

ITEM 2. INVESTMENTS HELD AS AT 30 SEPTEMBER 2017

FILE NO: X011299

SUMMARY

This report provides details of Council's investment portfolio and performance to 30 September 2017.

Council's total Investment and Cash position was \$564.0M at the end of September, with investments earning interest of \$1.3M for the month.

The majority of the City's cash and investments portfolio is held as internally restricted (\$301.4M) or externally restricted (\$100.7M) 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 represent working capital and funding required for the City's operating and capital expenditure commitments.

Council achieved an annualised monthly return of 2.78% for September, significantly above the 30 Day Bank Bill Rate (BBR) of 1.53%, the AusBond Bank Bill Index (published by Bloomberg) of 1.69% and the enhanced benchmark of 1.98% (BBR + 0.45%) as endorsed in October 2016 as part of the Investment Strategy.

Council's annual rolling return of 2.80% also continues to exceed the 12 month average 30 Day BBR of 1.61%, AusBond Bank Bill Index of 1.77% and the enhanced benchmark of 2.06% (BBR + 0.45%) as endorsed in the Investment Strategy in October 2016.

In accordance with Council's Investment Policy ('the Policy'), the quarterly investment reports advise the latest indicative market valuations of all direct securities (being Floating Rate Notes). The book value of the current portfolio increased by \$224.3K during the September quarter which represented 0.11% 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 that identify the distribution of Council's portfolio across credit ratings, investment product types and financial institutions. Separate charts depicting the City's cumulative 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. Both the Policy and Strategy have recently been further strengthened to state the City's preference for re-investing its surplus funds in line with community environmental expectations as identified in Sustainable Sydney 2030.

RECOMMENDATION

It is resolved that the Investment Report as at 30 September 2017 be received and noted.

ATTACHMENTS

Attachment A: Register of Investments and Cash as at 30 September 2017

Attachment B: Investment Performance as at 30 September 2017

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 45 basis points while performance also continues to be measured against the Bloomberg AusBond Bank Bill Index.
4. Council's total Investment and Cash position as at 30 September 2017 was \$564.0M, an increase of \$4.8M from the \$559.2M reported at 31 August 2017, reflecting rates and operating income partially offset by capital works expenditure and other operational payments. A schedule detailing all of Council's investments as at the end of September is provided at Attachment A.
5. The majority of the City's cash and investments portfolio are held as internally restricted (\$301.4M) or externally restricted (\$100.7M) 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.
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 2.78% for September, significantly above the 30 Day Bank Bill Rate (BBR) of 1.53%, the AusBond Bank Bill Index (published by Bloomberg) of 1.69% and the enhanced benchmark of 1.98% (BBR + 0.45%) as endorsed in October 2016 as part of the Investment Strategy.
8. Council's annual rolling return of 2.80% also continues to exceed the 12 month average 30 Day BBR of 1.61%, AusBond Bank Bill Index of 1.77% and the enhanced benchmark of 2.06% (BBR + 0.45%) as endorsed in the Investment Strategy in October 2016.
9. The RBA last adjusted the official cash rate in August 2016, when it was reduced to 1.50%. The market subsequently responded accordingly, and lower yields on investments have had a sustained adverse impact on Council's portfolio return. This trend is anticipated to continue, though in recent periods some improvement in longer term interest rates has been noted.
10. In accordance with Council's Investment Policy ('the Policy'), the quarterly investment reports advise the latest indicative market valuations of all direct securities (being Floating Rate Notes). The book value of the current portfolio increased by \$224.3K during the September quarter reflecting a volatile market. The movement represented 0.11% of the total value of the relevant securities.

