

ATTACHMENT A

**INVESTMENT POLICY FOR THE
MANAGEMENT OF SURPLUS FUNDS**

Investment Policy

Purpose

The Investment Policy sets out the requirements for the management of Council's cash and investment portfolio. The City requires that all investment activities be exercised with the care, diligence and skill of a prudent person, and not for speculative purposes.

The policy sets the framework to:

- safeguard the City's cash and investments portfolio
- achieve appropriate earnings
- manage Council's cash resources to ensure sufficient liquidity to meet Council's business objectives over the long, medium and short term.

The policy reinforces Council's ongoing commitment to maintain a conservative risk and return portfolio, an important component of its ongoing prudent financial management practices.

The Investment Strategy supports the policy by defining investment objectives and actions for the next 12 months.

The City of Sydney's financial policies are developed to ensure that the City satisfies legislative requirements and follows 'best practice' in its business operations, with due consideration for the effective and efficient management of the resources utilised within that business.

Scope

This policy applies to all managers and employees who actively manage Council's Cash and Investments or have the responsibility for employees who actively manage Council's Cash and Investments.

Definitions

The following definitions illustrate the structure of the City's investment portfolio and the relationship of the terms referred to in this policy:

| Term | Meaning |
|---|---|
| Cash | <p>Cash comprises:</p> <ul style="list-style-type: none"> • cheque accounts • daily call accounts <p>with Authorised Deposit-taking Institutions (ADIs).</p> <p>Cash assets typically have a maturity term at the time of placement of being immediately available or available within 24 hours.</p> <p>Cash assets are closely linked with investments but do not constitute investments. Cash is used to meet immediate operational cash needs.</p> |
| Investments | <p>Investments comprise:</p> <ul style="list-style-type: none"> • term deposits • bonds with an active secondary market <p>with government (including NSW T-Corp) and Authorised Deposit-taking Institutions (ADIs).</p> <p>Investment assets have maturities at the time of placements of 30 days or more</p> |
| Grandfathered investments | <p>Grandfathered investments are a part of total investments and comprise:</p> <ul style="list-style-type: none"> • investments where additional investment activity is prohibited by regulation • other investments over which additional investment activity is temporarily prohibited due to unintentional breaches of investment thresholds and limitations that arise due to changes in the level of unrelated investments within the portfolio (the prohibition only remains as long as the breaches remain in place). |
| Impairment | <p>The impairment of an investment represents the amount of the original cost of the investment that is not expected to be recovered at the investment's maturity date due to current adverse economic or investment conditions that impact on the investment's financial performance.</p> |
| Provision for market value differences | <p>The market values of tradeable investments may vary over the life of the investment due to changes in pricing factors such as interest rates and credit spreads. The pricing factors have diminishing influence as the investment nears maturity and is redeemed at face value. Since the accounting policy requires investments to be valued at market value, the net difference between the face value of the investments and their total current market value is calculated and recorded in a 'Provision' general ledger account which is added to the total cost of the investments to produce the market value.</p> |
| Approved Deposit-taking Institution (ADI) | <p>An institution that is authorised under the <i>Banking Act 1959</i> to accept term deposits and conduct banking activities in accordance with that Act and under the prudential supervision of the Australian Prudential Regulation Authority (APRA).</p> |

| Term | Meaning |
|-------------------------|--|
| Active secondary market | A market where investors purchase securities or assets from other investors, rather than from issuing companies themselves on an arms length (independent) basis. |
| Benchmark rates | <p>Benchmark rates comprise:</p> <ul style="list-style-type: none"> • Bloomberg AusBond Bank Bill Index - The Bloomberg AusBond Bank Bill index is constructed as a benchmark to represent the performance of a passively managed short-term money market portfolio. It comprises thirteen Bank Bills of equal face value, each with a maturity seven days apart. The average term to maturity is approximately 45 days. A Bank Bill is a non-interest bearing security issued by a bank whereby the bank takes on an obligation to pay an investor a fixed amount (face value) at a fixed future date. It is sold to an investor at a discount to the face value. Bank Bills are short-term money market investments with maturities usually between 30 days and 180 days. • 30 Day Bank Bill Index – The 30 Bank Bill Index is designed to measure the performance of the Australian short-term money market and consists of 13 weekly maturities out to varying dates. Interest rates applied to these maturities are interpolated from cash and Bank Bill Swap (BBSW) rates. BBSW rates are administered by the Australian Financial Markets Association (AFMA). |

