



Report to General Manager

Attachments:

1. Investment Portfolio as at 31 August 2016
 2. Monthly Investment Report – August 2016
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SUBJECT: Investments and Loan Borrowings Held as at 31 August 2016

AUTHOR: Garry Ross, Manager Financial Services (Responsible Accounting Officer)

ENDORSED BY: Sandra Moore, Acting Director Corporate Services

EXECUTIVE SUMMARY:

This report provides details of the performance of Council's investment portfolio for the August 2016.

The portfolio provided an annualised return of 3.63% for the year to date as at 31 August 2016, 1.62% above the reportable benchmark (BBSW Bank Bill Index)

Council has commenced a \$30 million debt facility and as at the 31 August 2016, has drawn down \$9.5 million for capital works projects.

FINANCIAL IMPLICATIONS:

Interest returns for the month ended 31 August 2016 remain consistently above the benchmark. This was attributed to additional funds being made available for investment and prudent selection and allocation of these funds to the financial institutions which make up the investment portfolio.

Interest returns for this financial year reflect estimated available funds and predicted expenditure of Council's reserves.

Council continues to monitor interest rate risk whenever it borrows, regardless of whether the interest rates are fixed or variable.

Comment by Responsible Accounting Officer:

The returns performance from investments for the financial year exceeded adopted estimates.

Loan borrowing fundings for project identified in the LTFP is appropriate. All borrowings need to comply with the identified principles of Council's Financial Management Policy.

RECOMMENDATION:

1. **THAT** the report be received.
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LINK TO DELIVERY PROGRAM

The relationship with the Delivery Program is as follows:

Direction: 5. Our Civic Leadership

Outcome: 5.2 Council is financially sustainable

BACKGROUND

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, the revised Investment Order issued by the Minister for Local Government and Council's Financial Investment Policy. The Financial Investment Policy is independently reviewed annually to ensure accountability and to reduce exposure to market risks.

CONSULTATION REQUIREMENTS

Community engagement is not required.

SUSTAINABILITY STATEMENT

The following table provides a summary of the key sustainability implications:

QBL Pillar	Implications
Environment	• There are no perceived short or long-term environmental implications.
Social	• There are no perceived short or long-term social implications.
Economic	• Provides Council with a significant source of income.
Governance	• Compliance with all legislative requirements and statutory obligations.

DETAIL

The following table provides details of the performance of Council's investment portfolio against the benchmark for the month of August 2016.

	August 2016	YTD as at 31 August 2016
Actual Return	3.63%	3.65%
Benchmark	2.01%	2.04%
Variance	1.62%	1.61%

The following table shows the actual cash inflows received from the portfolio for the month of August 2016 and for the year to date as at 31 August 2016.

	August 2016	YTD as at 31 August 2016
Capital Guaranteed	\$0.00	\$0.00
Cash Enhanced Funds	\$0.00	\$0.00
Fixed Cash Fund	\$0.00	\$0.00
Senior Bonds	\$71,196.59	\$189,037.62
Term Deposits	\$712,513.71	\$712,513.71
Trading Accounts	\$8,400.65	\$24,035.48
	\$792,110.95	\$925,586.81

Investment Performance

Investment returns continue to exceed the indicative benchmark (BBSW Bank Bill Index). All funds invested have been done so in accordance with the Act and the Regulations made thereunder and with Council's Financial Investment Policy. Further, Council's investment portfolio complies with the revised Investment Order issued by the Minister for Local Government, which places restrictions on the type of investments permitted. These restrictions have placed greater emphasis on obtaining competitive investment options and the need for sound investment advice from Council's independent advisor.

Council continues to seek independent advice for all investments and is actively managing the portfolio to ensure that returns are maximised, taking into account diversification and risk.

Summary of Returns from Investments:

Year	Original Budget	Revised Budget	YTD/Annual Actual (August)	YTD Budget Variance (August)
2016/17	\$2,000,000	\$2,000,000	\$579,338	\$246,005
2015/16	\$2,320,000	\$3,640,000	\$4,105,146	\$465,146
2014/15	\$3,400,000	\$4,150,000	\$4,414,692	\$264,692
2013/14	\$2,700,000	\$3,400,000	\$3,983,515	\$583,515
2012/13	\$2,000,000	\$2,887,751	\$4,238,785	\$1,353,069
2011/12	\$2,000,000	\$3,400,000	\$3,728,080	\$328,080

Investments held for August (Annualised):

Investment Type	%Portfolio	August 2016 (Purchase Value)	August 2016 (Market)	August % Return	August YTD% Return
Fixed Cash	0.0%	\$0.00	\$0.00	0.00%	0.00%
Senior Bonds	34.0%	\$36,000,000.00	\$36,154,040.00	3.08%	3.11%
Term Deposits	51.0%	\$54,500,000.00	\$54,500,000.00	3.98%	3.98%
Trading	15.0%	\$16,615,067.15	\$16,615,067.15	1.22%	1.24%

S & P	Investments Market Value	% of Portfolio (August)
AAA	\$0.00	0.00%
AA	\$0.00	0.00%
AA-	\$27,623,170.13	26.00%
	\$27,623,170.13	26.00%
A+	\$18,044,007.02	17.00%
A	\$2,001,020.00	2.00%
A-	\$27,514,340.00	26.00%
	\$47,559,367.02	45.00%
BBB+	\$22,086,570.00	20.00%
BBB	\$6,000,000.00	6.00%
BBB-	\$0.00	0.00%
	\$28,086,570.00	26.00%
NR	\$4,000,000.00	3.00%
	\$107,269,107.15	100.00%

Financial Investment Policy

The maximum holding limit in each rating category and the target credit quality weighting for Council's portfolio shall be:

Long Term Rating Range	Maximum Holding
AAA Category	100.00%
AA Category	100.00%
A Category	60.00%
BBB Category	35.00%
Unrated ADIs	10.00%

The policy has been independently reviewed by Council's investment advisors. Risk management guidelines and investment decision criteria have been amended. The main changes are:

- Compliance with other Council policies, those being Fraud Corruption and prevention Policy, Code of Conduct Policy and Financial Management Policy; and
- Investment decision criteria, in particular, the review mechanism associated with a rating down grade.

Loan Borrowings

BACKGROUND

Council has implemented an expanded capital works program which requires alternate sources of funding, both internal and from financial institutions. Council has been debt free for a considerable period, which has prompted the need for a loan borrowing program to ensure that there is intergenerational equity in the provision of essential infrastructure and other major capital projects.

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

The Policy's objective is to control Council's exposure to movements in interest rates through the application of fixed, floating or a combination of both in order to maintain its risk averse strategy.

Loan borrowing will be undertaken in line with the following principles:

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

The current Debt Facility is as follows:

Bank loan via the NAB Corporate Market loan (Variable Rate Option)

Facility Limit: \$30 million (Initial offer)

Capital projects purposes only (refer to loan funded projects list)

3 year tenor with facility to be reviewed annually

Interest rate linked to 90 day BBSY index + drawn margin%

Drawn margin: 0.57%

Facility Fee: 0.24%

Facility expiry date: 31 August 2018

Facility Utilisation: 31.7% (\$9.5m of \$30m)

The estimated Debt Service Cover Ratio this financial year is approximately 24% compared to the Local Government industry benchmark of greater than or equal to 2%

This ratio measures Council's availability of operating cash to service debt liabilities.

