10.7. Investment and Loan Borrowings Report as at 31 May 2023

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ATTACHMENTS	1. Imperium North Sydney Monthly Investment Review May 2023 [**10.7.1** - 22 pages]
CSP LINK	5. Our Civic Leadership 5.2 Strong civic leadership and customer focussed services

PURPOSE:

The purpose of this report is to provide Council with the details of the performance of Council's investments and details of loans for the month ending 31 May 2023.

EXECUTIVE SUMMARY:

- This report outlines Council's investment portfolio and performance to 31 May 2023.

- All investments have been made in accordance with the Act, Regulations, Council's Investment Policy, and the specific conditions of the TCorp Loan Agreement.

- For the month of May, the total portfolio (Term Deposits, Floating Rate Notes, and Bonds) provided a return of +0.23% (actual) or +2.76% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.29% (actual), or +3.53% p.a. (annualised). This is due recent aggressive official interest rate rises and Council holding term deposits made in a low inflation environment when these rises were not foreseeable. Council's investment adviser considers this underperformance to be temporary (for less than the next 6 months).

- Returns on investments exceed original YTD budget by $2.0 million due to higher-than-expected cash balances and higher than expected interest rates.

RECOMMENDATION:
1. THAT the report on Investments held on 31 May 2023, prepared in accordance with clause 212 of the Local Government (General) Regulation 2021 and information on Loan Borrowings, be received.

Background

Clause 212 of Local Government (General) Regulation 2021 states that The Responsible Accounting Officer must provide Council with a monthly report detailing all funds 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.

It is also prudent to report loan balances and compliance with borrowing orders issued by the Minister for Local Government and Council's Debt Management Policy.

Investment Portfolio

The following table details the performance of Council's investment portfolio (excluding cash deposits) to benchmark for the month of May 2023 and annualised for the year-to-date 31 May 2023 (including investments that have matured prior to that date).

	May 2023	**Annualised YTD**
Actual Return	0.23%	2.76%
Benchmark	0.29%	3.53%
Variance	-0.06%	-0.77%

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 amongst the best performing when compared to other NSW councils.

Asset Type	**Market Value**	**Portfolio Breakdown**
Term Deposits	$124,250,000	84.20%
Cash	$11,676,030	7.91%
Fixed Bonds	$9,000,000	6.10%
Floating Rate Notes (FRNs)	$2,645,855	1.79%
	$147,571,885	**100.00%**

Council's average duration of term deposits, which comprise 84.20% of the investment portfolio, is approximately 341 days.

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 invested 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; $64.9 million for 2022/23 and $79.4 million in 2023/24.

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 tend to outperform them in the shorter terms currently required.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 31 May 2023 are $142,000 more than the revised year-to-date budget. They are $2.0 million higher than the original YTD budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (May)	YTD/ Annual Actual (May)	YTD/Annual Actual FV adjustments (May)	YTD Budget to Actual Variance (May)
2022/23	**$1,290,000**	**$3,340,000**	**$3,063,000**	**$3,201,000**	**$4,000**	**$142,000**
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 (FRNs) are required to be revalued each month using the Fair Value (FV) method, an estimate of the market value of the investment. The YTD movement of FRN's has been an increase of $4,000.

Financial Investment Policy

All categories are within the Policy limits for credit ratings. The portfolio remains well diversified, with credit quality rated as BBB or higher. The maximum holding limit in each rating category and the target credit quality weighting for Council's portfolio are:

Long Term Rating Range (Standard & Poors)	Invested	Maximum Policy Holding	Distribution
AA Category	$98,926,030	100.00%	67.04%
A Category	$28,249,603	60.00%	19.14%
BBB Category	$20,396,252	35.00%	13.82%
Unrated ADIs (NR)	$0	10.00%	0.00%

Credit Quality Limits in TCorp Loan Agreement

Council's Loan Agreement with TCorp 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 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	Maximum Allowed	Distribution
AA+ to AA-/Aa1 to Aa3 Category	$98,926,030	100%	67.04%
A+ to A/A1 to A2 Category	$28,249,603	100%	19.14%
A-/A3 Category	$0	40%	0.00%
BBB+/Baa1 Category	$17,000,000	20%	11.52%
BBB/Baa2 Category	$3,396,252	10%	2.30%
BBB-/Baa3 Category	$0	5%	0.00%
Unrated	$0	0%	0.00%

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

Institution	Long Term Rating Range (Standard and Poors/Moody's)	Invested	Maximum Allowed	Distribution
AMP Bank Ltd	BBB/Baa2 Category	$2,000,000	5%	1.36%
Bendigo and Adelaide Bank Ltd	BBB+/Baa1 Category	$7,000,000	10%	4.74%
BOQ Ltd	BBB+/Baa1 Category	$10,000,000	10%	6.78%
Commonwealth Bank of Australia	AA+ to AA-/Aa1 to Aa3 Category	$33,676,030	100%	22.80%
ICBC Sydney Branch	A+ to A/A1 to A2 Category	$17,000,000	100%	11.52%
NAB Ltd	AA+ to AA-/Aa1 to Aa3 Category	$35,000,000	100%	23.71%
Newcastle Greater Mutual Group	BBB/Baa2 Category	$1,396,252	5%	0.97%
Northern Territory Treasury	AA+ to AA-/Aa1 to Aa3 Category	$9,000,000	100%	6.10%
Suncorp Bank Ltd	A+ to A/A1 to A2 Category	$11,249,603	100%	7.62%
Westpac Bank Ltd	AA+ to AA-/Aa1 to Aa3 Category	$21,250,000	100%	14.40%

Loan Borrowings

Council's Loan Borrowing Policy is the framework for Council's borrowing activities. It defines responsibilities and parameters for borrowing and related risk management activities. 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 a risk averse strategy.

Loan borrowings are 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 to be 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

Consultation requirements

Community engagement is not required.

