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

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ATTACHMENTS	1. Imperium Markets Monthly Report July 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 July 2023.

EXECUTIVE SUMMARY:

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

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

- For the month of July, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.25% (actual), or +2.98% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.37% (actual), or +4.48% p.a. (annualised). This is due to recent interest rate rises and Council holding term deposits made in a low inflation environment, when rises were not expected.

- Council's investment adviser considers this underperformance to be temporary (less than the next 6 months) as the AusBond benchmark is expected to fall in line with official interest rates, with staff reinvesting maturing term deposits at rates higher than those taken in the low-interest rate environment.

- Returns on investments exceed the YTD budget by $61,000. The total return for the 2023/2024 financial year to date is approximately $270,000. The total budget for 2023/2024 is $2.5 million. The total budget for this FY is less than the 2022/23 budget as it is forecast that Council will draw down on cash reserves to fund the large ($79.4 million) 2023/24 capital works program.

RECOMMENDATION:
1. THAT the report on Investments held on 31 July 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, also 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 the benchmark for the month of July 2023 and annualised for the year-to-date 31 July 2023 (including investments that have matured prior to that date).

	July 2023	**Annualised YTD**
Actual Return	0.25%	2.98%
Benchmark	0.37%	3.48%
Variance	-0.12%	-0.50%

The portfolio underperformance, as compared to the benchmark, is due to recent sharp rises in the RBA official cash rate and long-term investments that were placed when inflation expectations were low, before those increases were made. Council's investment advisor (Imperium Markets), as per the attached report, expects this relative underperformance to be temporary. The advice is that the portfolio will return to overperformance when the RBA ends its interest rate raising cycle, which they expect will be in the next six months. Imperium Markets further note that North Sydney Council's deposits portfolio rank amongst the best performing when compared to other NSW councils.

Asset Type	**Market Value**	**Portfolio Breakdown**
Term Deposits	$123,250,000	82.12%
Cash	$15,187,316	10.12%
Fixed Bonds	$9,000,000	6.00%
Floating Rate Notes (FRNs)	$2,650,199	1.77%
	$ 150,087,515	**100.00%**

Council's average duration of term deposits, which comprise 82.12% of the investment portfolio, is approximately 376 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 Capital Works budget of $79.4 million in 2023/24.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 31 July 2023 are $61,000 more than the year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (July)	YTD/ Annual Actual (July)	YTD/Annual Actual FV adjustments (July)	YTD Budget to Actual Variance (July)
2023/24	**$2,500,000**	**$2,500,000**	**$209,000**	**$273,000**	**-$3,000**	**$61,000**
Year	**Original Annual Budget**	**Revised Annual Budget**		**Final Result Interest**	**Final Result FV adjustments**	**Final Budget to Actual Variance**
2022/23	$1,290,000	$3,340,000		$1,244,337	-$64,865	$1,179,472
2021/22	$1,350,000	$1,350,000		$1,222,664	$93,735	-$33,601
2020/21	$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 seen a decrease of $3,000.

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	$101,437,316	100.00%	67.59%
A Category	$23,251,741	60.00%	15.49%
BBB Category	$25,398,458	35.00%	16.92%
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	$101,437,316	100%	67.59%
A+ to A/A1 to A2 Category	$23,251,741	100%	15.49%
A-/A3 Category	$0	40%	0.00%
BBB+/Baa1 Category	$22,000,000	20%	14.66%
BBB/Baa2 Category	$3,398,458	10%	2.26%
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%	1.33%
Bendigo and Adelaide Bank Ltd	BBB+/Baa1 Category	$2,000,000	10%	1.33%
BOQ Ltd	BBB+/Baa1 Category	$10,000,000	10%	6.66%
Commonwealth Bank of Australia	AA+ to AA-/Aa1 to Aa3 Category	$29,187,316	100%	19.45%
Heritage and People's Choice Limited	BBB+/Baa1 Category	$10,000,000	10%	6.66%
ICBC Sydney Branch	A+ to A/A1 to A2 Category	$17,000,000	100%	11.33%
NAB Ltd	AA+ to AA-/Aa1 to Aa3 Category	$40,000,000	100%	26.65%
Newcastle Greater Mutual Group	BBB/Baa2 Category	$1,398,458	5%	0.93%
Northern Territory Treasury	AA+ to AA-/Aa1 to Aa3 Category	$9,000,000	100%	6.00%
Suncorp Bank Ltd	A+ to A/A1 to A2 Category	$6,251,741	100%	4.17%
Westpac Bank Ltd	AA+ to AA-/Aa1 to Aa3 Category	$23,250,000	100%	15.49%

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**
1/07/2023	$5,456,690.24			
31/07/2022	$5,223,543.14	$56,492.44	$233,147.10	$ 289,639.54
31/10/2022	$4,986,831.69	$52,928.09	$236,711.45	$ 289,639.54
31/01/2023	$4,747,721.74	$50,529.58	$239,109.96	$ 289,639.54
30/04/2023	$4,505,143.18	$47,060.98	$242,578.56	$ 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 being 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**
01/07/2023	$29,989,374.70			
30/10/2023	$29,467,937.22	$624,720.2	$521,437.78	$1,157,212.52
29/04/2024	$28,935,444.96	$613,431.4	$532,492.26	$1,157,212.52

Consultation requirements

Community engagement is not required.

Financial/Resource Implications

Returns are in line with budget.