Council has no fixed interest rate loans. This situation will be reviewed when additional borrowings are required or when interest rates move from their current low level.

Loan Funded Capital Projects as at 31 August 2016

Project 1: Upgrading the car park in Alexander Street, Crows Nest

A **\$5 million** loan has been sourced to fund this project.

Current length of Loan as per LTFP: 20 years to 2035/36

Project 2: Upgrading of On-Street Parking Management System

A **\$4.5 million** loan has been sourced to fund this project.

Current length of Loan as per LTFP: 20 years to 2035/36

Loan Borrowings Summary 2016/17

No loan repayments made in August. Next payment due 14 September 2016.

North Sydney Council Investment Portfolio as at 31 August 2016

	Investment Face Value	Investment Market Value	%	S&P Rating #	Net Returns - 1 Month		Net Returns - FYTD		Maturity
Trading Account:					Return*	Income^	Return	Income^	
CBA Trading Account - General Fund	2,585,171.40	2,585,171.40	2%	AA-	1.60	1,964.10	1.60	2,858.40	At Call
CBA Business On-Line Saver	13,000,000.00	13,000,000.00	12%	AA-	1.05	4,087.83	1.05	8,211.80	At Call
AMP 31-day Notice Account	1,025,307.02	1,025,307.02	1%	A+	2.37	2,345.80	2.71	4,469.98	1-Oct-16
CBA Cash Management Account	4,588.73	4,588.73	0%	AA-	1.65	2.92	1.82	2.29	At Call
	16,615,067.15	16,615,067.15	15%		1.22	8,400.65	1.24	15,542.47	
Term Deposits:									
Auswide Bank @ 3.75%	2,000,000.00	2,000,000.00	2%	BBB	3.75	6,369.86	3.75	12,739.72	12-Sep-16
Auswide Bank @ 3.75%	3,000,000.00	3,000,000.00	3%	BBB	3.75	9,554.79	3.75	19,109.58	3-Oct-16
BoQ @ 4.50%	2,000,000.00	2,000,000.00	2%	A-	4.50	7,643.84	4.50	15,287.68	28-Nov-16
Auswide Bank @ 3.70%	1,000,000.00	1,000,000.00	1%	BBB	3.70	3,142.47	3.70	6,284.94	12-Dec-16
CUA @ 3.05%	2,000,000.00	2,000,000.00	2%	BBB+	3.05	5,180.82	3.05	10,361.64	23-Mar-17
Rabobank @ 5.70%	2,000,000.00	2,000,000.00	2%	A+	5.70	9,682.19	5.70	19,364.38	6-Jun-17
AMP @ 2.90%~	1,000,000.00	1,000,000.00	1%	A+	2.90	2,463.01	2.90	4,926.02	28-Aug-17
BoQ @ 4.90%	3,000,000.00	3,000,000.00	3%	A-	4.90	12,484.93	4.90	24,969.86	28-Aug-17
BCU @ 4.00%	2,000,000.00	2,000,000.00	2%	NR	4.00	6,794.52	4.00	13,589.04	28-Aug-17
Bendigo TD @ 2.90%	3,000,000.00	3,000,000.00	3%	A-	2.90	7,389.04	2.90	14,778.08	30-Aug-17
Bendigo TD @ 2.90%	3,000,000.00	3,000,000.00	3%	A-	2.90	7,389.04	2.90	14,778.08	4-Sep-17
CUA @ 3.75%	3,000,000.00	3,000,000.00	3%	BBB+	3.75	9,554.79	3.75	19,109.58	11-Sep-17
Bendigo TD @ 2.92%	2,000,000.00	2,000,000.00	2%	A-	2.92	4,960.00	2.92	9,920.00	15-Sep-17
BoQ @ 4.70%	1,000,000.00	1,000,000.00	1%	A-	4.70	3,991.78	4.70	7,983.56	27-Sep-17
BoQ Specialist @ 5.60%	500,000.00	500,000.00	0%	A-	5.60	2,378.08	5.60	4,756.16	2-Nov-17
AMP @ 3.20%~	4,000,000.00	4,000,000.00	4%	A+	3.20	10,871.23	3.20	21,742.46	5-Mar-18
Rabodirect @ 4.25%	2,000,000.00	2,000,000.00	2%	A+	4.25	7,219.18	4.25	14,438.36	20-Aug-18
Rabobank @ 4.05%	6,000,000.00	6,000,000.00	6%	A+	4.05	20,638.36	4.05	41,276.72	28-Aug-18
BCU @ 3.00%	1,000,000.00	1,000,000.00	1%	NR	3.00	246.58	3.00	246.58	29-Aug-18
Police CU @ 3.05%	1,000,000.00	1,000,000.00	1%	NR	3.05	2,590.41	3.05	5,180.82	10-Sep-18
BoQ @ 5.00%	3,000,000.00	3,000,000.00	3%	A-	5.00	12,739.73	5.00	25,479.46	29-Oct-18
ME Bank @ 5.10%	3,000,000.00	3,000,000.00	3%	BBB+	5.10	12,994.52	5.10	25,989.04	14-Feb-19
ING @ 4.95%	3,000,000.00	3,000,000.00	3%	A-	4.95	12,612.33	4.95	25,224.66	18-Feb-19
NAB Flexi Deposit	1,000,000.00	1,000,000.00	1%	AA-	3.61	3,066.03	3.61	6,132.06	12-Dec-19
Expired Deposits - Financial Year	-	-	-	-	-	2,953.42	-	6,223.36	Expired
	54,500,000.00	54,500,000.00	51%		3.98	184,910.95	3.98	369,891.84	
Senior Bonds:									
CUA FRN @ 3m BBSW + 1.20%	2,000,000.00	2,008,860.00	2%	BBB+	3.20	5,435.62	3.20	10,871.24	22-Dec-17
TMB FRN @ 3m BBSW + 1.05%	2,000,000.00	2,005,740.00	2%	BBB+	3.03	5,155.34	2.99	10,310.68	4-Dec-17
Credit Suisse FRN @ 3m BBSW + 1.05%	2,000,000.00	2,001,020.00	2%	A	2.78	5,056.16	2.91	10,228.49	24-Aug-18
Newcastle PBS FRN @ 3m BBSW + 1.60%	5,000,000.00	5,048,350.00	5%	BBB+	3.60	15,287.67	3.60	30,575.34	22-Mar-19
CUA FRN @ 3m BBSW + 1.60%	3,000,000.00	3,027,600.00	3%	BBB+	3.56	9,057.95	3.56	17,823.70	1-Apr-19
Westpac FRN @ 3m BBSW + 1.00%	0.00	0.00	0%	AA-	-	0.00	-	1,665.75	10-May-19
CBA FRN @ 3m BBSW + 0.98%	4,000,000.00	4,039,440.00	4%	AA-	2.93	9,953.97	2.93	20,541.37	18-Jul-19
Bendigo FRN @ 3m BBSW + 0.93%	2,000,000.00	2,004,540.00	2%	A-	2.92	4,968.49	2.92	9,936.98	17-Sep-19
Newcastle PBS FRN @ 3m BBSW + 1.35%	2,000,000.00	1,996,020.00	2%	BBB+	3.31	5,630.96	3.31	11,360.55	7-Apr-20
NAB FRN @ 3m BBSW + 0.80%	5,000,000.00	4,986,550.00	5%	AA-	2.79	11,869.18	2.79	23,738.36	3-Jun-20
Westpac FRN @ 3m BBSW + 0.90%	2,000,000.00	2,007,420.00	2%	AA-	2.76	4,696.71	2.76	9,807.67	28-Jul-20
Bendigo FRN @ 3m BBSW + 1.10%	5,000,000.00	5,009,800.00	5%	A-	2.84	12,659.74	2.97	25,795.67	18-Aug-20
AMP FRN @ 3m BBSW + 1.35%	2,000,000.00	2,018,700.00	2%	A+	3.08	5,565.75	3.21	11,247.67	24-May-21
	36,000,000.00	36,154,040.00	34%		3.08	95,337.54	3.11	193,903.47	
TOTAL PORTFOLIO **	107,115,067.15	107,269,107.15	100%		3.63	288,649.14	3.65	579,337.78	
BENCHMARK					2.01		2.04		