Financial/Resource Implications

The December Quarterly Budget Review Statement increased the budgeted income from investments by $1.5 million to $2.9 million. The March review increased budgeted income a further $550 thousand to $3.4 million This was due to higher-than-expected cash balances (due to delayed capital works) and interest rates greatly exceeding those available and foreseeable at the time the 2022/23 budget was made.

Legislation

Section 625 of the Local Government Act (NSW) allows councils to invest money that is not currently required for any other purpose. It further specifies how councils may invest. It specifies investments must be in accordance with the local government minister's orders.
Clause 212 of the Local Government Regulation (NSW) 2021 requires that the Responsible Accounting Officer must make a monthly report to Council setting out all details of money invested under Section 625 of the Local Government Act.

Sections 621 to 624 of the Local Government Act give councils the ability to borrow money and specify some further regulations on that borrowing. Council's staff considers it prudent to provide monthly reporting of loans.

Monthly Investment Report

May 2023

IMPERIUM MARKETS

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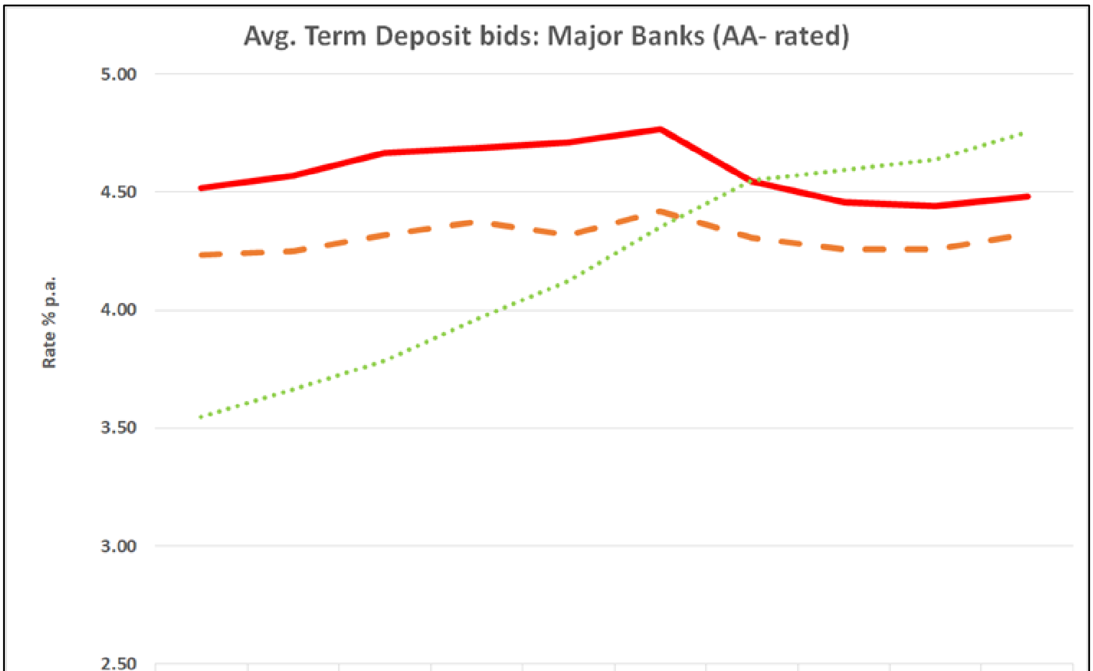
IMPERIUM MARKETS

Market Update Summary

Risk assets remained cautious seemingly trying to assess the economic implications from the US debt ceiling deal, potentially resulting in a bigger fiscal drag hampering an already challenged growth outlook. The prospects of higher interest rates in the near term also resulted in the mild sell off across bond and equity markets during May. Domestically, the RBA lifted rates in May by 25bp to 3.85% and subsequent rhetoric by Governor Lowe suggests the Bank will continue to lift rates in the short-term to ensure inflation is trending towards their target band of 2-3%.

Despite the aggressive rate hikes, over the past few months, the deposit market has already factored the peak of the rate hike cycle. Deposit rates rose up to 20-30bp across the long-end of the curve (+12 months) during May (compared to April), following the RBA's rhetoric suggesting rates are likely to move higher to tackle inflation. Interestingly, longer-term deposit rates offered by the higher rated institutions continue to reflect the possibility of future rate cuts:



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
May-2023	4.52	4.57	4.67	4.69	4.71	4.77	4.55	4.46	4.44	4.48
Apr-2023	4.23	4.25	4.32	4.37	4.32	4.42	4.31	4.26	4.26	4.32
Nov-2022	3.55	3.67	3.79	3.96	4.12	4.35	4.55	4.60	4.64	4.76

Source: Imperium Markets

'New' investments close to or above 4¾ - 5% p.a. is currently available if Council can place the majority of its surplus funds for terms of 12 months to 3 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), although this is primarily being offered by the lower rated ("BBB") ADIs.* ***<u>However due to upcoming capital outflows, this is currently restricting investments to shorter-tenors</u>***.

Council's Portfolio & Compliance

Asset Allocation

As at the end of May 2023, the portfolio was mainly directed to fixed term deposits (84%). The remaining portfolio is directed to FRNs (2%), fixed bonds (6%) and overnight cash accounts (8%).

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 remains 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. (mainly available from the regional banks).

However, noting the significant capital outflows expected in the near term, Council is currently largely hand-cuffed to investing into very short-term investments (under 6 months). This is suitable to invest in short-dated fixed term deposits.

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 over longer-term time periods. There is still high capacity to invest in the short-medium term horizon (1-2 years), with approximately $68m at month-end.

