10.3. Investment and Loan Borrowings Report as at 28 February 2025

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ATTACHMENTS	1. Arlo Advisory North Sydney Council Monthly Report February 2025 [**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 details of the performance of Council's investments and loans for the month ending 28 February 2025.

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 February, the total investment portfolio (which would include Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.31% (actual), or +4.14% p.a. (annualised), under-performing the benchmark AusBond Bank Bill Index return of +0.34% (actual), or +4.51% p.a. (annualised).

- Returns on investments exceed the February YTD budget by $464,000. This result includes fees paid to Council's investment adviser which total $9,000 year to date.

- Underperformance against the benchmark is due to Council holding a higher than usual percentage as cash to pay for expected project costs.

RECOMMENDATION:
1. THAT the report on Investments held at 28 February 2025, 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 balances are $145,085,649. 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 tables detail the reserves held. Council held an unrestricted cash balance of $25.6 million, indicating it has funded all its reserves. According to the last approved budget, the internally restricted reserves will be allocated to the North Sydney Olympic Pool project once the initially designated funds for the project are fully utilised.

The unrestricted cash balance is high due to the timing of rates collection and is expected to decline by the end of the year.

External Restrictions and Internal Allocations	
External restrictions	
Developer contributions – general	$42,769,202
Domestic waste management	$16,668,296
Unexpended Special Rates	$1,730,375
Unspent borrowings - North Sydney Olympic Pool redevelopment	$7,907,889
Specific purpose grants	$3,104,534
Other specific purpose contributions	$2,090,149
Total external restrictions	**$74,270,445**
Internal allocations	
Capital works	$7,384,579
Community housing - capital purchases	$1,010,101
Community housing - major maintenance	$490,657
Deposits, retentions, and bonds	$14,823,001
Employees leave entitlement	$7,127,000
I.T. hardware and software	$984,358

External Restrictions and Internal Allocations	
Income producing projects	$544,448
Olympic Pool Redevelopment	$9,717,472
Plant and vehicle replacement	$3,091,302
Total internal allocations	**$45,172,918**
Total Restrictions and Allocations	**$119,443,363**
Unrestricted Cash and Investments	$25,642,286
Total Cash and Investments	**$145,085,649**

Investment Portfolio

The following tables detail the performance of Council's investment portfolio (excluding cash deposits) to the benchmark for the month of February 2025 - and annualised for the year-to-date (including investments that have matured prior to that date).

	February 2025	Annualised YTD
Actual Return	0.31%	4.14%
Benchmark	0.34%	4.51%
Variance	-0.03%	-0.37%

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 before those increases were made and a higher than usual percentage of investments held as cash to pay for expected project costs.

Asset Type	Market Value	Portfolio Breakdown
Term Deposits	$114,500,000	78.92%
Cash	$24,585,649	16.95%
Fixed Bonds	$6,000,000	4.13%
Floating Rate Notes (FRNs)	$0	0.00%
	$145,085,649	**100.00%**

Council's average duration of term deposits, which comprised 78.92% of the investment portfolio, is approximately 123 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 Reports (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 and deposits at call to fund its Capital Works budget including the North Sydney Olympic Pool project.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 28 February 2025 are $464,349 more than the revised year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget	YTD Interest	YTD Actual FV adjustment	YTD Budget to Actual Variance
2024/25	$2,534,059	$3,034,059	$2,983,129	$3,458,074	-$1,596	$464,349
Previous Years						
Year	**Original Annual Budget**	**Revised Annual Budget**		**Final Result Interest**	**Final Result FV adjustments**	**Final Budget to Actual Variance**
2023/24	$2,490,000	$5,490,000		$5,425,310	$5,334	-$71,356
2022/23	$1,384,350	$3,340,000		$3,697,634	$4,647	$350,281
2021/22	$1,182,500	$1,362,500		$1,314,826	$64,865	$5,191

Floating Rate Notes (FRNs) are required to be revalued each month using the Fair Value (FV) method, an estimate of the market value of the investment. The YTD movement of FRN's has seen a decrease of $1,596. Council sold its final FRN in February 2025. Cash flow requirements, mean that Council will focus on shorter-term term deposits.

Financial Investment Policy

All categories are within the Policy limits for credit ratings. The portfolio remains well diversified, with credit quality rated as AA, 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	$113,085,649	100.00%	77.94%
A Category	$32,000,000	60.00%	22.06%
BBB Category	$0	35.00%	0.00%
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 three 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**
1/07/2024	$4,505,143.19			
31/07/2024	$4,261,152.46	$45,648.83	$243,990.71	$ 289,639.54
31/10/2024	$4,014,689.49	$43,176.57	$246,462.97	$ 289,639.54
31/01/2025	$3,765,729.20	$40,679.25	$248,960.29	$ 289,639.54
30/04/2025	$3,513,002.06	$36,912.40	$252,727.14	$ 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
Note: This On-Street Parking Management System is now redundant, having been replaced in July 2024.

Loans 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. At 31 May 2024, these loan funds had 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**
01/07/2024	$28,935,444.66			
30/10/2024	$28,391,663.57	$613,431.43	$543,781.09	$1,157,212.52
29/04/2025	$27,836,354.32	$601,903.27	$555,309.25	$1,157,212.52

In July 2024, Council established a $20 million TCorp loan facility to fund further budget requirements of the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 27 July 2024. The funds were invested with a maturity profile to match cash flow requirements of the project. The funds were restricted and are being released, as required, to fund project cash outflows. As at 31 December 2024 $7.9 million was restricted and as at 31 January 2025, $8.6 million.