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

July 2023

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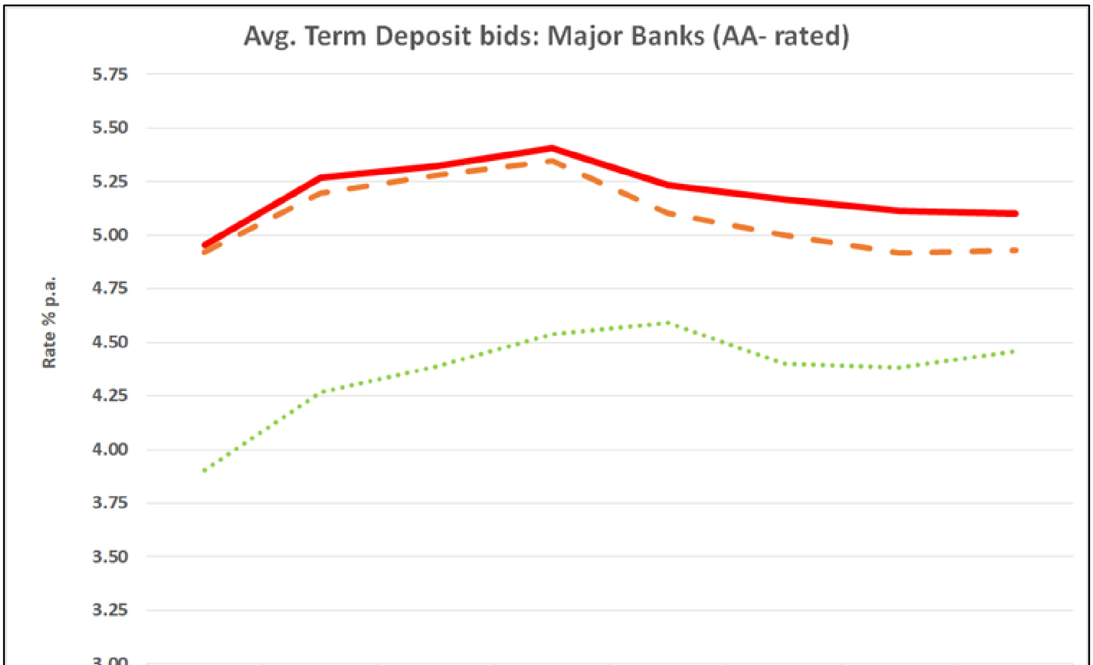
Market Update Summary

Risk markets were boosted over July about the prospects of inflation cooling and terminal interest rates peaking across several developed economies. Domestically, the latest CPI figure was largely used to justify a further pause at the RBA's Board meeting on 1st August on the basis of lower than expected core inflation together with the other uncertainties associated with the lags of monetary policy and the economic outlook. The RBA remains on a slight tightening bias, signalling further hike(s) may be required as it is determined to bring inflation back towards its target band.

Over July, across the short-end of the curve (3-12 months), major bank deposit rates marginally rose, on average, from the previous month. Deposit rates however continue to be lower in the long-end (2-5 years) compared to the shorter-end (6-12 months), reflective of the major banks believing that rate cuts may be required in future years once inflation has peaked and under control.



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Jul-2023	4.95	5.27	5.32	5.40	5.23	5.17	5.11	5.10
Jun-2023	4.92	5.19	5.28	5.35	5.10	5.00	4.92	4.93
Jan-2023	3.91	4.27	4.39	4.54	4.59	4.40	4.38	4.46

Source: Imperium Markets

'New' investments close to or above 5¼% p.a. is currently available if Council can place a proportion of funds between 9-12 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 5¼-5½% p.a. (small allocation only), although this is primarily being offered by the lower rated ("BBB") ADIs.*

Council's Portfolio & Compliance

Asset Allocation

As at the end of July 2023, the portfolio was mainly directed to fixed term deposits (82%). The remaining portfolio is directed to FRNs (2%), fixed bonds (6%) and overnight cash accounts (10%).

Senior FRNs remain relatively attractive as spreads have generally widened over the past 12-18 months – new issuances should now be considered again on a case by case scenario. In the interim, staggering a mix of fixed deposits between 9-12 months to 2 years remains a more optimal strategy to maximise returns over a longer-term cycle.

With recessionary fears being priced in coming years, investors can choose to allocate a small proportion of longer-term 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 17% 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 $69m 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.

In the interim, given the large upcoming capital expenditure of $74.4m flagged in the short-term, 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	$36,187,316	24.11%	10%	100%	$113,900,199
✓	91 - 365 days	$52,501,740	34.98%	20%	100%	$97,585,775
✓	1 - 2 years	$35,398,459	23.59%	0%	70%	$69,662,802
✓	2 - 5 years	$26,000,000	17.32%	0%	50%	$49,043,758
✓	5 - 10 years	$0	0.00%	0%	25%	$37,521,879
		$150,087,515	**100.00%**			

