10.5. Investment and Loan Borrowings Report as at 31 October 2024

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ATTACHMENTS	1. North Sydney Monthly Report October 2024 [**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 details of the performance of Council's investments and loans for the month ending 31 October 2024.

EXECUTIVE SUMMARY:

- All investments have been made in accordance with the Local Government Act and Regulations and Council's Financial Investments Policy.

- For the month of October, the total investment portfolio (Term Deposits, Floating Rate Notes and Bonds) provided a return of +0.33% (actual), or +3.92% p.a. (annualised), under-performing the benchmark AusBond Bank Bill Index return of +0.37% (actual), or +4.50% p.a. (annualised). This is due to Council holding term deposits made in a low inflation environment, and a higher than usual percentage held as cash to pay for expected project costs.

- Returns on investments exceed the YTD budget by $712,000.

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

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

Total Cash and Investment Balance and Reserves

The total cash and investment balance is $144,769,385. Most of this balance is held in reserves to be spent on certain activities and projects. Reserves fall into one of two categories:

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

The following table details the reserves, held as at 31 October 2024. Council holds an unrestricted cash balance of $15.5 million, indicating it has funded all its reserves. The unrestricted cash balance tends to be high in the first half of the financial year due to the timing of receipts of rates.

External Restrictions and Internal Allocations	
External restrictions	
Developer contributions – general	$44,203,811
Domestic waste management	$16,932,060
Unexpended Special Rates	$1,817,358
Unspent borrowings - North Sydney Olympic Pool redevelopment	$13,085,108
Specific purpose grants	$4,488,201
Other specific purpose contributions	$2,529,013
Total external restrictions	**$83,055,551**
Internal allocations	
Capital works	$8,918,922
Community housing - capital purchases	$960,101
Community housing - major maintenance	$490,657
Deposits, retentions, and bonds	$14,309,744
Employees leave entitlement	$7,127,000
I.T. hardware and software	$1,409,649
Income producing projects	$495,428
Olympic Pool Redevelopment	$8,918,922
Plant and vehicle replacement	$3,601,676

External Restrictions and Internal Allocations	
Total internal allocations	**$46,232,099**
Total Restrictions and Allocations	**$129,287,650**
Unrestricted Cash and Investments	$15,481,735
Total Cash and Investments	**$144,769,385**

Investment Portfolio

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

	October 2024	Annualised YTD
Actual Return	0.33%	3.92%
Benchmark	0.37%	4.50%
Variance	-0.04%	-0.58%

The portfolio underperformance, as compared to the benchmark, is due to rises in the RBA official cash rate and long-term investments that were placed when inflation expectations were low and before those increases were made and a higher than usual percentage of investments held as cash to pay for expected project costs.

Asset Type	Market Value	Portfolio Breakdown
Term Deposits	$111,500,000	77.02%
Cash	$22,868,265	15.80%
Fixed Bonds	$9,000,000	6.22%
Floating Rate Notes (FRNs)	$1,401,120	0.92%
	$144,769,385	**100.00%**

Council's average duration of term deposits, which comprise 77.02% of the investment portfolio, is approximately 176 days. The average duration continues to fall to align maturities with expected outflows on the capital works program.

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

Council continues to seek independent advice for investments and are actively managing the portfolio to ensure that returns are maximised, considering diversification and risk. A complete analysis of the performance is covered in the Monthly Investment 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 and deposits at call to fund its Capital Works budget including the North Sydney Olympic Pool project.

Summary of Returns from Investments (includes Fair Value adjustments)

The actual investment returns for the year-to-date 31 October 2024 are $282,184 more than the revised year-to-date budget.

Year	Original Annual Budget	Revised Annual Budget	YTD Budget (Oct)	YTD (Oct)	YTD Actual FV adjustments (Oct)	YTD Budget to Actual Variance (Oct)
2024/25	$2,534,059	$2,534,059	$844,352	$1,556,958	-$566	$712,040
Previous Years						
Year	**Original Annual Budget**	**Revised Annual Budget**		**Final Result Interest**	**Final Result FV adjustments**	**Final Budget to Actual Variance**
2023/24	$2,500,0I can ask him 00	$5,490,000		$5,413,310	$5,334	-$71,356
2022/23	$1,384,350	$3,340,000		$3,685,634	$4,647	$350,281
2021/22	$1,182,500	$1,362,500		$1,302,826	$64,865	$5,191

Floating Rate Notes (FRNs) are required to be revalued each month using the Fair Value (FV) method, an estimate of the market value of the investment. The YTD movement of FRN's has seen a decrease of $466.

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	$120,368,265	100.00%	83.14%
A Category	$23,000,000	60.00%	15.89%
BBB Category	$1,401,120	35.00%	0.97%
Unrated ADIs (NR)	$0	10.00%	0.00%

Loan Borrowings

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

Loan borrowings are in line with the following principles:

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

Council has three debt facilities:

Alexander Street Carpark and On-Street Carparking Management System Loan

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

Loan amount:	$ 9,500,000.00			
Loan term:	10 years			
From:	31/07/2018			
To:	31/07/2028			
Interest rate:	4.02%p.a.(fixed)			
Repayment:	Quarterly			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
1/07/2024	$4,505,143.19			
31/07/2024	$4,261,152.46	$45,648.83	$243,990.71	$ 289,639.54
31/10/2024	$4,014,689.49	$43,176.57	$246,462.97	$ 289,639.54
31/01/2025	$3,765,729.20	$40,679.25	$248,960.29	$ 289,639.54
30/04/2025	$3,513,002.06	$36,912.40	$252,727.14	$ 289,639.54

Loan Funded Capital Projects:

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

Project 2: Upgrading of On-Street Parking Management System
$4.5 million loan was sourced to fund project.
Current length of Loan as per LTFP: 10 years to 2028
Note: This On-Street Parking Management System is now redundant, having been replaced in July 2024.

Loans for North Sydney Olympic Pool Redevelopment

In February 2022, Council established a $31 million TCorp loan facility to partially fund the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 28 April 2022. The funds were restricted and released, as required, to fund project cash outflows. At 31 May 2024, these loan funds had been fully expended.

