

Attachment B

Investment Strategy 2023/24

Investment Strategy

Purpose

The annual Investment Strategy (“the Strategy”) sets out the City of Sydney’s (“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 requirements are met 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 annual inflation rate in Australia was 6.0 per cent as at June 2023, down slightly from a high of 7.8 per cent as at December 2022. While global factors explain much of the increase in inflation, domestic factors also play 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.

In response, the RBA responded with 13 consecutive interest rate increases. The current official cash rate is now 4.10 per cent up from the record low 0.10 per cent level in May 2022. At the July, August and September RBA Board meetings official interest rates were held steady, however, further increases have been foreshadowed in an attempt to curb inflation

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.

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.

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 2023):

Investment	Split
Big Four banks	67%
Australian mid-tier banks	23%
Australian government treasury bodies	1%
Foreign controlled Australian based ADIs	9%
Total	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, ensure adequate 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 coming 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 generally become more concentrated in the short and medium term rather than the longer term. 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. All of these investments are held with APRA regulated financial institutions so that credit risk likewise remains minimal.

The most favourable market for term deposits is often with APRA regulated Australian mid-tier banks. Accordingly, investments with these banks comprise approximately 23% of the City's total holdings at the time of writing and provide diversity within the portfolio.

Liquidity / Maturity

A significant portion 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.

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
1 month	10% or \$50M <i>(the greater of)</i>
2 to 12 months	40%
1 to 3 Years	55%
3 to 5 Years	90%
> 5 Years	100%

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

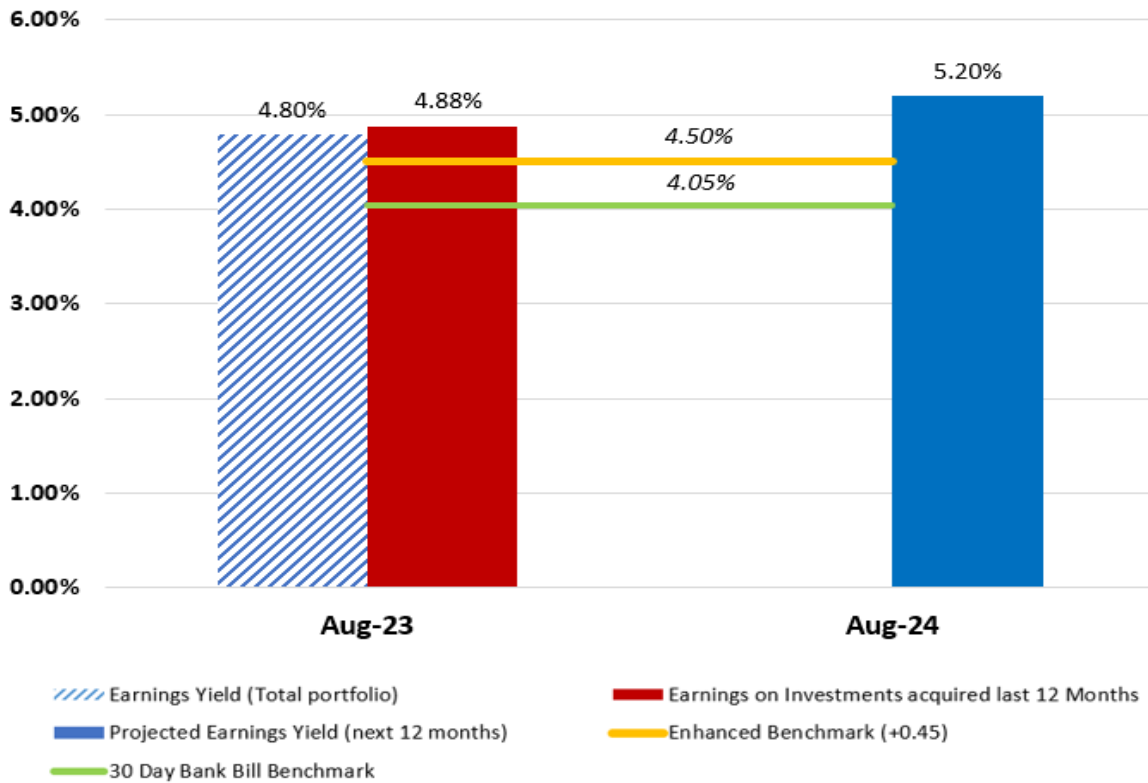
The City aims to achieve portfolio returns equal to or above these benchmark rates for the period. However, this achievement remains secondary to the critical strategies of maintaining a prudent and conservative risk profile and in meeting the City’s liquidity needs. This includes immediate operational and capital commitments as well as future years’ capital commitments.

