10.4. Investment and Loan Borrowings Report as at 30 September 2023

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ATTACHMENTS	1. Arlo Advisory (formerly Imperium Markets) Monthly Investment Review Septemeber 2023 [**10.4.1** - 21 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 30 September 2023.

EXECUTIVE SUMMARY:

- 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 September, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.29% (actual), or +3.56% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.34% (actual), or +4.18% 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.

- Returns on investments exceed the YTD budget by $506,000. The total return for the 2023/2024 financial year to date is approximately $1.1 million. The better-than-expected return is due to the payments for the capital works program progressing slower than expected in the first quarter. Interest income will be addressed in the September Quarter Budget Review. The total budget for 2023/2024 is $2.5 million.

RECOMMENDATION:
1. THAT the report on Investments held on 30 September 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 September 2023 and annualised for the year-to-date 30 September 2023 (including investments that have matured prior to that date).

	September 2023	**Annualised YTD**
Actual Return	0.29%	3.56%
Benchmark	0.34%	4.18%
Variance	-0.05%	-0.62%

The portfolio underperformance, as compared to the benchmark, is due to 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 (Arlo Advisory – formerly known as 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. Advisory further notes 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	$135,250,000	83.76%
Cash	$14,579,798	9.03%
Fixed Bonds	$9,000,000	5.57%
Floating Rate Notes (FRNs)	$2,649,706	1.64%
	$161,479,504	**100.00%**

Council's average duration of term deposits, which comprise 83.76% of the investment portfolio, is approximately 348 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, Arlo Advisory. 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 September 2023 are $506,000 more than the year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (Sept)	YTD (Sept)	YTD Actual FV adjustments (Sept)	YTD Budget to Actual Variance (Sept)
2023/24	**$2,500,000**	**$2,500,000**	**$623,000**	**$1,127,000**	**$2,000**	**$506,000**
Previous Years						
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 an increase of $2,000.

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	$116,829,798	100.00%	72.35%
A Category	$23,250,935	60.00%	14.40%
BBB Category	$21,398,480	35.00%	13.25%
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	$116,829,798	100%	72.35%
A+ to A/A1 to A2 Category	$23,250,935	100%	14.40%
A-/A3 Category	$0	40%	0.00%
BBB+/Baa1 Category	$20,000,000	20%	12.39%
BBB/Baa2 Category	$1,398,771	10%	0.87%
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
Bendigo and Adelaide Bank Ltd	BBB+/Baa1 Category	$2,000,000	10%	1.33%
BOQ Ltd	BBB+/Baa1 Category	$8,000,000	10%	6.66%
Commonwealth Bank of Australia	AA+ to AA-/Aa1 to Aa3 Category	$46,579,798	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	$33,000,000	100%	26.65%
Newcastle Greater Mutual Group	BBB/Baa2 Category	$1,398,771	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	$6,250,935	100%	4.17%
Westpac Bank Ltd	AA+ to AA-/Aa1 to Aa3 Category	$28,250,000	100%	17.49%

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. As of 30 June 2023, $17.8 million was restricted.

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 significantly higher than year to date budget as payments for capital works have been lower than expected. This will be addressed in the September Quarter Budget Review.

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 Review

September 2023

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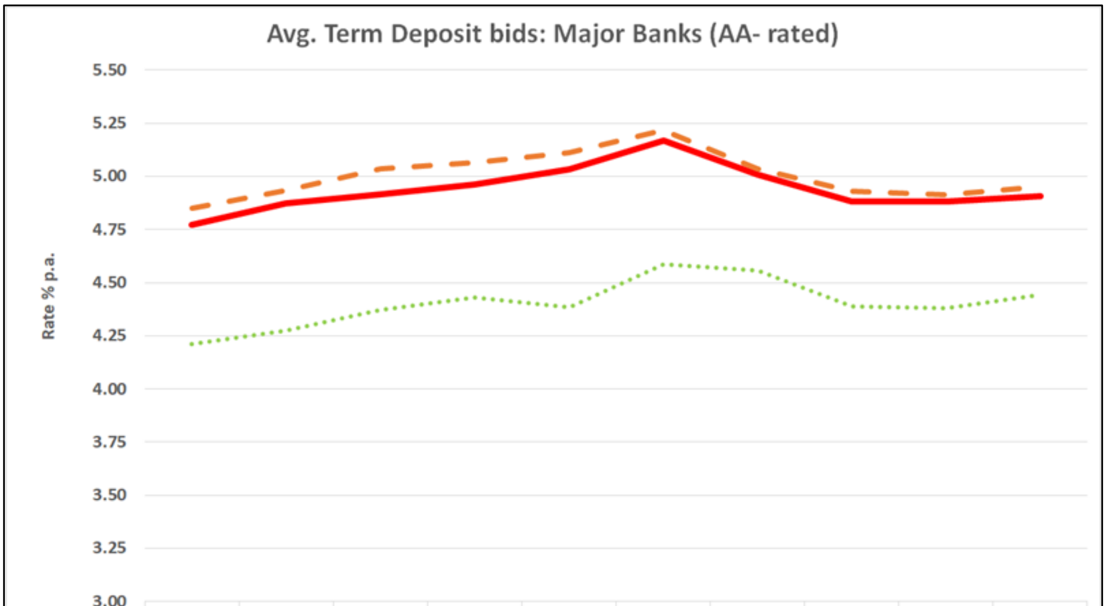
Market Update Summary