North Sydney Council Investment Portfolio as at 31 August 2016

Term	Market Value	%	Wgt. Avg
Working Capital (0-3 Months)	23,615,067.15	22%	2.03%
Short-Term (3-12 Months)	14,000,000.00	13%	3.96%
Short-Medium Term (1-2 Years)	28,515,620.00	27%	3.51%
Medium Term (2-5 Years)	41,138,420.00	38%	3.24%
Long Term (+5 Years)	0.00	0%	0.00%
Total	107,269,107.15	100%	

Performance	Council	AusBond BBI	Outperformance
FYTD	3.65%	2.04%	1.61%
1 year	3.86%	2.22%	1.64%
2 years	4.10%	2.36%	1.73%
3 years	4.25%	2.46%	1.79%
4 years	4.62%	2.64%	1.98%
5 years	4.95%	2.99%	1.95%

Benchmark	Investments
AusBond Bank Bill Index	Cash, Term Deposits, Senior Fixed and Senior FRN's

Investment Horizon	Investments
Working Capital (0-3 Months)	At-Call Accounts, Term Deposits
Short-Term (3-12 Months)	Term Deposits
Short-Medium Term (1-2 Years)	Senior Bonds, Term Deposits
Medium Term (2-5 Years)	Senior Bonds, Term Deposits
Long Term (+5 Years)	N/A

Summary by Credit Rating #	
AAA	0%
AA+	0%
AA	0%
AA-	26%
A+	17%
A	2%
A-	26%
BBB+	20%
BBB	6%
BBB-	0%
NR	3%
100%	



Monthly Investment Report

August 2016

Market

We refer to our more detailed *Economic Commentary* for the month.

International Markets

All three major US indices set record closes on August 15th before finishing slightly higher at +0.14% (S&P 500), +0.26% (Dow Jones) and +1.18% (NASDAQ) respectively.

London's FTSE index continued to soar post-Brexit vote, gaining +1.67%. The MSCI World ex-AUS returned +0.48% while the MSCI Emerging Markets Index finished +2.76% higher (both in local currency).

US 10-year bond yields sold off heavily to 1.58% (+12bp in August) following Fed comments flagging another 2016 rate hike is now more probable.

Domestic

The ASX200 closed -1.55% lower in August.

Australian headline CPI rose +0.4% in Q2 (below expectations of +0.5%) while YoY inflation rose +1.0% - the smallest annual rise since 1999. Underlying inflation was +1.5% YoY (down from +1.55% in Q1) and slightly above the forecasted +1.4%. Wages grew just +2.1%.

The RBA cut the cash rate to a new record low of 1.5%. The low Q2 CPI provided justification. The RBA was less concerned that easing would boost home prices, contradicted by auction clearance rates hitting their highest level in over a year. Apartment approvals jumped +23% to be +15.7% higher YoY.

The unemployment rate eased to 5.7% in July, down from 5.8% in June with participation flat. The Census no doubt influenced part time employment (+71,600) as full time employment fell (-45,400). Total hours worked increased after a period of weakness.

Australian 10-year bonds set record low yields. They finished 5bp lower at 1.83%.

Other Markets

The US non-farm payrolls report showed the addition of 255,000 jobs in July – exceeding expectations. Gains came from professional and business services, health care and financial activities whereas mining trended downwards.

Fed chair Janet Yellen commented that the case for an increase in the federal funds rate had strengthened in recent months, but stressing that future policy moves would be dependent on economic data. She was clearly not referring to CPI (just +0.8%) or GDP (revised down to +1.1% p.a. in Q2) – perhaps the Fed is alarmed by an overly strong housing market. New home sales were the highest since 2007.

Oil finished at \$44.70/bbl (+7.45%).

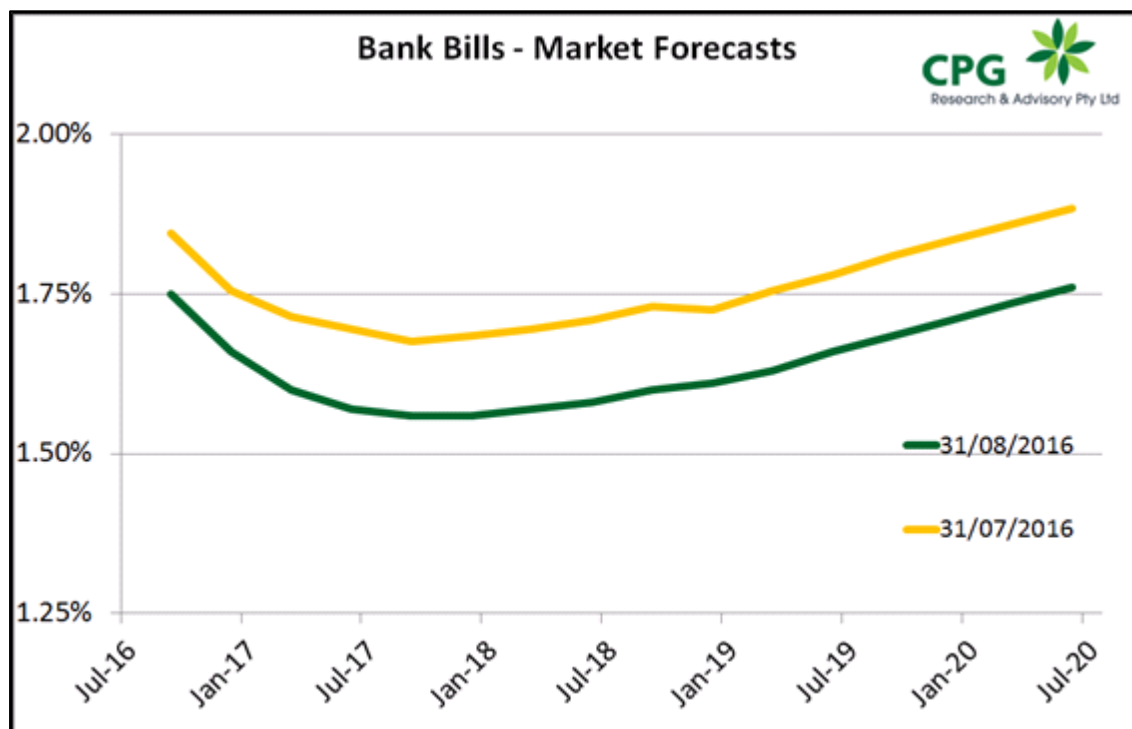
Gold fell back from recent highs at US\$1307 (-3.17%) as economic fears eased.

