

**ITEM 4. REVIEW OF THE INVESTMENT POLICY AND STRATEGY FOR THE  
MANAGEMENT OF COUNCIL'S SURPLUS FUNDS**

**FILE NO: X011299**

**SUMMARY**

This report presents the revised Investment Policy and Investment Strategy for the Management of Council's Surplus Funds.

The Policy and Strategy are reviewed annually, as a minimum, to ensure that they remain appropriate given changes to the economic, investment and legislative environments. The annual review of the Policy and Strategy, together with the proactive management of the portfolio, has resulted in a secure investment portfolio that consistently outperforms the benchmark returns required by the policy.

The scope of Council's investments and the wider NSW local government sector is limited. It is mandated under the Local Government Act 1993, through a Ministerial Investment Order, that constrains Council investments to deposits and / or bonds in Federal, State (including NSW TCorp) or Local governments and in banks that are Approved Deposit taking Institutions under the Banking Act. Councils are not permitted to invest in equities and therefore not permitted to invest directly in individual companies.

The Council first formally introduced social and responsible investment criteria into its investment policy and strategy back in 2008, although environmental investments were already being actively incorporated into the portfolio as appropriate instruments came onto the market. Since that time, the Council has progressively strengthened its position within its allowed investment framework.

In October 2016, Council endorsed a revised Investment Policy that further enhanced the social and responsible investment aspect of the City's investment policy. While the Policy already encouraged social and responsible investment, provided that products met the risk and return requirements of other investments, two amendments were adopted that:

- strengthened Council's commitment to social and responsible investment where returns and risk are equivalent to other available investments; and
- expanded the definition of environmentally harmful activities to include specific reference to coal, gas and oil.

The City has good relationships with its financial institutions and NSW Treasury Corp, and regularly meets to advocate for new investment vehicles and products that will achieve our desire to increase our commitments to social and responsible investment. The City has also discussed the development of fossil fuel free investment products and notes that it is a complex long term task. The City will, nonetheless, continue to advocate for continued and improved effort.

The Investment Policy sets out Council's investment objectives to safeguard the City's cash and investment portfolio, achieve appropriate rates of return and manage the portfolio to ensure sufficient liquidity to meet Council's business objectives. It includes investment criteria to frame investment decisions, risk management parameters, and investment governance standards to ensure transparency, internal controls and performance management.

The Investment Strategy outlines Council's investment intentions in light of the current economic, investment and legislative environments. The focus is on the investment opportunities available to Council, guiding investments to be maintained in the coming 12 months and the investment of new funds. The Strategy aims to accomplish a balanced and diversified portfolio in terms of investment products, credit ratings and term to maturity to ensure sufficient liquidity will be available as funds are required.

The legislative and regulatory environment for local government has remained static, and the existing Investment Policy continues to serve the City well. One minor amendment is proposed to the Policy for 2017/18 which is the inclusion of an example under the portfolio liquidity parameters to illustrate the guideline in effect.

In addition, a number of minor amendments to the policy which relate to clarifying of financial term definitions have been made. These do not constitute policy changes.

The key objectives of the current Investment Strategy remain valid for the present economic, investment and legislative environments. The Strategy remains unchanged as it presently meets liquidity requirements for Council's ongoing capital works program, as well as revised objectives for investment performance measurements.

The proposed Investment Policy and Strategy will continue to maintain an investment portfolio that is reasonably conservative, and comprise investments in institutions with high investment grade credit ratings that are all subject to APRA regulation, while at the same time allow some flexibility for appropriate investment opportunities that enhance the City's financial returns.

## **RECOMMENDATION**

It is resolved that Council adopt the revised Investment Policy and Investment Strategy for the management and investment of Council's surplus funds, as shown in Attachments A and B to the subject report.

## **ATTACHMENTS**

**Attachment A:** Investment Policy for the Management of Surplus Funds.

**Attachment B:** Investment Strategy for the Management of Surplus Funds.

**BACKGROUND**

1. The Local Government Act was amended in 2016 to strengthen Councils' fiduciary duty. The changes are intended to guide councils to carry out their functions in a way that facilitates local communities that are strong, healthy and prosperous, and include an explicit reference to councils carrying out their functions in a way that provides the best possible value for residents and ratepayers.
2. The investment policy and strategy are a key part of ensuring that the City continues to manage its finances in an effective, efficient and prudent manner. The amendments to the Local Government Act, as referred to above, reinforce the City's existing underlying financial principles.
3. The Act states that Councils should have effective financial and asset management, including sound policies and processes, for the following:
  - (a) performance management and reporting;
  - (b) asset maintenance and enhancement;
  - (c) funding decisions; and
  - (d) risk management practices.
4. The Local Government Code of Accounting Practice and Financial Reporting (the Code) states that:

“Councils must maintain an investment policy that complies with the Act, Local Government (General) Regulation 2005 (NSW) and the Ministerial Local Government Investment order and ensures it or its representatives exercise care, diligence and prudence when investing council funds”.
5. The purpose of the Policy and Strategy is to ensure the investments are secure, satisfy Council's risk/return criteria, compliant with the Local Government Act 1993, and to optimise investment income from the short and long term investment of funds that are surplus to Council's present operational needs.
6. The Investment Policy and Investment Strategy are reviewed annually to ensure they remain relevant to prevailing market and legislative conditions. In situations where market volatility and uncertainty arise from changes in the economic, investment and legislative environments, the review will be brought forward for adoption by Council at an earlier date so that key changes can be made to the Policy and Strategy to deal with the respective market conditions.
7. Council's investment portfolio remains conservative due to the robustness of the Australian domestic investment market under the supervision of the Australian Prudential Regulation Authority (APRA) which extends across the full range of financial institutions. Council has gradually diversified from its 2008 GFC-focused portfolio, which was highly conservative and significantly concentrated in the 'Big 4' AA-rated domestic banks. Its current portfolio remains conservative but more diversified, as it includes more APRA-regulated A-rated bank investments, together with a handful of investment-grade BBB-rated investments.

8. The Policy encourages investments in environmentally and socially responsible investments provided that they meet the risk and return requirements of other investments. Two amendments were adopted in October 2016 that:
  - (a) strengthened Council's commitment to sustainable investments where returns and risk are equivalent by changing the word 'desirable' to 'preferred' under the Environmentally and socially responsible investments criteria; and
  - (b) expanded the definition of environmentally harmful activities to include specific reference to coal, gas and oil.
9. The first amendment proposed the change of the word 'desirable' to 'preferred' under the criteria for environmentally and socially responsible investments. The change highlights that the Council will, all things being equal, invest in social and responsible investments.
10. The second amendment included 'coal, gas and oil' (fossil fuels) as criteria to avoid, being environmentally harmful activities. Fossil fuels are some of the major contributors to greenhouse gas emissions, resulting in climate change. Clearly identifying these items in the criteria section of environmentally harmful activities of the policy emphasises Council's intent not to invest in activities relating to fossil fuel use.
11. The amendments did not significantly change the overall intent of the Policy but provide a clearer signal to the broader community, public sector agencies/all levels of government and the financial sector as to the City's intent.
12. The legislative and regulatory environment for local government has remained static, and the existing Investment Policy continues to serve the City well. Accordingly only one minor amendment proposed to the Policy for 2017/18 which is the;
  - (a) inclusion of an example under the portfolio liquidity parameters to illustrate the guideline in effect.
13. The addition of example in the portfolio liquidity parameters aim to provide clarity to the adopted guidelines of the specified section.
14. There are a number of minor amendments to the policy which relate to clarifying of some financial term definitions. These changes are of a 'housekeeping nature' and do not constitute change in policy. The main definition change is the adding of distinction between short and long term investment periods. In addition, there is a revision of the benchmark rates definition.
15. The key objectives of the current Investment Strategy remain valid for the present economic, investment and legislative environments. The Strategy remains unchanged, as it presently meets liquidity requirements for Council's ongoing capital works program as well as revised objectives for investment performance measurements
16. The proposed Investment Policy and Investment Strategy continue to satisfy the compliance requirements of the Ministerial Investment Order.

17. It should be noted that the Investment Strategy is a 'guiding principles' document. As market conditions change significantly and very quickly, the Strategy may need to be amended from time to time, in which case Council would be advised through the monthly Investment Report.
18. Council's Investment Policy and Investment Strategy continue to permit and encourage environmental and socially responsible investment activity (SRI investments). While Council continues to pursue these objectives, the task has been made difficult in recent times as the Ministerial Investment Order restricts the range of financial institutions in which NSW councils can invest, and prohibits many of the available socially responsible investment products.
19. In addition to these statutory restrictions, Council also imposes its own additional restrictions through its Investment Policy in order to further minimise and manage investment risk. The combined effect of these restrictions is that Council now operates in an investment market with very little opportunity for socially responsible investments. This conservative approach has, however, safeguarded Council's funds and maintained an investment portfolio that continues to exceed industry performance benchmarks.

#### **KEY IMPLICATIONS**

20. Council's Investment Policy and Investment Strategy direct its investments to ensure compliance with the requirements of the Local Government Act 1993 and Minister's Investment Order within acceptable risk/return parameters.

#### **FINANCIAL IMPLICATIONS**

21. Investment returns over the past five years have gradually reduced, reflecting lower interest rates and the more limited investment opportunities now available under the Ministerial Investment Order, Investment Policy and Investment Strategy.
22. Portfolio returns are expected to remain reasonably low for the next year with interest rates at historic lows. Anticipated cash balances and resultant investment returns are subject to achievement of the planned capital program.

#### **RELEVANT LEGISLATION**

23. Council is authorised to invest its surplus cash under Section 625 of the Local Government Act 1993.
24. 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.
25. The Local Government Code of Accounting Practice and Financial Reporting (Legislative Requirements Update 10 at 11.3.5) states that Council must maintain an investment policy that complies with the Act and ensure it or its representatives exercise care, diligence and skill that a prudent person would exercise in investing Council funds.

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