Counterparty

As at the end of July, 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-	$29,187,316	19.45%	30.00%	$15,838,939
✓	NAB	AA-	$40,000,000	26.65%	30.00%	$5,026,255
✓	NTTC Treasury	AA-	$9,000,000	6.00%	30.00%	$36,026,255
✓	Westpac	AA-	$23,250,000	15.49%	30.00%	$21,776,255
✓	Suncorp	A+	$6,251,740	4.17%	15.00%	$16,261,387
✓	ICBC Sydney	A	$17,000,000	11.33%	15.00%	$5,513,127
✓	BOQ	BBB+	$10,000,000	6.66%	10.00%	$5,008,752
✓	Bendigo	BBB+	$2,000,000	1.33%	10.00%	$13,008,752
✓	Heritage	BBB+	$10,000,000	6.66%	10.00%	$5,008,752
✓	AMP Bank	BBB	$2,000,000	1.33%	10.00%	$13,008,752
✓	Newcastle PBS	BBB	$1,398,459	0.93%	10.00%	$13,610,293
			$150,087,515	**100.00%**		

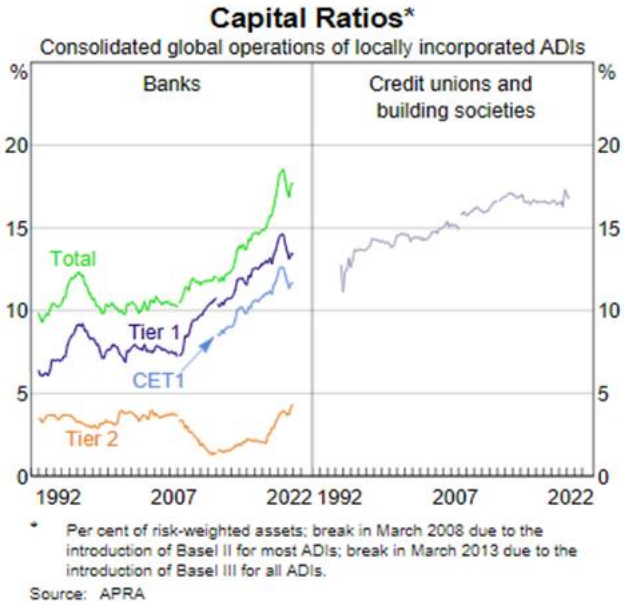
In July 2022, ANZ (AA-) announced it was putting a bid to buy Suncorp's banking division for ~$3.9bn. This deal has since been blocked by the Australian Competition and Consumer Commission (ACCC) in early August 2023, with the watchdog saying it was unconvinced the deal would deliver the public benefits claims put forward by ANZ.

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

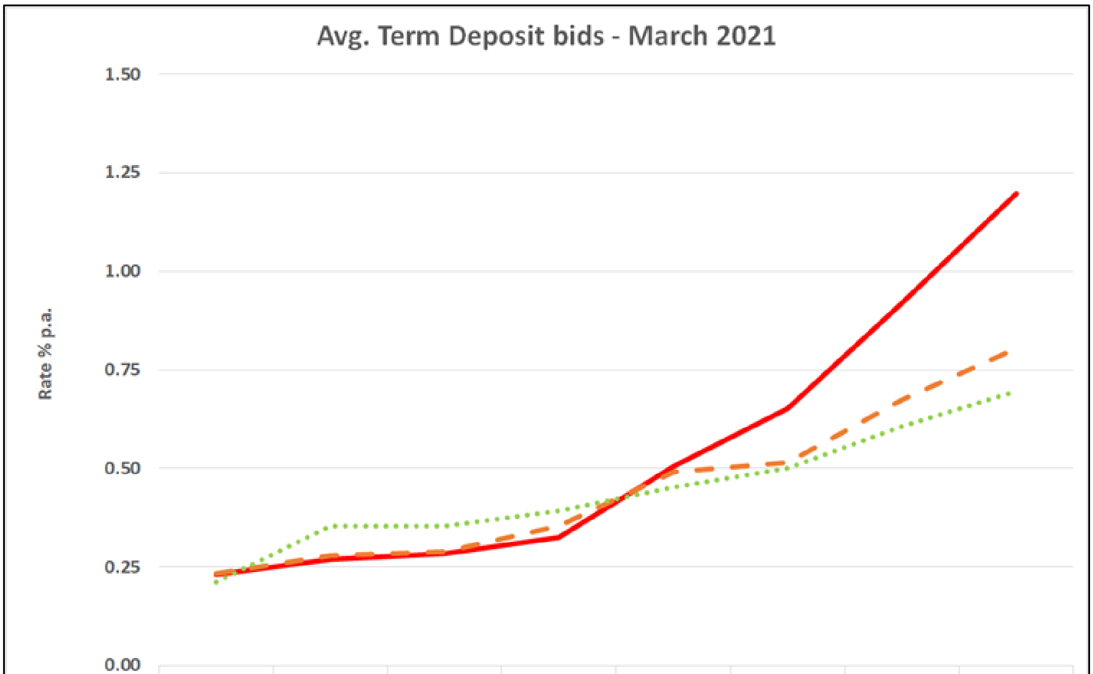
The portfolio remains well diversified from a credit ratings perspective, with all assets classified as investment grade (rated BBB- or higher). As at the end of July 2023, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$101,437,316	67.59%	100%	$48,650,199
✓	A Category	$23,251,740	15.49%	60%	$66,800,769
✓	BBB Category	$25,398,459	16.92%	35%	$27,132,172
✓	Unrated ADIs	$0	0.00%	10%	$15,008,752
		$150,087,515	**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 – 12 months after pandemic (March 2021)



