10.3. Investment and Loan Borrowings Report as at 31 January 2024

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ATTACHMENTS	1. Monthly Investment Review January 2024 [**10.3.1** - 21 pages]
CSP LINK	5. Our Civic Leadership 5.1 Lead North Sydney's strategic direction

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 January 2024.

EXECUTIVE SUMMARY:

- All investments have been made in accordance with the Local Government Act and Regulations. The balance held with Commonwealth Bank of Australia slightly exceeds the counter party limits in Council's Financial Investments Policy due to deposits that settled after close of business on 31 January. The Policy permits a limit of 30% of the portfolio with an AA rated counterparty, 30.09% was held. A high cash balance was held as rates available are higher than (short) term deposits and to fund upcoming capital works payments.

- The terms of the Loan Agreement with TCorp have been altered to remove their credit quality limits and replace them with those in Council's Financial Investments Policy. It is no longer necessary to report compliance with TCorp's limits.

- For the month of January, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.32% (actual), or +3.81% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.37% (actual), or +4.44% 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 $1.07 million. The total return for the 2023/2024 financial year to date is approximately $3.37 million. The better-than-expected return is due to the payments for the capital works program progressing slower than expected in the first two quarters.

RECOMMENDATION:
1. THAT the report on Investments held on 31 January 2024, prepared in accordance with clause 212 of the Local Government (General) Regulation 2021, and the 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.

Total Cash and Investment Balance and Reserves

The total cash and investment balance is $158,280,518. Most of this balance is held in reserves to be spent on certain activities and projects. Reserves fall into one of two categories:

- external restriction (Council is obliged by legislation, or contract, to spend the funds on certain projects and activities), and
- internal allocations (Council has resolved to spend the funds on certain projects and activities).

The following table details the reserves held as at 31 January 2024. Council holds an unrestricted cash balance of $11.1 million, indicating it has funded all its reserves.

External Restrictions and Internal Allocations	
External restrictions	
Developer contributions - general	$44,704,461
Domestic waste management	$15,699,241
Unexpended Special Rates	$1,596,135
Unspent borrowings - North Sydney Olympic Pool redevelopment	$17,757,000
Waste and sustainability improvement funds	$37,646
Specific purpose grants	$5,496,672
Other specific purpose contributions	$2,005,474
Total external restrictions	**$87,296,629**
Internal allocations	
Capital works	$9,447,262
Community housing - capital purchases	$962,601
Community housing - major maintenance	$490,657
Deposits, retentions and bonds	$13,335,124
Employees leave entitlement	$6,833,232
I.T. hardware and software	$1,087,899
Income producing projects	$781,728
Olympic Pool Redevelopment	$24,273,101
Plant and vehicle replacement	$2,716,574
Total internal allocations	**$59,928,178**

External Restrictions and Internal Allocations	
Total Restrictions and Allocations	**$147,224,807**
Unrestricted Cash and Investments	$11,055,711
Total Cash and Investments	**$158,280,518**

Investment Portfolio

The following table details the performance of Council's investment portfolio (excluding cash deposits) to the benchmark for the month of January 2024 and annualised for the year-to-date 31 January 2024 (including investments that have matured prior to that date).

	January 2023	Annualised YTD
Actual Return	0.32%	3.81%
Benchmark	0.37%	4.44%
Variance	-0.05%	-0.63%

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. Arlo 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	$127,000,000	80.24%
Cash	$19,630,557	12.40%
Fixed Bonds	$9,000,000	5.69%
Floating Rate Notes (FRNs)	$2,649,961	1.67%
	$158,280,518	**100.00%**

Council's average duration of term deposits, which comprise 80.24% of the investment portfolio, is approximately 268 days. The average duration continues to fall to align maturities with expected outflows on the capital works program.

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 held with Commonwealth Bank of Australia slightly exceeded the counterparty limits in Council's Investment Policy due to deposits that settled after close of business on 31 January. The Policy permits a limit of 30% of the portfolio, whereas 30.09% was held with the Commonwealth Bank. A high cash balance was held with the Commonwealth Bank in anticipation of outflows on the capital works program. At-call rates available are higher than those quoted for (short) term deposits.

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 original budget of $94.1 million in 2023/24.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 31 January 2024 are $1.07 million more than the year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (Jan)	YTD (Jan)	YTD Actual FV adjustments (Jan)	YTD Budget to Actual Variance (Jan)
2023/24	$2,500,000	$3,490,000	$2,302,980	$3,370,517	$2,202	$1,069,739
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 $2,202.

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	$119,630,557	100.00%	75.58%
A Category	$18,251,081	60.00%	11.53%
BBB Category	$20,398,880	35.00%	12.89%
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. The Loan Agreement was varied in January 2024 so that these limits are now those contained in Council's Financial Investment Policy. It is no longer necessary to report compliance with additional with TCorp limits.

Loan Borrowings

Council's Loan Borrowing Policy is the framework for Council's borrowing activities. This 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			
31/07/2023	$5,223,543.14	$56,492.44	$233,147.10	$ 289,639.54
31/10/2023	$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 January 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 31 January 2024, $17.8 million was unspent.