Iron Ore closed higher at \$57.18 (+1.08%).

Base Metals were mixed during the month; Tin and Zinc gained +5.77% and 4.84% while Copper, Aluminium and Nickel fell -5.16%, -0.93% and -6.89% respectively.

The \$A was relatively flat at US75.14 cents (0.11%) after initially rallying in defiance of the RBA.

Futures markets indicate a significantly lower outlook again, for rates across all terms:



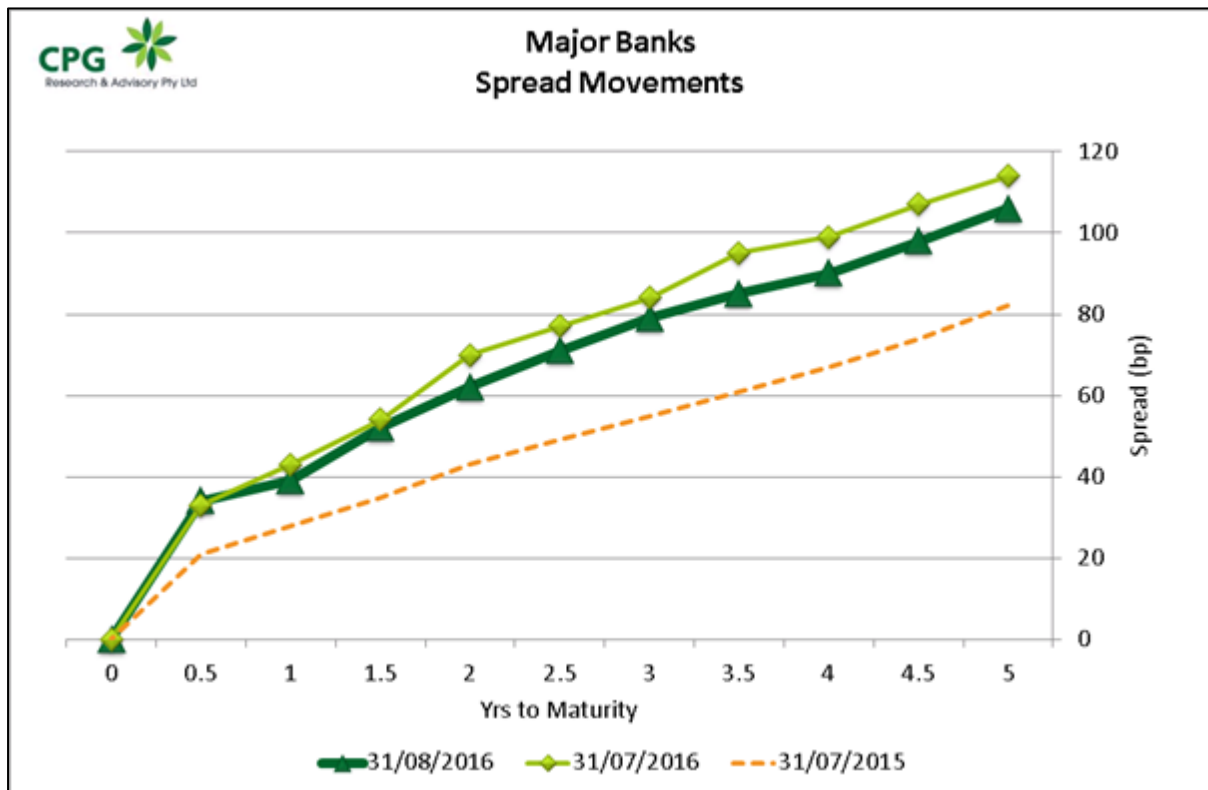
Credit Market

Credit spreads continued narrowing in Australia during the month, catching up to July's post-Brexit recovery in European and US indices. The Australian iTraxx tightened by 9bp with the other two effectively flat.

Credit Indices	31 Aug 16	31 Jul 16	31 Aug 15
iTraxx Australia 5 Yr CDS	100bp	109bp	107bp
iTraxx European 5 Yr CDS	68bp	68bp	72bp
CDX North American 5 Yr CDS	73bp	72bp	82bp

Source: MarkIt

In the physical market, A and AA bank senior FRNs tightened strongly across the curve after previously lagging.



Council's Portfolio

The portfolio has 15% of investments available at-call and a further 7% of assets maturing within 3 months. Additional short-dated funds have been gradually redeployed into a portfolio now well diversified by term – ahead of what has been a considerable decline in deposit rates.

Approximately 38% of the portfolio is represented as medium-term assets (2-5 years), with capacity freed up as the portfolio received an influx of surplus funds during the month.

A new adopted policy would also allow Council to classify liquid securities as designated for trading. This would allow Council to define a target date for sale of a liquid investment which would therefore reduce the overall duration of investments such as FRNs.

