# Attachment B

## 2021/22 Investment Strategy

# Investment Strategy

## Purpose

The annual Investment Strategy sets out the City's investment goals and targets for the coming year. The aim of the strategy is to guide the management of the City's investment portfolio over the short to medium term to:

- achieve a balanced and diversified portfolio, in terms of allowable investment products, credit ratings and maturation terms that will outperform the benchmark indices
- ensure liquidity when required for the City's operational and capital expenditure needs.

## Scope

The *Investment Strategy* applies to all managers and employees who actively manage the investment of surplus funds or have responsibility for employees who actively manage the investment of surplus funds.

This strategy should be read in conjunction with the *Investment Policy*.

## Context

The City's investment strategy is determined after taking into consideration a review of the following issues:

- global and domestic economic investment environments
- investment policy and legislative constraints
- current composition of Council's investment portfolio
- long, medium and short term financial plans.

### Global and domestic investment environments

The Covid-19 pandemic has created significant uncertainty in financial markets. One of the measures the Reserve Bank of Australia (RBA) has used to respond to the crisis is to reduce the official cash rate downward. It was reduced first on 3 March 2020 to 0.50 per cent and again on 20 March 2020, when it was further reduced to 0.25 per cent. On 2 November 2020, the RBA announced a further drop in the official cash rate to 0.10 per cent. In addition, the RBA launched its Term Funding Facility. This facility, now in the order of $200 billion, has reduced the funding costs of Authorised Deposit-Taking Institutions (ADIs). The market has responded by reducing the rates on offer and the resultant lower investment yields continue to have a sustained adverse impact on the City's portfolio return.

In the September Monetary Policy Statement the RBA reaffirmed its view that interest rates would remain low until at least 2024. It also indicated that it will continue to purchase government bonds at the rate of $4 Billion per month until February 2022 further supporting the economy and reducing the likelihood of rate increases.

This flood of cheap funding together with relatively low levels of credit growth have caused the unintended consequence of effectively shutting down the short-term money market. The City is part of a large sector of the investment market that relies on an active short-term money market issuing wholesale term deposits and other senior debt products such as floating rate notes. These investment types reflect a conservative investment policy, and the mandates of the Ministerial Investment Order.

The increase in the TFF offers a cheaper funding option for eligible ADIs, and most have taken the option at the expense of wholesale deposits. The City, like many other investors, has faced the unusual challenge of finding a bank willing to take their investment funds.

Investment advice obtained by the City suggests that new senior unsecured (FRN) issues are unlikely from any of the banks for the foreseeable future and potentially as long as 12 months. An active wholesale deposit market equivalent to pre-pandemic levels is also considered unlikely and this is in line with RBA statements. While many foreign banks who have not been eligible for TFF funding are still actively sourcing deposits, in the wholesale term deposit market, the City intends to continue a policy of conservative investment management, and does not propose to broaden investment parameters significantly at this time. Interest rates, already low over a sustained period, have further reduced in the past year as a result of the Covid-19 pandemic and the response measures detailed above. At the time of writing this low interest rate environment is anticipated to continue for the longer term, reducing the City's interest earnings when compared to historical trends.

In Australia, a history of prudent regulation of the financial institutions by the Australian Prudential Regulation Authority (APRA) has meant that Australian based regulated financial institutions have already operated for an extended period under stringent capital adequacy and liquidity requirements. The City's investments all fall under APRA regulation with the result that the portfolio is conservative and secure.

### Legislative environment

Council's investment opportunities are constrained by a combination of legislation, regulation and any directions and guidelines issued by the Minister or the Office of Local Government.

There has been no change to the investment legislative environment for a number of years and the most recent Ministerial Investment Order released in January 2011 continues to limit Council's investment options to:

- term deposits with Approved Deposit-taking Institutions (ADIs)
- other ADI senior ranked securities
- investments with Australian government treasury bodies, including NSW Treasury Corporation (T-Corp)
- funds or securities issued or guaranteed by the Commonwealth or any State or Territory.

### Composition of Council's investment portfolio

The conservative nature of Council's Investment Strategy is clearly reflected in the structure of the portfolio, where 100% of the portfolio is invested with APRA-regulated ADIs.

Council's current portfolio is as follows (as at the end of September 2021):

| Investment | Split |
|---|---|
| Big Four banks | 71% |
| Australian mid-tier banks | 28% |
| Australian government treasury bodies | 1% |
| Foreign controlled Australian based ADIs | 1% |

| Investment | Split |
|---|---|
| **Total APRA-regulated ADIs** | **100%** |

The allocation of assets within the portfolio is with very secure institutions. In the past year, the City has diversified the portfolio with further selected investment into the Australian mid-tier banks as they continue to reflect strength and stability.

## Investment strategy

The City's investment portfolio will continue to be prudently managed in accordance with:

- the City's Investment Policy and related legislative and regulatory requirements,
- documented risk management procedures to preserve capital; and
- the City's operational and capital funding requirements.

