10.10.Investment and Loan Borrowings Report as at 31 August 2023

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ATTACHMENTS	1. Imperium Markets Monthly Investment Report August 2023 [**10.10.1** - 21 pages]
CSP LINK	5. Our Civic Leadership 5.2 Strong civic leadership and customer focussed services

PURPOSE:

The purpose of this report is to provide Council with the details of the performance of Council's investments and loans for the month ending 31 August 2023.

EXECUTIVE SUMMARY:

- This report outlines Council's investment portfolio and performance to 31 August 2023.

- All investments have been made in accordance with the Local Government Act, Regulations, Council's Investment Policy, and the specific conditions of the TCorp Loan Agreement.

- For the month of August, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.28% (actual), or +3.34% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.37% (actual), or +4.39% p.a. (annualised). This is due to recent interest rate rises and Council holding term deposits made in a low inflation environment, when rises were not expected.

- Council's investment adviser considers this underperformance to be temporary (less than the next 6 months) as the AusBond benchmark is expected to fall with official interest rates, with staff reinvesting maturing term deposits at rates higher than those taken in the low-interest rate environment.

- Returns on investments are $46,000 more than YTD budget. The total return for the 2023/2024 financial year to date is approximately $463,000. The total budget for 2023/2024 is $2.5 million.

RECOMMENDATION:
1. THAT the report on Investments held on 31 August 2023, prepared in accordance with clause 212 of the Local Government (General) Regulation 2021 and 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, in accordance with the revised Investment Order issued by the Minister for Local Government and with 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.

Investment Portfolio

The following table details the performance of Council's investment portfolio (excluding cash deposits) to the benchmark for the month of August 2023 and annualised for the year-to-date 31 August 2023 (including investments that have matured prior to that date).

	August 2023	Annualised YTD
Actual Return	0.28%	3.34%
Benchmark	0.37%	4.39%
Variance	-0.09%	-1.05%

The portfolio underperformance, as compared to the benchmark, is due to recent sharp rises in the RBA official cash rate and long-term investments that were placed when inflation expectations were low, before those increases were made. Council's investment advisor (Imperium Markets), as per the attached report, expects this relative underperformance to be temporary. The advice is that the portfolio will return to overperformance when the RBA ends its interest rate raising cycle, which they expect will be in the next six months. Imperium Markets further note that North Sydney Council's deposits portfolio rank amongst the best performing when compared to other NSW councils.

Asset Type	Market Value	Portfolio Breakdown
Term Deposits	$137,250,000	84.84%
Cash	$12,882,119	7.96%
Fixed Bonds	$9,000,000	5.56%
Floating Rate Notes (FRNs)	$2,649,938	1.64%
	$ 161,782,057	**100.00%**

Council's average duration of term deposits, which comprise 84.87% of the investment portfolio, is approximately 353 days.

All funds have been invested in accordance with the Act and the Regulations made thereunder. Council's investment portfolio complies with the revised Investment Order issued by the Minister for Local Government, which places restrictions on the type of investments permitted. Funds invested also comply with the credit quality conditions contained in Council's loan agreement with TCorp.

Council continues to seek independent advice for investments and is actively managing the portfolio to ensure that returns are maximised, considering diversification and risk. A complete analysis of the performance is covered in the Monthly Investment Report (Attachment 1) prepared by Council's investment advisor Imperium Markets. The report contains advice about optimal investment options but also notes that Council's scope to act on that advice is limited by its cash flow requirements. Council has considerable requirements for short term investments to fund its Capital Works budget of $79.4 million in 2023/24.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 31 August 2023 are $46,000 more than the year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (August)	YTD/ Annual Actual (August)	YTD/Annual Actual FV adjustments (August)	YTD Budget to Actual Variance (August)
2023/24	**$2,500,000**	**$2,500,000**	**$417,000**	**$466,000**	**-$3,000**	**$46,000**
Year	**Original Annual Budget**	**Revised Annual Budget**		**Final Result Interest**	**Final Result FV adjustments**	**Final Budget to Actual Variance**
2022/23	$1,290,000	$3,340,000		$1,244,337	-$64,865	$1,179,472
2021/22	$1,350,000	$1,350,000		$1,222,664	$93,735	-$33,601
2020/21	$1,350,000	$1,529,055		$1,896,660	-$4,944	$362,661

Floating Rate Notes (FRNs) are required to be revalued each month using the Fair Value (FV) method, an estimate of the market value of the investment. The YTD movement of FRN's has seen a decrease of $3,000.

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	$115,132,119	100.00%	71.16%
A Category	$23,251,465	60.00%	14.37%
BBB Category	$23,398,473	35.00%	14.47%
Unrated ADIs (NR)	$0	10.00%	0.00%

Credit Quality Limits in TCorp Loan Agreement

Council's Loan Agreement with TCorp imposes credit quality limits additional to Council's Financial Investment Policy. In cases where the loan agreement imposes a credit quality limit more conservative than the Financial Investment Policy, Council's contractual obligations prevail, and the more conservative limit will be applied. 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 (Standard and Poors/Moody's)	Invested	Maximum Allowed	Distribution
AA+ to AA-/Aa1 to Aa3 Category	$115,132,119	100%	71.16%
A+ to A/A1 to A2 Category	$23,251,465	100%	14.37%
A-/A3 Category	$0	40%	0.00%
BBB+/Baa1 Category	$22,000,000	20%	13.60%
BBB/Baa2 Category	$1,398,473	10%	0.87%
BBB-/Baa3 Category	$0	5%	0.00%
Unrated	$0	0%	0.00%

The maximum counterparty limits and the allowed limits are as per the following table:

Institution	Long Term Rating Range (Standard and Poors/Moody's)	Invested	Maximum Allowed	Distribution
Bendigo and Adelaide Bank Ltd	BBB+/Baa1 Category	$2,000,000	10%	1.24%
BOQ Ltd	BBB+/Baa1 Category	$10,000,000	10%	6.18%
Commonwealth Bank of Australia	AA+ to AA-/Aa1 to Aa3 Category	$44,882,119	100%	27.74%
Heritage and People's Choice Limited	BBB+/Baa1 Category	$10,000,000	10%	6.18%
ICBC Sydney Branch	A+ to A/A1 to A2 Category	$17,000,000	100%	10.51%
NAB Ltd	AA+ to AA-/Aa1 to Aa3 Category	$38,000,000	100%	23.49%
Newcastle Greater Mutual Group	BBB/Baa2 Category	$1,398,473	5%	0.86%
Northern Territory Treasury	AA+ to AA-/Aa1 to Aa3 Category	$9,000,000	100%	5.56%
Suncorp Bank Ltd	A+ to A/A1 to A2 Category	$6,251,465	100%	3.86%
Westpac Bank Ltd	AA+ to AA-/Aa1 to Aa3 Category	$23,250,000	100%	14.37%

Loan Borrowings

Council's Loan Borrowing Policy is the framework for Council's borrowing activities. It 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:
That the capital cost of infrastructure be recognised over the period during which the benefits will be enjoyed.

a) That loan funds are a resource to fund the replacement and upgrading of existing infrastructure and to fund the creation of new infrastructure.
b) 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			
31/07/2022	$5,223,543.14	$56,492.44	$233,147.10	$ 289,639.54
31/10/2022	$4,986,831.69	$52,928.09	$236,711.45	$ 289,639.54
31/01/2023	$4,747,721.74	$50,529.58	$239,109.96	$ 289,639.54
30/04/2023	$4,505,143.18	$47,060.98	$242,578.56	$ 289,639.54

Loan Funded Capital Projects

<u>Project 1: Upgrading the Car Park in Alexander Street, Crows Nest</u>
$5 million loan was sourced to fund project.
Current length of Loan as per the Long-Term Financial Plan (LTFP): 10 years to 2028

<u>Project 2: Upgrading of On-Street Parking Management System</u>
$4.5 million loan was sourced to fund project.
Current length of Loan as per LTFP: 10 years to 2028

Loan for North Sydney Olympic Pool Redevelopment

In February 2022, Council established a $31 million TCorp loan facility to partially fund the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 28 April 2022. The funds were restricted and are being released, as required, to fund project cash outflows.

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 in line with budget.

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 considers it prudent to provide monthly reporting of loans.

Monthly Investment Report

August 2023

IMPERIUM MARKETS

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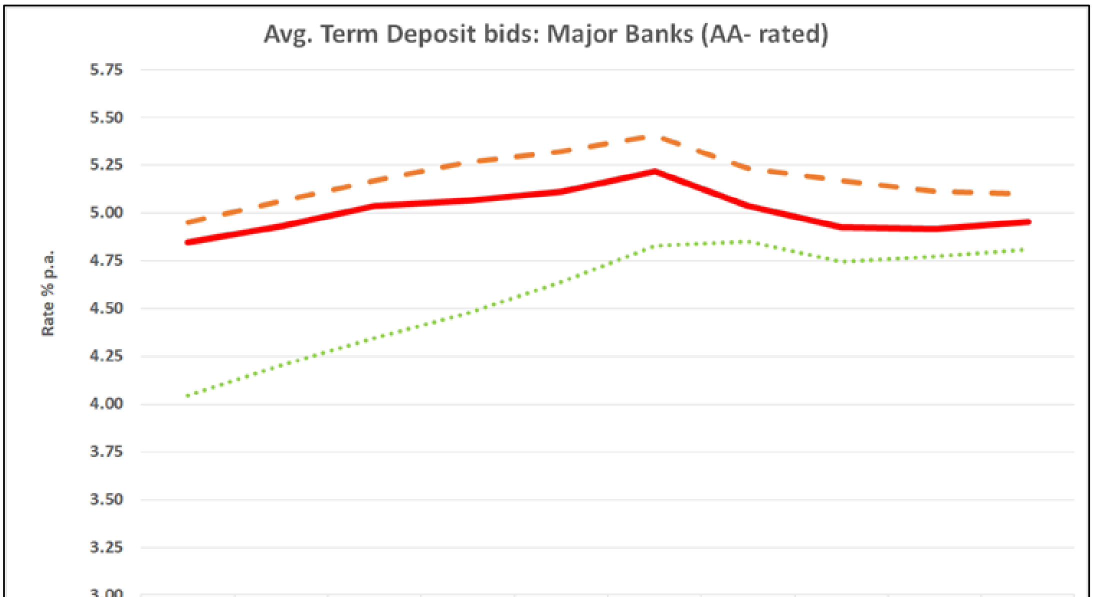
Market Update Summary

Risk markets marginally fell on concerns about the prospects of global growth, led by weaknesses seen in China's economy. Global inflation continues to show signs of decelerating and global interest rates are approaching their peak. But resilient labour forces remain a concern which may keep rates higher for longer. Domestically, the RBA remains on a slight tightening bias, although RBA Governor Lowe commented he hopes "*we're kind of in a world where we're just making, I hope, small adjustments to calibrate policy*", with markets quickly suggesting we may have already reached the peak of the RBA's rate hike cycle.

Over August, major bank deposit rates dropped around 20bp across the 6-12 month part of the curve, reacting to the RBA's pause and signs that inflation is decelerating. The average bids would have drifted even lower if one major bank (CBA) was not offering 'specials' that was up to 40bp higher than the entire market (not only their peers) across the shorter tenors. Deposit rates offered by the major banks continue to be lower in the long-end (2-5 years) compared to the shorter-end (6-12 months), reflective of the major banks believing that rate cuts may be required in future years should economic conditions deteriorate, inflation has decelerated and well under control.



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Aug-2023	4.85	4.93	5.04	5.07	5.11	5.22	5.04	4.93	4.92	4.95
Jul-2023	4.95	5.06	5.17	5.27	5.32	5.40	5.23	5.17	5.11	5.10
Feb-2023	4.05	4.20	4.35	4.48	4.64	4.83	4.85	4.74	4.77	4.81

Source: Imperium Markets

With recessionary fears being priced in coming years, investors may take an 'insurance policy' against a potentially lower rate environment by investing across 2-5 year fixed deposits and locking in rates above or close to 5% p.a. (small allocation only).