This loan is a fixed loan financing option, fully amortising the drawn down amount of $20,000,000 over 10 years, fixed interest rate with semi-annual repayments of interest and principal. The loan details are:

Loan amount:	$20,000,000.00			
Loan term:	10 years			
From:	26/07/2024			
To:	26/07/2034			
Interest rate:	5.29%p.a.(fixed)			
Repayment:	Semi-Annual			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
27/07/2024	$20,000,000.00			
28/01/2025	$19,228,419.44	$529,000.00	$771,580.56	$1,300,580.56

Consultation Requirements

Community engagement is not required.

Financial/Resource Implications

Returns are higher than budgeted in the month of February due to phasing of the Capital Works program. An adjustment to income is included in the December Quarter 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

February 2025

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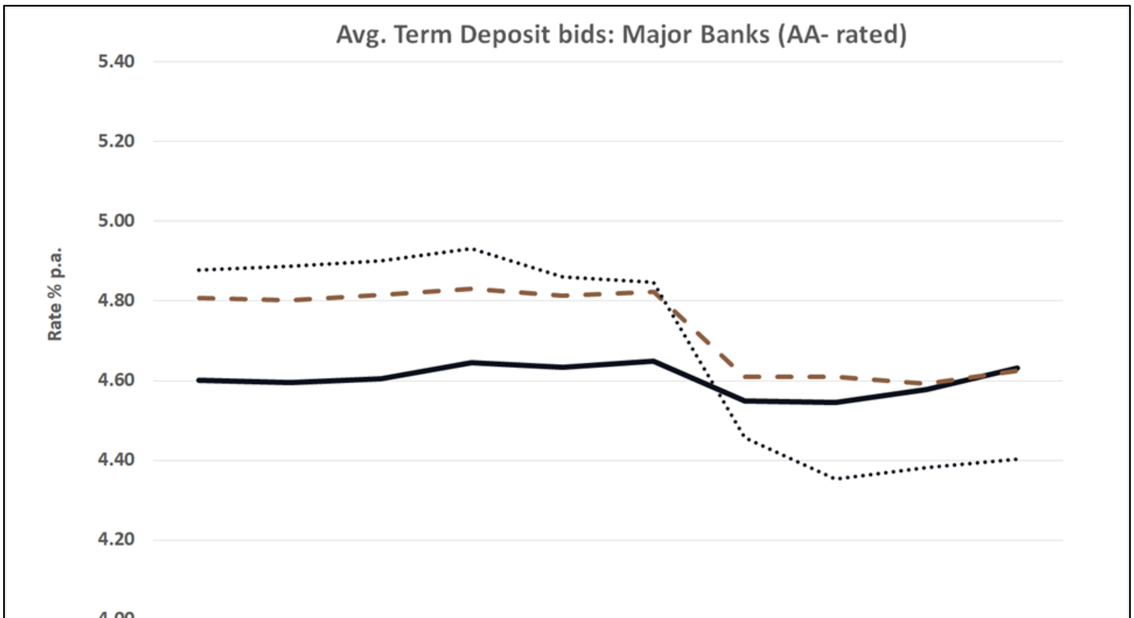
Market Update Summary

Risk markets experienced a downturn over February on the back of tariff uncertainty (led by the US) and ongoing geopolitics in the middle east.

In the deposit market, over February, at the very short-end of the curve (less than 12 months), the average deposit rates offered by the major banks fell by around 15-20bp compared to where they were the previous month (January), in response to the RBA's first rate cut this easing cycle. At the medium to longer-end of the curve (2-3 years), the average rates fell by around 5bp compared to where they were in January (and largely unchanged for 4-5 years).



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Feb-2025	4.60	4.60	4.61	4.65	4.63	4.65	4.55	4.55	4.58	4.63
Jan-2025	4.81	4.80	4.82	4.83	4.81	4.82	4.61	4.61	4.59	4.62
Aug-2024	4.88	4.89	4.90	4.93	4.86	4.85	4.46	4.35	4.38	4.40

Source: Imperium Markets

With additional rate cuts and a global economic downturn priced in over 2025, investors should consider diversifying and taking an 'insurance policy' against a potentially lower rate environment by investing across 1-5 year fixed deposits and locking in rates above 4½% p.a. (small allocation only).

North Sydney Council' Portfolio & Compliance

Asset Allocation

As at the end of February 2025, the portfolio was mainly directed to fixed term deposits (79%). The remaining portfolio is directed to fixed bonds (4%) and overnight cash accounts (17%).

Senior FRNs are becoming expensive on a historical basis, although new issuances should continue to be considered on a case by case scenario. In the interim, staggering a mix of fixed deposits between 12 months to 3 years remains a more optimal strategy to maximise returns over a longer-term cycle.

With additional rate cuts and a global economic downturn being priced in 2025, investors can choose to allocate a small proportion of longer-term funds and undertake an insurance policy against further rate cuts by investing across 1-5 year fixed deposits, locking in and targeting yields above 4½% p.a. Should inflation be within the RBA's target band of 2-3% over the longer-term, returns around 4½% p.a. or higher should outperform benchmark.

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 or high yielding cash accounts.

Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 7% of assets is directed to medium-term assets (1-2 years), which has resulted in solid performance 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 $91m 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 ongoing capital expenditure 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	$88,585,649	61.06%	10%	100%	$56,500,000
✓	91 - 365 days	$46,000,000	31.71%	20%	100%	$99,085,649
✓	1 - 2 years	$10,500,000	7.24%	0%	70%	$91,059,954
✓	2 - 5 years	$0	0.00%	0%	50%	$72,542,824
✓	5 - 10 years	$0	0.00%	0%	25%	$36,271,412
		$145,085,649	**100.00%**			

Counterparty

As at the end of February, 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 (high credit quality).

