10.5. Investment and Loan Borrowings Report as at 31 December 2023

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ATTACHMENTS	1. Monthly Investment Review December 2023 [**10.5.1** - 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 Council with details of the performance of Council's investments and details of loans for the month ending 31 December 2023.

EXECUTIVE SUMMARY:

- Council's cash and investments total $159.2 million dollars, including external restrictions of $86.5 million and internal allocation of $59.2 million. Council has an unrestricted cash balance of $13.7 million.

- 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 December, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.32% (actual), or +3.87% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.37% (actual), or +4.43% 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.

- Returns on investments exceed the YTD budget by $649,000. The total return for the 2023/2024 financial year to date is approximately $2.7 million. The better-than-expected return is due to the payments for the capital works program progressing slower than expected in the two quarters.

RECOMMENDATION:

1. THAT the report on Investments held on 31 December 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 Local Government (General) Regulation 2021, states that The Responsible Accounting Officer must provide Council with a monthly report detailing all funds invested under Section 625 of the Local Government Act 1993. This report must include certification that the investments have been made in accordance with the Act and the Regulations made thereunder, also the revised Investment Order issued by the Minister for Local Government and Council's Financial Investment Policy.

It is also prudent to report loan balances and compliance with borrowing orders issued by the Minister for Local Government and Council's Debt Management Policy.

Total Cash and Investment Balance and Reserves

The total cash and investment balance is $159,226,115. Most of this balance is held in reserves to be spent on certain activities and projects. Reserves fall into one of two categories:

- external restriction (Council is obliged by legislation, or contract, to spend the funds on certain projects and activities), and
- internal allocations (Council has resolved to spend the fund on certain projects and activities).

The following table details the reserves held as at 31 December 2023. Council holds an unrestricted cash balance of $13.2 million, indicating it has funded all its reserves.

External Restrictions and Internal Allocations	
External restrictions	
Developer contributions - general	$44,317,940
Domestic waste management	$15,071,396
Unexpended Special Rates	$1,687,840
Unspent borrowings - North Sydney Olympic Pool redevelopment	$17,757,000
Waste and sustainability improvement funds	$37,646
Specific purpose grants	$5,570,549
Other specific purpose contributions	$2,028,428
Total external restrictions	**$86,470,799**
Internal allocations	
Capital works	$8,962,235
Community housing - capital purchases	$962,601
Community housing - major maintenance	$490,657
Deposits, retentions and bonds	$13,300,909
Employees leave entitlement	$6,833,232
I.T. hardware and software	$1,076,531
Income producing projects	$781,728
Olympic Pool Redevelopment	$24,532,873
Plant and vehicle replacement	$2,251,074
Total internal allocations	**$59,191,840**

External Restrictions and Internal Allocations	
Total Restrictions and Allocations	**$145,662,639**
Unrestricted Cash and Investments	$13,563,476
Total Cash and Investments	**$159,226,115**

Investment Portfolio

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

	December 2023	Annualised YTD
Actual Return	0.32%	3.87%
Benchmark	0.37%	4.43%
Variance	-0.05%	-0.06%

The portfolio underperformance, as compared to the benchmark, is due to sharp rises in the RBA official cash rate and long-term investments that were placed when inflation expectations were low, before those increases were made. Council's investment advisor (Arlo Advisory – formerly known as 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. Arlo Advisory further notes 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	$129,000,000	81.02%
Cash	$18,577,862	11.67%
Fixed Bonds	$9,000,000	5.65%
Floating Rate Notes (FRNs)	$2,648,253	1.66%
	$159,226,115	**100.00%**

Council's average duration of term deposits, which comprise 81.02% of the investment portfolio, is approximately 283 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, Arlo Advisory. The report contains advice about optimal investment options, but also notes that Council's scope to act on that advice is limited by its cash flow requirements. Council has considerable requirements for short term investments to fund its Capital Works original budget of $94.1 million in 2023/24.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 31 December 2023 are $$649,000 more than the year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (Dec)	YTD (Dec)	YTD Actual FV adjustments (Dec)	YTD Budget to Actual Variance (Dec)
2023/24	**$2,500,000**	**$3,490,000**	**$2,095,000**	**$2,748,000**	**($4,000)**	**$649,000**
Previous Years						
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 $4,000.

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	$110,577,862	100.00%	69.45%
A Category	$18,250,409	60.00%	11.46%
BBB Category	$30,397,844	35.00%	19.09%
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	$110,577,862	100%	69.45%
A+ to A/A1 to A2 Category	$18,250,409	100%	11.46%
A-/A3 Category	$0	40%	0.00%
BBB+/Baa1 Category	$22,000,000	20%	13.82%
BBB/Baa2 Category	$8,397,844	10%	5.27%
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
BOQ Ltd	BBB+/Baa1 Category	$10,000,000	10%	6.66%
Commonwealth Bank of Australia	AA+ to AA-/Aa1 to Aa3 Category	$46,577,862	100%	31.01%
Heritage and People's Choice Limited	BBB+/Baa1 Category	$10,000,000	10%	6.66%
ICBC Sydney Branch	A+ to A/A1 to A2 Category	$17,000,000	100%	11.32%
NAB Ltd	AA+ to AA-/Aa1 to Aa3 Category	$34,000,000	100%	22.63%
Newcastle Greater Mutual Group	BBB/Baa2 Category	$1,397,844	5%	0.93%
Northern Territory Treasury	AA+ to AA-/Aa1 to Aa3 Category	$9,000,000	100%	5.99%
Suncorp Bank Ltd	A+ to A/A1 to A2 Category	$1,250,409	100%	0.83%
Westpac Bank Ltd	AA+ to AA-/Aa1 to Aa3 Category	$21,000,000	100%	13.98%

Loan Borrowings

Council's Loan Borrowing Policy is the framework for Council's borrowing activities. This defines responsibilities and parameters for borrowing and related risk management activities. The Policy's objective is to control Council's exposure to movements in interest rates through the application of fixed, floating, or a combination thereof, to maintain a risk averse strategy.