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

Loan amount:	$31,000,000.00			
Loan term:	20 years			
From:	28/04/2022			
To:	28/04/2042			
Interest rate:	4.24%p.a.(fixed)			
Repayment:	Semi-Annual			
Dates	**Principal Outstanding**	**Interest**	**Principal**	**Payment**
01/07/2024	$28,935,444.66			
30/10/2024	$28,391,663.57	$613,431.43	$543,781.09	$1,157,212.52
29/04/2025	$27,836,354.32	$601,903.27	$555,309.25	$1,157,212.52

In July 2024, Council established a $20 million TCorp loan facility to fund further budget requirements of the redevelopment of North Sydney Olympic Pool. Drawdown on the facility was processed on 27 July 2024. The funds have been invested with a maturity profile to match cash flow requirements of the project. The funds have been restricted and are being released, as required, to fund project cash outflows. As of 31 October 2024, $13.1 million is restricted.

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

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

Consultation Requirements

Community engagement is not required.

Financial/Resource Implications

Returns are higher than budgeted in the month of October due to phasing of the Capital Works program. An adjustment to income will be considered in the September Quarter Review..

Legislation

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

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

Monthly Investment Review

October 2024

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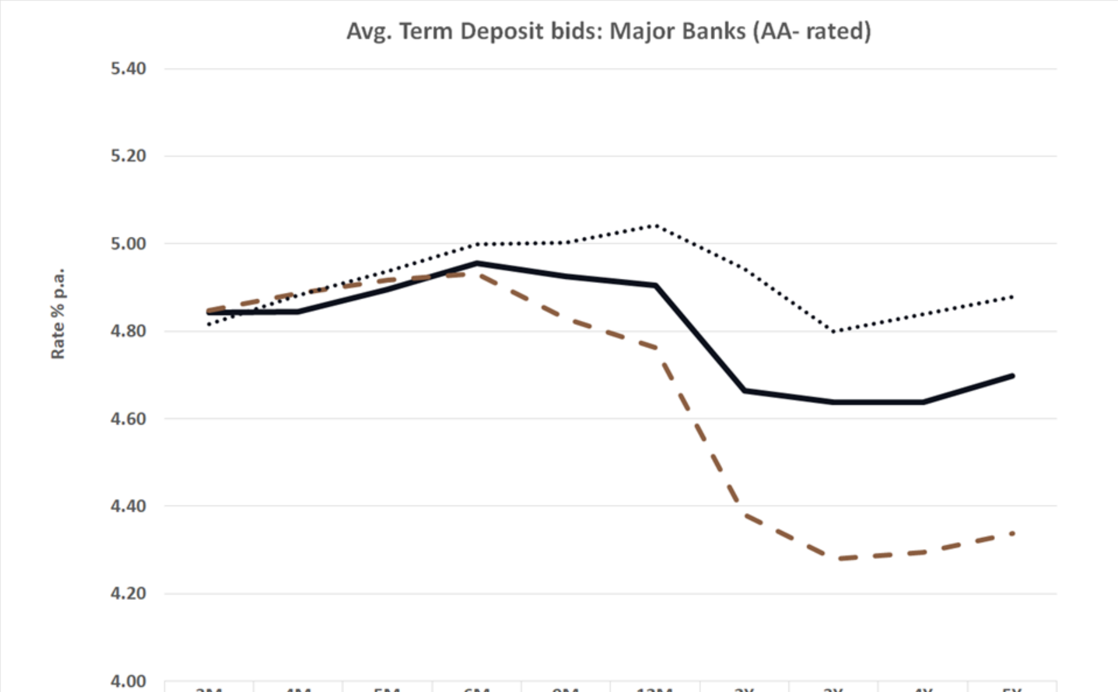
Market Update Summary

In October, financial markets experienced some risk aversion, partly due to ongoing Middle East tensions, the impending US election and China's economic woes. A combination of central bank rhetoric, a tight labour market and CPI prints have pushed out expectations of rate cuts both in the US and Australia.

In the deposit market, over October, at the very short-end of the curve, the average deposit rates offered by the major banks have remained relatively flat compared to where they were the previous month (September). The biggest moves have been seen at the long-end of the curve. The average rates offered for 9-12 month terms rose by around 10-15bp, whilst for 2-5 years, they have risen around 30-35bp to where they were in September. The market has lowered their expectations, not only with regards to the timing of the first rate cut, but also how many cuts are pencilled over 2025 (down to two).



	3M	4M	5M	6M	9M	12M	2Y	3Y	4Y	5Y
Oct-2024	4.84	4.85	4.90	4.96	4.93	4.90	4.66	4.64	4.64	4.70
Sep-2024	4.85	4.89	4.92	4.93	4.83	4.76	4.38	4.28	4.29	4.34
Apr-2024	4.82	4.88	4.94	5.00	5.00	5.04	4.94	4.80	4.84	4.88

Source: Imperium Markets

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

North Sydney Council' Portfolio & Compliance

Asset Allocation

As at the end of October 2024, the portfolio was mainly directed to fixed term deposits (77%). The remaining portfolio is directed to FRNs (1%), fixed bonds (6%) and overnight cash accounts (16%).

Senior FRNs remain relatively attractive as spreads have generally widened over the past 3 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 2025, 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 1-5 year fixed deposits, locking in and targeting yields above 4½-5% p.a. Should inflation be within the RBA's target band of 2-3% over the longer-term, returns around 4½% p.a. or higher should outperform benchmark.

However, noting the significant capital outflows expected in the near term, Council is currently largely restricted to investing into very short-term investments (under 6-12 months). This is suitable to invest in short-dated fixed term deposits or high yielding cash accounts.

Term to Maturity

Overall, the portfolio remains lightly diversified from a maturity perspective. Around 13% of assets is directed to medium-term assets (1-2 years), which has resulted in strong performance during the challenging economic environment over longer-term time periods. There is still high capacity to invest in the short-medium term horizon (1-2 years), with approximately $83m at month-end.

Where liquidity permits (once immediate capital projects are finalised), we recommend new surplus funds be directed to 1-3 year horizon given this will help optimise returns over the long-run. We suggest this be allocated to any remaining attractive fixed term deposits.

