

DUBBO REGIONAL COUNCIL
INVESTMENT STRATEGY

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
- ensure liquidity when required for Council's operational and capital expenditure needs.

This strategy has been prepared in consultation with Andrew Vallner, Managing Director at CPG Research & Advisory.

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*.

Effective Date

This document replaces any previous Strategy document approved by Council. The effective date of this Strategy is 11 March 2019 and will be reviewed annually 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

Financial and investment environments, both globally and domestically, continue to improve at different rates across various regions. The global financial recovery process has been aided by a more standardised international regulatory process with more stringent capital adequacy requirements for financial institutions.

In Australia, a history of prudential regulation of the financial institutions by the Australian Prudential Regulation Authority (APRA) and the prior regulation by the Reserve Bank of Australia (RBA) has meant that Australian based regulated financial institutions have already operated for an extended period under stringent capital adequacy and liquidity requirements. Council's investments all fall under APRA regulation with the result that the portfolio is conservative and secure.

Interest rates have remained low - while they have normalised in the US in 2018, the market expects further record lows in Australia.

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 100% of the portfolio is invested with APRA-regulated ADIs.

Council's current portfolio is as follows (as at the end of February 2019):

Investment	Split
Big Four banks	78%
Australian mid-tier banks	22%
Foreign controlled Australian based ADIs	0%
Total APRA-regulated ADIs	100%

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 the 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.

Council's capital funding requirements will continue to increase over the next few years, with Council anticipates the following major capital expenditure in 2019:

- Community & Recreation \$33M
- Airport \$22M
- Stormwater \$4M
- Water Augmentation & Asset Renewal \$6M
- Sewage Augmentation & Asset Renewal \$8M
- Road Network \$19M
- Property Development 4M
- Fire and Emergency \$2M

These projects are being funded from either grants or restricted assets and impact on the overall cash available for investment. As a result, the maturity profile of the investment portfolio has become more concentrated in the short and medium 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.

Liquidity / Maturity

The majority of Council's cash and investments portfolio is held as internally restricted and externally restricted cash reserves to satisfy the Council's legislative responsibilities and to set

aside specific funds for Council’s funding commitments to the major initiatives within the Dubbo 2040 Community Strategic Plan.

There are presently increased demands for funding of capital projects with the result that within the maturity profile of the investment portfolio there is a responsive shift of funds from the longer term to the short and medium terms. This could also be accommodated by a transition to a liquid securities portfolio.

To ensure Council has available funds to meet both these commitments and its short-term operational and capital cash 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 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*. Horizons reflect legal maturity, or such other expected holding period as adopted in a *Strategy*.

Return / Income

The Strategy throughout the past few years has been to prioritise long-dated deposits ahead of significant cuts to interest rates. This was justified by further RBA rate cuts over 2015 and 2016. Interest rates have now been stable for a record 30 months. Council’s duration has carried interest receipts through this period, and the cash portfolio earns around twice the official rate.

Income risk has been mitigated at no cost - indeed, the higher yields available from long-dated deposits have been an added benefit to returns. It is no longer clear that this will be true in future. Long duration deposits are unlikely to produce less than benchmark given the ~1% additional spread, but the yield curve is now inverse and already factoring in new rate cuts.

Currently, credit rating is no longer a portfolio stress. Downgrades of two major issuers to BBB by S&P and Moody’s created temporary overweights. Council’s current allocation in that space increased initially, but maturities and portfolio growth have addressed that comfortably. If anything, rating outlook may be positive due to the upgrade in Australia’s sovereign Outlook, as well as proposed capital raisings.

As at February, Council’s deposits yielded 2.98% p.a., an excellent result – this is consistent with much longer maturity profiles, and lower credit quality in today’s market. It is around as high as any deposit of any term now available.

To maximise performance, the intention is to pursue the following actions during this strategy period (subject to conditions broadly outlined in this document).

New Investments

- **Ratings:** Are less of a priority, as Council now has the most capacity for some years. This is best directed to FRNs paying above benchmark +100bp at shorter durations.
- **Cash:** Sourcing high yielding at-call accounts or cash notice accounts, checked against existing accounts or fixed rates. At time of writing, a spike in the bank bill rate has seen higher notice account yields.
- **Deposits:** Short-term investments (3-12 months) will most likely continue to be invested into fixed term deposits. Some A or AA banks offer rates that appear attractive relative to interest rate outlook at the shorter terms and broker specials can assist with securing retail pricing.
- **Floating Rate Notes:** For additional funds excess to liquidity requirements medium-term (3-5 years) liquid FRNs going forward. Council will work towards maintaining a portion of investments in the medium-term allocation, primarily FRNs in the near term.

The ability to transact quickly is important for new issues. To support this, Council has the ability to utilise existing at-call reserves (to be replenished from subsequent deposit maturities).

Environmentally and Socially Responsible Investments

Council will continue to explore opportunities for supporting environmentally and socially responsible 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 2004
- 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