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Ontario Teachers' CEO on inflation, real estate and where the $247-billion fund sees opportunities today

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Geopolitical uncertainty and macroeconomic headwinds pushed some of Canada's top institutional investors into negative territory in 2022, but not the Ontario Teachers' Pension Plan((financialpost.com)). The country's largest single professional pension((financialpost.com)) eked out a respectable four per cent return for the year, leaving it with $247.2 billion in assets and on track toward its goal of $300 billion by 2030. The Financial Post's Barbara Shecter sat down with Teachers' chief executive Jo Taylor to discuss the fund's strategy, how it's navigating inflation and where it's finding opportunities in uncertain times. This interview has been edited and condensed.

Financial Post: Teachers' seemed prepared to weather macro-economic trends such as rising inflation and interest rates in 2022. What was your strategy?

Jo Taylor: I took over as CEO around about three years ago, beginning in 2020. I think it's fair to say life's been pretty volatile over that three-year period, starting with the pandemic, then moving into both political and economic changes that have been quite material. The headline strategy for me is to be pretty bold, and to be as agile as we can be. Despite being relatively large, we felt we could make money within our capital allocation - and by avoiding areas where we thought we didn't want to be exposed.

FP: Where have those decisions paid off, in terms of shifting in and out at the right time?

JT: We've been very thoughtful about how much allocation we want to fixed income as an asset class: bonds, etc. And also into public equities, where we've taken the view for a little while that valuations look relatively full. And what we've essentially counterbalanced that with is a stronger allocation to private assets, particularly more recently to things like infrastructure where, last year, we invested the better part of $14 billion. We saw it as a stable, productive asset class for us and a good alternative to fixed income.

FP: What's your thinking now on fixed income? Short or long duration bonds?

JT: We've probably moved them all into the shorter end of the bond duration curve that, at the moment, seems to give us the most manageable amount of risk. The interesting question for us is: When are interest rate rises((financialpost.com)) going to sort of settle out? That's not only relevant to bonds; it's also relevant very much to equities in terms of how the markets price in those interest rate rises. The way we tried to think to this is: What's our view of inflation? Because that will give you some idea of where interest rates

may go. We've been, for a little while, more conservative. We would be more in the camp of expecting inflation to be higher for longer and therefore probably expecting it would be logical for interest rates to continue to rise through 2023.

The Bank of Canada building in Ottawa.

FP: How does inflation affect a fund like yours?

JT: Inflation for a defined-benefit pension plan is a very meaningful factor in terms of the impact it has. It increases our exposure to our liabilities because they're generally inflation linked, and it also has an impact on our assets because the inflation can erode the profitability and growth ability of those companies. So for us, what we're trying to do is acquire assets that give us some inflation protection. That's why we like infrastructure, because it's got inflation pass-through on a lot of those assets. For us, the optimal way forward probably would be that interest rates continue to rise a little bit and stay where they are, rather than start to go back again too early, to fully manage inflation risk.

FP: The federal government cancelled the real return bond (RRB) program((financialpost.com)) that many defined-benefit pension providers relied on to help manage inflation risks. How is that affecting you?

JT: We found that program very helpful. It is one of the means to actually match some of your assets to your liability profile. And we've seen that becoming more evident in the U.K. and some other parts of the world as an issue if you don't get the right matching. Discussions are being held to see if there would be adequate demand for RRBs if they were reintroduced and certainly, from our point of view, we would be an active participant. So our hope would be to see in a period of time that they are reintroduced, which would allow us to get access to bonds which actually have a closer correlation to our liabilities.

FP: What are your thoughts on equity markets. Are you planning any changes there?

JT: On the public equity side, we have exposure both through individual stocks (and) indices. The thing we're thinking more carefully about on buying an index is actually what sort of climate allocation do you acquire, and we do that through those investments.

Signage for the Toronto Stock Exchange (TSX) is seen in the financial district of Toronto.

FP: What about private markets? There's some concern that private assets haven't been adequately written down to reflect what's gone on in public markets since late last year.

JT: Firstly, the portfolio is performing well. Our performance across that portfolio in 2022 was very strong relative to 2021. Second thing I would say is that when we look to valuations, we don't just develop our own personal view, we actually get it reviewed by a number of other professional parties, which would be Deloitte as well as specialist advisers around some segments of the portfolio such as airports or other things where it's quite specialized. We try to take a pretty measured, conservative view of what looks like the right carrying value for those companies.

FP: How do you give pensioners faith those valuations will hold up?

JT: The best test of your carrying value for private assets is actually when you sell them - that you can sell assets at a 15 to 20 per cent premium to carrying value. If you're not able to do that and you're selling your assets broadly at carrying value, where is the good news outcome? We have a large portfolio of private assets that is performing well, we've been specializing in that for a while and we did a very exhaustive review of those as we do every year at year end - not just ourselves, but through third-party experts, and they came back with the view that they're fairly valued.

FP: One private asset class that's generating a lot of discussion amid rising interest rates is real estate, particularly commercial real estate((financialpost.com)). Are you seeing problems there?

