10.2. Investment and Loan Borrowings Report as at 28 February 2023

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ATTACHMENTS:
1. North Sydney Monthly Investment Report February 2023 [**10.2.1** - 22 pages]

PURPOSE:

This report provides details of the performance of Council's investment portfolio and borrowing limits for the period ending 28 February 2023.

EXECUTIVE SUMMARY:

Investment Portfolio

Independent advice regarding North Sydney Council's Investments is provided by Imperium Markets. This provides a layer of governance and expert advice in addition to Council's policy and procedures.

The Investment Portfolio (excluding cash balances) held for the period ending 28 February 2023 had a market value of $141,400,165. The annualised returns were 2.61%.

Cash deposits at call were $10,913,041, with $7,200,000 of these held in interest bearing at-call accounts. $3,713,041 cash is held in Council's interest-bearing transaction account with the Commonwealth Bank to meet day-to-day operational needs. This amount includes third instalment rates deposits that were due on 28 February 2023 and settled after close of business.

The investment portfolio is managed to ensure adequate liquidity to meet operational requirements, and to fund outflows on major projects. Cashflow is monitored and assessed on an on-going basis.

Actual year-to-date returns for cash and investments to 28 February 2023 are $2,186,000, compared to a revised year-to-date budget of $1,862,000.

The Reserve Bank of Australia (RBA) Board increased its cash rate by 25 basis points to 3.35%. The RBA continues to signal two or three more 25 basis point increases are likely in the coming months.

Borrowings

Loan Facility for Council Projects

Council entered into a fixed interest loan of $9.5 million with quarterly interest and principal payments on 31 July 2018. The principal outstanding as at 28 February 2023 is $5,691,792.

North Sydney Olympic Pool Redevelopment (NSOP)

In February 2022 Council established a $31 million TCorp loan facility to partially fund the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 28 April 2022, with an interest rate of 4.24%. The funds were restricted and will be released as required to fund cash outflows. The principal outstanding as at 28 February 2023 is $30,499,987.

FINANCIAL IMPLICATIONS:

Council's total investment portfolio performance for the financial year to date is 2.61% annualised. The actual year to date returns for cash and investments to 28 February 2023 were $2,186,000, compared to a revised year-to-date budget of $1,862,000.

RECOMMENDATION:

1.THAT the report on Investments and Loan Borrowings held on 28 February 2023, prepared in accordance with clause 212 of the Local Government (General) Regulation 2021, be received.

LINK TO COMMUNITY STRATEGIC PLAN

The relationship with the Community Strategic Plan is as follows:

5. Our Civic Leadership
5.1 Lead North Sydney's strategic direction
5.2 Council is well governed, and customer focused

BACKGROUND

The Responsible Accounting Officer must provide Council with a monthly report detailing all funds:

a. Invested under Section 625 of the Local Government Act 1993. This report must include certification that the investments have been made in accordance with the Act and the Regulations made thereunder, the revised Investment Order issued by the Minister for Local Government and Council's Financial Investment Policy.
b. Borrowed under Section 624 of the Local Government Act. This report must comply with the borrowings Order issued by the Minister for Local Government and Council's Debt Management Policy.

CONSULTATION REQUIREMENTS

Community engagement is not required.

DETAIL

Investment Portfolio

The following table provides details of the performance of Council's investment portfolio (excluding cash deposits) against the benchmark for the month of February 2023 and annualised for the year-to-date 28 February 2023 (including investments that have matured prior to 28 February 2023).

	February 2023	Annualised YTD as at 28 February 2023
Actual Return	0.20%	2.61%
Benchmark	0.24%	3.18%
Variance	-0.04%	-0.57%

The portfolio underperformance as compared to the benchmark is due to recent sharp rises in the RBA official cash rate and long-term investments placed when inflation expectations were low, before those increases were made. Council's investment advisor, as per the attached report, expects this relative underperformance to be temporary. The report further notes that North Sydney Council's deposits portfolio ranks among the best performing when compared to other NSW councils.

Asset Type	Market Value as at 28 February 2023	Portfolio Breakdown as at 28 February 2023
Term Deposits	$129,750,000	85.19%
Cash	$10,913,041	7.16%
Fixed Bonds	$9,000,000	5.91%
Floating Rate Notes (FRNs)	$2,650,165	1.74%
	$152,313,206	**100.00%**

Council's average duration of term deposits, which comprise 85.19% of the investment portfolio, was approximately 347 days as at 28 February 2023.

All funds have been invested in accordance with the Act and the Regulations made thereunder. Council's investment portfolio complies with the revised Investment Order issued by the Minister for Local Government, which places restrictions on the type of investments permitted. Funds used also comply with the credit quality conditions contained in Council's loan agreement with TCorp.

Council continues to seek independent advice for investments and is actively managing the portfolio to ensure that returns are maximised, considering diversification and risk. A complete analysis of the performance is covered in the Monthly Investment Report (Attachment 1) prepared by Council's investment advisor Imperium Markets. The report contains advice about optimal investment options but also notes that Council's scope to act on that advice is limited by its cash flow requirements. Council has considerable requirements for short term investments to fund its ambitious Capital Works budget ($95 million for 2022/23).

Council's Investment Policy and the contractual requirements of the loan agreement with TCorp are biased towards major and large institutions. This limits the scope to invest in regional institutions. The loan agreement with TCorp prohibits investing with non-rated institutions. Staff monitor rates available from rated regional institutions (as advised by Imperium) but finds that major and large institutions consistently outperform them in the shorter terms that we currently require. One term deposit of $5,000,000 was placed with the BBB+ rated regional, Bendigo and Adelaide Bank, in February. It was found to have the superior quote on the day the deposit was placed. Council's investment advisor on page seven of the attached report notes an emerging trend towards the "normal" pre-pandemic marketplace in which regional banks offer more competitive rates than majors.

The actual investment returns for the year-to-date 28 February 2023 have been reviewed and are $324,000 more than the revised year-to-date budgeted estimate. This result is driven by higher-than-forecast interest rates, and a higher-than-expected cash balance due to (i) delays to capital projects caused by wet weather and (ii) Covid lockdowns in the 2021/22 Financial Year.

Summary of Returns from Investments (includes Fair Value adjustments)

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (February)	YTD/ Annual Actual (February)	YTD/Annual Actual FV adjustments (February)	YTD Budget to Actual Variance (February)
2022/23	**$1,290,000**	**$2,790,000**	**$1,862,000**	**$2,178,000**	**$8,000**	**$324,000**
2021/22	$1,100,000	$1,300,000		$1,244,337	-$64,865	$1,179,472
2020/21	$1,350,000	$1,350,000		$1,222,664	$93,735	-$33,601
2019/20	$1,350,000	$1,529,055		$1,896,660	-$4,944	$362,661

Floating Rate Notes (FRN's) are required to be revalued each month using the Fair Value (FV) method which is an estimate in time of the potential market value of the investment. As of 28 February 2023, the YTD movement of FRN's has been an increase of $8,000.