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	ANZ (Suncorp)	AA-	$5,000,000	3.45%	30.00%	$38,525,695
✓	CBA	AA-	$29,585,649	20.39%	30.00%	$13,940,046
✓	NAB	AA-	$37,000,000	25.50%	30.00%	$6,525,695
✓	NTTC Treasury	AA-	$6,000,000	4.14%	30.00%	$37,525,695
✓	Westpac	AA-	$35,500,000	24.47%	30.00%	$8,025,695
✓	ICBC Sydney	A	$13,000,000	8.96%	15.00%	$8,762,847
✓	Bendigo	A-	$10,000,000	6.89%	15.00%	$11,762,847
✓	BOQ	A-	$9,000,000	6.20%	15.00%	$12,762,847
			$145,085,649	**100.00%**		

On 31st July 2024, ANZ's takeover of Suncorp Bank was formalised, and ratings agency S&P upgraded Suncorp's long-term credit rating to that of its parent company immediately (now rated AA-). Any future investments with Suncorp will now be reflected under the parent company being ANZ.

Credit Quality

The portfolio remains lightly diversified and is of very high quality. As at the end of February 2025, all categories were within the Policy limits, with all now in the AA or A rated categories:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$113,085,649	77.94%	100%	$32,000,000
✓	A Category	$32,000,000	22.06%	60%	$55,051,389
✓	BBB Category	$0	0.00%	35%	$50,779,977
✓	Unrated ADIs	$0	0.00%	10%	$14,508,565
		$145,085,649	**100.00%**		

Performance

Council's performance for the month ending February 2025 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.31%	1.04%	2.12%	2.86%	4.33%	4.21%	3.40%
AusBond Bank Bill Index	0.34%	1.10%	2.21%	2.98%	4.48%	4.29%	3.44%
Council's T/D Portfolio	0.32%	1.04%	2.06%	2.68%	3.95%	3.68%	3.09%
Council's FRN Portfolio	0.07%	1.02%	2.43%	3.39%	5.37%	5.28%	4.49%
Council's Bond Portfolio	0.10%	0.31%	0.60%	0.80%	1.19%	1.18%	1.18%
Council's Portfolio^	**0.31%**	**1.01%**	**1.98%**	**2.56%**	**3.78%**	**3.54%**	**2.98%**
Rel. Performance	**-0.03%**	**-0.10%**	**-0.24%**	**-0.42%**	**-0.70%**	**-0.75%**	**-0.46%**

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

Performance (% p.a.)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	4.10%	4.27%	4.31%	4.32%	4.33%	4.21%	3.40%
AusBond Bank Bill Index	4.51%	4.54%	4.51%	4.51%	4.48%	4.29%	3.44%
Council's T/D Portfolio	4.29%	4.31%	4.20%	4.05%	3.95%	3.68%	3.09%
Council's FRN Portfolio	0.97%	4.22%	4.95%	5.14%	5.37%	5.28%	4.49%
Council's Bond Portfolio	1.29%	1.27%	1.22%	1.21%	1.19%	1.18%	1.18%
Council's Portfolio^	**4.14%**	**4.14%**	**4.02%**	**3.87%**	**3.78%**	**3.54%**	**2.98%**
Rel. Performance	**-0.37%**	**-0.40%**	**-0.49%**	**-0.64%**	**-0.70%**	**-0.75%**	**-0.46%**

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

For the month of February, the total investment portfolio (excluding cash) provided a solid return of +0.31% (actual) or +4.14% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.34% (actual) or +4.51% p.a. (annualised). This relative 'underperformance' has been due to the unexpected aggressive rate hikes undertaken by the RBA following the aftermath of the pandemic and Russia's invasion of Ukraine, which resulted in spike in global inflation. Whilst this 'underperformance' may continue in the short-term, we do anticipate this to be fairly temporary given the RBA has now commenced its easing 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).

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 February 2025, Council's deposit portfolio was yielding **4.24% p.a.** (up 10bp from the previous month), with a weighted average duration of around 123 days (~4 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) are starting to become expensive but remain slightly appealing (particularly for those investors with portfolios skewed towards fixed assets) and should be considered on a case by case scenario. **Fixed Bonds** may also provide attractive opportunities from new (primary) issuances.

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

Council's Senior FRNs Sale/Switch Recommendations

The Newcastle FRN matured on 4th Feb 2025, whereby Council received the full face value of $1.4m.

Council's Senior Bonds

During October 2020, Council placed $3m in the Northern Territory Treasury Corporation (NTTC), locking in a yield of 1.00% p.a. for a 5 year term. 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. $6m x 0.25% = $15,000) 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 February, we see value in the following:

ADI	LT Credit Rating	Term	Rate % p.a.
ING Bank	A	5 years	4.82%
Hume Bank	BBB+	5 years	4.68%
Westpac	AA-	5 years	4.59%
ING Bank	A	4 years	4.70%
BoQ	A-	4 years	4.55%
Westpac	AA-	4 years	4.53%
Hume Bank	BBB+	4 years	4.52%
ING Bank	A	3 years	4.61%
Westpac	AA-	3 years	4.50%
BoQ	A-	3 years	4.50%
Hume Bank	BBB+	3 years	4.50%
ING Bank	A	2 years	4.60%
NAB	AA-	2 years	4.55%
Westpac	AA-	2 years	4.51%
BoQ	A-	2 years	4.50%

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.
ICBC Sydney	A	12 months	4.74%
Westpac	AA-	12 months	4.70%
ING Bank	A	12 months	4.67%
NAB	AA-	12 months	4.65%
ICBC Sydney	A	9 months	4.72%
BankVIC	BBB+	9 months	4.70%
NAB	AA-	9 months	4.65%
ING Bank	A	9 months	4.63%
Bank of Sydney	Unrated	6 months	4.78%
BankVIC	BBB+	6 months	4.75%
NAB	AA-	6 months	4.70%
Westpac	AA-	6 months	4.66%
Bank of Sydney	Unrated	3 months	4.79%
NAB	AA-	3 months	4.70%

For those investors that do not require high levels of liquidity and can stagger their investments longer term, they will be rewarded over a longer-term cycle if they roll for an average min. term of 12 months, with a spread of investments out to 5 years (this is where we see current value). In a normal market environment (upward sloping yield curve), investors could earn over a cycle, on average, up to ¼-½% p.a. higher compared to those investors that entirely invest in short-dated deposits.