Loan borrowings are in line with the following principles:

a) That the capital cost of infrastructure be recognised over the period during which the benefits will be enjoyed.
b) That loan funds are a resource to fund the replacement and upgrading of existing infrastructure and fund the creation of new infrastructure.
c) That loan funds will be limited to:
    - acquisition or enhancement of income producing assets;
    - construction and/or upgrading of buildings; and
    - infrastructure assets that have a life expectancy of greater than 10 years.

Council has two debt facilities:

Alexander Street Carpark and On-Street Carparking Management System Loan

This is a fixed loan financing option, fully amortising the drawn down amount of $9,500,000 over 10 years, fixed interest rate with quarterly repayments of interest and principal. The loan details are:

Loan amount:	$ 9,500,000.00			
Loan term:	10 years			
From:	31/07/2018			
To:	31/07/2028			
Interest rate:	4.02%p.a.(fixed)			
Repayment:	Quarterly			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
1/07/2023	$5,456,690.24			
31/07/2023	$5,223,543.14	$56,492.44	$233,147.10	$ 289,639.54
31/10/2023	$4,986,831.69	$52,928.09	$236,711.45	$ 289,639.54
31/01/2023	$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:

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 December 2022, Council established a $31 million TCorp loan facility to partially fund the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 28 April 2022. The funds were restricted and are being released, as required, to fund project cash outflows. As of 30 June 2023, $17.8 million was unspent.

This loan is a fixed loan financing option, fully amortising the drawn down amount of $31,000,000 over 20 years, fixed interest rate with semi-annual repayments of interest and principal. The loan details are:

Loan amount:	$ 31,000,000.00			
Loan term:	20 years			
From:	28/04/2022			
To:	28/04/2042			
Interest rate:	4.24%p.a.(fixed)			
Repayment:	Semi-Annual			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
01/07/2023	$29,989,374.70			
30/10/2023	$29,467,937.22	$624,720.2	$521,437.78	$1,157,212.52
29/04/2024	$28,935,444.96	$613,431.4	$532,492.26	$1,157,212.52

Consultation requirements

Community engagement is not required.

Financial/Resource Implications

Returns continue to be significantly higher than year to date budget as payments for capital works have been lower than expected. This will be addressed in the December Quarter Budget 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

December 2023

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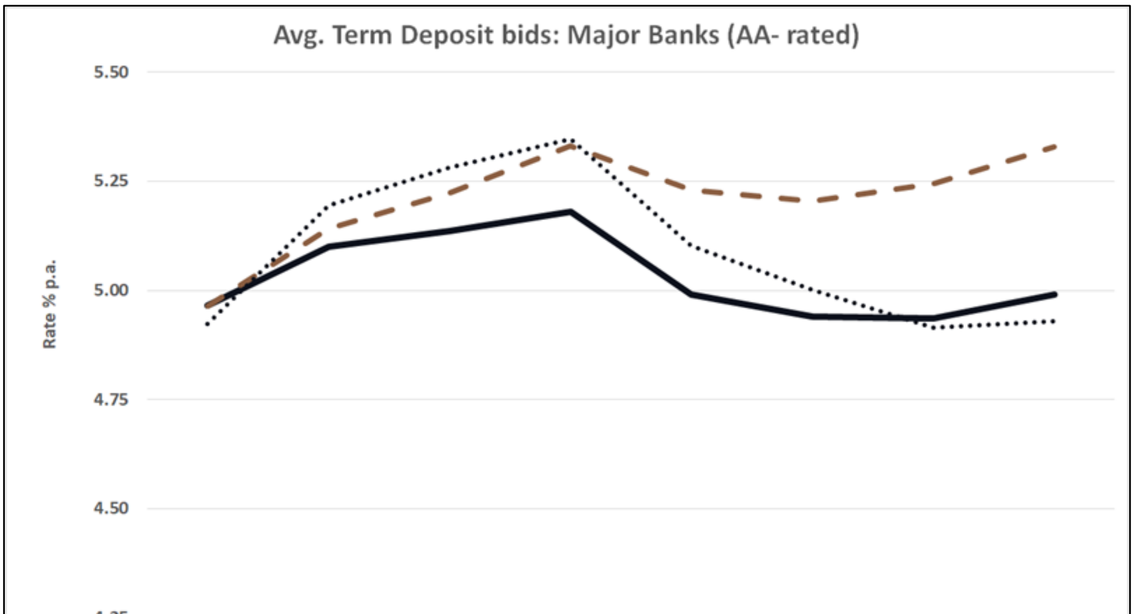
Market Update Summary

Financial markets continued their strong rally in December as inflation continues to ease and growing hopes that central banks will move towards an easing cycle (cut official interest rates) in 2024.

Over December, major bank deposit rates fell ~5-10bp for 6-12 month tenors, as the market turns its attention to potential rate cuts in 2024. Interestingly, at the longer-end (2-5 years), deposit rates offered by the majors banks fell between ~25-30bp with the banks clearly pricing in rate cuts in 2024 and into 2025. Rates are now inverse again across the longer-tenors (1-5 year rates), with the peak rate offered in the 12 month tenor.



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Dec-2023	4.97	5.10	5.14	5.18	4.99	4.94	4.94	4.99
Nov-2023	4.96	5.14	5.22	5.33	5.23	5.21	5.24	5.33
Jun-2023	4.92	5.19	5.28	5.35	5.10	5.00	4.92	4.93

Source: Imperium Markets

With a global economic downturn and multiple interest rate cuts 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, targeting rates above or close to 5% p.a. (small allocation only).