Financial markets were partially sold off in September with the view that sticky inflation may translate to official rates being held at higher levels than previously forecasted. Even though the peak of the rate hike cycle may be approaching, rates may stay at elevated levels for a longer period than previously thought with some underlying values of inflation remaining sticky. Domestically, the RBA remains on a tightening bias, warning that some further tightening may be required to ensure that inflation returns to target in a reasonable timeframe, but that this will continue to depend upon the data and the evolving assessment of risks. Markets are still factoring in one more rate hike in the US and Australia over coming months.

Over September, major bank deposit rates fell around 5-10bp across the 6-12 month part of the curve (compared to August), despite the RBA remaining on a slight tightening bias. The average bids by the major banks partially fell after CBA dropped their 'specials' by around 30-40bp across the shorter tenors this month. Deposit rates offered by the major banks 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 after inflation has seemingly peaked.



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Sep-2023	4.77	4.87	4.91	4.96	5.03	5.17	5.01	4.88	4.88	4.91
Aug-2023	4.85	4.93	5.04	5.07	5.11	5.22	5.04	4.93	4.92	4.95
Mar-2023	4.21	4.28	4.37	4.43	4.39	4.59	4.56	4.39	4.38	4.44

Source: Arlo Advisory

With recessionary fears being priced in coming years, investors may take an 'insurance policy' against a potentially lower rate environment by investing across 2-5 year fixed deposits, targeting rates above 5% p.a. (small allocation only).

North Sydney Council' Portfolio & Compliance

Asset Allocation

As at the end of September 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 (9%).

Senior FRNs remain relatively attractive as spreads have generally widened over the past 12-18 months. New issuances may 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 2-5 year fixed deposits, locking in and targeting yields close to or above 5% p.a.

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 6-12 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 13% 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 $71m 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	$41,829,798	25.90%	10%	100%	$119,649,706
✓	91 - 365 days	$57,251,094	35.45%	20%	100%	$104,228,410
✓	1 - 2 years	$41,398,613	25.64%	0%	70%	$71,637,040
✓	2 - 5 years	$21,000,000	13.01%	0%	50%	$59,739,752
✓	5 - 10 years	$0	0.00%	0%	25%	$40,369,876
		$161,479,504	**100.00%**			

Counterparty

As at the end of September, 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-	$46,579,798	28.85%	30.00%	$1,864,054
✓	NAB	AA-	$33,000,000	20.44%	30.00%	$15,443,851
✓	NTTC Treasury	AA-	$9,000,000	5.57%	30.00%	$39,443,851
✓	Westpac	AA-	$28,250,000	17.49%	30.00%	$20,193,851
✓	Suncorp	A+	$6,251,094	3.87%	15.00%	$17,970,832
✓	ICBC Sydney	A	$17,000,000	10.53%	15.00%	$7,221,926
✓	BOQ	BBB+	$8,000,000	4.95%	10.00%	$8,147,950
✓	Bendigo	BBB+	$2,000,000	1.24%	10.00%	$14,147,950
✓	Heritage	BBB+	$10,000,000	6.19%	10.00%	$6,147,950
✓	Newcastle PBS	BBB	$1,398,613	0.87%	10.00%	$14,749,338
			$161,479,504	**100.00%**		

In early August 2023, ANZ's takeover of Suncorp was blocked by the Australian Competition and Consumer Commission (ACCC), with the watchdog saying it was unconvinced the deal would deliver the public benefits claims put forward by ANZ (although ANZ has since appealed the decision).

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 September 2023, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$116,829,798	72.35%	100%	$44,649,706
✓	A Category	$23,251,094	14.40%	60%	$73,636,609
✓	BBB Category	$21,398,613	13.25%	35%	$35,119,214
✓	Unrated ADIs	$0	0.00%	10%	$16,147,950
		$161,479,504	**100.00%**		

Performance

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

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.33%	1.02%	1.97%	1.02%	3.54%	2.07%	1.41%
AusBond Bank Bill Index	0.34%	1.08%	1.99%	1.08%	3.56%	2.03%	1.36%
Council's T/D Portfolio	0.30%	0.85%	1.55%	0.85%	2.82%	2.11%	1.89%
Council's FRN Portfolio	0.43%	1.31%	2.50%	1.31%	4.63%	3.27%	2.62%
Council's Bond Portfolio	0.10%	0.29%	0.58%	0.29%	1.17%	1.16%	-
Council's Portfolio^	**0.29%**	**0.82%**	**1.51%**	**0.82%**	**2.75%**	**2.07%**	**1.85%**
Rel. Performance	**-0.05%**	**-0.26%**	**-0.49%**	**-0.26%**	**-0.82%**	**0.04%**	**0.49%**

^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%	4.10%	3.98%	4.10%	3.54%	2.07%	1.41%
AusBond Bank Bill Index	4.18%	4.35%	4.01%	4.35%	3.56%	2.03%	1.36%
Council's T/D Portfolio	3.69%	3.40%	3.12%	3.40%	2.82%	2.11%	1.89%
Council's FRN Portfolio	5.36%	5.30%	5.05%	5.30%	4.63%	3.27%	2.62%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.16%	-
Council's Portfolio^	**3.56%**	**3.29%**	**3.03%**	**3.29%**	**2.75%**	**2.07%**	**1.85%**
Rel. Performance	**-0.62%**	**-1.06%**	**-0.99%**	**-1.06%**	**-0.82%**	**0.04%**	**0.49%**

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

For the month of September, the total investment portfolio (excluding cash) provided a solid return of +0.29% (actual) or +3.56% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.34% (actual) or +4.18% 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 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. 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.