JT: If you look at Cadillac Fairview (the $40-billion real estate firm owned by Teachers'), which is an excellent developer and operator of assets, it's been historically quite heavily focused on office and retail - both of those segments of the real estate market have more recently had their challenges. Cadillac Fairview, I think, has done extremely well through the pandemic and beyond to make sure that we have good occupancy of both our shopping malls and retail real estate, but also in our offices in Toronto and Vancouver particularly, being the cities we concentrate on. And in both of those areas, operationally, they're doing really well at the moment so they have good retail sales through the shopping malls, probably driven more, I would say, by higher spend than necessarily fully recovered from before the pandemic. And on the office side, we've maintained higher levels of occupancy with good covenants (and) professional firms, particularly because they're class A buildings, so they're actually at the more desirable end where people would like to occupy office space.

The logo of Cadillac Fairview on their headquarters in Toronto.

FP: Do you plan any changes in light of the challenges?

JT: How to get some balance or better balance into our overall real estate portfolio is really a journey we started a few years ago. What the Cadillac Fairview team is largely focusing on is providing more multifamily real estate opportunities in Canada, which is something that everybody is looking for because there is not enough available housing for people to rent. And we can do that at some of our retail sites because we have the land, subject to planning, to be able to develop there. We also have the potential for some industrial development on sites where it's appropriate. So we can try and move away a little bit from those two segments (office and retail) that I mentioned.

FP: Any other diversification plans?

JT: The other thing we're trying to do is move away to some extent from Canada into other international markets, which the team has been doing for a while, but we've accelerated that over the last three or four years. So to that end, we've been investing in places like Europe and the U.S. And generally what the team has done, I think quite well, is to invest in operating platforms where we can then invest in assets that we like. So you take Lincoln,

which is one of the platforms we did down in Texas that does a lot of multifamily development within the U.S. And we also did a platform investment in Stanhope in the U.K. where we've done two or three developments with that team in quite interesting industrial and office properties in that part of Europe.

FP: What are the biggest challenges you see in real estate as an asset class?

JT: Real estate is like all private asset classes. It's not necessarily that liquid. If you look around Canada at the moment, there haven't been that many marquee disposals so no recent indication of pricing for either retail or office where we're probably most active. And really the issue for us, because we are long-term investors, is to say, How do we enhance and improve our real estate portfolio over time? And that's really what we're going to do by taking a measured and a patient approach to try and get it slightly better balanced - but also making sure it continues to operate with good returns.

FP: What about the lending side of commercial real estate, and mortgage renewals? That's where pressure is expected to build as a result of rising rates.

JT: I would say the model we operate in real estate is with low levels of borrowing. Whilst I would say honestly that market is quite challenging at the moment in terms of finding access to lending and capital from third parties, our model isn't predicated on that. So it's not as if we need that to be able to be competitive. And we distinguished between ourselves and other investors by actually being able to operate through good local partners where we can then actually find the right sites and, with the right level of financial support from us, we can develop those out when the market is suitable. So, you know, with real estate, you can either press the green button today or you can wait a little bit and I think in some cases we'll probably be reflecting on when is the right moment to push forward (with) more development versus today.

FP: What would make you push the green button? Lower rates and inflation?

JT: I think for us, it's more looking at the returns available and the demand side of the equation because it will be a mix of multifamily and office. So we should have to figure out how that is looking relative to some of the uncertainties that are out there in the world at the moment. I would guess for real estate, one of the uncertainties is return to office((financialpost.com)). So how many people are going to be back in offices on a fairly permanent basis in the future and that's one of the things you know, it'd be wise for us to just to try and get a better handle on for sure.

Office buildings in Toronto's financial district.

FP: Where are you seeing the most deal opportunities?

JT: The most activity we probably have at the moment is on the private equity side, helping our existing portfolio (companies) to acquire bolt-on companies to grow. That's been something that is easier to execute at the moment and we can still generate good value with the business. We know, in terms of how well it's executing, where the risks are. So in many ways, that's an attractive alternative to doing a new proposition where you have to get up to speed on all those issues.

FP: You did have to write down one venture investment entirely, and took some heat for having invested alongside other sophisticated institutional investors in now-defunct crypto platform FTX. Any more plans for crypto?

JT: FTX was a learning experience for us. We wanted to look at crypto. We chose an exchange (because) we thought it was a business of scale that would allow us to look and learn. It didn't turn out as we hoped. We're still processing some of the learning from that and until we have done, I think we're probably unlikely to do anything new.

How HOOPP is tackling the challenge of green investing((financialpost.com))

Do Canadian pensions have a legal obligation to consider climate?((financialpost.com))

Pensions face repercussions from bond program cancellation((financialpost.com))

FP: Is there anything that keeps you up at night?

JT: 'Not much' is probably the honest truth. But if you asked what is the risk that is difficult to fully identify, but could have a significant impact on many international investors and their activities, it would probably be the current situation in Ukraine. Because I think if that went the wrong way, that could be a catalyst for a material change in confidence in international markets at a time when there are already some risks in play.

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