Financial Investment Policy

As at the end of February, all categories were within the Policy limits for credit ratings and the portfolio remains well diversified, with all asset credit quality classified as BBB or higher. The maximum holding limit in each rating category and the target credit quality weighting for Council's portfolio are as per the following table:

Long Term Rating Range (Standard & Poors)	Invested as of 28 February 2023	Maximum Policy Holding	Distribution as of 28 February 2023
AA Category	$100,663,041	100.00%	66.09%
A Category	$33,250,892	60.00%	21.83%
BBB Category	$18,399,273	35.00%	12.08%
Unrated ADIs (NR)	$0	10.00%	0.00%

Credit Quality Limits in TCorp Loan Agreement

The TCorp Loan Agreement imposes credit quality limits additional to Council's Financial Investment Policy. In cases where the loan agreement imposes a credit quality limit more conservative than the Financial Investment Policy, Council's contractual obligations will prevail and the more conservative limit will be applied. The maximum holding limit in each rating category and the target credit quality weighting for Council's portfolio are as per the following table:

Long Term Rating Range (Standard and Poors/Moody's)	Invested as at 28 February 2023	Maximum Holding Allowed	Distribution as at 28 February 2023
AA+ to AA-/Aa1 to Aa3 Category	$100,663,041	100%	66.09%
A+ to A/A1 to A2 Category	$33,250,892	100%	21.83%
A-/A3 Category	$0	40%	0.00%
BBB+/Baa1 Category	$15,000,000	20%	9.85%
BBB/Baa2 Category	$3,399,273	10%	2.23%
BBB-/Baa3 Category	$0	5%	0.00%
Unrated	$0	0%	0.00%

The maximum counterparty limits and the target allowed limit are as per the following table:

Institution	Long Term Rating Range (Standard and Poors/Moody's)	Invested as at 28 February 2023	Maximum Holding Allowed	Distribution as at 28 February 2023
AMP Bank Ltd	BBB/Baa2 Category	$2,000,000	5%	1.31%
Bendigo and Adelaide Bank Ltd	BBB+/Baa1 Category	$5,000,000	10%	3.28%
BOQ Ltd	BBB+/Baa1 Category	$10,000,000	10%	6.57%
Commonwealth Bank of Australia	AA+ to AA-/Aa1 to Aa3 Category	$41,413,041	100%	27.19%
ICBC Sydney Branch	A+ to A/A1 to A2 Category	$17,000,000	100%	11.16%
NAB Ltd	AA+ to AA-/Aa1 to Aa3 Category	$29,000,000	100%	19.04%
Newcastle Permanent	BBB/Baa2 Category	$1,399,273	5%	0.92%
Northern Territory Treasury	AA+ to AA-/Aa1 to Aa3 Category	$9,000,000	100%	5.91%
Suncorp Bank Ltd	A+ to A/A1 to A2 Category	$16,250,892	100%	10.67%
Westpac Bank Ltd	AA+ to AA-/Aa1 to Aa3 Category	$21,250,000	100%	13.95%

Loan Borrowings

Council's Loan Borrowing Policy provides the framework for Council's borrowing activities and defines key responsibilities and the operating parameters within which borrowing and related risk management activities are carried out.

The Policy's objective is to control Council's exposure to movements in interest rates through the application of fixed, floating or a combination thereof to maintain its risk averse strategy.

Loan borrowings are undertaken in line with the following principles:

a) That the capital cost of infrastructure be recognised over the period during which the benefits will be enjoyed.
b) That loan funds are a resource to fund the replacement and upgrading of existing infrastructure and fund the creation of new infrastructure.
c) That loan funds will be limited to:
    - acquisition or enhancement of income producing assets;
    - construction and/or upgrading of buildings; and
    - infrastructure assets that have a life expectancy of greater than 10 years.

Council has two debt facilities:

Alexander Street Carpark and On-street Carparking Management System Loan

This is a fixed loan financing option, fully amortising the drawn down amount of $9,500,000 over 10 years, fixed interest rate with quarterly repayments of interest and principal.

The loan details are:

Loan amount:	$ 9,500,000.00			
Loan term:	10 years			
From:	31/07/2018			
To:	31/07/2028			
Interest rate:	4.02%p.a.(fixed)			
Repayment:	Quarterly			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
1/07/2022	$6,373,191.95			
29/07/2022	$6,147,427.51	$63,875.10	$225,764.44	$ 289,639.54
28/10/2022	$5,921,431.53	$63,643.56	$225,995.98	$ 289,639.54
27/01/2023	$5,691,791.50	$59,999.51	$229,640.03	$ 289,639.54
28/04/2023	$5,456,690.24	$54,538.28	$235,101.26	$ 289,639.54

Loan Funded Capital Projects

Project 1: Upgrading the Car Park in Alexander Street, Crows Nest
$5 million loan was sourced to fund project.
Current length of Loan as per the Long-Term Financial Plan (LTFP): 10 years to 2028

Project 2: Upgrading of On-Street Parking Management System
$4.5 million loan was sourced to fund project.
Current length of Loan as per LTFP: 10 years to 2028

Loan for North Sydney Olympic Pool Redevelopment

In February 2022 Council established a $31 million TCorp loan facility to partially fund the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 28 April 2022. The funds were restricted and are released as required to fund project cash outflows.

This loan is a fixed loan financing option, fully amortising the drawn down amount of $31,000,000 over 20 years, fixed interest rate with semi-annual repayments of interest and principal.

The loan details are:

Loan amount:	$ 31,000,000.00			
Loan term:	20 years			
From:	28/04/2022			
To:	28/04/2042			
Interest rate:	4.24%p.a.(fixed)			
Repayment:	Semi-Annual			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
01/07/2022	$31,000,000			
28/10/2022	$30,499,987	$657,200	$500,013	$1,157,213
28/04/2023	$29,989,375	$646,600	$510,613	$1,157,213

Monthly Investment Report

February 2023

IMPERIUM MARKETS

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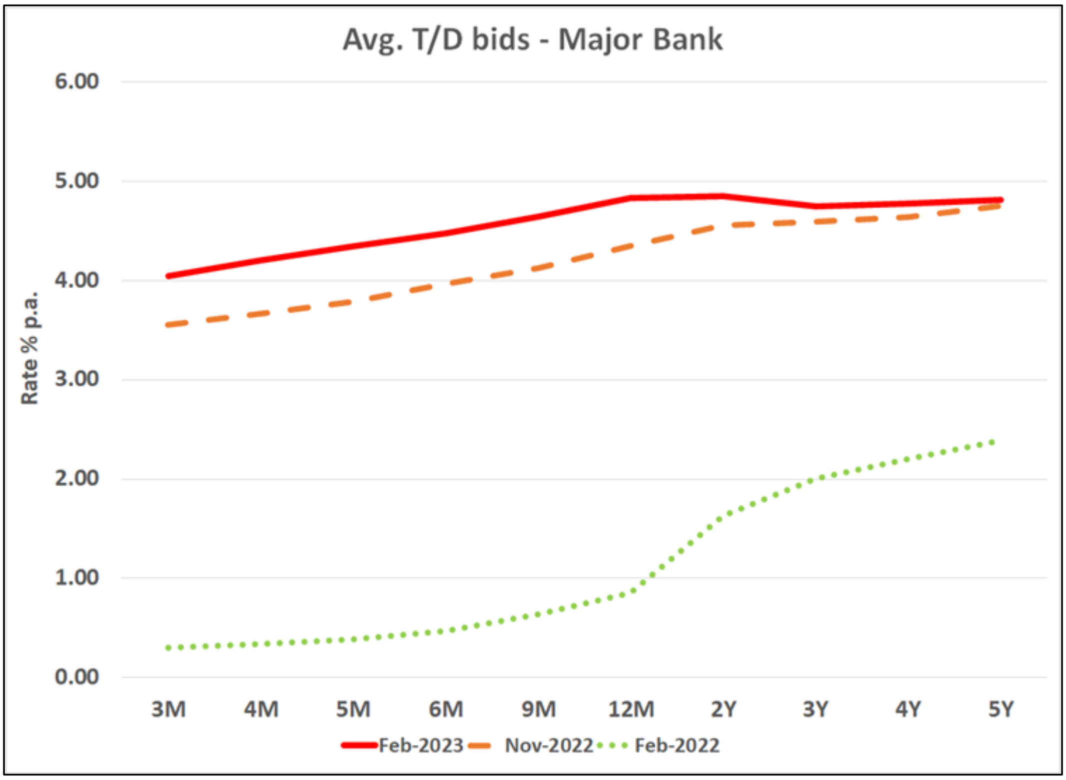
Market Update Summary

Risk markets were generally sold off in February after several stronger-than-expected reports on the US economy (particularly employment) changed the outlook on the peak of the interest rate cycle.