### Objectives

The City's investment strategy for the period is to maintain the highly secure profile of the portfolio, provide liquidity and deliver competitive investment returns commensurate with the portfolio structure.

As noted in the investment policy, the City's primary objective in the purchase of financial investments is to collect contractual cash flows (i.e. interest revenue) over the life of the investment, and redeem the principal sum at maturity, rather than to regularly trade to make a profit. This constitutes a 'Held-to-Maturity business model'; one of three options described under AASB 9 – Financial Instruments. Under AASB 9, the classification and measurement of financial instruments is determined by an entity's business model.

### Risk profile

The risk profile for the City's investment portfolio is based on the principles of being prudent, conservative and risk averse. This is achieved by managing the diversity and creditworthiness of investments in accordance with the Investment Policy and other relevant requirements.

The City's capital funding requirements will continue to remain high over the next few years, including the funding of infrastructure development for Green Square, potential community and commercial property acquisitions and the purchase of land for future open space. As a result, the maturity profile of the investment portfolio has become more concentrated in the short and medium term rather than the longer term.

As a consequence, the proportion of longer dated floating rate notes in the portfolio is reducing while the proportion of short to medium dated term deposits and floating rate notes are increasing. All of these investments are with APRA regulated financial institutions so that credit risk remains minimal. The maturity profile of the investments is adequately spread over those periods to ensure that liquidity and maturity risks are also kept to a minimum.

The most favourable market for term deposits is mainly with the APRA regulated Australian mid-tier banks with the result that these banks comprise approximately 28% of investment holdings at the time of writing and provide diversity within the portfolio.

### Liquidity / Maturity

The majority of the City's cash and investments portfolio is held as internally restricted and externally restricted cash reserves to satisfy the City's legislative responsibilities and to set aside specific funds for the City's funding commitments to the major initiatives within the

Sustainable Sydney 2030 Community Strategic Plan, including the Green Square Town Centre and sustainable energy projects.

As noted above, expected demands for funding of capital projects and property acquisitions and ongoing uncertainty associated with Covid-19 have resulted in a corresponding shift in the maturity profile of the investment portfolio towards shorter term investment maturities.

To ensure the City has available funds to meet these commitments and its short-term operational and capital cash commitments, the following liquidity targets are set in accordance with the Investment Policy.

| Investment period | Cumulative Minimum % of total portfolio | Maximum % of total portfolio |
| --- | --- | --- |
| 1 month | 10% or $50M | 100% |
| 2 to 12 months | 40% | 80% |
| 1 to 3 Years | 55% | 40% |
| 3 to 5 Years | 90% | 35% |
| > 5 Years | 100% | 10% |

The City's liquidity is monitored on a daily basis to ensure the City's cash requirements are met and that liquidity parameters remain within allowable limits set out in the *Investment Policy*.

**Return / Income**

The City uses the following benchmarks to measure investment performance, in relation to both current month and 12-month rolling returns, against its return/income objectives:

- Bloomberg AusBond Bank Bill Index
- 30 day Bank Bill Rate as published by the Reserve Bank of Australia

The City aims to achieve returns equal to or above these benchmark rates for the period. However, this achievement remains secondary to the critical strategies of maintaining a prudent and conservative risk profile and in meeting the City's liquidity needs.

The City's current cash balances are applied in meeting immediate operational and capital commitments as well as future year's capital commitments. The City over the past few years took the opportunity to invest the funds that are required for future years into long term secure higher yielding investments before the interest rates relating to those investments began to decline. This strategy is one of the main reasons as to why the City currently delivers income returns in excess of the benchmark rates.  However, this gap is continuing to narrow over time as these higher yielding investments mature and new investments are made at the currently offered lower yields.

Since 2015, the City has utilised an additional strategic benchmark rate to measure its investment performance by exceeding the 30 day benchmark returns, by at least 45 additional basis points (0.45% p.a.). The 45 basis point increase is based on observed historical average increased credit spreads (or margins) over bank bill rates on offer in relation to 30–90 day investments.  The 30-90 bank bill rates represented a reflective benchmark at the time of adoption, but this spread has reduced in recent months.

The strategic benchmark rate is an increasingly challenging target, with interest rates anticipated to remain supressed for the foreseeable future, given current economic conditions. The capacity of City staff to invest in a manner that meets liquidity requirements while achieving the “enhanced” benchmark returns (as detailed above) is increasingly limited however the best available returns are actively sought whenever surplus funds are invested.

