8.9. Investment and Loan Borrowings Report held as at 31 May 2022

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ATTACHMENTS:
1. Investment and Loan Borrowings Report held as at 31 May 2022 [**8.9.1** - 19 pages]

PURPOSE:

The report provides details of the performance of Council's investment portfolio and borrowing limits for the period ending 31 May 2022.

EXECUTIVE SUMMARY:

Investment Portfolio:

The Investment Portfolio (excluding cash balances) held for the period ending 31 May 2022 had a market value of $118,897,647. The annualised returns were 1.27%. This return exceeded the Australian Bond Bank Bill performance benchmark by 1.22%.

Cash deposits at call were $31,452,654 with $30,046,047 of these held in interest bearing accounts. $1,406,608 cash is held in Council's non-interest-bearing transaction account with the Commonwealth Bank to meet day-to-day operational needs.

The investment portfolio is managed to ensure liquidity to meet operational requirements and to fund outflows on major projects. Cashflow is monitored and assessed on an on-going basis.

The actual year to date returns for cash and investments for May 2022 were $1,059,000 compared to a year-to-date budget of $1,168,500.

The Reserve Bank of Australia (RBA) Board increased the official cash rate by 25 basis points to 0.35%. The Board indicated it will do what is necessary to ensure inflation returns to the target rate. This will require further lifts in interest rates in the period ahead.

Historically, returns on cash (i.e., "at call" accounts) and short-term investments have been quite strong. With the low official cash rate, market variability in monthly returns may mean short to medium term investment returns could be flat or potentially slightly negative. The capacity for Council staff to invest in a manner that meets liquidity requirements whilst achieving the "enhanced" benchmark returns (as detailed in the Investment Policy) is limited. The best available returns, however, are actively sought when surplus funds are invested.

Recent increases in the official cash rate are starting to flow though to term deposit rates bringing the prospect of improving returns for new investments in the coming months.

Borrowings:

Loan Facility for Council Projects

Council entered into a fixed interest loan of $9.5 million with quarterly interest and principal payments on 31 July 2018. The principal outstanding as at 31 May 2022 is $6,373,192.

The projects funded are outlined in the body of the report.

North Sydney Olympic Pool Redevelopment

In January 2022 Council established a $31 million TCorp loan facility to partially fund the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 28 April 2022. The drawdown rate is 4.24%. The funds will be restricted and then released as required to fund project cash outflows.

FINANCIAL IMPLICATIONS:

Council’s total investment portfolio performance for the financial year to date is 1.22% above the benchmark (1.27% against 0.05%). The actual year to date returns for cash and investments for May 2022 were $1,059,000 compared to a year-to-date budget of $1,185,000.

Investment returns will continue to be monitored and reported to ensure the estimate is consistent with the actual returns.

RECOMMENDATION:

1. THAT the report on Investments and Loan Borrowings held at 31 May 2022 be received.

LINK TO COMMUNITY STRATEGIC PLAN

The relationship with the Community Strategic Plan is as follows:

5. Our Civic Leadership
5.1 Council leads the strategic direction of North Sydney

BACKGROUND

The Responsible Accounting Officer must provide Council with a monthly report detailing all funds:

a. 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, the revised Investment Order issued by the Minister for Local Government and Council's Financial Investment Policy.

b. Borrowed under Section 624 of the Local Government Act. This report must comply with the borrowings Order issued by the Minister for Local Government and Council's Debt Management Policy.

CONSULTATION REQUIREMENTS
Community engagement is not required.

DETAIL
Investment Portfolio
The following table provides details of the performance of Council's investment portfolio (excluding cash deposits) against the benchmark for the month of May 2022 and annualised for the year-to-date 31 May 2022 (including investments which have matured prior to 31 May 2022).

	May 2022	**Annualised YTD as at 31 May 2022**
Actual Return	0.09%	1.27%
Benchmark	0.03%	0.05%
Variance	0.06%	1.22%

The portfolio performance continues to be driven by a handful of the longer-dated deposits that were locked-in prior to the interest rate cuts of recent years. Council's Floating-Rate Notes (FRNs) were locked in at attractive margins.

Asset Type	Market Value as at 31 May 2022	Portfolio Breakdown as at 31 May 2022
Term Deposits	$101,250,000	67.34%
Cash (Interest Bearing)	$30,046,047	19.98%
Cash (Non-Interest Bearing)	$1,406,608	0.94%
Fixed Bonds	$9,000,000	5.99%
FRTD	$6,000,000	3.99%
Floating Rate Notes (FRN's)	$2,647,647	1.76%
	$150,350,302	**100.00%**

Council's average duration of term deposits which comprise approximately 67% of the investment portfolio was approximately 548 days as at 31 May 2022.

Investment returns continue to exceed the indicative benchmark (Ausbond Bank Bill Index). All funds have been invested in accordance with the Act and the Regulations made thereunder and with Council's Financial Investment Policy. 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. These restrictions have placed greater emphasis on obtaining competitive investment options and the need for sound investment advice from Council's independent advisor.

Council continues to seek independent advice for all investments and is actively managing the portfolio to ensure that returns are maximised taking into account diversification and risk. A complete analysis of the performance is covered in the Monthly Investment Report prepared by Council's investment advisor (refer to attachment).

The actual investment returns for the year-to-date 31 May 2022 have been reviewed and are $109,151 less than the year-to-date budgeted estimate.

Summary of Returns from Investments (includes Fair Value adjustments):

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (May)	YTD/Annual Actual (May)	YTD/Annual Actual FV adjustments (May)	YTD Budget to Actual Variance (May)
2021/22	**$1,100,000**	**$1,282,000**	**$1,168,498**	**$1,119,435**	**- $60,089**	**-$109,151**
2020/21	$1,350,000	$1,350,000		$1,222,664	$93,735	-$33,601
2019/20	$1,500,000	$1,529,055		$1,896,660	-$4,944	$362,661
2018/19	$1,590,000	$1,730,000		$2,253,497	$91,056	$614,553

Floating Rate Notes (FRN's) are required to be revalued each month using the Fair Value (FV) method which is an estimate in time of the potential market value of the investment. As of 31 May 2022, the YTD movement of FRN's has been a decrease of $60,089.