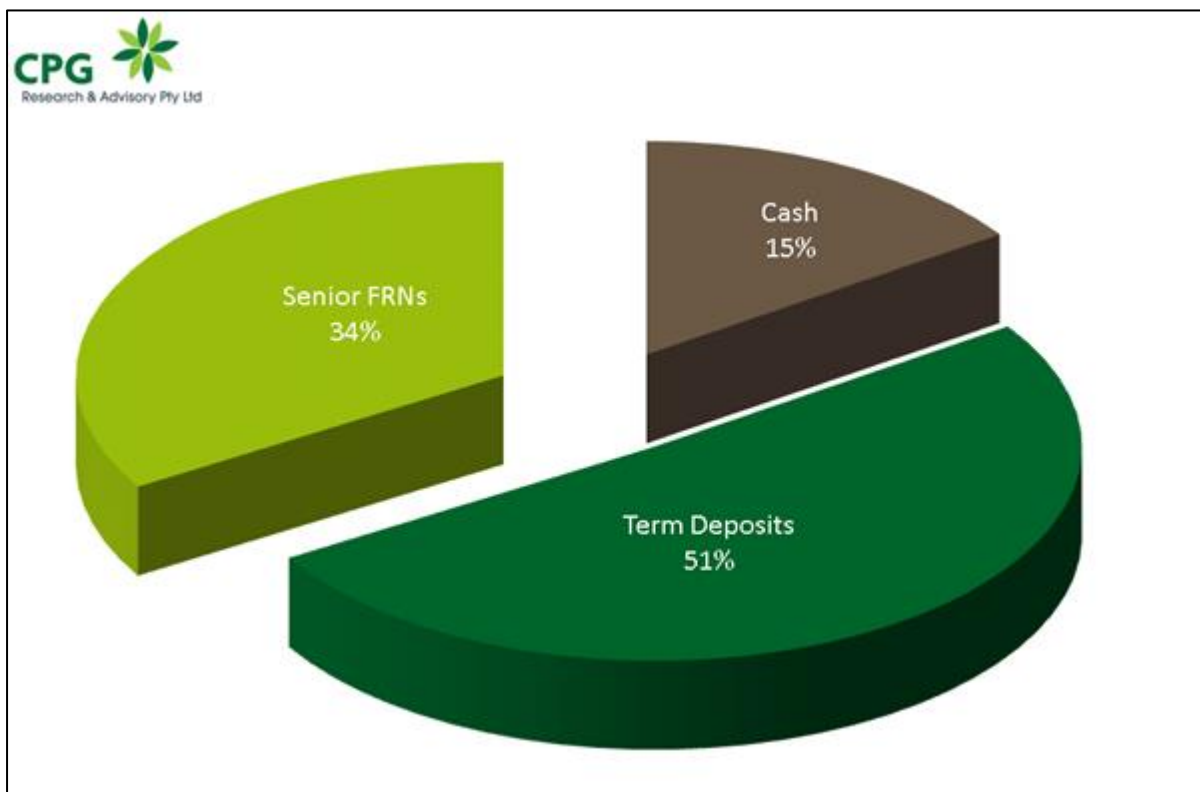
Council has a growing number of senior FRNs as additional cover for liquidity requirements (access to funds within 2 business days).

Term to Maturity	%	Maximum	Capacity
0-3 months	22%	100%	78%
3-12 months	13%	100%	87%
1-2 years	27%	70%	43%
2-5 years	38%	50%	12%
5+ years	0%	25%	25%

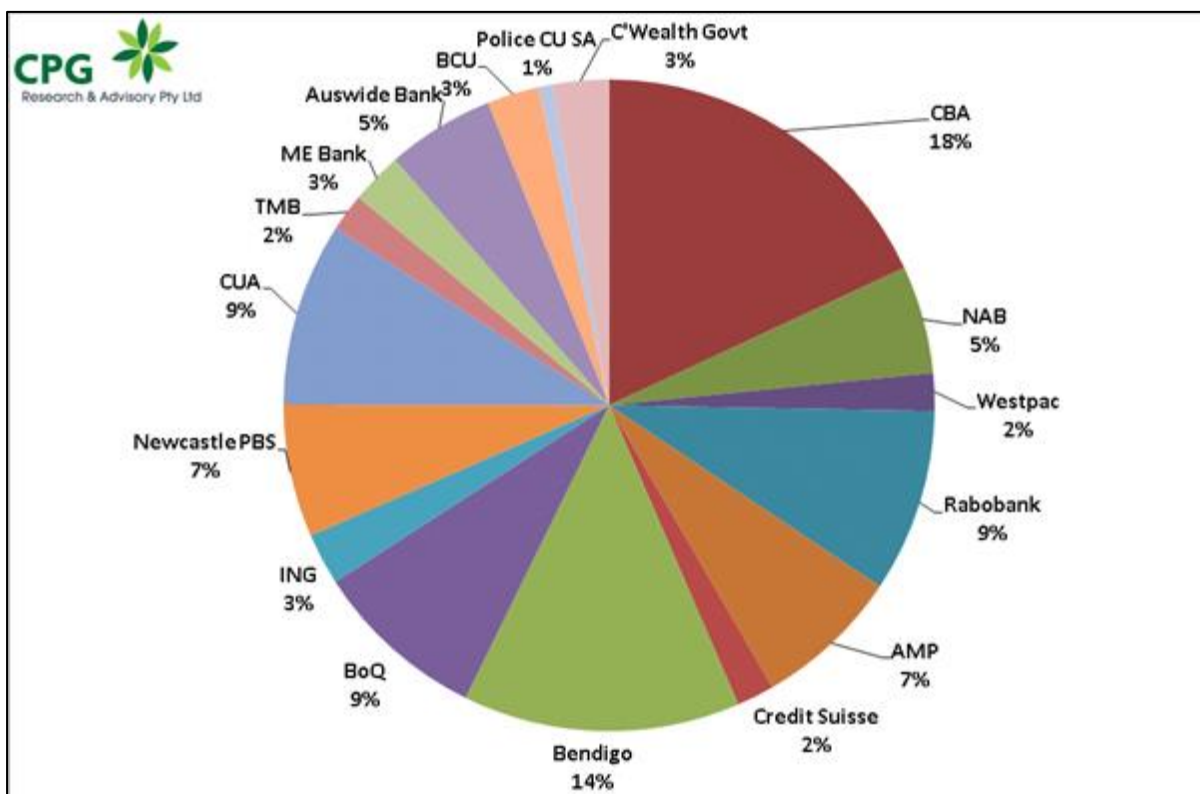
Council's portfolio is currently mainly directed to term deposits (51%) across a broad range of counterparties; credit assets (senior securities) are around 34% of the portfolio.

Over the past few years, our advice has focused on fixed rate deposits as the core investment theme, supplemented by other fixed rate investments. This has been justified by another significant downtrend in deposit yields, with 2014's new longer-dated investments now yielding well above market returns.

The deposit curve remains steep, with the top 3-5 year deposit rate earning up to +135bp margin. Currently, we see value in both longer-dated deposits and in tradeable securities (FRNs).



The investment portfolio is well diversified in complying assets across the entire credit spectrum, with CBA, Bendigo, Rabobank, BoQ and CUA dominant:



Credit Quality

The portfolio is diversified from a rating perspective. Credit quality is diversified and is predominately invested amongst the investment grade ADIs (BBB- or higher), with a slightly smaller allocation to unrated ADIs.

There is still capacity to invest across the entire spectrum.

Rating Category	Actual	Per C/Party	Aggregate	Capacity
AAA Govt	3%	100%	100%	97%
AAA	0%	40%	100%	100%
AA	25%	30%	100%	75%
A	43%	15%	60%	17%
BBB	25%	10%	40%	15%
NR ADI	3%	5%	10%	7%

All of these are well within Policy limits.

From time to time, broker specials continue to be offered with some BBB rated and unrated Credit Unions paying an additional premium above leading direct rates – **pricing is generally quite favourable, but for short terms**. This is covered in the daily emails and our advice at the time of investment.

Compliance

We have tested the portfolio provided against Council's current investment policy and report the following:

Most individual counterparty exposures comply with the Policy.

Bendigo-Adelaide Bank and CUA remain close to capacity limits, and this will be driven by the movement in the portfolio's balances on a monthly basis.

