10.2. Investment and Loan Borrowings Report as at 30 June 2024

AUTHOR	Christian Menday, Manager Financial Services Aigul Utegenova, Chief Financial Officer
ENDORSED BY	Luke Harvey, Director Corporate Services
ATTACHMENTS	1. Arlo Advisory Monthly Investment Report June 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 30 June 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 June, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.28% (actual), or +3.50% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.35% (actual), or +4.34% 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 are less than the adjusted YTD budget by $21,276. The total return for the 2023/2024 financial year is $5.47 million. The original budget was $2.50 million. The better-than-expected return is due to payments for the capital works program progressing slower than expected in the first two quarters.

RECOMMENDATION:
1. THAT the report on Investments held 30 June 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 the 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 $127,163,677. Most of this balance is held in reserves to be spent on certain activities and projects. Reserves fall into one of two categories:

- external restrictions (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 30 June 2024. Council holds an unrestricted cash balance of $5.4 million, indicating it has funded all its reserves. Work on the Financial Statements is underway, and the final figure is subject to revision. It will be reported to the meeting of 28 October 2024 with the Financial Statements.

External Restrictions and Internal Allocations	
External restrictions	
Developer contributions	$49,107,843
Domestic waste managementas of m	$14,976,472
Unexpended Special Rates	$131,838
Unspent borrowings - North Sydney Olympic Pool redevelopment	$0
Waste and sustainability improvement funds	$37,646
Specific purpose grants	$6,441,587
Other specific purpose contributions	$2,364,381
Total external restrictions	**$73,059,767**
Internal allocations	
Capital works	$10,721,537
Community housing - capital purchases	$962,601
Community housing - major maintenance	$490,657
Deposits, retentions, and bonds	$14,485,610
Employees leave entitlement	$7,092,831
I.T. hardware and software	$1,282,323
Income producing projects	$782,006
Olympic Pool Redevelopment	$9,573,641

External Restrictions and Internal Allocations	
Plant and vehicle replacement	$3,317,990
Total internal allocations	**$48,709,196**
Total Restrictions and Allocations	**$121,768,963**
Unrestricted Cash and Investments	$5,394,714
Total Cash and Investments	**$127,163,677**

Investment Portfolio

The following table details the performance of Council's investment portfolio (excluding cash deposits) to the benchmark for the month of June 2024 - and annualised for the year-to-date 30 June 2024 (including investments that have matured prior to that date).

	June 2024	Annualised YTD
Actual Return	0.28%	3.50%
Benchmark	0.35%	4.34%
Variance	-0.07%	-0.84%

The portfolio underperformance, as compared to the benchmark, is due to 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	$98,500,000	77.46%
Cash	$18,262,976	14.36%
Fixed Bonds	$9,000,000	7.08%
Floating Rate Notes (FRNs)	$1,400,701	1.10%
	$127,163,677	**100.00%**

Council's average duration of term deposits, which comprise 77.46% of the investment portfolio, is approximately 255 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 had considerable requirements for short term investments to fund its Capital Works budget of $92.6 million in 2023/24.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 30 June 2024 are $21,276 less than the revised year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (June)	YTD (June)	YTD Actual FV adjustments (June)	YTD Budget to Actual Variance (June)
2023/24	$2,500,000	$5,490,000	$5,490,000	$5,462,963	$5,761	-$21,276
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 $5,761.

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	$92,762,976	100.00%	72.95%
A Category	$28,000,000	60.00%	22.02%
BBB Category	$6,400,701	35.00%	5.03%
Unrated ADIs (NR)	$0	10.00%	0.00%

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 released, as required, to fund project cash outflows. The loan funds have been fully expended.

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 the original budget as payments for capital works were lower than expected in the first two quarters. $1 million upward budget revisions were adopted each of the September, December, and March Quarterly Budget Reviews.