Financial Investment Policy

As at the end of May, all categories were within the Policy limits for credit ratings and the portfolio remains well diversified, with all asset credit quality classified as BBB or higher. The maximum holding limit in each rating category and the target credit quality weighting for Council's portfolio are as per the following table:

Long Term Rating Range	Invested as 31 May 2022	Maximum Policy Holding	Distribution as 31 May 2022
AA Category	$97,904,797	100.00%	65.12%
A Category	$32,041,103	60.00%	21.31%
BBB Category	20,404,402	35.00%	13.57%
Unrated ADIs (NR)	$0	10.00%	0.00%

Loan Borrowings

Council's Loan Borrowing Policy provides the framework for Council's borrowing activities and defines key responsibilities and the operating parameters within which borrowing and related risk management activities are carried out.

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 its risk averse strategy.

Loan borrowing will be undertaken 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.

Debt Facility established July 2018:

This facility 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.

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**
1/07/2021	$7,253,977.04			
31/07/2021	$7,037,040.24	$72,702.74	$216,936.80	$ 289,639.54
30/10/2021	$6,817,929.20	$70,528.49	$219,111.04	$ 289,639.54
29/01/2022	$6,598,874.84	$70,585.18	$219,054.36	$ 289,639.54
30/04/2022	$6,373,191.95	$63,956.66	$225,682.88	$ 289,639.54

The next loan instalment is due on 29 July 2022.

Loan Funded Capital Projects as at 31 May 2022:

Project 1: Upgrading the Car Park in Alexander Street, Crows Nest
$5 million loan was sourced to fund project.

Current length of Loan as per the Long-Term Financial Plan (LTFP): 10 years to 2028

Project 2: Upgrading of On-Street Parking Management System
$4.5 million loan was sourced to fund project.

Current length of Loan as per LTFP: 10 years to 2028

Loan for North Sydney Olympic Pool Redevelopment

In January 2022 Council established a $31 million TCorp loan facility to partially fund the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 28 April 2022. The drawdown rate is 4.24%. The funds will be restricted and released as required to fund project cash outflows.

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**
28/04/2022	$31,000,000.00
30/06/2022	$31,000,000.00

The first loan instalment is due on 28 October 2022.

Monthly Investment Report

May 2022

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Impact of COVID-19 to Council's Portfolio

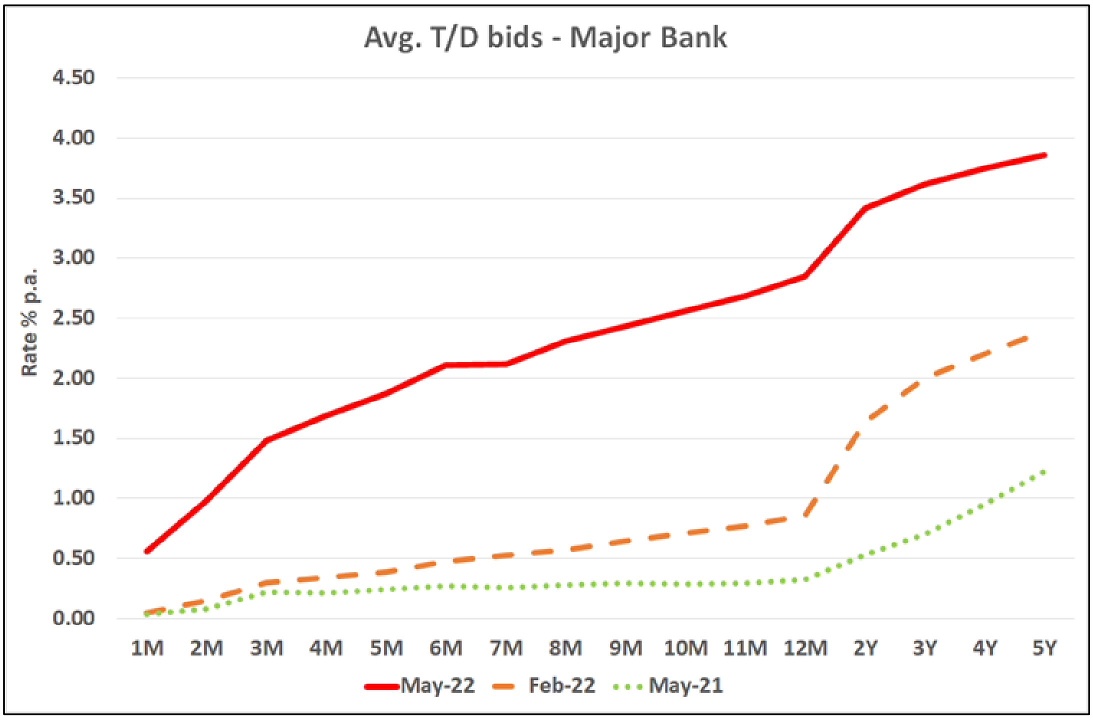
COVID-19 has adversely impacted financial markets, which in turn, has also affected Council's investment portfolio. We provide a quick summary in this section.

The RBA cut rates to record lows on 3rd November 2020 to 0.10%, consistent with most global central banks resetting their official rates to emergency levels. As global markets transitioned to the recovery phase, supply chain issues has resulted in surging inflationary pressures. Longer-term bond yields have risen significantly in recent months as central banks reverse their easing policy measures (i.e. quantitative easing), whilst also flagging the potential to aggressive hike official interest rates to combat surging inflation. Importantly though when interpreting the stance of monetary policy, it is not just about the cash rate, but how broader financial conditions are influencing the economic outlook, **with markets now factoring the possibility of a recession as official rates move higher**. **The RBA lifted the official cash rate by 25bp to 0.35% on 4th May 2022 – the first time it has increased rates in over a decade**.