Definitions relating to statutory accounts, in accordance with Australian Accounting Standards:

| Term | Meaning |
|---------------------------|---|
| Cash and cash equivalents | <p>Investment assets that have a maturity date of 90 days or less at the time of acquisition, including:</p> <ul style="list-style-type: none"> • cash • call accounts • term deposits • bonds with an active secondary market . |
| Investments | <p>Investment assets that have a maturity date of greater than 90 days at time of acquisition, including:</p> <ul style="list-style-type: none"> • term deposits • bonds with an active secondary market <p>with government (including NSW T-Corp) and Authorised Deposit-taking Institutions (ADIs).</p> |

Policy statement

The City's investment objective is to ensure funds that are surplus to Council's immediate requirements are invested within acceptable risk parameters to optimise interest income while ensuring the security of these funds.

Legislative authority for investments

All investments are to be made in accordance with:

- Australian Accounting Standards
- Office of Local Government Investment Circulars
- Office of Local Government Investment Policy Guidelines
- Local Government (General) Regulation 2005 – Clause 212
- Local Government Act 1993 (particularly section 625)
- Local Government Code of Accounting Practice & Financial Reporting
- Minister's Investment Order (gazetted)
- Trustee Act 1925 (NSW) (particularly sections 14A(2), 14C(1) and (2))

Investment governance

The following internal control practices are in place to ensure adequate governance and allow transparent and clear performance measurement for the management of the City's cash and investment portfolio:

- financial planning and cash-flow management
- delegated authorities and investment approval
- measurement of investment performance
- performance benchmarks
- reporting and review
- audit oversight.

These internal control practices are explained in more detail below.

Financial planning and cash-flow management

Funds that are surplus to Council's immediate cash requirements will be managed in accordance with the long, medium and short-term financial cash requirements of the City.

Long term financial plans are developed to ensure the long term financial sustainability of Council. These plans will incorporate forecasts of cash inflows and outflows to:

- estimate cash surpluses and shortages in future periods
- identify the longer and medium term investment horizon for surplus funds.

Shorter term financial plans are used to predict funds availability and monitor the Council's cash management needs throughout the year. These cash flow models are monitored daily to facilitate informed investment decisions and to ensure that sufficient liquidity exists to satisfy Council's financial commitments.

Delegated authorities and investment responsibilities

Authorities and investment responsibilities are defined within Council's Delegation Authority. Authority for the implementation of the Investment Policy is delegated by Council to the Chief Executive Officer in accordance with the *Local Government Act 1993*.

The Chief Executive Officer has also delegated authority to invest surplus funds as follows:

- Chief Operating Officer (COO)
- Chief Financial Officer (CFO)
- other senior financial officers who have the requisite skills to undertake investment functions (as per the Delegations Register).

Officers with delegated authority are required to acknowledge they have received a copy of this policy and understand their obligations in this role.

Investment responsibilities

The City's Finance Unit prepares investment recommendations in accordance with this policy and the Investment Strategy. To achieve the best value for the City's investments, recommendations will consider:

- credit risk
- forecast cash requirements
- alternative investments with comparable risk
- liquidity and maturity profiles.

A minimum of two price quotations of like or similar investments must be obtained for the acquisition of all market investments in order to verify the fairness of the purchase price.

Two authorised signatories, with appropriate delegation limits, must approve each investment recommendation. Recommendations must be retained on file as a permanent record.

Any single investment exceeding \$5M, or, investments with maturity terms (or initial call dates) that exceed 5 years, require the written authority by any two of the CEO, COO, CFO, Manager Financial Planning and Reporting or Manager Business Planning and Performance. Where a recommendation consists of multiple investments, the amount and maturity of each investment must be considered separately.

