10.2. Investment and Loan Borrowings Report as at 31 March 2024

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ATTACHMENTS	1. Arlo Advisory Monthly Investment Report March 2024 [**10.2.1** - 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 details of the performance of Council's investments and loans for the month ending 31 March 2024.

EXECUTIVE SUMMARY:

- All investments have been made in accordance with the Local Government Act and Regulations and Council's Financial Investments Policy.

- For the month of March, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.31% (actual), or +3.70% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.37% (actual), or +4.41% p.a. (annualised). This is due to Council holding term deposits made in a low inflation environment when interest rate rises were not expected.

- Returns on investments exceed the YTD budget by $885.55 thousand. The total return for the 2023/2024 financial year to date is approximately $4.18 million. The better-than-expected return is due to payments for the capital works program progressing slower than expected in the first two quarters. The budget will be reviewed in the March Quarterly Budget Review.

RECOMMENDATION:

1. THAT the report on Investments held 31 March 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 $135,786,903. 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
- enternal allocations (Council has resolved to spend the funds on certain projects and activities).

The following table details the reserves, held as at 31 March 2024. Council holds an unrestricted cash balance of $4.6 million, indicating it has funded all its reserves.

External Restrictions and Internal Allocations	
External restrictions	
Developer contributions – general	$51,110,048
Domestic waste management	$15,541,610
Unexpended Special Rates	$1,214,006
Unspent borrowings - North Sydney Olympic Pool redevelopment	$7,418,111
Waste and sustainability improvement funds	$37,646
Specific purpose grants	$5,004,550
Other specific purpose contributions	$2,440,258
Total external restrictions	**$82,766,229**
Internal allocations	
Capital works	$10,535,385
Community housing - capital purchases	$962,601
Community housing - major maintenance	$490,657
Deposits, retentions and bonds	$13,904,280
Employees leave entitlement	$5,087,421
I.T. hardware and software	$1,166,255
Income producing projects	$781,728
Olympic Pool Redevelopment	$9,724,572
Plant and vehicle replacement	$2,857,735
Total internal allocations	**$45,510,634**

External Restrictions and Internal Allocations	
Total Restrictions and Allocations	**$128,276,863**
Unrestricted Cash and Investments	$7,510,040
Total Cash and Investments	**$135,786,903**

Investment Portfolio

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

	March 2024	Annualised YTD
Actual Return	0.31%	3.70%
Benchmark	0.37%	4.41%
Variance	-0.06%	-0.71%

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 and before those increases were made.

Asset Type	Market Value	Portfolio Breakdown
Term Deposits	$113,000,000	83.22%
Cash	$11,135,368	8.20%
Fixed Bonds	$9,000,000	6.63%
Floating Rate Notes (FRNs)	$2,651,535	1.95%
	$135,786,903	**100.00%**

Council's average duration of term deposits, which comprise 83.22% of the investment portfolio, is approximately 250 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. All investments accord with Council's Financial Investments Policy.

Council continues to seek independent advice for investments and are 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 $94.2 million in 2023/24.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 31 March 2024 are $885.6 thousand more than the year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (Mar)	YTD (Mar)	YTD Actual FV adjustments (Mar)	YTD Budget to Actual Variance (Mar)
2023/24	$2,500,000	$4,650,000	$3,292,738	$4,173,850	$4,442	$885,554
Previous Years						
Year	**Original Annual Budget**	**Revised Annual Budget**		**Final Result Interest**	**Final Result FV adjustments**	**Final Budget to Actual Variance**
2022/23	$1,384,350	$3,340,000		$3,685,634	$4,647	$350,281
2021/22	$1,182,500	$1,362,500		$1,302,826	$64,865	$5,191
2020/21	$1,350,000	$1,350,000		$1,222,664	$93,735	-$33,601

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 $4,442.

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	$105,135,368	100.00%	77.43%
A Category	$18,250,964	60.00%	13.44%
BBB Category	$12,400,571	35.00%	9.13%
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 February 2024, so that these limits are now contained in Council's Financial Investment Policy. It is no longer necessary to report compliance with additional 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
31/01/2024	$4,747,721.74	$50,529.58	$239,109.96	$ 289,639.54
30/04/2024	$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 31 March 2024, $7.4 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 million upward revision was adopted at the September Quarter Budget Review. The December Quarter Review adopted a further upward revision of $1 million. This report indicates that a further upward revision of $1 million is in order at the March Quarterly 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 consider it prudent to provide monthly reporting of loans.