Recommendations for Council

Term Deposits

As at the end of September 2023, Council's deposit portfolio was yielding **3.59% p.a.** (up 4bp from the previous month), with a weighted average duration of around 348 days (~11½ months). We recommend Council maintains this weighted average duration, should cash flows allow in future.

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

Please refer to the section below for further details on the Term Deposit market.

Securities

Primary (new) **FRNs** (with maturities between 3-5 years) continue to be appealing (particularly for those investors with portfolios skewed towards fixed assets) and should be considered on a case by case scenario.

Please refer to the section below for further details on the FRN market.

Council's Senior FRNs Sale/Switch Recommendations

We recommend Council retains the Newcastle FRN at this stage (still yielding well above 5% p.a.). We will inform Council when there is an opportunity to sell this FRN to boost the overall returns of the investment portfolio. We now recommend Council switch/sell out of the following FRN over the next few months given it is now yielding a low rate of return, if held to maturity:

Issuer	Rating	Maturity Date	ISIN	Face Value	Trading Margin	Capital Price ($)	~Unrealised Gain ($)
Sunc.	A+	30/07/2024	AU3FN0049144	$1,250,000	+61.5bp	$100.086	$1,000

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.

Term Deposit Market Review

Current Term Deposits Rates

As at the end of September, we see value in:

Index	LT Credit Rating	Term	Rate % p.a.
P&N Bank	BBB	4-5 years	5.30%
ING	A	2-3 years	5.25%
P&N Bank	BBB	3 years	5.25%
P&N Bank	BBB	2 years	5.20%
Westpac	AA-	2 years	5.20%
NAB	AA-	2 years	5.20%
BoQ	BBB+	2 years	5.15%
CBA	AA-	2 years	5.09%
Suncorp	A+	2 years	4.99%

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 (*we stress that rates are indicative, dependent on daily funding requirements and different for industry segments*):

ADI	LT Credit Rating	Term	T/D Rate % p.a.
CBA (>$2m)	AA-	12 months	5.34%
NAB	AA-	12 months	5.30%
ING	A	12 months	5.30%
ICBC	A	12 months	5.26%
CBA (>$2m)	AA-	9 months	5.26%
NAB	AA-	11 months	5.25%
ING	A	11 months	5.25%
BoQ	BBB+	9-12 months	5.25%
Westpac	AA-	12 months	5.20%
BoQ	BBB+	6 months	5.15%
P&N Bank	BBB	12 months	5.15%
CBA (>$2m)	AA-	6 months	5.13%
NAB	AA-	6 months	5.10%
NAB	AA-	3 months	4.90%

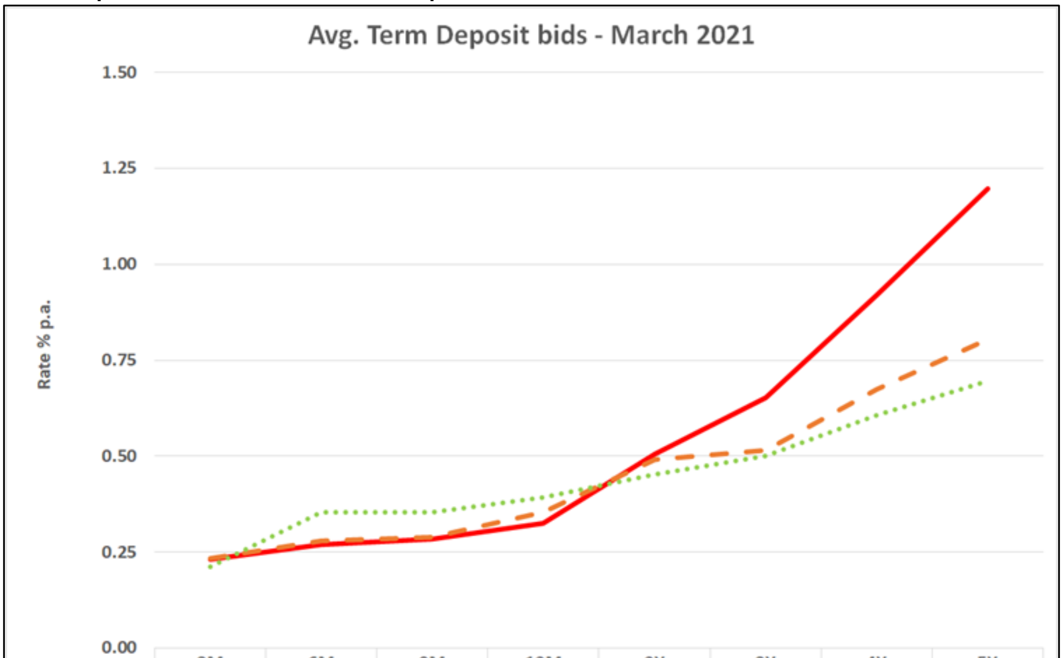
If Council does not require high levels of liquidity and can stagger a proportion of its investments across the longer term horizons (1-5 years), it will be rewarded over a longer-term cycle. Investing a spread of 12 months to 3 year horizons is likely to yield, on average, up to ¼-½% p.a. higher compared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