In the interim, given the large upcoming capital expenditure of $94.1 (as per the September 2023 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	$67,868,265	46.88%	10%	100%	$76,901,120
✓	91 - 365 days	$55,401,120	38.27%	20%	100%	$89,368,265
✓	1 - 2 years	$18,500,000	12.78%	0%	70%	$82,838,569
✓	2 - 5 years	$3,000,000	2.07%	0%	50%	$69,384,692
✓	5 - 10 years	$0	0.00%	0%	25%	$36,192,346
		$144,769,385	**100.00%**			

Counterparty

As at the end of October, all individual limits comply with the Policy. We remind Council exposures to individual ADIs are driven by the portfolio's movements throughout any month. Overall, the portfolio is lightly diversified across the investment grade spectrum, with no exposure to the unrated ADIs (high credit quality).

Compliant	Issuer	Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	CBA	AA-	$33,868,265	23.39%	30.00%	$9,562,551
✓	NAB	AA-	$39,000,000	26.94%	30.00%	$4,430,815
✓	NTTC Treasury	AA-	$9,000,000	6.22%	30.00%	$34,430,815
✓	Westpac	AA-	$38,500,000	26.59%	30.00%	$4,930,815
✓	ICBC Sydney	A	$17,000,000	11.74%	15.00%	$4,715,408
✓	BOQ	A-	$6,000,000	4.14%	15.00%	$15,715,408
✓	Newcastle PBS	BBB+	$1,401,120	0.97%	10.00%	$13,075,818
			$144,769,385	**100.00%**		

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

Credit Quality

The portfolio remains lightly diversified from a credit ratings perspective, with all assets classified as investment grade (rated BBB- or higher). As at the end of October 2024, all categories were within the Policy limits, with the majority rated AA or A rated:

Compliant	Credit Rating	Invested ($)	Invested (%)	Max. Limit (%)	Available ($)
✓	AA Category	$120,368,265	83.14%	100%	$24,401,120
✓	A Category	$23,000,000	15.89%	60%	$63,861,631
✓	BBB Category	$1,401,120	0.97%	35%	$49,268,165
✓	Unrated ADIs	$0	0.00%	10%	$14,476,938
		$144,769,385	**100.00%**		

Performance

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

Performance (Actual)	1 month	3 months	6 months	FYTD	1 year	2 years	3 years
Official Cash Rate	0.36%	1.08%	2.17%	1.45%	4.36%	4.01%	2.94%
AusBond Bank Bill Index	0.37%	1.12%	2.23%	1.49%	4.45%	4.05%	2.94%
Council's T/D Portfolio	0.34%	0.98%	1.88%	1.27%	3.85%	3.39%	2.76%
Council's FRN Portfolio	0.47%	1.40%	2.83%	1.88%	5.68%	5.23%	4.19%
Council's Bond Portfolio	0.10%	0.29%	0.59%	0.39%	1.17%	1.17%	1.17%
Council's Portfolio^	**0.33%**	**0.93%**	**1.79%**	**1.21%**	**3.68%**	**3.27%**	**2.67%**
Rel. Performance	**-0.05%**	**-0.19%**	**-0.44%**	**-0.28%**	**-0.77%**	**-0.79%**	**-0.27%**

^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%	4.35%	4.35%	4.36%	4.01%	2.94%
AusBond Bank Bill Index	4.50%	4.50%	4.47%	4.50%	4.45%	4.05%	2.94%
Council's T/D Portfolio	4.12%	3.93%	3.77%	3.82%	3.85%	3.39%	2.76%
Council's FRN Portfolio	5.66%	5.66%	5.69%	5.67%	5.68%	5.23%	4.19%
Council's Bond Portfolio	1.17%	1.17%	1.17%	1.17%	1.17%	1.17%	1.17%
Council's Portfolio^	**3.92%**	**3.74%**	**3.59%**	**3.63%**	**3.68%**	**3.27%**	**2.67%**
Rel. Performance	**-0.58%**	**-0.76%**	**-0.88%**	**-0.87%**	**-0.77%**	**-0.79%**	**-0.27%**

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

For the month of October, the total investment portfolio (excluding cash) provided a solid return of +0.33% (actual) or +3.92% p.a. (annualised), underperforming the benchmark AusBond Bank Bill Index return of +0.37% (actual) or +4.50% p.a. (annualised). This relative 'underperformance' has been due to the unexpected aggressive rate hikes undertaken by the RBA since May 2022. Whilst this 'underperformance' may continue in the short-term, we do anticipate this to be fairly temporary, especially if the RBA is approaching the end of its rate hike cycle.

Note this ongoing period of underperformance is also highly dependent on reinvesting maturing funds at prevailing market rates *beyond 6 month tenors*. With large capital outflows, maturing funds are largely being spent or kept in low yielding short-dated assets. Council should also remind itself it has consistently 'outperformed' over longer-term time periods (last +10yrs).

We are pleased that North Sydney Council remains amongst the best performing Councils in the state of NSW where deposits are concerned. We have been pro-active in our advice about protecting interest income for many years and encouraged to maintain a slightly long duration position as this optimises the overall returns of the portfolio in the long-run.

Recommendations for Council

Term Deposits

As at the end of October 2024, Council's deposit portfolio was yielding **4.08% p.a.** (up 8bp from the previous month), with a weighted average duration of around 176 days (~6 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 close to 5½% p.a.). We will inform Council if there is an opportunity to sell this FRN to boost the overall returns of the investment portfolio, although this is now likely to be held to maturity (4th Feb 2025) with no rate cuts imminent in the immediate future.

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 (sister company of Arlo Advisory). We believe these investments were prudent at the time of investment especially after the rate cut delivered in early November 2020 to 0.10% and the RBA's forward guidance on official interest rates (no rate rises "until at least 2024"). The NTTC bonds are a 'retail' offering and not 'wholesale' issuances. Given the lack of liquidity and high penalty costs if they were to be sold/redeemed prior to the maturity date, they are considered to be a hold-to-maturity investment and will be marked at par value ($100.00) throughout the term of investment.

