Attachment B

2022/23 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 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. 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.

Inflation in Australia is at its highest level since the early 1990s. Inflation was 6.1 per cent over the year to the June quarter; in underlying terms it was 4.9 per cent. Global factors explain much of this increase, 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

In response, the RBA increased the official cash rate to 0.35 per cent on 3 May 2022. Rates were further increased by 0.5 per cent at each of the next four RBA monthly board meetings, to 2.35 per cent on 6 September 2022. Additional increases have been foreshadowed by the RBA governor.The City's returns from the investment portfolio are in line with cash managed funds in the market. 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 and are re-invested.

While the returns have remained below longer-term trends, relative to returns recently 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. They 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.

In Australia, a history of judicious 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 the City'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 August 2022):

Investment	Split
Big Four banks	75%
Australian mid-tier banks	23%
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 an expansive capital works program, 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 23% 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 Delivering Sustainable Sydney 2030-2050 Community Strategic Plan.

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.

In addition, 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.

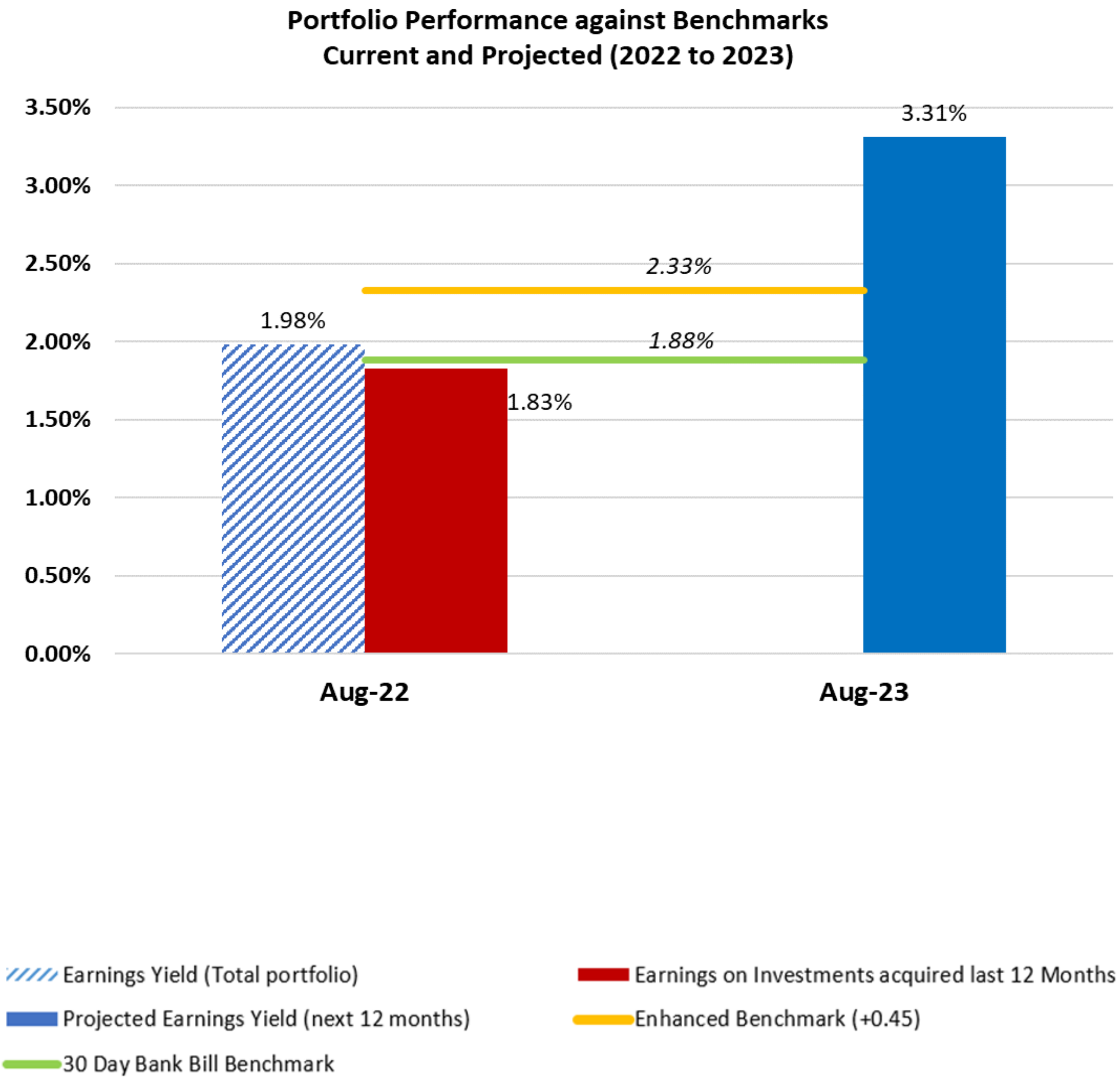
The City's current cash balances are applied in meeting immediate operational and capital commitments as well as future year's capital commitments. It is anticipated that 2022/23 will present new opportunities to the City in delivering higher investment income returns, including the following:

- 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.

- A number of short-term investments that were locked in at prevailing (lower) rates of return during the Covid-19 pandemic period are yet to mature. While available rates for reinvestment have significantly increased since March 2022, the higher yields will not be fully reflected in average portfolio returns until the maturity of these legacy deposits.

- The City's cash position has remained reasonably resilient throughout the Covid-19 pandemic. However, a number of major revenue streams including parking services and commercial property income remain at risk.

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 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.



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
- excess demand for environmentally and socially responsible investments has reduced market rates of return on these products.

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 environmentally 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 • Local Government (General) Regulation 2021 • Ministerial Investment Order • Local Government Code of Accounting Practice and Financial Reporting • Australian Accounting Standards • 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	