Cash

The City retains funds for daily operational payment needs in a combination of a cheque account and/or daily call accounts. Transfers between these accounts are undertaken in order to ensure the cheque account has the appropriate level of funds to fulfil immediate payment obligations of the City and such transfers therefore do not constitute investments in the context of this Policy.

Delegated authority to enable transfers of call funds between the cheque and call accounts is as follows:

The Chief Executive Officer has delegated authority to transfer call funds as follows:

- Chief Operating Officer (COO)
- Chief Financial Officer (CFO)
- other senior financial officers who have the requisite skills to undertake investment functions (as per the Delegations Register).

Two authorised signatories, with appropriate delegation limits, must approve each call funds transfer recommendation. Recommendations must be retained on file as a permanent record.

Any single transfer of call funds exceeding \$10M requires the written authority by any two of the CEO, COO, CFO, Manager Financial Planning and Reporting or Manager Business Planning and Performance.

Conflict of interest

Officers shall not engage in activities that would conflict with the proper execution and management of Council's investment portfolio. Any potential conflicts of interest should be appropriately disclosed in accordance with Council's Code of Conduct.

Measurement of investment performance

Investment performance includes both interest returns and any change in the underlying capital value of the investments.

Interim fluctuations of capital value are excluded from the monthly measurement of investment performance on the basis that:

- investments are mainly acquired with the intention of holding them through to maturity
- cash liquidity requirements are structured and managed to ensure that Council is not in a financial position that will require a forced sale of these assets.

Notwithstanding the above position, changes in capital value are important and the quarterly investment report will therefore provide Council with indicative market valuations of each investment. In the event that the capital value of any investment becomes permanently impaired, or a capital loss or gain is actually realised (through disposal), the loss or gain of value will be recognised within that month's financial accounts.

In accordance with the requisite accounting standards, all investments are required to be 'marked to market value' at year end. A provision will therefore be recognised for the net changes in the indicative market values of all direct investments at the end of each financial year.

Performance benchmarks

Investment performance will be measured monthly against the chosen benchmarks in relation to both current month and 12-month rolling returns.

The CFO will approve the use of independently determined benchmarks. Where Council changes independently determined benchmarks, monthly reports for the month of change and the next five months thereafter shall contain reporting of investment returns against benchmark for both the following:

- the benchmark that is being replaced, and
- the new benchmark, backdated on a twelve month basis.

Council currently uses two performance benchmarks:

- Bloomberg AusBond Bank Bill Index –provides a common benchmark against other councils so that the City's investment performance can be compared on an industry basis and against other portfolios with similar or different risk and reward profiles
- 30 day Bank Bill Rate – provides a fair indicator of the risk free rate of return so that Council can understand the return that has been earned from diversifying its investment portfolio and accepting conservative levels of risk.

Reporting and Review

The City will maintain a separate record of money it has invested under section 625 of the *Local Government Act 1993*, in accordance with the criteria defined by the *Local Government Code of Accounting Practice and Financial Reporting*.

Pursuant to the *Local Government (General) Regulation 2005* (clause 212), the City will provide a monthly report to Council on investments. The monthly report to Council will include:

- the total value of the portfolio
- a complete schedule of all investments within the total portfolio
- full disclosure of all investments by type, current credit rating and face value
- net investment income for the month (actual against budget)
- the weighted average investment returns for the current month and the last 12 months rolling period (actual against benchmark)
- informative commentary on portfolio compliance and performance, current economic investment environment, and any change to current strategy
- certification that investments accord with the Act, regulations and Council's investment policy and strategy.

Each calendar quarter, the monthly report will also include:

- indicative market valuations of Council's investments
- analysis of the portfolio's liquidity (maturity) profile
- analysis of the portfolio's risk profile (credit ratings)
- analysis of the portfolio's product diversification (investment types)

In accordance with the Local Government Code of Accounting Practice & Financial Reporting, the City will undertake an annual review of its Investment Policy and Investment Strategy.

If there are any significant changes to the Act, regulations, issued guidelines, or if the market changes to a degree that warrants an earlier examination, the Policy and/or Strategy will be reviewed and brought back to Council for its consideration.

Audit oversight

The City's external auditors will review Council's investments as part of the Annual Financial Reports. This includes seeking independent certification from the relevant financial institutions (banks, fund managers, etc.) to confirm the balance of investments held on Council's behalf at the end of the financial year, and the adequacy of their internal control procedures.

