10.3. Investment and Loan Borrowings Report as at 29 February 2024

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ATTACHMENTS	1. Monthly Investment Review February 2024 [**10.3.1** - 21 pages]
CSP LINK	5. Our Civic Leadership 5.1 Lead North Sydney's strategic direction

PURPOSE:

The purpose of this report is to provide Council with the details of the performance of Council's investments and details of loans for the month ending 29 February 2024.

EXECUTIVE SUMMARY:

- All investments have been made in accordance with the Local Government Act and Regulations. The balance held with Commonwealth Bank of Australia exceeds the counter party limits in Council's Financial Investments Policy due to the need to hold liquid balances in the Business Online Saver account and the transaction account to pay a large invoice on 29 February. The Policy permits a limit of 30% of the portfolio with an Australian Major Bank counterparty, 35.82% was held.

- For the month of February, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.30% (actual), or +3.83% p.a. (annualised), marginally under-performing the benchmark AusBond Bank Bill Index return of +0.34% (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 $746.29 thousand. The total return for the 2023/2024 financial year to date is approximately $3.82 million. The better-than-expected return is due to the payments for the capital works program progressing slower than expected in the first two quarters.

RECOMMENDATION:

1. THAT the report on Investments held on 29 February 2024, prepared in accordance with clause 212 of the Local Government (General) Regulation 2021, and the information on Loan Borrowings be received.

Background

Clause 212 of 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 $164,609,756. 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 funds on certain projects and activities).

The following table details the reserves held as at 29 February 2024. Council holds an unrestricted cash balance of $14.7 million, indicating it has funded all its reserves.

External Restrictions and Internal Allocations	
External restrictions	
Developer contributions - general	$45,005,304
Domestic waste management	$16,364,518
Unexpended Special Rates	$1,983,039
Unspent borrowings - North Sydney Olympic Pool redevelopment	$12,714,024
Waste and sustainability improvement funds	$37,646
Specific purpose grants	$5,369,887
Other specific purpose contributions	$2,400,183
Total external restrictions	**$83,874,601**
Internal allocations	
Capital works	$11,154,329
Community housing - capital purchases	$962,601
Community housing - major maintenance	$490,657
Deposits, retentions and bonds	$13,904,280
Employees leave entitlement	$5,634,625
I.T. hardware and software	$1,132,385
Income producing projects	$781,728
Olympic Pool Redevelopment	$29,302,441
Plant and vehicle replacement	$2,659,737
Total internal allocations	**$66,022,783**

External Restrictions and Internal Allocations	
Total Restrictions and Allocations	**$149,897,384**
Unrestricted Cash and Investments	$14,712,372
Total Cash and Investments	**$164,609,756**

Investment Portfolio

The following table details the performance of Council's investment portfolio (excluding cash deposits) to the benchmark for the month of February 2024 and annualised for the year-to-date 28 February 2024 (including investments that have matured prior to that date).

	February 2023	Annualised YTD
Actual Return	0.30%	3.83%
Benchmark	0.34%	4.43%
Variance	-0.04%	-0.60%

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	$119,000,000	72.29%
Cash	$33,957,672	20.63%
Fixed Bonds	$9,000,000	5.47%
Floating Rate Notes (FRNs)	$2,652,084	1.61%
	$164,609,756	**100.00%**

Council's average duration of term deposits, which comprise 72.29% of the investment portfolio, is approximately 259 days. The average duration continues to fall to align maturities with expected outflows on the capital works program.

All funds have been invested in accordance with the Act and the Regulations made thereunder. Council's investment portfolio complies with the revised Investment Order issued by the Minister for Local Government, which places restrictions on the type of investments permitted.

Funds held with Commonwealth Bank of Australia exceeded the counterparty limits in Council's Investment Policy due the need to hold liquid funds to make a large payment for the pool project on 29 February. The payment was delayed by last minute discussions with the vendor. The Policy permits a limit of 30% of the portfolio, whereas 35.82% was held with the Commonwealth Bank.

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 $94.2 million in 2023/24.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 29 February 2024 are $746.29 thousand more than the year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (Feb)	YTD (Feb)	YTD Actual FV adjustments (Feb)	YTD Budget to Actual Variance (Feb)
2023/24	$2,500,000	$4,650,000	$3,070,005	$3,811,304	$4,991	$746,290
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 an increase of $4,991.

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	$130,957,672	100.00%	79.56%
A Category	$18,251,441	60.00%	11.09%
BBB Category	$15,400,643	35.00%	9.35%
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. The Loan Agreement was varied in February 2024 so that these limits are now those contained in Council's Financial Investment Policy. It is no longer necessary to report compliance with additional with TCorp limits.

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 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. As of 29 February 2024, $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 the year-to-date budget as payments for capital works have been lower than expected. A $1.00 million upward revision was adopted at the September Quarter Budget Review. The December Quarter Review will propose a further upward revision of $1 million.

Legislation

Section 625 of the Local Government Act (NSW) allows councils to invest money that is not currently required for any other purpose. It further specifies how councils may invest. It specifies investments must be in accordance with the local government minister's orders.
Clause 212 of the Local Government Regulation (NSW) 2021 requires that the Responsible Accounting Officer must make a monthly report to Council, setting out all details of money invested under Section 625 of the Local Government Act.

Sections 621 to 624 of the Local Government Act give councils the ability to borrow money and specify some further regulations on that borrowing. Council's staff consider it prudent to provide monthly reporting of loans.