Term Deposit Market Review

Current Term Deposits Rates

As at the end of October, we see value in the following:

ADI	LT Credit Rating	Term	Rate % p.a.
ING Bank	A	5 years	5.15%
Westpac	AA-	5 years	4.95%
BoQ	A-	5 years	4.80%
ING Bank	A	4 years	5.04%
Westpac	AA-	4 years	4.90%
BoQ	A-	4 years	4.75%
ING Bank	A	3 years	4.95%
Westpac	AA-	3 years	4.85%
Suncorp	AA-	3 years	4.80%
NAB	A	3 years	4.70%
ING Bank	A	2 years	4.94%
Westpac	AA-	2 years	4.87%
Suncorp	AA-	2 years	4.85%
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*):

ADI	LT Credit Rating	Term	Rate % p.a.
ICBC	A	12 months	5.17%
Westpac	AA-	12 months	5.12%
ING Bank	A	12 months	5.10%
Suncorp	AA-	12 months	5.08%
NAB	AA-	12 months	5.05%
Suncorp	AA-	9 months	5.09%
ICBC	A	9 months	5.12%
ING Bank	A	9 months	5.02%
NAB	AA-	9 months	5.00%
Suncorp	AA-	6 months	5.08%
Bank of Sydney	Unrated	6 months	5.08%
ICBC	A	6 months	5.06%
NAB	AA-	6 months	5.00%
Bank of Sydney	Unrated	3 months	4.98%
NAB	AA-	3 months	4.95%
Westpac	AA-	3 months	4.92%

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 can likely yield up to, on average, an extra ¼-½% p.a. higher compared to those investors that entirely invest in short-dated deposits (under 6-9 months).

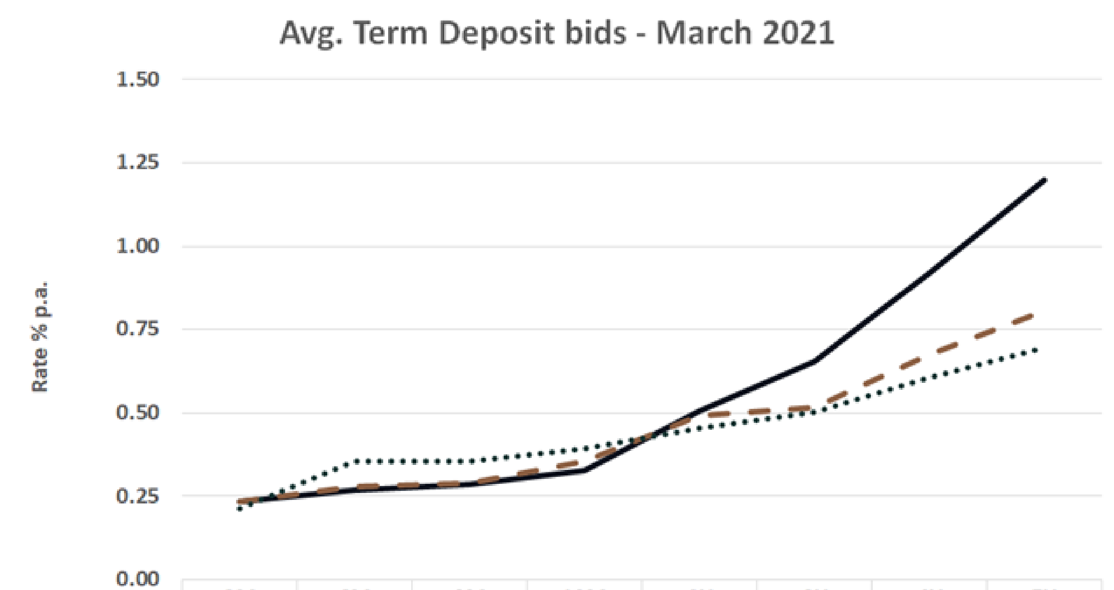
With a global economic slowdown and multiple interest rate cuts being priced over 2025, investors should strongly consider diversifying by allocating some longer term surplus funds and undertake an insurance policy by investing across 1-5 year fixed deposits and locking in rates above 4½-5% p.a. This will provide some income protection with the RBA now potentially looking to cut rates by mid-2025.

Arlo Advisory

Term Deposits Analysis

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

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



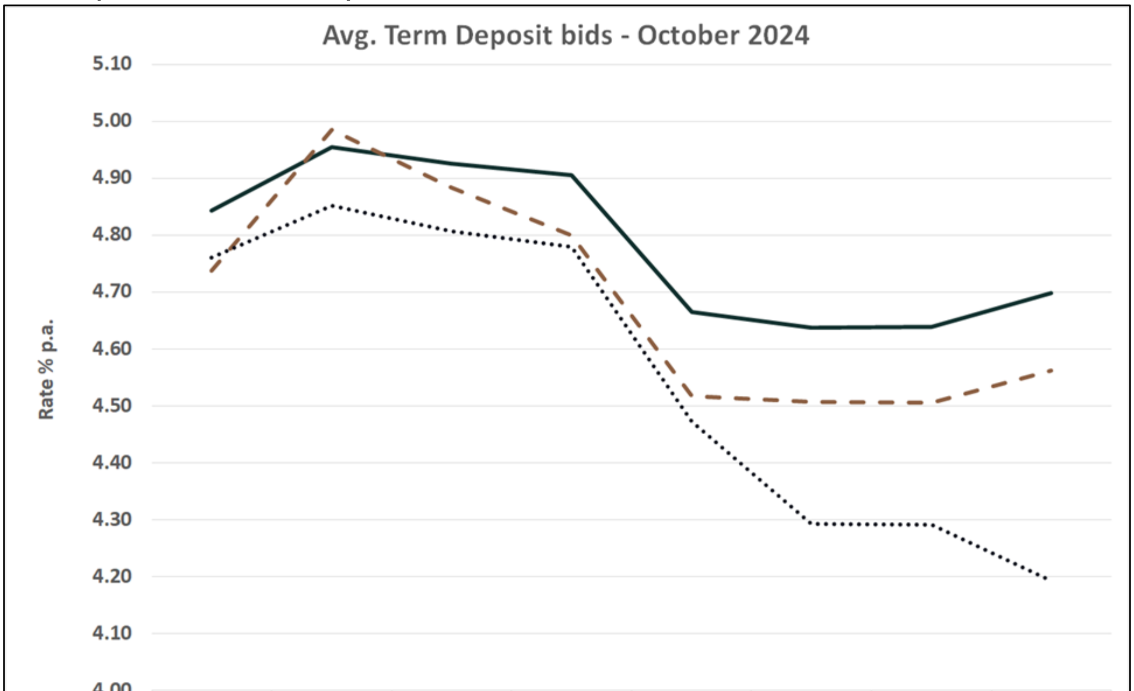
	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	0.23	0.27	0.29	0.33	0.51	0.65	0.92	1.20
A Rated	0.23	0.28	0.29	0.35	0.49	0.52	0.68	0.81
BBB Rated	0.21	0.36	0.35	0.39	0.45	0.50	0.61	0.70