The largest impact to Council's investment portfolio is with regards to its largest exposure being assets held in bank term deposits (fixed and floating), which accounts for around ~71% of Council's total investment. The biggest risk that Council faces over the medium-longer term in this environment is not the potential loss of capital (given all the banks are well capitalised and regulated by APRA), but the rapid loss of interest income as interest rates plummeted to all-time lows during the pandemic.

Council's term deposit portfolio was yielding 1.09% p.a. at month-end, with a weighted average duration of around 548 days or ~1½ years. This average duration will provide some income protection against the low interest rate environment over the next 12 months.

With markets factoring in additional rate hikes over coming months, this has seen a significant shift in longer-term deposit rates:



Source: Imperium Markets

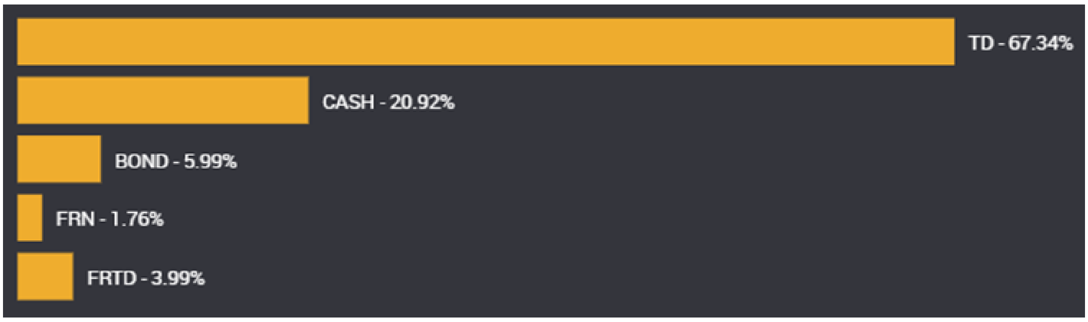
'New' investments above 3% p.a. now appears likely if Council can continue to place the majority of its surplus funds for terms of 12 months to 2 years.

Council's Portfolio & Compliance

Asset Allocation

As at the end of May 2022, the portfolio was mainly directed to fixed and floating rate term deposits (71.33%). The remaining portfolio is directed to FRNs (1.76%), fixed bonds (5.99%) and overnight cash accounts (20.92%).

Senior FRNs are now becoming more attractive as spreads have widened in recent months – new issuances should now be considered again on a case by case scenario. In the interim, fixed deposits for 12 months to 2 years appear quite appealing following the spike in longer-term rates in recent months.



Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 34% of assets is directed to medium-term assets (2-5 years), which is sensible in this low rate environment. There is still some capacity to invest in the medium-term horizon, with approximately $23.5m at month-end.

Where liquidity permits, we recommend new surplus funds be directed to 1-2 year horizon given this is where the most attractive value can be found. We suggest this be allocated to any remaining attractive fixed term deposits.

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 90 days	$64,452,654	42.87%	10%	100%	$85,897,647
X	91 - 365 days	$13,000,000	8.65%	20%	100%	$137,350,301
✓	1 - 2 years	$21,250,000	14.13%	0%	70%	$83,995,211
✓	2 - 5 years	$51,647,647	34.35%	0%	50%	$23,527,504
✓	5 - 10 years	$0	0.00%	0%	25%	$37,587,575
		$150,350,301	**100.00%**			

Although the 3-12 month allocation is underweight relative to the min. 20% limit, this is more than offset by the large allocation (~43%) to the 0-3 month horizon (highly liquid).

Counterparty

As at the end of May, all individual limits comply with the Policy. Exposures to individual ADIs are driven by the portfolio's movements throughout any month. Overall, the portfolio is well diversified across the investment grade spectrum, with no exposure to the unrated ADIs.

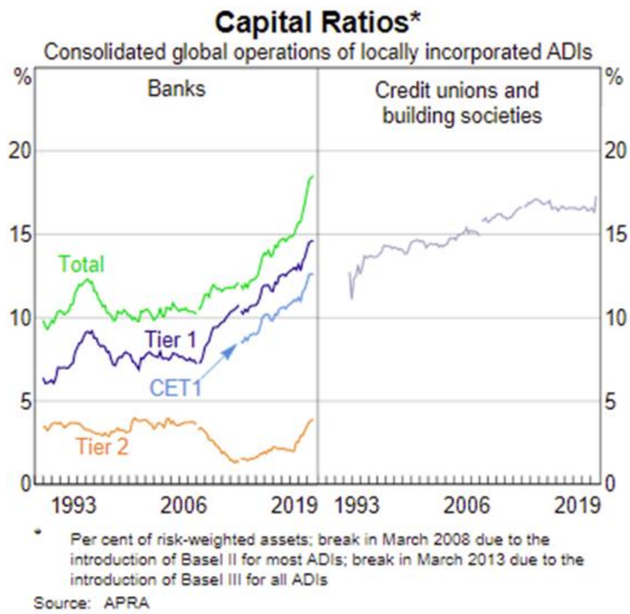
Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	CBA	AA-	$35,406,608	23.55%	30.00%	$9,698,483
✓	NAB	AA-	$25,000,000	16.63%	30.00%	$20,105,090
✓	NTTC Treasury	AA-	$9,000,000	5.99%	30.00%	$36,105,090
✓	Suncorp	AA-	$1,248,189	0.83%	30.00%	$43,856,902
✓	Westpac	AA-	$27,250,000	18.12%	30.00%	$17,855,090
✓	Macquarie	A+	$15,041,103	10.00%	15.00%	$7,511,442
✓	ICBC Sydney	A	$17,000,000	11.31%	15.00%	$5,552,545
✓	BOQ	BBB+	$10,000,000	6.65%	10.00%	$5,035,030
✓	AMP Bank	BBB	$6,004,944	3.99%	10.00%	$9,030,086
✓	Auswide Bank	BBB	$3,000,000	2.00%	10.00%	$12,035,030
✓	Newcastle PBS	BBB	$1,399,458	0.93%	10.00%	$13,635,572
			$150,350,301	**100.00%**		

We remain supportive of the regional and unrated ADI sector (and have been even throughout the 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.