Monthly Investment Review

February 2024

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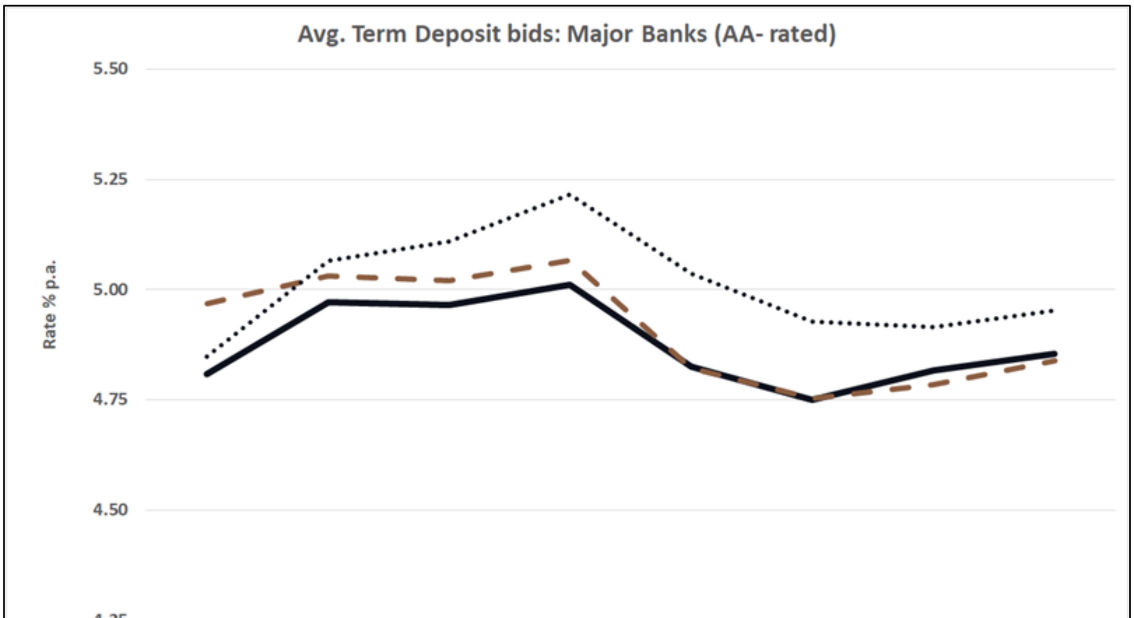
Market Update Summary

Financial markets continued their rally in February largely reflective of the overall continued easing in inflation globally. Focus remains on when central banks will begin their interest rate cuts this year.

Over February 2024, movements for major bank term deposit rates were mixed compared to the previous month (January 2024). Major bank deposit rates dropped by as much as 16bp across the shorter-tenors (3-12 months), whilst flat across the medium term (2-3 years), and was slightly up by around 2-3bp across the longer-tenors (4-5 years). Interestingly, major bank deposit rates are approximately 10-22bp lower than what they were 6 months ago (August 2023), clearly pricing in the future rate cuts expected later this year.



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Feb-2024	4.81	4.97	4.97	5.01	4.82	4.75	4.82	4.85
Jan-2024	4.97	5.03	5.02	5.07	4.82	4.75	4.78	4.84
Aug-2023	4.85	5.07	5.11	5.22	5.04	4.93	4.92	4.95

Source: Imperium Markets

With a global economic downturn and multiple interest rate cuts being priced in coming years, investors should consider taking an 'insurance policy' against a potentially lower rate environment by investing across 2-5 year fixed deposits, targeting rates above or close to 4¾-5% p.a. (small allocation only).

North Sydney Council' Portfolio & Compliance

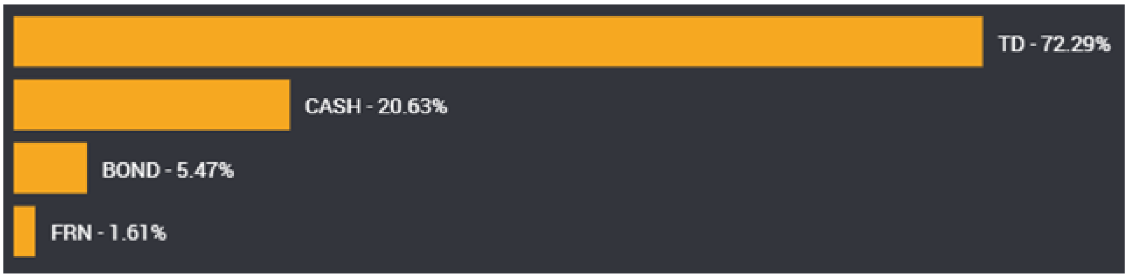
Asset Allocation

As at the end of February 2024, the portfolio was mainly directed to fixed term deposits (72%). The remaining portfolio is directed to FRNs (2%), fixed bonds (5%) and overnight cash accounts (21%).

