

## Review of the Investment Policy and Strategy

File No: X020701

### Summary

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

The Policy and Strategy are reviewed annually, as a minimum, to ensure they remain appropriate and respond to changes in 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 aims to continue to outperform 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 (SRI) 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 and the City now holds over \$100M in explicitly SRI investments.

The City has developed good relationships with its financial institutions, partnered with them to help launch new products and continued to meet regularly with them to advocate for new investment vehicles and products that will achieve our desire to increase our commitments to social and responsible investment.

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

The key objectives of the current Investment Strategy remain valid for the challenging economic and investment environment brought on by the Covid-19 pandemic and conform to the current legislative requirements. The Strategy remains unchanged as it presently meets liquidity requirements for Council's ongoing capital works program, the objectives for investment performance and continues to prudently manage credit risk.

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 funds, as shown in Attachments A and B to the subject report.

## **Attachments**

**Attachment A.** 2022/23 Investment Policy

**Attachment B.** 2022/23 Investment Strategy

## 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 1993, 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 2021 (NSW).
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 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.
10. 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.
11. 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. Currently, the City has invested \$105 million in this Westpac product.
12. 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.
13. 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.

14. The key objectives of the current Investment Strategy remain valid for the challenging economic and investment environment brought on by the Covid-19 pandemic. The Strategy remains unchanged, aside from some minor administrative adjustments, as it presently meets liquidity requirements for Council's ongoing capital works program, the objectives for investment performance and continues to prudently manage credit risk. Sections of the Investment Strategy that detail the current investment portfolio and its performance were amended to reflect the present results.
15. The proposed Investment Policy and Strategy continue to satisfy the compliance requirements of the Ministerial Investment Order.
16. 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**

17. 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 Financial Implications.

### **Financial Implications**

18. Investment returns over the past five years have gradually reduced, reflecting lower interest rates in the past three years due to Covid-19 impact, and the more limited investment opportunities now available under the Ministerial Investment Order, Investment Policy and Investment Strategy.
19. Inflation in Australia is the highest it has been since the early 1990s. Inflation was 6.1 per cent over the year to the June 2022 quarter; in underlying terms it was 4.9 per cent. Global factors explain much of the increase in inflation, but domestic factors are also playing a role. There are widespread upward pressures on prices from strong demand, a tight labour market and capacity constraints in some sectors of the economy along with recent weather events.
20. In response, the Reserve Bank of Australia (RBA) increased the official cash rate to 0.35 per cent on 3 May 2022, 0.85 per cent on 7 June 2022, 1.35 per cent on 5 July 2022 and on 2 August 2022 the rate was lifted further to 1.85 per cent. The RBA cash rate was further increased to 2.35 per cent on 6 September 2022. The financial markets are expecting that the RBA will continue to increase cash rate over the medium term which will assist in improving the City's investment returns in the current financial year.
21. The City's cash balances, and resultant investment returns, are subject to cash flows and achievement of the planned capital program. While the returns remain below longer-term trends, the recent increases to official cash rates have seen improvements in rates of return offered by the market which will allow future maturing deposits and surplus funds to be re-invested at higher rates. This trend is anticipated to continue beyond the current financial year.
22. In 2021/22 the City earned \$4.6M on its financial investments. As a result of the changed interest rate environment, the City is forecasting to achieve \$15.0M in interest earnings for 2022/23, which is approaching pre pandemic levels.

**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 2021 (Clause 212) requires the City 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.

**BILL CARTER**

Chief Financial Officer