Source: Imperium Markets

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

Going forward, 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 or considered 'ethical'. We are slowly seeing this trend emerge, although the major banks always seem to react more quickly than the rest of the market during periods of volatility:

Term Deposit Rates – Currently (October 2024)



	3M	6M	9M	12M	2Y	3Y	4Y	5Y
Majors	4.84	4.96	4.93	4.90	4.66	4.64	4.64	4.70
A Rated	4.74	4.99	4.88	4.80	4.52	4.51	4.51	4.56
BBB Rated	4.76	4.85	4.81	4.78	4.47	4.29	4.29	4.19

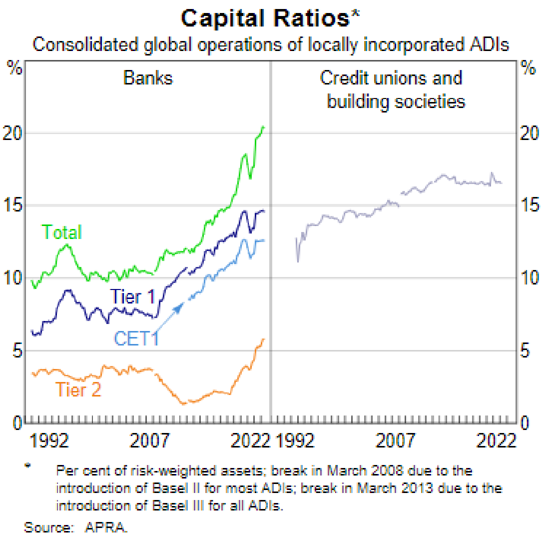
Source: Imperium Markets

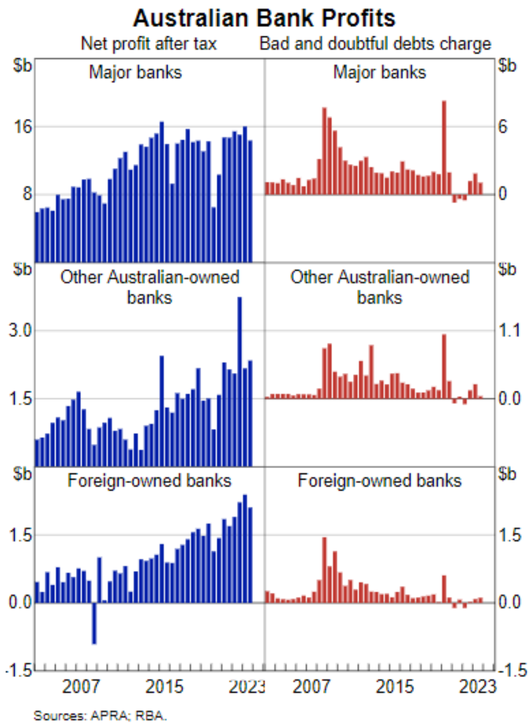
Financial Stability of the Banking (ADI) Sector

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

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

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

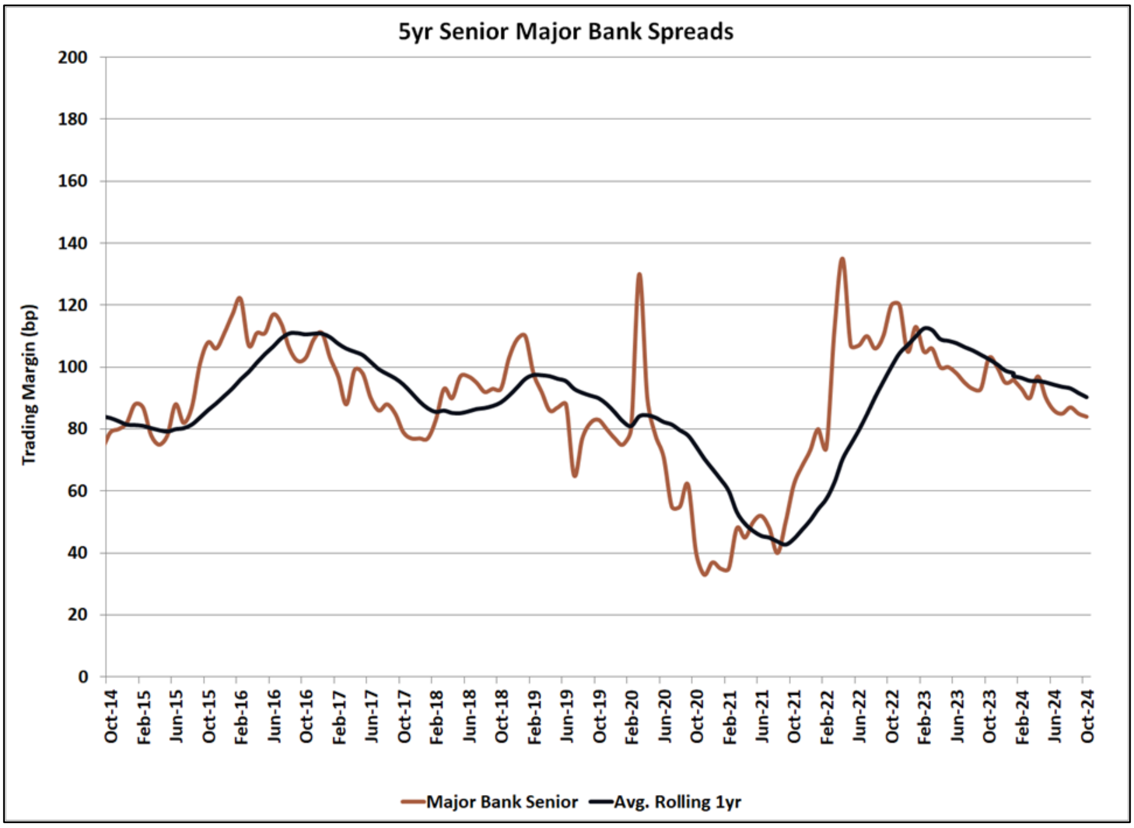




Arlo Advisory

Senior FRNs Market Review

Over October, amongst the senior major bank FRNs, physical credit securities marginally tightened at the long-end of the curve. During the month, NAB (AA-) issued a 3 year senior deal at +70b. Major bank senior securities remain at fair value on a historical basis although looking fairly expensive if the 5yr margin tightens to +80bp in the near future.