Where liquidity permits (once immediate capital projects are finalised), we recommend new surplus funds be directed to 1-2 year horizon given this will help optimise returns over the long-run. 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 in coming months, 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	$53,676,030	36.37%	10%	100%	$93,895,856
✓	91 - 365 days	$31,250,000	21.18%	20%	100%	$116,321,885
✓	1 - 2 years	$34,645,856	23.48%	0%	70%	$68,654,464
✓	2 - 5 years	$28,000,000	18.97%	0%	50%	$45,785,943
✓	5 - 10 years	$0	0.00%	0%	25%	$36,892,971
		$147,571,885	**100.00%**			

Counterparty

As at the end of May, 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-	$33,676,030	22.82%	30.00%	$10,595,536
✓	NAB	AA-	$35,000,000	23.72%	30.00%	$9,271,566
✓	NTTC Treasury	AA-	$9,000,000	6.10%	30.00%	$35,271,566
✓	Westpac	AA-	$21,250,000	14.40%	30.00%	$23,021,566
✓	Suncorp	A+	$11,249,604	7.62%	15.00%	$10,886,179
✓	ICBC Sydney	A	$17,000,000	11.52%	15.00%	$5,135,783
✓	BOQ	BBB+	$10,000,000	6.78%	10.00%	$4,757,189
✓	Bendigo	BBB+	$7,000,000	4.74%	10.00%	$7,757,189
✓	AMP Bank	BBB	$2,000,000	1.36%	10.00%	$12,757,189
✓	Newcastle PBS	BBB	$1,396,252	0.95%	10.00%	$13,360,937
			$147,571,885	**100.00%**		

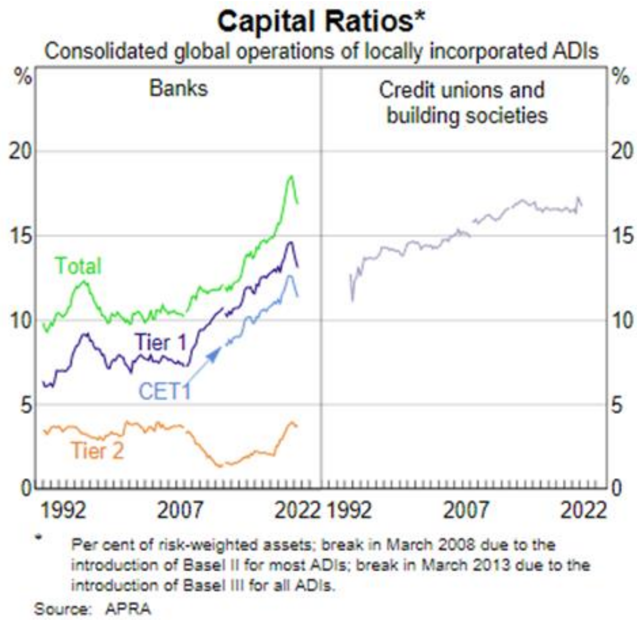
In late June 2022, Standard & Poor's downgraded Suncorp-Metway from AA- to A+ (negative watch). Suncorp recently announced that it is undertaking a strategic review of its banking operations. The downgrade reflects S&P's view that the Suncorp Group's likelihood of support for the bank had "*slightly*" 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 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

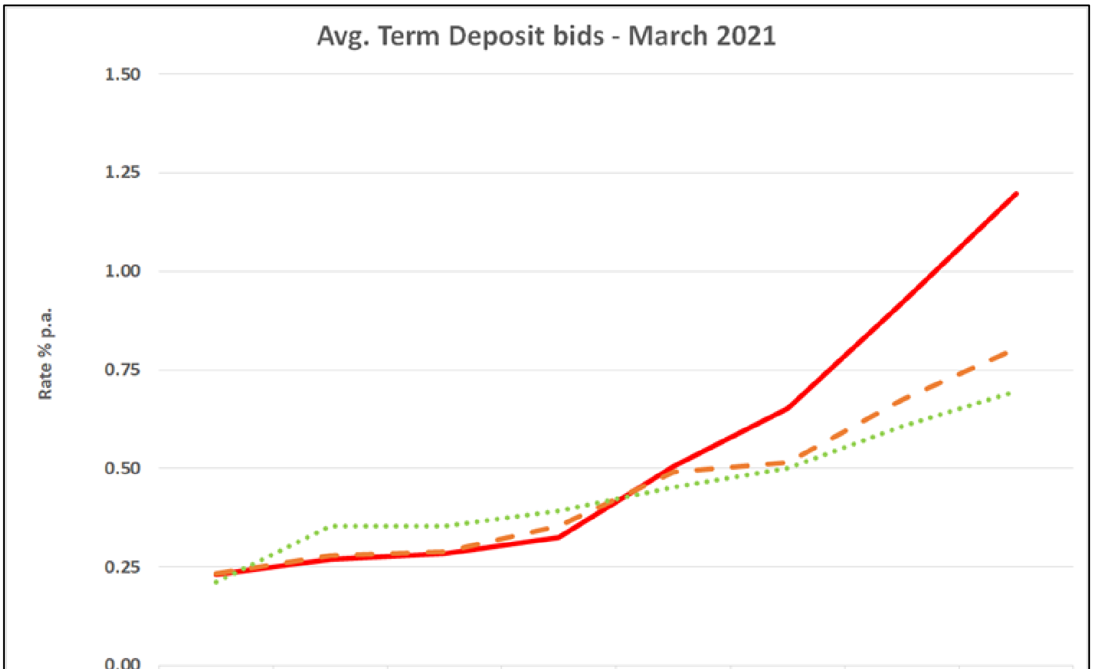
The portfolio remains well diversified from a credit ratings perspective, with all assets classified as investment grade (rated BBB- or higher). As at the end of May 2023, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$98,926,030	67.04%	100%	$48,645,856
✓	A Category	$28,249,604	19.14%	60%	$60,293,527
✓	BBB Category	$20,396,252	13.82%	35%	$31,253,908
✓	Unrated ADIs	$0	0.00%	10%	$14,757,189
		$147,571,885	**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.