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

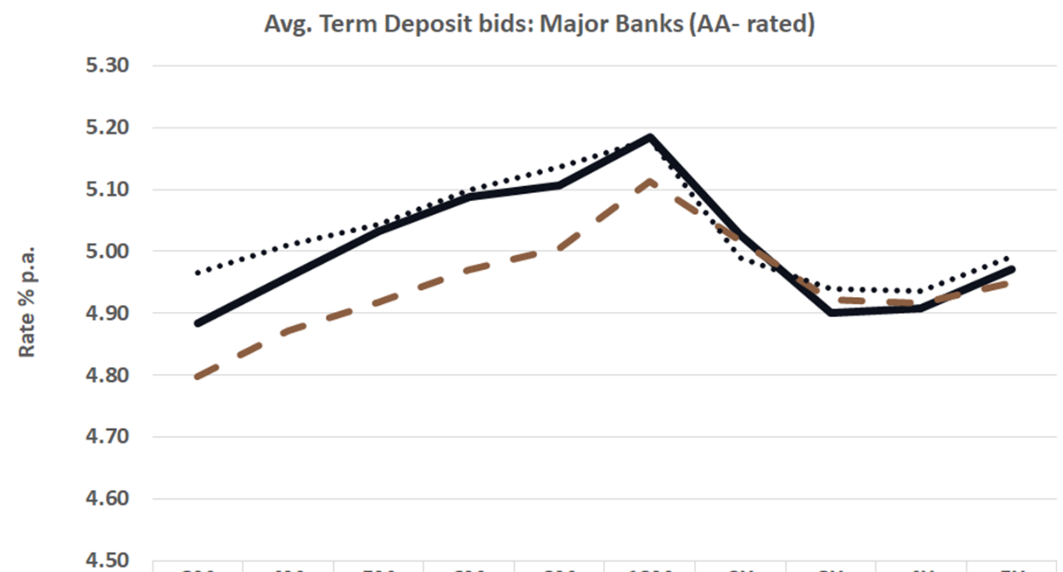
June 2024

Arlo Advisory Pty Ltd
ABN: 55 668 191 795
Authorised Representative of InterPrac Financial Planning Pty Ltd
AFSL 246 638
Phone: +61 2 9053 2987
Email: michael.chandra@arloadvisory.com.au / melissa.villamin@arloadvisory.com.au
125 Middle Harbour Road, East Lindfield NSW 2070

Market Update Summary

In June, financial markets continue to reprice the time of rate cuts across several developed countries. Domestically, the market is now actually forecasting the small chance of a hike in coming months in response to ongoing inflationary pressures.

In the deposit market, over June, the average deposit rates offered by the major banks at the short-end (up to 12 months) rose between 8-11bp following the higher than expected monthly inflation figure. In the medium-longer term (2-5 years), the average bids from the major banks remained relatively flat, reflective of the market still factoring rate cuts in future years. The deposit curve is largely back to where it was 6 months ago (Dec 2023).



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Jun-2024	4.88	4.96	5.03	5.09	5.11	5.19	5.03	4.90	4.91	4.97
May-2024	4.80	4.87	4.92	4.97	5.01	5.11	5.02	4.92	4.92	4.95
Dec-2023	4.97	5.01	5.04	5.10	5.14	5.18	4.99	4.94	4.94	4.99

Source: Imperium Markets

With a global economic downturn and interest rate cuts still being priced over the next 18-24 months, investors should consider diversifying and taking 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).

Arlo Advisory

North Sydney Council' Portfolio & Compliance

Asset Allocation

As at the end of June 2024, the portfolio was mainly directed to fixed term deposits (77%). The remaining portfolio is directed to FRNs (1%), fixed bonds (7%) and overnight cash accounts (14%).

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 interest 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 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 $66m 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	$47,262,976	37.17%	10%	100%	$79,900,701
✓	91 - 365 days	$49,400,701	38.85%	20%	100%	$77,762,976
✓	1 - 2 years	$22,500,000	17.69%	0%	70%	$66,514,574
✓	2 - 5 years	$8,000,000	6.29%	0%	50%	$55,581,838
✓	5 - 10 years	$0	0.00%	0%	25%	$31,790,919
		$127,163,677	**100.00%**			

Counterparty

As at the end of June, all individual limits comply with the Policy. We remind Council 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-	$31,262,976	24.58%	30.00%	$6,886,128
✓	NAB	AA-	$29,000,000	22.81%	30.00%	$9,149,103
✓	NTTC Treasury	AA-	$9,000,000	7.08%	30.00%	$29,149,103
✓	Westpac	AA-	$23,500,000	18.48%	30.00%	$14,649,103
✓	ICBC Sydney	A	$17,000,000	13.37%	15.00%	$2,074,552
✓	BOQ	A-	$9,000,000	7.08%	15.00%	$10,074,552
✓	Bendigo	A-	$2,000,000	1.57%	15.00%	$17,074,552
✓	Heritage	BBB+	$5,000,000	3.93%	10.00%	$7,716,368
✓	Newcastle PBS	BBB+	$1,400,701	1.10%	10.00%	$11,315,666
			$127,163,677	**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).

In early April 2024, BoQ and Bendigo-Adelaide were upgraded by S&P from BBB+ to A-. Separately, several other regional banks were upgraded from BBB to BBB+, as well as BBB- to BBB. This has resulted in increased capacity to invest in some of these individual institutions from a counterparty perspective, as well as the aggregate "BBB" rated category (see Credit Quality section).