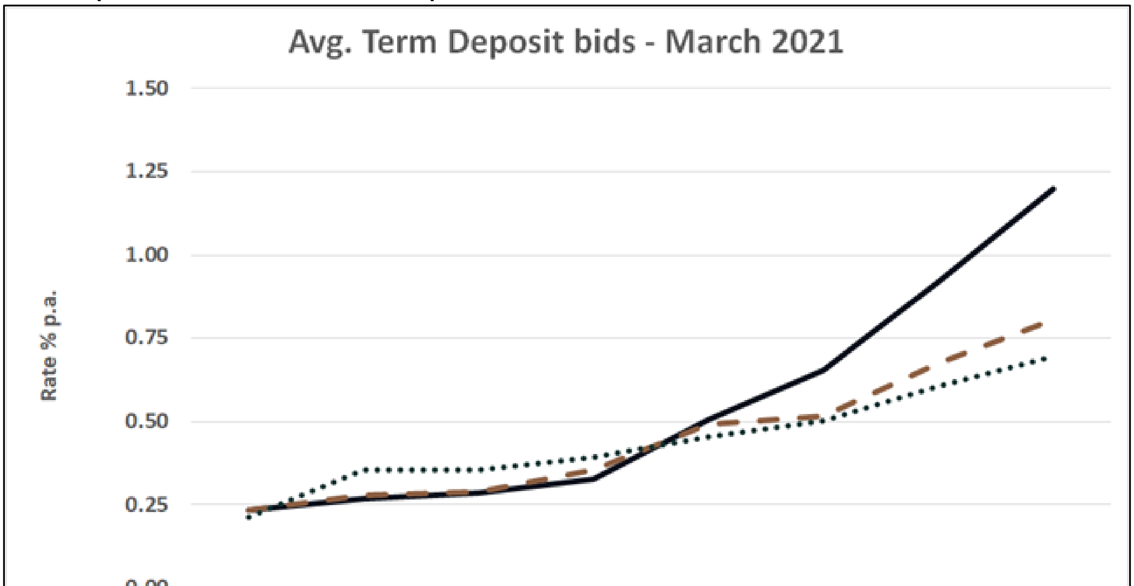
With additional rate cuts and a global economic downturn priced in over 2025, investors should consider allocating some longer-term surplus funds and undertake an insurance policy by investing across 1-5 year fixed deposits and locking in rates above 4½% p.a. This will provide some income protection if the RBA decides to continue cutting rates over 2025.

Arlo Advisory

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)



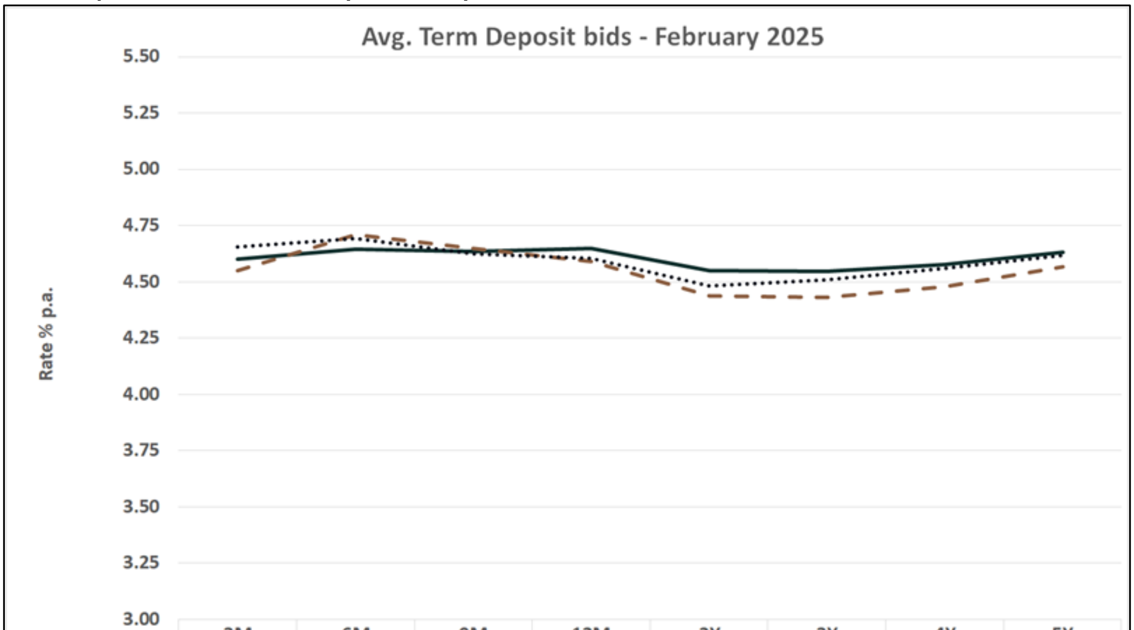
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

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, investors 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, although the major banks always seem to react more quickly than the rest of the market during periods of volatility:

Term Deposit Rates – Currently (February 2025)



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.60	4.65	4.63	4.65	4.55	4.55	4.58	4.63
A Rated	4.55	4.71	4.65	4.59	4.44	4.43	4.48	4.57
BBB Rated	4.66	4.69	4.63	4.61	4.48	4.51	4.56	4.62