Domestically, the RBA continues to signal that it expects to increase interest rates, with at least two or three more 25bp hikes over the months ahead, likely locking in a March rate hike, and then possibly another in April and/or May. Thereafter, noting the lags in monetary policy, a pause around the end of Q2-Q3 is likely whilst the RBA monitors the economic data. Interestingly, RBA Governor Lowe commented that "*if inflation expectations stay well anchored, the supply-side problems get fixed up, wage growth and wage setting doesn't move up too fast and we can come back on that narrow path. So that is a plausible scenario: that rates rise and then start coming down next year. But a few things are going to have to go right for that to happen. It's possible, but there are other scenarios as well*".

Despite more rate rises on the horizon, given an upward sloping deposit curve, maintaining a slightly longer average duration position on deposits will continue to outperform shorter durations. The deposit market has largely already factored in the current rate hike cycle, reflected by the flattening of the curve over the past few months, particularly at the long end of the curve (+2yrs). Interestingly, some 2-5 year deposit rates continue to be offered slightly below or close to the same level as the 12 month rate from a number of ADIs, as the market factors in the potential for a recession and official rates to subsequently fall in coming years:



Source: Imperium Markets

'New' investments above 4¾% p.a. is currently available if Council can continue to place the majority of its surplus funds for terms of 12 months to 2 years. *With recessionary fears being priced in coming years, investors may take an 'insurance policy' against future rate cuts by investing across 3-5 year fixed deposits and locking in rates above or close to 5% p.a. (small allocation only).*

Council's Portfolio & Compliance

Asset Allocation

As at the end of February 2023, the portfolio was mainly directed to fixed term deposits (85%). The remaining portfolio is directed to FRNs (2%), fixed bonds (6%) and overnight cash accounts (7%).

Senior FRNs remain relatively attractive as spreads have widened over the past year – new issuances should now be considered again on a case by case scenario. In the interim, fixed deposits for 12 months to 3 years appear quite appealing following the spike in medium-to longer-term yields during the rate hike cycle.

With recessionary fears being priced in coming years, investors can choose to allocate some longer-term surplus funds and undertake an insurance policy against any potential future rate cuts by investing across 3-5 year fixed deposits, locking in and targeting yields close to or above 5% p.a.

Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 19% of assets is directed to medium-term assets (2-5 years), which has resulted in strong outperformance during the challenging economic environment. There is still high capacity to invest in the short-medium term horizon (1-2 years), with approximately $84m at month-end.

Where liquidity permits, we recommend new surplus funds be directed to 1-2 year horizon given this is where the most attractive value can be found. We suggest this be allocated to any remaining attractive fixed term deposits.

However in the interim, given the large upcoming capital expenditure of $94.4m flagged for FY2023, Council is likely to invest across shorter-tenors to match the capital program's cash flow requirements.

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 90 days	$50,413,041	33.10%	10%	100%	$101,900,165
✓	91 - 365 days	$50,250,000	32.99%	20%	100%	$102,063,206
✓	1 - 2 years	$22,650,165	14.87%	0%	70%	$83,969,079
✓	2 - 5 years	$29,000,000	19.04%	0%	50%	$47,156,603
✓	5 - 10 years	$0	0.00%	0%	25%	$38,078,302
		$152,313,206	**100.00%**			

Counterparty

As at the end of February, all individual limits comply with the Policy. Exposures to individual ADIs are driven by the portfolio's movements throughout any month. Overall, the portfolio is well diversified across the investment grade spectrum, with no exposure to the unrated ADIs.

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	CBA	AA-	$41,413,041	27.19%	30.00%	$4,280,921
✓	NAB	AA-	$29,000,000	19.04%	30.00%	$16,693,962
✓	NTTC Treasury	AA-	$9,000,000	5.91%	30.00%	$36,693,962
✓	Westpac	AA-	$21,250,000	13.95%	30.00%	$24,443,962
✓	Suncorp	A+	$16,250,892	10.67%	15.00%	$6,596,089
✓	ICBC Sydney	A	$17,000,000	11.16%	15.00%	$5,846,981
✓	BOQ	BBB+	$10,000,000	6.57%	10.00%	$5,231,321
✓	Bendigo	BBB+	$5,000,000	3.28%	10.00%	$10,231,321
✓	AMP Bank	BBB	$2,000,000	1.31%	10.00%	$13,231,321
✓	Newcastle PBS	BBB	$1,399,273	0.92%	10.00%	$13,832,047
			$152,313,206	**100.00%**		

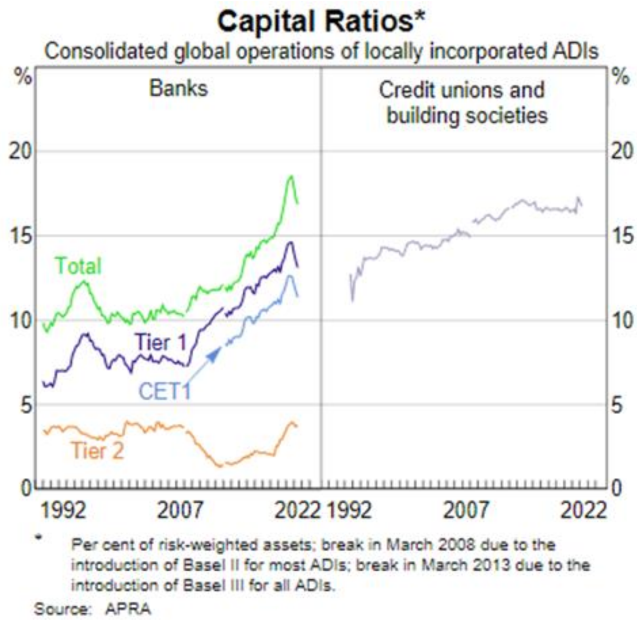
In late June 2022, Standard & Poor's downgraded Suncorp-Metway from AA- to A+ (negative watch). Suncorp recently announced that it is undertaking a strategic review of its banking operations. The downgrade reflects S&P's view that the Suncorp Group's likelihood of support for the bank had "*slightly*" diminished and that it was no longer a core part of the Group. In July 2022, ANZ (AA-) announced it was putting a bid to buy Suncorp's banking division for ~$3.9bn. Should that takeover be formalised, Suncorp-Metway's (A+) current credit rating is likely to be upgraded to ANZ's (AA-).