North Sydney Council's Portfolio & Compliance

Asset Allocation

As at the end of August 2023, the portfolio was mainly directed to fixed term deposits (85%). The remaining portfolio is directed to FRNs (2%), fixed bonds (6%) and overnight cash accounts (8%).

Senior FRNs remain relatively attractive as spreads have generally widened over the past 12-18 months – new issuances should now 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 recessionary fears 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 hand-cuffed to investing into very short-term investments (under 6-9 months). This is suitable to invest in short-dated fixed term deposits.

Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 16% 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 $74m at month-end.

Where liquidity permits (once immediate capital projects are finalised), we recommend new surplus funds be directed to 1-2 year horizon given this will help optimise returns over the long-run. We suggest this be allocated to any remaining attractive fixed term deposits.

In the interim, given the large upcoming capital expenditure of $74.4m 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	$39,132,119	24.19%	10%	100%	$122,649,937
✓	91 - 365 days	$58,251,465	36.01%	20%	100%	$103,530,592
✓	1 - 2 years	$38,398,472	23.74%	0%	70%	$74,848,967
✓	2 - 5 years	$26,000,000	16.07%	0%	50%	$54,891,028
✓	5 - 10 years	$0	0.00%	0%	25%	$40,445,514
		$161,782,057	**100.00%**			

Counterparty

As at the end of August, 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-	$44,882,119	27.74%	30.00%	$3,652,498
✓	NAB	AA-	$38,000,000	23.49%	30.00%	$10,534,617
✓	NTTC Treasury	AA-	$9,000,000	5.56%	30.00%	$39,534,617
✓	Westpac	AA-	$23,250,000	14.37%	30.00%	$25,284,617
✓	Suncorp	A+	$6,251,465	3.86%	15.00%	$18,015,843
✓	ICBC Sydney	A	$17,000,000	10.51%	15.00%	$7,267,308
✓	BOQ	BBB+	$10,000,000	6.18%	10.00%	$6,178,206
✓	Bendigo	BBB+	$2,000,000	1.24%	10.00%	$14,178,206
✓	Heritage	BBB+	$10,000,000	6.18%	10.00%	$6,178,206
✓	Newcastle PBS	BBB	$1,398,472	0.86%	10.00%	$14,779,733
			$161,782,057	**100.00%**		

In early August 2023, ANZ's takeover of Suncorp was blocked by the Australian Competition and Consumer Commission (ACCC), with the watchdog saying it was unconvinced the deal would deliver the public benefits claims put forward by ANZ (although ANZ has since appealed the decision).

Credit Quality

The portfolio remains well diversified from a credit ratings perspective, with all assets classified as investment grade (rated BBB- or higher). As at the end of August 2023, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$115,132,119	71.16%	100%	$46,649,937
✓	A Category	$23,251,465	14.37%	60%	$73,817,769
✓	BBB Category	$23,398,472	14.46%	35%	$33,225,248
✓	Unrated ADIs	$0	0.00%	10%	$16,178,206
		$161,782,057	**100.00%**		

Performance

Council's performance for the month ending August 2023 is summarised as follows:

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.34%	1.02%	1.94%	0.68%	3.39%	1.90%	1.31%
AusBond Bank Bill Index	0.37%	1.04%	1.94%	0.74%	3.37%	1.86%	1.25%
Council's T/D Portfolio	0.29%	0.78%	1.48%	0.55%	2.70%	2.02%	1.84%
Council's FRN Portfolio	0.44%	1.27%	2.44%	0.88%	4.46%	3.09%	2.51%
Council's Bond Portfolio	0.10%	0.29%	0.59%	0.20%	1.17%	1.16%	-
Council's Portfolio^	**0.28%**	**0.76%**	**1.44%**	**0.53%**	**2.64%**	**1.98%**	**1.80%**
Rel. Performance	**-0.09%**	**-0.29%**	**-0.50%**	**-0.21%**	**-0.73%**	**0.12%**	**0.55%**

^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%	4.10%	3.89%	4.10%	3.39%	1.90%	1.31%
AusBond Bank Bill Index	4.39%	4.20%	3.88%	4.44%	3.37%	1.86%	1.25%
Council's T/D Portfolio	3.45%	3.13%	2.96%	3.26%	2.70%	2.02%	1.84%
Council's FRN Portfolio	5.35%	5.15%	4.91%	5.27%	4.46%	3.09%	2.51%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.16%	-
Council's Portfolio^	**3.34%**	**3.04%**	**2.88%**	**3.16%**	**2.64%**	**1.98%**	**1.80%**
Rel. Performance	**-1.05%**	**-1.17%**	**-1.00%**	**-1.28%**	**-0.73%**	**0.12%**	**0.55%**

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

For the month of August, the total investment portfolio (excluding cash) provided a solid return of +0.28% (actual) or +3.34% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.37% (actual) or +4.39% p.a. (annualised). This relative 'underperformance' has been due to the unexpected aggressive rate hikes undertaken by the RBA. Whilst this 'underperformance' may continue in the short-term, we do anticipate this to be fairly temporary (within the next 6 months), especially if the RBA is approaching the end of its rate hike cycle. Council should also remind itself it has consistently 'outperformed' over longer-term time periods (last +10yrs) as demonstrated by the longer-term returns of the overall investment portfolio (e.g. 2 and 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 August 2023, Council's deposit portfolio was yielding **3.55% p.a.** (up 37bp from the previous month), with a weighted average duration of around 353 days (~12 months). We recommend Council maintains this weighted average duration, should cash flows allow in future.

In the immediate future, given the significant outflows anticipated from capital projects, short-dated term deposits are suitable for North Sydney Council's purposes.

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

Securities

Primary (new) **FRNs** (with maturities between 3-5 years) continue to be appealing (particularly for those investors with portfolios skewed towards fixed assets) and should be considered on a case by case scenario.