[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

Term Deposit Rates – During Pandemic (March 2021)



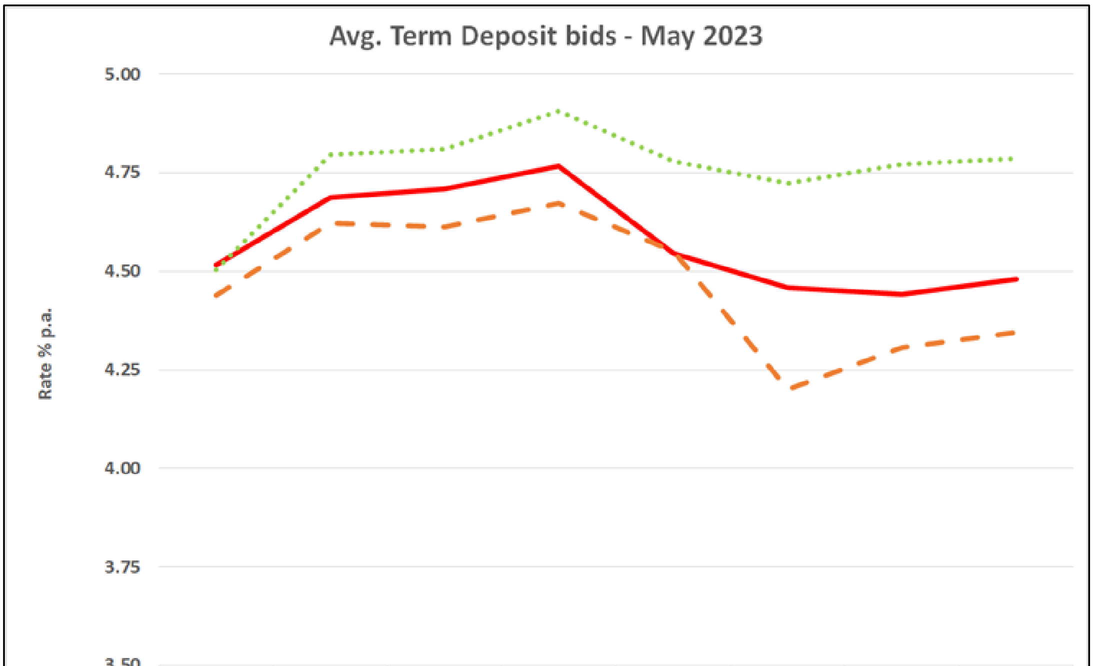
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

Source: Imperium Markets

The abnormal marketplace experienced during the pandemic is starting to reverse as the competition for deposits increases. We are now starting to see some of the lower rated ADIs ("BBB" rated) offering slightly higher rates compared to the higher rated banks ("A" or "AA" rated) on different parts of the curve (i.e. pre-pandemic environment). Some of this has been attributed to lags in adjusting their deposit rates as some banks (mainly the lower rated ADIs) simply set their rates for the week.

Going forward, 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. We are slowly seeing this trend emerge, as has been the case over the past month again:

Term Deposit Rates – Currently (May 2023)



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.52	4.69	4.71	4.77	4.55	4.46	4.44	4.48
A Rated	4.44	4.62	4.61	4.67	4.55	4.20	4.31	4.34
BBB Rated	4.51	4.79	4.81	4.91	4.78	4.72	4.77	4.79

Source: Imperium Markets

Performance

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

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years
Official Cash Rate	0.32%	0.92%	1.70%	2.63%	2.70%	1.40%
AusBond Bank Bill Index	0.29%	0.89%	1.65%	2.58%	2.64%	1.33%
Council's T/D Portfolio	0.24%	0.70%	1.33%	2.22%	2.32%	1.80%
Council's FRN Portfolio	0.41%	1.16%	2.22%	3.64%	3.78%	2.57%
Council's Bond Portfolio	0.10%	0.29%	0.58%	1.07%	1.17%	1.14%
Council's Portfolio^	**0.23%**	**0.68%**	**1.30%**	**2.17%**	**2.27%**	**1.77%**
Outperformance	**-0.06%**	**-0.21%**	**-0.35%**	**-0.41%**	**-0.36%**	**0.44%**

^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	3.85%	3.68%	3.43%	2.87%	2.70%	1.40%
AusBond Bank Bill Index	3.53%	3.56%	3.34%	2.82%	2.64%	1.33%
Council's T/D Portfolio	2.83%	2.79%	2.69%	2.42%	2.32%	1.80%
Council's FRN Portfolio	4.90%	4.67%	4.49%	3.97%	3.78%	2.57%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.14%
Council's Portfolio^	**2.76%**	**2.72%**	**2.62%**	**2.37%**	**2.27%**	**1.77%**
Outperformance	**-0.77%**	**-0.84%**	**-0.72%**	**-0.45%**	**-0.36%**	**0.44%**

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

For the month of May, the total investment portfolio (excluding cash) provided a solid return of +0.23% (actual) or +2.76% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.29% (actual) or +3.53% 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 fairly 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 slightly long duration position as this optimises the overall returns of the portfolio in the long-run.

Council's Term Deposit Portfolio & Recommendation

As at the end of May 2023, Council's deposit portfolio was yielding **2.77% p.a.** (up 3bp from the previous month), with a weighted average duration of around 341 days (~11 months). We recommend Council maintains an average duration close to 12 months, should cash flows allow in future.

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:

ADI	LT Credit Rating	Term	T/D Rate
P&N Bank	BBB	5 years	5.40% p.a.
P&N Bank	BBB	4 years	5.40% p.a.
P&N Bank	BBB	3 years	5.30% p.a.
P&N Bank	BBB	2 years	5.30% p.a.
AMP Bank	BBB	2-3 years	5.10% p.a.^
Australian Military	BBB+	2 years	4.88% p.a.
CBA	AA-	2 years	4.85% p.a.
ING	A	2 years	4.78% p.a.
BoQ	BBB+	2 years	4.75% p.a.
Westpac	AA-	2 years	4.73% p.a.
NAB	AA-	2 years	4.60% p.a.