With recessionary fears and a global economic slowdown being priced in coming years, investors should consider allocating some longer term surplus funds and undertake an insurance policy by investing across 2-5 year fixed deposits, targeting rates above 5% p.a. This will provide some income protection if central banks decide to cut rates in future years, assuming inflation has stabilised.

Term Deposits Analysis

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, 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. 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.

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

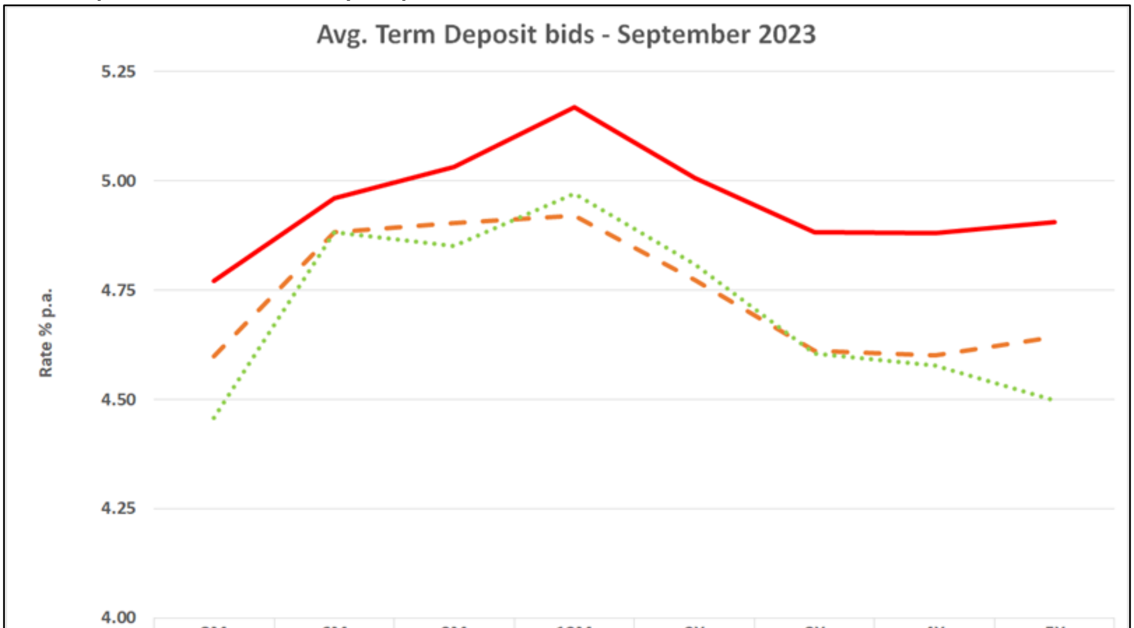
Source: Imperium Markets

The abnormal marketplace experienced during the pandemic is starting to reverse as the competition for deposits slowly increases. In recent months, we have started 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.

Arlo Advisory

Going forward, Council should have a larger opportunity to invest a higher proportion of its 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, although the past two months (August and September) have been an exception due to CBA (AA-), who was offering 'specials' on parcel sizes greater than $2m, paying up to 30-40bp above the entire market:

Term Deposit Rates – Currently (September 2023)



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.77	4.96	5.03	5.17	5.01	4.88	4.88	4.91
A Rated	4.60	4.88	4.90	4.92	4.77	4.61	4.60	4.64
BBB Rated	4.46	4.88	4.85	4.97	4.81	4.60	4.58	4.50

Source: Imperium Markets

Regional & Unrated ADI Sector

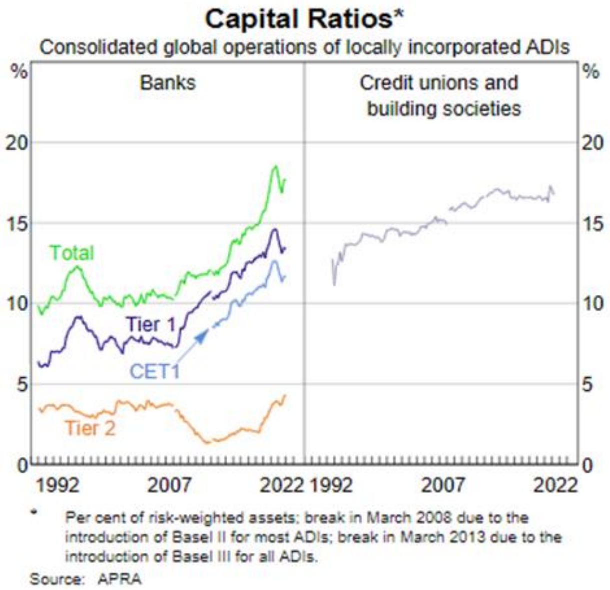
Ratings agency S&P has commented that "*mergers remain compelling for mutuals lenders*" in providing smaller lenders greater economies of scale and assisting them in being able to price competitively and will see "the banking landscape will settle with a small number of larger mutual players". S&P expects that consolidation to continue over the next two years.