Monthly Investment Review

March 2024

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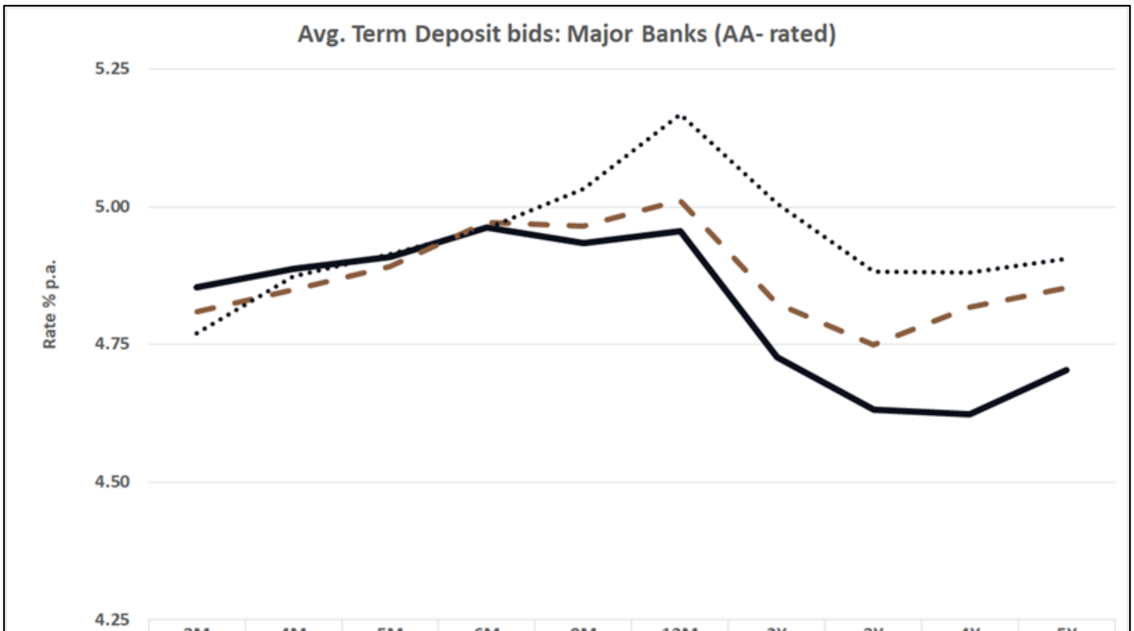
Market Update Summary

Risk assets performed well in March as the narrative of economic resilience overshadowed concerns that rates may remain higher for an extended period of time.

Over March, at the very short-end (3-5 months), the average major bank deposit rates were around 2-4bp higher compared to the previous month. In contrast, major bank deposit rates at the long-end fell between 10-20bp across the 2-5 year tenors. The longer-term rates are around 20-30bp lower across the board compared to where they were 6 months ago (September 2023), with rate cut expectations now gathering pace.



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Mar-2024	4.85	4.89	4.91	4.96	4.93	4.96	4.73	4.63	4.62	4.70
Feb-2024	4.81	4.85	4.89	4.97	4.97	5.01	4.82	4.75	4.82	4.85
Sep-2023	4.77	4.87	4.91	4.96	5.03	5.17	5.01	4.88	4.88	4.91

Source: Imperium Markets

With a global economic downturn and multiple interest rate cuts being priced starting later this year, 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 March 2024, the portfolio was mainly directed to fixed term deposits (83%). The remaining portfolio is directed to FRNs (2%), fixed bonds (7%) and overnight cash accounts (8%).

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 12 months). This is suitable to invest in short-dated fixed term deposits or high yielding cash accounts.

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 $68m at month-end.

Where liquidity permits (once immediate capital projects are finalised), we recommend new surplus funds be directed to 1-3 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	$48,135,368	35.45%	10%	100%	$87,651,535
✓	91 - 365 days	$52,651,535	38.78%	20%	100%	$83,135,368
✓	1 - 2 years	$27,000,000	19.88%	0%	70%	$68,050,832
✓	2 - 5 years	$8,000,000	5.89%	0%	50%	$59,893,452
✓	5 - 10 years	$0	0.00%	0%	25%	$33,946,726
		$135,786,903	**100.00%**			

Counterparty

As at the end of March, all individual limits comply with the Policy. We note the significant capital outflows of around $29m during the month, which has brought down the overall portfolio's balance.

Exposures to individual ADIs are driven by the portfolio's movements throughout any month. Overall, the portfolio is lightly diversified across the investment grade spectrum, with no exposure to the unrated ADIs.

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	CBA	AA-	$36,135,368	26.61%	30.00%	$4,600,703
✓	NAB	AA-	$34,000,000	25.04%	30.00%	$6,736,071
✓	NTTC Treasury	AA-	$9,000,000	6.63%	30.00%	$31,736,071
✓	Westpac	AA-	$26,000,000	19.15%	30.00%	$14,736,071
✓	Suncorp	A+	$1,250,964	0.92%	15.00%	$19,117,072
✓	ICBC Sydney	A	$17,000,000	12.52%	15.00%	$3,368,035
✓	BOQ	BBB+	$4,000,000	2.95%	10.00%	$9,578,690
✓	Bendigo	BBB+	$2,000,000	1.47%	10.00%	$11,578,690
✓	Heritage	BBB	$5,000,000	3.68%	10.00%	$8,578,690
✓	Newcastle PBS	BBB	$1,400,571	1.03%	10.00%	$12,178,119
			$135,786,903	**100.00%**		

In February 2024, ANZ's takeover of Suncorp was given the green light by the Australian Competition Tribunal (ACT), six months after the Australian Competition and Consumer Commission (ACCC) blocked the deal on the grounds that it could lessen competition in the mortgage market. As such, Suncorp's assets are likely to be upgraded to AA- in the near future by S&P (but also, they may be flagged as an ADI lending to the fossil fuel industry in future).