APRA's Chairman affirmed that the banks had satisfactorily moved towards an '*unquestionably strong*' capital position and that bank's stress testing contingency plans were now far better positioned that was previously the case years ago. ***RBA Governor Lowe has commented that they have not seen any signs of stress in the financial system and that unlike during the GFC, the banks now have cash, are well capitalised and are acting as "shock absorbers" in the current pandemic crisis***.

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). We believe that deposit investments with the lower rated ADIs should be continued 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 ADIs continue to carry high levels of capital, particularly amongst the lower ("BBB") and unrated ADIs. There is minimal (if any) probability of any ADI defaulting on their deposits going forward – this was stress tested during the GFC. **APRA's mandate is to "*protect depositors*" and provide "*financial stability*".**



Credit Quality

The portfolio remains well diversified from a credit ratings perspective, with all assets classified as investment grade (rated BBB- or higher).

From a ratings perspective, the "BBB" rated banks now generally dominate the number of ADIs issuing deposits within the investment grade space. There has been further signs of appetite developing in the wholesale deposit market as additional lower rated ("BBB" and unrated) ADIs have come to market to raise 'new' money. Over the coming year, we may start to see a more 'normalised' environment where the lower rated banks start to offer higher rates compared to the higher rated banks as the competition for deposits grow.

As at the end of May 2022, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$97,904,796	65.12%	100%	$52,445,505
✓	A Category	$32,041,103	21.31%	60%	$58,169,078
✓	BBB Category	$20,404,402	13.57%	35%	$32,218,204
✓	Unrated ADIs	$0	0.00%	10%	$15,035,030
		$150,350,301	**100.00%**		

Performance

Council's performance for the month ending 31 May 2022 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years
Official Cash Rate	0.03%	0.05%	0.07%	0.11%	0.12%	0.14%
AusBond Bank Bill Index	0.03%	0.02%	0.04%	0.05%	0.05%	0.06%
Council's T/D Portfolio	0.09%	0.29%	0.60%	1.17%	1.29%	1.45%
Council's FRN Portfolio	0.15%	0.32%	0.58%	1.28%	1.36%	1.53%
Council's Bond Portfolio	0.10%	0.29%	0.58%	1.03%	1.11%	-
Council's Portfolio^	**0.09%**	**0.29%**	**0.60%**	**1.16%**	**1.27%**	**1.43%**
Outperformance	**0.06%**	**0.27%**	**0.56%**	**1.11%**	**1.22%**	**1.38%**

^Total portfolio performance excludes Council's cash account holdings. Overall returns would be lower if cash was included.

Performance (% p.a.)	1 month	3 months	6 months	FYTD	1 year	2 years
Official Cash Rate	0.35%	0.18%	0.14%	0.12%	0.12%	0.14%
AusBond Bank Bill Index	0.41%	0.09%	0.07%	0.05%	0.05%	0.06%
Council's T/D Portfolio	1.09%	1.15%	1.20%	1.27%	1.29%	1.45%
Council's FRN Portfolio	1.75%	1.29%	1.18%	1.39%	1.36%	1.53%
Council's Bond Portfolio	1.13%	1.15%	1.16%	1.12%	1.11%	-
Council's Portfolio^	**1.11%**	**1.15%**	**1.20%**	**1.26%**	**1.27%**	**1.43%**
Outperformance	**0.70%**	**1.06%**	**1.12%**	**1.21%**	**1.22%**	**1.38%**

^Total portfolio performance excludes Council's cash account holdings. Overall returns would be lower if cash was included.

For the month of May, the total investment portfolio (excluding cash) provided a strong return of +0.09% (actual) or +1.11% p.a. (annualised), easily outperforming the benchmark AusBond Bank Bill Index return of +0.03% (actual) or +0.41% p.a. (annualised). The strong performance continues to be driven by the handful of the longer-dated deposits that were locked-in prior to the RBA's rate cuts, as well as the FRNs locked in at attractive margins.

Over the past 12 months, the total portfolio (excluding cash) returned an outstanding +1.27% p.a., outperforming bank bills by 1.22% p.a. This has been very strong given deposit rates reached their all-time lows and credit margins have generally contracted over the past 3 years.

With deposit margins tightening over the past few years, the FRN portfolio's performance has narrowed the gap compared to term deposits, although this is likely to reverse following the multiple interest rate cuts over the past year.

We are pleased that North Sydney Council remains amongst the best performing Councils in the state of NSW where deposits are concerned (as per our March 2022 Council Rankings), earning around $428,000 in additional interest income versus the average NSW Council. We have been pro-active in our advice about protecting interest income and addressing reinvestment risk for many years and encouraged to maintain a long duration position. This is now reflected by the high performance of the investment portfolio.

Council's Term Deposit Portfolio & Recommendation

As at the end of May 2022, Council's deposit portfolio was yielding an **attractive 1.09% p.a.** (up 4bp from the previous month), with an average duration of around 548 days (~1.5 years). We recommend Council maintains an average duration above 12 months.

As the past decade or so has highlighted (post-GFC era), we have seen too many portfolios overpay for liquidity and generally not insured themselves by diversify their funding across various tenors. Those investors that can maintain a weighted average duration of +12-18 months are likely to yield, on average, up to 1% p.a. higher than those investors who maintain a weighted average duration of less than 6-9 months.

At the time of writing, we see value in:

ADI	LT Credit Rating	Term	T/D Rate
ICBC, Sydney	A	3 years	4.24% p.a.
BoQ/ME Bank	BBB+	3 years	4.00% p.a.
ICBC, Sydney	A	2 years	3.95% p.a.
Westpac	AA-	3 years	3.95% p.a.
Australian Unity	BBB+	3 years	3.90% p.a.
BoQ/ME Bank	BBB+	2 years	3.80% p.a.
Westpac	AA-	2 years	3.79% p.a.
CBA	AA-	2 years	3.77% p.a.
NAB	AA-	2 years	3.65% p.a.

