

Review of the Investment Policy and Strategy for the Management of Council's Surplus Funds

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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 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 the City'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 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 the City, 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 City first formally introduced social and responsible investment criteria into its investment policy and strategy in 2008, although environmental investments were already being actively incorporated into the portfolio as appropriate instruments came onto the market. Since that time, the City 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:

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

These two amendments continue to be included in the policy.

The City has good relationships with its financial institutions, 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.

In November 2018, Westpac informed the City that they had developed a new sustainable investment product known as a Green Tailored Deposit, which has been independently certified to meet the Climate Bonds Standard while not compromising the credit risk of the product. These deposits are associated with a defined pool of eligible assets which meet the Climate Bond Standard criteria including renewable energy, low carbon transport, low carbon intensity emitting buildings, waste and water products and will be independently certified annually. The City was the first council to invest in this new product and at the time of writing has invested \$75 million.

The legislative and regulatory environment for local government has remained static, and the existing Investment Policy continues to serve the City well.

One amendment to the Investment Policy is in response to the introduction of a new financial instruments standard - AASB 9, which came into effect for accounting periods beginning on or after 1 January 2018. For the City, this revised standard simplifies the accounting for the valuation of investments. The requirement to continually revalue all of the City's investments that could be sold in a secondary market (i.e. floating rate notes) has ceased, as all investments held by the City will now always be recorded at their face value, with any premium or discount paid at acquisition amortised over the life of the investment.

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 meet 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. 2019/20 Investment Policy for the Management of Surplus Funds

Attachment B. 2019/20 Investment Strategy for the Management of Surplus Funds

Background

1. The Local Government Act 1993 (the Act) was amended in 2016 to strengthen council's 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 Investment Policy and 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.
6. The purpose of the Policy and Strategy is to ensure the investments are secure, satisfy Council's risk / return criteria and are compliant with the Local Government Act 1993, as well as to optimise investment income from the short and long term investment of funds that are surplus to the City's present operational needs.
7. The City'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. The City 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 social and responsible investment where returns and risk are equivalent to other available investments; 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 City 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. Council's Investment Policy and Investment Strategy continue to permit and encourage environmental and socially responsible investment activity (SRI investments). The Ministerial Investment Order limits the range of financial institutions in which NSW councils can invest, and prohibits many of the available socially responsible investment products.
13. The City has good relationships with its financial institutions, 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. In a welcome development, in November 2018, Westpac informed the City that they had created a new sustainable investment product known as a Green Tailored Deposit, which has been independently certified to meet the Climate Bonds Standard while not compromising the credit risk of the product. These deposits are associated with a defined pool of eligible assets which meet the Climate Bond Standard criteria including renewable energy, low carbon transport, low carbon intensity emitting buildings, waste and water products and are independently certified annually. To date the City has invested \$75 million in this Westpac product.
14. One amendment to the Investments Policy is in response to the introduction of a new financial instruments standard - AASB 9, which came into effect for accounting periods beginning on or after 1 January 2018. For the City, this revised standard simplifies the accounting for the valuation of investments. The requirement to continually revalue all of Council's investments that could be sold in a secondary market (i.e. floating rate notes) has ceased, as all investments held by the City will now always be recorded at their face value, with any premium or discount paid at acquisition amortised over the life of the investment.

15. This change required a one-off accounting adjustment to write-back any unrealised cumulative valuation gains or losses, which had been recognised for the City's floating rate notes under the previous accounting standard, rather than incrementally adjusting these values back to face value over the life of the investment.
16. 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. Sections of the Investment Strategy that detail the current investment portfolio and its performance were amended to reflect the present results.
17. The proposed Investment Policy and Strategy continue to satisfy the compliance requirements of the Ministerial Investment Order.
18. 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.

Key Implications

19. 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

20. 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.
21. Portfolio returns are expected to remain reasonably low, that is between 1.50-2.50%, for the next year with interest rates continuing at historic lows. Anticipated cash balances and resultant investment returns are subject to achievement of the planned capital program.

Relevant Legislation

22. Council is authorised to invest its surplus cash under Section 625 of the Local Government Act 1993.
23. The Local Government (General) Regulation 2005 (Clause 212) requires the City to provide a written monthly report of all monies invested, under Section 625 of the Act.
24. 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.

BILL CARTER

Chief Financial Officer