Source: IBS Capital

There was minimal issuance again during the month apart from:

- Bendigo-Adelaide (A-) 3 year senior FRN at +96bp
- Great Southern Bank (BBB+) 3 year senior FRN at +103bp

Amongst the "A" rated sector, the securities marginally tightened by around 2bp at the longer-end of the curve. The "BBB" rated sector tightened significantly, largely as a result of Great Southern Bank's new 3 year deal. Overall, credit securities are looking more attractive given the widening of spreads over the past 3 years. 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), whilst also providing some diversification to those investors skewed towards fixed assets.

Senior FRNs (ADIs)	31/10/2024	30/09/2024
“AA” rated – 5yrs	+84bp	+85bp
“AA” rated – 3yrs	+65bp	+66bp
“A” rated – 5yrs	+100bp	+102bp
“A” rated – 3yrs	+80bp	+82bp
“BBB” rated – 3yrs	+110bp	+127bp

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 2026 for the “AA” rated ADIs (domestic major banks);
- On or before 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 3 years (valuations have fallen) as markets have reacted sharply.

This has resulted in some opportunities in the secondary market. We currently see value in the following fixed bond lines, with the 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	1.33	1.1000%	4.73%
AU3CB0280030	BoQ	A-	Senior	06/05/2026	1.52	1.4000%	4.93%
AU3CB0299337	Bendigo	A-	Senior	15/05/2026	1.54	4.7000%	4.79%
AU3CB0296168	BoQ	A-	Senior	27/01/2027	2.25	4.7000%	4.92%
AU3CB0308955	BoQ	A-	Senior	30/04/2029	4.51	5.3580%	5.05%

Economic Commentary

International Market

In October, financial markets experienced some risk aversion, partly due to ongoing Middle East tensions, the impending US election and China's economic woes. A combination of central bank rhetoric, a tight labour market and CPI prints have pushed out expectations of rate cuts both in the US and Australia.

Across equity markets, the S&P 500 Index fell -0.99%, whilst the NASDAQ lost -0.52%. Europe's main indices also fell, led by France's CAC (-3.74%), UK's FTSE (-1.54%) and Germany's DAX (-1.28%).

US core CPI was +0.3% m/m vs. +0.2% expected. Headline was +0.2% m/m vs. +0.1% expected. The CPI data overall should reinforce getting back to 2% inflation may not be smooth path, and that it is dangerous to extrapolate trends in certain CPI components such as goods.

US Fed Chair Powell noted that the Fed will move back to neutral "*over time*". He commented "*looking forward, if the economy evolves broadly as expected, policy will move over time toward a more neutral stance. But we are not on any preset course. The risks are two-sided, and we will continue to make our decisions meeting by meeting*".

The Bank of Canada's cut rates by 50bp, meeting market expectations and brings their total easing for the cycle to 125bp.

The Eurozone headline and core CPI came in at +1.8% y/y and 2.7% y/y respectively, largely in line with expectations. The European Central Bank (ECB) cut its policy rate for the third time, bringing it to 3.25%, reaffirming that "*disinflationary process is well on track*", while financial conditions remain restrictive.

The RBNZ cut their official cash rate by 50bp to 4.75% but was largely discounted by market pricing.

Japan's CPI inflation fell to +2.5% y/y in September (from +3.0%), with the figure weighed down by the impact of government subsidies for utilities.

China's Q3 GDP printed at +4.6% y/y, decelerating from +4.7% in Q2 and below the +5.0% 2024 growth target (these were the weakest two quarter growth rate in modern times outside of phases of Covid-19 shutdowns).

The MSCI World ex-Aus Index fell -1.94% for the month of October:

Index	1m	3m	1yr	3yr	5yr	10yr
S&P 500 Index	-0.99%	+3.32%	+36.04%	+7.40%	+13.44%	+10.95%
MSCI World ex-AUS	-1.94%	+2.14%	+31.88%	+4.83%	+10.46%	+8.06%
S&P ASX 200 Accum. Index	-1.31%	+2.10%	+24.89%	+8.01%	+8.17%	+8.32%

Source: S&P, MSCI

Domestic Market

The RBA Minutes contained little new information on top of the Governor's press conference. The already flagged discussion of scenarios around "*what would we need to see to go either a raise in interest rates or a lowering in interest rates*" was detailed. Importantly, "*each of these outcomes was conceivable given the considerable uncertainty about the economic outlook*".

Governor Bullock commented in her post-Meeting press conference saying "*the message clearly from the Board is that in the near term it does not see interest rate cuts*", but it seems the Board is broadly ok with markets pricing in cuts by early-mid 2025.

Q3 inflation trimmed mean came in at +0.8% q/q and +3.5% y/y, in line with consensus and the RBA's forecasts. Headline inflation came in at +0.2% q/q and +2.8% y/y. The drop in the headline inflation (which the RBA will look through) was mainly due to a -17.3% q/q fall in measured electricity prices due to the introduction of large rebates for households, and a -6.7% fall in fuel prices. Electricity rebates and higher rent assistance will also weigh on Q4 CPI. Overall services inflation was broadly stable at +4.6% from +4.5% y/y.

Australian employment growth was 64.1k in September versus 25.0k forecast and 42.6k prior. This marks the sixth consecutive month that jobs growth exceeded expectations. The unemployment rate slightly decreased to 4.067% (versus 4.2% consensus), which is also now well below the RBA's August SoMP forecast of 4.3% for Q4 2024.