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 4¾-5% 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 5% 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 $83m 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	$72,957,672	44.32%	10%	100%	$91,652,084
✓	91 - 365 days	$51,652,084	31.38%	20%	100%	$112,957,672
✓	1 - 2 years	$32,000,000	19.44%	0%	70%	$83,226,829
✓	2 - 5 years	$8,000,000	4.86%	0%	50%	$74,304,878
✓	5 - 10 years	$0	0.00%	0%	25%	$41,152,439
		$164,609,756	**100.00%**			

Counterparty

As at the end of February, all individual limits comply with the Policy, except for CBA (AA-) due to the high cash balance. 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 ($)	Invested (%)	Max. Limit (%)	Available ($)
X	CBA	AA-	$58,957,672	35.82%	30.00%	**-$9,574,745**
✓	NAB	AA-	$35,000,000	21.26%	30.00%	$14,382,927
✓	NTTC Treasury	AA-	$9,000,000	5.47%	30.00%	$40,382,927
✓	Westpac	AA-	$26,000,000	15.79%	30.00%	$23,382,927
✓	Suncorp	A+	$1,251,441	0.76%	15.00%	$23,440,022
✓	ICBC Sydney	A	$17,000,000	10.33%	15.00%	$7,691,463
✓	BOQ	BBB+	$4,000,000	2.43%	10.00%	$12,460,976
✓	Bendigo	BBB+	$2,000,000	1.21%	10.00%	$14,460,976
✓	Heritage	BBB	$10,000,000	6.07%	10.00%	$6,460,976
✓	Newcastle PBS	BBB	$1,400,643	0.85%	10.00%	$15,060,333
			$164,609,756	**100.00%**		

In February 2024, ANZ's takeover of Suncorp was given the green light by the Australian Competition Tribunal (ACT), six months after the Australian Competition and Consumer Commission (ACCC) blocked the deal on the grounds that it could lessen competition in the mortgage market. As such, Suncorp's assets are likely to be upgraded to AA- in the near future by S&P.

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 February 2024, all categories were within the Policy limits:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$128,957,672	78.34%	100%	$35,652,084
✓	A Category	$18,251,441	11.09%	60%	$80,514,412
✓	BBB Category	$17,400,643	10.57%	35%	$40,212,772
✓	Unrated ADIs	$0	0.00%	10%	$16,460,976
		$164,609,756	**100.00%**		

Performance

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

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.34%	1.07%	2.10%	2.80%	4.09%	2.94%	1.99%
AusBond Bank Bill Index	0.34%	1.09%	2.12%	2.88%	4.10%	2.92%	1.95%
Council's T/D Portfolio	0.31%	0.98%	1.91%	2.46%	3.42%	2.66%	2.22%
Council's FRN Portfolio	0.43%	1.34%	2.68%	3.58%	5.19%	4.05%	3.23%
Council's Bond Portfolio	0.09%	0.29%	0.58%	0.78%	1.17%	1.17%	1.13%
Council's Portfolio^	**0.30%**	**0.94%**	**1.84%**	**2.38%**	**3.30%**	**2.59%**	**2.17%**
Rel. Performance	**-0.05%**	**-0.14%**	**-0.29%**	**-0.50%**	**-0.80%**	**-0.34%**	**0.22%**

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

Performance (% p.a.)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	4.35%	4.35%	4.27%	4.22%	4.09%	2.94%	1.99%
AusBond Bank Bill Index	4.43%	4.43%	4.31%	4.34%	4.10%	2.92%	1.95%
Council's T/D Portfolio	3.98%	3.99%	3.86%	3.71%	3.42%	2.66%	2.22%
Council's FRN Portfolio	5.49%	5.48%	5.45%	5.40%	5.19%	4.05%	3.23%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.17%	1.13%
Council's Portfolio^	**3.83%**	**3.84%**	**3.72%**	**3.57%**	**3.30%**	**2.59%**	**2.17%**
Rel. Performance	**-0.60%**	**-0.60%**	**-0.59%**	**-0.76%**	**-0.80%**	**-0.34%**	**0.22%**

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

For the month of February, the total investment portfolio (excluding cash) provided a solid return of +0.30% (actual) or +3.83% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.34% (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 February 2024, Council's deposit portfolio was yielding **3.83% p.a.** (down 3bp from the previous month), with a weighted average duration of around 259 days (~8½ months). We recommend Council slightly increases this weighted average duration, should cash flows allow in future.

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

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

Securities

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

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

Council's Senior FRNs Sale/Switch Recommendations

We recommend Council retains the Newcastle FRN at this stage (still yielding well above 5¼% p.a.). We will inform Council when there is an opportunity to sell this FRN to boost the overall returns of the investment portfolio. **We now recommend Council switch/sell out of the following FRN immediately 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	+37.0bp	$100.115	$1,441

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 February, we see value in the following:

Index	LT Credit Rating	Term	Rate % p.a.
ING	A	5 years	5.04%
BoQ	BBB+	5 years	5.00%
ING	A	2 years	4.95%
BoQ	BBB+	4 years	4.95%
ING	A	4 years	4.92%
Australian Unity	BBB+	2 years	4.90%
ING	A	3 years	4.87%
Suncorp	A+	2 years	4.85%
BoQ	BBB+	2 years	4.85%
Westpac	AA-	5 years	4.82%
Westpac	AA-	2 years	4.82%
NAB	AA-	2 years	4.75%

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.
NAB	AA-	5-8 months	5.10%
ING	A	12 months	5.08%
Suncorp	A+	6 months	5.08%
NAB	AA-	12 months	5.05%
Westpac	AA-	12 months	5.05%
Suncorp	A+	9 months	5.05%
BoQ	BBB+	9 months	5.05%
Hume Bank	BBB+	12 months	5.04%
Bendigo	BBB+	9 months	5.03%
BoQ	BBB+	6 months	5.00%

