

Item 3.

Investments Held as at 30 June 2022

File No: X020701

Summary

This report provides details of the City's investment portfolio and performance to 30 June 2022.

The City's total Investment and Cash position was \$714.0M at 30 June 2022, with investments earning interest of \$0.8M for the month.

The Covid-19 pandemic has created significant uncertainty in financial markets. The Reserve Bank of Australia (RBA) responded to the crisis by reducing the official cash rate, firstly on 3 March 2020 to 0.50 per cent, again on 20 March 2020 to 0.25 per cent, and then again on 2 November 2020 down to an official cash rate of 0.10 per cent. However, this calendar year inflation has increased significantly, as a combination of global factors and domestic capacity constraints have raised costs and ultimately consumer prices.

Over the 12 months to the March quarter 2022, headline inflation was 5.1 per cent (Sydney 4.4 per cent) and 3.7 per cent in underlying terms. Further rises in inflation are expected in the near term, and the RBA's forecast for 2022 is for headline inflation of close to 6 per cent, and underlying inflation of around 4.75 per cent. In response, the RBA increased the official cash rate to 0.35 per cent on 3 May 2022, 0.85 per cent on 7 June 2022 and on 05 July 2022 the rate was lifted further to 1.35 per cent.

The City's cash inflows have been negatively impacted as the economic consequences of the pandemic continue to reduce major revenue streams, in particular commercial property and parking related income. A greater focus on maintaining adequate liquidity with shorter investment maturities, and an extended period of limited opportunities to invest funds at adequate rates of return, has continued to affect the City's interest revenue.

The majority of the City's cash and investments portfolio is held as internally restricted (\$329.4M) or externally restricted (\$71.8M) 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, infrastructure and community facilities in the Green Square urban renewal area and open space acquisitions. The balance of investment funds represents working capital and funding required for the City's operating and capital expenditure commitments, including the Covid-19 relief grants program.

The City achieved an annualised monthly return of 1.44 per cent for June, which remains above the 30 Day Bank Bill Rate (BBR) of 0.92 per cent, the latest AusBond Bank Bill Index (published by Bloomberg) of 0.60 per cent and the enhanced benchmark of 1.37 per cent (BBR + 0.45 per cent) as endorsed in October 2021 as part of the Investment Strategy.

The City's annual rolling return of 1.17 per cent also continues to exceed the 12 month average 30 Day Bank Bill Rate of 0.12 per cent, the latest AusBond Bank Bill Index of 0.10 per cent and the enhanced benchmark of 0.57 per cent (BBR + 0.45 per cent) as endorsed in the Investment Strategy in October 2021.

It is worth noting that 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. These guidelines were developed, in large part, as a response to the Global Financial Crisis and its impact on the local government sector's investments. They effectively limit the City's investment profile to something similar to a cash managed fund, which generally produce lower returns but provide a high level of security. The City's returns from the investment portfolio remain in line with cash managed funds in the market.

While the current returns remain below longer-term trends, the recent increases to official cash rates have seen improvements in rates of return offered by the market, allowing maturing deposits to be re-invested at higher rates. This trend is anticipated to continue as investments placed during the period of suppressed interest rates reach maturity.

This report includes graphs demonstrating that the City's liquidity profile continues to satisfy the requirements of the Policy, and charts that identify the distribution of the City'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 Bank Bill Rate benchmarks have also been included to provide further insight into the City's total investment portfolio performance.

The structure of the City'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. The Policy and Strategy also maintain the City's commitment to sustainable investments where returns and risks are equivalent, under the environmentally and socially responsible investment criteria.

Recommendation

It is resolved that the Investment Report as at 30 June 2022 be received and noted.