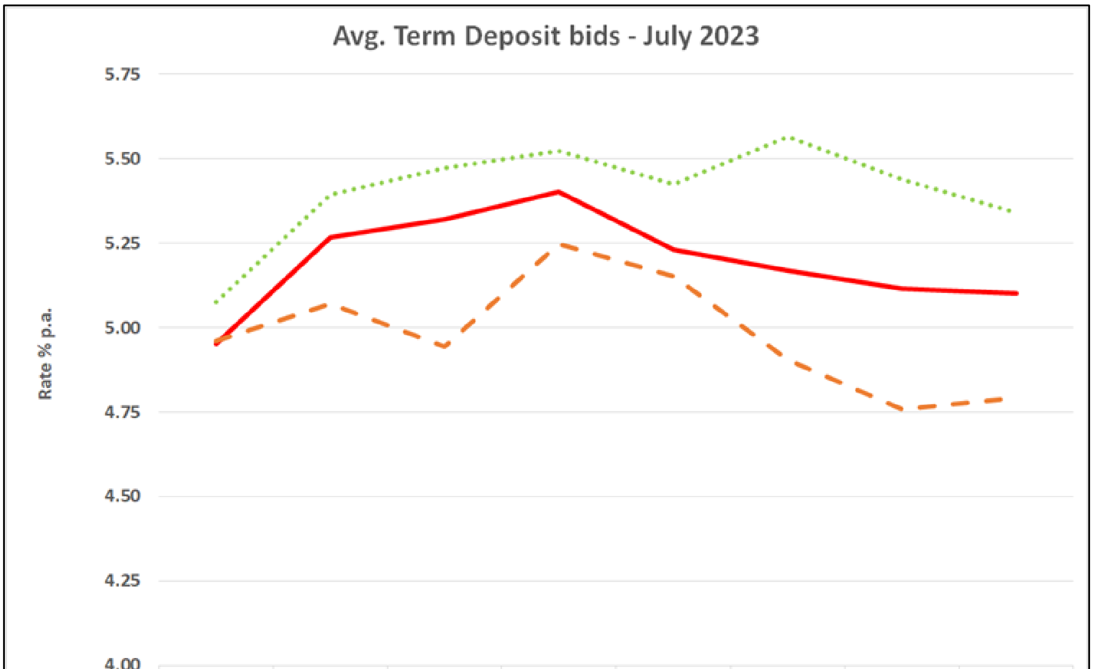
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

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 (July 2023)



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.95	5.27	5.32	5.40	5.23	5.17	5.11	5.10
A Rated	4.96	5.07	4.95	5.25	5.15	4.91	4.76	4.79
BBB Rated	5.08	5.39	5.47	5.52	5.43	5.57	5.44	5.34

Source: Imperium Markets

Performance

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

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.34%	1.00%	1.85%	0.34%	3.20%	1.73%	1.20%
AusBond Bank Bill Index	0.37%	0.97%	1.81%	0.37%	3.15%	1.67%	1.13%
Council's T/D Portfolio	0.26%	0.73%	1.39%	0.26%	2.58%	1.93%	1.79%
Council's FRN Portfolio	0.43%	1.24%	2.34%	0.43%	4.27%	2.90%	2.39%
Council's Bond Portfolio	0.10%	0.29%	0.58%	0.10%	1.17%	1.15%	-
Council's Portfolio^	**0.25%**	**0.71%**	**1.36%**	**0.25%**	**2.52%**	**1.90%**	**1.76%**
Rel. Performance	**-0.12%**	**-0.26%**	**-0.45%**	**-0.12%**	**-0.63%**	**0.22%**	**0.63%**

^Total portfolio performance excludes Council's cash account holdings.

Performance (% p.a.)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	4.10%	4.02%	3.77%	4.10%	3.20%	1.73%	1.20%
AusBond Bank Bill Index	4.48%	3.91%	3.69%	4.48%	3.15%	1.67%	1.13%
Council's T/D Portfolio	3.07%	2.92%	2.83%	3.07%	2.58%	1.93%	1.79%
Council's FRN Portfolio	5.18%	4.99%	4.77%	5.18%	4.27%	2.90%	2.39%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.15%	-
Council's Portfolio^	**2.98%**	**2.84%**	**2.76%**	**2.98%**	**2.52%**	**1.90%**	**1.76%**
Rel. Performance	**-1.50%**	**-1.07%**	**-0.93%**	**-1.50%**	**-0.63%**	**0.22%**	**0.63%**

^Total portfolio performance excludes Council's cash account holdings.

For the month of July, the total investment portfolio (excluding cash) provided a solid return of +0.25% (actual) or +2.98% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.37% (actual) or +4.48% 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 (within the next 6 months), especially if the RBA is approaching the end of its rate hike cycle. Council should also remind itself it has consistently 'outperformed' over longer-term time periods (last +10yrs) as demonstrated by the longer-term returns of the overall investment portfolio (e.g. 2 and 3 year returns).