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 June 2024, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$92,762,976	72.95%	100%	$34,400,701
✓	A Category	$28,000,000	22.02%	60%	$48,298,206
✓	BBB Category	$6,400,701	5.03%	35%	$38,106,586
✓	Unrated ADIs	$0	0.00%	10%	$12,716,368
		$127,163,677	**100.00%**		

Performance

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

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.35%	1.07%	2.15%	4.28%	4.28%	3.62%	2.46%
AusBond Bank Bill Index	0.35%	1.08%	2.18%	4.37%	4.37%	3.63%	2.44%
Council's T/D Portfolio	0.30%	0.91%	1.89%	3.74%	3.74%	3.09%	2.48%
Council's FRN Portfolio	0.46%	1.45%	2.81%	5.56%	5.56%	4.80%	3.66%
Council's Bond Portfolio	0.10%	0.29%	0.58%	1.17%	1.17%	1.17%	1.15%
Council's Portfolio^	**0.28%**	**0.87%**	**1.81%**	**3.59%**	**3.59%**	**2.99%**	**2.41%**
Rel. Performance	**-0.07%**	**-0.21%**	**-0.37%**	**-0.78%**	**-0.78%**	**-0.64%**	**-0.03%**

^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%	4.35%	4.27%	4.28%	3.62%	2.46%
AusBond Bank Bill Index	4.34%	4.41%	4.42%	4.36%	4.37%	3.63%	2.44%
Council's T/D Portfolio	3.67%	3.72%	3.83%	3.72%	3.74%	3.09%	2.48%
Council's FRN Portfolio	5.72%	5.95%	5.72%	5.54%	5.56%	4.80%	3.66%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.17%	1.15%
Council's Portfolio^	**3.50%**	**3.55%**	**3.67%**	**3.58%**	**3.59%**	**2.99%**	**2.41%**
Rel. Performance	**-0.85%**	**-0.86%**	**-0.75%**	**-0.78%**	**-0.78%**	**-0.64%**	**-0.03%**

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

For the month of June, the total investment portfolio (excluding cash) provided a solid return of +0.28% (actual) or +3.50% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.35% (actual) or +4.34% p.a. (annualised). This relative 'underperformance' has been due to the unexpected aggressive rate hikes undertaken by the RBA over the past two years. Whilst this 'underperformance' may continue in the short-term, we do anticipate this to be fairly temporary, especially if the RBA is approaching the end of its rate hike cycle.

Note this ongoing period of underperformance is also highly dependent on reinvesting maturing funds at prevailing market rates beyond 6 month tenors. With large capital outflows, maturing funds are largely being spent or kept in low yielding short-dated assets. 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 June 2024, Council's deposit portfolio was yielding **3.55% p.a.** (down 13bp from the previous month), with a weighted average duration of around 255 days (~8½ 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, most likely over the next 3-4 months.

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 June, we see value in the following:

ADI	LT Credit Rating	Term	Rate % p.a.
ING	A	5 years	5.38%
BoQ	A-	5 years	5.20%
ING	A	4 years	5.32%
BoQ	A-	4 years	5.20%
ING	A	3 years	5.29%
BoQ	A-	3 years	5.10%
ING	A	2 years	5.35%
BoQ	A-	2 years	5.20%
Bank of Us	BBB+	2 years	5.20%
NAB	AA-	2 years	5.10%

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.
Bank of Sydney	Unrated	12 months	5.47%
NAB	AA-	12 months	5.45%
ING	A	12 months	5.43%
ICBC	A	12 months	5.33%
Bank of Us	BBB+	12 months	5.31%
NAB	AA-	9 months	5.35%
Police CU	Unrated	9 months	5.35%
BoQ	A-	9 months	5.30%
NAB	AA-	6 months	5.30%
Suncorp	A+	6 months	5.23%
ICBC	A	6 months	5.20%
NAB	AA-	3 months	5.15%
ICBC	A	3 months	5.10%

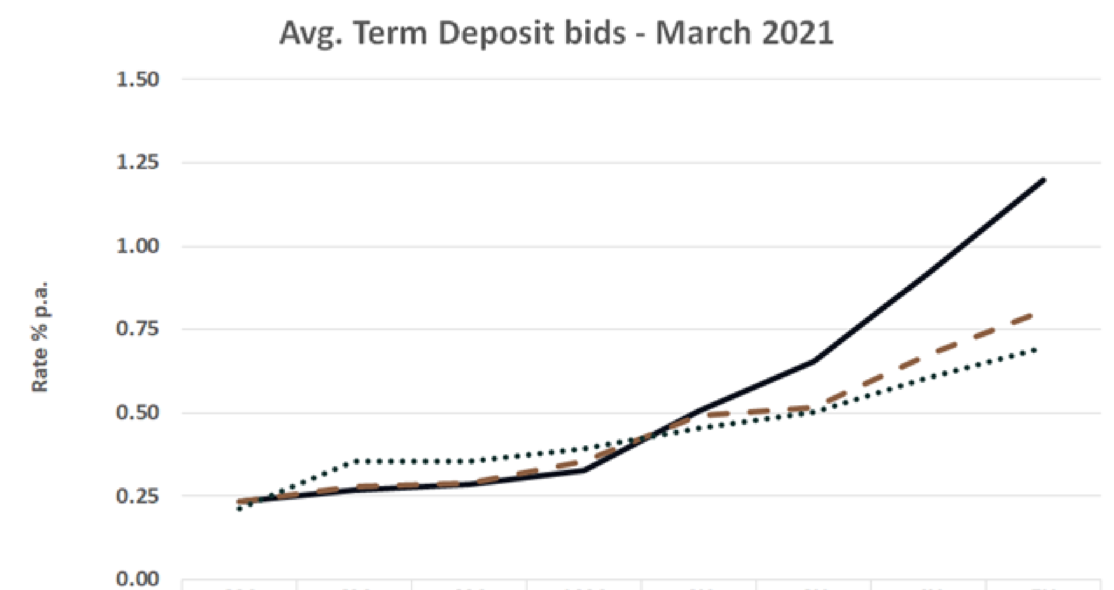
If Council does not require high levels of liquidity and can stagger a proportion of its investments across the longer term horizons (1-5 years), it will be rewarded over a longer-term cycle. Investing a spread of 12 months to 3 year horizons is likely to yield, on average, up to ¼-½% p.a. higher compared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