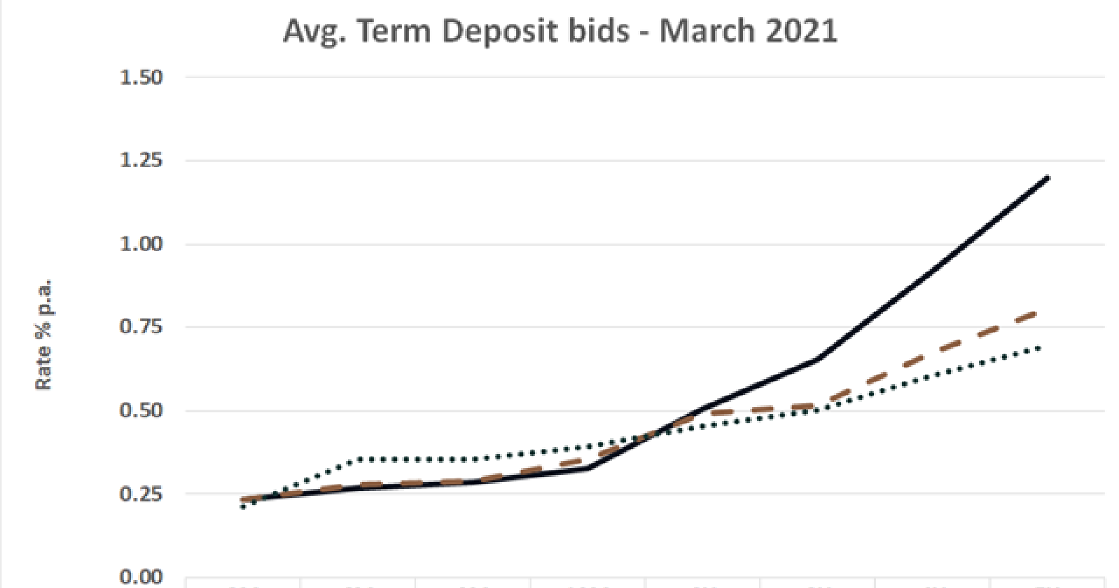
If Council does not require high levels of liquidity and can stagger a proportion of its investments across the longer term horizons (1-5 years), it will be rewarded over a longer-term cycle. Investing a spread of 12 months to 3 year horizons is likely to yield, on average, up to ¼-½% p.a. higher compared 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 strongly consider and allocate some longer term surplus funds to undertake an insurance policy by investing across 2-5 year fixed deposits and locking in rates close to or above 4¾-5% p.a. This will provide some income protection with central banks now likely to cut rates at some stage later this year.

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)



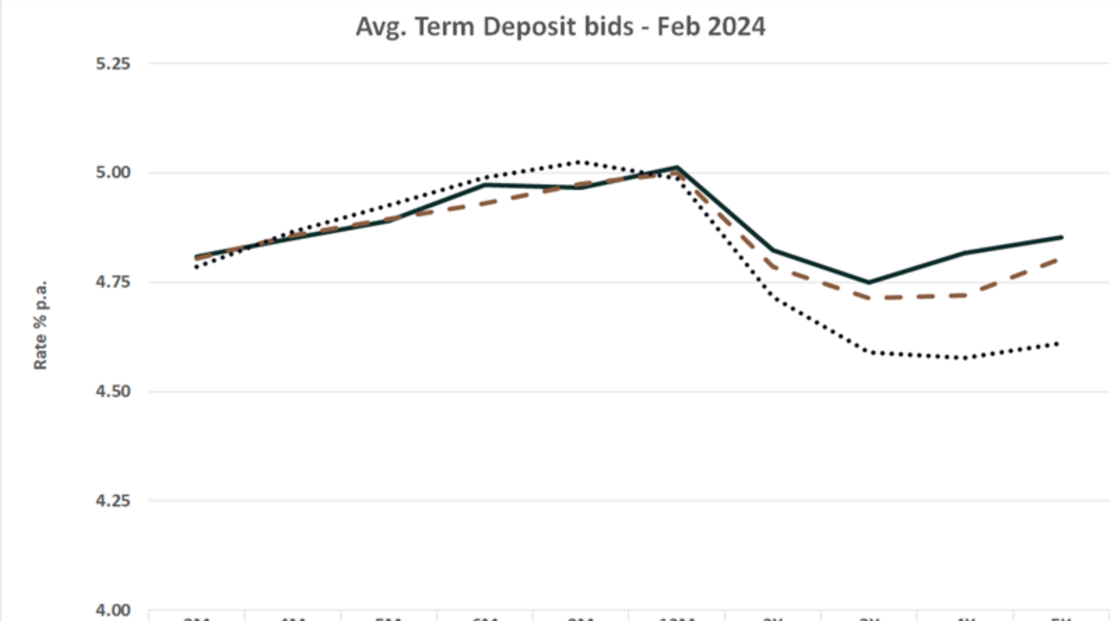
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

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 the past few months with the lower rated institutions (mainly "A" rated) lagging the major banks in dropping their rates:

Term Deposit Rates – Currently (February 2024)



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.81	4.85	4.89	4.97	4.97	5.01	4.82	4.75	4.82	4.85
A Rated	4.80	4.86	4.90	4.93	4.98	5.00	4.79	4.71	4.72	4.80
BBB Rated	4.79	4.87	4.93	4.99	5.03	4.99	4.72	4.59	4.58	4.61