ADI	Exposure	FCS	Net	Rating	Policy Limit	Actual	Capacity
ANZ	\$0	\$0	\$0	AA-	30%	0%	\$32,180,732
CBA	\$19,629,200	\$250,000	\$19,379,200	AA-	30%	18%	\$12,801,532
NAB	\$5,986,550	\$250,000	\$5,736,550	AA-	30%	5%	\$26,444,182
Westpac	\$2,007,420	\$0	\$2,007,420	AA-	30%	2%	\$30,173,312
Rabobank	\$10,000,000	\$250,000	\$9,750,000	A+	15%	9%	\$6,340,366
AMP	\$8,044,007	\$250,000	\$7,794,007	A+	15%	7%	\$8,296,359
Suncorp	\$0	\$0	\$0	A+	15%	0%	\$16,090,366
Credit Suisse	\$2,001,020	\$0	\$2,001,020	A	15%	2%	\$14,089,346
Bendigo	\$15,014,340	\$250,000	\$14,764,340	A-	15%	14%	\$1,326,026
BoQ	\$9,500,000	\$250,000	\$9,250,000	A-	15%	9%	\$6,840,366
ING	\$3,000,000	\$250,000	\$2,750,000	A-	15%	3%	\$13,340,366
Newcastle PBS	\$7,044,370	\$0	\$7,044,370	BBB+	10%	7%	\$3,682,541
CUA	\$10,036,460	\$250,000	\$9,786,460	BBB+	10%	9%	\$940,451
TMB	\$2,005,740	\$0	\$2,005,740	BBB+	10%	2%	\$8,721,171
ME Bank	\$3,000,000	\$250,000	\$2,750,000	BBB+	10%	3%	\$7,976,911
Auswide Bank	\$6,000,000	\$250,000	\$5,750,000	BBB	10%	5%	\$4,976,911
Bank of Sydney	\$0	\$0	\$0	NR	5%	0%	\$5,363,455
BCU	\$3,000,000	\$250,000	\$2,750,000	NR	5%	3%	\$2,613,455
Police CU SA	\$1,000,000	\$250,000	\$750,000	NR	5%	1%	\$4,613,455
C'wealth Govt	\$107,269,107	\$3,000,000	\$104,269,107	AAA	100%	97%	
Total	\$107,269,107		\$104,269,107			100%	

^ Under the Financial Claims Scheme (FCS), the first \$250,000 is guaranteed by the Federal Government (rated AAA by S&P) per investor, per ADI.

Subsidiaries such as Bank of Queensland Specialist Bank are grouped in the exposures of the parent (Bank of Queensland, rated A-).

From May 2015, new Rabobank Australia deposits are not guaranteed by the global group, but existing deposits have their guarantee grandfathered. They are generally not accepting new investments or rollovers from institutional investors.

Performance Returns

Council's Performance as at 31 August 2016

Performance	Council	AusBond BBI	Outperformance
1 month	3.63%	2.01%	1.63%
3 months	3.65%	2.03%	1.62%
FYTD	3.65%	2.04%	1.61%
1 year	3.86%	2.22%	1.64%
2 years	4.10%	2.36%	1.73%
3 years	4.25%	2.46%	1.79%
4 years	4.62%	2.64%	1.98%
5 years	4.95%	2.99%	1.95%

The total investment portfolio had another strong month, returning **+3.63% p.a. for the month of August**, outperforming the AusBond Bank Bill Index¹, which returned +2.01% p.a.

Council's returns, while lower in absolute terms than historically the case, remains very strong compared to most short deposits rolling in the mid-high 2%'s. The highest 5-year deposit today remains below 3.2%.

The portfolio's performance continues to be anchored by the longer-dated deposits, particularly those invested above 4%. FRNs, purchased at attractive margins, have also contributed positively to overall performance.

Cash continues to be a drag on performance after the RBA recommenced its easing cycle, cutting in May and August. This can be mitigated through a switch into higher yielding accounts such as AMP's 31 day notice account paying cash rate + 0.80%, which includes CPG's 10bp rebate. The account requires 31 days notice in return for the additional yield – it is not a substitute for at-call money.

¹ Previously UBS Bank Bill Index - the sale of the UBS index to Bloomberg, and subsequent change of names, is now effective.

Term Deposits

At month-end, deposits accounted for approximately 51% of the total investment portfolio. The weighted average duration of the deposit portfolio stood at approximately **1.3 years** - having been significantly lengthened (compared to benchmark) during the RBA's easing cycle over the past few years.

This has produced a measurable uplift in yield at a time when deposit rates have plunged to record lows, and cushioned the RBA's rate cutting cycle.

It will provide strong protection to Council's budgeted income over the coming year, which we will be looking to support over the next 12 months. ***An average yield of 4.00% p.a. remains much higher than any deposit available today. It continues to yield more than 2½ times the prevailing cash rate!***

It is inevitable that returns will again ease from here, and this will accelerate should the RBA continue its easing cycle. Money markets continue to factor in another rate cut by the end of Q3 2017.

One deposit matured and was reinvested for 2 years at twice the prevailing cash rate (3%).

Across the longer-end of the curve, the highest 4 and 5 year fixed deposit margins dipped to around +135bp over bank bills. Given further downside risks to interest rates, we believe there is strong value and visibility by locking in the top 3 year rate of 3.00% p.a. offered by Newcastle Permanent Building Society (BBB+), which is around +135bp over bills.

The shape of the deposit curve remains quite rational and investors are still rewarded for illiquidity, with some medium-term durations factoring in significantly more upside risk than we build into cash rate scenarios. We have a "Buy" rating again on some medium-term T/Ds at current levels, after a period of a "Neutral" view.

The relative opportunity is being driven by a combination of lower bond yields and more difficult conditions for banks attempting to finance themselves in wholesale debt markets.

Going forward, we would again expect to see further migration into a more balanced and liquid portfolio - with FRNs offering excellent returns on a 2-year horizon.

Market conditions are generally now much more favourable to FRN investments than at any time since 2012 – perhaps, since the immediate post-GFC period. This represents a significant reversal of what had been a long-standing theme for Councils dating back to as early as 2010.

Shorter-terms remain under pressure, although some have also widened above +100bp, although they are generally with the lower rated ADIs (e.g. Arab Bank Australia is actually rated below investment grade by S&P).

Some above market rates (“specials”) continue to be offered by the “BBB” and unrated ADIs, often through the broker intermediaries. Previously, A or AA banks tended to overpay relative to peers, providing a “free lunch” for yield and credit quality.

We refer to the detailed analysis in our August *Fixed Interest Analytics*.

Securities (FRNs)

The long-end of the wholesale senior bank FRNs tightened up to 10bp across the long-end of the curve for the month of August. Despite the tightening, they remain near multi-year wides and as such, we believe newly issued bank FRNs remain attractive and one of the highest yielding (and complying) source of returns going forward.

We continue to recommend selling any senior major bank FRNs maturing on or before mid-2018 as most are marked less than +70bp and the curve remains relatively steep. 2018 FRNs are now also generally saleable at the higher credit qualities; lower rated institutions tend to see spreads converge only as they shorten very close to maturity – we flag the final year as the likely exit point for those. Still, switching may well be recommended opportunistically.

Apart from providing diversification and additional liquidity in a portfolio, this strategy has been highly lucrative - more so than (even unrated) ADI deposits over the past few years at times of most favourable pricing.