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 continue to be significantly higher than the year-to-date budget as payments for capital works have been lower than expected. A $1.00 million upward revision was adopted at the September Quarter Budget Review. The December Quarter Review will propose a further upward revision of $1 million.

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 consider it prudent to provide monthly reporting of loans.

Monthly Investment Review

January 2024

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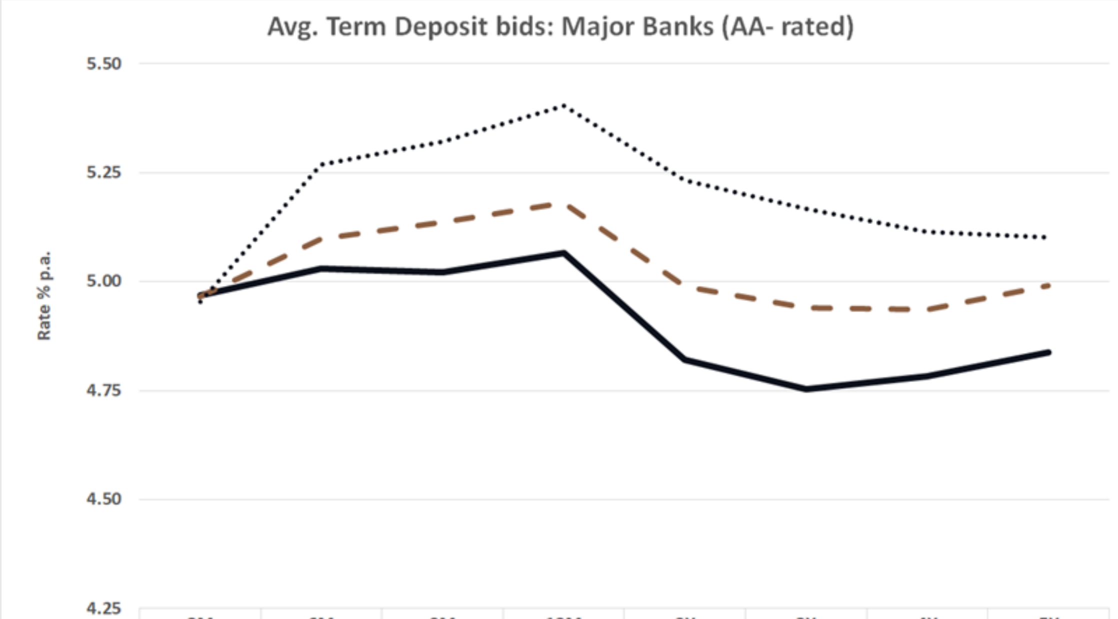
Market Update Summary

Financial markets continued their rally in January following the shift by central banks indicating that inflationary pressures globally have receded more quickly than they had expected. The market is now clearly focused on the timing of the first interest rate cuts in 2024.

Over January 2024, major bank deposit rates were lower across the board compared to the previous month (December 2023). Major bank deposit rates dropped by as much as 12bp across the shorter-tenors (3-12 months) and by around 15-20bp across the longer-tenors (2-5 years). Interestingly, major bank deposit rates are approximately 20-40bp lower than what they were 6 months ago (July 2023).



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Jan-2024	4.97	5.03	5.02	5.07	4.82	4.75	4.78	4.84
Dec-2023	4.97	5.10	5.14	5.18	4.99	4.94	4.94	4.99
Jul-2023	4.95	5.27	5.32	5.40	5.23	5.17	5.11	5.10

Source: Imperium Markets

With a global economic downturn and multiple interest rate cuts being priced in coming years, investors should consider taking an 'insurance policy' against a potentially lower rate environment by investing across 2-5 year fixed deposits, targeting rates above or close to 4¾-5% p.a. (small allocation only).

North Sydney Council' Portfolio & Compliance

Asset Allocation

As at the end of January 2024, the portfolio was mainly directed to fixed term deposits (81%). The remaining portfolio is directed to FRNs (2%), fixed bonds (6%) and overnight cash accounts (12%).

Senior FRNs remain relatively attractive as spreads have generally widened over the past 2 years. 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 multiple rate cuts and a global economic downturn 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 4¾-5% p.a.

However, noting the significant capital outflows expected in the near term, Council is currently largely restricted 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 6% 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 $76m 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 $94.1 (as per the September Quarter Budget Review) 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	$66,630,557	42.10%	10%	100%	$91,649,961
✓	91 - 365 days	$47,251,081	29.85%	20%	100%	$111,029,437
✓	1 - 2 years	$34,398,880	21.73%	0%	70%	$76,397,483
✓	2 - 5 years	$10,000,000	6.32%	0%	50%	$69,140,259
✓	5 - 10 years	$0	0.00%	0%	25%	$39,570,129
		$158,280,518	**100.00%**			