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 March 2024, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$105,135,368	77.43%	100%	$30,651,535
✓	A Category	$18,250,964	13.44%	60%	$63,221,178
✓	BBB Category	$12,400,571	9.13%	35%	$35,124,845
✓	Unrated ADIs	$0	0.00%	10%	$13,578,690
		$135,786,903	**100.00%**		

Performance

Council's performance for the month ending March 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%	1.07%	2.14%	3.18%	4.15%	3.13%	2.11%
AusBond Bank Bill Index	0.37%	1.09%	2.15%	3.26%	4.19%	3.11%	2.08%
Council's T/D Portfolio	0.32%	0.97%	1.93%	2.79%	3.51%	2.77%	2.29%
Council's FRN Portfolio	0.45%	1.34%	2.71%	4.05%	5.28%	4.24%	3.36%
Council's Bond Portfolio	0.10%	0.29%	0.58%	0.88%	1.17%	1.17%	1.14%
Council's Portfolio^	**0.31%**	**0.93%**	**1.86%**	**2.69%**	**3.39%**	**2.69%**	**2.24%**
Rel. Performance	**-0.06%**	**-0.16%**	**-0.30%**	**-0.57%**	**-0.80%**	**-0.42%**	**0.16%**

^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%	4.31%	4.24%	4.15%	3.13%	2.11%
AusBond Bank Bill Index	4.41%	4.42%	4.34%	4.35%	4.19%	3.11%	2.08%
Council's T/D Portfolio	3.87%	3.94%	3.89%	3.73%	3.51%	2.77%	2.29%
Council's FRN Portfolio	5.48%	5.49%	5.47%	5.41%	5.28%	4.24%	3.36%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.17%	1.14%
Council's Portfolio^	**3.70%**	**3.78%**	**3.74%**	**3.59%**	**3.39%**	**2.69%**	**2.24%**
Rel. Performance	**-0.70%**	**-0.64%**	**-0.60%**	**-0.76%**	**-0.80%**	**-0.42%**	**0.16%**

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

For the month of March, the total investment portfolio (excluding cash) provided a solid return of +0.31% (actual) or +3.70% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.37% (actual) or +4.41% 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 and also dependent on reinvesting maturing funds at prevailing market rates beyond 6 month tenors), and 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 March 2024, Council's deposit portfolio was yielding **3.77% p.a.** (down 6bp from the previous month), with a weighted average duration of around 250 days (~8 months). We recommend Council slightly increases 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 immediately 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	+31.0bp	$100.077	$964

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 (sister company of Arlo Advisory). 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 March, we see value in the following:

ADI	LT Credit Rating	Term	Rate % p.a.
ING	A	5 years	5.03%
BoQ	BBB+	5 years	5.00%
ING	A	2 years	4.96%
BoQ	BBB+	4 years	4.95%
BankVic	BBB+	2 years	4.95%
ING	A	4 years	4.90%
ING	A	3 years	4.86%
BoQ	BBB+	2 years	4.85%
BankVic	BBB+	3 years	4.85%
Westpac	AA-	1½ years	4.82%
Suncorp	A+	2 years	4.75%
Westpac	AA-	2 years	4.70%
NAB	AA-	2 years	4.70%

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	Rate % p.a.
BankVic	BBB+	12 months	5.15%
ING	A	12 months	5.11%
BoQ	BBB+	6 months	5.10%
ING	A	11 months	5.06%
NAB	AA-	6-7 months	5.05%
Suncorp	A+	6 months	5.04%
Suncorp	A+	12 months	5.03%
ING	A	10 months	5.02%
Bendigo-Adelaide	BBB+	9 months	5.02%
NAB	AA-	8-12 months	5.00%
BoQ	BBB+	12 months	5.00%
Westpac	AA-	12 months	4.97%