Primary issues continue to be favoured over secondary market offers in the wholesale market. For example, ANZ (+118bp) and Credit Suisse (+195bp) both priced new 5-year issues substantially wider than the existing curve earlier this year. In July, CBA (+121bp) launched a new 5-year FRN around +5bp above secondary market equivalents which was tightened to around +103bp recently. ANZ was the latest to issue a new 5 year senior FRN at +113bp in mid-August, which has now tightened around 11bp to +102bp (or \$100% capital).

For new issues, the regional ADIs (rated A or BBB) naturally offer a higher spread compared to the major banks due to their lower credit rating. Our FRN analytics suggest that the respective curves are relatively fair, with higher spread but greater difficulty extracting capital gains from regional bank FRNs. However, again the new issue discount provides additional value to investors.

Newcastle Permanent Building Society (BBB+) and Credit Union of Australia (BBB+) issued new 3 year FRNs at +160bp in mid-March. We saw this as good value and recommended these issues, where there was capacity to do so. After some price recovery since Q1, ME Bank (BBB+) launched a new 3-year FRN at +145bp in early July, which has now tightened around 8bp to +137bp.

This highlights that FRNs, across the various credit spectrum, remain ahead of deposit margins even without factoring in gains at exit - and that investors are being rewarded for supporting the primary issuance market.

Private placement FRNs or secondary market ‘taps’ can sometimes be offered, usually at a premium yield to the wholesale secondary market although we note they are generally less liquid due to their smaller issue sizes and daily turnover. The most recent example was Greater Bank’s (BBB+) new 3 year private placement FRN at +155bp, issued in late August.

Heritage retail bonds traded firmer again, finishing the month at a yield of 2.97% (+115bp to swap). With just over 9 months to run, brokerage knocks 10-15bp out of the return, with the bigger problem being to secure volume without unduly moving a lightly traded security. **At current levels, we suggest holding, and either buying or selling on significant divergences. The security has swung wildly in both directions recently, on low volume.**

In an emergency, Council’s \$4m holding in the CBA 18/07/2019 FRN is now ‘in the money’ and saleable. We may look to switch into a newly issued FRN, if offered at an attractive level.

We recommend that Council retain its FRN portfolio at this stage. In a fairly stable credit environment, we look for an exit opportunity towards the midpoint of a security’s life to maximise the potential gain, and will inform Council accordingly.

Fixed Interest Market Background

The British pound advanced for the first week since mid-July versus the euro as economic data continue defying post-Brexit expectations for a slowdown. The currency climbed against all 31 of its major peers in late August, capped by data showing an index of UK consumer confidence rose in August by the most in more than three years. That added to a spate of better-than-expected economic data released throughout August suggesting that the immediate impact of the country’s decision to leave the European Union was not as bad as many had predicted.

After cutting interest rates by 25bp to a record low of 2% in early August, the Reserve Bank of New Zealand (RBNZ) said its current interest rate track involves further cuts to balance a number of risks while targeting an increase in inflation.

Bank of Japan governor Haruhiko Kuroda said he was ready to authorise more quantitative easing or lower negative interest rates “without hesitation” to lift low inflation expectations.

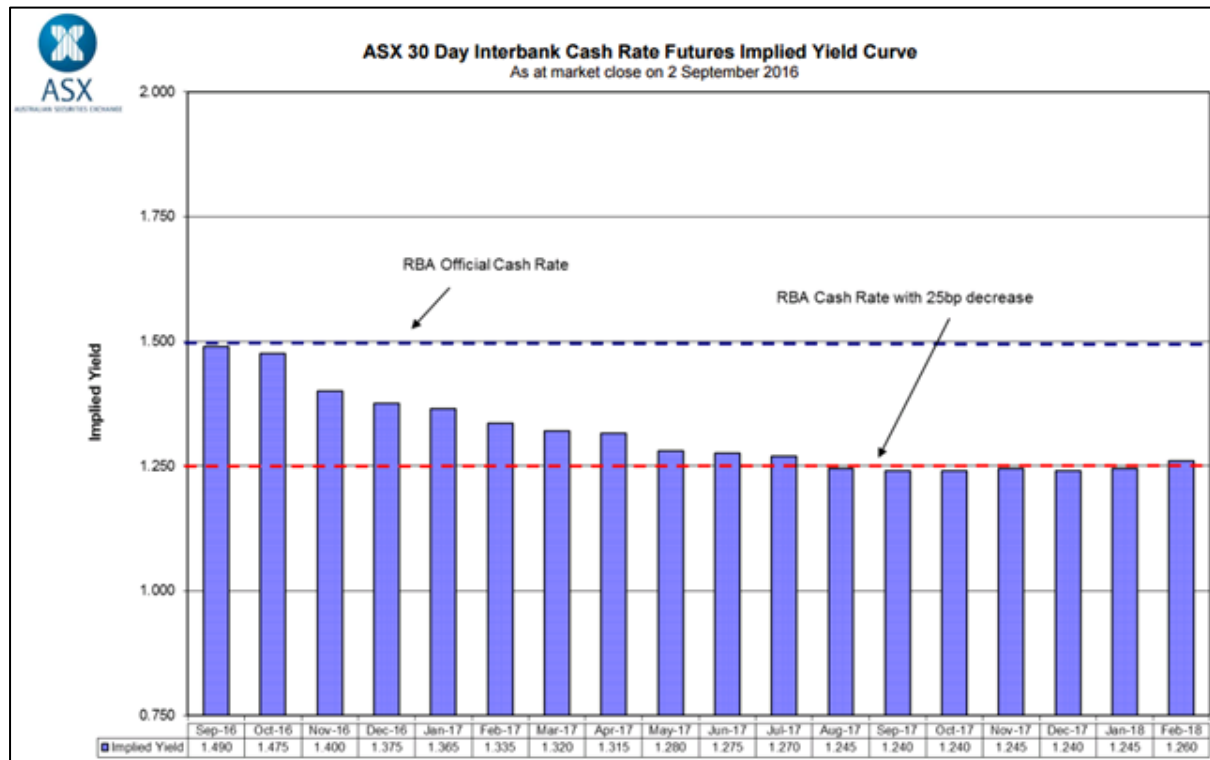
The US Federal Reserve’s (Fed) more upbeat comments and willingness to increase interest rates over coming months may allow the Reserve Bank of Australia (RBA) to hold off cutting rates in the near future. US Fed chair Yellen expressed confidence that tighter labour markets over time would push inflation back to the central bank’s 2% goal, setting up a rate increase in September or December.

The \$A has already declined after the Fed’s positive rhetoric, experiencing its first back-to-back weekly slide since May, after initially rallying in defiance of the RBA’s decision to cut rates in early August.

While Australia’s unemployment rate ticked down to 5.7%, this has continued to be driven by the significant increase in part-time jobs. Underemployment has increased most in sectors such as

hospitality and retail. In the past year, the economy created almost 220,000 jobs, but 190,000 of these, the vast majority, were part time. Full-time employment grew by just under 30,000, or 0.4%, in the year to July.

Money markets continue to price in another 25bp rate cut by Q3 2017.