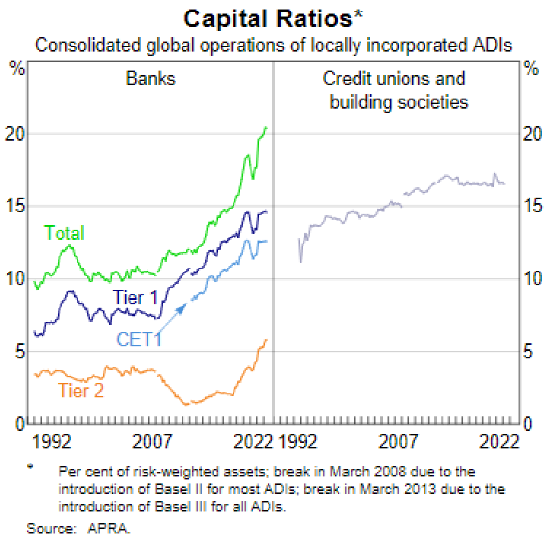
Source: Imperium Markets

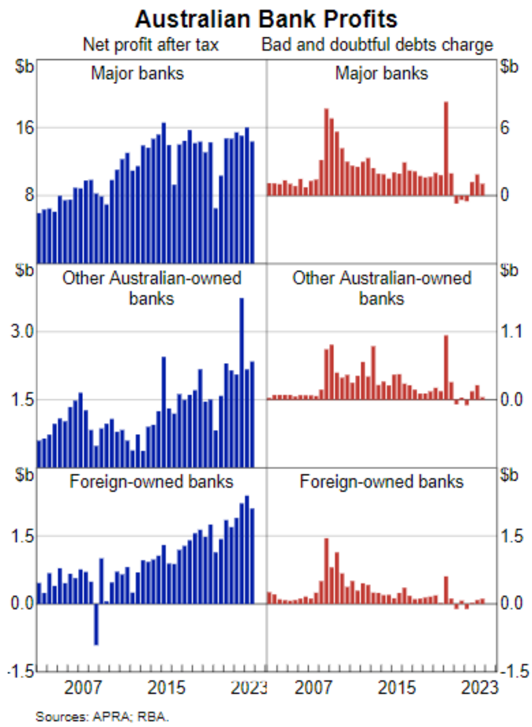
Financial Stability of the Banking (ADI) Sector

The RBA's latest Financial Stability report of 2024 reaffirms the strong balance sheet across the ADI sector. They noted that the risk of widespread financial stress remains limited due to the generally strong financial positions of most (individual) borrowers. Very few mortgage borrowers are in negative equity, limiting the impact on lenders (ADIs) in the event of default and supporting their ability to continue providing credit to the economy. Most businesses that have entered insolvency are small and have little debt, limiting the broader impact on the labour market and thus household incomes, and on the capital position of lenders (ADIs).

Australian banks (collectively the APRA regulated ADIs) have maintained prudent lending standards and are well positioned to continue supplying credit to the economy. A deterioration in economic conditions or temporary disruption to funding markets is unlikely to halt lending activity. Banks have anticipated an increase in loan arrears and have capital and liquidity buffers well above regulatory requirements (*see Capita Ratios chart below*). APRA's mandate is to "*protect depositors*" and provide "*financial stability*".

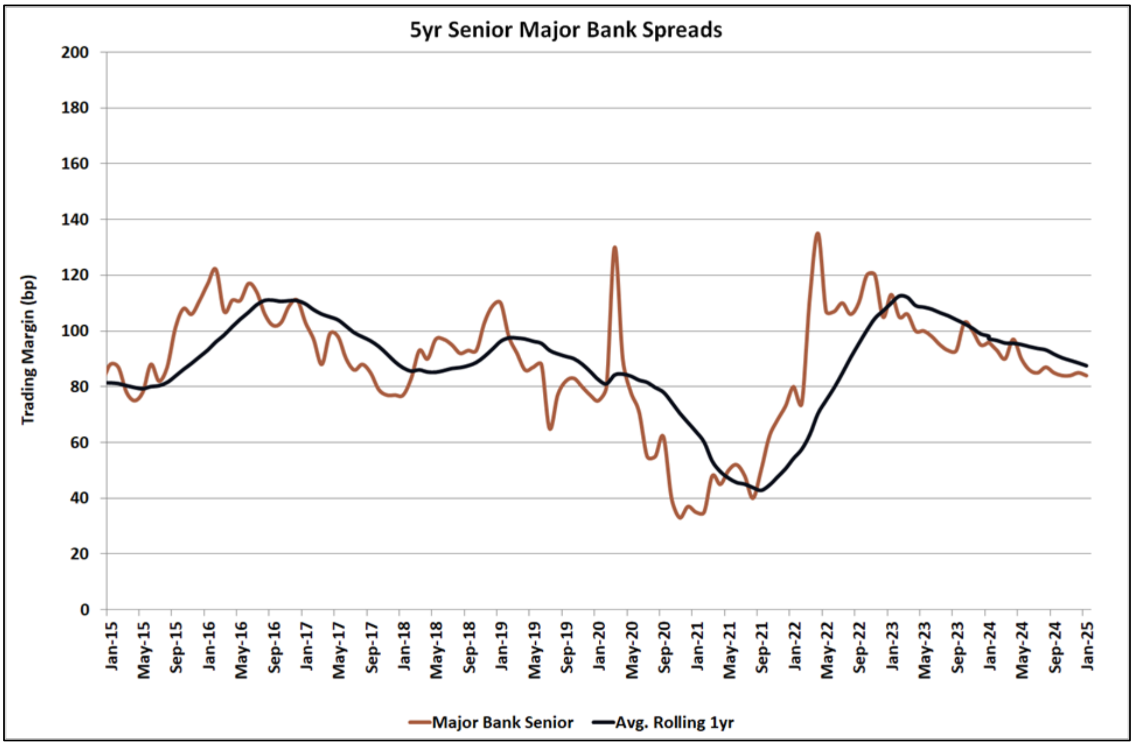
Over the past two decades, both domestic and international banks continue to operate and demonstrate high levels of profitability (*see Australian Bank Profits chart below*), which also includes two stress-test environments being the GFC (September 2008) and the COVID pandemic (March 2020):





Senior FRNs Market Review

Over February, amongst the senior major bank FRNs, physical credit securities tightened by up to 5bp at the longer-end of the curve. During the month, ANZ (AA-) issued a dual 3 and 5 year senior security +68bp and +81bp respectively. Long-term major bank senior securities are approaching the 'expensive' territory especially if the 5yr margin tightens towards +80bp.