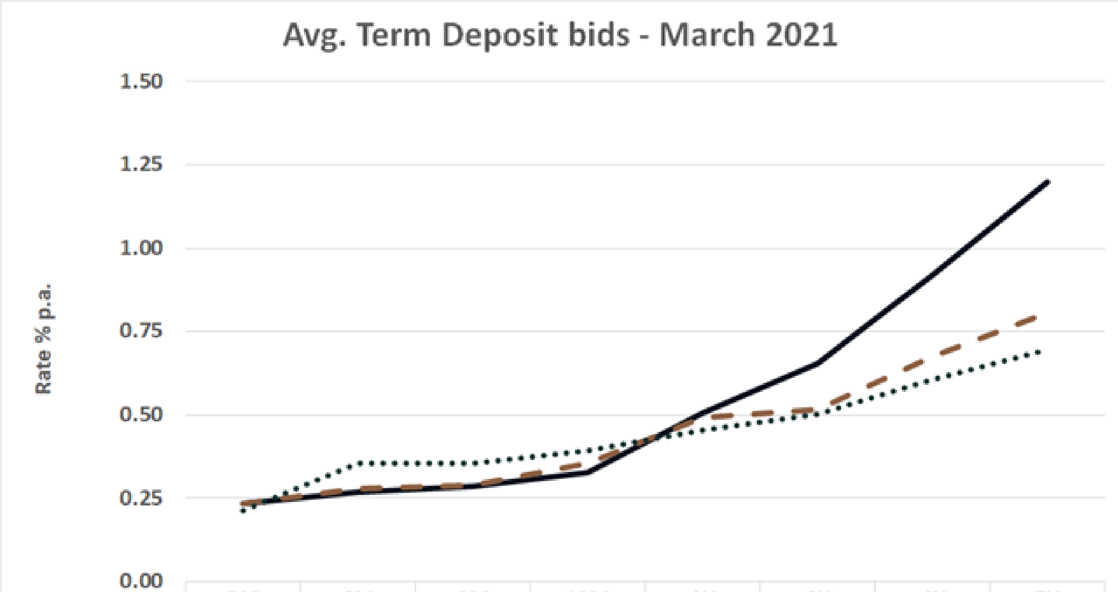
If Council does not require high levels of liquidity and can stagger a proportion of its investments across the longer term horizons (1-5 years), it will be rewarded over a longer-term cycle. Investing a spread of 12 months to 3 year horizons is likely to yield, on average, up to ¼-½% p.a. higher compared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

With a global economic slowdown and multiple rate cuts being priced by calendar year-end, 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, potentially as early as mid-2024.

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)



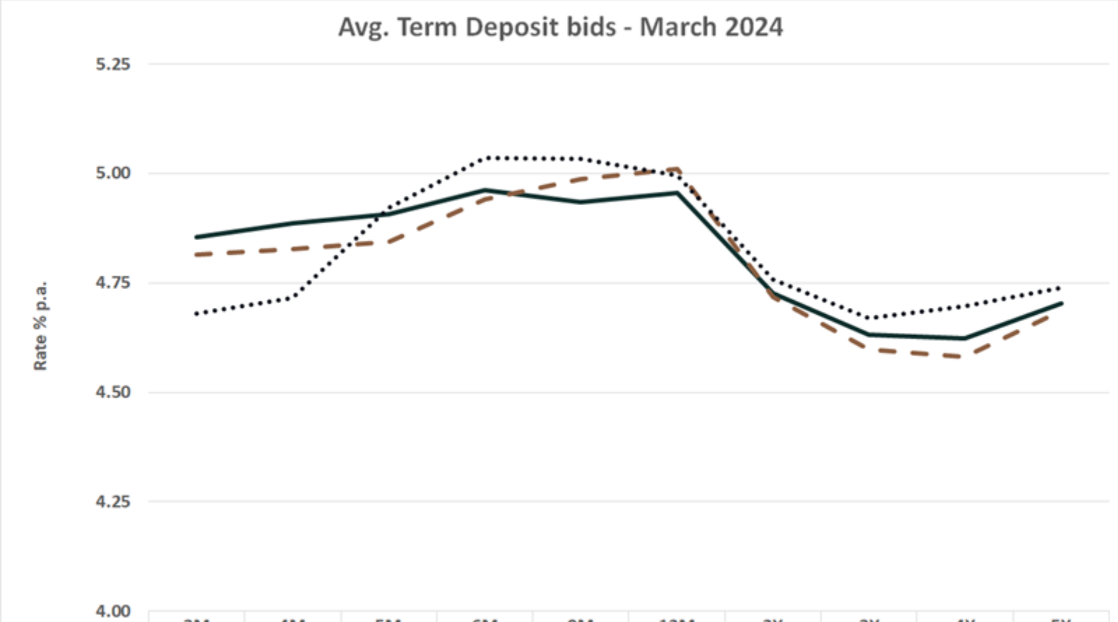
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

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 or considered 'ethical'. We are slowly seeing this trend emerge, as was the case this month:

Term Deposit Rates – Currently (March 2024)



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.85	4.89	4.91	4.96	4.93	4.96	4.73	4.63	4.62	4.70
A Rated	4.81	4.83	4.84	4.94	4.99	5.01	4.72	4.60	4.58	4.69
BBB Rated	4.68	4.72	4.92	5.04	5.03	5.00	4.76	4.67	4.70	4.74