Source: Imperium Markets

Regional & Unrated ADI Sector

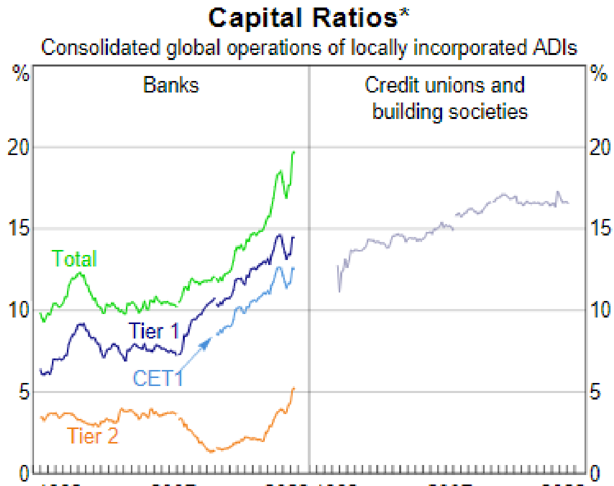
Ratings agency S&P has commented that "*mergers remain compelling for mutuals lenders*" in providing smaller lenders greater economies of scale and assisting them in being able to price competitively and will see "*the banking landscape will settle with a small number of larger mutual players*". S&P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

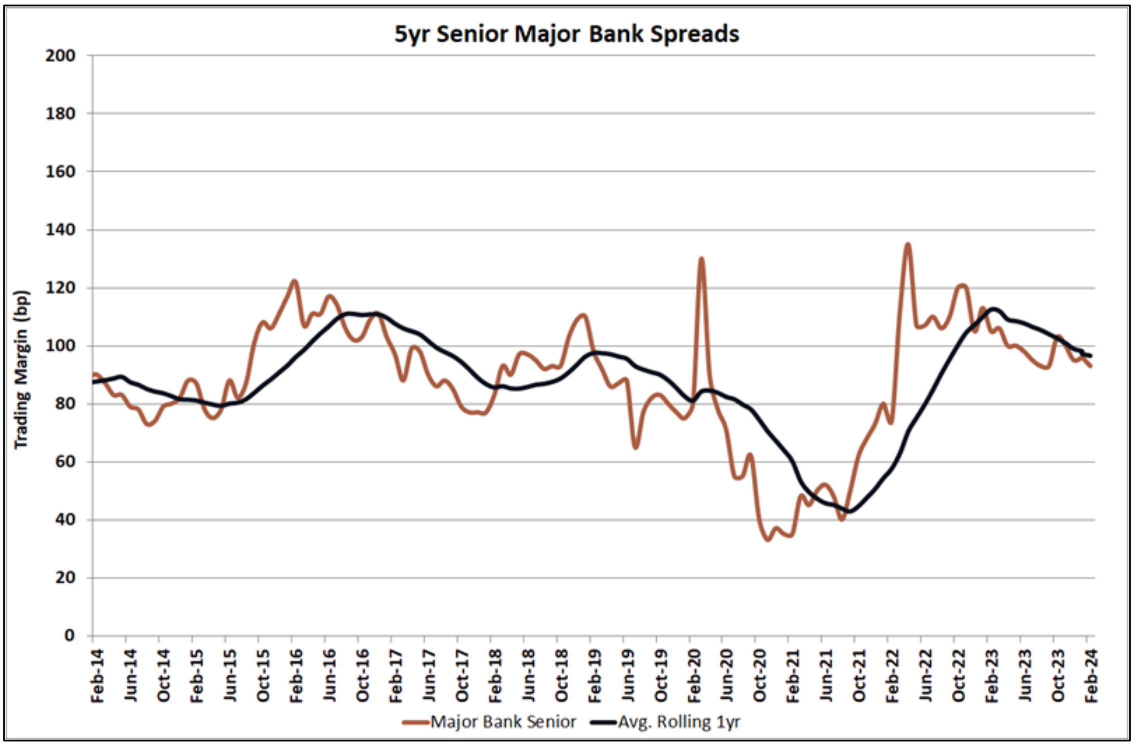


* Per cent of risk-weighted assets; break in March 2008 due to the introduction of Basel II for most ADIs; break in March 2013 due to the introduction of Basel III for all ADIs.

Source: APRA.

Senior FRNs Market Review

Over February, amongst the senior major bank FRNs, physical credit securities tightened by around 3-7bp at the long-end of the curve. Major bank senior securities remain at fair value on a historical basis (5yr margins around +93bp level).



Source: IBS Capital

During the month, there were several new (primary) issuances including:

- Heritage (BBB) 3 year senior FRN at +160bp
- Newcastle Greater (BBB) 5 year senior FRN at +185bp
- Bank Australia (BBB) 4 year senior FRN at +170bp
- DBS Bank (AA-) 3 year senior security at +77bp
- Rabobank Australia Branch (A+) 3 & 5 year senior security at +87bp and +103bp respectively
- MUFG Bank Sydney Branch (A) 3 & 5 year senior FRN at +85bp and +99bp respectively
- Members Banking Group (RACQ Bank) (BBB+) 3 year senior FRN at +160bp
- OCBC Sydney Branch (AA-) 3 year senior FRN at +72bp

Amongst the "A" rated sector, the securities tightened by around 12-20bp at the longer-end of the curve, whilst the "BBB" rated sector widened by around 12bp at the 3 year part of the curve. Overall, credit securities are looking much more attractive given the widening of spreads over the past 2 years and as more primary issuances become available. FRNs will continue to play a role in investors' portfolios mainly on the basis of their liquidity and the ability to roll down the curve and gross up returns over ensuing years (in a relatively stable credit environment).