North Sydney Council' Portfolio & Compliance

Asset Allocation

As at the end of December 2023, the portfolio was mainly directed to fixed term deposits (81%). The remaining portfolio is directed to FRNs (2%), fixed bonds (6%) and overnight cash accounts (12%).

Senior FRNs remain relatively attractive as spreads have generally widened over the past 2 years. New issuances may be considered again on a case by case scenario. In the interim, staggering a mix of fixed deposits between 9-12 months to 2 years remains a more optimal strategy to maximise returns over a longer-term cycle.

With multiple rate cuts and a global economic downturn being priced in coming years, investors can choose to allocate a small proportion of longer-term funds and undertake an insurance policy against any potential future rate cuts by investing across 2-5 year fixed deposits, locking in and targeting yields close to or above 5% p.a.

However, noting the significant capital outflows expected in the near term, Council is currently largely restricted to investing into very short-term investments (under 6-12 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 6% of assets is directed to medium-term assets (2-5 years), which has resulted in strong outperformance during the challenging economic environment over longer-term time periods. There is still high capacity to invest in the short-medium term horizon (1-2 years), with approximately $77m 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 $94.1 (as per the September Quarter Budget Review) flagged in the short-term, Council is likely to invest across shorter-tenors to match the capital program's cash flow requirements.

Compliant	Horizon	Invested ($)	Invested (%)	Min. Limit (%)	Max. Limit (%)	Available ($)
✓	0 - 90 days	$59,577,862	37.42%	10%	100%	$99,648,253
✓	91 - 365 days	$55,250,409	34.70%	20%	100%	$103,975,706
✓	1 - 2 years	$34,397,844	21.60%	0%	70%	$77,060,436
✓	2 - 5 years	$10,000,000	6.28%	0%	50%	$69,613,057
✓	5 - 10 years	$0	0.00%	0%	25%	$39,806,529
		$159,226,115	**100.00%**			

Counterparty

As at the end of December, 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-	$46,577,862	29.25%	30.00%	$1,189,973
✓	NAB	AA-	$34,000,000	21.35%	30.00%	$13,767,834
✓	NTTC Treasury	AA-	$9,000,000	5.65%	30.00%	$38,767,834
✓	Westpac	AA-	$21,000,000	13.19%	30.00%	$26,767,834
✓	Suncorp	A+	$1,250,409	0.79%	15.00%	$22,633,508
✓	ICBC Sydney	A	$17,000,000	10.68%	15.00%	$6,883,917
✓	BOQ	BBB+	$10,000,000	6.28%	10.00%	$5,922,611
✓	Bendigo	BBB+	$2,000,000	1.26%	10.00%	$13,922,611
✓	Heritage	BBB+	$10,000,000	6.28%	10.00%	$5,922,611
✓	Auswide	BBB	$7,000,000	4.40%	10.00%	$8,922,611
✓	Newcastle PBS	BBB	$1,397,844	0.88%	10.00%	$14,524,767
			$159,226,115	**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 December 2023, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$110,577,862	69.45%	100%	$48,648,253
✓	A Category	$18,250,409	11.46%	60%	$77,285,260
✓	BBB Category	$30,397,844	19.09%	35%	$25,331,296
✓	Unrated ADIs	$0	0.00%	10%	$15,922,611
		$159,226,115	**100.00%**		

Performance

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

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.36%	1.06%	2.09%	2.09%	3.89%	2.59%	1.76%
AusBond Bank Bill Index	0.37%	1.06%	2.15%	2.15%	3.89%	2.56%	1.71%
Council's T/D Portfolio	0.34%	0.96%	1.81%	1.81%	3.18%	2.43%	2.08%
Council's FRN Portfolio	0.45%	1.35%	2.67%	2.67%	5.00%	3.69%	2.99%
Council's Bond Portfolio	0.10%	0.29%	0.59%	0.59%	1.17%	1.17%	1.12%
Council's Portfolio^	**0.32%**	**0.92%**	**1.75%**	**1.75%**	**3.09%**	**2.37%**	**2.04%**
Rel. Performance	**-0.05%**	**-0.14%**	**-0.40%**	**-0.40%**	**-0.80%**	**-0.19%**	**0.33%**

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

Performance (% p.a.)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	4.35%	4.27%	4.18%	4.18%	3.89%	2.59%	1.76%
AusBond Bank Bill Index	4.43%	4.26%	4.31%	4.31%	3.89%	2.56%	1.71%
Council's T/D Portfolio	4.02%	3.84%	3.62%	3.62%	3.18%	2.43%	2.08%
Council's FRN Portfolio	5.48%	5.45%	5.37%	5.37%	5.00%	3.69%	2.99%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.17%	1.12%
Council's Portfolio^	**3.87%**	**3.70%**	**3.49%**	**3.49%**	**3.09%**	**2.37%**	**2.04%**
Rel. Performance	**-0.57%**	**-0.56%**	**-0.81%**	**-0.81%**	**-0.80%**	**-0.19%**	**0.33%**

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

For the month of December, the total investment portfolio (excluding cash) provided a solid return of +0.32% (actual) or +3.87% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.37% (actual) or +4.43% 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. 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 December 2023, Council's deposit portfolio was yielding **3.90% p.a.** (down 5bp from the previous month), with a weighted average duration of around 283 days (~9 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 the Newcastle FRN at this stage (still yielding well above 5¼% p.a.). We will inform Council when there is an opportunity to sell this FRN to boost the overall returns of the investment portfolio. We now recommend Council switch/sell out of the following FRN over the next few months given it is now yielding a low rate of return, if held to maturity:

Issuer	Rating	Maturity Date	ISIN	Face Value	Trading Margin	Capital Price ($)	~Unrealised Gain ($)
Sunc.	A+	30/07/2024	AU3FN0049144	$1,250,000	+60.0bp	$100.045	$566

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 Deposits Rates

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

Index	LT Credit Rating	Term	Rate % p.a.
ING	A	2 years	5.14%
ING	A	5 years	5.08%
ING	A	3-4 years	5.03%
Suncorp	A+	1½ years	4.95%
BoQ	BBB+	2 years	4.90%
Suncorp	A+	2 years	4.85%
Westpac	AA-	2 years	4.74%
NAB	AA-	2 years	4.70%

The above deposits are suitable for investors looking to maintain diversification and lock-in a slight premium compared to purely investing short-term.