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

Council's Senior FRNs Sale/Switch Recommendations

We recommend Council retains 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 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 Deposit Rates

As at the end of August, we see value in:

ADI	LT Credit Rating	Term	T/D Rate
ING Bank	A	2 years	5.05% p.a.
ING Bank	A	3 years	5.00% p.a.
Westpac	AA-	2 years	4.94% p.a.
NAB	AA-	2 years	4.90% p.a.
CBA	AA-	2 years	4.88% p.a.

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 (dependent on daily funding requirements):

ADI	LT Credit Rating	Term	T/D Rate
AMP Bank (rollovers only)	BBB	11-12 months	5.30% p.a.^
CBA (>$2m)	AA-	12 months	5.27% p.a.
NAB	AA-	10-12 months	5.15% p.a.
CBA (>$2m)	AA-	6 months	5.13% p.a.
NAB	AA-	6-9 months	5.10% p.a.
ING Bank	A	12 months	5.10% p.a.
AMP Bank (rollovers only)	BBB	5-8 months	5.10% p.a.^
Westpac	AA-	12 months	5.08% p.a.
Bendigo	BBB+	9-12 months	5.00% p.a.
BoQ	BBB+	6-12 months	5.00% p.a.
NAB	AA-	3 months	4.90% p.a.

^Contact us to get an additional 20bp rebated commission. Aggregate limits temporarily lifted to $10m (from $5m).

Once capital projects are completed, 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).

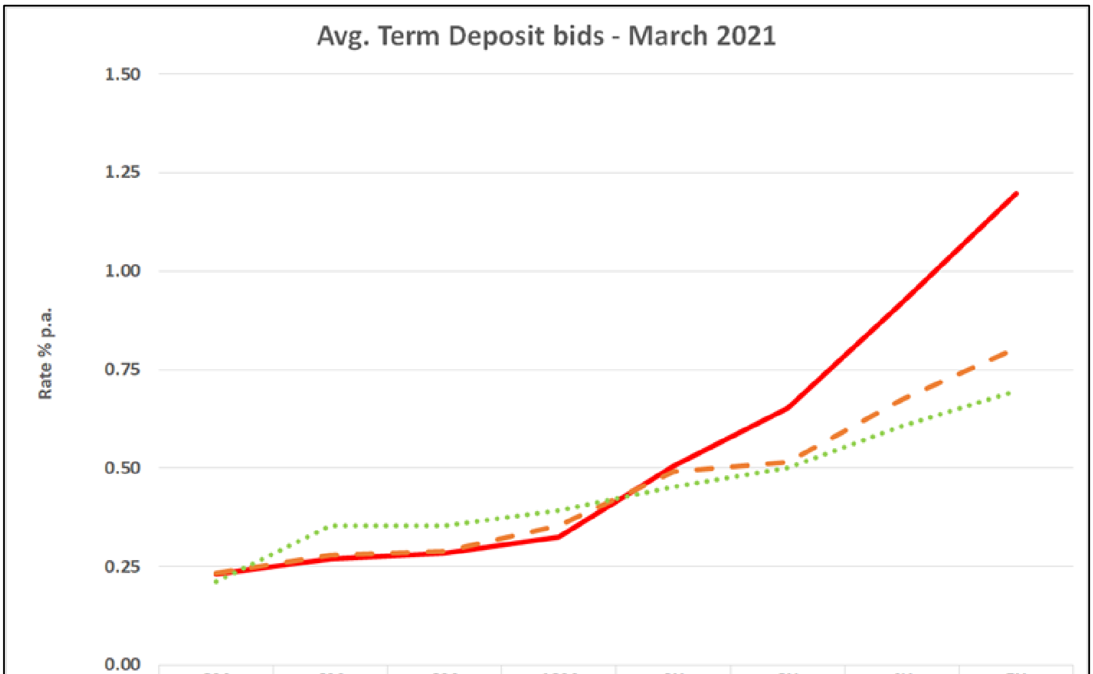
With recessionary fears and a global economic slowdown being priced in coming years, investors should consider allocating some longer term surplus funds and undertake an insurance policy by investing across 2-5 year fixed deposits and locking in rates close to or above 5% p.a. (mainly available from the lower rated ADIs). This will provide some income protection if central banks decide to cut rates in future years, assuming inflation has stabilised. *This strategy will only be practicably implemented once the large capital projects have been completed*.

IMPERIUM MARKETS

Term Deposit Rates 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) since mid-2020[1], 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 from the likes of Council. 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

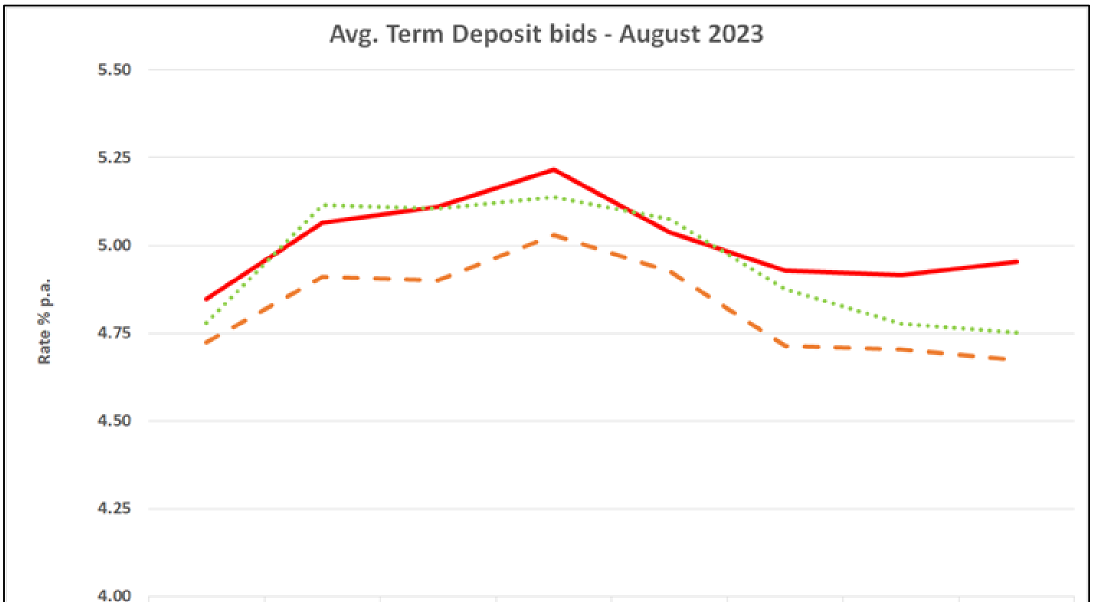
Source: Imperium Markets

The abnormal marketplace experienced during the pandemic is starting to reverse as the competition for deposits increases. We are now starting to see some of the lower rated ADIs ("BBB" rated) offering slightly higher rates compared to the higher rated banks ("A" or "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.