Senior FRNs (ADIs)	29/02/2024	31/01/2024
"AA" rated – 5yrs	+93bp	+96bp
"AA" rated – 3yrs	+73bp	+80bp
"A" rated – 5yrs	+105bp	+125bp
"A" rated – 3yrs	+87bp	+99bp
"BBB" rated – 3yrs	+160bp	+148bp

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 early 2026 for the "AA" rated ADIs (domestic major banks);
- On or before early 2025 for the "A" rated ADIs; and
- Within 6-9 months for the "BBB" rated ADIs (consider case by case).

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

Senior Fixed Bonds – ADIs (Secondary Market)

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

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

ISIN	Issuer	Rating	Capital Structure	Maturity Date	~Remain. Term (yrs)	Fixed Coupon	Indicative Yield
AU3CB0278174	UBS	A+	Senior	26/02/2026	1.99	1.10%	5.01%
AU3CB0280030	BoQ	BBB+	Senior	06/05/2026	2.18	1.40%	5.16%
AU3CB0299337	Bendigo	BBB+	Senior	15/05/2026	2.21	4.70%	5.08%
AU3CB0296168	BoQ	BBB+	Senior	27/01/2027	2.91	4.70%	5.13%

Economic Commentary

International Market

Financial markets continued their rally in February largely reflective of the overall continued easing in inflation globally. Focus remains on when central banks will begin their interest rate cuts this year.

Across equity markets, the S&P 500 Index gained +5.17% over the month, whilst the NASDAQ surged +6.12%. Europe's main indices also experienced material gains, led by Italy's FTSE MIB (+7.34%), Germany's DAX (+4.58%), and France's CAC (+3.54%). UK's FTSE (-0.01%) was the exception, which was largely flat against the rally in global equity markets.

In the US, January CPI was +0.3% m/m vs +0.2% expected, with the core reading at +0.4% m/m (+2.8% y/y) vs +0.3% expected.

In Europe, the CPI was +2.8% y/y in January, down from +2.9% y/y recorded in December. Additionally, wage growth declined to +4.5% y/y in January (from +4.7% the previous month).

UK CPI data for January also came in lower than expected, where the headline rate held at +4.0% (expected +4.1%), as did core at +5.1% (versus +5.2% expected). UK Q4 GDP fell -0.3% in Q4 following the -0.1% contraction in Q3, resulting in a technical recession. The UK labour market data was stronger than expected, with the unemployment rate 0.2% lower than expected at 3.8% and wages inflation not falling as fast as expected.

Canadian CPI was +2.9% in January from a year ago, which was much lower than the expected +3.3%. Additionally, unemployment in Canada fell to 5.7% vs. 5.9% expected and employment was +37.5k vs. +15.0k expected.

Whilst in Japan, core CPI eased to +2.0%y/y in January compared with +2.3%y/y in December.

In China, the People's Bank of China lowered the five-year loan prime rate by 25bp to 3.95%. This surprise cut is aimed to revive China's property sector as it could improve affordability for buyers by lowering mortgage rates.

The MSCI World ex-Aus Index rose +4.22% for the month of February:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	+5.17%	+11.57%	+28.36%	+10.17%	+12.85%	+10.61%
MSCI World ex-AUS	+4.22%	+10.43%	+23.37%	+7.12%	+10.01%	+7.31%
S&P ASX 200 Accum. Index	+0.79%	+9.39%	+10.64%	+9.32%	+8.61%	+7.95%

Source: S&P, MSCI

Domestic Market

According to the RBA February Board meeting minutes, the Board had considered to hike the cash rate by 25bp or to hold steady; however, it ultimately decided to hold the cash rate steady given recent signs inflation had moderated further. However, the minutes stated, *"it was not yet possible to rule in or out further increases in interest rates"* and it would take *"some time"* to have sufficient confidence inflation was on track.

The monthly consumer price index (CPI) fell -0.3% in January, leaving the annual rate unchanged at +3.4% y/y (which was lower than market expectations of +3.6% y/y). When excluding volatile items, the annual rise was +4.1%, down from +4.2% recorded in December.

The Wage Price Index (WPI) was +0.9% over the December 2023 quarter and +4.2% over calendar 2023 (the highest annual growth since the March 2009 quarter). The annual growth in the WPI exceeded forecasts and was driven by newly-implemented enterprise agreements in the public sector. Wages growth in the public sector rose by +4.3% y/y, outpacing the +4.2% y/y wages growth in the private sector.

The unemployment rate rose to 4.1% from 3.9% (consensus 4.0%), though unrounded it rose only by 0.1% to 4.0577%. Employment growth was flat at +0.5k vs. the +25.0k consensus, and hours worked fell sharply by -2.5% m/m. The participation rate also fell by 0.1% to 66.8% from 66.9% and underemployment rose by 0.1% to 6.6%.

Retail sales increased +1.1% m/m in January, which was lower than expectations of +1.6% m/m, but rebounded from the -2.7% recorded in December.

Dwelling approvals fell sharply in December by -9.5% m/m, driven by a sharp fall in the volatile non-house component (i.e. apartments; -25.3% m/m).

The December goods trade surplus fell slightly to $10.96bn from $11.8bn (consensus $10.5bn). The largely on consensus print was driven by a partial rebound in imports (+4.8% m/m after last month's -8.4%; or $1.7bn).