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 nine 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.

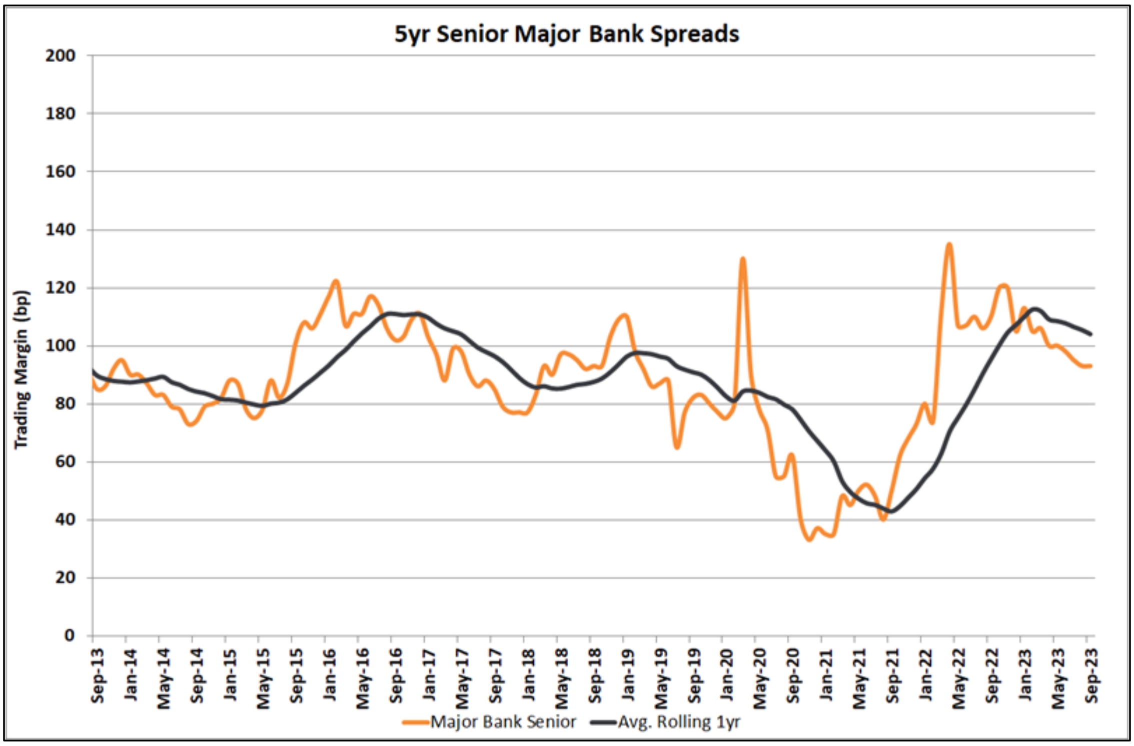
We believe that deposit investments with the lower rated ADIs should be considered going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns. The lower rated entities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



Senior FRNs Market Review

Over September, amongst the senior major bank FRNs, physical credit securities remained flat at the long-end of the curve. Major bank senior securities remain at fair value in the rising rate environment (5yr margins above +90bp level). During the month, WBC (AA-) issued a new 5 year senior FRN at +93bp.



Source: IBS Capital

Outside of Westpac, there were a handful of other new (primary) issuances during September:

- 3yr Mizuho (A) senior FRN at +85bp
- 3yr Macquarie Bank (A+) senior FRN at +85bp

Amongst the "A" and "BBB" rated sector, the securities tightened by around 2bp at the longer-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)	30/09/2023	31/08/2023
“AA” rated – 5yrs	+93bp	+93bp
“AA” rated – 3yrs	+74bp	+75bp
“A” rated – 5yrs	+115bp	+118bp
“A” rated – 3yrs	+90bp	+92bp
“BBB” rated – 3yrs	+115bp	+120bp

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 2025 for the “AA” rated ADIs (domestic major banks);
- On or before mid-late 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.

Senior Fixed Bonds – ADIs (Secondary Market)

With global inflation remaining elevated, 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	0.83	1.85%	4.99%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	0.94	1.70%	5.02%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	1.08	2.00%	5.22%
AU3CB0287498	Bendigo	BBB+	Senior	17/03/2025	1.46	3.00%	5.21%
AU3CB0273407	UBS	A+	Senior	30/07/2025	1.83	1.20%	5.37%
AU3CB0293967	Bendigo	AAA	Covered	11/11/2025	2.12	5.10%	5.17%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.60	1.40%	5.47%
AU3CB0282358	ING	AAA	Covered	19/08/2026	2.89	1.10%	4.99%
AU3CB0284149	BoQ	BBB+	Senior	27/10/2026	3.07	2.10%	5.49%

Economic Commentary

International Market

Financial markets were sold off on concerns that official interest rates may remain at higher levels than previously anticipated due to sticky inflation.