For terms under 12 months, we believe the strongest value is currently being offered by the following ADIs (*we stress that rates are indicative, dependent on daily funding requirements and different for industry segments*):

Index	LT Credit Rating	Term	Rate % p.a.
ING	A	12 months	5.32%
ING	A	9 months	5.22%
Suncorp	A+	9 months	5.17%
Suncorp	A+	12 months	5.15%
NAB	AA-	12 months	5.13%
NAB	AA-	6-11 months	5.10%
BoQ	BBB+	9 months	5.10%
Bendigo	BBB+	9 months	5.05%
BoQ	BBB+	12 months	5.05%
NAB	AA-	3-5 months	5.05%
Westpac	AA-	12 months	5.01%
BoQ	BBB+	3 months	5.00%

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

With a global economic slowdown and rate cuts 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. This will provide some income protection if central banks decide to cut rates in future years, assuming inflation has well and truly stabilised.

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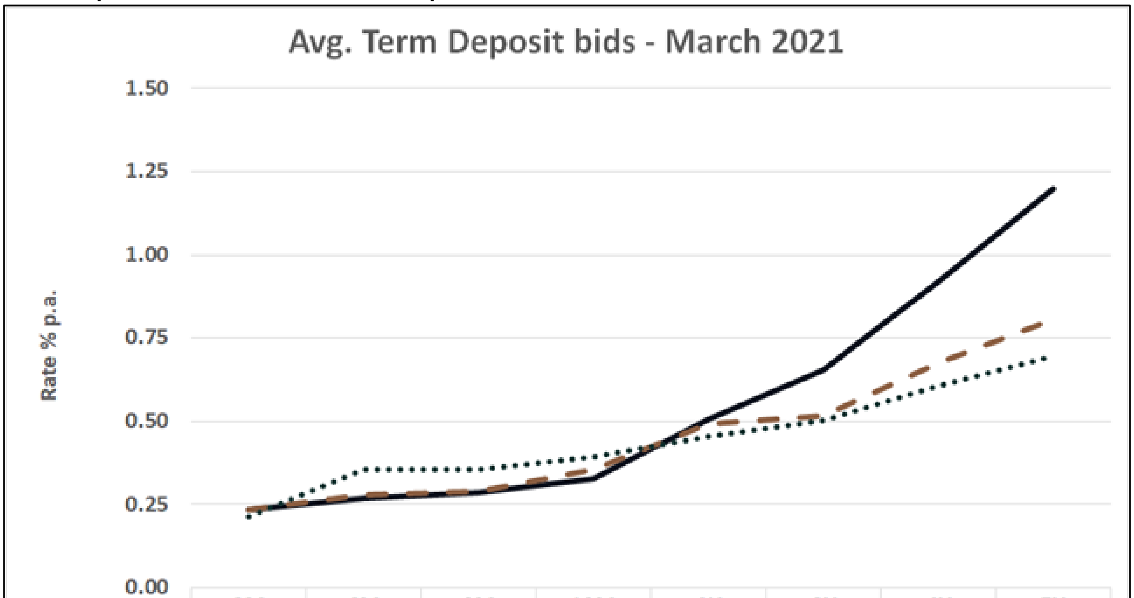
Term Deposits Analysis

Pre-pandemic (March 2020), a 'normal' marketplace meant the lower rated ADIs (i.e. BBB category) were offering higher rates on term deposits compared to the higher rated ADIs (i.e. A or AA rated). But due to the cheap funding available provided by the RBA via their Term Funding Facility (TFF) during mid-2020, allowing the ADIs to borrow as low as 0.10% p.a. fixed for 3 years, those lower rated ADIs (BBB rated) did not require deposit funding from the wholesale deposit. Given the higher rated banks had more capacity to lend (as they have a greater pool of mortgage borrowers), they subsequently were offering higher deposit rates. In fact, some of the lower rated banks were not even offering deposit rates at all. As a result, most investors placed a higher proportion of their deposit investments with the higher rated (A or AA) ADIs over the past three years.

Term Deposit Rates – 12 months after pandemic (March 2021)



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

Source: Imperium Markets

The abnormal marketplace experienced during the pandemic is starting to reverse as the competition for deposits slowly increases. In recent months, we have started to periodically see some of the lower rated ADIs (“A” and “BBB” rated) offering slightly higher rates compared to the domestic major banks (“AA” rated) on different parts of the curve (i.e. pre-pandemic environment). Some of this has been attributed to lags in adjusting their deposit rates as some banks (mainly the lower rated ADIs) simply set their rates for the week.