The City's Internal Audit unit will also periodically review the adequacy of the Investment Policy, Strategy and management's internal controls as part of its audit review program.

Investment criteria

This section sets out the criteria for investments to be considered for inclusion within the City's portfolio. In particular, it defines the mandatory investment criteria which all investments must satisfy.

Current investment regulations require Councils to invest with either the NSW Treasury Corporation (NSW TCorp) or Approved Deposit-taking Institutions (ADI) such as Australian banks or branches of foreign owned banks, credit unions and/or building societies as it acknowledges the additional assurance that arises from their regulation by the Australian Prudential Regulation Authority (APRA).

Mandatory investment criteria

Scope

Investments must comply with the legislative authorities as described in the Legislative Authority for Investments paragraph of this policy.

Currency

Investments must be denominated in Australian Dollars.

Ownership

Investments must be held in the City of Sydney's name.

Term / Maturity

The term to maturity of investments may not exceed the periods shown below:

| Investments | Maximum term |
|-----------------|--------------|
| All investments | 10 years |

Credit rating

The following credit rating criteria apply to City investments:

- Investments must have a credit rating. The credit rating structure of the total portfolio must comply with the following table:

| Maximum Thresholds – Portfolio Percentage Limits | | |
|---|--|--|
| Credit rating / Organisation | Direct investment products (as a % of Total Portfolio) | Exposure to a single institution (as a % of Total Portfolio) |
| AAA | 100% | 33 ⅓ % |
| ADIs within either the ANZ, Commonwealth Bank, NAB or Westpac Banking Groups ('Big Four') | 100% | 33 ⅓ % |
| AA | 100% | 25% |
| A | 60% | 20% (Maximum of the lesser of: \$50M Or 5% of Net Equity as per the latest published financial statements) |
| Below A (to minimum investment grade rating – currently BBB) | 10% | 10% (Maximum of \$10M) |

- Credit ratings apply to both products and institutions. However this policy requires the rating applicable to the institution responsible for the product (e.g. guarantor) to be taken as the relevant rating given this represents the underlying risk to the City.
- Credit ratings must be monitored regularly by Finance staff to ensure ongoing compliance. Investments with credit ratings downgraded to an extent that they no longer comply will be divested as soon as practicable, in accordance with the grandfathering provisions of this policy.
- Credit risk investment parameters are based on credit rating bands as published by the credit rating agencies (e.g. S&P, Moodys and Fitch). If an investment is rated by more than one ratings agency, the credit rating to be used will be based on the order of S&P, Moodys and then Fitch.
- Where the principal amount and accrued interest of any investment with a financial institution are directly guaranteed by the Australian Federal Government for full repayment, the parameters in the table above may be exceeded as follows:
 - exposure to single institutions may exceed the stated limits provided that the excess amount comprises only guaranteed investments
 - exposure of the total portfolio to credit ratings lower than AAA may be exceeded, provided that the excess amount comprises only guaranteed investments.

As a result, investments directly guaranteed by the Australian Federal Government may comprise the total investment portfolio. Management should ensure that any excess of investments over the parameters specified in the table above that is comprised of Australian Federal Government guaranteed investments can be managed back to within the specified parameter levels prior to the expiration of any such guarantee.

- Where investments with different credit ratings are held with the same financial institution (for example, where credit ratings for short-term and long-term investments in the same institution are different), the maximum credit rating threshold is determined as follows:
 - investments with the lower credit ratings are subject to the maximum thresholds associated with those relevant credit rating bands
 - investments with the highest credit rating band for that financial institution are subject to a maximum threshold equal to (i) the maximum threshold for the highest credit rating band applicable to that financial institution, less (ii) the total amount of investments held at any time in the lower credit rating bands with the same institution.

Portfolio liquidity parameters

The portfolio liquidity parameters specify the maximum and minimum amounts or percentages of the City's total investment portfolio that can be held within the various investment maturity bands.

The liquidity / maturity profile of the total portfolio must comply with the parameters shown in the tables below.