With a global economic slowdown and interest rate cuts being priced over the next few years, investors should strongly consider diversifying by allocating some longer term surplus funds and undertake an insurance policy by investing across 2-5 year fixed deposits and locking in rates above 5% p.a. This will provide some income protection with central banks now potentially looking to cut rates in 2025.

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)



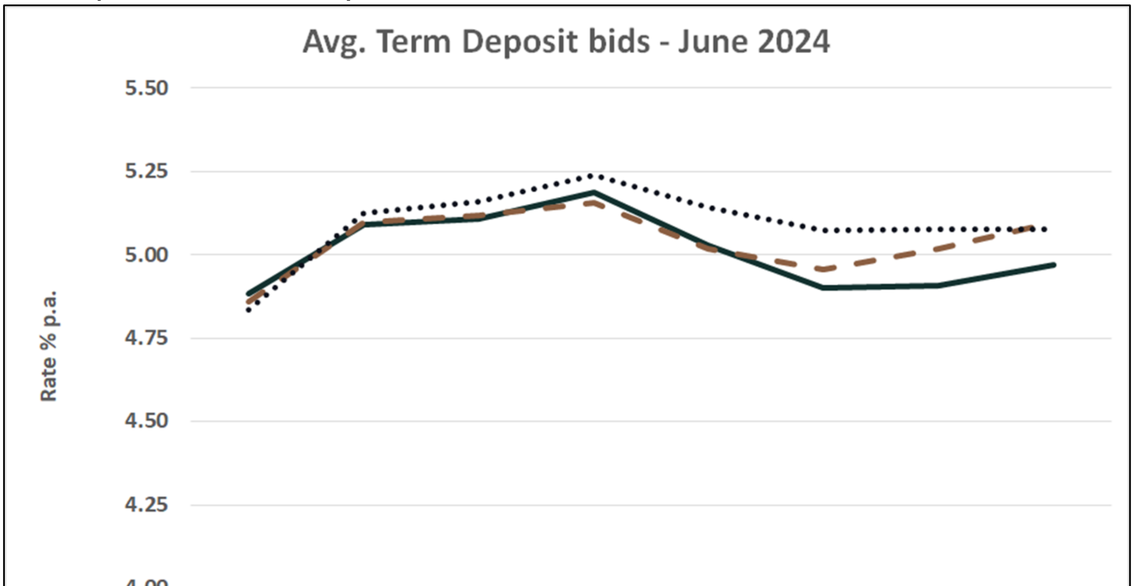
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

Source: Imperium Markets

The abnormal marketplace experienced during the pandemic is starting to reverse as the competition for deposits slowly increases, partially driven by the RBA's term funding facility coming to an end. 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), although the major banks always seem to react more quickly than the rest of the market during periods of volatility:

Term Deposit Rates – Currently (June 2024)



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.88	5.09	5.11	5.19	5.03	4.90	4.91	4.97
A Rated	4.86	5.10	5.12	5.16	5.02	4.96	5.02	5.10
BBB Rated	4.84	5.13	5.16	5.24	5.14	5.07	5.08	5.08

Source: Imperium Markets

Regional & Unrated ADI Sector

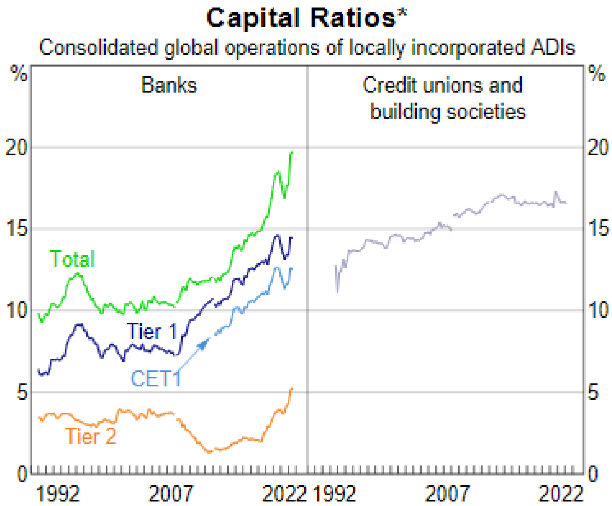
Ratings agency S&P has commented that "*mergers remain compelling for mutuals lenders*" in providing smaller lenders greater economies of scale and assisting them in being able to price competitively and will see "*the banking landscape will settle with a small number of larger mutual players*". S&P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

