

# Investment Policy

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### 1. Objectives

The purpose of this policy is to provide a framework for making decisions concerning the appropriate investment of Council's funds, at the most favourable rate of interest available to it at the time to maximise returns, whilst having due consideration of risk, liquidity and security for its investments.

Council may pursue other objectives that maximise community benefits, including more restrictive rules to qualify for concessional debt funding.

The policy establishes a series of limits within which Council officers must operate in the planning and process of investing Council monies. In setting these limits Council is determining the general level of risk that is acceptable for monies managed on trust for the community of Shoalhaven.

While exercising the power to invest, consideration is to be given to the preservation of capital, liquidity, and the return of investment. Council, therefore, has several key objectives for its investment portfolio:

- Compliance with legislation, regulations, the prudent person tests of the Trustee Act and best practice guidelines;
- Preservation of the amount invested for defensive fixed interest investments. Some NSW Tcorp Funds are highly volatile, and Council understands it should take a long-term view when placing surplus assets into any of their managed funds;
- To ensure there is sufficient liquid funds to meet all reasonably anticipated cash flow requirements.
- Adherence to debt covenants.
- To generate income from the investment that exceeds the performance benchmarks mentioned later in this document.

### 2. Legislative Requirements

All investments are to comply with the following:

- *Local Government Act 1993*;
- *Local Government (General) Regulation 2021*;
- Ministerial Investment Order;
- *The Trustee Amendment (Discretionary Investments) Act 1997 – Section 14*;
- *Local Government Code of Accounting Practice and Financial Reporting*;
- Australian Accounting Standards;
- Office of Local Government *Investment Policy Guidelines*; and
- Office of Local Government Circulars.

### 3. Authority

Authority for implementation of the Investment Policy is delegated by Council to the General Manager in accordance with the *Local Government Act 1993*.

The CEO may in turn delegate the day-to-day management of Council's investment portfolio to the Responsible Accounting Officer and/or other Finance staff who must ensure adequate skill, support and oversight is exercised in the investment of Council funds.

Officers' delegated authority to manage Council's investments shall be recorded and they will be required to acknowledge they have received a copy of this policy and understand their obligations in this role.

### 4. Risk Management

Investments obtained are to be considered in light of the following key criteria:

- *Preservation of capital* – the requirement for preventing losses in an investment portfolio's total value (considering the time value of money);
- *Diversification* – the requirement to place investments in a broad range of products so as not to be overexposed to a particular sector of the investment market;
- *Credit risk* – the risk that a party or guarantor to a transaction will fail to fulfil its obligations. In the context of this document it relates to the risk of loss due to the failure of an institution/entity with which an investment is held to pay the interest and/or repay the principal of an investment;
- *Fidelity, legal and documentary risk* – the risks of suffering loss from staff or counterparty fraud, theft, failure to document transactions and title with enforceable documents or compensation to third parties for these failures;
- *Market risk* – the risk that the fair value or future cash flows of an investment will fluctuate due to changes in market prices or benchmark returns will unexpectedly overtake the investment's return.
- *Covenant risks* – the risk of breaching debt covenants and bearing additional costs.
- *Liquidity Risk* – the risk an institution runs out of cash, is unable to redeem investments at a fair price within a timely period, and thereby Council incurs additional costs (or in the worst case is unable to execute its spending plans).
- *Maturity Risk* – the risk relating to the length of term to maturity of the investment. The larger the term, the greater the length of exposure and risk to market volatilities; and
- *Rollover Risk* - the risk that income will not meet expectations or budgeted requirement because interest rates are lower than expected in future

The following indicates the limitations to be applied so as to avoid these risks:

#### a) Authorised Investments

All investments must be denominated in Australian Dollars. Authorised Investments are limited to those allowed by the Ministerial Investment Order and include:

- Commonwealth / State / Territory Government securities, e.g. bonds;
- Interest bearing deposits / senior securities issued by an eligible authorised deposit-taking institution (ADI);
- Bills of Exchange (< 200 days duration) guaranteed by an ADI;
- Debentures issued by a NSW Council under *Local Government Act 1993*;
- Deposits with TCorp &/or Investments in TCorpIM Funds; and
- Existing investments grandfathered under the Ministerial Investment Order, or under the terms of any debt covenants.