The above deposits are suitable for investors looking to maintain diversification and likely to lock-in a 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 (dependent on daily funding requirements):

ADI	LT Credit Rating	Term	T/D Rate
BoQ/ME Bank	BBB+	12 months	3.30% p.a.
CBA	AA-	12 months	3.23% p.a.
Westpac	AA-	12 months	3.18% p.a.
Suncorp	AA-	12 months	3.13% p.a.
ICBC	A	12 months	3.08% p.a.
NAB	AA-	12 months	3.05% p.a.

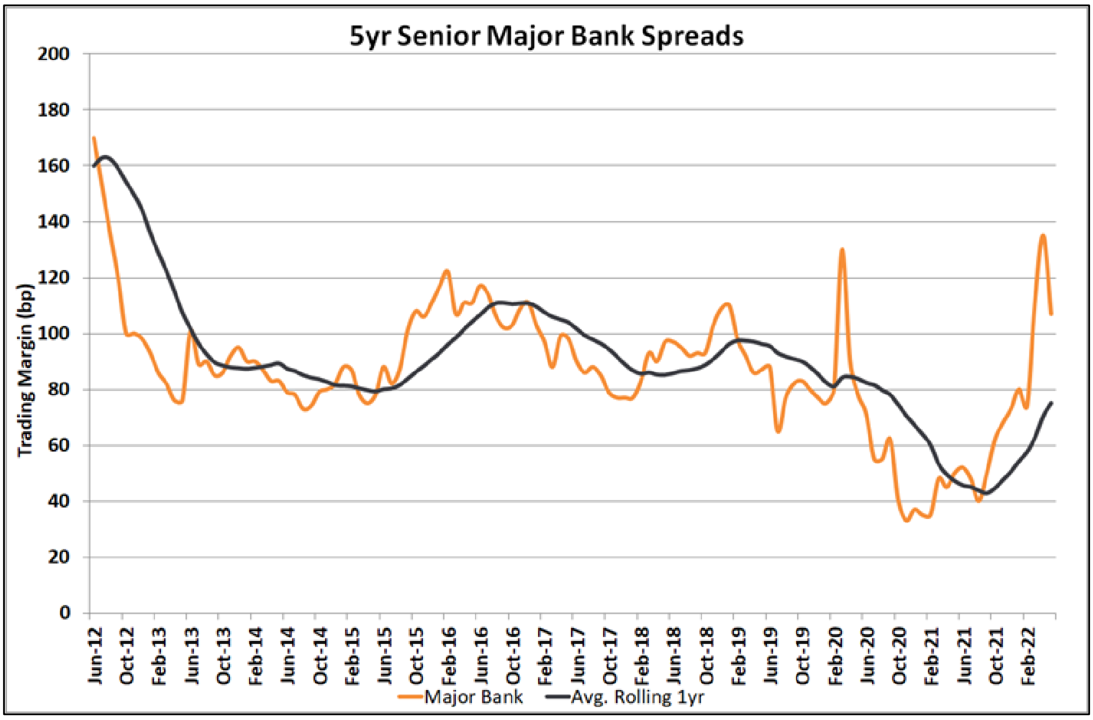
Despite the expectations of further rate rises, we still believe there is better value in slightly longer dated terms of 18 months - 2 years. For those investors that do not require high levels of liquidity and can stagger their investments longer-term, they will be rewarded over coming years if they roll for an average min. term of 18 months - 2 years (this is where we current value), yielding, on average, up to ½%-1% p.a. higher compared to those investors that entirely invest in short-dated deposits.

Senior FRNs Review

During May 2022, amongst the senior major bank FRNs, physical credit securities tightened by up to 25-30bp at the long-end of the curve. There was a significant pick-up in primary issuances from the major banks, issuing senior securities as follows:

- ANZ (AA-) 3 year fixed and FRN at +77bp
- ANZ (AA-) 5 year FRN at +97bp
- WBC (AAA) 3 year fixed and floating covered security at +73bp
- WBC (AA-) 5 year FRN at +105bp
- NAB (AA-) 3 year fixed and FRN at +90bp

Major bank senior securities are now looking fairly attractive again in a rising rate environment:



Source: IBS Capital

Outside of the major banks, there were also noticeable senior issuances from:

- RACQ Bank (BBB+) 3 year senior FRN at +125bp
- ING (AAA) 3 year fixed and floating covered security at +78bp
- ING (AAA) 5 year fixed covered bond at 4.50% s.a.

Amongst the "A" and "BBB" rated sector, the securities tightened by around 25bp at the long-end of the curve over May.

Credit securities are looking much more attractive given the widening of spreads in recent months. FRNs will continue to play a role in investor's portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	31/05/2022	30/04/2022
"AA" rated – 5yrs	+107bp	+135bp
"AA" rated – 3yrs	+90bp	+115bp
"A" rated – 5yrs	+125bp	+150bp
"A" rated – 3yrs	+100bp	+125bp
"BBB" rated – 3yrs	+115bp	+140bp

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-2024 for the "AA" rated ADIs (domestic major banks)**;
- On or before mid-2023 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 low interest rate environment, any boost in overall returns should be locked in when it is advantageous to do so, particularly as switch opportunities become available.

Primary (new) FRNs are now looking more appealing and should be considered on a case by case scenario.

Council's Senior FRNs Sale/Switch Recommendations

We recommend Council retains its remaining two FRNs at this stage. We will inform Council when there is an opportunity to sell these assets to boost the overall returns of the investment portfolio.

Council's Senior Bonds

During October 2020, Council placed two parcels of $3m (totalling $6m) with the Northern Territory Treasury Corporation (NTTC), locking in yields of 0.90% p.a. and 1.00% p.a. for a 4 and 5 year term respectively. In August 2021, it placed another $3m parcel with NTTC (AA-), locking in a yield of 1.50% p.a. for a 5 year term.