^Contact us to get an additional 20bp rebated commission. Aggregate limits temporarily lifted to $10m (from $5m).

The above deposits are suitable for investors looking to maintain diversification and lock-in a slight 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
P&N Bank	BBB	12 months	5.30% p.a.
AMP Bank	BBB	11-12 months	5.25% p.a.^
AMP Bank	BBB	6-7 months	5.20% p.a.^
BankVIC	BBB+	12 months	5.12% p.a.
CBA	AA-	12 months	5.07% p.a.
Australian Military	BBB+	10 months	5.04% p.a.
NAB	AA-	12 months	5.00% p.a.
Suncorp	A+	6-11 months	4.96% p.a.
NAB	AA-	6-11 months	4.95% p.a.
Westpac	AA-	12 months	4.95% p.a.
BoQ	BBB+	6 & 12 months	4.95% p.a.
ING	A	12 months	4.94% p.a.
Bendigo-Adelaide	BBB+	12 months	4.90% p.a.
Suncorp	A+	12 months	4.83% p.a.
NAB	AA-	3 months	4.70% p.a.

^Contact us to get an additional 20bp rebated commission. Aggregate limits temporarily lifted to $10m (from $5m).

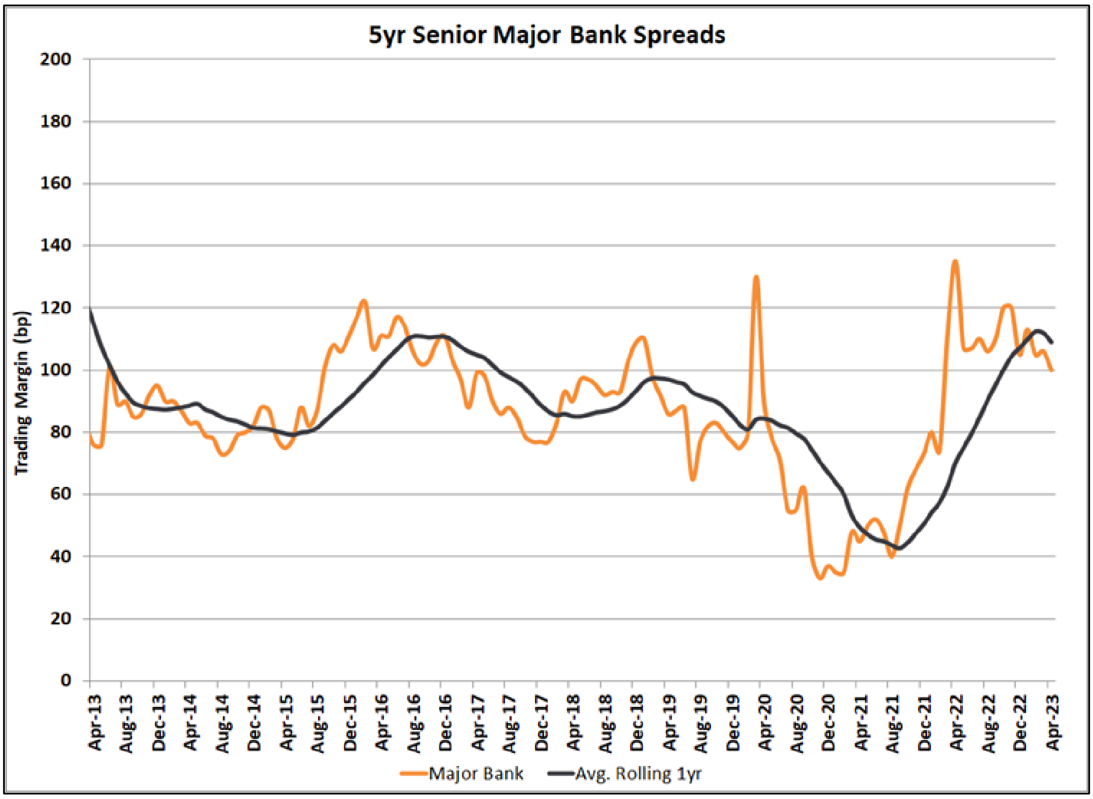
If Council does not require high levels of liquidity and can stagger its investments across the longer term horizons (1-5 years), it will be rewarded over a longer-term cycle if it can roll for an average min. term of 12 months to 3 years (this is where we current value), yielding, on average, up to 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 should consider allocating 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, and assuming inflation has peaked and is under control.

In the immediate future, given the significant outflows anticipated from capital projects, short-dated term deposits are suitable for North Sydney Council's purposes.

Senior FRNs Review

Over May, amongst the senior major bank FRNs, physical credit securities remained relatively flat at the long-end of the curve. Major bank senior securities remain fairly attractive again in the rising rate environment (5 year margins around the +100bp level):



Source: IBS Capital

In contrast to the previous month, there was a significant number of new (primary) issuances during the month of May:

- 5yr BoQ (AAA) covered FRN at +120bp
- 3yr & 5yr NAB (AA-) senior security (fixed and floating) at +78bp and +100bp respectively
- 3yr Bendigo-Adelaide (BBB+) senior security (fixed and floating) at +125bp
- 3yr & 5y UBS (A+) senior security (fixed and floating) at +130bp and +155bp respectively
- 3yr Suncorp (A+) senior security (fixed and floating) at +105bp
- 3yr OCBC (AA-) senior 'Green' FRN at +78bp
- 3yr Rabobank (A+) senior FRN at +88bp
- 1yr Bank of Us (BBB+) senior FRN at +95bp

Amongst the "A" rated sector, the securities were marked around 10bp wider at the 3-5 year part of the curve, mainly due to new issuances. In contrast, the "BBB" rated sector was marked flat during the month.

Credit securities are looking much more attractive given the widening of spreads over the past year. 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 future years (in a relatively stable credit environment).