Source: Imperium Markets

Regional & Unrated ADI Sector

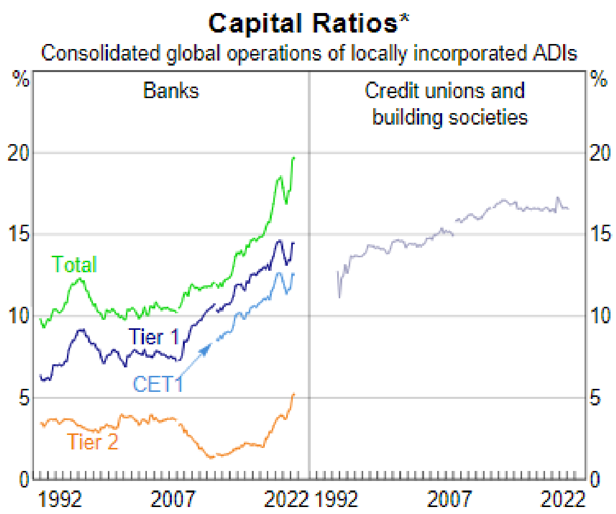
Ratings agency S&P has commented that "*mergers remain compelling for mutuals lenders*" in providing smaller lenders greater economies of scale and assisting them in being able to price competitively and will see "*the banking landscape will settle with a small number of larger mutual players*". S&P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

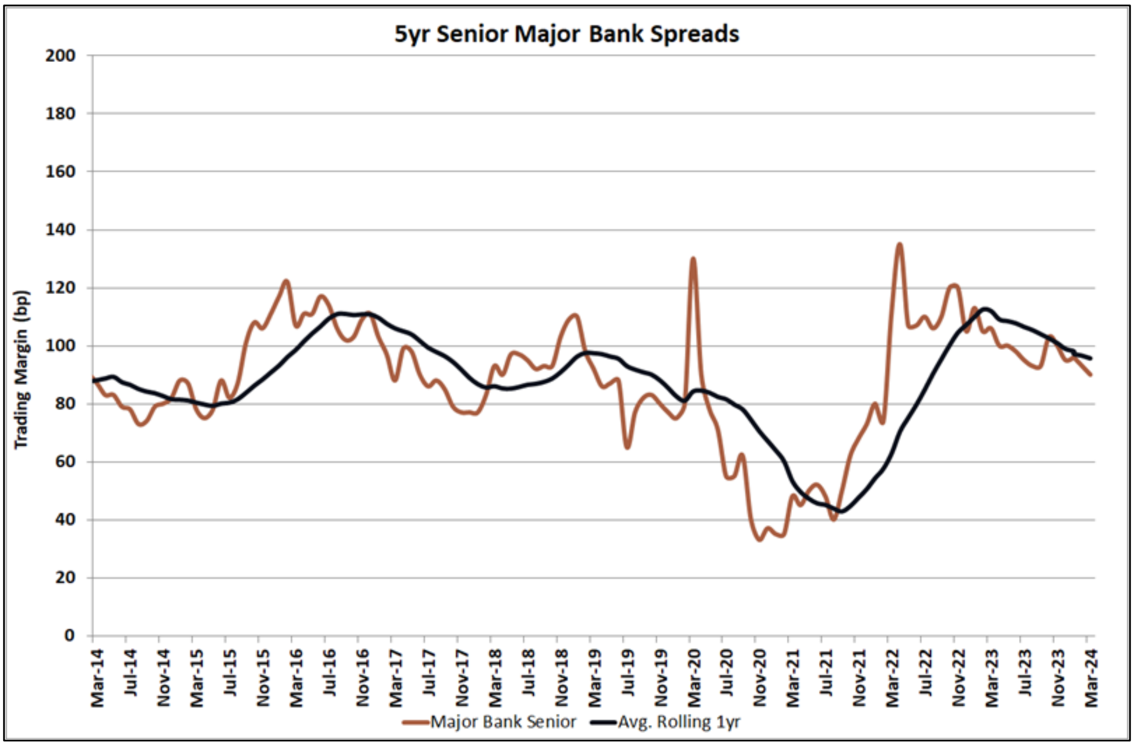


* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs.

Source: APRA.

Senior FRNs Market Review

Over March, amongst the senior major bank FRNs, physical credit securities tightened by around 3-9bp at the long-end of the curve. Major bank senior securities remain at fair value on a historical basis (5yr margins around +90bp level). During the month, NAB (AA-) issued a new 5 year senior security at +90bp.



Source: IBS Capital

There other notable new (primary) senior issuances during the month included:

- Mizuho (A) 4 year senior FRN at +88bp
- Suncorp (A+) 4 year senior security at +98bp
- ING (A) 3 year senior security at +95bp
- Auswide (BBB) 3 year senior FRN at +160bp

Amongst the "A" rated sector, the securities tightened by around 4-5bp at the longer-end of the curve, whilst the "BBB" rated sector remained flat at the 3 year part of the curve (mainly driven by new issuances). Overall, credit securities are looking much more attractive given the widening of spreads over the past 2 years and as more primary issuances become available. FRNs will continue to play a role in investors' portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	28/03/2024	29/02/2024
“AA” rated – 5yrs	+90bp	+93bp
“AA” rated – 3yrs	+64bp	+73bp
“A” rated – 5yrs	+100bp	+105bp
“A” rated – 3yrs	+83bp	+87bp
“BBB” rated – 3yrs	+160bp	+160bp

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
AU3CB0278174	UBS	A+	Senior	26/02/2026	1.92	1.10%	4.92%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.11	1.40%	5.14%
AU3CB0299337	Bendigo	BBB+	Senior	15/05/2026	2.14	4.70%	5.00%
AU3CB0296168	BoQ	BBB+	Senior	27/01/2027	2.84	4.70%	5.04%

Economic Commentary

International Market

Risk assets performed well in March as the narrative of economic resilience overshadowed concerns that rates may be higher for longer.