[1] The RBA's Term Funding Facility (TFF) allowed the ADI to borrow as low as 0.10% fixed for 3 years: https://www.rba.gov.au/mkt-operations/term-funding-facility/overview.html

Going forward, Council should have a larger opportunity to invest a higher proportion of its funds with the lower rated institutions (up to Policy limits), from which the majority are not lending to the Fossil Fuel industry. We are slowly seeing this trend emerge, although this month was an exception due to CBA (AA-), who was offering 'specials' on parcel sizes greater than $2m, paying up to 40bp above the entire market on shorter tenors:

Term Deposit Rates – Currently (August 2023)



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.85	5.07	5.11	5.22	5.04	4.93	4.92	4.95
A Rated	4.72	4.91	4.90	5.03	4.92	4.71	4.70	4.67
BBB Rated	4.78	5.12	5.10	5.14	5.08	4.87	4.78	4.75

Source: Imperium Markets

Regional and Unrated ADI Sector

During August 2023, the ACCC confirmed it would deny authorisation for ANZ's proposed acquisition of Suncorp Group's banking business stating that "*the proposed acquisition of Suncorp Bank by ANZ would further entrench an oligopoly market structure*".

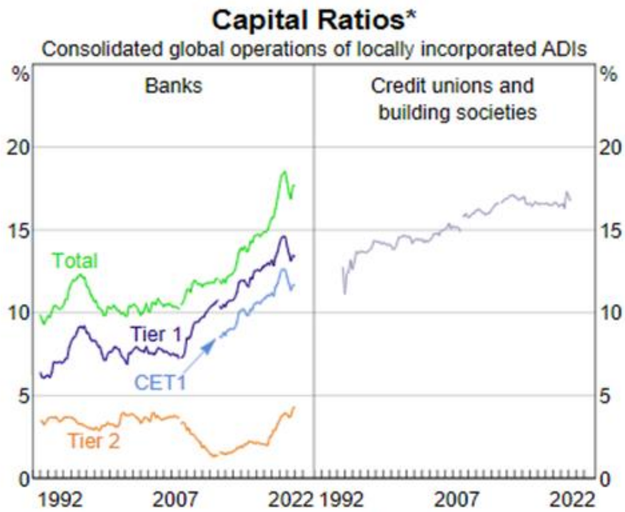
Ratings agency S&P has commented that "*mergers remain compelling for mutuals lenders*" in providing smaller lenders greater economies of scale and assisting them in being able to price competitively and will see "*the banking landscape will settle with a small number of larger mutual players*". S&P 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 nine years. Over the same time, banks' assets have grown by 44%. Some of the extra capital is supporting growth in the banking system itself but clearly, there has been a strengthening in overall resilience and leverage in the system is lower.

We believe that deposit investments with the lower rated ADIs should be considered going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns. The lower rated entities are generally deemed to be the more 'ethical' ADIs compared to the higher rated ADIs.

In the current environment of high regulation and scrutiny, all domestic (and international) ADIs continue to carry high levels of capital. There is minimal (if any) probability of any ADI defaulting on their deposits going forward – this was stress tested during the GFC and the pandemic period. **APRA's mandate is to "*protect depositors*" and provide "*financial stability*".**



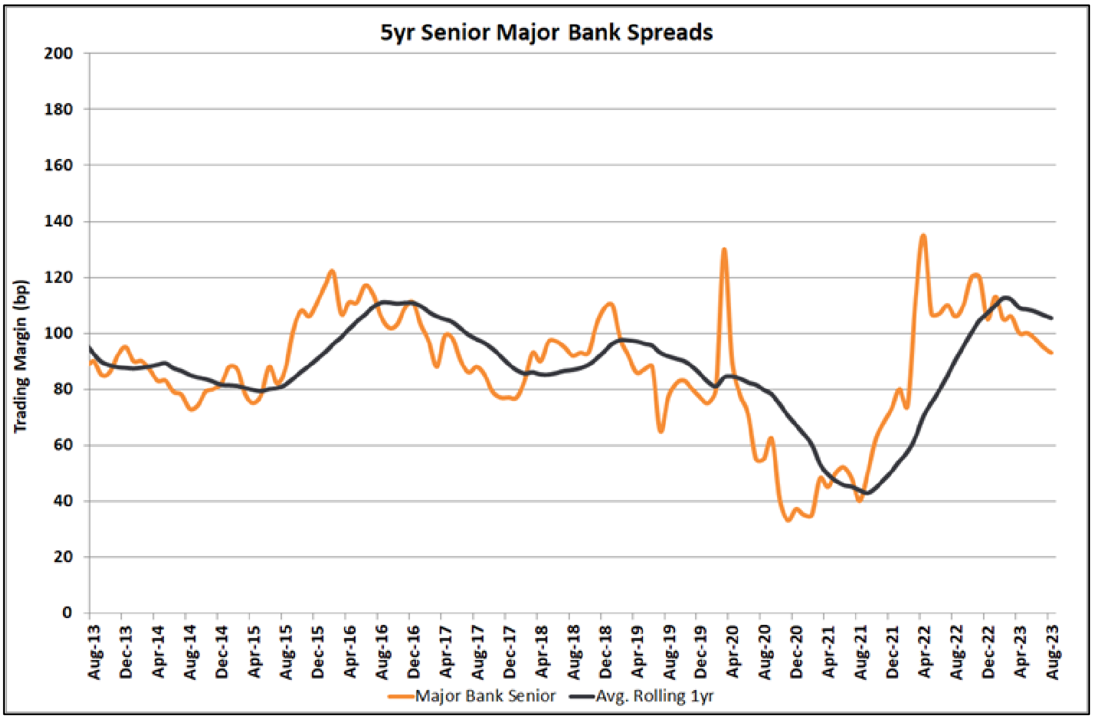
* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs.