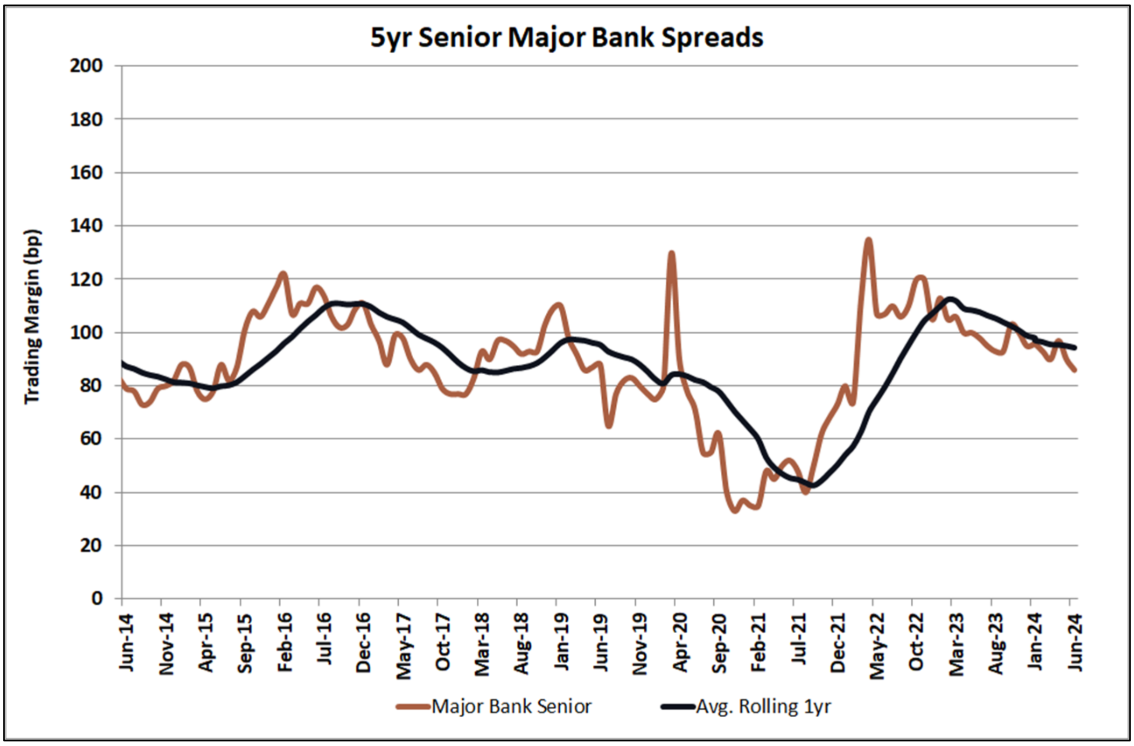


* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs.

Source: APRA.

Senior FRNs Market Review

Over June, amongst the senior major bank FRNs, physical credit securities tightened by around 4bp at the 5 year part of the curve. During the month, ANZ (AA-) issued a dual 3 & 5 year senior deal at +70bp and +86bp respectively. Major bank senior securities remain at fair value on a historical basis although looking fairly expensive if the 5yr margin tightens to +80bp in the near future.



Source: IBS Capital

There was minimal issuance again during the month apart from:

- Bendigo-Adelaide (A-) 1 year senior FRN at +60bp
- Teachers Mutual (BBB+) 3 year senior FRN at +130bp

Amongst the "A" rated sector, the securities remained flat at the longer-end of the curve, whilst the "BBB" rated sector tightened around 30bp at the 3 year part of the curve due to Teacher's Mutual deal. Overall, credit securities are looking more attractive given the widening of spreads over the past 2-3 years. 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), whilst also providing some diversification to those investors skewed towards fixed assets.

Senior FRNs (ADIs)	28/06/2024	31/05/2024
"AA" rated – 5yrs	+86bp	+90bp
"AA" rated – 3yrs	+71bp	+68bp
"A" rated – 5yrs	+105bp	+105bp
"A" rated – 3yrs	+82bp	+85bp
"BBB" rated – 3yrs	+130bp	+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 mid-2026 for the "AA" rated ADIs (domestic major banks);
- On or before mid-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 2-3 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	1.67	1.1000%	5.25%
AU3CB0280030	BoQ	A-	Senior	06/05/2026	1.86	1.4000%	5.47%
AU3CB0299337	Bendigo	A-	Senior	15/05/2026	1.88	4.7000%	5.37%
AU3CB0296168	BoQ	A-	Senior	27/01/2027	2.59	4.7000%	5.46%
AU3CB0308955	BoQ	A-	Senior	30/04/2029	4.84	5.3580%	5.54%

Economic Commentary

International Market

In June, risk assets traded in a relatively narrow range despite further evidence of sticky inflation pushing back expectations of rate cuts across several advanced economies.