Source: SFE / ASX

Portfolio Listing & Performance

North Sydney Council Investment Portfolio as at 31 August 2016									
Trading Account:	Investment Face Value	Investment Market Value	%	S&P Rating *	Net Returns - 1 Month Return*	Net Returns - 1 Month Income^	Net Returns - FYTD Return	Net Returns - FYTD Income^	Maturity
CBA Trading Account - General Fund	2,585,171	2,585,171	2%	AA-	1.60	\$1,964	1.60	\$2,858	At Call
CBA Business On-Line Saver	13,000,000	13,000,000	12%	AA-	1.05	\$4,088	1.05	\$8,212	At Call
AMP 31-day Notice Account	1,025,307	1,025,307	1%	A+	2.37	\$2,346	2.71	\$4,470	1-Oct-16
CBA Cash Management Account	4,589	4,589	0%	AA-	1.65	\$3	1.82	\$3	At Call
	16,615,067	16,615,067	15%		1.22	\$8,401	1.24	\$15,543	
Term Deposits:									
Auswide Bank @ 3.75%	2,000,000	2,000,000	2%	BBB	3.75	\$6,370	3.75	\$12,740	12-Sep-16
Auswide Bank @ 3.75%	3,000,000	3,000,000	3%	BBB	3.75	\$9,555	3.75	\$19,110	3-Oct-16
BoQ @ 4.50%	2,000,000	2,000,000	2%	A-	4.50	\$7,644	4.50	\$15,288	28-Nov-16
Auswide Bank @ 3.70%	1,000,000	1,000,000	1%	BBB	3.70	\$3,142	3.70	\$6,285	12-Dec-16
CUA @ 3.05%	2,000,000	2,000,000	2%	BBB+	3.05	\$5,181	3.05	\$10,362	23-Mar-17
Rabobank @ 5.70%	2,000,000	2,000,000	2%	A+	5.70	\$9,682	5.70	\$19,364	6-Jun-17
AMP @ 2.90%	1,000,000	1,000,000	1%	A+	2.90	\$2,463	2.90	\$4,926	28-Aug-17
BoQ @ 4.90%	3,000,000	3,000,000	3%	A-	4.90	\$12,485	4.90	\$24,970	28-Aug-17
BCU @ 4.00%	2,000,000	2,000,000	2%	NR	4.00	\$6,795	4.00	\$13,589	28-Aug-17
Bendigo TD @ 2.90%	3,000,000	3,000,000	3%	A-	2.90	\$7,389	2.90	\$14,778	30-Aug-17
Bendigo TD @ 2.90%	3,000,000	3,000,000	3%	A-	2.90	\$7,389	2.90	\$14,778	4-Sep-17
CUA @ 3.75%	3,000,000	3,000,000	3%	BBB+	3.75	\$9,555	3.75	\$19,110	11-Sep-17
Bendigo TD @ 2.92%	2,000,000	2,000,000	2%	A-	2.92	\$4,960	2.92	\$9,920	15-Sep-17
BoQ @ 4.70%	1,000,000	1,000,000	1%	A-	4.70	\$3,992	4.70	\$7,984	27-Sep-17
BoQ Specialist @ 5.60%	500,000	500,000	0%	A-	5.60	\$2,378	5.60	\$4,756	2-Nov-17
AMP @ 3.20%	4,000,000	4,000,000	4%	A+	3.20	\$10,871	3.20	\$21,742	5-Mar-18
Rabodirect @ 4.25%	2,000,000	2,000,000	2%	A+	4.25	\$7,219	4.25	\$14,438	20-Aug-18
Rabobank @ 4.05%	6,000,000	6,000,000	6%	A+	4.05	\$20,638	4.05	\$41,277	28-Aug-18
BCU @ 3.00%	1,000,000	1,000,000	1%	NR	3.00	\$247	3.00	\$247	29-Aug-18
Police CU @ 3.05%	1,000,000	1,000,000	1%	NR	3.05	\$2,590	3.05	\$5,181	10-Sep-18
BoQ @ 5.00%	3,000,000	3,000,000	3%	A-	5.00	\$12,740	5.00	\$25,479	29-Oct-18
ME Bank @ 5.10%	3,000,000	3,000,000	3%	BBB+	5.10	\$12,995	5.10	\$25,989	14-Feb-19
ING @ 4.95%	3,000,000	3,000,000	3%	A-	4.95	\$12,612	4.95	\$25,225	18-Feb-19
NAB Flexi Deposit	1,000,000	1,000,000	1%	AA-	3.61	\$3,066	3.61	\$6,132	12-Dec-19
Expired Deposits - Financial Year	-	-	-	-	-	\$2,953	-	\$6,223	Expired
	54,500,000	54,500,000	51%		3.98	\$184,911	3.98	\$369,892	
Senior Bonds:									
CUA FRN @ 3m BBSW + 1.20%	2,000,000	2,008,860	2%	BBB+	3.20	\$5,436	3.20	\$10,871	22-Dec-17
TMB FRN @ 3m BBSW + 1.05%	2,000,000	2,005,740	2%	BBB+	3.03	\$5,155	2.99	\$10,311	4-Dec-17
Credit Suisse FRN @ 3m BBSW + 1.05%	2,000,000	2,001,020	2%	A	2.78	\$5,056	2.91	\$10,228	24-Aug-18
Newcastle PBS FRN @ 3m BBSW + 1.60%	5,000,000	5,048,350	5%	BBB+	3.60	\$15,288	3.60	\$30,575	22-Mar-19
CUA FRN @ 3m BBSW + 1.60%	3,000,000	3,027,600	3%	BBB+	3.56	\$9,058	3.56	\$18,116	1-Apr-19
Westpac FRN @ 3m BBSW + 1.00%	-	-	0%	AA-	-	\$0	-	\$13,241	10-May-19
CBA FRN @ 3m BBSW + 0.98%	4,000,000	4,039,440	4%	AA-	2.93	\$9,954	2.93	\$20,541	18-Jul-19
Bendigo FRN @ 3m BBSW + 0.93%	2,000,000	2,004,540	2%	A-	2.92	\$4,968	2.92	\$9,937	17-Sep-19
Newcastle PBS FRN @ 3m BBSW + 1.35%	2,000,000	1,996,020	2%	BBB+	3.31	\$5,631	3.31	\$11,361	7-Apr-20
NAB FRN @ 3m BBSW + 0.80%	5,000,000	4,986,550	5%	AA-	2.79	\$11,869	2.79	\$23,738	3-Jun-20
Westpac FRN @ 3m BBSW + 0.90%	2,000,000	2,007,420	2%	AA-	2.76	\$4,697	2.76	\$9,808	28-Jul-20
Bendigo FRN @ 3m BBSW + 1.10%	5,000,000	5,009,800	5%	A-	2.84	\$12,660	2.97	\$25,796	18-Aug-20
AMP FRN @ 3m BBSW + 1.35%	2,000,000	2,018,700	2%	A+	3.08	\$5,566	3.21	\$11,248	24-May-21
	36,000,000	36,154,040	34%		3.08	\$95,338	3.11	\$205,771	
TOTAL PORTFOLIO **	107,115,067	107,269,107	100%		3.63	\$288,649	3.65	\$591,206	
BENCHMARK					2.01		2.04		

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