Attachments

Attachment A. Register of Investments and Cash as at 30 June 2022

Attachment B. Investment Performance as at 30 June 2022

Background

1. In accordance with the principles of financial management, cash that is surplus to the City'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 the City's Investment Policy and Strategy.
3. The benchmark performance goal of the City's Investment Policy and Strategy is to surpass the 30 Days Bank Bill Rate (BBR) by 45 basis points while performance also continues to be measured against the Bloomberg AusBond Bank Bill Index.
4. The City's total Investment and Cash position as at 30 June 2022 is \$714.0M, a decrease of approximately \$28.6M from the \$742.6M reported as at 31 May 2022. The monthly movement reflects capital works expenditure and other operational payments for the period in excess of operating income. A schedule detailing all of the City's investments as at the end of June is provided at Attachment A.
5. A substantial portion of the City's cash and investments portfolio is held as internally restricted (\$329.4M) or externally restricted (\$71.8M) 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, infrastructure and community facilities in the Green Square urban renewal area and the acquisition of open space. The balance of investment funds represents working capital and funding required for the City's operating and other capital expenditure commitments.
7. The City achieved an annualised monthly return of 1.44 per cent for June, which remains above the 30 Day Bank Bill Rate (BBR) of 0.92 per cent, the latest AusBond Bank Bill Index (published by Bloomberg) of 0.60 per cent and the enhanced benchmark of 1.37 per cent (BBR + 0.45 per cent) as endorsed in October 2021 as part of the Investment Strategy.
8. The City's annual rolling return of 1.17 per cent also continues to exceed the 12 month average 30 Day Bank Bill Rate of 0.12 per cent, the latest AusBond Bank Bill Index of 0.10 per cent and the enhanced benchmark of 0.57 per cent (BBR + 0.45 per cent) as endorsed in the Investment Strategy in October 2021.
9. While the returns remain significantly below longer-term trends, relative to returns currently available in the equity and property markets, it is worth noting 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. These guidelines were developed, in large part, as a response to the Global Financial Crisis and its impact on the local government sectors investments.
10. These controls effectively limit the City's investment profile to something similar to a cash managed fund, which produces lower returns but provides a high level of security. The City's returns from the investment portfolio are line with cash managed funds in the market.

11. In response to the global Covid-19 pandemic, the Reserve Bank of Australia (RBA) adjusted the official cash rate on 3 March 2020, again on 20 March 2020, and in November 2020 down to 0.10 per cent. However, this calendar year, inflation has increased significantly as a combination of global factors, and domestic capacity constraints have lifted costs and ultimately consumer prices.
12. Over the year to the March quarter, headline inflation was 5.1 per cent (Sydney 4.4 per cent) and 3.7 per cent in underlying terms. At the time of writing the June results are yet to be released. A further rise in inflation is expected in the near term, with the RBA's forecast for headline inflation in 2022 of close to 6 per cent and underlying inflation of around 4.75 per cent. By mid-2024, headline and underlying inflation are forecast to have moderated and returned to the RBA's target range of between 2 to 3 per cent. The forecast reduction assumes that interest rates are gradually increased, and the RBA increased the official cash rate from 0.10 per cent to 0.35 per cent on 3 May 2022, 0.85 per cent on 7 June 2022 and it was lifted further to 1.35 per cent on 5 July 2022.
13. The recent increases to official cash rates have seen improvements in rates of return offered by the market, allowing maturing deposits to be re-invested at higher rates, a trend that is anticipated to continue as investments placed during the period of suppressed interest rates reach maturity.
14. Despite these recent increases, low investment yields are expected to continue to adversely impact the City's portfolio return over the next twelve months as most of the investment portfolio is held in fixed return term deposits. Increased returns will only arise as these investments mature and can be reinvested in products offering higher returns, provided the funds are not required for Council' operations or works programs. Around 75 per cent of the portfolio is due to mature within the coming year, which will allow the City to gradually access the improving returns.
15. The City's cash inflows, whilst reasonably resilient, have been negatively impacted for a prolonged period, as the economic consequences of the pandemic have continued to affect major revenue streams, in particular commercial property and parking related income. A greater focus on maintaining adequate liquidity with shorter investment maturities, and increasingly limited opportunities to invest funds at adequate rates of return, will also continue to affect the City's interest revenue.
16. The report includes graphs depicting that the City's cumulative portfolio returns over and above both the 90 day Bloomberg AusBond, and 30 day Bank Bill Rate benchmarks have also been included to provide further insight into the City's total investment portfolio performance.
17. The structure of the City'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.