## b) Prohibited Investments

This Investment Policy prohibits the following types of new investment:

- Derivative based instruments<sup>1</sup>;
- Principal only investments or securities that provide potentially nil or negative cash flow;
- Stand-alone securities issued that have underlying futures, options, forwards contracts and swaps of any kind;
- Mortgage of land;
- Investment trusts, even where the trusts adhere to the Minister’s Order fully with the exception of T-CorpIM Funds; and
- Any other investment written out of the Minister’s Order.

This policy also prohibits the use of leveraging (borrowing to invest) an investment. However, nothing in the policy shall prohibit the short-term investment of loan proceeds where the loan is raised for non-investment purposes and there is a delay prior to the expenditure of loan funds.

## c) Liquidity and Maturity

Investments should be allocated to ensure there is sufficient liquidity to meet all reasonably anticipated cash flow requirements, as and when they fall due, without incurring the risk of significant costs due to the unanticipated sale of an investment. Therefore, the maturity dates of each investment must be carefully chosen and reviewed to ensure that cash levels are sufficient to fulfil these estimated requirements.

## d) Credit Quality Limits

The portfolio credit guidelines to be adopted will reference the Standard & Poor’s (S&P) ratings system format, with Moody’s also used – the lower of these ratings (stated in this format) is to be used.

However, the primary control of credit quality is the prudential supervision and government support and implicit and explicit guarantees of the ADI sector, not ratings.

The maximum holding limit in each rating category for Council’s portfolio shall be:

Long-Term Rating Range	Maximum % of Portfolio
AAA category	100%
AA category or Major Banks	100%
A+ to A	100%
A-	40%
BBB+ to BBB*	35%
BBB- and below category	0%
TCorp Investments **	15%

<sup>1</sup> Prohibited investments are not limited to the list above and extend to any investment carried out for speculative purposes.

\* Of this 35%, the Borrower is permitted to invest a maximum of 15% in investments with a Long-Term credit rating of BBB such investments constituting a 15% sub limit of the permitted 35% portfolio limit.

\*\* Council should refer to the TCorpIM Funds Offer Document dated 1 February 2020 and, section 4 (Risks of Investing) and, if appropriate, seek independent financial advice prior to making any investment in TCorp Investments. Investments are not guaranteed.

### e) Counterparty Limits

Exposure to individual counterparties/financial institutions will be restricted by their rating so that single entity exposure is limited, as detailed in the table below. No further investment will be made with Unrated institutions beyond their government guaranteed level, except for local ADIs concentrating in the Illawarra or South Coast regions.

Individual Institution or Counterparty Limits		
Long-Term Rating Range	Not exceed the smaller of:	
	Maximum % of Portfolio	% of Institution or Counterparty's Net Assets
AAA	100%	n/a
AA + to AA-	100%	n/a
A+ to A	100%	n/a
A-	20%	n/a
BBB+	10%	2%
BBB	5%	2%
BBB- and below: Local ADIs (Authorised Deposit Taking Institutions)	-	2%
TCorp Investments	15%	n/a

### f) Term to Maturity Limits

Council's investment portfolio shall be structured around the horizon of investment to ensure that liquidity and income requirements are met, as well as restricting the tenor of individual investments.

Once the primary aim of liquidity is met, Council will ordinarily diversify its maturity profile as this will ordinarily be a low-risk method of obtaining additional return as well as reducing the risks to Council's income. However, Council always retains the flexibility to invest as short as required by internal requirements or the economic outlook. Judgment of the state of domestic and global economic circumstances should also be carefully taken into account when making decisions on the terms of an investment.

