ms Antoniuk: Each medium measures things differently, but in terms of an impression that's the number of times it appears on people's screens based on the market we're targeting for that post or whether they follow our page specifically.

The Chair: Excellent. Thank you.

Now I'll call upon the committee clerk to provide a brief overview of the costs associated with the public meeting.

Mr. Roth: Thank you, Mr. Chair. As members are aware, there was a small document on the internal website outlining some of the expenses. It was on par pretty well with last year's meeting, slightly higher but within the same range as last year's meeting.

If there are any questions, I can certainly aim to answer those.

The Chair: Sure. I can turn the floor over to any questions on the public meeting. See? It just goes that smoothly every year.

Anyone on the phone? Okay.

Ms McKitrick: I don't know if we can thank the staff for their work on the communication for the public meeting, if it's been done, because I know that Albertans are concerned about the heritage fund. They understand the importance of the heritage fund, and they're interested in the history and the work that AIMCo is doing and so on and so on. So the staff should be thanked for the work they've done in terms of advertising the opportunity for the meeting and just the logistics of the meeting.

The Chair: Thank you for that, Ms McKitrick. I second that. I'm sure we all share that. For all the hard work: a thank you to everyone that worked on that. I know it's a lot of prep to get that up and running. I guess no questions on that?

We'll move on, then, on the agenda here to the committee's annual report to the Legislative Assembly. One of the functions of the committee, as mandated in section 6(4)(c) of the Alberta Heritage Savings Trust Fund Act, is to "report to the Legislature as to whether the mission of the Heritage Fund is being fulfilled." The last such report was made to the Legislative Assembly on March 22, 2018, which covers the activities of the committee for 2017. Since that time the committee has met a number of times and performed several of its functions as outlined in the act. Past practice has been for the committee clerk to prepare a draft report for the committee's consideration and that the committee make its report to the Assembly in the spring session of the Legislature. Do any members have any comments or questions regarding the process of reporting its activities to the Legislative Assembly? Okay.

Seeing none, now we'll move on to other business. At this time is there any other business?

Seeing and hearing none, the date of the next meeting of the committee will be at the call of the chair.

Now I'll call for a motion to adjourn. Mr. Horne moves that the January 16, 2019, meeting of the Standing Committee on the Alberta Heritage Savings Trust Fund be adjourned. All in favour? Any opposed? Hearing none, the meeting is adjourned.

Thank you.

[The committee adjourned at 2:08 p.m.]

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