We remain supportive of the regional and unrated ADI sector (and have been even throughout the post-GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to 25-40% more capital than the domestic major banks, and well above the Basel III requirements.

Overall, the lower rated ADIs (BBB and unrated) are generally now in a better financial position then they have been historically (see the Capital Ratio figure below). The financial regulator, APRA has recently noted that the Common Equity Tier 1 capital of Australian banks now exceeds a quarter of a trillion dollars. It has increased by $110 billion, or more than 70%, over the past eight years. Over the same time, banks' assets have grown by 44%. Some of the extra capital is supporting growth in the banking system itself but clearly, there has been a strengthening in overall resilience and leverage in the system is lower.

We believe that deposit investments with the lower rated ADIs should be considered going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns. The lower rated entities are generally deemed to be the more 'ethical' ADIs compared to the higher rated ADIs.

In the current environment of high regulation and scrutiny, all domestic (and international) ADIs continue to carry high levels of capital. There is minimal (if any) probability of any ADI defaulting on their deposits going forward – this was stress tested during the GFC and the pandemic period. **APRA's mandate is to "*protect depositors*" and provide "*financial stability*".**



Credit Quality

The portfolio remains well diversified from a credit ratings perspective, with all assets classified as investment grade (rated BBB- or higher). As at the end of February 2023, all categories were within the Policy limits:

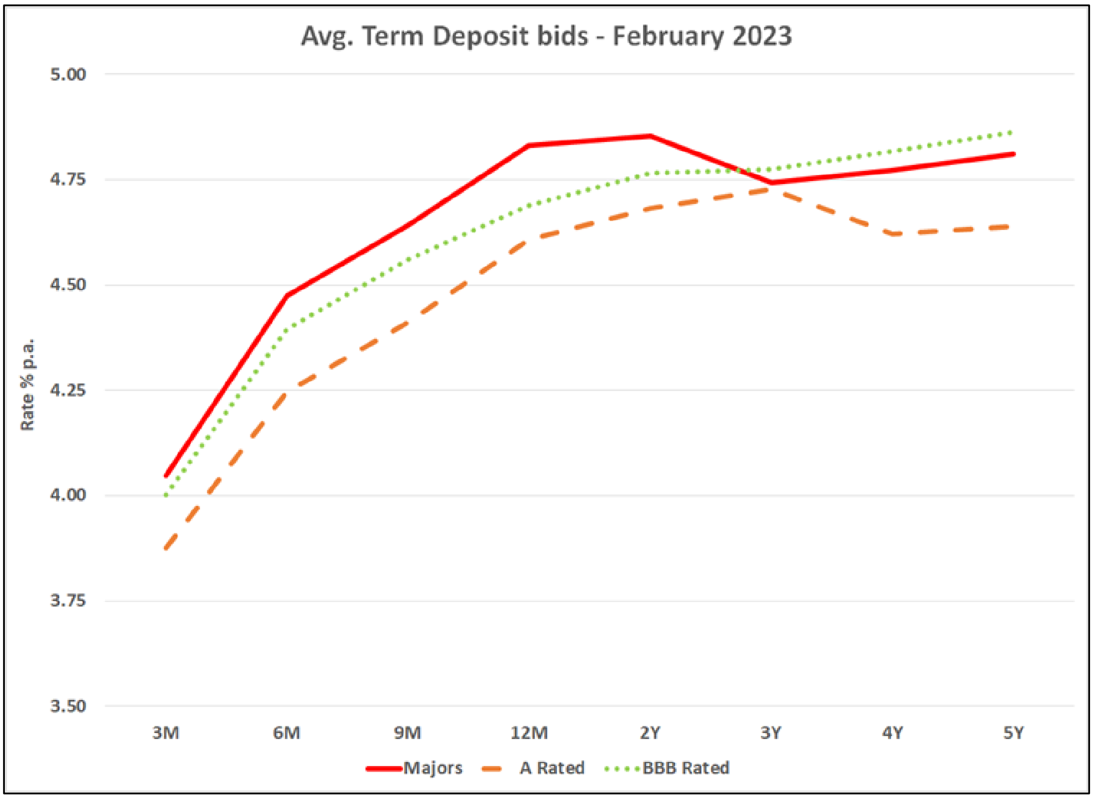
Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$100,663,041	66.09%	100%	$51,650,165
✓	A Category	$33,250,892	21.83%	60%	$58,137,032
✓	BBB Category	$18,399,273	12.08%	35%	$34,910,349
✓	Unrated ADIs	$0	0.00%	10%	$15,231,321
		$152,313,206	**100.00%**		

Pre-pandemic (March 2020), a 'normal' marketplace meant the lower rated ADIs (i.e. BBB category) were offering higher rates on term deposits compared to the higher rated ADIs (i.e. A or AA rated). But due to the cheap funding available provided by the RBA via their Term Funding Facility (TFF) since mid-2020[1], allowing the ADIs to borrow as low as 0.10% p.a. fixed for 3 years, those lower rated ADIs (BBB rated) did not require deposit funding from the wholesale deposit from the likes of Council. Given the higher rated banks had more capacity to lend (as they have a greater pool of mortgage borrowers), they subsequently were offering higher deposit rates. In fact, some of the lower rated banks were not even offering deposit rates at all. As a result, most investors placed a higher proportion of their deposit investments with the higher rated (A or AA) ADIs over the past three years.

In the interim, the 'abnormal' marketplace still largely exists, with the higher rated banks (majors) often paying a higher rate of return over the lower rated institutions across various parts of the curve on any particular day. Over the next few years, with the RBA now removing these cheap borrowing facilities, this should result in some of the lower rated banks (BBB rated) starting to become more competitive as the market starts to 'normalise'. Council should have a larger opportunity to invest a higher proportion of its surplus funds with the lower rated institutions (up to Policy limits), from which the majority are not lending to the Fossil Fuel industry or considered more 'ethical'.

We are slowly seeing this trend emerge, as has been the case in recent months:

[1] The RBA's Term Funding Facility (TFF) allowed the ADI to borrow as low as 0.10% fixed for 3 years: https://www.rba.gov.au/mkt-operations/term-funding-facility/overview.html



Source: Imperium Markets

Performance

Council's performance for the month ending 28 February 2023 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years
Official Cash Rate	0.25%	0.77%	1.42%	1.70%	1.81%	0.95%
AusBond Bank Bill Index	0.24%	0.76%	1.40%	1.68%	1.76%	0.89%
Council's T/D Portfolio	0.20%	0.63%	1.20%	1.51%	1.90%	1.63%
Council's FRN Portfolio	0.34%	1.05%	1.96%	2.45%	2.93%	2.27%
Council's Bond Portfolio	0.09%	0.29%	0.58%	0.78%	1.16%	1.11%
Council's Portfolio^	**0.20%**	**0.62%**	**1.18%**	**1.48%**	**1.87%**	**1.61%**
Outperformance	**-0.04%**	**-0.14%**	**-0.22%**	**-0.20%**	**0.12%**	**0.72%**

^Total portfolio performance excludes Council's cash account holdings. Overall returns would be lower if cash was included.