Across equity markets, the S&P 500 Index rose +3.47% over the month, whilst the NASDAQ surged +5.91%. In contrast, Europe's main indices fell across the board, led by France's CAC (-6.42%), Germany's DAX (-1.42%), and UK's FTSE (-1.34%).

The US unemployment rate increased to 4.0% from 3.9%, the highest level in over two years.

US headline CPI came in cooler than expected at +0.0% m/m vs. +0.1% expected (annual terms at +3.3% versus +3.4% expected). The core CPI also came in below expectations at +3.4% y/y versus +3.5% y/y.

Canadian CPI in May was +2.9% y/y from +2.7% (expected +2.6%). The average of the median and trim core measures rose 0.1% to +2.85%. The lift came from services inflation at +4.6% y/y from +4.2% and driven by health.

Eurozone CPI suggested the same goods vs. sticky services dynamic of the US. Core CPI printed at +2.9% y/y vs. +2.7% expected.

Canada became the second G10 nation, after Sweden, to initiate a monetary policy easing cycle. They cut rates by 25bp to 4.75% as expected, whilst signalling more easing ahead. The ECB then followed by easing monetary policy, dropping all key rates by 25bp and taking the Deposit Rate to 3.75%.

The Swiss National Bank lowered its policy rate for a second consecutive time, down 25bp to 1.25%. The central bank believes the policy rate is now balanced and it also had lowered its inflation forecasts.

The Bank of England kept its policy rate steady at 5.25% despite the slowdown in UK inflation to +2.0% y/y in May. The BoE signalled a rate reduction is possible at its next meeting in August.

The MSCI World ex-Aus Index rose +1.93% for the month of June:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+3.47%	+3.92%	+22.70%	+8.31%	+13.17%	+10.79%
MSCI World ex-AUS	+1.93%	+2.18%	+18.55%	+5.32%	+10.20%	+7.44%
S&P ASX 200 Accum. Index	+1.01%	-1.05%	+12.10%	+6.37%	+7.26%	+8.06%

Source: S&P, MSCI

Domestic Market

The RBA left the cash rate on hold at 4.35% as widely expected. The Board reiterated that all options are still on the table in its fight against inflation. The Board "*did discuss the case*" for a possible rate hike at its June meeting, but ultimately decided to keep the policy rate unchanged. RBA Governor Bullock added, "*I wouldn't say that the case for a rate rise is increasing*", but *"…there's been a few things that have made the Board alert to the upside risks"*.

The Monthly CPI Indicator surged by 0.4% to +4.0% y/y in May from +3.6%. The ex-volatiles and travel reading did marginally slow, from +4.1% to +4.0% and key services categories remain too strong but do show some cooling.

The unemployment rate fell 0.1% to 4.0% from 4.1%. That fallback was expected because there was an unusually elevated number of unemployed people waiting to start a new job in April that moved into employment in May.

GDP rose by +0.1% q/q (+1.1% y/y), slightly weaker than consensus and the RBA's average quarterly expectation for H1. Overall, aggregate GDP growth continued to soften in both annual and quarterly terms (and is still falling in per capita terms).

The April trade balance widened to $6.5bn, back to around its February level after a surge in imports in March saw the surplus dip to its lowest since November 2020. In the month, exports fell -2.5%, while good imports fell -7.5% m/m.

The Australian dollar fell -0.20%, finishing the month at US66.24 cents (from US66.37 cents the previous month).

Credit Market

The global credit indices finally widened across the board in June. They remain at their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	June 2024	May 2024
CDX North American 5yr CDS	54bp	51bp
iTraxx Europe 5yr CDS	62bp	52bp
iTraxx Australia 5yr CDS	71bp	65bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	June 2024	May 2024
Bloomberg AusBond Bank Bill Index (0+YR)	+0.35%	+0.37%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.77%	+0.39%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.41%	+0.50%
Bloomberg AusBond Credit Index (0+YR)	+0.44%	+0.70%
Bloomberg AusBond Treasury Index (0+YR)	+0.69%	+0.35%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+0.55%	-0.30%