Household deposits lifted by $30.8bn for the month of August (non-seasonally adjusted), its largest increase ever (though data only goes back to 2019), and well in excess of the $18.7bn seen in July 2023.

Retail sales jumped +0.7% for the month of August and +3.1% higher over the year. This is above its 2019 pace of +2.75%, and on a trend basis retail sales growth is annualising above +4%.

The Australian dollar fell -5.24%, finishing the month at US65.69 cents (from US69.32 cents the previous month).

Credit Market

The global credit indices remained relatively flat in October. They remain at their levels in early 2022 (prior to the rate hike cycle from most central banks):

Index	October 2024	September 2024
CDX North American 5yr CDS	54bp	53bp
iTraxx Europe 5yr CDS	59bp	59bp
iTraxx Australia 5yr CDS	66bp	63bp

Source: Markit

Fixed Interest Review

Benchmark Index Returns

Index	October 2024	September 2024
Bloomberg AusBond Bank Bill Index (0+YR)	+0.37%	+0.36%
Bloomberg AusBond Composite Bond Index (0+YR)	-1.88%	+0.31%
Bloomberg AusBond Credit FRN Index (0+YR)	+0.50%	+0.43%
Bloomberg AusBond Credit Index (0+YR)	-0.88%	+0.54%
Bloomberg AusBond Treasury Index (0+YR)	-2.06%	+0.24%
Bloomberg AusBond Inflation Gov't Index (0+YR)	-2.57%	+0.63%

Source: Bloomberg

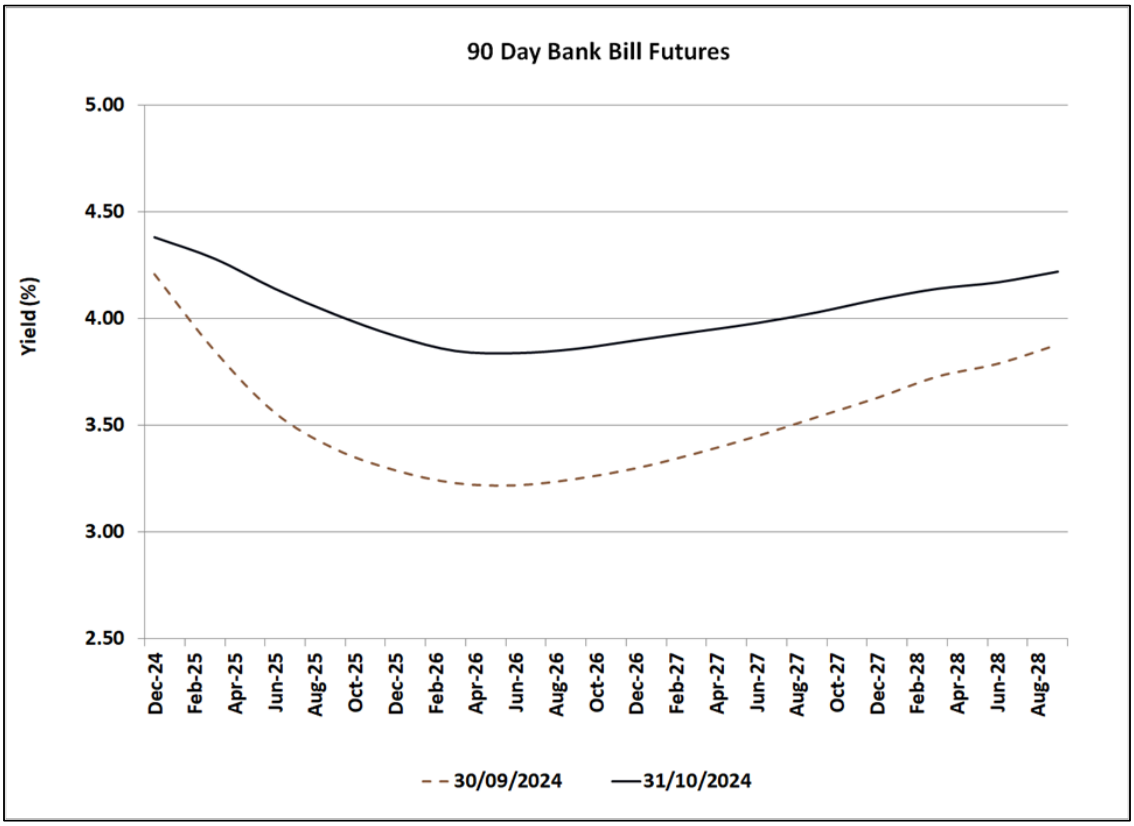
Other Key Rates

Index	October 2024	September 2024
RBA Official Cash Rate	4.35%	4.35%
90 Day (3 month) BBSW Rate	4.42%	4.43%
3yr Australian Government Bonds	4.02%	3.53%
10yr Australian Government Bonds	4.50%	3.99%
US Fed Funds Rate	4.75%-5.00%	4.75%-5.00%
2yr US Treasury Bonds	4.16%	3.66%
10yr US Treasury Bonds	4.28%	3.81%

Source: RBA, ASX, US Department of Treasury

90 Day Bill Futures

Bill futures rose across the board this month in response to expectations that rate cuts will not be as fast or as large as previously anticipated.