Counterparty

As at the end of January, all individual limits comply with the Policy, except for CBA (AA-) due to the high cash balance. 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 ($)	Invested (%)	Max. Limit (%)	Available ($)
X	CBA	AA-	$47,630,557	30.09%	30.00%	-$146,401
✓	NAB	AA-	$40,000,000	25.27%	30.00%	$7,484,155
✓	NTTC Treasury	AA-	$9,000,000	5.69%	30.00%	$38,484,155
✓	Westpac	AA-	$21,000,000	13.27%	30.00%	$26,484,155
✓	Suncorp	A+	$1,251,081	0.79%	15.00%	$22,490,996
✓	ICBC Sydney	A	$17,000,000	10.74%	15.00%	$6,742,078
✓	BOQ	BBB+	$9,000,000	5.69%	10.00%	$6,828,052
✓	Bendigo	BBB+	$2,000,000	1.26%	10.00%	$13,828,052
✓	Heritage	BBB+	$10,000,000	6.32%	10.00%	$5,828,052
✓	Newcastle PBS	BBB	$1,398,880	0.88%	10.00%	$14,429,172
			$158,280,518	**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 January 2024, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$117,630,557	74.32%	100%	$40,649,961
✓	A Category	$18,251,081	11.53%	60%	$76,717,230
✓	BBB Category	$22,398,880	14.15%	35%	$32,999,301
✓	Unrated ADIs	$0	0.00%	10%	$15,828,052
		$158,280,518	**100.00%**		

Performance

Council's performance for the month ending January 2024 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.36%	1.08%	2.11%	2.46%	4.00%	2.77%	1.88%
AusBond Bank Bill Index	0.37%	1.09%	2.15%	2.53%	4.00%	2.75%	1.83%
Council's T/D Portfolio	0.33%	0.98%	1.88%	2.15%	3.30%	2.55%	2.16%
Council's FRN Portfolio	0.45%	1.35%	2.70%	3.14%	5.10%	3.88%	3.12%
Council's Bond Portfolio	0.10%	0.29%	0.59%	0.69%	1.17%	1.17%	1.13%
Council's Portfolio^	**0.32%**	**0.94%**	**1.82%**	**2.07%**	**3.20%**	**2.48%**	**2.11%**
Rel. Performance	**-0.05%**	**-0.15%**	**-0.33%**	**-0.46%**	**-0.80%**	**-0.26%**	**0.27%**

^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	4.35%	4.35%	4.22%	4.21%	4.00%	2.77%	1.88%
AusBond Bank Bill Index	4.44%	4.41%	4.30%	4.33%	4.00%	2.75%	1.83%
Council's T/D Portfolio	3.97%	3.95%	3.77%	3.67%	3.30%	2.55%	2.16%
Council's FRN Portfolio	5.48%	5.48%	5.42%	5.39%	5.10%	3.88%	3.12%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.17%	1.13%
Council's Portfolio^	**3.81%**	**3.79%**	**3.63%**	**3.54%**	**3.20%**	**2.48%**	**2.11%**
Rel. Performance	**-0.63%**	**-0.61%**	**-0.67%**	**-0.79%**	**-0.80%**	**-0.26%**	**0.27%**

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

For the month of January, the total investment portfolio (excluding cash) provided a solid return of +0.32% (actual) or +3.81% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.37% (actual) or +4.44% 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 January 2024, Council's deposit portfolio was yielding **3.86% p.a.** (down 4bp from the previous month), with a weighted average duration of around 268 days (~9 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 5¼% 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	+55.0bp	$100.086	$1,081

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 January, we see value in the following (note rates likely to be at least 5-10bp lower across the board following the lower than expected inflation print on 31st January):

Index	LT Credit Rating	Term	Rate % p.a.
ING	A	5 years	5.13%
ING	A	4 years	5.02%
ING	A	2 years	4.97%
ING	A	3 years	4.95%
BoQ	BBB+	5 years	4.95%
Suncorp	A+	2 years	4.94%
BoQ	BBB+	4 years	4.90%
Suncorp	A+	3 years	4.86%
Westpac	AA-	2 years	4.76%
NAB	AA-	2 years	4.75%

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*):

Index	LT Credit Rating	Term	Rate % p.a.
Australian Unity	BBB+	12 months	5.19%
Suncorp	A+	12 months	5.17%
ING	A	12 months	5.17%
NAB	AA-	12 months	5.15%
Suncorp	A+	9 months	5.14%
NAB	AA-	5-9 months	5.10%
Suncorp	A+	6 months	5.10%
Bendigo	BBB+	9 months	5.06%
BoQ	BBB+	9 months	5.05%
NAB	AA-	3-4 months	5.05%
Westpac	AA-	12 months	5.02%

