



March

Investment
Strategy

2023

Investment Strategy

Purpose

The annual Investment Strategy sets out Council's investment goals and targets for the coming year. The aim of the strategy is to guide the management of Council's investment portfolio over the short to medium term to:

- achieve a balanced and diversified portfolio, in terms of allowable investment products, credit ratings and maturation terms that will outperform the benchmark indices; and
- ensure liquidity when required for Council's operational and capital expenditure needs.

This strategy has been prepared in consultation with Laminar Capital Pty Ltd.

Scope

The *Investment Strategy* applies to all managers and employees who actively manage investments or have responsibility for employees who actively manage investments.

This strategy should be read in conjunction with Council's *Investment Policy*.

Effective Date

This document replaces any previous Strategy document approved by Council.

The effective date of this Strategy is 23 March 2023 and will be reviewed in March each year or when a change in either regulation or market conditions necessitates a review.

Context

Council'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 global economy is showing signs of recovery from the impact of the Covid-19 pandemic. Interest rates remained low throughout 2021 and the beginning of 2022 to provide a supportive environment for investment, however inflation concerns as well as supply chain

issues exacerbated by the Ukraine War have caused central banks to begin raising interest rates from all-time lows.

Bond, credit and share markets fell in December 2022 amid concerns that central banks may need to underpin higher interest rates for longer to return inflation to their targets. A longer period of higher interest rates would increase the already high risk of a global recession developing through 2023.

Australia and New Zealand have been notable exceptions on the inflation front compared to Europe and the US, where annual rates are still rising and are still coming in higher than expected. Even where annual inflation is receding, the growing optimism about the economic outlook may prove to be premature if central banks stick to their guidance of doing “all that it takes” to get inflation down to their targets.

Labour markets are still exceptionally tight almost everywhere. Annual wage growth is running, or threatening to run, at rates that will not allow inflation to come down to target consistently over the next few years. Central banks will need to see some easing of tight labour market conditions before they can end rate hikes.

The RBA lifted the cash rate by 25bps to 3.10% at its early December 2022 policy meeting and indicated more rate hikes would occur over coming months while the RBA assess economic readings. The economic data released during December 2022 and January 2023 show continuing strong spending other than on housing.

In terms of the yield curve, with central banks regularly hiking official rates, adding to risk of a weaker economic growth outlook, the upward pressure remaining on bond yields in the current cycle is likely to be more pronounced on shorter-term bond yields rather than longer-term bond yields. More rate hikes heighten the risk of recession in 2023 and notwithstanding recent yield curve steepening on more positive economic news that implies the yield curve moves towards flat shape and eventually inverse for a period.

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 and at-call deposits with Approved Deposit-taking Institutions (ADIs);
- other ADI senior ranked securities;
- investments with NSW Treasury Corporation including their investment management division (TCorp and TCorpIM);
- funds or securities issued or guaranteed by the Commonwealth or any State or Territory.

Composition of Council's investment portfolio

The conservative nature of Council's Investment Strategy is clearly reflected in the structure of the portfolio, where 94.42% of the portfolio is invested with Australian Prudential Regulation Authority (APRA) - regulated ADIs and 5.58% of the portfolio is invested in Northern Territory Government Bonds.

Council's current portfolio is as follows (as at the end of January 2023)

Investment	Split
Big Four banks	21.67%
Australian mid-tier banks	63.05%
Foreign controlled Australian based ADIs	8.84%
Unrated – Local ADI	0.86%
Total APRA-regulated ADIs	94.42%
Northern Territory Government Bonds	5.58%
Total Investment Composition	100.00%

Investment strategy

Council's investment portfolio will continue to be prudently managed in accordance with:

- Council's *Investment Policy* and related legislative and regulatory requirements;
- documented risk management procedures to preserve capital; and
- Council's operational and capital funding requirements.

Objectives

Council'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.

Risk profile

The risk profile for Council'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.

Current investments are with APRA regulated financial institutions and Northern Territory Government Bonds so that credit risk remains minimal.

The maturity profile of the investments is adequately spread to ensure that liquidity and maturity risks are also kept to a minimum.

Securities are highly liquid and Council makes full use of this rather than holding at-call money. Council has historically held Floating Rate Notices (FRNs) to maturity, but is increasingly seeking to optimise the entry and exit points for these types of investments.

Liquidity / Maturity

The majority of Council’s cash and investments portfolio is held as restricted reserves to satisfy legislative responsibilities and funding commitments contained within the *Dubbo 2040 Community Strategic Plan*.

To ensure Council has available funds to meet these short-term commitments, the following liquidity targets are set in accordance with the *Investment Policy*.

Investment Horizon Description	Investment Horizon - Maturity Date	Minimum Allocation	Maximum Allocation
Working capital funds	0-3 months	10%	100%
Short term funds	3-12 months	20%	100%
Short-Medium term funds	1-2 years	0%	70%
Medium term funds	2-5 years	0%	50%
Long term funds	5-10 years	0%	25%

Council’s capital funding requirements will continue to increase over the next few years. Major capital expenditures in 2023 are anticipated to be approximately \$80 million.

Projects are being funded from either grants or restricted assets and impact the overall cash available for investment. The maturity profile of the investment portfolio has become more concentrated in the short and medium term rather than the longer term.

Council’s liquidity will be monitored on an ongoing basis to ensure cash requirements are met and that liquidity parameters remain within allowable limits set out in the *Investment Policy*.

The Strategy

Investments are to be placed with the advantageous rate to Council and within the limits as set in the tables included in the *Investment Policy* and the Investment Strategy as listed below;

- Investment Policy - Performance Benchmark Table
- Investment Policy - Credit Rating Structure and Tenor Limits
- Investment Strategy – Investment Horizon Description

To maximise performance, the intention is to pursue the following actions during this strategy period;

- Maintain to slightly reduce current cash holdings due to changes to cash rate forecasts from static to rising significantly.

- Increase fixed term deposits past 12 months as comparable term deposit rates have begun to improve.
- Take advantage of longer tenor specials available up to a maximum of 2 to 3 years unless an advantageous rate is available.
- Take advantage of special rates being offered by banks such as Bank of Sydney, Australian Unity bank, BankVic and Auswide bank.
- Identify opportunity in Regional Covered Bonds and Floating Rate Notes.
- Purchase secondary market FRNs where investment can be optimised reducing the liquidity risk and interest rate risk while having no impact on credit risk of the portfolio
- Maintain a well-structured portfolio with a mix of maturities laddered across tenors.
- Maintain longer term investment mix where FRN's represent 30% (currently 17.91 %) is deemed appropriate.

Environmentally and Socially Responsible Investments

Council'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
- the global financial crisis caused significant declines in the valuation of the financial assets that comprise many of these investments.

Council will, however, continue to explore opportunities for supporting environmentally and socially responsible investments within these constraints. The investment climate is changing over time and Council notes that many large scale renewable projects are expected to evolve, which may offer sustainable investment opportunities in the future *via* co-investments. Council 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