Source: Bloomberg

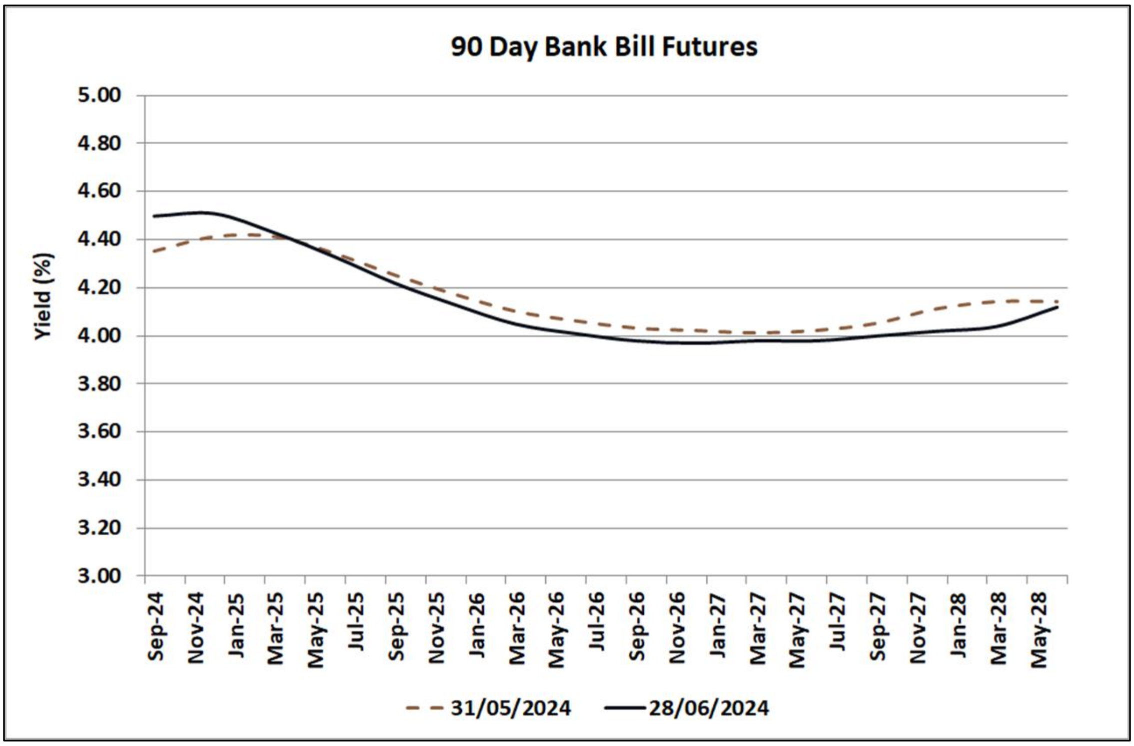
Other Key Rates

Index	June 2024	May 2024
RBA Official Cash Rate	4.35%	4.35%
90 Day (3 month) BBSW Rate	4.45%	4.35%
3yr Australian Government Bonds	4.07%	4.05%
10yr Australian Government Bonds	4.31%	4.41%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	4.71%	4.89%
10yr US Treasury Bonds	4.36%	4.51%

Source: RBA, ASX, US Department of Treasury

90 Day Bill Futures

Bill futures remained relatively flat at the long-end this month, despite ongoing evidence of sticky inflation. Markets continue to push back their expectations of when the first rate cut will be delivered, resulting in a flattening of the curve.