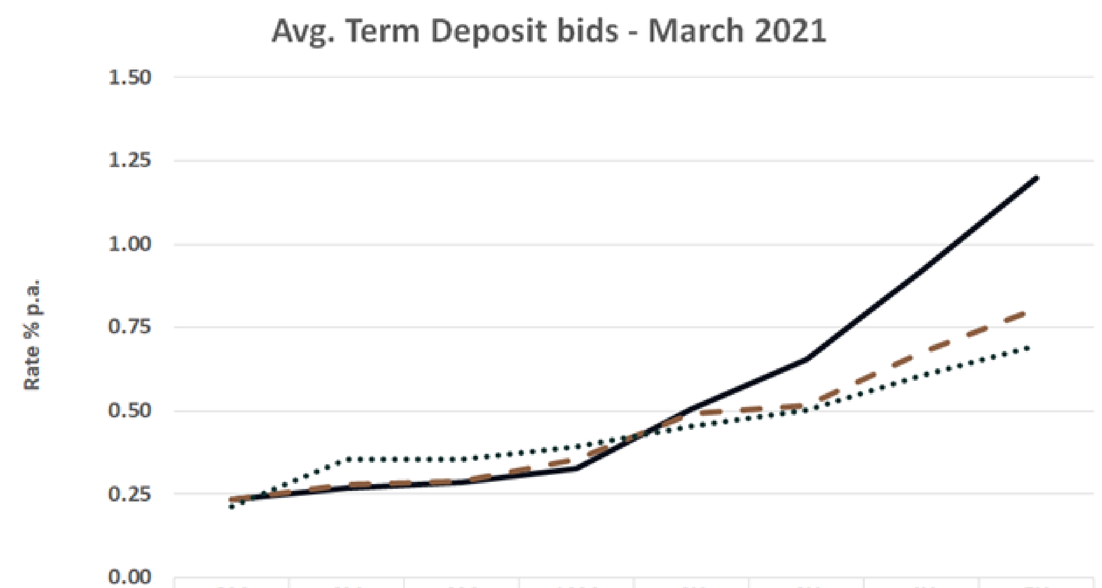
If Council does not require high levels of liquidity and can stagger a proportion of its investments across the longer term horizons (1-5 years), it will be rewarded over a longer-term cycle. Investing a spread of 12 months to 3 year horizons is likely to yield, on average, up to ¼-½% p.a. higher compared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

With a global economic slowdown and rate cuts being priced in coming years, investors should strongly consider and allocate some longer term surplus funds to undertake an insurance policy by investing across 2-5 year fixed deposits and locking in rates close to or above 4¾-5% p.a. This will provide some income protection with central banks now likely to cut rates at some stage later this year.

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) during 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)



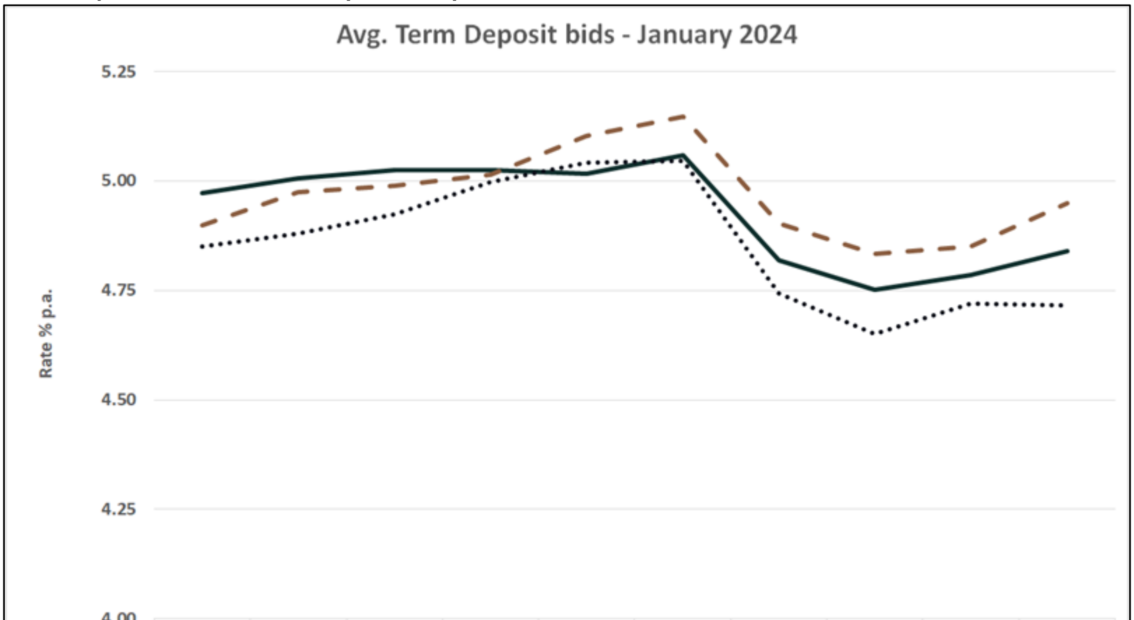
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

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 periodically see some of the lower rated ADIs ("A" and "BBB" rated) offering slightly higher rates compared to the domestic major banks ("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 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 few months have been an exception, with the major banks repricing more rapidly to the movement in the bond market than their lower rated counterparts. This reversed somewhat over the past few months with the lower rated institutions (mainly "A" rated) lagging the major banks in dropping their rates:

Term Deposit Rates – Currently (January 2024)



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.97	5.01	5.02	5.02	5.02	5.06	4.82	4.75	4.79	4.84
A Rated	4.90	4.97	4.99	5.02	5.10	5.15	4.90	4.83	4.85	4.95
BBB Rated	4.85	4.88	4.92	5.00	5.04	5.05	4.74	4.65	4.72	4.72