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 July 2023, Council's deposit portfolio was yielding **3.18% p.a.** (up 23bp from the previous month), with a weighted average duration of around 376 days (~12 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	5.50% p.a.
P&N Bank	BBB	4 years	5.40% p.a.
AMP Bank	BBB	3 years	5.45% p.a. ^
AMP Bank	BBB	2 years	5.45% p.a.^
Australian Military	BBB+	2 years	5.36% p.a.
BoQ	BBB+	2 years	5.25% p.a.
P&N Bank	BBB	2 years	5.20% p.a.
Suncorp	A+	2 years	5.13% p.a.
Westpac	AA-	2 years	5.12% p.a.
NAB	AA-	2 years	5.10% p.a.
CBA	AA-	2 years	5.06% 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
AMP Bank	BBB	11-12 months	5.50% p.a.^
AMP Bank	BBB	6-7 months	5.45% p.a.^
Heritage & People's Choice	BBB+	12 months	5.40% p.a.
BoQ	BBB+	9 months	5.40% p.a.
Australian Military	BBB+	12 months	5.36% p.a.
NAB	AA-	9-12 months	5.35% p.a.
NAB	AA-	6-8 months	5.30% p.a.
BoQ	BBB+	12 months	5.30% p.a.
Bendigo-Adelaide	BBB+	6-12 months	5.30% p.a.
Westpac	AA-	12 months	5.27% p.a.
Suncorp	A+	12 months	5.23% p.a.
CBA	AA-	12 months	5.22% p.a.
NAB	AA-	3 months	5.00% p.a.

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

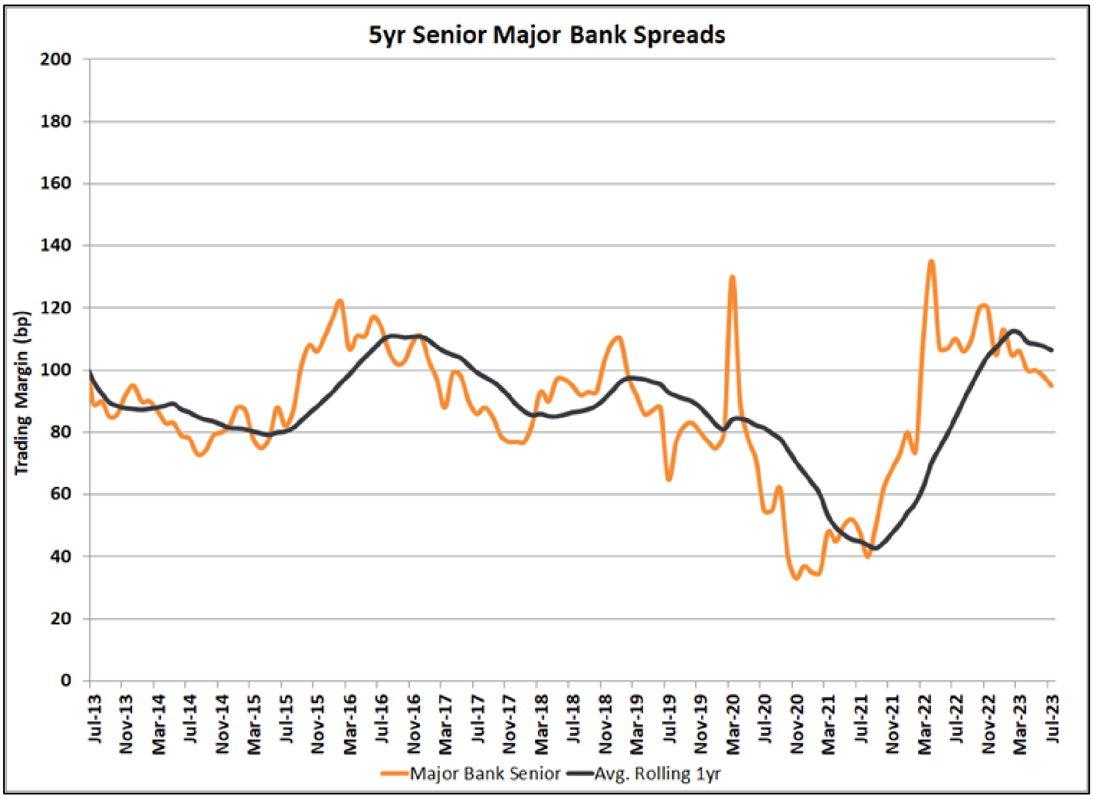
If Council does not require high levels of liquidity and can stagger a proportion of its investments across the longer term horizons (1-5 years), it will be rewarded over a longer-term cycle. Investing a spread of 12 months to 3 year horizons is likely to yield, on average, up to ¼-½% p.a. higher compared to those investors that entirely invest in short-dated deposits (under 6-9 months).

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 July, amongst the senior major bank FRNs, physical credit securities tightened by around 1-3bp at the long-end of the curve. Major bank senior securities remain fairly attractive in the rising rate environment (5 year margins around the +95bp level):



Source: IBS Capital

During the month, there was a lack of primary (new) issuances amongst the ADIs. The main securities that were issued were the following:

- 5yr Suncorp (AAA) covered security at +105bp
- 1yr Bank of China (A) senior FRN at +70bp

Amongst the "A" and "BBB" rated sector, the securities were marked around 5bp tighter at the long-end of the curve. Credit securities are looking much more attractive given the widening of spreads over the past ~18 months. 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)	31/07/2023	30/06/2023
"AA" rated – 5yrs	+95bp	+98bp
"AA" rated – 3yrs	+74bp	+75bp
"A" rated – 5yrs	+115bp	+120bp
"A" rated – 3yrs	+95bp	+100bp
"BBB" rated – 3yrs	+125bp	+130bp

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 12-18 months (valuations fallen) 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
AU3CB0265403	Suncorp	A+	Senior	30/07/2024	1.00	1.85%	5.11%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	1.10	1.70%	5.19%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	1.25	2.00%	5.36%
AU3CB0287498	Bendigo	BBB+	Senior	17/03/2025	1.63	3.00%	5.28%
AU3CB0293967	Bendigo	AAA	Covered	11/11/2025	2.28	5.10%	5.17%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.77	1.40%	5.47%
AU3CB0284149	BoQ	BBB+	Senior	27/10/2026	3.24	2.10%	5.54%

Economic Commentary

International Market

Risk markets were boosted over July about the prospects of inflation cooling and terminal interest rates peaking across several developed economies.