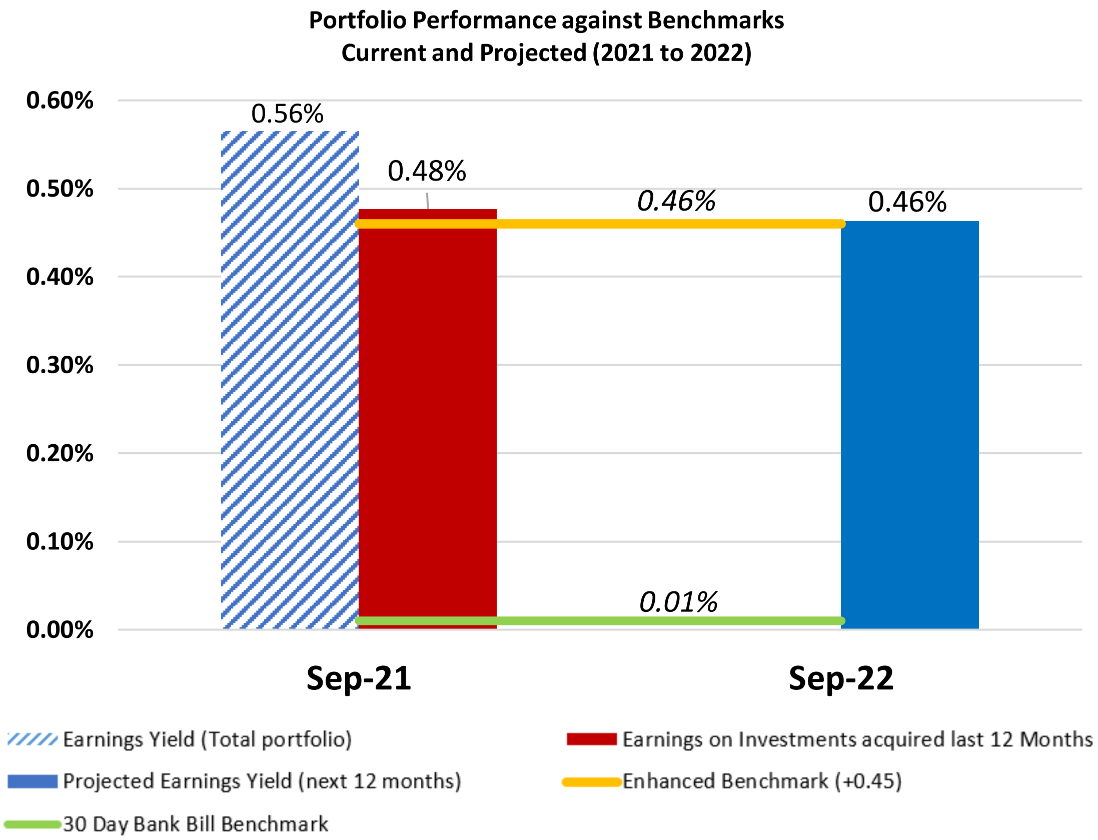
Additionally, 2022 will present continued challenges to the City in delivering higher investment income returns, including the following:

- Interest rates continue to remain at low levels and expectations are that in the medium-term they may remain at these levels.

- A small number of long-term investments that are locked in at higher rates offered in previous years continue to mature. As these funds can now only be reinvested at the current lower yields offered in the market, average earnings will likely continue to fall.

- The City's cash position, whilst reasonably resilient and showing signs of recovery, has been negatively impacted as the economic consequences of the pandemic affect major revenue streams including parking services, commercial property income and timely payment of rates and annual charges, and additional expenditure is incurred as part of Covid-19 community support measures. These factors will continue to affect the City's interest revenue.

The following chart illustrates how earnings yields may potentially be impacted over the coming year as a result of the above factors. The chart assumes the re-investment of maturing deposits at prevailing rates at the time of writing. The narrowing of the gap between actual investment returns and the investment benchmarks is evident. Additionally, the chart also reflects the current lower earnings yield on investments acquired during the last 12 months when interest rates have been at historically low levels.




**Environmentally and Socially Responsible Investments**

The City's ability to acquire environmentally and socially responsible investments within the current investment and policy environment remains limited, as:

- the structure of many of these investments remains prohibited under the current Ministerial Investment Order; and
- the global financial crisis caused significant declines in the valuation of the financial assets that comprise many of these investments.

The City will, however, continue to explore opportunities for supporting environmentally and socially responsible investments within these constraints. The investment climate is changing over time and the City notes that many large scale renewable projects are expected to evolve, which may offer sustainable investment opportunities in the medium to long term. There has been a significant increase in acquiring enviornmentally and socially responsible investments, but the City remains constrained by our own policy and are limited by market condition. The City will continue to encourage and give preference to these investments where they comply with the Ministerial Investment Order and satisfy Council's policy and investment objectives.

## References

| | |
|---|---|
| **Laws and standards** | • Local Government Act 1993<br>• Local Government (General) Regulation 2021<br>• Ministerial Investment Order<br>• Local Government Code of Accounting Practice and Financial Reporting<br>• Australian Accounting Standards<br>• Office of Local Government Circulars |
| **Policies and procedures** | • Investment Policy |

## Approval

## 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. | October 2022 | |