Maximum thresholds are set to control the proportion of the total portfolio that can be invested into longer term investments to ensure that Council has adequate access to short and medium term liquidity to satisfy its business objectives. The maximum thresholds reduce as the maturity horizon extends further into the future.

| | 1 month | 2 to 12 months | 1 to 3 Years | 3 to 5 Years | > 5 Years |
|------------------------------|---------|----------------|--------------|--------------|-----------|
| Maximum % of Total Portfolio | 100% | 80% | 40% | 35% | 10% |

Minimum thresholds are set to ensure that there will always be an adequate amount of liquidity available in earlier maturity bands before funds may be committed to longer term investments. The minimum thresholds are obviously higher in the shorter term where liquidity is of the greatest concern.

| | 1 month | 2 to 12 months | 1 to 3 Years | 3 to 5 Years | > 5 Years |
|---|---|----------------|--------------|--------------|-----------|
| Cumulative Minimum % of Total Portfolio | 10% or \$50M <i>(the greater of)</i> | 40% | 55% | 90% | Nil |

The relationship of the maximum and cumulative minimum thresholds is illustrated by the following example. Essentially, before an investment can be considered for a particular maturity band, firstly the total portfolio must be in compliance with the cumulative minimum thresholds and secondly, the investment should then not cause the maximum thresholds to be exceeded. As an example, if an investment of 2 years duration is being considered, the following thresholds must be complied with:

- First, at least 40% of the total portfolio must have a maturity date of less than 12 months and 10% of the portfolio (or at least \$50M) must have a maturity date of less than 1 month.
- Secondly, once the investment is added to the portfolio, the total amount of investments maturing between 1 and 3 years may not exceed 40% of the total portfolio.

The thresholds are aimed at ensuring minimum liquidity requirements are always met. Hence, if 45% of the portfolio has a maturity date of less than one month, it means that an investment with a maturity of 1 to 3 years can be made because there is an adequate cumulative threshold of 45% of the portfolio that has a maturity of up to 12 months to meet the 40% minimum threshold i.e. excess levels may be applied to meeting the minimum thresholds of succeeding maturity bands. Upon reinvestment consideration must be given to ensuring that the minimum thresholds of the succeeding maturity bands are always maintained when the shorter term investments mature.

The minimum requirement for very short term access to investments is set at \$50M to ensure adequate liquidity to meet Council’s working capital requirements.

The City may utilise pre-approved overdraft facilities to manage short-term liquidity short falls where it is both prudent and financially advantageous. It is anticipated that this facility would be utilised to avoid penalties arising from early redemption of term deposits or where favourable investments arise a day or two ahead of the maturity dates of existing investments that are earmarked for future investment. Overdrafts should be limited to no more than \$10M and for a duration of no more than 2 weeks.

Breaches of criteria

Procedures for dealing with unavoidable breaches of any particular thresholds are contained in the next section on grandfathering of investments.

Grandfathering of Investments

This policy imposes limits and thresholds in relation to the acquisition and holding of investments. However, situations may occur where inadvertent breaches of these limitations or thresholds arise, other than from the acquisition of investments. For example:



- amendments to regulatory directives or legislation
- changes in the total value or amount of Council's investment portfolio which consequently changes any of the threshold limits so that they no longer meet the portfolio liquidity parameters.

Breach as a result of regulatory change

When limitations or thresholds are breached due to amendments to regulatory directives or legislation, the investment portfolio must be managed in accordance with the respective amendments. Where the amendments enable retention and grandfathering of existing investments, Council may continue to actively manage those investments within the portfolio in accordance with all other regulations and policies applicable to such investments. This includes a strategy of holding or divesting such investments in accordance with regular investment considerations.

Breach as a result of a change in the total investment portfolio

Where limitations or thresholds are breached due to a change in the overall size of the total investment portfolio, the following process will apply:

- an immediate freeze is imposed on the acquisition of new investments in the relevant category until the portfolio can be effectively managed back to accord with the requirements of this policy
- the relevant category of investments must be managed back in accord with the policy limits within a period that takes into account any adversity created by market liquidity, current valuations of these investments and the risks of default.

The immediate forced sale of the investments in breach of the limits or thresholds will not be required.

