

ITEM 3. INVESTMENTS HELD AS AT 31 DECEMBER 2015

FILE NO: S106935

SUMMARY

This report provides details of Council's investment portfolio and performance to 31 December 2015.

Council's total Investment and Cash position was \$567.5M at the end of December, with investments earning interest of \$1.7M for the month.

The majority of the City's cash and investments portfolio are held as internally restricted (\$350M) and externally restricted (\$144.6M) cash reserves to satisfy the City's legislative responsibilities and to set aside specific funds for Council's funding commitments to the major initiatives within the Sustainable Sydney 2030 Community Strategic Plan.

Key commitments within the City's Long Term Financial Plan include public domain works in the CBD to support the implementation of the CBD and South East light rail project and stormwater, town centre infrastructure and community facilities in the Green Square urban renewal area. The balance of investment funds represents working capital and funding required for the City's operating and capital expenditure commitments.

Council achieved an annualised monthly return of 3.32% for December, significantly above the 30 Day Bank Bill Rate (BBR) of 2.07%, the Bloomberg AusBond Bank Bill Index of 2.28% and the enhanced benchmark of 2.47% (BBR + 0.40%) as endorsed in the current Investment Strategy.

Council's annual rolling return of 3.33% also continues to exceed the 12 month 30 Day BBR of 2.16%, the Bloomberg AusBond Bank Bill Index of 2.33% and the enhanced benchmark of 2.56% (BBR + 0.40%) as endorsed in the current Investment Strategy.

In accordance with Council's Investment Policy, the quarterly investment reports advise the latest indicative market valuations of all direct securities (being Floating Rate Notes). The value of the current portfolio decreased by \$1.2M during the December quarter in a volatile market. The movement represented 0.5% of the total value of the relevant securities.

The report includes graphs which demonstrate that Council's liquidity profile continues to satisfy the requirements of the policy, and charts to identify the distribution of Council's portfolio across credit ratings, investment product types and investment institutions. Separate charts, depicting the City's portfolio returns over and above both the 90 day Bloomberg AusBond and 30 day BBR benchmarks for the past eight years, have also been included to provide further insight into the City's total investment portfolio performance.

The structure of Council's investment portfolio continues to reflect the conservative approach outlined in the Investment Policy and Strategy which remains appropriate for the current global and domestic economic conditions and meets NSW Treasury guidelines.

RECOMMENDATION

It is resolved that the Investment Report as at 31 December 2015 be received and noted.

ATTACHMENTS

Attachment A: Register of Investments and Cash as at 31 December 2015.

Attachment B: Investment Performance as at 31 December 2015.

BACKGROUND

1. In accordance with the principles of financial management, cash that is surplus to Council's immediate requirements is invested within acceptable risk parameters to optimise interest income while ensuring the security of these funds.
2. Surplus cash is only invested in authorised investments that comply with governing legislation and Council's Investment Policy and Strategy.
3. The benchmark performance goal of Council's Investment Policy and Strategy is to surpass the 30 Day Bank Bill Rate (BBR) by 40 basis points while performance continues to be also measured against the Bloomberg AusBond Bank Bill Index.
4. Council's total Investment and Cash position as at 31 December 2015 is \$567.5M, a decrease of \$126.9M from the \$694.4M reported at 30 November 2015, reflecting capital works expenditure and other operational payments offsetting revenue receipts. The reduction also reflects a payment of \$48.6M to Transport for NSW in December. This is the second instalment of the City's agreed total \$220M contribution to the South-East Light Rail project. A schedule detailing all of Council's investments as at the end of December is provided at Attachment A.
5. The majority of the City's cash and investments portfolio are held as internally restricted (\$350M) and externally restricted (\$144.6M) reserves. These reserves are held to satisfy the City's legislative responsibilities and underpin our funding commitment towards the major initiatives identified within the Sustainable Sydney 2030 Community Strategic Plan.
6. Key commitments within the City's Long Term Financial Plan include public domain works in the CBD to support the implementation of the CBD and South-East light rail project and stormwater, town centre infrastructure and community facilities in the Green Square urban renewal area. The balance of investment funds represents working capital and funding required for the City's operating and other capital expenditure commitments.
7. Council achieved an annualised monthly return of 3.32% for December, significantly above the 30 Day Bank Bill Rate (BBR) of 2.07%, the Bloomberg AusBond Bank Bill Index of 2.28% and the enhanced benchmark of 2.47% (BBR + 0.40%) as endorsed in the current Investment Strategy.
8. Council's annual rolling return of 3.33% also continues to exceed the 12 month 30 Day BBR of 2.16%, the Bloomberg AusBond Bank Bill Index of 2.33% and the enhanced benchmark of 2.56% (BBR + 0.40%) as endorsed in the current Investment Strategy.
9. The outperformance of both the industry and enhanced benchmarks has continued due to the acquisition over the last two or three years of investments with locked in higher yields in anticipation of future rate cuts. The situation is expected to gradually decline over the next two to three years as these investments steadily mature.
10. The RBA cut the official rate to 2.50% in August 2013 where it remained until further reductions of 0.25% each in February and May 2015 to leave the rate at 2.00%. The market has responded accordingly by offering lower yields on investments, which is likely to have an adverse impact on Council's future investment returns.