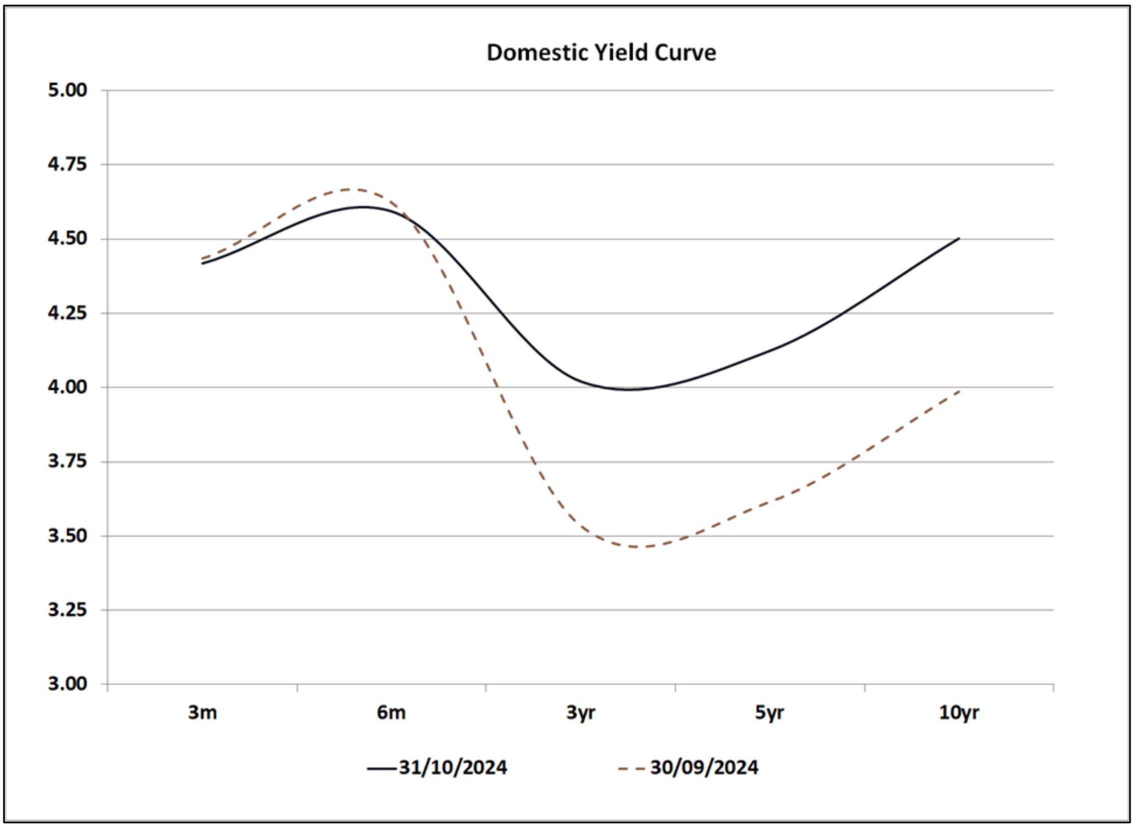
Source: ASX

Fixed Interest Outlook

The latest US Fed dot plot shows a median rate of 4.375% by the end of 2024, implying a further 50bp of cuts out of the remaining two meetings of the year. For 2025, the median is for a further 100bp of cuts (to 3.375%), then a further 50bp in 2026 (to 2.875%) in 2026. This 2.875% level is also now the new Fed estimate of the 'long run' or neutral rate. However, with the latest strong US retail sales data, market pricing for Fed cuts by year-end is now down to around 40bp (previously 50bp almost a certainty), and the terminal rate pricing for the market is now at 3.35% in early 2026.

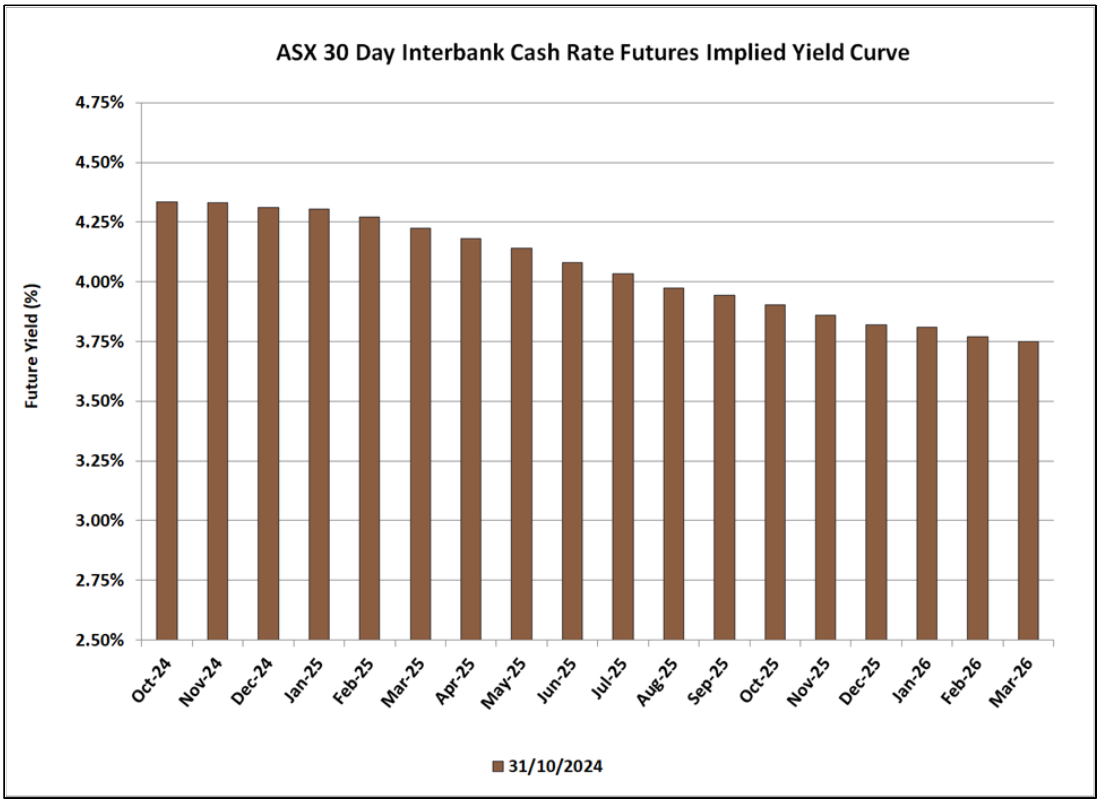
The RBA continues to push back on any immediate talks of rate cuts. The latest (strong) labour market figures for September confirms the view that a rate cut is unlikely anytime soon. RBA Deputy Governor Hauser reaffirmed that inflation remains too high and that official rates would not fall as much or as early as other central banks. The RBA remains alert and ready to respond on rates in either direction. On neutral rates, Hauser said the RBA models show this to be between 3% and 4%.

Over the month, longer-term yields rose up to 51bp at the very long end of the curve (but remains an inverse yield curve):



Source: ASX, RBA

Financial markets have pushed back their expectations of rate cuts, with the first cut pencilled in by Q2 2025, and now only 50bp of cuts priced by the end of 2025.



Source: ASX