Source: APRA

Senior FRNs Market Review

Over August, amongst the senior major bank FRNs, physical credit securities tightened by around 2bp at the very long-end of the curve. Major bank senior securities remain at fair value in the rising rate environment (5 year margins above +90bp level). During the month, two major banks issued dual 3 and 5 year senior deals:

- CBA (AA-) issued a 3 and 5 year senior security at +75bp and +95bp respectively
- ANZ (AA-) issued a 3 and 5 year senior security at +75bp and +93bp respectively



Source: IBS Capital

Outside of the major banks, there were a handful of other new (primary) issuances during August:

- 3yr Bank of China (A) senior FRN at +105bp
- 3yr Agricultural Bank of China (A) senior FRN at +90bp
- ~5½yr Treasury Corporation of Victoria (AA) senior FRN at +11½bp

Amongst the “A” and “BBB” rated sector, the securities remained relatively flat at the longer-end of the curve. Credit securities are looking much more attractive given the widening of spreads over the past ~18 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 future years (in a relatively stable credit environment).

Senior FRNs (ADIs)	31/08/2023	31/07/2023
“AA” rated – 5yrs	+93bp	+95bp
“AA” rated – 3yrs	+75bp	+74bp
“A” rated – 5yrs	+118bp	+115bp
“A” rated – 3yrs	+92bp	+95bp
“BBB” rated – 3yrs	+120bp	+125bp

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 2025 for the “AA” rated ADIs (domestic major banks)**;
- On or before mid-late 2024 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) are now generally holding sub-optimal investments and are not maximising returns by foregoing, potentially significant 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.

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

Senior Fixed Bonds Market Review

As global inflationary pressures remain, this has seen a significant lift in longer-term bond yields over the past 12-18 months (valuations 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
AU3CB0265403	Suncorp	A+	Senior	30/07/2024	0.92	1.85%	4.96%
AU3CB0266377	Bendigo	BBB+	Senior	06/09/2024	1.02	1.70%	5.05%
AU3CB0268027	BoQ	BBB+	Senior	30/10/2024	1.17	2.00%	5.14%
AU3CB0287498	Bendigo	BBB+	Senior	17/03/2025	1.55	3.00%	5.14%
AU3CB0273407	UBS	A+	Senior	30/07/2025	1.92	1.20%	5.34%
AU3CB0293967	Bendigo	AAA	Covered	11/11/2025	2.21	5.10%	5.02%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.69	1.40%	5.33%
AU3CB0282358	ING	AAA	Covered	19/08/2026	2.97	1.10%	4.87%
AU3CB0284149	BoQ	BBB+	Senior	27/10/2026	3.17	2.10%	5.41%

Economic Commentary

International Market

Risk markets marginally fell on concerns about the prospects of global growth, led by weaknesses seen in China's economy.

Across equity markets, the S&P 500 Index fell -1.77%, whilst the NASDAQ dropped -2.17%. Europe's main indices also experienced losses, led by UK's FTSE (-3.38%), Germany's DAX (-3.04%) and France's CAC (-2.42%).

US July core PCE deflator rose by +0.2% as expected, lifting the annual rate to +4.3% from +4.2%. The US unemployment rate fell to 3.5% in July, near 50 year lows, after adding +187k jobs for the month.

US retail sales exceeded expectations on all measures: headline +0.7% against +0.4% consensus.

The US FOMC minutes for the July meeting showed most participants continue to see upside risks to inflation which could require further tightening of monetary policy, but that there was uncertainty about policy lags and some officials saw downside risks to growth despite the resilience shown thus far.

China's CPI and PPI for July fell together for the first time since 2020. CPI fell -0.3% y/y which is the first decline since February 2021. China's retail sales fell -0.06% for July, down from an increase of +0.23% in the prior month, bringing the annual rate to +2.5%.

Eurozone core CPI was 0.1% higher than expected at +5.5% y/y vs. +5.4% expected.

UK GDP grew +0.2% q/q, higher than the 0.0% expected. UK annual inflation fell to +6.8% in July from +7.8% in June, driven by lower gas and electricity prices. Core inflation was marginally higher than expected and was unchanged at +6.9% from the previous month.

The Bank of England raised interest rates 25bp in line with expectations at its August meeting, bucking the trend of other central banks and follows a surprise 50bp hike in June. Inflation in the UK remains the highest of the G7 countries.

The RBNZ left rates unchanged at 5.5% at the August Monetary Policy Statement. It was the second consecutive meeting the Official Cash Rate was left on hold and was unanimously expected by economists.

The MSCI World ex-Aus Index fell -2.50% for the month of August:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-1.77%	+7.84%	+13.97%	+8.80%	+9.21%	+10.69%
MSCI World ex-AUS	-2.50%	+6.68%	+13.97%	+6.83%	+6.67%	+7.52%
S&P ASX 200 Accum. Index	-2.08%	+2.51%	+8.07%	+10.18%	+6.72%	+7.82%

Source: S&P, MSCI

Domestic Market

The RBA kept official interest rates unchanged at 4.10% in its meeting in August (consensus was split), but maintained its hawkish bias. Importantly, extended inflation forecasts has CPI inflation within 2-3% by late 2025. The final paragraph was little changed, with "*some further tightening of monetary policy may be required to ensure that inflation returns to target in a reasonable timeframe, but that will depend upon the data and the evolving assessment of risks*".

The RBA downgraded its near-term growth forecasts for the economy. It expects real GDP to expand by just +0.9% for 2023, down from its previous forecast of +1.2% and below the current rate of +2.3%. Outside the pandemic, it would be the slowest rate of growth since the early 1990s recession.