Going forward, Council should have a larger opportunity to invest a higher proportion of its funds with the lower rated institutions (up to Policy limits), from which the majority are not lending to the Fossil Fuel industry. We are slowly seeing this trend emerge, although the past few months have been an exception, with the major banks repricing more rapidly to the movement in the bond market than their lower rated counterparts. This reversed somewhat over December with the lower rated institutions lagging the major banks in dropping their rates:

Term Deposit Rates – Currently (December 2023)

	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.97	5.01	5.04	5.10	5.14	5.18	4.99	4.94	4.94	4.99
A Rated	4.86	5.02	5.05	5.06	5.17	5.23	5.07	4.96	4.99	5.08
BBB Rated	4.91	5.03	5.06	5.04	5.14	5.19	5.04	5.08	5.10	5.14

Source: Imperium Markets

Regional & Unrated ADI Sector

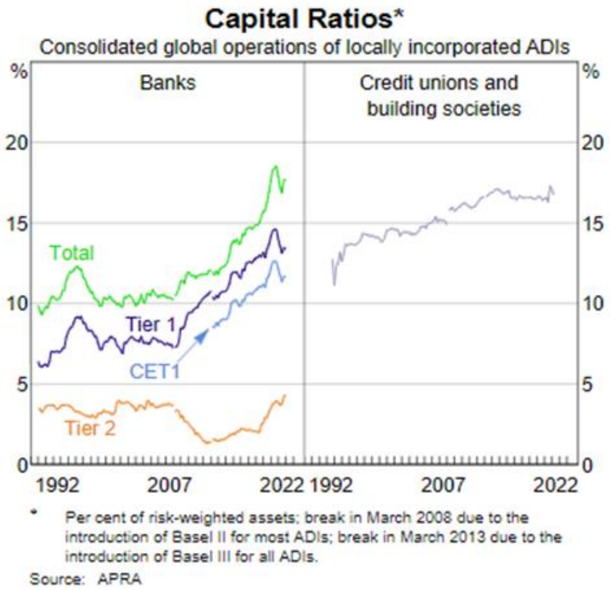
Ratings agency S&P has commented that "*mergers remain compelling for mutuals lenders*" in providing smaller lenders greater economies of scale and assisting them in being able to price competitively and will see "*the banking landscape will settle with a small number of larger mutual players*". S&P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

We remain supportive of the regional and unrated ADI sector (and have been even throughout the post-GFC period). They continue to remain solid, incorporate strong balance sheets, while exhibiting high levels of capital – typically, much higher compared to the higher rated ADIs. Some unrated ADIs have up to 25-40% more capital than the domestic major banks, and well above the Basel III requirements.

Overall, the lower rated ADIs (BBB and unrated) are generally now in a better financial position then they have been historically (see the Capital Ratio figure below). The financial regulator, APRA has noted that the Common Equity Tier 1 capital of Australian banks now exceeds a quarter of a trillion dollars. It has increased by $110 billion, or more than 70%, over the past 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.

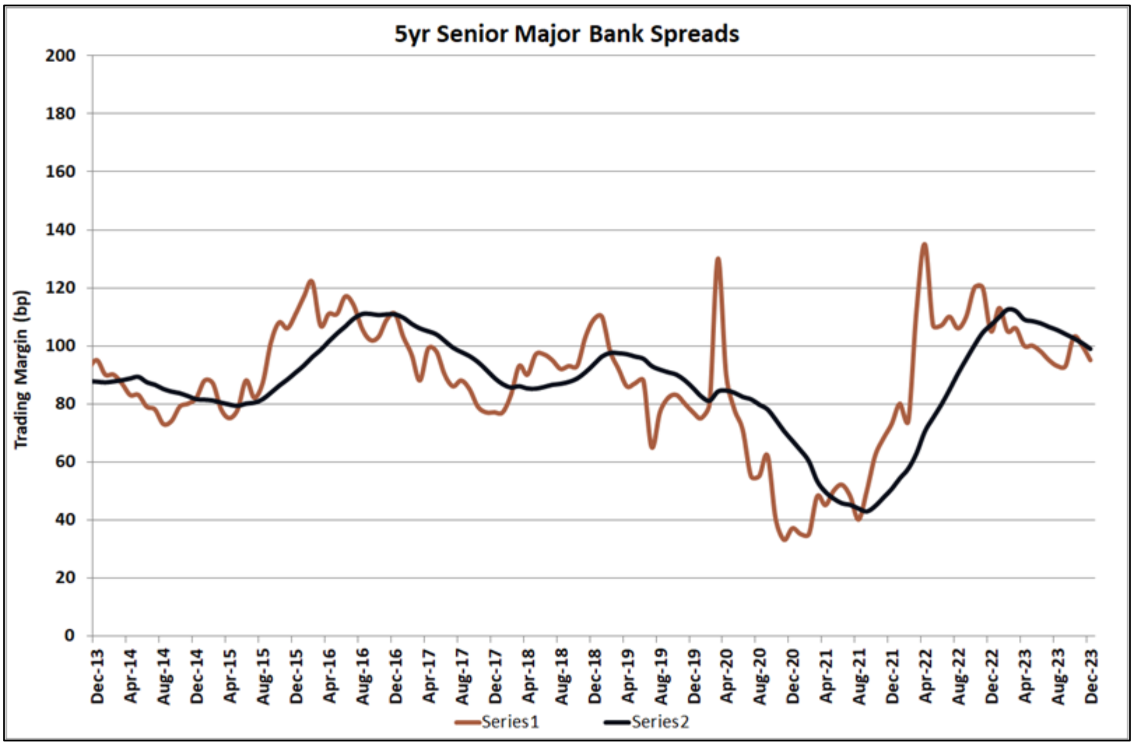
We believe that deposit investments with the lower rated ADIs should be considered going forward, particularly when they offer 'above market' specials. Not only would it diversify the investment portfolio and reduce credit risk, it would also improve the portfolio's overall returns. The lower rated entities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



Senior FRNs Market Review

Over December, amongst the senior major bank FRNs, physical credit securities tightened by around 5-10bp at the long-end of the curve. Major bank senior securities remain at fair value on a historical basis (5yr margins around +95bp level).



