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Ontario Teachers' returns disappoint as markets soar and interest rates hit real estate

Pension plan prepared for recession and missed out on market gains

Barbara Shecter || March 12, 2024

The Ontario Teachers' Pension Plan ended 2023 with a net return of 1.9 per cent. PHOTO BY COLE BURSTON /The Canadian Press

The Ontario Teachers' Pension Plan ended 2023 with disappointing results after allocating assets based on expectations of a recession, but chief executive Jo Taylor said he's not planning a major shift into equities given that markets still look overheated.

Underexposure to listed equities plus valuation adjustments in Teachers' infrastructure and real estate portfolios stemming from higher interest rates led to a net return of 1.9 per cent to end the year with $247.5 billion in assets.

"We only have about 10 per cent of our portfolio invested in listed equities," Taylor said in an interview, adding that what the pension did hold performed well as markets soared at the end of last year. "But you look at valuations as we go into 2024 — they look as challenging if not more challenging than they were when we entered 2023, and that's going to be an interesting debate for us in terms of, if we want to blend the risk up a little bit, how we do that?" he said.

Real estate

About 28 per cent of the fund is invested in global real estate and infrastructure, both of which took valuation hits in the higher interest rate environment. Taylor said some retail space in downtowns was affected by continuing struggles in the aftermath of the COVID-19 pandemic, while an infrastructure project in Europe was subject to a regulatory change that affected projections.

Adjustments were made to real estate capitalization rates — an indicator of the rate of return expected from an investment based on operating income and costs — in both 2022 and 2023, Taylor said. Now, the pension fund is in a holding pattern to see whether interest rates come down, he said.

Teachers' real estate portfolio generated a negative return of 5.9 per cent against a positive benchmark of two per cent in 2023. For infrastructure, the 2023 return was negative 2.8 per cent against a benchmark positive return of 7.6 per cent.

"The overall prognosis for real estate, I would say, in 2024 and possibly 2025 is still pretty tough," Taylor said, through he added that Teachers' Canadian real estate portfolio is fairly concentrated in major cities, including Toronto and Vancouver, that are doing relatively well.

"We've got good occupancy within our office portfolio and pretty good occupancy levels in our retail portfolio as well, so operationally they're doing fine. It's just really, who would want to buy at what prices in terms of transaction values."

Taylor said Teachers' is not looking to be a seller at the moment.

"We like the assets we have, but I think if you did want to sell anything, people would be looking for a bargain at the moment."

Investing in Canada

Taylor said his response to the growing debate about whether Canadian pensions should invest more in their home market is to continue on the path Teachers' has followed since it was set up in its current form as an active investor in 1990.

"We are investing in Canada. We have $20 billion in (real estate unit) Cadillac Fairview in Canada. We have about $100 billion in total in Canada, it's about 35 per cent of our portfolio," he said, adding that the run rate for private equity investing in Canada is around 15 to 20 per cent. "So what are we not doing? We're probably not investing a lot in Canadian listed equities. But, you know, I think we invest enough in other areas to compensate for that."

When it comes to Canadian infrastructure, "slower uptake … isn't necessarily our issue," Taylor said. "It's what's made available to us."

He said he will look at any projects brought forward by the newly created Ontario Infrastructure Bank, adding that pensions are most interested in operating assets rather than those under development that will take years to start throwing cash.

"We've run airports, we've run lotteries, we've run a few things of that type. I think we could show we've been a good custodian of important, sometimes politically sensitive assets," he said. "So I think we're well placed to be eligible to be considered to either co-own or operate those assets independently."

Teachers' posted a ten-year annualized total-fund net return of 7.6 per cent in 2023 and a 9.3 per cent return since inception. The pension retained a $19.1 billion preliminary funding surplus and is fully funded for the eleventh year in a row.