Investment Strategy

The City will prepare an annual Investment Strategy to guide the management of its surplus cash and investments within the requirements of this policy.

The Investment Strategy will document all key objectives relating to management of cash and investment assets over the short to medium term in the context of prevailing market conditions at the time. The strategy will:

- consider Council's current investment portfolio, its financial position and financial commitments, current legislative constraints and the global investment environment
- specify our investment goals and targets for the forthcoming year.

Mandatory components of Council's Investment Strategy will comprise the management of the following aspects of the investment portfolio:

- risk profile
- liquidity/maturity
- return/income
- environmentally and socially responsible investments

Requirements in respect of each component are detailed below.

Risk profile

The City's risk profile in relation to investing surplus funds is to be relatively prudent, conservative and risk averse. The profile will be achieved by effectively managing within the investment portfolio:

- the **diversity** of the investments
- the **creditworthiness** of the investments

Diversity is achieved by placing limits on the maximum exposure the City may have to individual:

- funds or financial institutions
- credit rating bands.

Creditworthiness of investments is primarily determined using long and short term credit and fund Industry Standard Credit Ratings of Moodys, Standard & Poors (S&P) or Fitch.

Liquidity/Maturity

The cash requirements of the City will be satisfied by monitoring and structuring the total maturity profile of the investment portfolio in accordance with the Investment Policy.

Return/Income

Investment returns are closely correlated to the risk profile of the underlying investments. Appropriate benchmark rates of return will be set in relation to the risk profile and returns will be required to meet or exceed benchmark rates.

Environmentally and socially responsible investments

Subject to compliance with legislation and investment policy objectives and parameters, the City supports investment securities that are environmentally and socially responsible investments (SRI). SRI status may be in respect of the individual investment, the issuer of the investment, or both and should be endorsed by an accredited environmentally and socially responsible industry body or institution.

Environmentally and Socially Responsible Investments will be assessed on the same basis as other investment opportunities and the City will select the investment that best meets its overall investment selection criteria.

The City's criteria relating to an SRI are those which:

- direct investment towards the socially and environmentally **productive** activities listed below
- avoid investment in the socially and environmentally **harmful** activities listed below.

The criteria for SRI are all preferred and not mandatory requirements.

Environmentally **productive** activities are considered to be:

- resource efficiency-especially water and energy
- renewable energy
- production of environmentally friendly products
- recycling, and waste and emissions reduction

Socially **productive** activities are considered to be:

- fair trade and provision of a living wage
- human health and aged care
- equal opportunity employers, and those that support the values of communities, indigenous peoples and minorities
- provision of housing, especially affordable housing

Environmentally **harmful** activities are considered to be:

- production of pollutants, toxins and greenhouse gases (coal, oil and gas)
- habitat destruction, especially destruction of forests and marine eco-systems.
- nuclear power
- uranium mining

Socially **harmful** activities are considered to be:

- abuse of Human Rights and Labour Rights
- involvement in bribery/corruption
- production or supply of armaments
- manufacture of alcohol, tobacco or gambling products

The City will advocate for the further development of SRI options through engagement with financial institutions.

Evaluation

The policy is evaluated through the measured results required under **Monthly Reporting**.

References

| | |
|--------------------------------|---|
| Laws and standards | <ul style="list-style-type: none"> • Australian Accounting Standards • Division of Local Government – Local Government Code of Accounting Practice & Financial Reporting • Division of Local Government Investment Circulars • Division of Local Government Investment Policy Guidelines • Local Government (General) Regulation 2005 • Local Government Act 1993 • Minister’s Investment Order (gazetted) • Trustee Act 1925 (NSW) |
| Policies and procedures | <ul style="list-style-type: none"> • Code of Conduct • Disciplinary Policy & Procedures • Fraud & Corruption Internal Reporting Policy • Investment Strategy |

Approval

The Council approved this policy on 31 October 2016.

Review

| Review period | Next review date | TRIM reference |
|--|------------------|----------------|
| The Code of Accounting Practice & Financial Reporting requires Council to undertake an annual review of its Investment Policy and Investment Strategy. | March 2017 | 2016/508484 |