Source: IBS Capital

Outside of ANZ (AA-), there was a few more notable primary deals:

- Rabobank (A+) 2½ and 5 year senior FRN at +65bp and +85bp respectively
- Mizuho (A) 3¼ year senior FRN at +72bp
- United Overseas Bank (AA-) 3 year senior FRN at +65bp
- MUFG (A) 3 year senior FRN at +67bp

Amongst the "A" and "BBB" rated sectors, the securities tightened by around 3-5bp at the longer-end of the curve. Overall, credit securities remain fair value on a historical basis without being overly exciting. FRNs will continue to play a role in investors' portfolios mainly based on 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)	28/02/2025	31/01/2025
"AA" rated – 5yrs	+81bp	+84bp
"AA" rated – 3yrs	+65bp	+70bp
"A" rated – 5yrs	+90bp	+95bp
"A" rated – 3yrs	+72bp	+78bp
"BBB" rated – 3yrs	+115bp	+117bp

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-2027 for the "AA" rated ADIs (domestic major banks);
- On or before mid-2026 for the "A" rated ADIs; and
- Within 6-9 months for the "BBB" rated ADIs (consider case by case).

Investors holding onto the above senior FRNs ('benchmark' issues only) in their last few years are now generally holding sub optimal investments and are not maximising returns by foregoing realised capital gains. In the current challenging economic environment, any boost in overall returns should be locked in when it is advantageous to do so, particularly as switch opportunities become available.

Senior Fixed Bonds – ADIs (Secondary Market)

With global inflation remaining elevated by historical standards, this has seen a lift in longer-term bond yields over the past 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 some 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	1.00	1.10%	4.41%
AU3CB0280030	BoQ	A-	Senior	06/05/2026	1.19	1.40%	4.64%
AU3CB0299337	Bendigo	A-	Senior	15/05/2026	1.21	4.70%	4.52%
AU3CB0296168	BoQ	A-	Senior	27/01/2027	1.92	4.70%	4.68%

Economic Commentary

International Market

Risk markets experienced a downturn over February on the back of tariff uncertainty (led by the US) and ongoing geopolitics in the middle east.

Across equity markets, the US S&P 500 Index fell -1.42%, whilst the NASDAQ lost -3.97%. Europe's main indices bucked the trend, with gains in Germany's DAX (+3.77%), France's CAC (+2.03%) and UK's FTSE (+1.57%).

US President Trump postponed the tariff increases on Canada and Mexico to early April, whilst the 10% additional tariffs on China have gone ahead. Canada, Mexico and China have all said they would retaliate, while Trump's Executive Order also includes a clause that would allow the US to increase the scope of duties in the event of retaliation.

In the US, headline payrolls came in at 143k, below the 175k consensus. The unemployment rate fell 0.1% to 4.0% (consensus 4.1%). Headline US CPI grew at +0.5% m/m in January and the core ex-food and energy measure at +0.3% m/m. Rate cut expectations have been pared, with just 25bp of cuts now priced this year.

Canadian employment data was stronger than expected, with employment rising 76k vs 25k expected and the unemployment rate falling 0.1% to 6.6% (6.8% expected). Headline CPI was as expected at +1.9% y/y but core measures was around 0.2% higher than expected.

The Bank of England (BoE) cuts Bank Rate by 25bp to 4.50% as expected. The vote was 7:2 with 2 dissenters preferring a 50bp cut. The unemployment rate in the UK was steady at 4.4% compared to an expected pickup to 4.5%. UK January CPI rose to +3.0% from +2.5%, above the +2.8% expected.

The RBNZ cut rates by 50bp to 3.75%. Governor Orr said he anticipated the cash rate will be around 3.00% by year-end but that the Bank needs to be a bit more cautious depending on inflation prints (positioning 25bp cuts the remainder of this year).

Chinese CPI was +0.5% vs +0.4% expected. The core measure rose to +0.6% from +0.4%, its fourth straight rise.

The MSCI World ex-Aus Index fell -0.75% for the month of February:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-1.42%	-1.29%	+16.84%	+10.83%	+15.05%	+10.96%
MSCI World ex-AUS	-0.75%	+2.67%	+14.29%	+8.67%	+12.36%	+8.11%
S&P ASX 200 Accum. Index	-3.79%	-2.56%	+9.94%	+9.24%	+8.87%	+7.51%

Source: S&P, MSCI

Domestic Market

The RBA cut rates by 25bp to 4.10% as widely expected. The post-Meeting Statement stated that "*some of the upside risks to inflation appear to have eased and there are signs that disinflation might be occurring a little more quickly than earlier expected*". However, risks were seen as two sided and the post-meeting commentary was seen as hawkish - if policy is "*eased too much too soon, disinflation could stall, and inflation would settle above the midpoint*".

The RBA's trimmed mean inflation is now forecast to return to the 2-3% target band six months earlier, however it flatlines at 2.7% from mid-2025. The RBA also lowered its projection of the unemployment rate by 0.3%, seeing unemployment peaking at 4.2% in June-2025 from a prior peak of 4.5% by December 2025.