In addition, the City has utilised an additional strategic benchmark rate to measure its investment performance - 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 returns from the investment portfolio are in line with cash managed funds in the market. 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. As at August 2023 around 74 per cent of the portfolio, including at call account, is due to mature in the coming year and the City will be able to take advantage of improving returns.

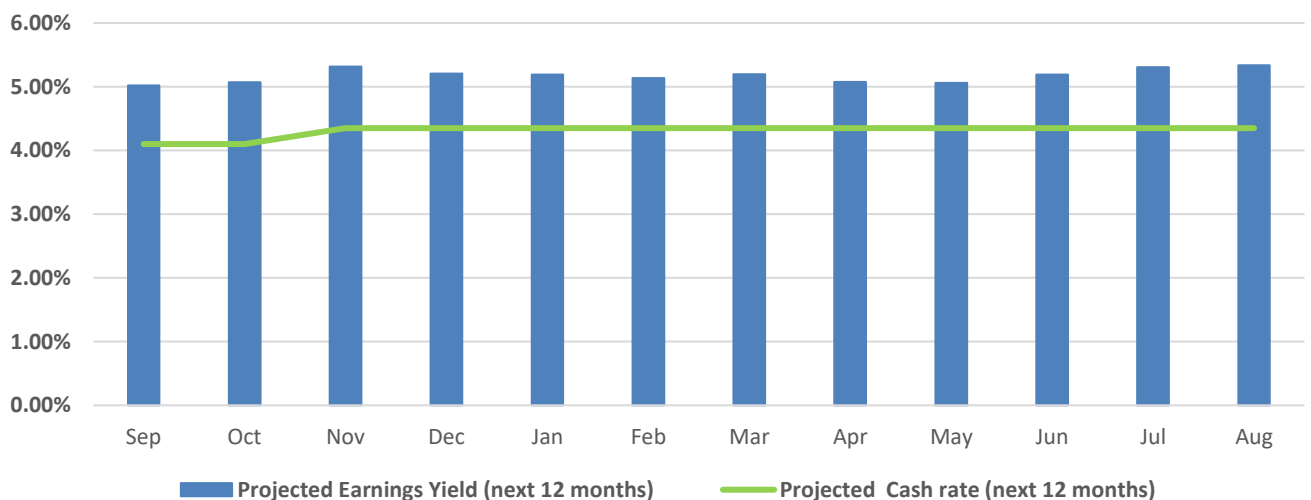
The following chart illustrates how earnings yields may potentially be impacted over the coming year as a result of the above factors. The chart assumes the re-investment of maturing deposits at prevailing rates at the time of writing. The recent increases to official cash rates have seen improvements in rates of return offered by the market which will allow future maturing deposits and surplus funds to be re-invested at higher rates.

**Portfolio Performance against Benchmarks
Current and Projected (2023 to 2024)**



This trend is anticipated to continue beyond the current financial year which is represented in the chart below. The below chart represents a correlation between cash rate increases and projected earnings yield for the next 12 months.

Portfolio Benchmarks Projected Cash Rate and Earnings (Sep 2023 to Aug 2024)



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 result in additional sustainable investment offers in the medium to long term. The City has been active in acquiring environmentally and socially responsible investments, but opportunities to invest further are constrained by market conditions, particularly the credit rating of investments and associated investment limits under the City’s Investment Policy. 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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 2023	