11. In accordance with Council's Investment Policy, the quarterly investment reports advise the latest indicative market valuations of all direct securities (being Floating Rate Notes). The value of the current portfolio decreased by \$1.2M during the December quarter in a volatile market. The movement represented 0.5% of the total value of the relevant securities.
12. The value of the current portfolio reflects a total unrealised gain of \$1.9M, which has arisen because of the significant number of investments held by Council that have locked in higher yields that significantly exceed the earning rates currently offered in the market. Council regularly assesses whether to realise the gain through a sale of those investments. Council will only realise the gain if the amount of the gain and the returns from its subsequent reinvestment significantly exceed the future interest earnings yet to be generated by holding the current investments to maturity. Currently, this is not the situation and, as a result, future interest earnings will more than offset both the \$1.2M reduction in value this quarter as well as the remaining unrealised gain of \$1.9M.
13. There are a number of reasons for the reduction in value of the bond portfolio this quarter of \$1.2M. The falling Australian dollar has resulted in lower demand for Australian Bonds and expectations of future higher interest rates mean bonds (which have fixed margin yields) are less attractive to investors. In addition, \$45.5M in FRNs matured in the December quarter resulting in a reversal of \$0.3M in unrealised profits as these bonds matured at face value. The \$0.3M was more than compensated for in higher interest earnings during the same period on those investments.
14. The report also includes graphs which demonstrate that Council's liquidity profile continues to satisfy the requirements of the policy, and charts to identify the distribution of Council's portfolio across credit ratings, investment product types and investment institutions. Separate charts, depicting the City's portfolio returns over and above both the 90 day Bloomberg AusBond and 30 day BBR benchmarks for the past 10, years have also been included to provide further insight into the City's total investment portfolio performance.
15. Council has, for an extended period, outperformed the industry benchmarks and enhanced benchmarks (Investment Strategy benchmarks based on returns currently available in the 30-90 day investment market) on both a monthly and annual rolling basis. Council was able to lock in, over the past two to three years, a number of investments that had fixed rates above 5.00% p.a. as well as floating rates that had fixed margins which were significantly above the risk free rate. As these investments mature, only lower rates are now offered in the market.
16. These investments will continue to generate an enhanced performance until they have all matured within the next three years. The investments are maturing gradually over each month and, consequently, the margin of achieved performance over benchmarks will also decline.
17. Prior to the Global Financial Crisis (GFC) in 2008, a number of financial institutions sold investment products called Collateralised Debt Obligations (CDOs) to investors. The CDOs carried attractive credit ratings higher than those of the Big Four Australian banks and, as a result, were acquired by other financial institutions, as well as a significant number of not-for-profit entities (NFPs) and local government councils. Council only acquired a small quantity of these investments which, at any time, comprised no more than 2 per cent of the portfolio.

18. Following the collapse of Lehmann Brothers in the 2008 GFC, CDOs were no longer liquid and some began to suffer partial or even complete losses of the capital amount originally invested. Many NFPs and councils consequently suffered significant losses in their portfolios. The smaller quantity of CDOs held by Council meant that its losses were not of the same magnitude. Council wrote off these losses when the investments were no longer recoverable.
19. In a number of these actions, the financial institutions were alleged to have breached their duty of care or engaged in misleading and deceptive conduct. As a result, these institutions are now offering settlements to all investors who suffered losses to compensate for the institution's part in contributing to these losses. Council has lodged two claims for compensation. The first claim is for \$2M and, in December, it received payment against this claim amounting to \$0.6M.
20. The second claim is against Lehman Brothers, which is in liquidation. This claim is also for \$2M as an unsecured creditor and is subject to settlement at a future prevailing liquidation dividend rate, estimated to be between 30-50%. To date, \$0.2M has been received on the second claim. The recovered amounts are treated as revenue when received.
21. The structure of Council's investment portfolio continues to reflect the conservative approach outlined in the Investment Policy and Strategy which remains appropriate for the current global and domestic economic conditions.

KEY IMPLICATIONS

22. Council's investments accord with all legislative and policy requirements, as detailed below, and continue to achieve returns above minimum benchmark rates.

FINANCIAL IMPLICATIONS

23. Council's investments earned interest of \$1.7M for the month of December 2015, against budgeted earnings of \$1.2M, reflecting higher than anticipated opening cash balances for the year. Year to date earnings are \$3M higher than anticipated in the budget.

RELEVANT LEGISLATION

24. Council is authorised to invest its surplus cash under section 625 of the Local Government Act 1993.
25. The Local Government (General) Regulation 2005 (clause 212) requires Council to provide a written monthly report of all monies invested, under Section 625 of the Act.
26. Council's investments accord with the Minister's Investment Order, the Division of Local Government's Investment Policy Guidelines, and the City's own Investment Policy and Strategy as adopted by Council on 17 March 2014.

CRITICAL DATES / TIME FRAMES

27. A monthly investment report must be submitted for Council's information and review within the following month.

PUBLIC CONSULTATION

28. Consultation is regularly undertaken with a number of financial institutions and investment advisers to consider options and ensure that Council continues to maximise its investment return within appropriate risk parameters.

BILL CARTER

Chief Financial Officer