Source: IBS Capital

During December, there was a lack of new issuances from the ADIs heading into the holiday period. The only two notable issuances were as follows:

- QBank (BBB-) 3yr senior FRN at +165bp
- BoQ (BBB+) 1yr senior FRN at +87bp

Amongst the "A" rated sector, the securities tightened by around 10bp at the longer-end of the curve. The "BBB" rated sector remained relatively flat, particularly given there is noticeably less secondary market trading. Credit securities are looking much more attractive given the widening of spreads over the past ~2 years. 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)	31/12/2023	30/11/2023
"AA" rated – 5yrs	+95bp	+100bp
"AA" rated – 3yrs	+71bp	+81bp
"A" rated – 5yrs	+125bp	+135bp
"A" rated – 3yrs	+97bp	+110bp
"BBB" rated – 3yrs	+148bp	+150bp

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

Senior Fixed Bonds – ADIs (Secondary Market)

With global inflation still high by historical standards, this has seen a significant lift in longer-term bond yields over the past 2 years (valuations have fallen) as markets have reacted sharply.

This has resulted in some opportunities in the secondary market. We currently see value in the following fixed bond lines, with the majority now being marked at a significant discount to par (please note supply in the secondary market may be limited on any day):

ISIN	Issuer	Rating	Capital Structure	Maturity Date	~Remain. Term (yrs)	Fixed Coupon	Indicative Yield
AU3CB0273407	UBS	A+	Senior	30/07/2025	1.60	1.20%	5.02%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.36	1.40%	5.22%
AU3CB0299337	Bendigo	BBB+	Senior	15/05/2026	2.39	4.70%	5.05%
AU3CB0296168	BoQ	BBB+	Senior	27/01/2027	3.09	4.70%	5.10%

Economic Commentary

International Market

Risk markets continued their rally in December on the back of easing inflation and central banks turning their focus on the timing of future interest rate cuts in 2024.

Across equity markets, the S&P 500 Index gained +4.42%, whilst the NASDAQ added +5.52%. Europe's main indices also experienced further gains, led by UK's FTSE (+3.75%), Germany's DAX (+3.31%) and France's CAC (+3.18%).

As widely expected, the US Federal Reserve held its policy rate unchanged at 5.25-5.50% for the third consecutive meeting. The Fed acknowledged US economic growth "*has slowed from its strong pace in the third quarter*" plus a recognition that *"inflation has eased over the past year"*. The US central bank also released its latest economic projections, and its latest 'dot plot' which shows each Fed official's projection for the central bank's key short-term interest rates. The new 'dot plot' effectively eliminated any further hints of rate hikes and showed an average of 75bp of interest rate cuts over 2024, and a further 100bp of cuts in 2025.

The latest US inflation data, which was released just prior to the US central bank policy meeting in mid-December, was in line with expectations, with headline consumer price index (CPI) rising +3.1% y/y and +0.1% m/m.

UK CPI surprised sharply lower in November, the headline falling -0.2% m/m and +3.9% y/y (+4.3% expected) and the core sliding to +5.1% y/y from +5.7% (consensus +5.6%).

The European Central Bank (ECB) and Bank of England (BoE) kept their respective interest rates steady. However unlike the Fed, both the ECB and BoE maintained higher interest rates had to continue. The BoE stated monetary policy was *"likely to need to be restrictive for an extended period of time"* and *"further tightening would be required if there were evidence of more persistent inflationary pressure"*.

The Bank of Canada held its policy rate at 5.00%, its third consecutive pause, whilst maintaining a tightening bias, noting "*the Governing Council is still concerned about risks to the outlook for inflation and remains prepared to raise the policy rate further if needed*". Canada's employment rose a little ahead of expectation at +25k vs +14k expected. The unemployment ticked up to 5.8% from 5.7% as expected.

The MSCI World ex-Aus Index rose +4.70% for the month of December:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+4.42%	+11.24%	+24.23%	+8.29%	+13.73%	+9.94%
MSCI World ex-AUS	+4.70%	+11.00%	+22.04%	+5.70%	+11.09%	+6.83%
S&P ASX 200 Accum. Index	+7.26%	+8.40%	+12.42%	+9.24%	+10.28%	+7.93%

Source: S&P, MSCI

Domestic Market

The RBA kept rates on hold at 4.35% as expected in its December meeting. The RBA Minutes continued in their recent tradition as reading more hawkish than the post-Meeting Statement. This was particularly the case this time around given it was not clear whether the case of a rate hike was genuinely discussed in December. Adding to the hawkish tone in the December Statement was the RBA's concerns over domestic driven inflation and the need to target the mid-point of the 2-3% inflation band, rather than just the top of the band.

The updated agreement between the RBA Board and the Government on key aspects of Australia's monetary and central banking framework revealed two significant changes. Firstly, the RBA will look to target the mid-point of the 2-3% inflation target. Secondly, the RBA has a dual mandate of sustained full employment and inflation ("*current maximum level of employment that is consistent with low and stable inflation*").

Australia's unemployment rate increased to 3.9% in November (3.8% in October) despite the creation of more than 60,000 new jobs over the month. This was due to the rise in the participation rate which increased to a record high of 67.2% in November (67.0% in October) largely driven by high net migration which boosted domestic labour supply.

GDP rose by a weaker-than-expected +0.2% q/q (+2.1% y/y), signifying a clear further slowing in both domestic final demand and GDP growth, with the 'highlight' being flat Household Consumption in the quarter.