The January Monthly CPI Indicator printed close to consensus at +2.5% y/y vs. +2.6% expected. The monthly core measures of inflation came in largely as expected at +2.8%-2.9% y/y.

The wage price index (WPI) rose +0.7% q/q in Q4 and +3.2% y/y. The consensus and RBA forecasts were for +0.8%/+3.2%. Wages growth has moderated substantially from its peak of +4.2% y/y over 2023 as the labour market has rebalanced.

The seasonally adjusted unemployment rate rose by 0.1% to 4.1% in January. Employment rose +44k, following a bump of +56k a month prior.

Retail sales in December was strong, falling just -0.1% m/m in December (consensus -0.7% m/m).

The Australian dollar fell around -0.18%, finishing the month at US62.14 cents (from US62.25 cents the previous month).

Credit Market

The global credit indices remained relatively flat during the month. They remain near the levels seen in early 2022 (prior to the rate hike cycle from most central banks):

Index	February 2025	January 2025
CDX North American 5yr CDS	50bp	48bp
iTraxx Europe 5yr CDS	53bp	53bp
iTraxx Australia 5yr CDS	65bp	66bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	February 2025	January 2025
Bloomberg AusBond Bank Bill Index (0+YR)	+0.34%	+0.38%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.93%	+0.19%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.47%	+0.47%
Bloomberg AusBond Credit Index (0+YR)	+0.79%	+0.44%
Bloomberg AusBond Treasury Index (0+YR)	+0.90%	+0.14%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+0.72%	-0.23%

Source: Bloomberg

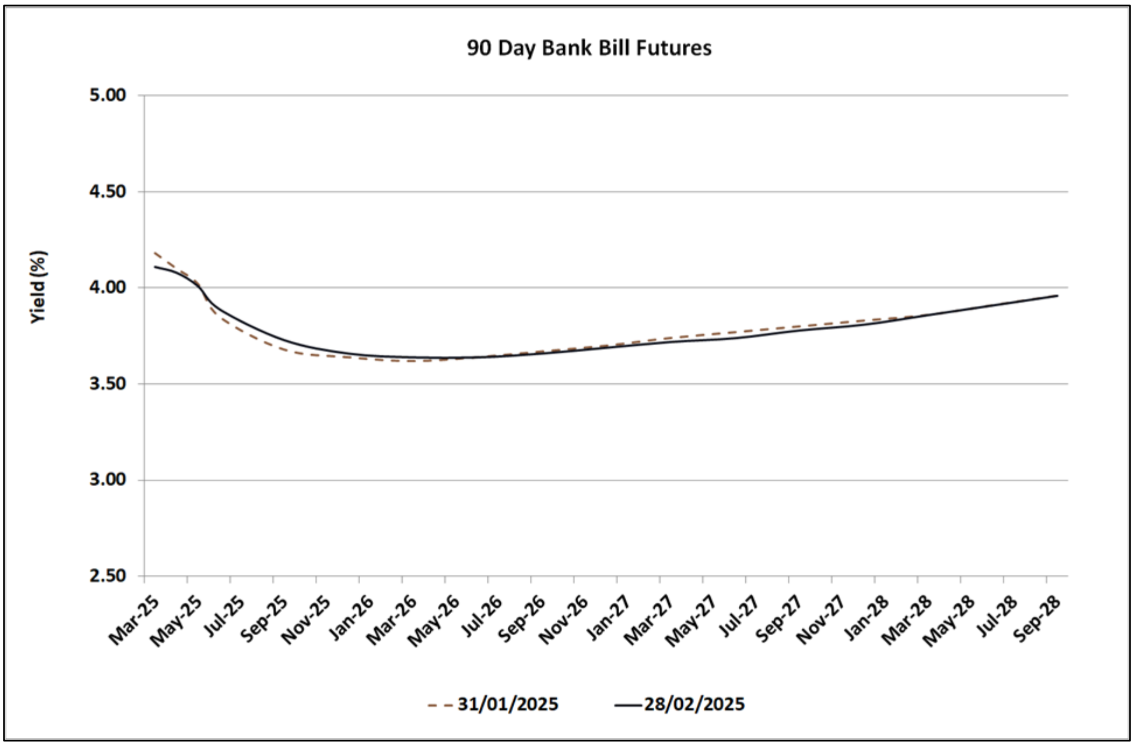
Other Key Rates

Index	February 2025	January 2025
RBA Official Cash Rate	4.10%	4.35%
90 Day (3 month) BBSW Rate	4.12%	4.25%
3yr Australian Government Bonds	3.75%	3.80%
10yr Australian Government Bonds	4.30%	4.43%
US Fed Funds Rate	4.25%-4.50%	4.25%-4.50%
2yr US Treasury Bonds	3.99%	4.22%
10yr US Treasury Bonds	4.24%	4.58%

Source: RBA, ASX, US Department of Treasury

90 Day Bill Futures

Bill futures remained relatively flat this month after the RBA delivered its first rate cut and downplayed expectations of the markets timing of additional rate cuts:



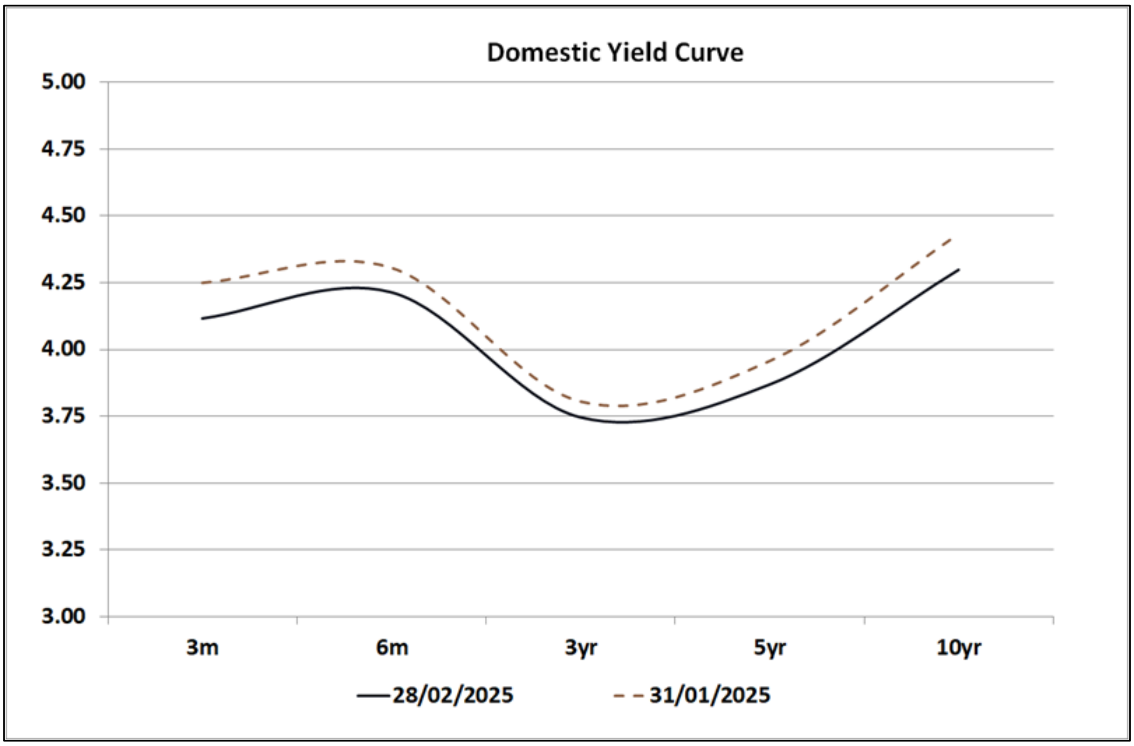
Source: ASX

Fixed Interest Outlook

US Fed Chair Powell's recently confirmed the Fed is going to be much more cautious in 2025 and they "*do not need to be in a hurry to adjust our policy stance*", reflective of sticky inflation combined with President-elect Trump's proposed economic policies (which is expected to exacerbate price pressures). The futures market is now only pricing in two rate cuts in the US over 2025.

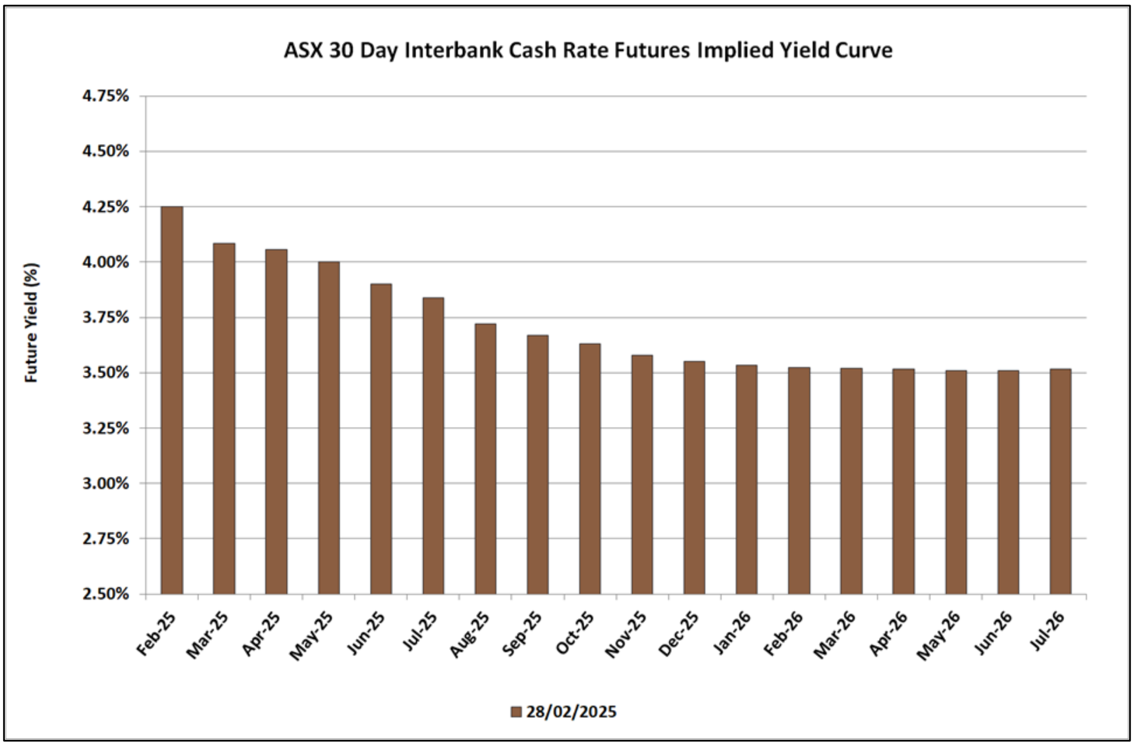
Domestically, RBA Governor Bullock reinforced the hawkish framing after their first cut. She explicitly pushed back on the additional 50bp of rate cuts underpinning their forecasts given they only forecast trimmed mean CPI flatlining at 2.70% from mid-2025. The Governor said, "*the board needs more evidence that inflation is continuing to decline before making decisions about the future path of interest rates*". She noted the RBA wants to see easing wage costs, disinflation in market services and housing inflation continuing to ease.

Yields remained fell up to 13bp across the short and long-end of the curve, adjusting to the RBA's first rate cut.



Source: ASX, RBA

Financial markets continue to price in up to two additional rate cuts in 2025, despite Governor Bullock's jawboning against such expectations:



Source: ASX