The Australian dollar slightly fell -0.84%, finishing the month at US65.19 cents (from US65.74 cents the previous month).

Credit Market

The global credit indices tightened over February 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	February 2024	January 2024
CDX North American 5yr CDS	52bp	55bp
iTraxx Europe 5yr CDS	55bp	60bp
iTraxx Australia 5yr CDS	64bp	68bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	February 2024	January 2024
Bloomberg AusBond Bank Bill Index (0+YR)	+0.34%	+0.37%
Bloomberg AusBond Composite Bond Index (0+YR)	-0.30%	+0.21%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.53%	+0.44%
Bloomberg AusBond Credit Index (0+YR)	+0.05%	+0.41%
Bloomberg AusBond Treasury Index (0+YR)	-0.36%	+0.16%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-0.48%	-0.69%

Source: Bloomberg

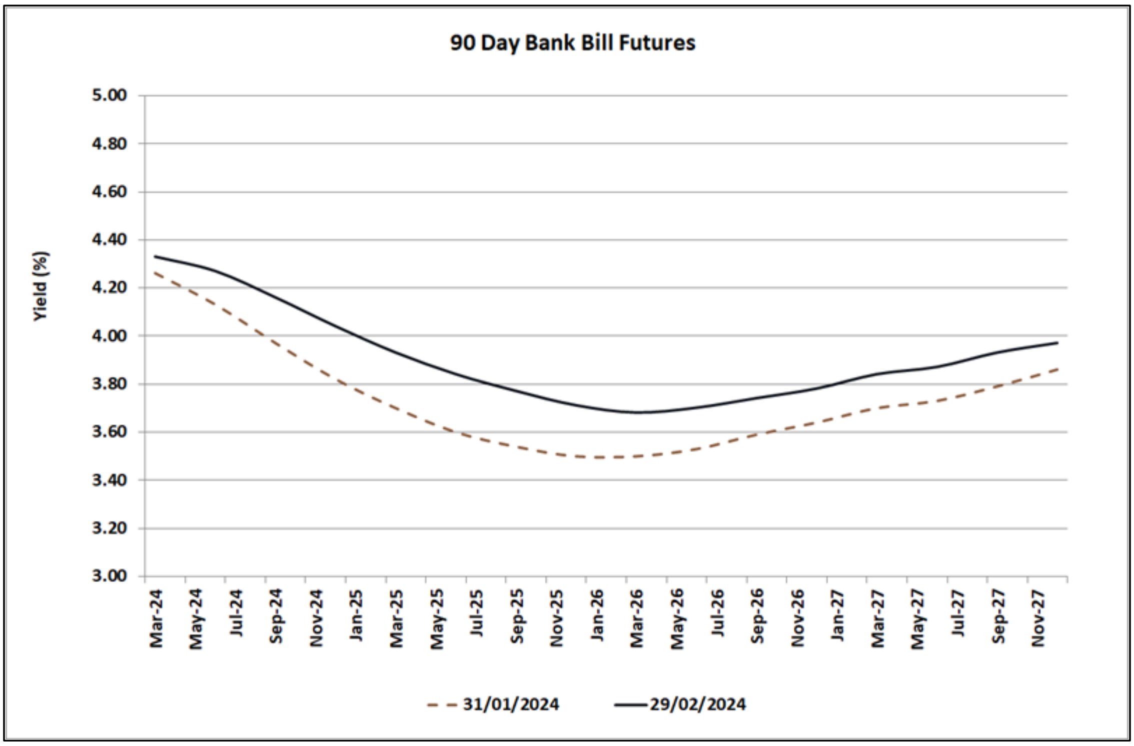
Other Key Rates

Index	February 2024	January 2024
RBA Official Cash Rate	4.35%	4.35%
90 Day (3 month) BBSW Rate	4.34%	4.35%
3yr Australian Government Bonds	3.71%	3.56%
10yr Australian Government Bonds	4.14%	4.02%
US Fed Funds Rate	5.25%-5.50%	5.25%-5.50%
2yr US Treasury Bonds	4.64%	4.27%
10yr US Treasury Bonds	4.25%	3.99%

Source: RBA, ASX, US Department of Treasury

90 Day Bill Futures

Bill futures increased across the board this month, following the movement in the global bond market. The focus from the market remains on when the first rate cut will be delivered:



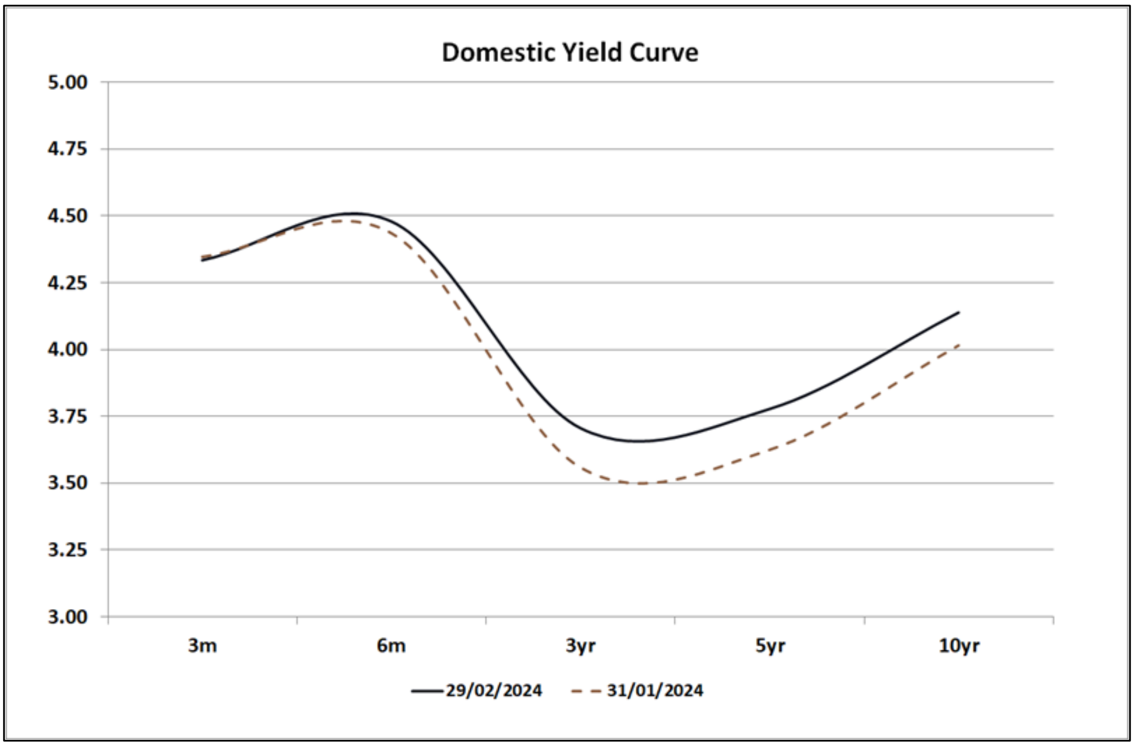
Source: ASX

Fixed Interest Outlook

There is uncertainty when central banks will start to cut official rates in 2024. The latest minutes of the US Federal Reserve's latest meeting stated significant progress has been made to date on inflation; however, policymakers noted "*restrictive*" policy has more work to do. This suggests the Fed is therefore in no rush to cut rates as it wants to see more evidence inflation is firmly on a downward path to the 2% target before lowering interest rates. Financial markets are currently pricing in around 80bp of US Fed rate cuts in 2024, with the first cut expected at the Fed's July meeting.

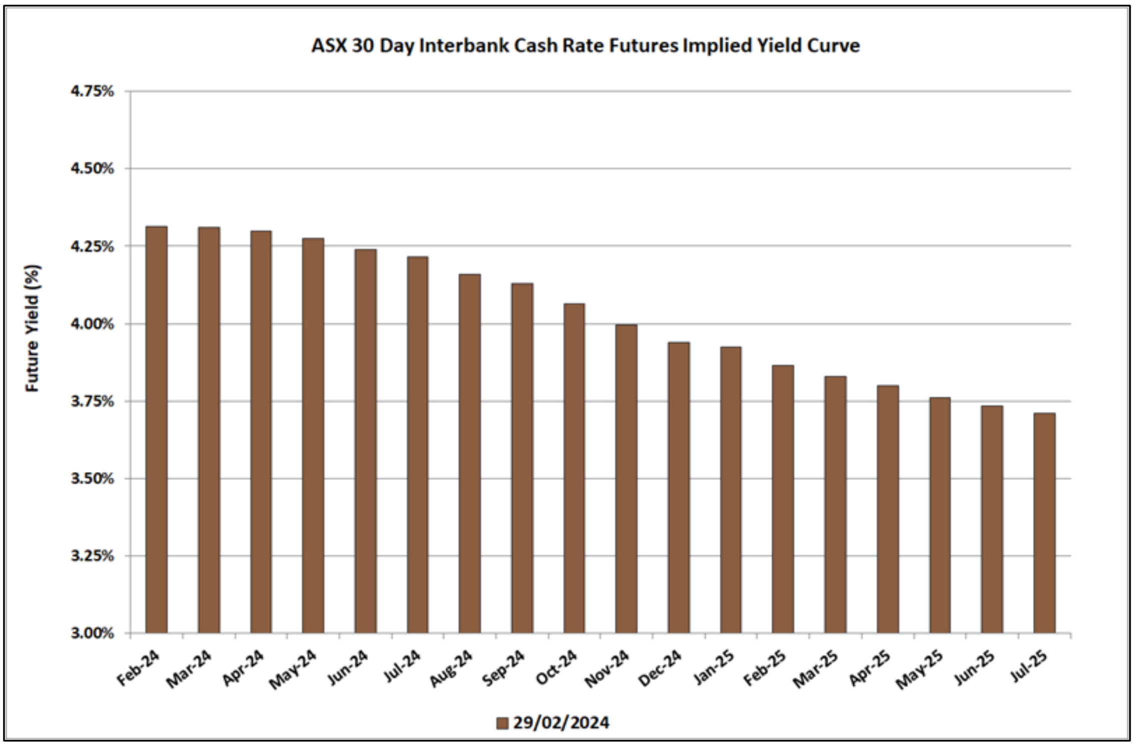
Domestically, the RBA currently remains on a mild tightening bias and appears to be comfortable with the current level of the cash rate being restrictive enough. The RBA February Board meeting minutes stated, *"it was not yet possible to rule in or out further increases in interest rates"* and it would take *"some time"* to have sufficient confidence inflation was on track. The Board therefore wants to keep the optionality in the event of future shocks. Nevertheless, financial markets anticipate the RBA to cut rates by year end.

Over the month, longer-term yields rose up to 15bp at the very 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, with financial markets pricing in the first rate cut by October 2024:



Source: ASX

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