The factors and/or information used by Council to determine minimum allocations to the shorter durations include:

- Council's liquidity requirements to cover both regular payments as well as sufficient buffer to cover reasonably foreseeable contingencies;
- Medium term financial plans and major capital expenditure forecasts;
- Known grants, asset sales or similar one-off inflows; and

- Seasonal patterns to Council's investment balances.

Investment Horizon Description	Horizon	Maximum % of Portfolio
Working Capital Funds	0-3 months	100%
Short-Term Funds	3-12 months	100%
Short-Medium Term Funds	1-2 years	70%
Medium-Term Funds	2-5 years	50%
Long-Term Funds	5-10 years	25%

Within these broad ranges, Council relies upon assumptions of expected investment returns and market conditions that have been examined with its investment advisor.

On advice, Council shall designate an appropriate horizon to investment in managed funds, which have no maturity date. In addition, Council may allocate a horizon to eligible tradeable or callable securities which have an anticipated holding period shorter than the legal maturity.

The following tenor limitation applies:

Long-Term Ratings	Maximum Tenor
AAA	Not applicable
AA range or A+	5 years
A or A-	3 years
BBB+	3 years
BBB and below	12 months
TCorp Investments	Not applicable

Note: Council has requested an exception from TCorp regarding the tenor limits for Investments in A+ rated companies which includes the major banks.

Management noted that other Councils have received waivers to continue long-standing investment programmes that include liquid assets, hence, Council requested for amendment of the A+ category from 3-year tenor limit to 5 years.

TCorp will provide a response to address this query during the next credit committee meeting and respond to Council's request.

## 5. Third Party Suppliers and Dealers

Council will structure its affairs in order to be economical in its investment management costs, favouring dealing direct in its fixed interest, where possible (or, where intermediated, arrangements that result in a rebate of brokerage).

At times, it will be advantageous to deal with third parties that are remunerated on a transaction, rather than retainer basis. Council will use such suppliers where it is to its advantage and apply a "best execution" test. Specifically, Council will have regard to:

- Administrative cost savings;
- Ability to access higher (retail) rates where exceeding the direct transaction costs;

- Access to ADIs that would not normally have an institutional direct channel;
- Limited access or initial offering deals, or other secondary market opportunities that are only available from specific sources; and
- The costs of other distribution channels that do not involve transaction remuneration.

Council will take steps to ensure that:

- Any suppliers used are appropriately licensed, reputable and capable;
- Funds and identification data are sufficiently secured;
- Third party arrangements do not materially worsen Council's credit risks by creating exposure to the dealer as counterparty;
- Council maintains ownership of investments facilitated by a third party at all times; and
- Remuneration arrangements are reasonable and transparent, whether paid by Council or by the issuer directly.

## 6. Investment Advisor

Council's investment advisor is appointed by the Council and must be licensed by the Australian Securities and Investment Commission (ASIC). The advisor must be independent and must confirm in writing that they have no actual or potential conflict of interest in relation to investment products being recommended and are free to choose the most appropriate product within the terms and conditions of the Investment Policy. This includes receiving no commissions or other benefits in relation to the investments being recommended or reviewed unless such remuneration is rebated 100% to Council.

## 7. Accounting

Council will comply with appropriate accounting standards in valuing its investments and quantifying its investment returns.

In addition to recording investment income according to accounting standards, published reports may show a break-down of its duly calculated investment returns into realised and unrealised capital gains and losses, and interest.

Other relevant issues will be considered in line with relevant Australian Accounting Standards, such as discount or premium, designation as held-to-maturity or on a fair value basis and impairment.

## 8. Safe Custody Arrangements

Where necessary, investments may be held in safe custody on Council's behalf, as long as the following criteria are met:

- Council must retain beneficial ownership of all investments;
- Adequate documentation is provided, verifying the existence of the investments at inception, in regular statements and for audit;
- The Custodian conducts regular reconciliation of records with relevant registries and/or clearing systems; and
- The Institution or Custodian recording and holding the assets will be:
  - The Custodian nominated by TCorpIM for its Funds;



- Austraclear;
- An investment-grade institution by Standard and Poor’s, Moody’s, or Fitch rating; or
- An institution with adequate insurance, including professional indemnity insurance and other insurances considered prudent and appropriate to cover its liabilities under any agreement.