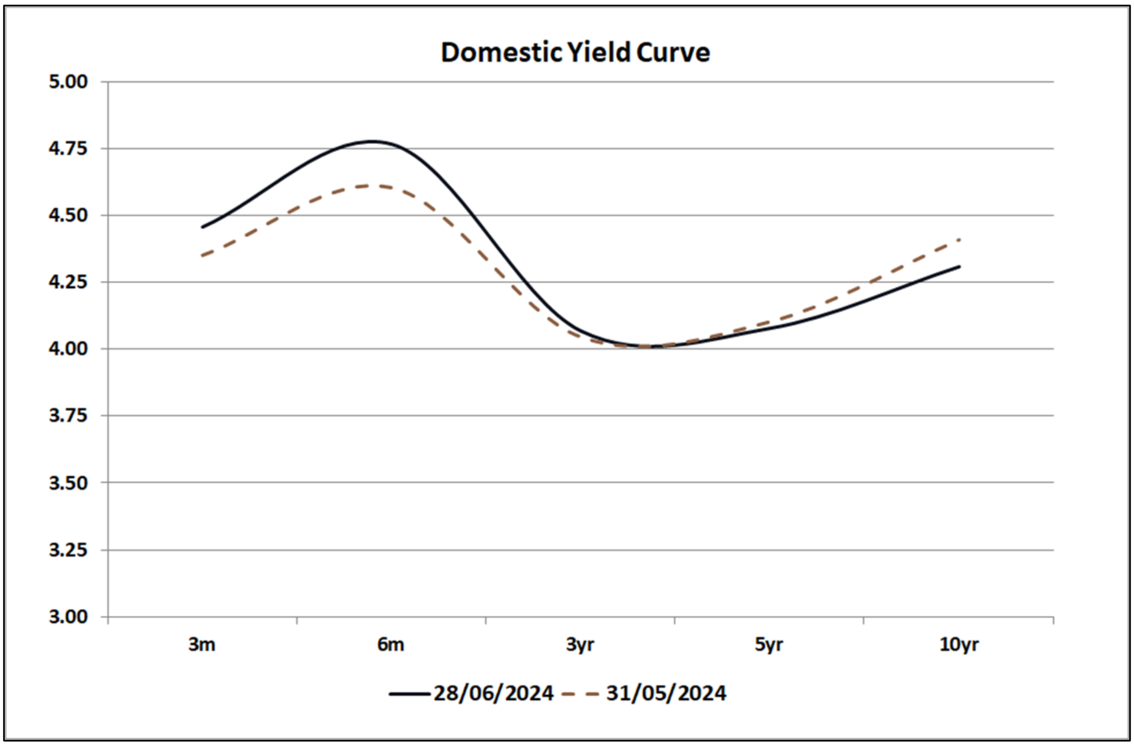
Source: ASX

Fixed Interest Outlook

US Federal Reserve officials again highlighted the importance of waiting for further progress in bringing inflation back to the Fed's 2% target before cutting rates. Policymakers currently expect the policy rate would be cut by just a single 25bp this year, down from at least three reductions earlier this year. The longer-run median US Fed dot plot is currently around 2.80%. US Fed Chair Powell commented that officials were "*coming to the view that rates are less likely to go down to their pre pandemic level*".

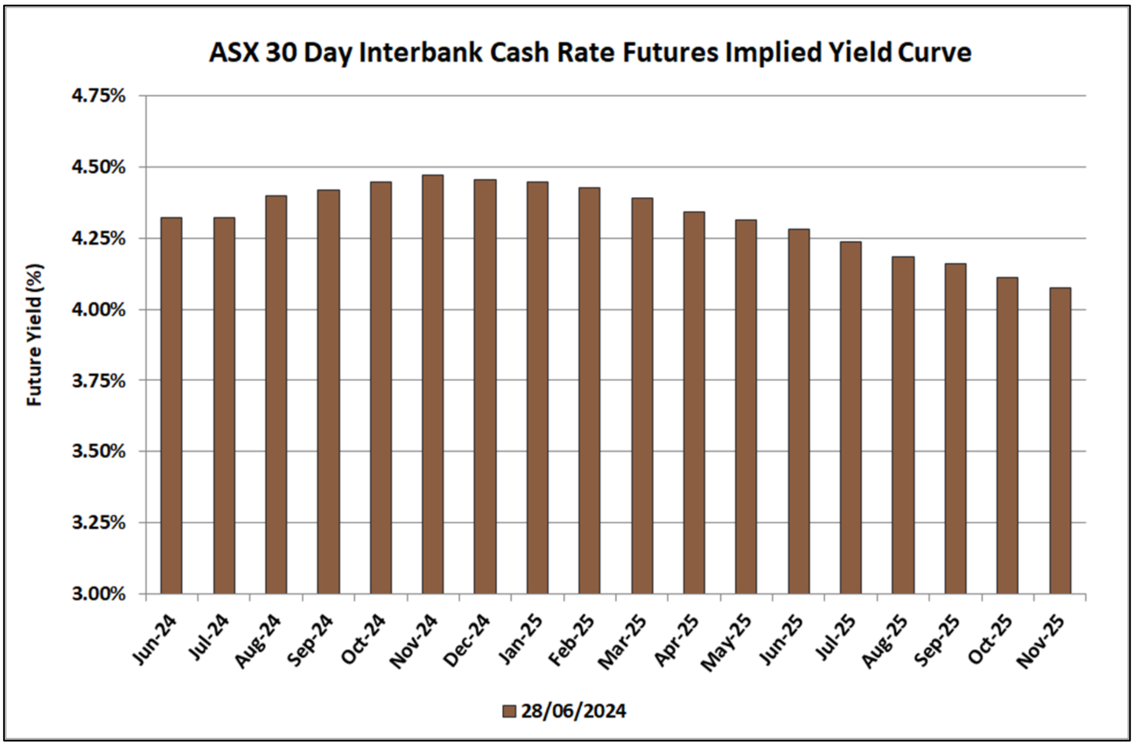
Domestically, the RBA kept the cash rate unchanged at its June meeting, with the central bank emphasising, "*The board is not ruling anything in or out…we still think we're on the narrow path, [but] it does appear to be getting a bit narrower.*" As is the case with most central banks at the moment, the RBA is waiting for current economic data to show a clear trend before taking any decisive action. The June quarter inflation data will be published on 31 July and will therefore give the RBA a comprehensive view of what is happening with inflation prior to its next policy meeting on 6 August.

Over the month, longer-term yields fell around 10bp at the very long end of the curve (remains an inverse yield curve):



Source: ASX, RBA

The market is now factoring the potential of another rate hike later this year with inflation seemingly remaining sticky. Financial markets have pushed back their expectations of rate cuts, with the first cut pencilled in for mid-late 2025.



Source: ASX