Across equity markets, the S&P 500 Index gained +3.10% over the month, whilst the NASDAQ added +1.79%. Europe's main indices also continued their gains, led by Italy's FTSE MIB (+6.66%), Germany's DAX (+4.61%), UK's FTSE (+4.23%) and France's CAC (+3.51%).

The US central bank kept the fed funds rate at the current target range of 5.25%-5.50%. The Fed still expects three rate cuts in 2024 though fewer cuts in the coming years than they had estimated in December as policymakers are now forecasting US GDP growth to strengthen than previously.

US core CPI printed at +0.4%, which was 0.1% stronger than consensus although the unrounded print was 'just' +0.36% m/m so the miss was not egregious, and the annual rate still ticked down slightly to +3.2%.

The Bank of Canada kept its policy rate on hold at 5.00% for a fifth consecutive meeting and Governor Macklem said, "*it's still too early to consider lowering the policy interest rate*".

The ECB kept its main refinancing rate at 4.00% as universally expected and is anticipated to be at a neutral setting for the immediate future.

The Swiss National Bank unexpectedly cut interest rates by 25bp to 1.50% at its latest meeting as their CPI fell to +1.2% y/y and core inflation to +1.1%. SNB marks as the first major developed central bank to ease monetary policy.

The Bank of Japan (BoJ) raised rates to the range of 0%–0.1%, the first hike in 17 years. The BoJ also decided to abandon its yield curve control and discontinue its purchase of assets such as exchange-traded funds (ETFs), which it began buying in 2010 as part of its stimulus programme.

China reported February CPI and PPI data, with CPI surprising to the upside at +0.7% year-on-year, its highest level since March 2023, aided by pork prices turning positive in annual terms for the first time in nine months (+0.2%).

The MSCI World ex-Aus Index rose +3.03% for the month of March:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+3.10%	+10.16%	+27.86%	+9.77%	+13.14%	+10.87%
MSCI World ex-AUS	+3.03%	+8.66%	+23.48%	+7.06%	+10.43%	+7.65%
S&P ASX 200 Accum. Index	+3.27%	+5.33%	+14.45%	+9.62%	+9.15%	+8.27%

Source: S&P, MSCI

Domestic Market

The RBA kept rates on hold at 4.35% as expected in its March meeting. The central bank was perceived to now adopt a more neutral approach to monetary policy as it removed its previous phrases - "*a further increase in interest rates cannot be ruled out*" and "*will do what is necessary to achieve that outcome*". However, the addition of "*the Board is not ruling anything in or out*" still provides the RBA with sufficient flexibility when upside risks emerge.

The monthly CPI indicator held at +3.4% y/y in January (consensus +3.5%). The RBA will likely wait and see the full Q1 CPI on 27 April before updating their forecasts and potentially change their future guidance on rates.

The unemployment rate fell from 4.1% in January to 3.7% in February as the economy added 116,500 new jobs compared with economists forecast of around 40,000. This strong labour data was largely due to a high number of people who had found work in December/January but whose jobs only started in February.

GDP rose by +0.2% q/q (+1.5% y/y). Private domestic demand growth remained weak, while public sector spending helped to keep overall domestic final demand growth over the last year at a reasonable level. The key story remains the weakness in household consumption, which rose just +0.1% q/q and +0.1% for 2023 as a whole – the slowest annual growth in almost 40 years outside of COVID and the GFC.

The current account widened sharply to $11.8bn in Q4 on the back of higher commodity export values.

Building approvals fell -1% in January, partially due to a -9.9% fall in detached dwellings, which was mostly offset by a rebound in the volatile attached dwelling series in the month.

The Australian dollar marginally rose by +0.20%, finishing the month at US65.32 cents (from US65.19 cents the previous month).