Performance (% p.a.)	1 month	3 months	6 months	FYTD	1 year	2 years
Official Cash Rate	3.35%	3.18%	2.89%	2.56%	1.81%	0.95%
AusBond Bank Bill Index	3.18%	3.11%	2.85%	2.54%	1.76%	0.89%
Council's T/D Portfolio	2.67%	2.58%	2.44%	2.28%	1.90%	1.63%
Council's FRN Portfolio	4.49%	4.32%	4.00%	3.71%	2.93%	2.27%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.16%	1.11%
Council's Portfolio^	**2.61%**	**2.52%**	**2.39%**	**2.23%**	**1.87%**	**1.61%**
Outperformance	**-0.57%**	**-0.59%**	**-0.45%**	**-0.30%**	**0.12%**	**0.72%**

^Total portfolio performance excludes Council's cash account holdings. Overall returns would be lower if cash was included.

For the month of February, the total investment portfolio (excluding cash) provided a strong return of +0.20% (actual) or +2.61% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.24% (actual) or +3.18% p.a. (annualised). This relative 'underperformance' has been due to the unexpected aggressive rate hikes undertaken by the RBA. Whilst this 'underperformance' may continue in the short-term, we do anticipate this to be temporary. Council should also remind itself it has consistently 'outperformed' over longer-term time periods as demonstrated by the longer-term returns of the overall investment portfolio.

We are pleased that North Sydney Council remains amongst the best performing Councils in the state of NSW where deposits are concerned. We have been pro-active in our advice about protecting interest income for many years and encouraged to maintain a long duration position. This is now reflected by the strong consistent performance of the investment portfolio over the longer term horizons.

Council's Term Deposit Portfolio & Recommendation

As at the end of February 2023, Council's deposit portfolio was yielding **2.65% p.a.** (up 6bp from the previous month), with a weighted average duration of around 347 days (~11½ months). We recommend Council maintains an average duration above 12 months, should cash flows allow.

Over a longer-term cycle, investors are rewarded if they can continue to maintain a slightly longer average duration. In a 'normal' marketplace, yields at the long-end are generally offered at a slight premium over shorter tenors.

At the time of writing, we see value in:

	LT Credit Rating	Term	T/D Rate
ING	A	5 years	5.13% p.a.
ING	A	4 years	5.12% p.a.
ING	A	3 years	5.11% p.a.
ING	A	2 years	5.10% p.a.
BoQ	BBB+	2 years	5.00% p.a.
Westpac	AA-	2 years	4.93% p.a.
NAB	AA-	2 years	4.90% p.a.
CBA	AA-	2 years	4.85% p.a.

The above deposits are suitable for investors looking to maintain diversification and lock-in a premium compared to purely investing short-term. For terms under 12 months, we believe the strongest value is currently being offered by the following ADIs (dependent on daily funding requirements):

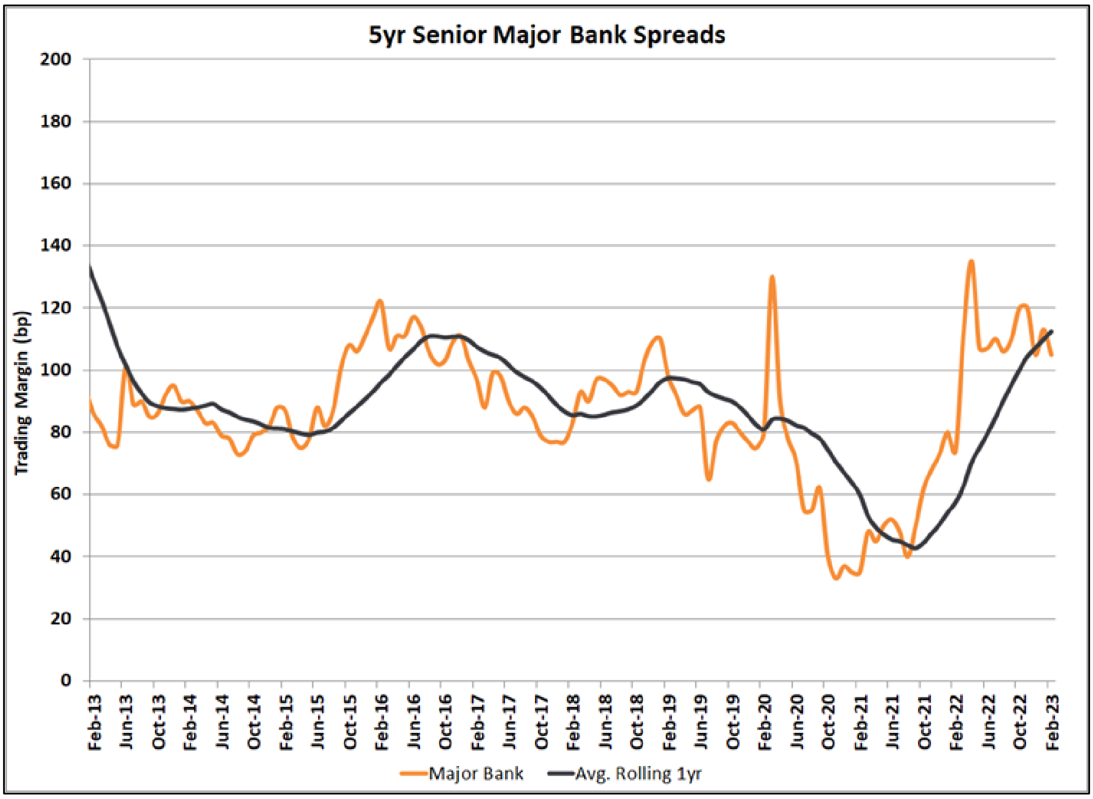
ADI	LT Credit Rating	Term	T/D Rate
ING	A	12 months	4.98% p.a.
NAB	AA-	12 months	4.95% p.a.
Westpac	AA-	12 months	4.92% p.a.
BoQ	BBB+	12 months	4.90% p.a.
CBA	AA-	12 months	4.88% p.a.
CBA	AA-	6 months	4.70% p.a.
WBC	AA-	6 months	4.65% p.a.
NAB	AA-	6 months	4.60% p.a.
CBA	AA-	3 months	4.31% p.a.

If Council does not require high levels of liquidity and can stagger its investments across the longer term horizons (2-5 years), it will be rewarded over coming years if it can roll for an average min. term of 12 months to 2 years (this is where we current value), yielding, on average, up to ¼-½% p.a. higher compared to those investors that entirely invest in short-dated (under 6 months) deposits.

With recessionary fears being priced in coming years, Council can allocate some longer-term surplus funds and undertake an insurance policy by investing across 3-5 year fixed deposits and locking in rates close to or above 5% p.a. This will provide some income protection if central banks decide to cut rates in future years, assuming inflation gets under control.

Senior FRNs Review

Over February, amongst the senior major bank FRNs, physical credit securities tightened by up to 10bp at the long-end of the curve. Nevertheless, major bank senior securities remain fairly attractive again in a rising rate environment (5 year margins above the +105bp level):



Source: IBS Capital

During February, there were other noticeable new primary issuance, mainly from the international banks:

- MUFG, Sydney Branch (A) 3 year senior FRN at +87bp
- Sumitomo, Sydney Branch (A+) 3 year senior FRN at +85bp
- RACQ (BBB+) 3 year senior FRN at +150bp
- DBS, Sydney Branch (AA-) 5 year dual senior security at +75bp
- Bank Australia (BBB) 4 year senior ‘sustainable’ FRN at +155bp
- Mizuho, Sydney Branch (A) 3 year FRN at +86bp
- HSBC, Sydney Branch (A+) 5 year dual senior security at +105bp

Amongst the “A” and “BBB” rated sector, the securities were marked between 5-10bp tighter at the 3-5 year part of the curve, with movements largely dictated by new issuances.