Employment disappointed in July, falling -15k (consensus +15k), and the unemployment rate rose 0.2% to 3.7% (consensus 3.6%).

The Monthly CPI Indicator for July fell to +4.9% y/y from +5.4%. Inflation has moderated over recent months, with the RBA now seeing a credible path back to target without further interest rate increases.

The wage price index (WPI) rose +0.8% q/q and +3.6% y/y, a little below consensus and RBA forecasts for +0.9% q/q. Year-ended wages growth ticked down from +3.7% to +3.6%.

The ACCC confirmed it would deny authorisation for ANZ's proposed acquisition of Suncorp Group's banking business stating that "*the proposed acquisition of Suncorp Bank by ANZ would further entrench an oligopoly market structure*".

Home loan approvals were at their weakest level since June 2020 and a slump in new home loan commitments over 2023 suggests a bleak outlook for future housing activity.

The June monthly trade surplus beat expectations with the surplus at $11.3bn (consensus $10.8bn) from a downwardly revised $10.5bn previously. Exports fell -1.7% m/m (or -$1.0bn), while imports dropped far larger at -3.9% m/m (or -$1.8bn).

The Australian dollar fell -2.95%, finishing the month at US64.85 cents (from US66.82 cents the previous month).

Credit Market

The global credit indices marginally widened over August. They are now back to their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	August 2023	July 2023
CDX North American 5yr CDS	64bp	63bp
iTraxx Europe 5yr CDS	71bp	68bp
iTraxx Australia 5yr CDS	78bp	72bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	August 2023	July 2023
Bloomberg AusBond Bank Bill Index (0+YR)	+0.37%	+0.37%
Bloomberg AusBond Composite Bond Index (0+YR)	+0.74%	+0.52%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.46%	+0.46%
Bloomberg AusBond Credit Index (0+YR)	+0.99%	+0.85%
Bloomberg AusBond Treasury Index (0+YR)	+0.61%	+0.49%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+0.70%	+0.92%

Source: Bloomberg

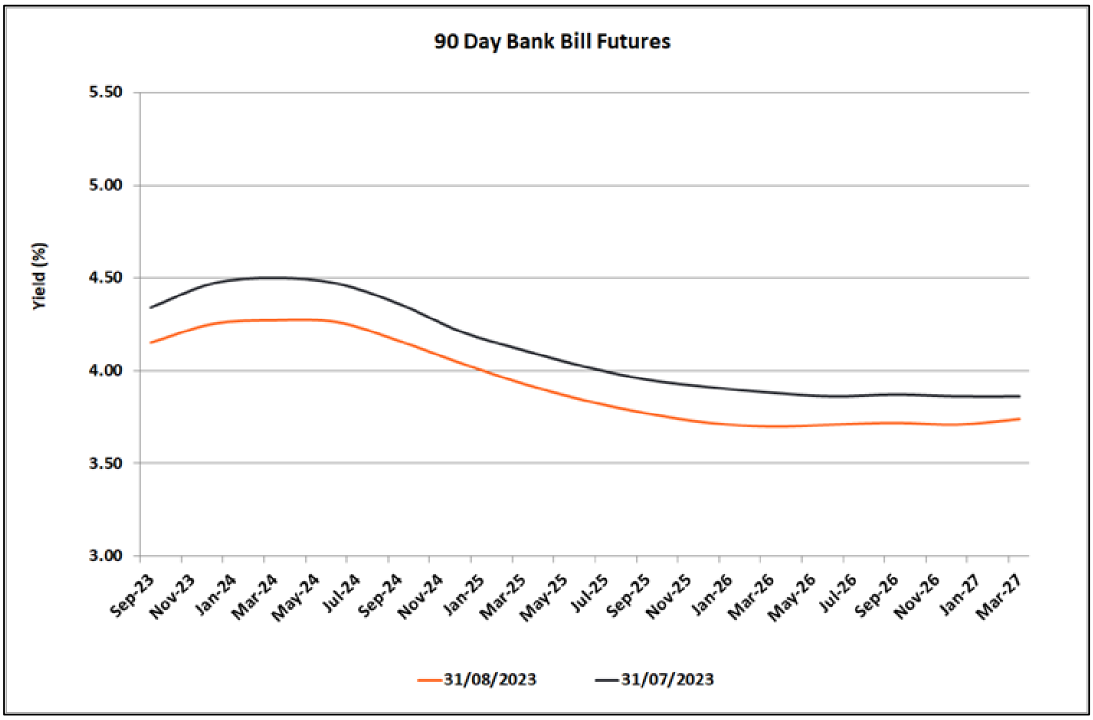
Other Key Rates

Index	August 2023	July 2023
RBA Official Cash Rate	4.10%	4.10%
90 Day (3 month) BBSW Rate	4.13%	4.26%
3yr Australian Government Bonds	3.74%	3.87%
10yr Australian Government Bonds	4.02%	4.05%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	4.85%	4.88%
10yr US Treasury Bonds	4.09%	3.97%

Source: RBA, AFMA, US Department of Treasury

90 Day Bill Futures

Bill futures fell across the board this month, with momentum gathering pace and signs that overall inflation is steadily declining. Markets have been quick to revise their interest rate forecasts, with largely no additional rate hikes priced into the futures pricing. The bills market continues to factor in the possibility of a recession over the next few years, highlighted by the drop in the futures pricing by mid-late 2024:



Source: ASX

Fixed Interest Outlook

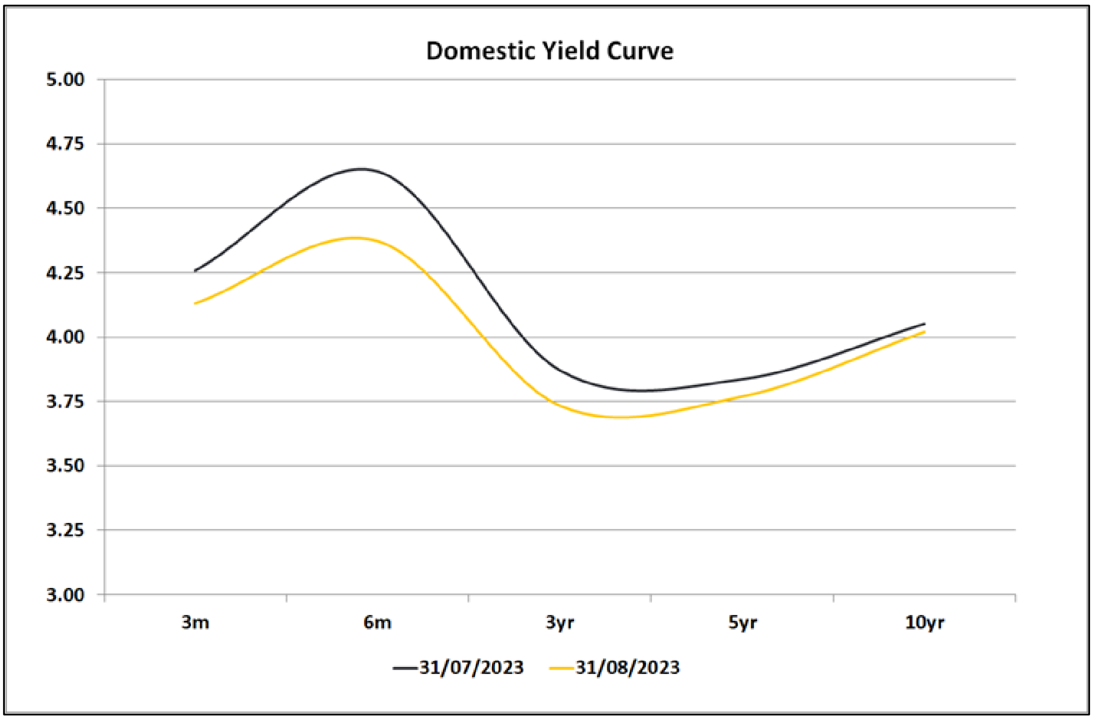
Global inflation continues to show signs of decelerating, although there are a few concerns that incremental falls from here could be difficult. Global policy rates are near peaks, but resilient labour forces remain a concern and could keep rates higher for longer.

After the US Fed lifted rates to 5.25%-5.50%, markets continue to price around a 40% chance of a follow up hike by December, though pricing of cuts extended with over 100bp of cuts thereafter by the end of 2024.

Domestically, the RBA's practice of using the latest data to base their forecasts leaves them exposed to potentially another hike should Q3 CPI print high as some forecasters expect. Nevertheless, the RBA over recent months also appears to be more concerned around the outlook for growth, particularly the consumer, even though headline activity forecasts were little changed. This suggests that they may well be approaching the peak of their interest hike cycle.

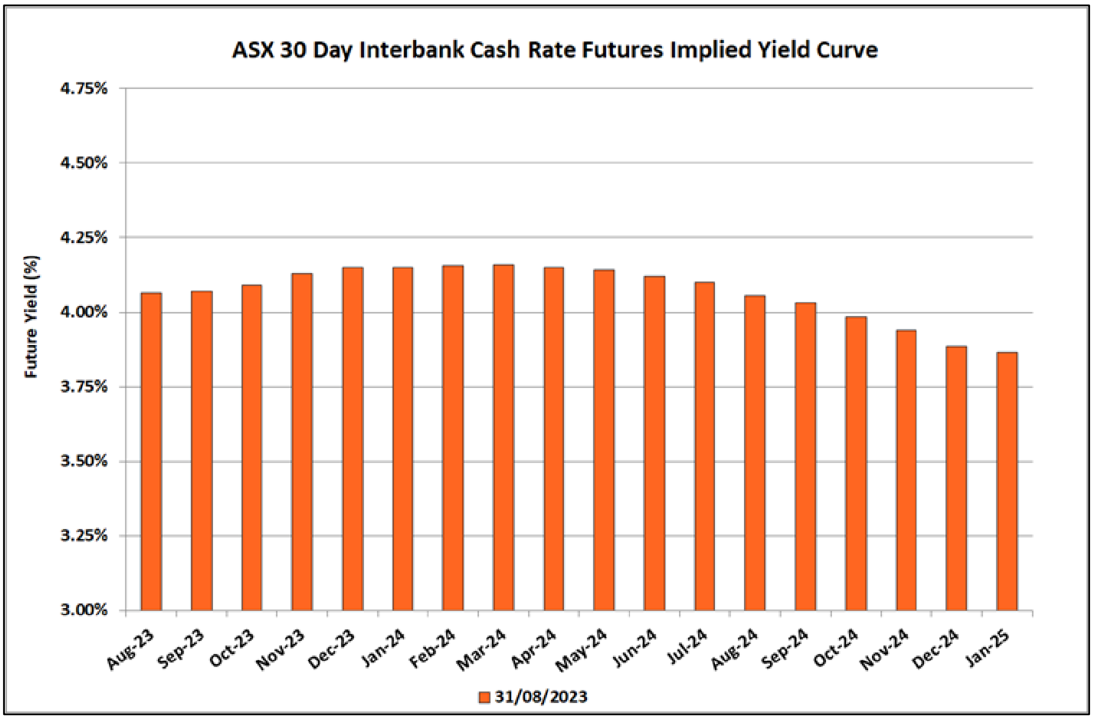
The RBA's August SoMP key statement was "*members observed that there was a credible path back to the inflation target with the cash rate staying at its present level*". This was made in the context of a better than expected outcome for inflation in Q2. The board forecast core trimmed mean inflation at +3.9% y/y by end-2023, +2.9% y/y by mid-2025 and at +2.8% y/y by end-2025.

Over the month, yields fell up to 27bp at the short-end of the curve, with markets parring back the chances of another rate hike:



Source: AFMA, ASX, RBA

Markets have been quick to revise their interest rate forecasts with now only potentially only one more rate hike priced this cycle. Interestingly, rate cuts are now more likely being forecasted, but not at least until Q3-Q4 2024.



Source: ASX

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