Across equity markets, the S&P 500 Index fell -4.87%, whilst the NASDAQ dropped -5.81%. Europe's main indices also experienced losses, led by Germany's DAX (-3.51%) and France's CAC (-2.48%). UK's FTSE was an exception, gaining +2.27%.

As universally expected, the US Fed kept the Funds rate target unchanged at 5.25%-5.50%. In the Statement, the main change is that the economy is described as growing at a "*solid pace*", an upward revision from "*moderate pace*" in July. Also as expected, the new Fed dot plot shows the median 2023 dot unchanged at 5.625% (meaning one more quarter point hike this year).

US core CPI printed at +0.278% m/m vs. +0.2% expected. In 3m annualised terms, the trend on core CPI is looking favourable at +2.4%, whilst the Fed's preferred PCE measure is running at +1.9%.

The US unemployment rate jumped up to 3.8% from 3.5% - its highest since February 2022 from where it has fallen to as low of 3.4%. The participation rate rose from 62.6% to 62.8%, the highest level prior to the pandemic.

Canada's inflation rose to +4.0% y/y from +3.3% y/y in July, faster than the +3.8% y/y expected. The annual rate has accelerated from +2.8% y/y in June as base effect tailwinds have rolled off and fuel prices rose.

The ECB raised interest rates 25bp, taking the deposit rate to 4.00%, commenting that "*the Governing Council considers that the key ECB interest rates have reached levels that, maintained for a sufficiently long duration will make a substantial contribution to the timely return of inflation to the target*".

Chinese CPI was in line with expectations, creeping back above zero to +0.1% y/y from -0.3%, supported by summer travel. CPI rose +0.3% m/m, picking up from +0.2% m/m in July. The core rate excluding food and energy costs rose to +0.8% y/y.

The Swiss National Bank defied widely held expectations for a 25bp hike and left its policy rate unchanged, while central banks for Sweden and Norway both hiked the expected 25bp respectively. Brazil's central bank cut rates by the expected 50bp, its first easing this cycle, following recent rate cuts by Poland and Chile.

The MSCI World ex-Aus Index fell -4.46% for the month of September:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-4.87%	-3.65%	+19.59%	+8.44%	+8.03%	+9.81%
MSCI World ex-AUS	-4.46%	-3.81%	+20.16%	+6.48%	+5.61%	+6.53%
S&P ASX 200 Accum. Index	-1.50%	-0.77%	+13.46%	+11.00%	+6.67%	+7.43%

Source: S&P, MSCI

Domestic Market

As unanimously expected, the RBA left its official cash rate unchanged at 4.10% for the third successive month in its September meeting. The accompanying statement continues to suggest the RBA retains a bias to tighten further if needed, but is hopeful that it has done enough to return inflation to target.

The RBA September Minutes confirmed there was little reassessment from their previous meeting. In deciding to hold rates at 4.10% for the third consecutive meeting, the Board again considered but opted against the case for a 25bp increase. That case was centred on "*the expectation that inflation will remain above the Bank's target for a prolonged period and the risk that this period might be extended*". The case for a hold, the outcome at this meeting, reflected that "*the effects of tighter monetary policy were yet to be fully realised*".

GDP rose by +0.4% q/q (+2.1% y/y), in line with consensus and slightly stronger than the RBA's August SMP (+0.2%). With an upward revision to Q1 (now +0.4%), this shows the economy broadly maintained momentum, despite a further small slowing in consumption growth, helped by government infrastructure and business investment spending.

Employment in August rose +65k (consensus +25k). Gains came in part-time (+62.1k), whilst full-time also rose slightly (+2.8k). The lift in the participation rate by 0.1% to a record high 67.0% meant the unemployment rate remained unchanged at 3.7%. Markets still sees very little chance of a hike from the RBA in October, but November pricing is around 36% from 31%.

The Monthly CPI Indicator for August rose to +5.2% y/y from +4.9%, with the underlying details revealing that services inflation remains sticky.

Retail sales rose +0.2% m/m in August, signalling a subdued pace of growth.

The July Trade Balance narrowed to $8.0bn from a downwardly revised $10.3bn (consensus $10bn). That was driven by a combination of lower exports (-2.0% or $1.1bn) and higher imports (+2.5% or +$1.1bn).

The Australian dollar fell -0.42%, finishing the month at US64.58 cents (from US64.85 cents the previous month).