The October goods trade surplus rose to $7.1bn (consensus $7.5bn). Goods exports rose (+0.4% m/m or $0.2bn) driven by 'metal ores and minerals' (+2.3% m/m or $0.4bn) and 'metals' (+21.6% m/m or $0.3bn).

The Australian dollar rose +2.89%, finishing the month at US68.40 cents (from US66.48 cents the previous month).

Credit Market

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

Index	December 2023	November 2023
CDX North American 5yr CDS	56bp	63bp
iTraxx Europe 5yr CDS	60bp	68bp
iTraxx Australia 5yr CDS	72bp	75bp

Source: Markit

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Fixed Interest Review

Benchmark Index Returns

Index	December 2023	November 2023
Bloomberg AusBond Bank Bill Index (0+YR)	+0.37%	+0.35%
Bloomberg AusBond Composite Bond Index (0+YR)	+2.69%	+2.97%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.51%	+0.45%
Bloomberg AusBond Credit Index (0+YR)	+2.10%	+1.84%
Bloomberg AusBond Treasury Index (0+YR)	+2.77%	+3.08%
Bloomberg AusBond Inflation Gov't Index (0+YR)	+4.65%	+2.47%

Source: Bloomberg

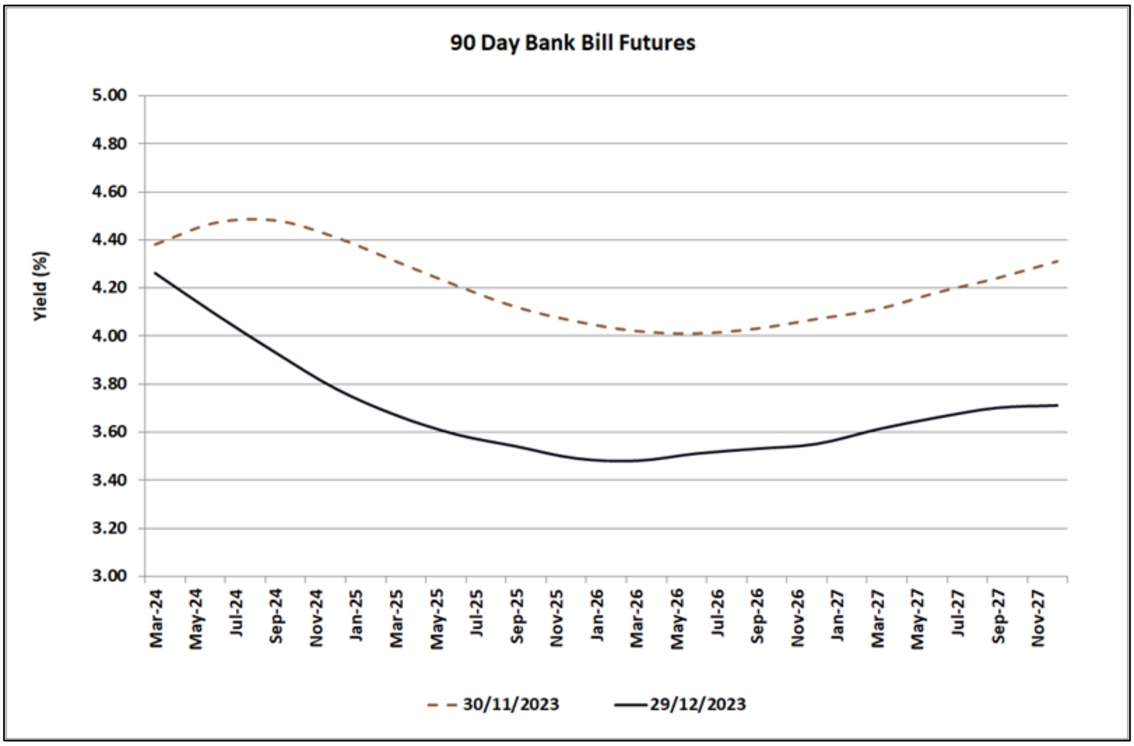
Other Key Rates

Index	December 2023	November 2023
RBA Official Cash Rate	4.35%	4.35%
90 Day (3 month) BBSW Rate	4.36%	4.37%
3yr Australian Government Bonds	3.61%	4.01%
10yr Australian Government Bonds	3.97%	4.41%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	4.23%	4.73%
10yr US Treasury Bonds	3.88%	4.37%

Source: RBA, ASX, US Department of Treasury

90 Day Bill Futures

Bill futures fell across the board this month, following the movement in the global bond market. The market has quickly turned and now focusing more on when the first rate cuts will be delivered in 2024:



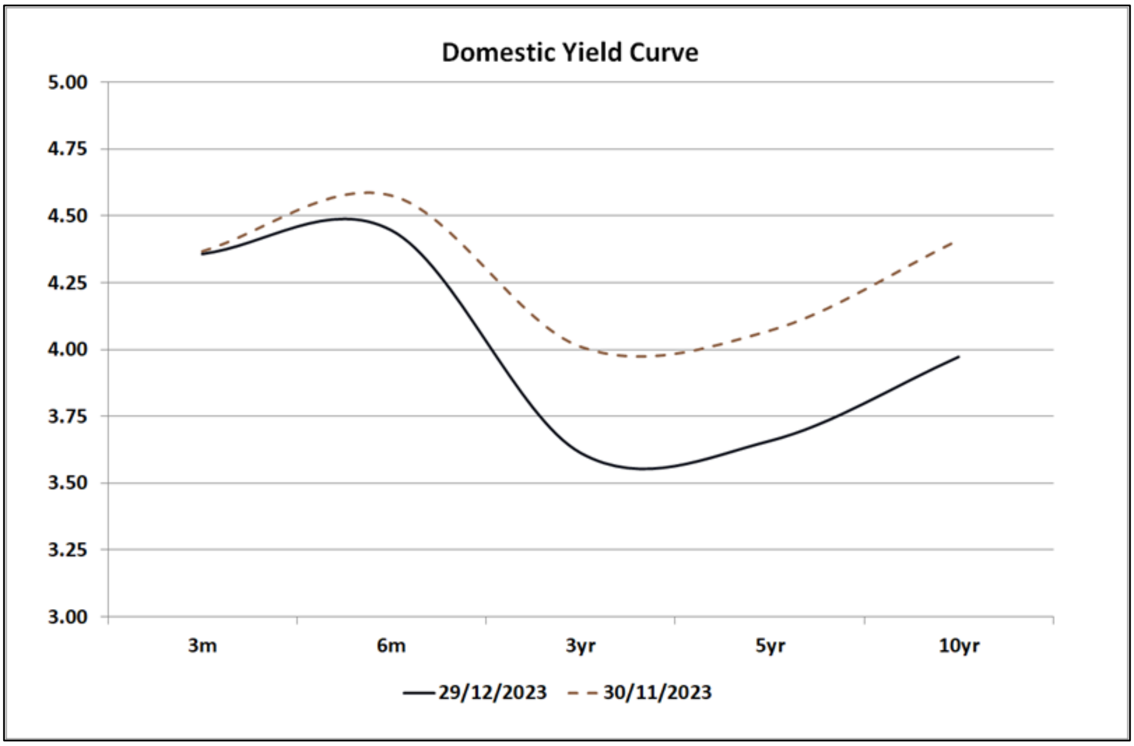
Source: ASX

Fixed Interest Outlook

Despite signs of easing, global inflation has remained somewhat sticky across advanced economies, with elevated energy prices remaining a risk to headline inflation. There is some uncertainty when central banks will start to cut official rates in 2024. Importantly, there was a change in stance by the US Federal Reserve as their latest '*dot plot*' released in mid-December had no policymakers projecting further interest rate hikes for the first time since early 2021, with 17 of 19 Fed officials predicted lower rates by December 2024. Financial markets are now pricing in around 75-100bp of Fed rate cuts in 2024, with the first cut projected as early as March 2024.

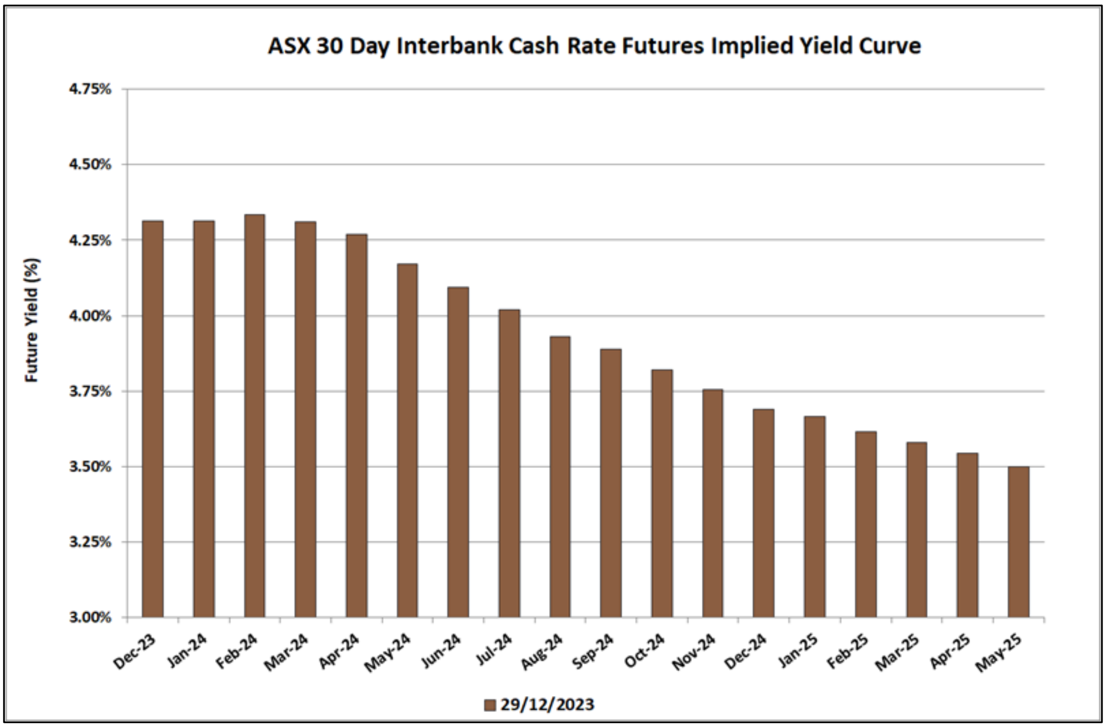
The Fed's pivot in monetary policy stance has reduced the risk of the RBA needing to raise rates its first meeting in 2024 (February). However, we note the RBA remains on a mild tightening bias, with the Board commenting that whilst the trend in global inflation has been favourable, it was heavily caveated, consistent with the RBA waiting for the Q4 CPI to determine whether further tightening is required rather than taking significant signal from recent offshore developments. Key data to influence the RBA ahead of its next policy meeting in February will be Q4 CPI on 31 January 2024 and before then the November Monthly Inflation Indicator on 10 January 2024 which has better coverage of key services sectors.

Over the month, yields fell by 44bp at the long end of the curve:



Source: ASX, RBA

The consensus from the broader market is that we have reached the peak of the interest rate cycle, though there are still a handful that believe the RBA will deliver one more rate hike (likely in Feb 2024). Interestingly, financial markets have pushed forward their rate cut expectations, with the first rate cut fully priced in by June 2024:



Source: ASX

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