11. In total, the current portfolio includes a total unrealised gain of \$2.2M which has arisen because of the significant number of investments held by Council that have locked in higher yields, significantly exceeding the earning rates currently offered in the market. Council will only sell and realise this gain in cases where the proceeds from subsequent reinvestment are expected to significantly exceed the future interest earnings that will be generated by holding the current investments to maturity.
12. Pursuant to amendments made to the City's Investment Policy, as endorsed by Council in October 2016, two Environmentally and Socially Responsible Investment (SRI) products are currently held within the City's investment portfolio. These investments offered a rate of return that was competitive with other Floating Rate Notes (FRNs) already held in Council's portfolio; and also, generally, competitive with rates currently on offer for other FRN products in the market. The investments are shown separately in the Register of Investments and Cash under the heading 'Floating Rate Notes (FRN's) Green/Climate Bonds'.
13. The report includes graphs demonstrating that Council's liquidity profile continues to satisfy the requirements of the Policy, and charts that 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 ten years have also been included to provide further insight into the City's total investment portfolio performance.
14. Council has been able to outperform the industry benchmarks, and our own enhanced benchmarks (Investment Strategy benchmarks are based on returns currently available in the 30-90 day investment market), on both a monthly and annual rolling basis. This performance largely reflects council's prior decisions to lock in a number of investments with fixed rates of 4.5% p.a. and floating rates with fixed margins significantly above the risk free rate. However, as these investments have continued to mature, surplus funds have been reinvested at lower rates, as offered in the market.
15. 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.
16. As noted in recent investment reports, Standard and Poors Global Ratings (S&P) downgraded its long term ratings for 23 Australian financial institutions in May 2017; reflecting their view of the risks associated with the ongoing build-up of private sector debt and housing prices, particularly in Sydney and Melbourne. A number of the financial institutions with which the City invests were affected, however the most significant implications were as a result of both the Bank of Queensland and Bendigo & Adelaide Bank being downgraded from A- to BBB+ rating. The downgrade of these institutions will affect the future placement of funds in order to ensure ongoing compliance with the Policy.

17. The City's Investment Policy includes a tiered risk management structure that limits the exposure of Council's surplus funds to individual financial institutions, which incorporates a consideration of their risk rating within the market. The downgrade to below A rating for these two institutions, reduced the maximum amount that may be invested to \$10M each. The City currently holds \$16M of long-term investments with Bendigo & Adelaide Bank, with the earliest maturity date scheduled for a \$6M investment on 14 November 2018. The Investment Policy's "grandfathering" provisions has been applied, allowing the existing investments to be maintained or divested in accordance with all regular investment considerations, but no further investment will be permissible at this time.

KEY IMPLICATIONS

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

FINANCIAL IMPLICATIONS

19. Council's investments earned interest of \$1.2M for the month of September 2017, against budgeted earnings of \$1.1M. Investment earnings for the full year are forecast at \$13.0M.

RELEVANT LEGISLATION

20. Council is authorised to invest its surplus cash under Section 625 of the *Local Government Act 1993*.
21. 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.
22. The Investment Policy and Strategy was revised in October 2016, strengthening Council's commitment to sustainable investments where returns and risks are equivalent by changing the word 'desirable' to 'preferred' under the environmentally and socially responsible investment criteria. The revision also expanded the definition of environmentally harmful activities to include specific reference to coal, gas and oil.
23. The 2017 revision of the Investment Policy and Strategy, which has been submitted as part of the current Council round, will guide investment decisions from October 2017 forward and maintains the City's commitment to environmentally and socially responsible investment.
24. Council's investments accord with the Minister's Investment Order, the Office of Local Government's Investment Policy Guidelines, and the City's own Investment Policy and Strategy as adopted by Council on 24 October 2016.

CRITICAL DATES / TIME FRAMES

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

PUBLIC CONSULTATION

26. 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.
27. Council does meet regularly with representatives of each of the 'Big 4' banks. At these meetings Council officers actively advocate for socially responsible investment (SRI) opportunities. To date, feedback from these meetings is that there is a well-known appetite in the market for these products and they are investigating the development of suitable products, however it is difficult to match the level of funds to available SRI opportunities that meets both the credit risk and maturity profile requirements of Councils

BILL CARTER

Chief Financial Officer