Credit Market

The global credit indices widened significantly over September 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	September 2023	August 2023
CDX North American 5yr CDS	73bp	64bp
iTraxx Europe 5yr CDS	80bp	71bp
iTraxx Australia 5yr CDS	89bp	78bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	September 2023	August 2023
Bloomberg AusBond Bank Bill Index (0+YR)	+0.34%	+0.37%
Bloomberg AusBond Composite Bond Index (0+YR)	-1.53%	+0.74%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.37%	+0.46%
Bloomberg AusBond Credit Index (0+YR)	-0.58%	+0.99%
Bloomberg AusBond Treasury Index (0+YR)	+1.88%	+0.61%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-2.20%	+0.70%

Source: Bloomberg

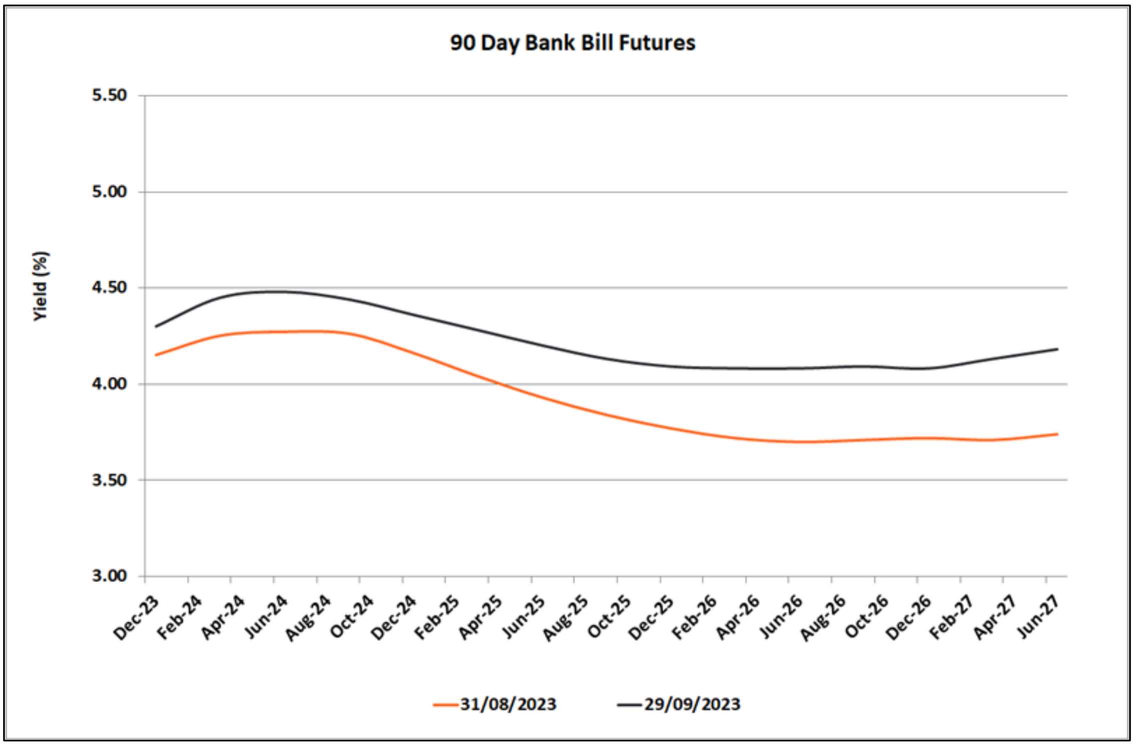
Other Key Rates

Index	September 2023	August 2023
RBA Official Cash Rate	4.10%	4.10%
90 Day (3 month) BBSW Rate	4.14%	4.13%
3yr Australian Government Bonds	4.08%	3.74%
10yr Australian Government Bonds	4.48%	4.02%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	5.03%	4.85%
10yr US Treasury Bonds	4.59%	4.09%

Source: RBA, ASX, US Department of Treasury

90 Day Bill Futures

Bill futures rose across the board this month, following the movement in the global bond market. The RBA remains on a slight tightening bias and will react with additional hike(s) if economic data suggests inflation will remain elevated. 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