Key Implications

Strategic Alignment - Sustainable Sydney 2030-2050 Continuing the Vision

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

Financial Implications

19. The City's investments earned interest of \$0.8M for the month of June 2022, which is above budgeted earnings of \$0.2M, as cash balances have remained higher than anticipated when the budget was prepared.
20. The interest income budget for 2021/22 was substantially reduced from prior years, reflecting the reduced rates environment that was forecast when the budget was set. However, for the financial year to end of June 2022, interest income was \$4.7M and is significantly above the annual budgeted earnings of \$2.2M. The result reflects higher cash balances over the full year, and the higher market rates for the final quarter..

Economic

21. The extent of the local and global economic impact resulting from Covid-19 has created significant uncertainty in financial markets. Many Governments and central banks, including the Australian Government and the Reserve Bank of Australia (RBA), had until recently implemented large scale responses to the economic crisis, including coordinated stimulus measures involving significant increases in government spending and borrowing combined with large scale buying of bonds by central banks.
22. The RBA reduced the official cash rate down to 0.10 per cent on 2 November 2020, and had indicated that this cash rate was unlikely to be lifted until it was confident the economy had recovered sufficiently to lift annual inflation inside its targeted 2 per cent to 3 per cent range. The RBA increased the official cash rate from 0.10 per cent to 0.35 per cent on 3 May 2022, 0.85 per cent on 7 June 2022 and it was lifted further to 1.35 per cent on 5 July 2022.
23. While the capacity for City staff to invest in a manner that meets liquidity requirements, whilst achieving the "enhanced" benchmark returns (as detailed in the Investment Policy) has been limited for some time, the best available returns continue to be actively sought when surplus funds are invested. As noted above, current market indications suggest that improved investment returns are likely in the future.

Relevant Legislation

24. Council is authorised to invest its surplus cash under section 625 of the Local Government Act 1993.
25. The Local Government (General) Regulation 2021 (section 212) requires the City to provide a written monthly report of all monies invested, under section 625 of the Act.
26. The Investment Policy and Strategy was last revised in October 2021, maintaining Council's commitment to give preference to sustainable investments where returns and risks are equivalent to other investments.

27. The City'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 18 October 2021.

Critical Dates / Time Frames

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

Public Consultation

29. Consultation is regularly undertaken with a number of financial institutions and investment advisers to consider options and ensure the City continues to maximise its investment return within appropriate legislative and risk parameters.
30. City staff meet regularly with representatives of each of the 'Big 4' banks and NSW TCorp. At these meetings City staff actively advocate for Socially Responsible Investment (SRI) opportunities.
31. The banks acknowledge the appetite in the market for these products and they continue to investigate the development of suitable products, however it has been challenging to match the level of funds to available Socially Responsible Investment opportunities that meet the credit risk and maturity profile requirements of the City.
32. As noted in previous Investment Reports, Westpac were able to bring a Green Tailored Deposit product to market, which delivers a comparable return while achieving the City's preferred outcomes. The City currently holds \$105M in seventeen tranches with this Green Tailored deposit.
33. The City has also invested a \$10M parcel with the Commonwealth Bank of Australia (CBA) in Environmental Social and Governance Term Deposit (ESGTDs) certified by Responsible Investment Association Australasia (RIAA), whilst also meeting the City's risk / return aims. RIAA is an active network of members engaged in responsible, ethical and impact investing across Australia and New Zealand. Their mission is to 'promote, advocate for and support approaches to responsible investment that align capital with achieving a healthy and sustainable society, environment and economy'. This includes investing in products that seek to mitigate environmental and social risks. ESGTDs provide the opportunity to allocate capital towards financing Sustainability-Linked Loans.
34. The City has also invested \$5M in a Floating Rate Note (FRN) / Sustainability Bond issued by Bank Australia, based on an investment framework that meets the main guidelines for issuance of Green, Social and Sustainability Bonds in the global capital markets. This Socially Responsible investment opportunity met both the credit risk and maturity profile requirement of the City.

BILL CARTER

Chief Financial Officer