Credit securities are looking much more attractive given the widening of spreads in 2022. FRNs will continue to play a role in investor's portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	28/02/2023	31/01/2023
"AA" rated – 5yrs	+105bp	+113bp
"AA" rated – 3yrs	+75bp	+88bp
"A" rated – 5yrs	+125bp	+130bp
"A" rated – 3yrs	+90bp	+103bp
"BBB" rated – 3yrs	+145bp	+150bp

Source: IBS Capital

We now generally recommend switches ('benchmark' issues only) into new primary issues, out of the following senior FRNs that are maturing:

- **On or before early 2025 for the "AA" rated ADIs (domestic major banks)**;
- On or before early 2024 for the "A" rated ADIs; and
- Within 6-9 months for the "BBB" rated ADIs (consider case by case).

Investors holding onto the above senior FRNs ('benchmark' issues only) in their last few years are now generally holding sub-optimal investments and are not maximising returns by foregoing realised capital gains. In the current challenging economic environment, any boost in overall returns should be locked in when it is advantageous to do so, particularly as switch opportunities become available.

Primary (new) FRNs are now looking more appealing and should be considered on a case by case scenario.

Council's Senior FRNs Sale/Switch Recommendations

We recommend Council retains its remaining two FRNs at this stage. We will inform Council when there is an opportunity to sell these assets to boost the overall returns of the investment portfolio.

Council's Senior Bonds

During October 2020, Council placed two parcels of $3m (totalling $6m) with the Northern Territory Treasury Corporation (NTTC), locking in yields of 0.90% p.a. and 1.00% p.a. for a 4 and 5 year term respectively. In August 2021, it placed another $3m parcel with NTTC (AA-), locking in a yield of 1.50% p.a. for a 5 year term.

Council received the full rebated commission of 0.25% on the total face value of investments (i.e. $9m x 0.25% = $22,500) as it was introduced by Imperium Markets. We believe these investments were prudent at the time of investment especially after the rate cut delivered in early November 2020 and the RBA's forward guidance on official interest rates (no rate rises "*until at least 2024*").

The NTTC bonds are a 'retail' offering and not 'wholesale' issuances. Given the lack of liquidity and high penalty costs if they were to be sold/redeemed prior to the maturity date, they are considered to be a hold-to-maturity investment and will be marked at par value ($100.00) throughout the term of investment.

Senior Fixed Bonds – ADIs (Secondary Market)

As global inflationary pressures remain, this has seen a significant lift in longer-term bond yields (valuations fell) as markets have reacted accordingly.

This has resulted in some opportunities in the secondary market. We currently see value in the following fixed bond lines, with the majority now being marked at a significant discount to par (please note supply in the secondary market may be limited on any day):

ISIN	Issuer	Rating	Capital Structure	Maturity Date	~Remain. Term (yrs)	Fixed Coupon	Indicative Yield
AU3CB0255776	ING	AAA	Covered	07/09/2023	0.53	3.00%	4.46%
AU3CB0258465	Westpac	AA-	Senior	16/11/2023	0.72	3.25%	4.39%
AU3CB0265403	Suncorp	A+	Senior	30/07/2024	1.42	1.85%	4.91%
AU3CB0263275	Westpac	AA-	Senior	16/08/2024	1.47	2.25%	4.69%
AU3CB0265718	ING	AAA	Covered	20/08/2024	1.48	1.45%	4.82%
AU3CB0266179	ANZ	AA-	Senior	29/08/2024	1.50	1.55%	4.68%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	1.53	1.70%	4.90%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	1.67	2.00%	5.07%
AU3CB0269710	ANZ	AA-	Senior	16/01/2025	1.89	1.65%	4.66%
AU3CB0269892	NAB	AA-	Senior	21/01/2025	1.90	1.65%	4.68%
AU3CB0270387	Macquarie	A+	Senior	12/02/2025	1.96	1.70%	4.91%
AU3CB0287415	Westpac	AA-	Senior	17/03/2025	2.05	2.70%	4.67%
AU3CB0291508	Westpac	AA-	Senior	11/08/2025	2.45	3.90%	4.72%
AU3CB0291672	CBA	AA-	Senior	18/08/2025	2.47	4.20%	4.67%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	3.19	1.40%	5.24%
AU3CB0282358	ING	AAA	Covered	19/08/2026	3.48	1.10%	4.92%
AU3CB0284149	BoQ	BBB+	Senior	27/10/2026	3.67	2.10%	5.23%
AU3CB0286037	Westpac	AA-	Senior	25/01/2027	3.91	2.40%	4.91%

Economic Commentary

International Market

Risk markets were generally sold off in February after several stronger-than-expected reports on the US economy (particularly employment) changed the outlook on the peak of the interest rate cycle.

Across equity markets, the S&P 500 Index fell -2.61%, while the NASDAQ lost -1.11%. Europe's main indices bucked the trend, with gains led by France's CAC (+2.62%), Germany's DAX (+1.57%) and UK's FTSE (+1.35%).

The US FOMC agreed (unanimously among the voters) to lift rates another 25bp to 4.50%-4.75% range, downshifting hikes further from the two 50bp moves and earlier more aggressive 75bp moves.

US headline payrolls came in at +517k vs. +188k expected, and the unemployment rate fell 0.10% to 3.4% (its lowest in 54 years), versus an expected rise to 3.6%. US Fed Chair Powell noted how the strength in the labour market underscores why the Fed thinks it could take time to bring inflation down. Powell then remarked that "*we think we're going to have to do further [rate] increases, and we think we'll have to hold policy at a restrictive level for some time*".

US CPI came in marginally above consensus. The core and headline came in-line with the median forecast at +0.4% m/m and +0.5% m/m, but they slowed less than expected on a year-ended basis. Headline CPI fell to +6.4% from +6.5%, while the core CPI fell to +5.6% y/y from +5.7%.

Canada's employment rose +150k, where consensus was for just +15k and the unemployment rate remained at 5.0%.

UK Q4 GDP was flat, as expected, following Q3's -0.2% q/q decline, with year-ended growth coming in at +0.4%. That sees the economy avoiding a recession for now. The Bank of England (BoE) hiked rates by 50bp, in line with the consensus forecast to 4%.

The RBNZ raised the OCR by 50bp to 4.75% as widely anticipated and there was only a minor tweak to the projected track, with the peak still assumed to be 5.5% but taking slightly longer to get there.

China's inflation data remained low by global standards and did nothing to warn authorities against keeping policy stimulatory. CPI rose to +2.1% y/y from +1.8%, in line with expectations.

The IMF raised its 2023 world GDP growth forecast to +2.9%, up from +2.7% forecast last October, supported by China's reopening. China is now expected to grow by +5.2% in 2023.