Senior FRNs (ADIs)	31/05/2023	30/04/2023
"AA" rated – 5yrs	+100bp	+100bp
"AA" rated – 3yrs	+76bp	+75bp
"A" rated – 5yrs	+125bp	+115bp
"A" rated – 3yrs	+100bp	+90bp
"BBB" rated – 3yrs	+135bp	+135bp

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 mid-2025 for the "AA" rated ADIs (domestic major banks)**;
- On or before mid-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) are now generally holding sub-optimal investments and are not maximising returns by foregoing, potentially significant 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 to 0.10% 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 over the past year (valuations fell) as markets have reacted sharply.

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	0.29	3.00%	4.37%
AU3CB0258465	Westpac	AA-	Senior	16/11/2023	0.47	3.25%	4.43%
AU3CB0265403	Suncorp	A+	Senior	30/07/2024	1.16	1.85%	4.63%
AU3CB0263275	Westpac	AA-	Senior	16/08/2024	1.21	2.25%	4.51%
AU3CB0265718	ING	AAA	Covered	20/08/2024	1.22	1.45%	4.65%
AU3CB0266179	ANZ	AA-	Senior	29/08/2024	1.25	1.55%	4.50%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	1.27	1.70%	4.88%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	1.41	2.00%	4.99%
AU3CB0269710	ANZ	AA-	Senior	16/01/2025	1.63	1.65%	4.52%
AU3CB0269892	NAB	AA-	Senior	21/01/2025	1.64	1.65%	4.52%
AU3CB0270387	Macquarie	A+	Senior	12/02/2025	1.71	1.70%	4.82%
AU3CB0287415	Westpac	AA-	Senior	17/03/2025	1.80	2.70%	4.52%
AU3CB0291508	Westpac	AA-	Senior	11/08/2025	2.22	3.90%	4.51%
AU3CB0291672	CBA	AA-	Senior	18/08/2025	2.22	4.20%	4.53%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.93	1.40%	5.09%
AU3CB0282358	ING	AAA	Covered	19/08/2026	3.23	1.10%	4.67%
AU3CB0284149	BoQ	BBB+	Senior	27/10/2026	3.42	2.10%	5.13%
AU3CB0286037	Westpac	AA-	Senior	25/01/2027	3.67	2.40%	4.62%

Economic Commentary

International Market

Risk assets remained cautious seemingly trying to assess the economic implications from the US debt ceiling deal, potentially resulting in a bigger fiscal drag hampering an already challenged growth outlook. The prospects of higher interest rates in the near term also resulted in the mild sell off across bond and equity markets during May.

Across equity markets, the S&P 500 Index marginally gained +0.25%, whilst the NASDAQ added +5.80%. Europe's main indices were sold off, led by UK's FTSE (-5.39%), France's CAC (-5.24%) and Germany's DAX (-1.62%).

The US Fed unanimously delivered the widely expected 25bp hike to 5.00-5.25% on the fed funds rate target. The accompanying statement dropped the explicit expectation that additional tightening may be appropriate.

US payrolls printed much better than expected, with the unemployment rate falling (not rising, at 3.4% vs. 3.6% expected). The data overall is consistent with a still tight labour market.

The US core PCE deflator showed little progress on the current phase to fight inflation. In 3m annualised terms, the core PCE deflator was +4.3%, the same rate it was a year ago in April 2022.

Canada's headline employment came in at 41.4k vs. 20.0 expected, with unemployment staying at 5.0% vs. 5.1% expected. The CPI unexpectedly ticked up to +4.4% y/y in April but the average of the two key core measures were in line, down from +4.5% to +4.2%.

The Bank of England raised rates by 25bp to 4.25% as expected, and guided that more tightening would be required if there was evidence of more persistent inflation pressures. UK CPI for May far exceeded expectations, with the headline only dropping to +8.7% from +10.1%, against +8.2% expected. More disconcerting was the core reading lifting to +6.8% from +6.2% (no change expected).

The RBNZ lifted rates by 25bp to 5.50% as was widely anticipated. What surprised the market was the RBNZ's outlook, which was consistent with the end of the tightening cycle being reached – the MPC now "*confident*" that policy was restrictive enough to meet its inflation objective.

China's export growth slowed in April while imports slumped. Exports expanded +8.5% from a year earlier to $295 billion vs +8% expected. Exports received a boost from still-resilient demand from places such as Southeast Asia.

The MSCI World ex-Aus Index fell -1.25% for the month of May:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+0.25%	+5.28%	+1.15%	+11.14%	+9.09%	+9.87%
MSCI World ex-AUS	-1.25%	+3.17%	+0.34%	+9.25%	+6.00%	+6.64%
S&P ASX 200 Accum. Index	-2.53%	-0.89%	+2.90%	+11.43%	+7.47%	+8.12%

Source: S&P, MSCI

Domestic Market

The RBA surprised markets in May by raising the cash rate a further 25bp to 3.85% after the briefest of pauses the previous month (April). Underpinning the Bank's concerns are signs that the labour market remains tight, wages growth has picked up but remains consistent with target only if productivity growth picks up (both are key risks over this year to the RBA's outlook).

The RBA Minutes for May confirmed upcoming meetings are very live with extensive discussion around the need for productivity growth to pick up "*to ensure consistency of the wages growth forecast with the Bank's inflation forecast*".

April employment data was softer than expected, with employment falling -4k against expectations for a +25k increase and the unemployment rate rising by 0.1% to 3.7%.

The wage price index (WPI) rose +0.8% q/q and +3.7% y/y in Q1. At +0.84% q/q unrounded, it was a little below the +0.9% consensus. This broadly matched the RBA's most recent May SoMP forecast of +0.9% q/q and +3.6% y/y. This gives the Bank more confidence in its read that wages growth was stabilising.

The April Monthly CPI Indicator rose +6.8% y/y from +6.3%y/y in March.