Council received the full rebated commission of 0.25% on the total face value of investments (i.e. $9m x 0.25% = $22,500) as it was introduced by Imperium Markets. We believe this was prudent given the low rate environment.

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.

Senior Bonds - Northern Territory Treasury Corporation (NTTC)

Investors should be aware of the following senior retail bond offering from Northern Territory Treasury Corporation (NTTC) effective 2nd May 2022:

Maturity Date	Rate % p.a.^	Interest Paid
15/06/2023	1.10%	Annually
15/06/2024	2.10%	Annually
15/06/2025	2.60%	Annually
15/06/2026	2.80%	Annually
15/06/2027	3.10%	Annually

^^The rates offered in the above table can be reviewed and changed at any time from Treasury. The rate for broker sponsored applications will be dropped by 0.20% p.a. effective 1 October 2020.

Any investor interested in this product should avoid placing through the broker channel and contact Imperium Markets to receive the full commission of 0.25% (plus GST) on the face value of the investment, in the form of an additional rebate. If placed through the brokers, they are likely to keep the 0.25% commission (on the face value of the investment).

Overview	Description
Issuer	Northern Territory Government
Credit Rating	Aa3 (Moody's), which is AA- equivalent (S&P)
Type	Fixed senior (retail) bonds
Program	Territory Bonds Issue 112
Date for applications	**01/01/2022 – 31/05/2022**
Liquidity	Weekly redemptions available, subject to the prevailing market rate and administration costs^^

^^ Note given this is a retail bond offering (min. parcel size of $5,000), for wholesale investors, we would not consider this to be a liquid investment (the largest redemptions to date have only been $200-$300k).

The product should be viewed as a hold-to-maturity product, noting there are significant penalty costs including admin fees, the prevailing market interest rate, and factors in any associate commissions that were previously paid. Given the longer-term outlook for official interest rates, any investor interested should invest through Imperium Markets to receive an effectively higher rate, once factoring in the rebated commission. *These offers will need to be compared to other complying assets at the time of investment – term deposits are currently a better alternative.*

Senior Fixed Bonds – ADIs (Secondary Market)

As global inflationary pressures have emerged, this has seen a significant lift in longer-term bond yields (valuations fell) as markets have strongly factored in a tightening of global central bank policy measures (i.e. withdrawal of Quantitative Easing and lifting official interest rates).

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
AU3CB0255776	ING	AAA	Covered	07/09/2023	1.28	3.00%	3.07%
AU3CB0258465	Westpac	AA-	Senior	16/11/2023	1.48	3.25%	3.12%
AU3CB0265403	Suncorp	AA-	Senior	30/07/2024	2.18	1.85%	3.69%
AU3CB0265593	Macquarie	A+	Senior	07/08/2024	2.20	1.75%	3.64%
AU3CB0265718	ING	AAA	Covered	20/08/2024	2.24	1.45%	3.66%
AU3CB0266179	ANZ	AA-	Senior	29/08/2024	2.26	1.55%	3.51%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	2.28	1.70%	3.74%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	2.43	2.00%	3.84%
AU3CB0269710	ANZ	AA-	Senior	16/01/2025	2.65	1.65%	3.65%
AU3CB0269892	NAB	AA-	Senior	21/01/2025	2.66	1.65%	3.70%
AU3CB0270387	Macquarie	A+	Senior	12/02/2025	2.72	1.70%	3.84%
AU3CB0287415	Westpac	AA-	Senior	17/03/2025	2.81	2.70%	3.73%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	3.95	1.40%	4.38%
AU3CB0282358	ING	AAA	Covered	19/08/2026	4.24	1.10%	4.17%
AU3CB0284149	BoQ	BBB+	Senior	27/10/2026	4.42	2.10%	4.37%
AU3CB0286037	Westpac	AA-	Senior	25/01/2027	4.67	2.40%	4.01%

Economic Commentary

International Market

Market focus continues to be on central banks and the extent of their rate hikes this cycle. Importantly though when talking about the stance of monetary policy, it is not just about the cash rate, but how broader financial conditions are influencing the economic outlook.

In the US, the S&P 500 Index remained flat, while the NASDAQ fell -2.05%. Europe's main indices were mixed, with France's CAC falling -0.99%, while Germany's DAX (+2.06%) and UK's FTSE (+0.84%) gained.

The US Federal Reserve delivered their expected 50bp rate rise during May, taking the target range to 0.75%- 1.00%. It was the first 50bp hike since 2000 and the first back-to-back rise since 2006. Fed Chair Powell acknowledged that 50bp hikes, "*are on the table for the next couple of meetings*".

The US Fed FOMC Minutes revealed a broad consensus for 50bp hikes in June and July and the possibility for a pause later in the year. The US the core PCE inflation dipped to +5.2% from +5.3%, marking the first decline since October 2020.

Europe inflation rose +7.5%y/y in April, in line with expectations, but the big surprise came from the core reading, jumping from +2.9%y/y in March to +3.5%y/y in April. The Eurozone unemployment rate declined to 6.8% in March from an upwardly revised 6.9%.

The ECB is now aligned to start a rate hike process in July, with the market pricing in 3 x 25bp rises to +0.25% by December, but no 50bp moves.

The Bank of England raised its cash rate by 0.25% to 1.00%. Markets had prices some risk of a larger 50bp move, as 3 of 9 members voted in favour of 50bp. The UK's unemployment rate fell to 3.7 % in Q1, the lowest level since 1974. Meanwhile, UK's headline CPI hit +9.0% y/y, 0.1% less than expected and up from +7.0% y/y in March. Core CPI rose to +6.2% from +5.7%, in line with expectations.

The RBNZ raised interest rates by 50bp to 2.00% as it tries to get a handle on inflation, while signalling the benchmark rate would peak at nearly 4% in the second half of next year and remain there into 2024.

There was ongoing concerns about COVID spreading and the risk of tighter containment measures being stoked by an increase in recorded cases in Beijing, which would exacerbate existing inflationary pressures.