The MSCI World ex-Aus Index fell -2.42% for the month of February:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-2.61%	-2.70%	-9.23%	+10.35%	+7.91%	+10.12%
MSCI World ex-AUS	-2.42%	-0.25%	-8.98%	+8.29%	+5.19%	+7.04%
S&P ASX 200 Accum. Index	-2.45%	+0.30%	+7.16%	+7.93%	+7.90%	+8.10%

Source: S&P, MSCI

Domestic Market

The RBA raised rates by 25bp to 3.35%, the ninth consecutive increase. The Statement was hawkish with the RBA Board expecting "fu*rther increases in interest rates will be needed over the months ahead"*. Dr Lowe said "*inflation [was] way too high and it needs to come down*" and that the risks at the moment are "*two sided*" with the "*risk we haven't done enough on interest rates*". He added there was a risk the central bank's most rapid tightening cycle in a generation had not done enough to dampen household spending and tame inflation. "*How far we have to go up – I don't know. It's going to depend upon the inflation data, the resilience of spending, the strength of the global economy and what's happening with growth and wages"*.

The unemployment rate unexpectedly jumped to 3.7% in January (from 3.5% in December), with the participation rate decreasing to 66.5% (66.6%).

The wage price index (WPI) rose +0.8% for the December quarter and +3.3% y/y. This was 0.2% below the consensus of +1.0% q/q and +3.5%, which was also what the RBA had pencilled in. As for headline details, private sector wages rose +0.85% q/q and +3.6% y/y, a slower pace than the +1.2% q/q rise in Q3. Public sector wages rose +0.7% q/q and +2.5% y/y.

Retail sales fell a sharp -3.9% m/m in December (consensus -0.2%), following an upwardly revised November to +1.7% m/m (from +1.4%). The key implication is that we may be starting to see the first signs that monetary tightening is starting to weigh on consumption.

The December trade surplus was $12.2bn (consensus $12.5bn) from an upwardly revised November balance of $13.5bn. Exports fell 1.4% (-0.8bn) with key resource export categories all lower.

Private sector credit growth slowed to +0.3% m/m in December from +0.5% in November (consensus +0.5%). The annual rate slowed to +8.3% y/y, the second consecutive month of deceleration from its recent +9.5% peak in October.

Australian dwelling prices fell -1.0% m/m in January, the ninth consecutive month of decline. House prices nationally are now 8.9% below their peak, but remain 14.6% above pre-pandemic levels.

The Australian dollar lost -4.36%, finishing the month at US67.30 cents (from US70.37 cents the previous month).

Credit Market

The global credit indices widened over February in the 'risk-off' environment. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	February 2023	January 2023
CDX North American 5yr CDS	75bp	72bp
iTraxx Europe 5yr CDS	80bp	79bp
iTraxx Australia 5yr CDS	87bp	82bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	February 2023	January 2023
Bloomberg AusBond Bank Bill Index (0+YR)	+0.24%	+0.27%
Bloomberg AusBond Composite Bond Index (0+YR)	-1.32%	+2.76%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.43%	+0.42%
Bloomberg AusBond Credit Index (0+YR)	-0.62%	+2.19%
Bloomberg AusBond Treasury Index (0+YR)	-1.58%	+2.94%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-2.20%	+4.87%

Source: Bloomberg

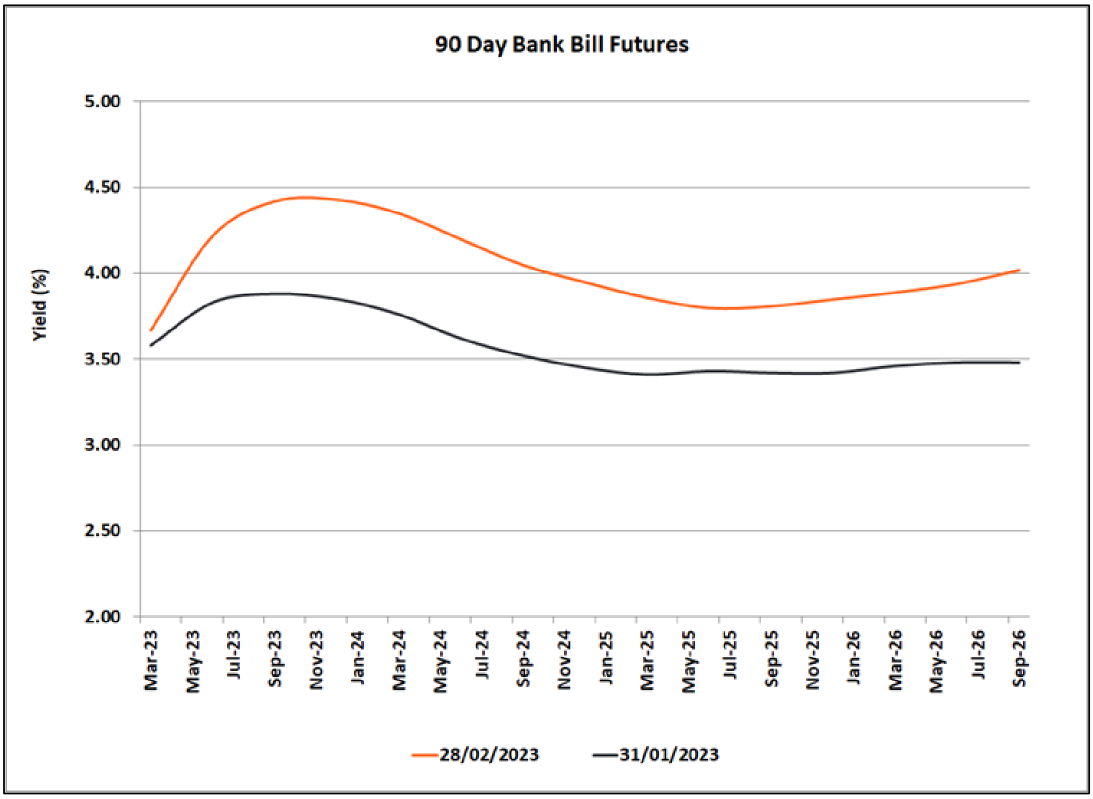
Other Key Rates

Index	February 2023	January 2023
RBA Official Cash Rate	3.35%	3.10%
90 Day (3 month) BBSW Rate	3.56%	3.37%
3yr Australian Government Bonds	3.60%	3.17%
10yr Australian Government Bonds	3.85%	3.55%
US Fed Funds Rate	4.50%-4.75%	4.25%-4.50%
3yr US Treasury Bonds	3.81%	3.90%
10yr US Treasury Bonds	3.92%	3.52%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Over February, bill futures rose significantly across the board, with the market reacting to the US Fed Reserve's comments that they are still looking to raise rates over coming months. The markets continue to factor in the possibility of a global recession over the next few years, highlighted by the drop in the futures pricing in early 2024:



Source: ASX

Fixed Interest Outlook

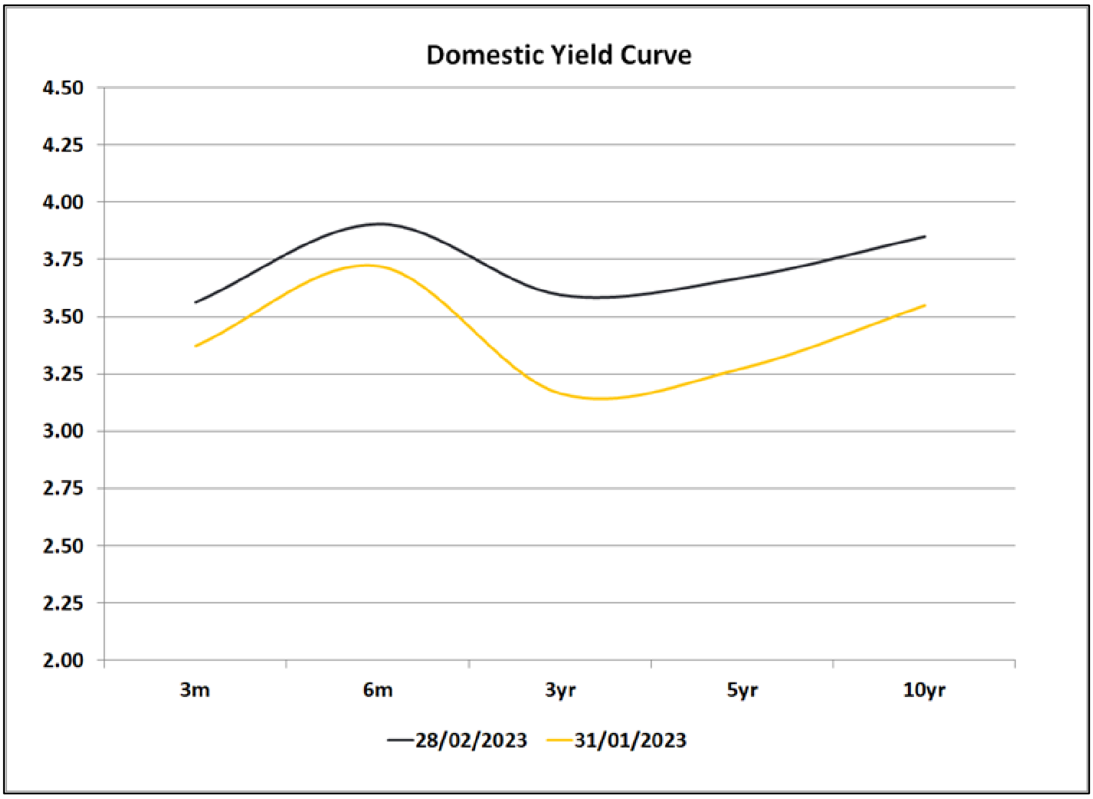
Money markets are now pricing for the US Fed to reach a mid-point of the 5.25%-5.50% target range. Futures markets nevertheless continue to factor in that rates will be coming down within 6 months of the peak being reached. US Fed Chair Powell sounded slightly less hawkish as he noted how the disinflationary process had already begun, however he still suggested that have a long way to go, particularly within the services sector. Powell also noted how the strength in the labour market underscores why the Fed thinks it could take time to bring inflation down to its 2% target.

Domestically, RBA Governor Lowe recently commented "*I don't think we're at the peak yet but how far they need to go, we're still unsure*". He sees monetary policy as restrictive and indicated the RBA Board is still "*trying to navigate a narrow path here*" and "*want to get inflation down*", "*but also preserve the gains*" seen in the labour market. However, that narrow path is highly uncertain with Dr Lowe noting that he doesn't "*know the answer*" to how far unemployment will need to rise.

The latest RBA Minutes revealed they considered moves for both 25bp or 50bp in February. The main arguments for moving by 25bp are that policy has already "*been adjusted substantially*" with considerable "*uncertainty around the outlook*", that there are substantial lags in policy and that "*monthly meetings provided the Board with frequent opportunities to assess how' uncertainties were being resolved*". For the RBA to step back to 50bp hikes, it is likely that the RBA would need to be convinced that wage and inflation expectations had shifted substantially.

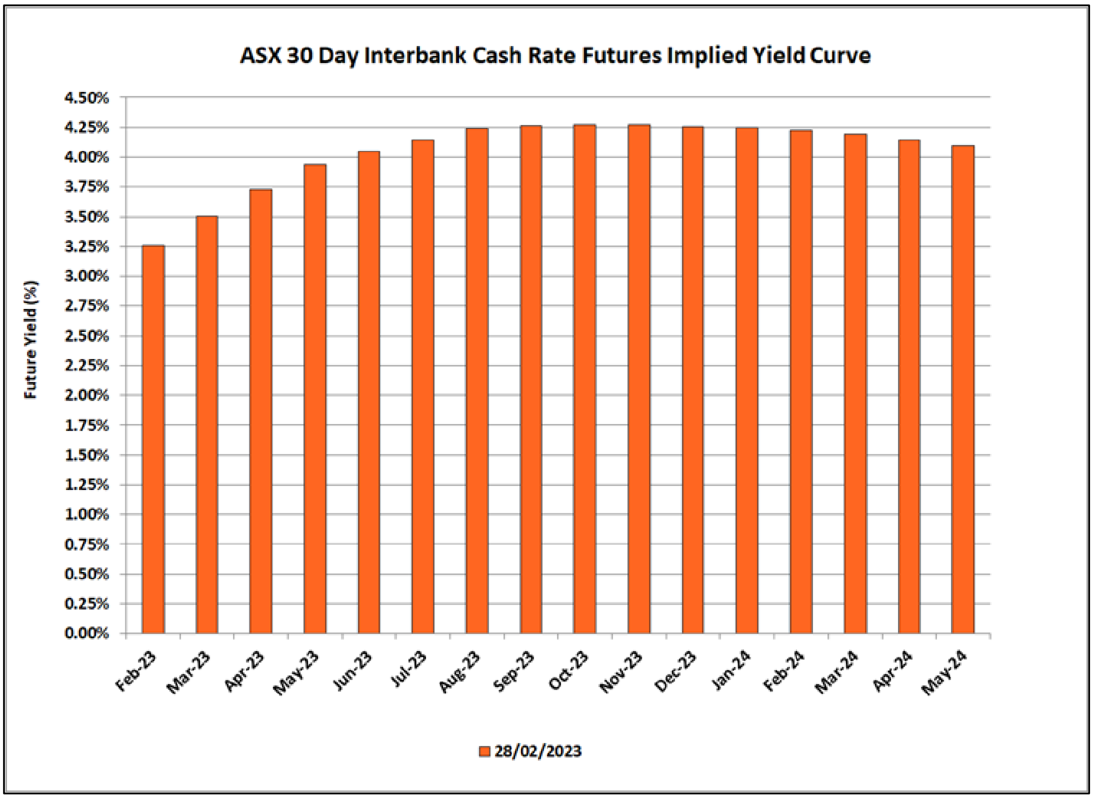
For now, the RBA continues to signal that it expects to increase interest rates, with at least two or three more 25bp hikes over the months ahead, likely locking in a March rate hike, and then possibly another in April and/or May. Thereafter, noting the lags in monetary policy, a pause around the end of Q2-Q3 is likely whilst the RBA monitors the economic data. Markets are currently pricing in up to 4 additional rate rises into mid-2023 (up to 4.25%). Fears of a looming global recession have actually seen rate cuts start to be priced in towards the start of 2024, although this seems unlikely for now.

Over the month, yields rose up to 40bp at the long-end of the curve:



Source: AFMA, ASX, RBA

RBA Governor Lowe commented that "*if inflation expectations stay well anchored, the supply-side problems get fixed up, wage growth and wage setting doesn't move up too fast and we can come back on that narrow path. So that is a plausible scenario: that rates rise and then start coming down next year. But a few things are going to have to go right for that to happen. It's possible, but there are other scenarios as well*".



Source: ASX

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