Source: Imperium Markets

Regional & Unrated ADI Sector

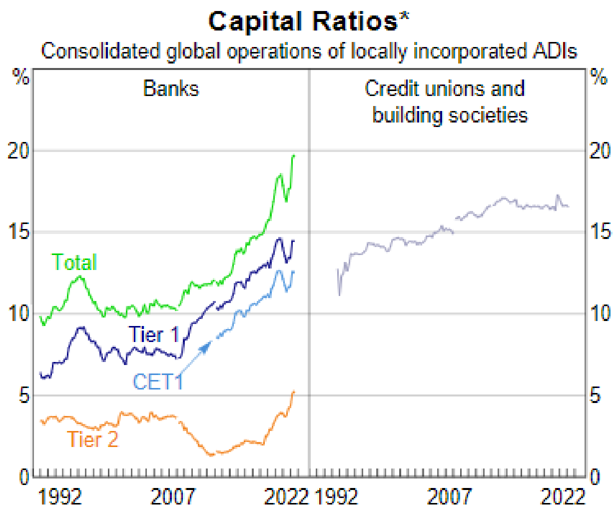
Ratings agency S&P has commented that "*mergers remain compelling for mutuals lenders*" in providing smaller lenders greater economies of scale and assisting them in being able to price competitively and will see "*the banking landscape will settle with a small number of larger mutual players*". S&P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



* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs.

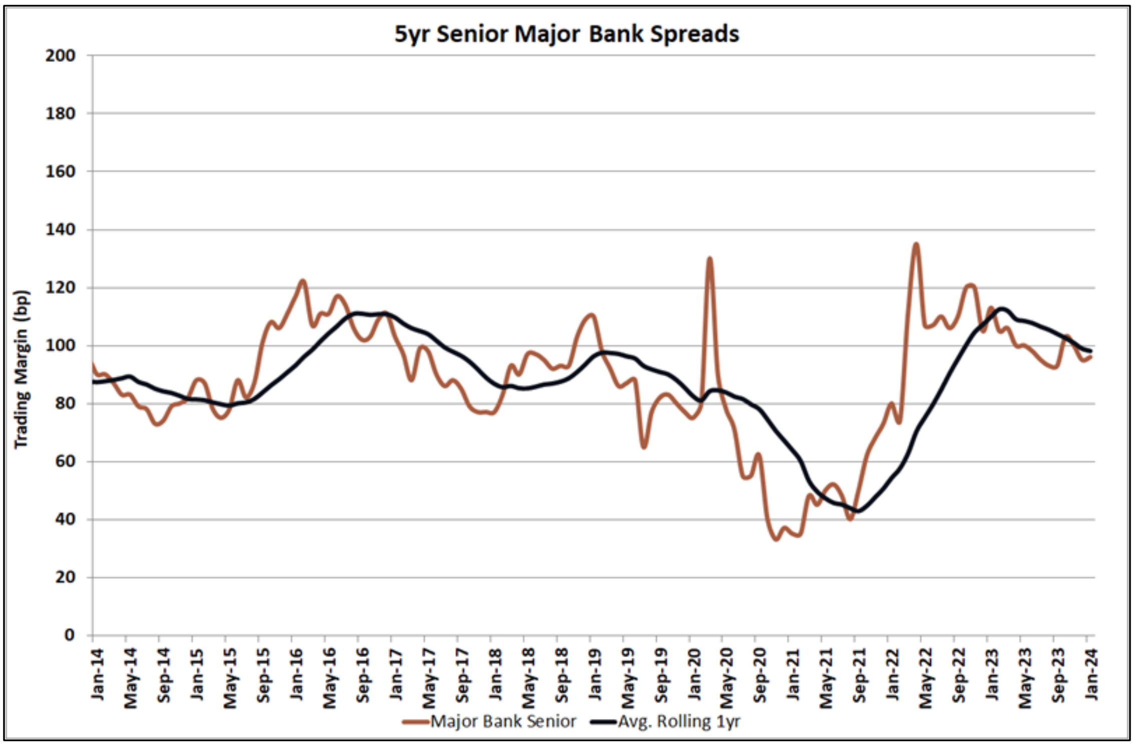
Source: APRA.

Senior FRNs Market Review

Over January, amongst the senior major bank FRNs, physical credit securities widened up to 9bp at the long-end of the curve. During the month, there were notable new issuances from:

- WBC (AA-) ~3yr & 5yr senior security at +82bp and +100bp respectively
- ANZ (AA-) 3 & 5yr senior security at +80bp and +96bp respectively
- QTC (AA+) 10yr fixed sustainable bond at 4.75% s.a.

Major bank senior securities remain at fair value on a historical basis (5yr margins around +96bp level).



Source: IBS Capital

During the month, the other new notable issuances were as follows:

- Great Southern Bank (BBB) 3yr senior FRN at +160bp
- Mizuho (A) 3yr senior FRN at +88bp
- Heritage (BBB) 3yr senior FRN at +160bp

Amongst the "A" and "BBB" rated sectors, the securities remained relatively flat at the longer-end of the curve. Credit securities are looking much more attractive given the widening of spreads over the past ~2 years. 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)	31/01/2024	31/12/2023
"AA" rated – 5yrs	+96bp	+95bp
"AA" rated – 3yrs	+80bp	+71bp
"A" rated – 5yrs	+125bp	+125bp
"A" rated – 3yrs	+99bp	+97bp
"BBB" rated – 3yrs	+148bp	+148bp