Across equity markets, the S&P 500 Index gained +3.11%, whilst the NASDAQ added +4.05%. Europe's main indices also provided solid returns, led by UK's FTSE (+2.23%), Germany's DAX (+1.85%) and France's CAC (+1.32%).

The US FOMC hiked rates by 25bp to 5.25%-5.50% as universally expected, the post-meeting Statement was almost unchanged, while there was minimal forward guidance given in the press conference. US GDP rose an annualised +2.4% in Q2, well above the +1.8% expected by consensus.

Annual US inflation rose at its slowest pace in more than two years in June, with underlying price pressures receding. The PCE price index rose +0.2% in June to be up +3.0% y/y, whilst the core PCE price index climbed +0.2% m/m, gaining +4.1% y/y.

Canada's unemployment rate increased to 5.4% from 5.2%, amid high population growth and a lift in the participation rate. Headline CPI in June came in lower at +2.8% y/y vs. +3.0% expected. The core measures showed less improvement with the trimmed mean coming in at +3.7% y/y vs. +3.6% expected.

The ECB lifted its deposit rate by 25bps to 3.75% as widely expected. The statement noted that the ECB will ensure that rates remain sufficiently restrictive given that inflation was still expected to remain "*too high for too long*".

UK's CPI came in softer than expected on both the headline (+7.9% y/y vs, +8.2% expected) and core measures (+6.9% y/y vs. +7.1% consensus).

China's economic momentum is slowing with deflation a concern for markets. The economy grew at +0.8% q/q in Q2, down from the +2.2% recorded in Q1. On an annual basis, the economy grew at +6.3%, well below the +7.1% expected. China's CPI inflation declined from -0.2% y/y in May to 0.0% last month, a 28 month low, raising concerns of deflation.

The RBNZ held rates steady at 5.50% after 12 consecutive hikes that began in October 2021. NZ's Q2 headline CPI printed at +1.1% q/q, taking the annual rate to +6.0% y/y. This was down from +1.2% in Q1 or +6.7% on an annual basis.

The MSCI World ex-Aus Index rose +3.27% for the month of July:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+3.11%	+10.06%	+11.11%	+11.95%	+10.26%	+10.53%
MSCI World ex-AUS	+3.27%	+8.15%	+11.76%	+10.04%	+7.46%	+7.53%
S&P ASX 200 Accum. Index	+2.88%	+2.04%	+11.67%	+11.99%	+7.47%	+8.32%

Source: S&P, MSCI

Domestic Market

The RBA decided to keep interest rates unchanged at 4.10% in July to provide additional time to assess the outlook for the economy. The Statement somewhat strangely removed much of the commentary on upside risks to inflation that was present in the two previous months at which the RBA tightened.

Deputy Governor Michele Bullock will be Australia's next RBA Governor, taking over from current Governor Philip Lowe on September 18. The RBA is to move to eight meetings a year from February 2024 (instead of the current eleven). The quarterly Statement of Monetary Policy will be published with the Board meeting Statement in February, May, August and November, rather than the following Friday as is currently the case.

Headline inflation printed below both the market's expectation and the RBA's SoMP forecast profile. Q2 CPI was +0.8% q/q and +6.0% y/y (consensus +1.0%/+6.2%). The core trimmed mean was +0.9% q/q and +5.9% y/y (consensus +1.1%/+6.0%). For both headline and trimmed mean, it was the lowest quarterly read since September 2021. The details revealed greater than expected goods disinflation is now occurring, but services inflation – often seen as stickier - moved higher.

Australia's employment growth was double market expectations in June, rising +32.6k in the month (consensus +15k). The unemployment rate fell 0.1% to 3.5% and has averaged 3.5% since July 2022, having only moved lower in October 2022 to 3.4%.

Retail sales fell -0.8% m/m in June, much weaker than the 0.0% consensus.

Australian dwelling prices rose +1.1% m/m in June to be +3.4% above their recent February low. Sydney continues to lead the bounce in dwelling values, gaining +1.7% m/m to be +6.4% higher than February 2023.

Dwelling approvals surged in May, up +20.6% m/m (consensus +3.0%). The large rise was the result of a +59.4% m/m gain in the volatile attached dwelling approvals category, led by a spike in NSW apartment approvals.

The Australian dollar gained +0.78%, finishing the month at US66.82 cents (from US66.30 cents the previous month).

