

ITEM 2. INVESTMENTS HELD AS AT 31 AUGUST 2007**FILE NO: S03-4147****SUMMARY**

This report provides details of Council's Investment Portfolio as at 31 August 2007.

Council's total Investment and Cash position as at 31 August 2007 is \$445.1M, with investments earning interest of \$1.3M during the month of August 2007.

Council's monthly net return annualised for August 2007 of 4.51% underperformed the USBA Bank Bill Index of 6.36%, reflecting the performance of its Managed Funds, particularly Blackrock Investments. The Managed Funds have been significantly effected by their investment in corporate debt securities (including bonds) as global market's have repriced their expectations for credit risk following on from the concerns first raised in the US sub prime residential mortgage market.

Financial analysts suggest that the market repricing of these securities may be overly conservative at this time given there is nothing to indicate that the underlying fundamentals, credit quality and capital value of these securities has been impaired. For instance corporate defaults have not increased and underlying earnings if anything remain strong. However the Managed Funds are required to adjust their portfolios to reflect market values each month which is reflected in August's sub-par results.

While Council has been a long term advocate of investing through a diversified pool of Fund Managers, to leverage off their financial expertise and analytical resources, the asset diversification strategies of the Cash Plus funds are not performing given the credit pricing currently evident in the market. This is expected to be a short to medium term situation and Council is therefore acting to reduce its exposure until the current market volatility stabilises.

Council staff are therefore actively repositioning the investment portfolio by transferring funds to more Cash dominated funds and acquiring a range of direct securities with approved deposit taking institutions. This approach accords with that discussed in the investment briefing provided to Councillors on 27 August and will continue in September to improve the current portfolio performance.

Council's annual rolling return for August 2007 of 6.55% continues to outperform the USBA Bank Bill Index of 6.48%.

RECOMMENDATION

It is resolved that the Investment Report as at 31 August 2007 be received and noted.

ATTACHMENTS

Attachment A: Register of Investments and Cash as at 31 August 2007

Attachment B: Investment Performance as at 31 August 2007.

Attachment C: Comparative Portfolio Structure – July to September 2007

Attachment D: Investment Performance forecast as at 6 September 2007

BACKGROUND

1. In accordance with the principles of financial management, cash that is surplus to Council's immediate requirements is invested within accepted risk parameters to optimise interest income while ensuring the security of these funds.
2. Surplus cash is invested in authorised investments per governing legislation and in accordance with Council's Investment Policy and Strategy.
3. The benchmark performance goal of Council's Investment Policy and Strategy is to surpass the UBSA Bank Bill Index.
4. Council's total Investment and Cash position as at 31 August 2007 is \$445.1M, an increase of \$33.4M from the \$411.7M reported at July 2007. This increase reflects first quarter rates receipts.
5. Council's monthly net return annualised for August 2007 of 4.51% underperformed the UBSA Bank Bill Index of 6.36%, reflecting the performance of its Managed Funds, particularly Blackrock Investments. The Managed Funds have been significantly effected by their investment in corporate debt securities (including bonds) as global market's have repriced their expectations for credit risk following on from the concerns first raised in the US sub prime residential mortgage market.
6. Financial analysts suggest that the market repricing of these securities may be overly conservative at this time given there is nothing to indicate that the underlying fundamentals, credit quality and capital value of these securities has been impaired. For instance corporate defaults have not increased and underlying earnings if anything remain strong. However the Managed Funds are required to adjust their portfolios to reflect market values each month which is reflected in August's sub-par results.
7. While Council has been a long term advocate of investing through a diversified pool of Fund Managers, to leverage off their financial expertise and analytical resources, the asset diversification strategies of the Cash Plus funds are not performing given the credit pricing currently evident in the market. This is expected to be a short to medium term situation and Council is therefore acting to reduce its exposure until the current market volatility stabilises.
8. Council staff are therefore actively repositioning the investment portfolio by transferring funds to more Cash dominated funds and acquiring a range of direct securities with approved deposit taking institutions. This approach accords with that discussed in the investment briefing provided to Councillors on 27 August and will continue in September to improve the current portfolio performance.
9. In the month of August Council reduced its existing Managed Funds Portfolio by a net \$50M with \$8M transferred to a Cash based fund manager and the balance of \$42M invested directly in term deposits and floating rate note securities to improve returns. Additional revenue from the first quarter rates receipts was also invested in term deposits. These transfers and investment returns, demonstrating their out-performance of the UBSA Bank Bill Index, are provided at Attachment A.
10. Note that Council's annual rolling return for August 2007 of 6.55% continues to outperform the USBA Bank Bill Index of 6.48%. This result is shown in the charts at Attachment B.

11. Market information in early September does not provide any assurance that the current repricing of securities held by the fund manager's has stabilised and in fact analysts suggest that the volatility may remain in the market for some time. Staff will therefore continue to search for appropriate securities, in line with Council's Investment Policy and Strategy, that are better able to out-perform the benchmark at this time.
12. The repositioning of the portfolio investments, and the transfer of funds from the Managed Funds to term deposits and floating rate notes in August and September to date, is reflected at Attachment C.
13. Additional charts have been prepared to indicate the forecast portfolio weighted returns, both per month annualised and rolling 12 months, against the forecast benchmark following re-positioning of the portfolio to 6 September. The forecast results are presented in Attachment D.
14. As advised in Council brief of 27 August 2007, all CDOs within the investment portfolio continue to retain their credit rating as at 31 August. While this reflects the quality and strength of the underlying securities within each CDO, it should be understood that they are not immune to individual and collective price volatility in the markets. As advised in the briefing, indicative market valuations will be provided to Council on a regular basis, with the first update to be provided in the September Investment Report. However, financial analysts suggest that given the quality of our CDOs, the most appropriate course of action at this point in time is to continue to retain these securities.

KEY IMPLICATIONS

15. Council's investments are in accordance with Council's Investment Policy.

FINANCIAL IMPLICATIONS

16. Council's investments earned interest of \$1.3M for August 2007.

RELEVANT LEGISLATION

17. Council is authorised to invest its surplus cash under Section 625 of the Local Government Act 1993.
18. The Local Government (Financial Management) Regulation 1999 (clause 16) requires Council to provide a written monthly report of all monies invested, under Section 625 of the Act.

CRITICAL DATES / TIME FRAMES

19. A monthly investment report must be submitted for Council's information and review within the following month.

PUBLIC CONSULTATION

20. Consultation is regularly undertaken with a number of fund managers and investment advisers to consider options and ensure that Council continues to maximise its investment return within appropriate risk parameters.

JOHN BARBELER

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