Source: IBS Capital

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

- On or before early 2026 for the "AA" rated ADIs (domestic major banks);
- On or before early 2025 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 still high by historical standards, this has seen a significant lift in longer-term bond yields over the past 2 years (valuations have 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
AU3CB0273407	UBS	A+	Senior	30/07/2025	1.50	1.20%	5.07%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.27	1.40%	5.14%
AU3CB0299337	Bendigo	BBB+	Senior	15/05/2026	2.29	4.70%	5.10%
AU3CB0296168	BoQ	BBB+	Senior	27/01/2027	2.99	4.70%	5.16%

Economic Commentary

International Market

Financial markets continued their rally in January following the shift by central banks indicating that inflationary pressures globally have receded more quickly than they had expected. With global economic activity and labour markets continuing to gradually cool, investors are becoming more confident of a soft landing, reflected by the fall in bond yields and a rise in equities in recent months.

Across equity markets, the S&P 500 Index gained +1.59%, whilst the NASDAQ added +1.02%. Europe's main indices also experienced further gains, led by France's CAC (+1.51%) and Germany's DAX (+0.91%). UK's FTSE (-1.33%) was the exception, losing ground against global trends.

In the US, the latest core personal consumption expenditures (PCE) index, which is the US central bank's preferred measure of inflation (which excludes volatile food and energy costs), recorded a +0.2% increase for the month of December, taking the annual rate to +2.9%.

The US economy grew at a +3.3% annual rate in the fourth quarter of 2023, which was well above the +2.0% consensus, though down from the +4.9% rate in the third quarter.

As widely expected, the Bank of Japan, European Central Bank (ECB) and Bank of Canada all held their respective interest rates steady at their policy meetings. The commentary accompanying their monetary policy decisions were largely unchanged, with these central banks reaffirming their commitment to fight inflation.

Germany reported that GDP had shrunk -0.3% for the calendar year of 2023 and in Q4 - though the Eurozone's biggest economy has been spared a technical recession in H2 2023 by an upward revision Q3, from -0.1% to 0.0%.

China is sinking deeper into its worst deflation in years. It signals continuing economic distress in China, which could mean weaker sales for Western brands that do business there. China's population also fell by 2 million last year, highlighting the challenges facing the world's second-largest economy.

The World Bank released the latest edition of its Global Economics Prospects. It provided a fairly pessimistic view, with advanced economies GDP growth set to slow, from +1.5% on average in 2023 to +1.2% in 2024.

The MSCI World ex-Aus Index rose +1.20% for the month of January:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+1.59%	+15.54%	+18.86%	+9.27%	+12.37%	+10.52%
MSCI World ex-AUS	+1.20%	+15.71%	+15.51%	+6.51%	+9.72%	+7.36%
S&P ASX 200 Accum. Index	+1.19%	+13.99%	+7.09%	+9.56%	+9.71%	+8.39%

Source: S&P, MSCI

Domestic Market

The consumer price index (CPI) rose +0.6% during Q4 2023, resulting in an annual increase of +4.1%. Inflation has fallen to its lowest level in two years, dampening the chances of a further interest rate rise. The monthly measure of inflation also showed price pressures easing even further. This measure dropped to +3.4% in December from +4.3% in November. The measure of underlying inflation also eased, to +4.0% from +4.6%.

Employment fell a sharp -65.1k in December, following the upwardly revised +72.6k surge in November and October's +44.2k. The unemployment rate was unchanged at 3.9% (or 3.8820% unrounded). Since October 2022, the unemployment rate has risen by 0.47%, highlighting that whilst the labour market remains tight, the degree of tightness in the labour market is easing.

Retail sales rose +2.0% m/m in November (consensus +1.2%). That reflects the shift towards increased spending at Black Friday rather than a trend acceleration in what remains sluggish consumer spending growth. Consumers delayed spending from October, when retail sales fell -0.4% m/m, to November and likely also pulled forward more spending from December.

Dwelling approvals rose +1.6% m/m in November, as a rise in attached approvals offset a small fall in detached approvals.

The November goods trade surplus rose to $11.4bn (consensus $7.3bn), from an upwardly revised $7.7bn. The large surprise was driven by a fall back in imports (-7.9% m/m or -$2.99bn).

The Government announced changes to stage three tax cuts. Those earning $200,000 or more will receive a $4,529 cut, instead of the legislated $9,075 they were due to receive from 1 July. Those earning between $45,000 and $135,000 will be taxed at 30%, while the 37% tax rate will be reinstated and apply to incomes between $135,000 and $190,000, after which the 45% rate will apply.

Iron ore prices tumbled by the most in at least five months on concerns about a weakening economy of top consumer China and heightened tensions in the Taiwan Strait and the Red Sea.

The Australian dollar fell -3.89%, finishing the month at US65.74 cents (from US68.40 cents the previous month).