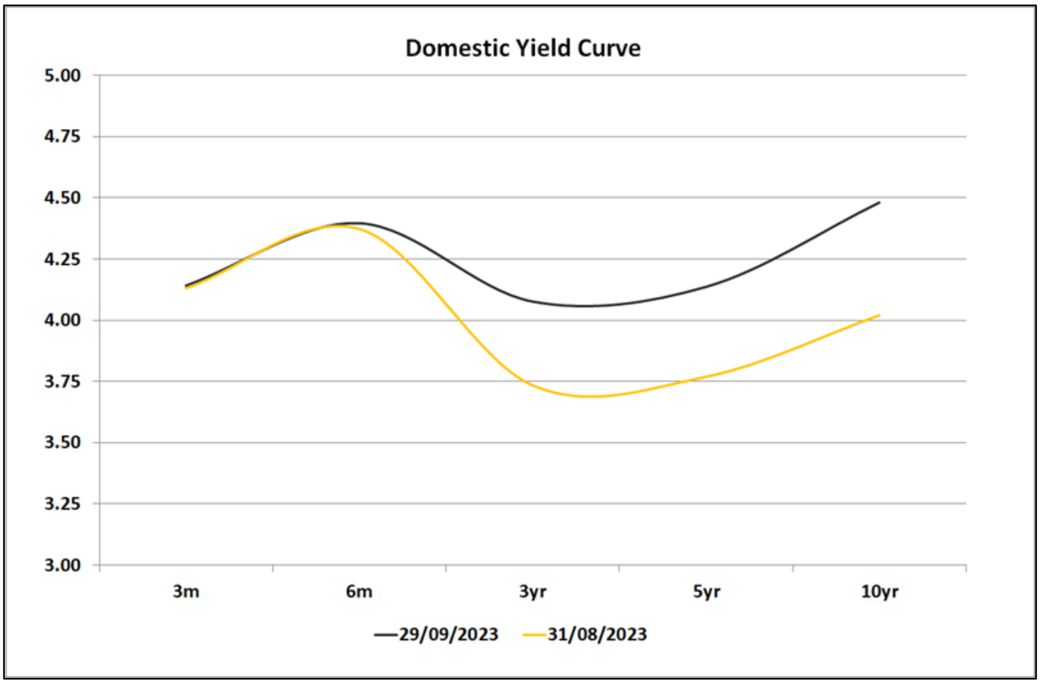
Fixed Interest Outlook

Global inflation has accelerated in recent months – ending the trend of disinflation exhibited in early to mid-2023, albeit this largely reflected an uptick in India and Turkey, rather than a broad-based increase. Inflation among advanced economies continued to ease – edging down to +4.4% annually.

The slowing inflation trend in advanced economies has increased the likelihood that most major central banks have either reached the end of their tightening cycle or are near the peak. That said, this assumption is predicated on inflation continuing to trend lower (with rising energy prices a risk to headline inflation), and near-term risk around policy rates is still to the upside. There is considerable uncertainty around when central banks will start to cut rates – markets have pushed back their expectations over September, resulting the sell-off in bonds (yields rose).

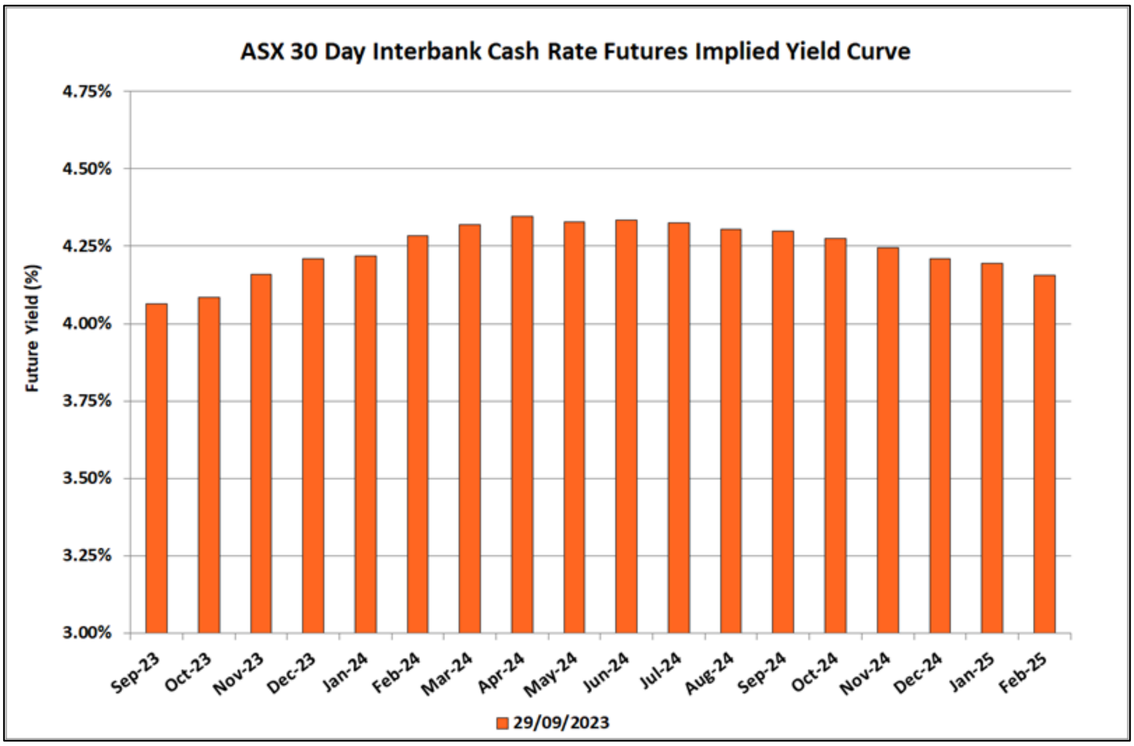
Domestically, the RBA remains committed to tightening further if required, again warning that some further tightening may be required to ensure inflation returns to target in a reasonable timeframe, but this will continue to depend upon the data and the evolving assessment of risks. Broader measures of services inflation is running at +5.6% y/y, where it has been since December 2022, and illustrative of the stickiness in services inflation. This may force the RBA to hike again in coming months, consistent with what market expectations are pricing (likely to wait for confirmation in the full Q3 CPI on 25th October).

Over the month, yields rose up to 46bp at the long end of the curve:



Source: ASX, RBA

Markets have been quick to revise their interest rate forecasts with one more rate hike priced this cycle. Interestingly, rate cuts are still being forecasted, but not at least until Q3-Q4 2024:



Source: ASX

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