The MSCI World ex-Aus Index fell -0.13% for the month of May:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+0.01%	-5.53 %	-1.71%	+14.51%	+11.37%	+12.17%
MSCI World ex-AUS	-0.13%	-6.46%	-6.21%	+11.04%	+7.96%	+9.20%
S&P ASX 200 Accum. Index	-2.60%	+3.21%	+4.84%	+7.85%	+8.84%	+10.37%

Source: S&P, MSCI

Domestic Market

The RBA somewhat surprised markets by raising the official cash rate by 25bp to 0.35% (consensus 15bp to 0.25%). The Board commented it was, "*committed to doing what is necessary to ensure that inflation in Australia returns to target over time. This will require a further lift in interest rates over the period ahead*". The RBA's forecast for underlying inflation is to have slowed only to 3% by mid-2024 even with an assumption of further increases in interest rates.

The wage price index (WPI) showed wages rose +0.7% q/q and +2.4% y/y in Q1, below consensus of +0.8% q/q.

The unemployment rate printed in line with expectations at 3.9%. That was a decline of 0.1% to 3.85% from a downwardly revised 3.93% in unrounded terms and is the lowest unemployment rate since 1974. The participation rate unexpectedly declined to 66.3% from 66.4% but remains near its record highs.

Retail sales rose +0.9% m/m in April (consensus +1.0%). Retail sales are now +22% above pre-pandemic levels and at their highest level ever.

Construction Work Done fell -0.9% q/q in Q1, below the +1.0% q/q rise expected.

Residential rents are rising with nationwide rents up +1.4% m/m after having increased by +2.4% in the previous month. Relative to a year ago, asking rents for Sydney houses are up +19.4% y/y and for Melbourne up +9.4% y/y.

Anthony Albanese was sworn as Australia's 31st prime minister. Federal Labor is reportedly confident of securing enough seats to govern in its own right even though the election delivered an historically large crossbench.

S&P noted the change of government itself had no effect on Australia's AAA rating, as long as the "*fundamentals, such as our projected fiscal recovery, that support the rating remain sound*".

Credit Market

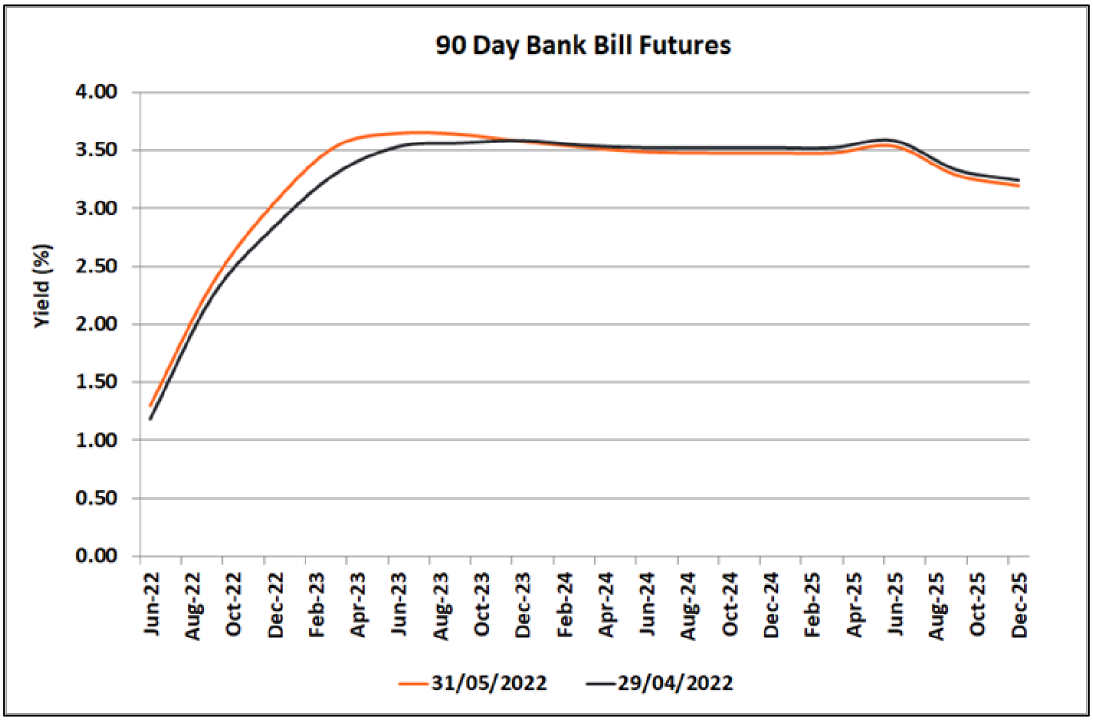
The global credit indices remained flat over the month, although widened significantly in Australia as the market prepares itself for a series of aggressive rate hikes. The indices are back to their levels experienced in mid-2020:

Index	May 2022	April 2022
CDX North American 5yr CDS	81bp	81bp
iTraxx Europe 5yr CDS	89bp	89bp
iTraxx Australia 5yr CDS	108bp	97bp

Source: Markit

90 Day Bill Futures

Over May, bill futures rose sharply at the short-end of the curve as the market prepares itself for the RBA to hike rates aggressively after increasing rates for the first time in over a decade. At the longer-end of the curve, bill futures fell as the markets remain nervous about the pace of the rate hikes, factoring in the possibility of a recession:



Source: ASX

Fixed Interest Outlook

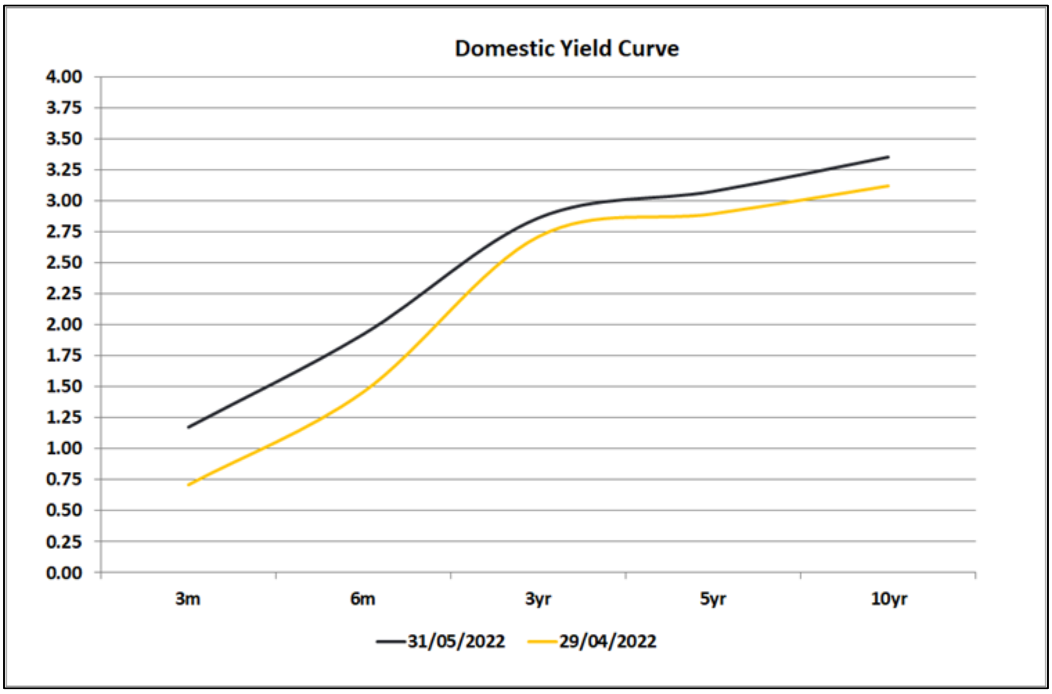
The US Fed meets again on June 15 and a 50bp Fed funds rate hike is all priced in, followed by another 50bp in the July meeting.

Domestical, the RBA's accompanying May Statement of Monetary Policy (SoMP) was broadly in line with the messaging from Governor Lowe previously suggesting "*further increases in interest rates will be necessary over the months ahead*" and of the cash rate lifting to around 2.50% over the next few years. The forecasts in the SoMP though highlights the risk that the RBA front loads its hiking cycle given core inflation is only forecast to get to within the 2-3% band by mid-2024 at +2.9% y/y, at which point wages growth is forecast to be running at +3.7% y/y.

The RBA Minutes from the May meeting contained two key insights:

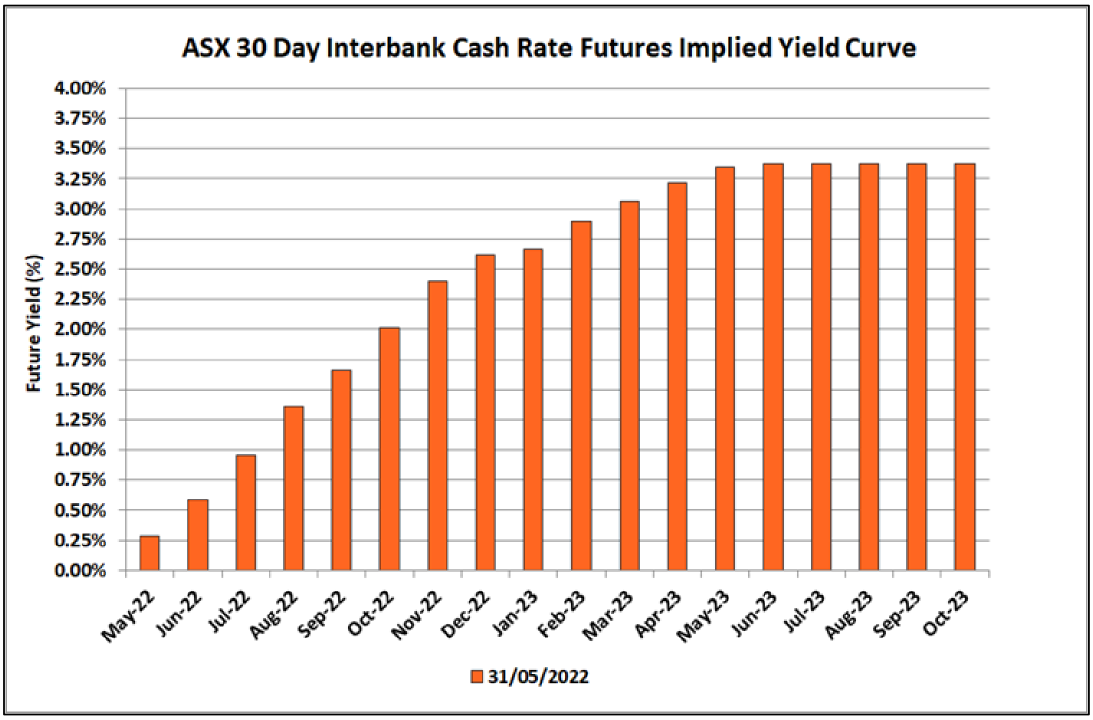
1. The RBA will most likely increase interest rates in June no matter what the WPI prints given "*…the recent evidence on wages growth from the Bank's liaison and business surveys was clear*"; and
2. The RBA is prepared to move in greater than 25bp increments if necessary, noting that May's decision to lift interest rates by 25bp reflected "*the historical practice of changing the cash rate in increments of at least 2bp*" and that "*an argument for an increase of 40bp could be made given the upside risks to inflation and the current very low level of interest rates*".

The domestic bond market continues to suggest a prolonged low period of interest rates on a historical basis (10-year government bond yields still under 3½%). Over the month, yields rose around 23bp at the long-end of the curve:



Source: AFMA, ASX, RBA

Following the RBA's rate rise in May, markets are currently pricing in around twelve additional rate rises over the next two years (up to 3.25%), against the RBA's 'neutral' target of 2½%:



Source: ASX

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