Credit Market

The global credit indices remained relatively flat over January as risk markets continued their rally. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	January 2024	December 2023
CDX North American 5yr CDS	55bp	56bp
iTraxx Europe 5yr CDS	60bp	60bp
iTraxx Australia 5yr CDS	68bp	72bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	January 2024	December 2023
Bloomberg AusBond Bank Bill Index (0+YR)	+0.37%	+0.37%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.21%	+2.69%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.44%	+0.51%
Bloomberg AusBond Credit Index (0+YR)	+0.41%	+2.10%
Bloomberg AusBond Treasury Index (0+YR)	+0.16%	+2.77%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-0.69%	+4.65%

Source: Bloomberg

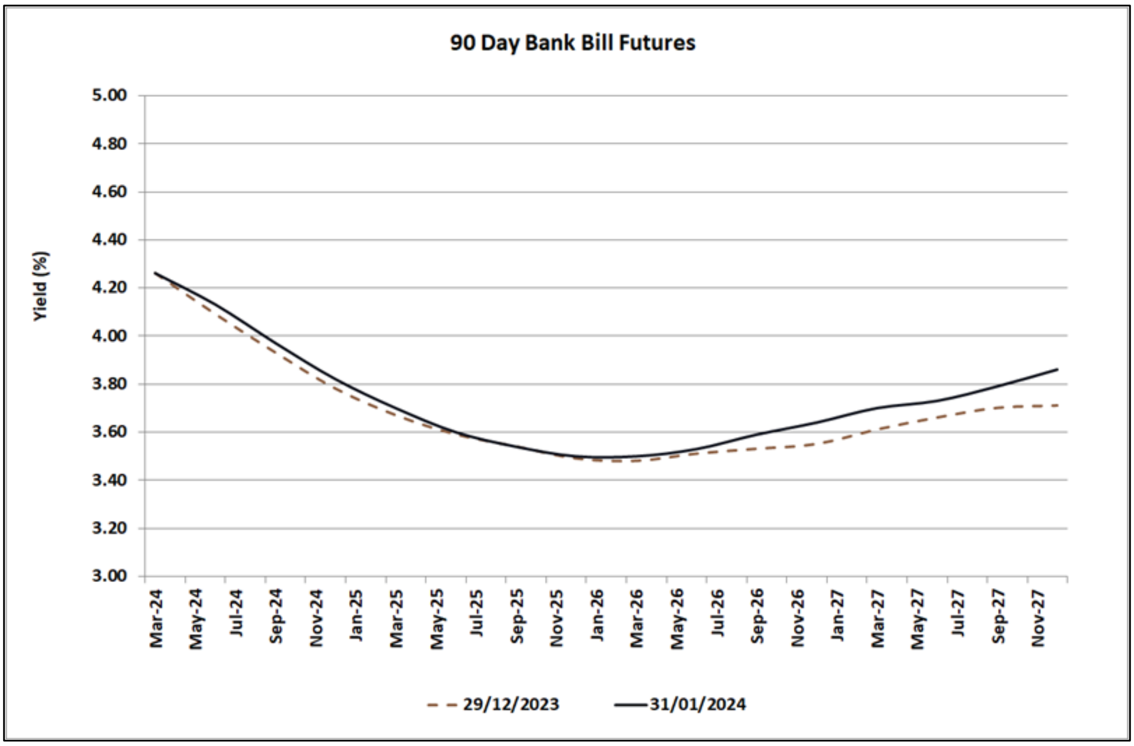
Other Key Rates

Index	January 2024	December 2023
RBA Official Cash Rate	4.35%	4.35%
90 Day (3 month) BBSW Rate	4.35%	4.36%
3yr Australian Government Bonds	3.45%	3.61%
10yr Australian Government Bonds	4.01%	3.96%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	4.27%	4.23%
10yr US Treasury Bonds	3.99%	3.88%

Source: RBA, ASX, US Department of Treasury

90 Day Bill Futures

Bill futures marginally rose at the long-end of the curve, following the movement in the global bond market. The focus from the market remains on when the first rate cut will be delivered:



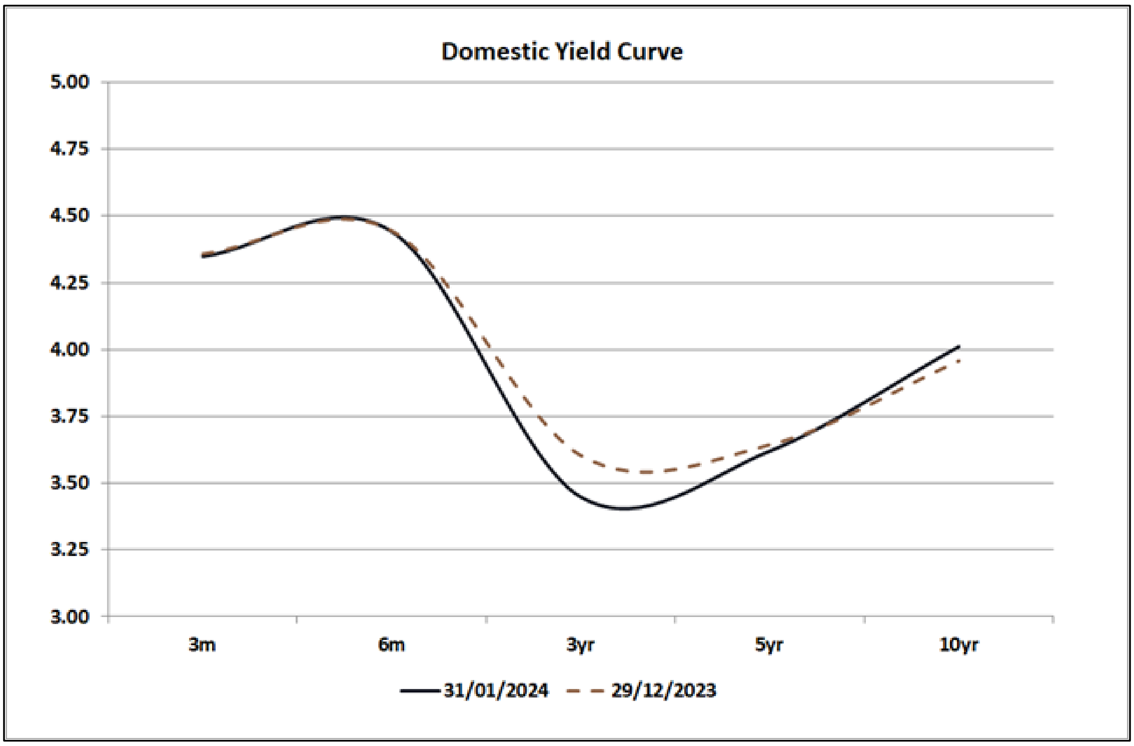
Source: ASX

Fixed Interest Outlook

There is uncertainty when central banks will start to cut official rates in 2024. In recent weeks, financial markets have been pricing more and more delays for rate cuts, particularly in the US, suggesting that with the economy seemingly in relatively good health, there is no immediate need to cut rates quickly. This was supported by the stronger than expected US economic growth recorded in the last quarter of 2023 of +3.3% on an annual basis (which was well above the +2.0% forecast). Nevertheless, financial markets continue to price in more than 100bp of US Fed rate cuts in 2024.

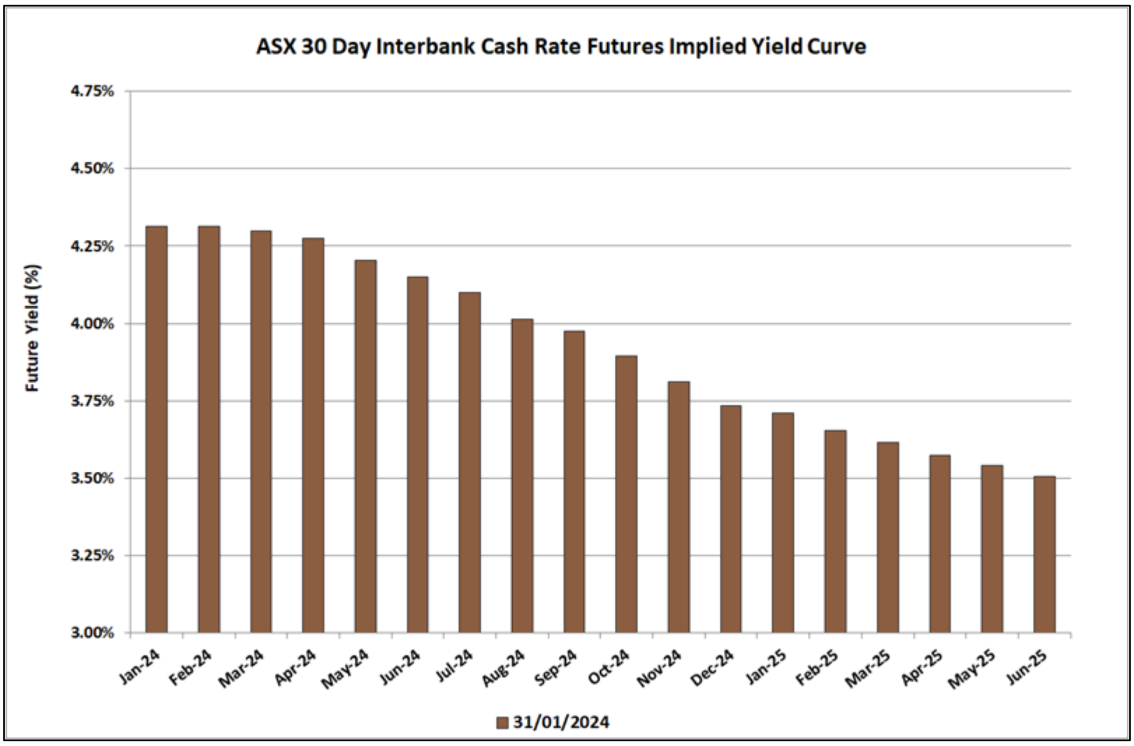
The Fed's pivot in monetary policy stance (easing bias) has reduced the risk of the RBA needing to raise rates in the immediate future. The RBA remains on a mild tightening bias, with the Board commenting that whilst the trend in global inflation has been favourable, it was heavily caveated, consistent with them waiting for the Q4 CPI (on 31st January). Inflation did print lower than expected, so this may allow the RBA to remove its mild tightening bias for its meeting on the 6th February.

Over the month, longer-term yields rose by 5bp at the very long end of the curve:



Source: ASX, RBA

The consensus from the broader market is that we have reached the peak of the interest rate cycle. Financial markets have pushed forward their rate cut expectations, with the first rate cut fully priced in by July 2024 following the lower than anticipated inflation number.



Source: ASX

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