

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 funds, 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, like 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 an increasingly volatile world, it should be noted that the investment policy continues to contain provisions that encourage environmentally and socially responsible investments (SRI) and seek to avoid investments in environmentally and socially harmful activities.

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 legislative requirements. 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.

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 allowing 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. 2024/25 Investment Policy

Attachment B. 2024/25 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 may 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 post 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 also includes APRA-regulated A+ to A rated bank investments together with a handful of investment-grade A- to 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. Investments will continue to be avoided in institutions that undertake socially harmful activities including the abuse of human rights and labour rights and the sale of armaments.

9. 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.
10. There are only minor administrative changes including revising the language of the definitions and formatting updates that were incorporated to the policy. The amendments above do not change the overall intent of the Policy but clarifying the City's intent and simplify the administration of the policy.
11. 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.
12. 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 \$80 million in this Westpac product type.
13. The City currently holds \$5M in a sustainability bond/floating rate note (FRN) with Bank Australia due to mature on 24 November 2025 and an additional \$4.5M invested in February 2023 due to mature on 22 February 2027. This is based on an investment framework that is in line with the 2021 versions of the ICMA Green Bond Principles (GBP), Social Bond Principles (SBP) and Sustainability Bond Guidelines (SBG). This Socially Responsible investment opportunity meets both the credit risk and maturity profile requirement of the City.
14. The key objectives of the current Investment Strategy remain valid for the present economic, investment and legislative environments. The Strategy remains unchanged, aside from some minor administrative adjustments, as it presently meets liquidity requirements for Council's ongoing capital works program, 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. 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.
19. Annual CPI inflation was 2.8% in the September quarter, significantly down from 3.8% in the June quarter. This is the lowest annual inflation rate since the March 2021 quarter. Even though the inflation has fallen within the target range of 2% to 3%, economic forecasters remain concerned the decline may only be temporary. While global factors explain much of the variation in inflation, domestic factors also continue to play a role. Widespread upward pressures on prices remain in the economy due to strong demand, a tight labour market and capacity constraints in some sectors of the economy.
20. The Reserve Bank of Australia (RBA) board last raised the official cash rate on 7 November 2023, by 25 basis points to 4.35% a 12-year high, up from the record low of 0.10% level in May 2022. While inflation is declining, economic analysts note that the decline has been slower than anticipated, increasing the possibility of a further cash rate rise. However, the general expectation of majority of the banks is that official rates will remain on hold until late this calendar year with potential for rate cuts to follow, provided that the declining inflation trend continues.
21. The City's returns from the investment portfolio are in line with cash managed funds in the market. Past increases to official cash rates have seen improvements in rates of return offered by the market. However, in August 2024 banks began reducing term deposit rates in anticipation of a cash rate cut from the Reserve Bank of Australia, which is expected to occur early in the 2025 calendar year.
22. Annual interest earnings for the 2023/24 financial year were \$38.9M. The annual interest budget for the 2024/25 financial year is \$35.0M.

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 (section 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.

SCOTT MCGILL

Acting Chief Financial Officer