Credit Market

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

Index	March 2024	February 2024
CDX North American 5yr CDS	52bp	52bp
iTraxx Europe 5yr CDS	55bp	55bp
iTraxx Australia 5yr CDS	66bp	64bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	March 2024	February 2024
Bloomberg AusBond Bank Bill Index (0+YR)	+0.37%	+0.34%
Bloomberg AusBond Composite Bond Index (0+YR)	+1.12%	-0.30%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.50%	+0.53%
Bloomberg AusBond Credit Index (0+YR)	+0.90%	+0.05%
Bloomberg AusBond Treasury Index (0+YR)	+1.15%	-0.36%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+1.34%	-0.48%

Source: Bloomberg

Other Key Rates

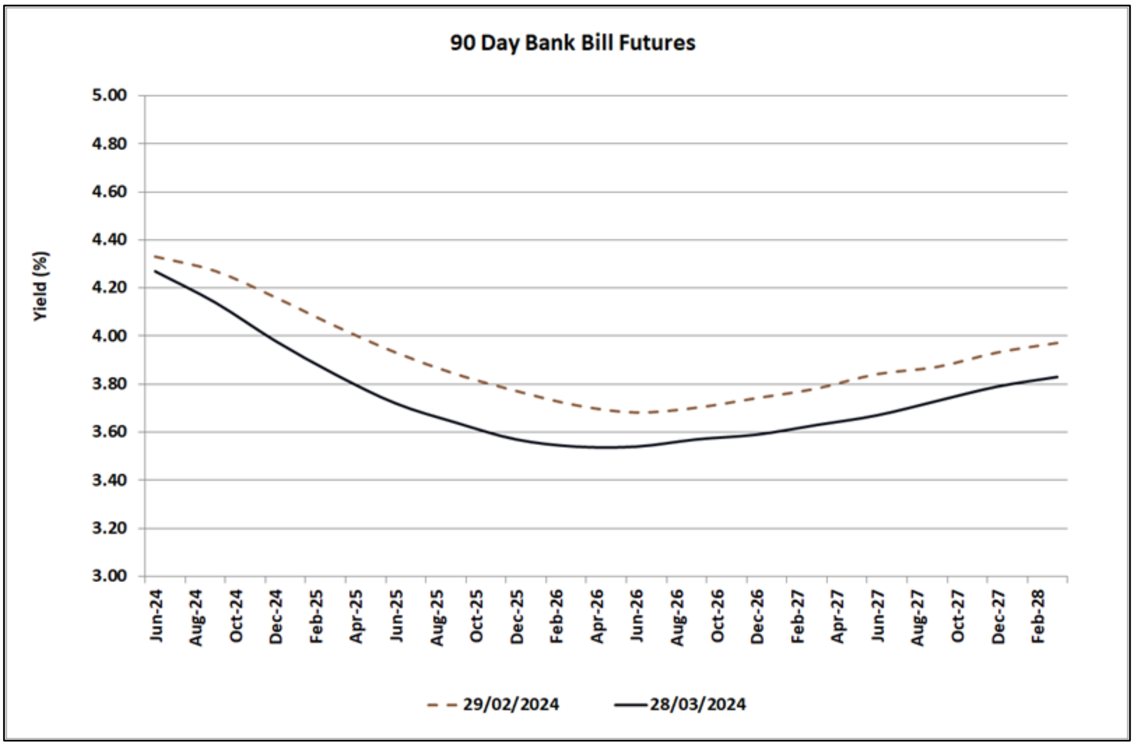
Index	March 2024	February 2024
RBA Official Cash Rate	4.35%	4.35%
90 Day (3 month) BBSW Rate	4.34%	4.34%
3yr Australian Government Bonds	3.59%	3.71%
10yr Australian Government Bonds	3.97%	4.14%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	4.59%	4.64%
10yr US Treasury Bonds	4.20%	4.25%

Source: RBA, ASX, US Department of Treasury

Arlo Advisory

90 Day Bill Futures

Bill futures fell across the board this month, following the movement in the domestic bond market. The focus from the market remains on when the first rate cut will be delivered:



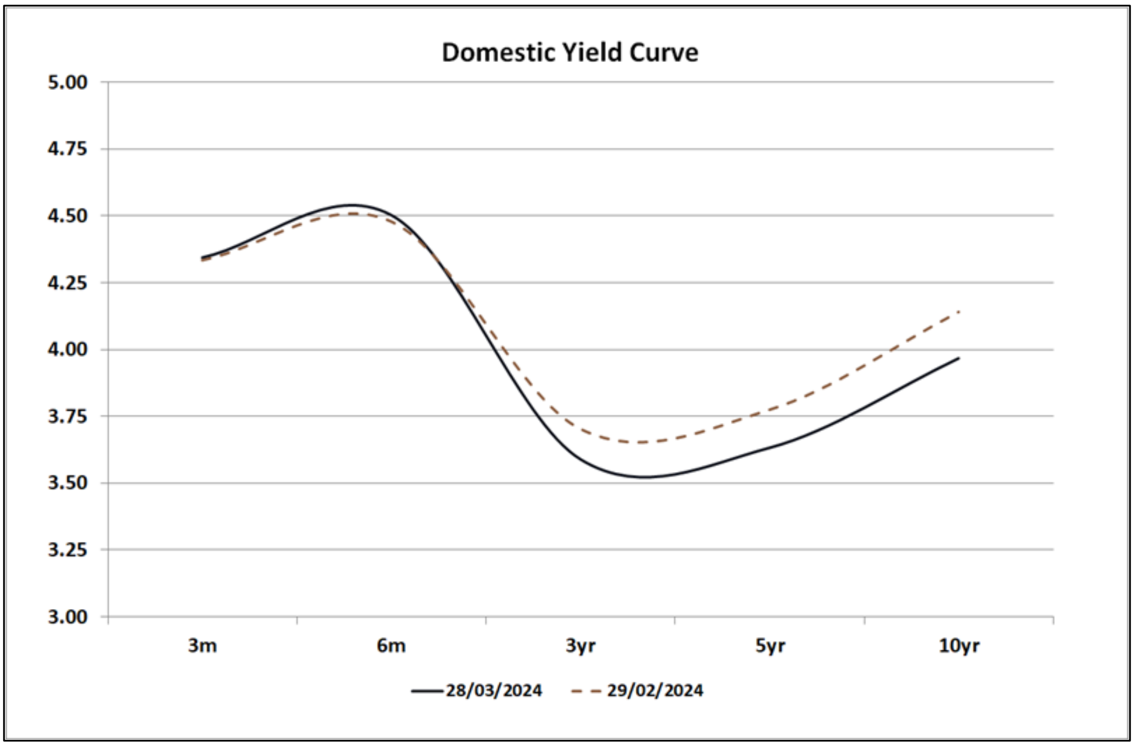
Source: ASX

Fixed Interest Outlook

In the latest FOMC statement, the US central bank reiterated from previous months that "*the Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2%*". The Federal Reserve therefore continues to be in the wait-and-see approach as it assesses incoming data when it would likely be appropriate to dial back policy restraint (cut rates). The 'dot plots' continues to show 75bp of US Fed rate cuts in 2024 and another 75bp in 2025.

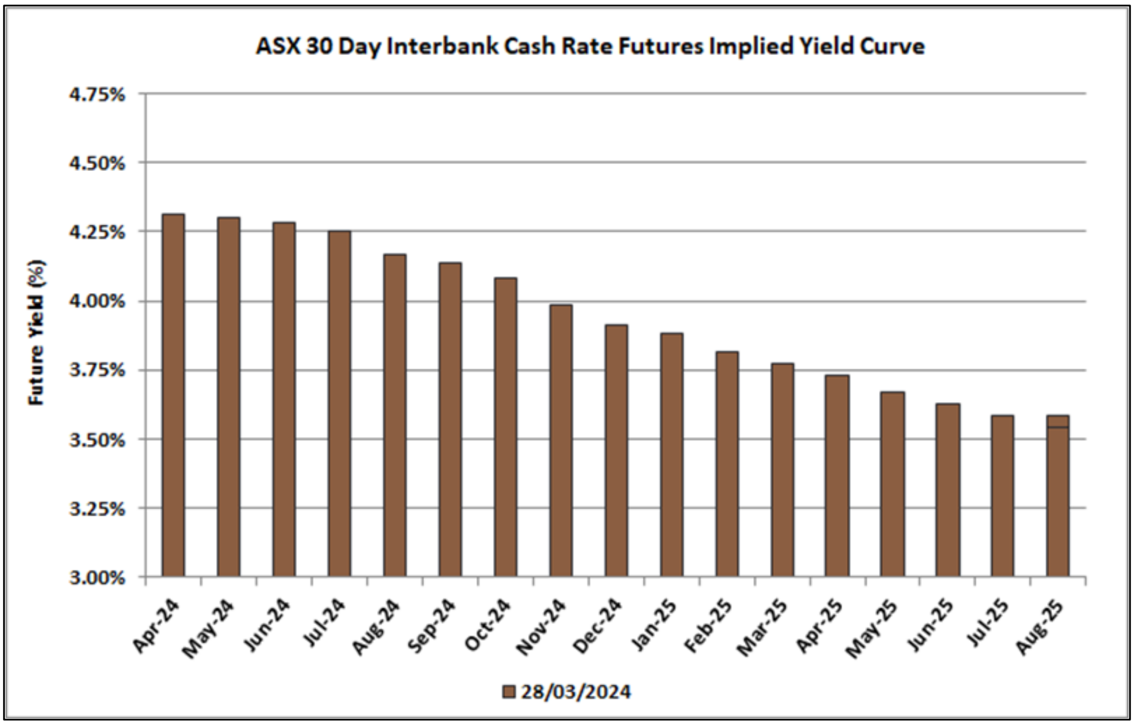
Domestically, Australian inflation is lagging, but expectations is that the RBA is likely to join by year end. Following its March meeting, the RBA is now perceived to adopt a more neutral approach to monetary policy; however, the addition of *"the Board is not ruling anything in or out"* in its latest policy statement suggests the Board wants to keep the optionality in the event of future shocks.

Over the month, longer-term yields fell up to 17bp at the very long end of the curve (remains an inverse yield curve):



Source: ASX, RBA

The consensus from the broader market is that we have reached the peak of the interest rate cycle. Financial markets are currently fully pricing in the first rate cut in Australia by October 2024, lagging behind the US market (largely pricing in a rate cut by June 2024).



Source: ASX