Australian dwelling prices rose +0.5% m/m in April. That follows the +0.6% rise in March that broke a streak of 10 consecutive monthly declines.

Retail sales rose +0.4% m/m, a little above consensus for a +0.2% gain.

The March trade balance beat expectations with the trade surplus widening to $15.3bn, its second highest on record, from an upwardly revised February (consensus $13.0bn). Exports rose 3.8% m/m, outpacing a 2.5% increase in imports.

The Federal budget is expected to be in surplus by $4.2bn (0.2% of GDP) for 2022-23. While foreshadowed in the monthly financial statements, it is a dramatic improvement on the most recent October Budget estimate of -$36.9bn.

The Australian dollar lost -1.74%, finishing the month at US64.95 cents (from US66.10 cents the previous month).

Credit Market

The global credit indices slightly tightened over May. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	May 2023	April 2023
CDX North American 5yr CDS	76bp	79bp
iTraxx Europe 5yr CDS	82bp	86bp
iTraxx Australia 5yr CDS	83bp	91bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	May 2023	April 2023
Bloomberg AusBond Bank Bill Index (0+YR)	+0.29%	+0.30%
Bloomberg AusBond Composite Bond Index (0+YR)	-1.21%	+0.19%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.34%	+0.46%
Bloomberg AusBond Credit Index (0+YR)	-0.51%	+0.45%
Bloomberg AusBond Treasury Index (0+YR)	-1.39%	+0.01%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-0.65%	+0.32%

Source: Bloomberg

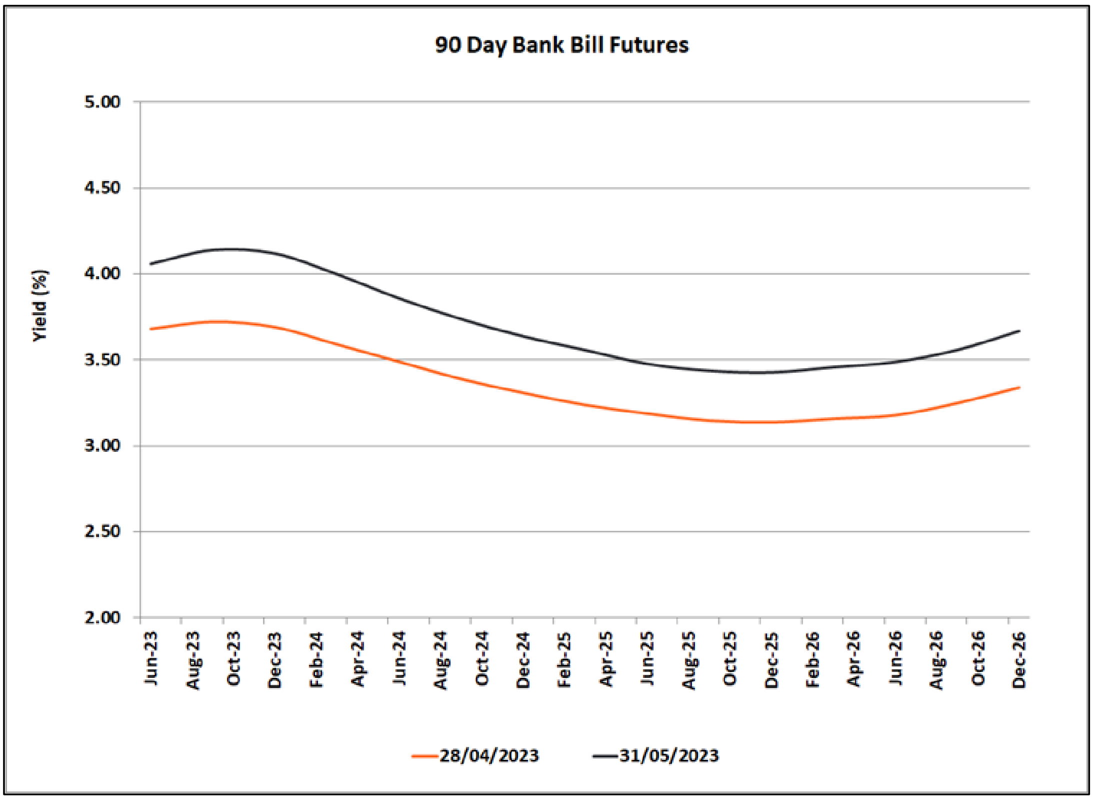
Other Key Rates

Index	May 2023	April 2023
RBA Official Cash Rate	3.85%	3.60%
90 Day (3 month) BBSW Rate	3.98%	3.68%
3yr Australian Government Bonds	3.37%	3.00%
10yr Australian Government Bonds	3.61%	3.34%
US Fed Funds Rate	5.00%-5.25%	4.75%-5.00%
2yr US Treasury Bonds	4.40%	4.04%
10yr US Treasury Bonds	3.64%	3.44%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Bill futures rose across the board in May driven by RBA Governor Lowe's comments suggesting further rate hikes would be required to combat inflation. 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