## 9. Performance Benchmark

The performance of each investment will be assessed against the benchmarks listed in the table below. It is Council’s expectation that the performance of each investment will be greater than or equal to the applicable benchmark by sufficient margin to justify the investment considering its risks, liquidity, and other benefits of the investment, and executed at the best pricing reasonably possible.

Investment	Performance Benchmark	Time Horizon
11am accounts, short dated bills, ADI deposits of appropriate term, TCorpIM Cash.	AusBond Bank Bill Index (Net of Fees and Expenses)	3 months or less
Term Deposits or FRNs of appropriate remaining term.		3 months to 12 months
Term Deposits with a maturity date between 1 and 2 Years, FRNs, TCorpIM Short Term Income.		1 to 2 yrs.
FRNs, Bonds, Term deposits with a maturity date between 2 and 5 Years.		2 to 5 yrs.
TCorpIM Managed Funds (outside fixed interest sectors)	Fund’s Internal Benchmark (Net of Fees and Expenses)	3 yrs. (M/T Growth) 5+ yrs. (L/T Growth)

The decision on when to exit such investments are based on a range of criteria specific to the investments – including but not limited to factors such as:

- Returns expected over the remaining term
- Fair values
- Competing investment opportunities
- Costs of holding
- Liquidity and transaction costs
- Outlook for future investment values

In general, it is expected that professional advice will be sought before transacting in “grandfathered” investments. This policy does not presume disposal; however, the removal of an asset from the Minister’s Order would warrant a review of its suitability for retention.

## 10. Reporting and Reviewing of Investments

Documentary evidence must be held for each investment and details thereof maintained in an investment register.

The documentary evidence must provide Council legal title to the investment.



For audit purposes, certificates must be obtained from the banks/fund managers/custodian confirming the amounts of investment held on Council's behalf at 30 June each year and reconciled to the investment register.

All investments are to be appropriately recorded in Council's financial records and reconciled at least on a monthly basis. The report will detail the investment portfolio in terms of holdings and impact of changes in market value since the previous report and the investment performance against the applicable benchmark. Council may also nominate additional content for reporting.

A monthly report will be provided to Council detailing the money invested as required by clause 212 of the *Local Government (General) Regulations 2005*.

### **11. Duties and Responsibilities of Council Officers**

The *Trustee Act 1925* requires trustees to “*exercise the care, diligence and skill that a prudent person of business would exercise*” in investing beneficiary funds, and this test is adopted by the Guidelines, which also state “*A prudent person is expected to act with considerable duty of care, not as an average person would act, but as a wise, cautious and judicious person would.*”

As trustees of public monies, officers are to manage Council's investment portfolios to safeguard the portfolio in accordance with the spirit of this Investment Policy and not for speculative purposes.

When exercising the power of investment, the council officer should consider the following issues:

- The risk of capital or income loss as well as other risks referenced in this Policy.
- The likely income return and the timing of income return;
- The length of term of the proposed investment;
- The liquidity and marketability of the proposed investment;
- The likelihood of inflation affecting the value of the proposed investment; and
- The costs (such as commissions, fees, charges and duties) of making the proposed investment.

### **12. Ethics and Conflict of Interest**

Officers shall refrain from personal activities that would conflict with the proper execution and management of Council's investment portfolio. This policy requires officers to disclose any conflict of interest to the General Manager.

Independent advisors are also to declare that they have no actual or perceived conflicts of interest and receive no inducements in relation to Council's investments, as outlined more fully in the Investment Advisor section.

### **13. Implementation**

The Finance Section within the City Performance Directorate has responsibility for implementation of this policy.

### **14. Review**

This policy shall be reviewed annually and as required in the event of legislative change or as a result of significantly changed economic/market conditions. Any proposed amendments to the Investment Policy must be approved by a resolution of Council.