Credit Market

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

Index	July 2023	June 2023
CDX North American 5yr CDS	63bp	69bp
iTraxx Europe 5yr CDS	68bp	82bp
iTraxx Australia 5yr CDS	72bp	76bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	July 2023	June 2023
Bloomberg AusBond Bank Bill Index (0+YR)	+0.37%	+0.30%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.52%	-1.95%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.46%	+0.41%
Bloomberg AusBond Credit Index (0+YR)	+0.85%	-1.08%
Bloomberg AusBond Treasury Index (0+YR)	+0.49%	-2.28%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+0.92%	-2.38%

Source: Bloomberg

Other Key Rates

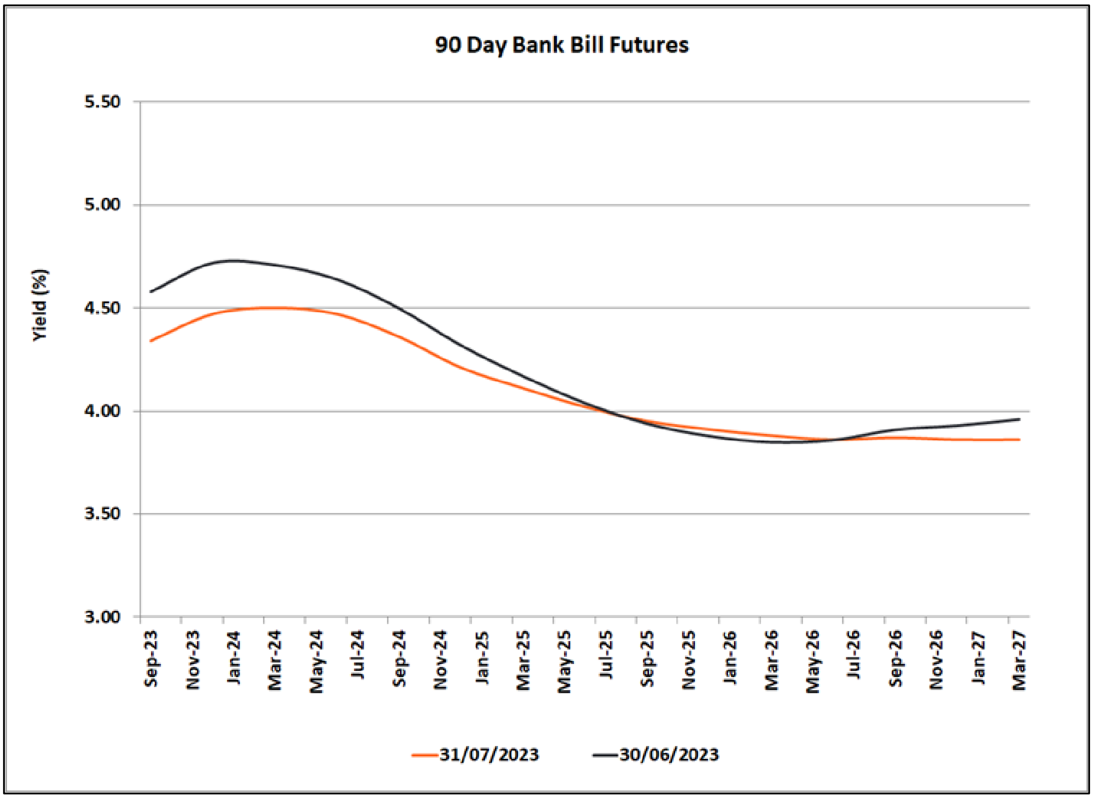
Index	July 2023	June 2023
RBA Official Cash Rate	4.10%	4.10%
90 Day (3 month) BBSW Rate	4.26%	4.35%
3yr Australian Government Bonds	3.87%	4.03%
10yr Australian Government Bonds	4.05%	4.03%
US Fed Funds Rate	5.25%-5.50%	5.00%-5.25%
2yr US Treasury Bonds	4.88%	4.87%
10yr US Treasury Bonds	3.97%	3.81%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Bill futures fell at the short-end of the curve this month, following the movement in the bond market. The RBA remains on a slight tightening bias and firm on its primary objective to bring inflation back within its target band. With the annual rate of CPI falling in the latest reading, the RBA may decide to pause if it views rates are sufficiently restrictive enough for inflation to keep trending downwards.

The bills market continues to factor in the possibility of a recession over the next few years, highlighted by the drop in the futures pricing by the beginning of 2024:



Source: ASX

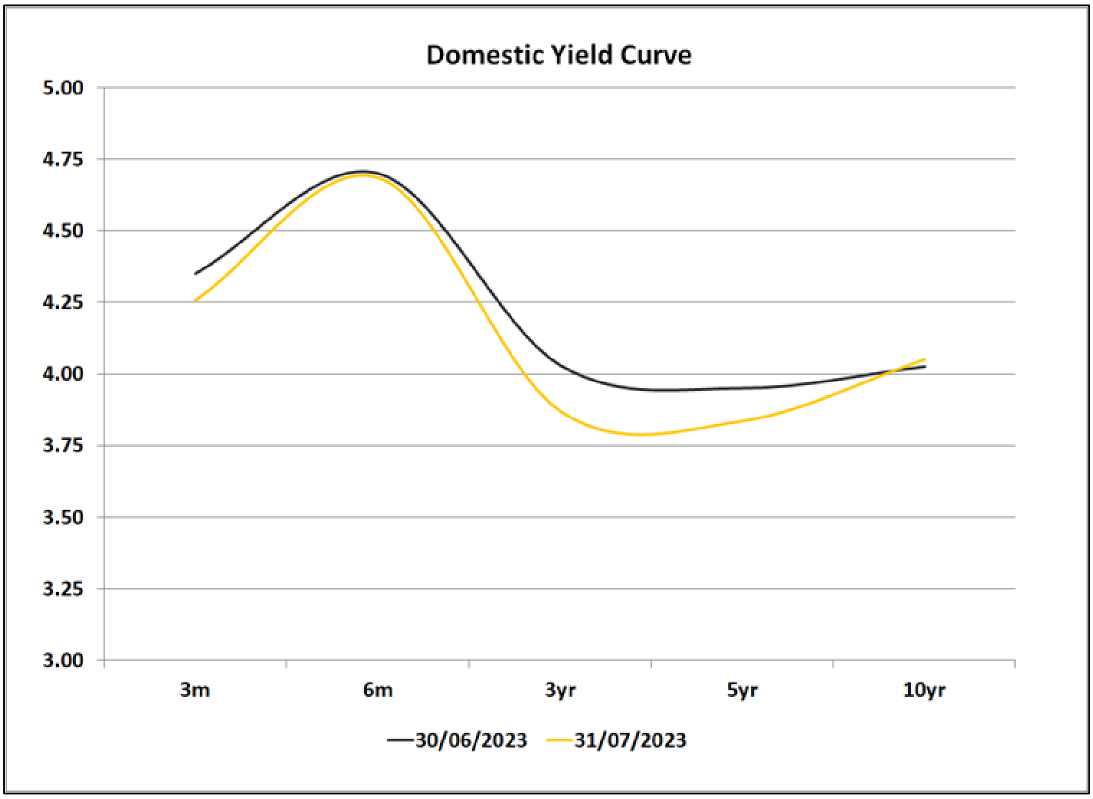
Fixed Interest Outlook

After the US Fed lifted rates to 5.25%-5.50%, markets continue to price around a 40% chance of a follow up hike by November, though pricing of cuts extended with over 130bp of cuts thereafter by the end of 2024.

Domestically, the latest CPI figure could be used to justify a further pause at the RBA's Board meeting on 1st August on the basis of lower than expected core inflation together with the other uncertainties associated with lags and the economic outlook that were used to justify the July pause. The main concern going forward remains sticky services inflation, which could impede the RBA's aim of getting inflation back to 3% by mid-2025.

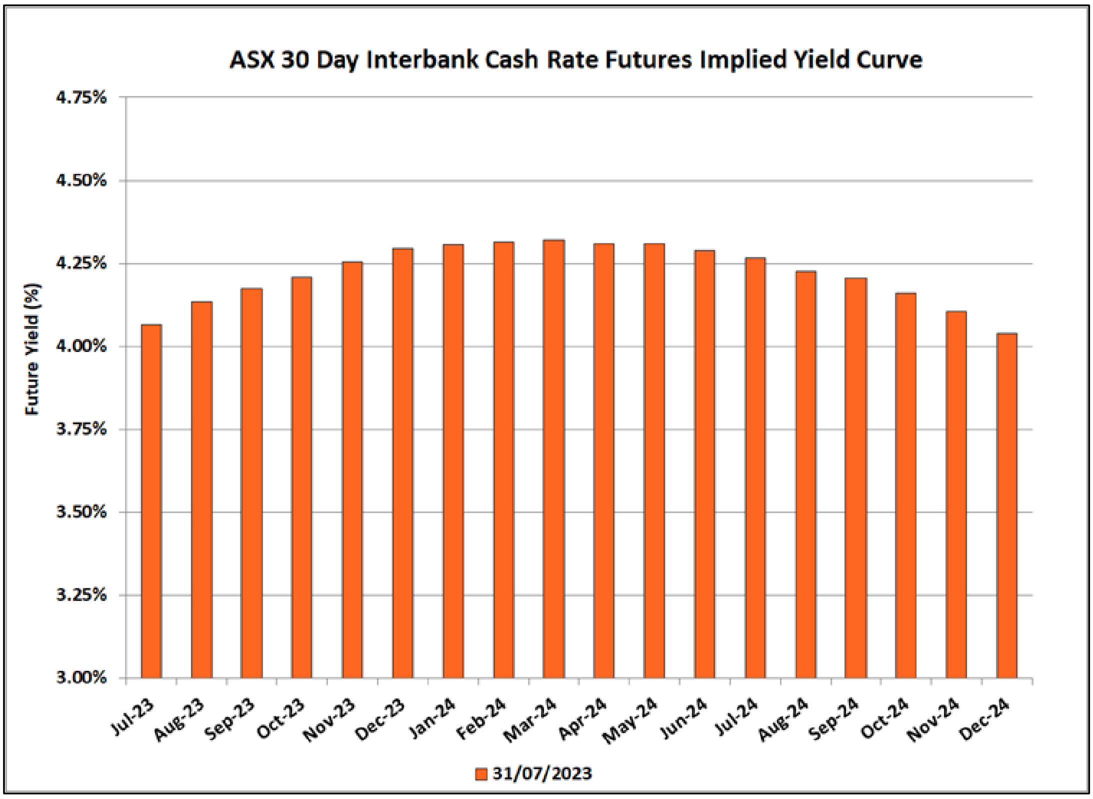
The overall inflation picture suggests the risk remains of some further tightening by the RBA in the next few months, but that at the same time we are close to the peak in interest rates.

Over the month, yields fell up to 16bp at the long-end of the curve:



Source: AFMA, ASX, RBA

Markets have been quick to revise their interest rate forecasts with one more rate hike priced by early 2024 (peak rate of ~4.35%). Rate cuts have now been pushed back to Q3-Q4 2024.



Source: ASX

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