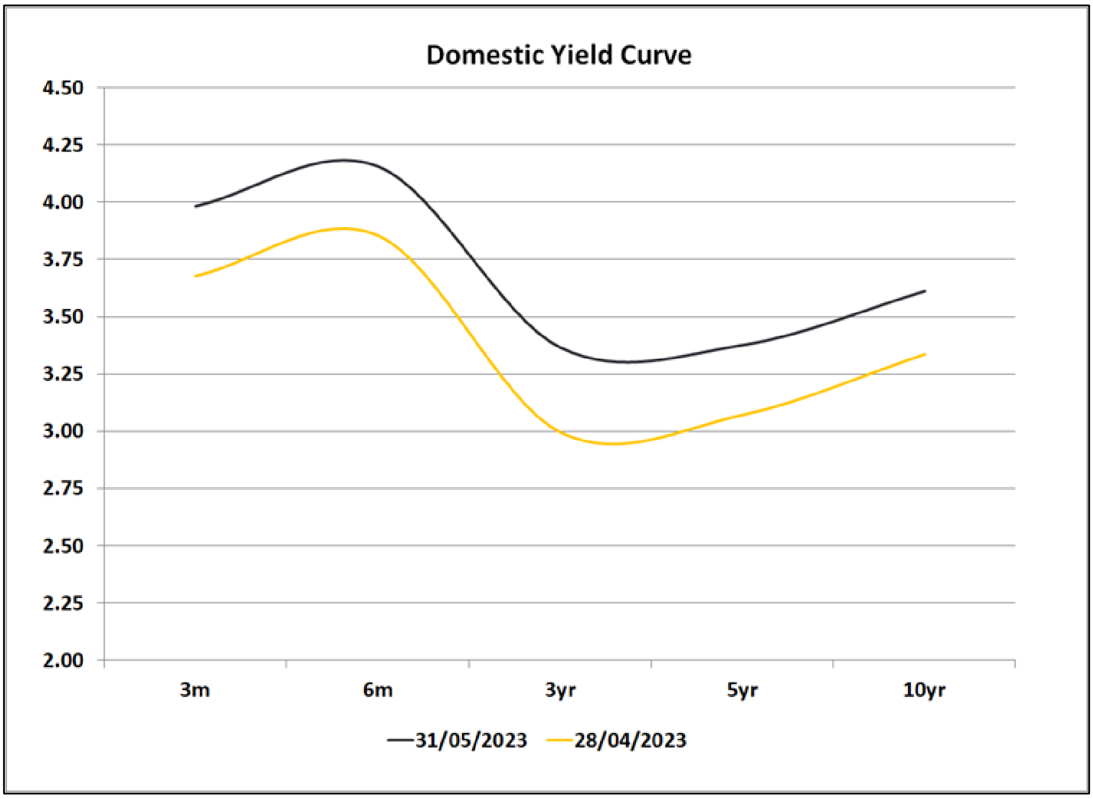
Fixed Interest Outlook

Most US FOMC members are open to a pause in June, but if they did pause, they have not ruled out future rate hikes. A June hike is now ~70% priced, and another 25bp hike is 90% priced in the July meeting. Near term cut expectations have also been pared.

Domestically, after delivering another 25bp hike in May, the RBA's commentary concluded that "*some further tightening of monetary policy may be required*", reinforcing a continuing commitment to do what is necessary to return inflation to target and a bias that still higher interest rates might be required to return inflation to target. Governor Lowe has commented that as per the views of other central banks, there are costs to inflation remaining too high for too long, as this would require even higher interest rates and greater job losses in the future.

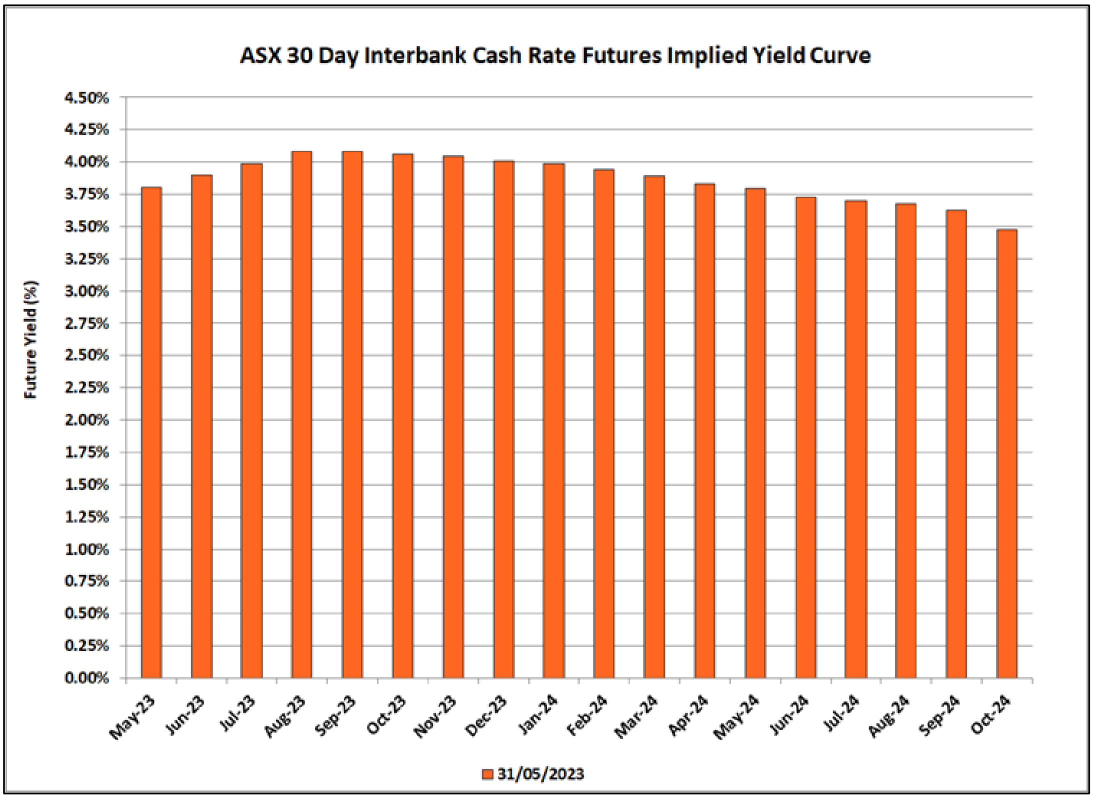
Overall, the risk continues to be to the upside in the near term with the RBA to remain reactive to the data flow, especially around inflation and wages.

Over the month, yields rose up to 37bp at the long-end of the curve:



Source: AFMA, ASX, RBA

Despite the RBA's rhetoric that rates may still need to move higher should inflation remain sticky, markets are still currently placing bets that their next move is a cut by early to mid-2024.



Source: ASX

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