

ITEM 4. INVESTMENTS HELD AS AT 31 DECEMBER 2007**FILE NO: S034147****SUMMARY**

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

Council's total Investment and Cash position as at 31 December 2007 is \$448.5M. Investments earned interest of \$2.6M for the month of December 2007.

Council's monthly net return annualised for December 2007 of 7.33% performed above the UBSA Bank Bill Index of 7.20%, despite continued volatility in global credit markets during the month.

This outcome continues to reflect the ongoing strategy of redirecting funds from the Managed Funds portion of the portfolio to invest in cash dominated funds and direct securities (term deposits and floating rate notes) that are currently providing enhanced returns. Managed Funds represent 13% of the total investment portfolio and direct investments constitute 86% of the total portfolio, the 1% balance comprising cash holdings.

Council's annual rolling return for December 2007 of 7.30% continues to outperform the USBA Bank Bill Index of 6.73%.

This quarterly investment report also provides revised indicative market valuations and credit ratings of direct securities (including CDOs, CPPIs and Floating Rate Notes) with the CDOs in particular continuing to reflect the current adverse effects of negligible trading opportunities and the ongoing tight global credit markets. Council's objective in acquiring these investments remains one of realising enhanced yields above benchmark and increasing the diversification of the portfolio over a longer term investment horizon. The investments are managed within the overall investment portfolio to ensure that their "forced" liquidation will not be required to satisfy the City's short-term cash requirements in unfavourable markets.

In December, Council also acquired three long term sustainable investments with links to climate change responsibility (ANZ-SAM Climate Fund), use of renewable energy and water resource management (Westpac-Dandelion Note) and the adoption of ethical practices and procedures (Longreach-Perpetual Wholesale SRI Fund). These investments accord with the City's Investment Policy and Strategy, our commitment to the Sustainable Investments for Local Government Project, and are capital protected at maturity.

RECOMMENDATION

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

ATTACHMENTS

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

Attachment B: Investment Performance and Structure as at 31 December 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 December 2007 is \$448.5M, a decrease of \$17.8M from the \$466.3M reported at November 2007, reflecting creditor and expense payments during a month with minimal rates receipts. A schedule detailing all of Council's investments as at December is provided at Attachment A.
5. Council's monthly net return annualised for December 2007 of 7.33% is above the UBSA Bank Bill Index of 7.20%. Council implemented a strategy in the latter half of 2007 to redirect funds from the Managed Funds portfolio into higher yielding direct securities (term deposits and floating rate notes) where the returns were not directly linked to the credit market. Consequently, Council has realised the enhanced returns that are currently available for direct securities to outperform the bank bill index and at the same time has avoided adverse returns on credit based investments.
6. Attachment B provides graphical representations of Council's monthly returns annualised, the 12 month rolling return achieved, the cumulative interest performance above the benchmark over the last 3 years, and the diversified investment portfolio structure during this financial year.
7. From July to December, the strategy of redirecting the funds has decreased the proportion of the total portfolio invested in Managed Funds from 65% to 13% with a corresponding increase in our direct investments from 30% to 86%. This strategy remains appropriate for the current credit markets and Council continues to maintain sufficient managed fund investments to provide the liquidity necessary to support operational and capital cash requirements. The Managed Funds produced a return of 7.58% for December and performed above the UBSA Bank Bill Index of 7.20%.
8. The Council's annual rolling return for December 2007 of 7.30% continues to outperform the USBA Bank Bill Index of 6.73%.

9. Revised indicative market valuations at 31 December 2007 of all direct securities (including CDOs, CPPIs and Floating Rate Notes) have also been included in this quarterly report. While the values of the CDOs continue to reflect the current non-liquid “buyers” market, and the impact of ongoing tight credit markets, analysts advise that the underlying fundamentals and credit quality of these securities remain sound and that the appropriate strategy in the current market environment is to hold these investments. It is important to note that Council acquired these securities (CDOs, CPPIs and Floating Rate Notes) to achieve higher investment yields above benchmark, to increase the diversification of the portfolio over a longer term investment horizon, and that their inclusion within the overall investment portfolio is managed to ensure that their “forced” liquidation will not be required to satisfy the City’s cash requirements within unfavourable markets.
10. Despite the current state of the credit markets, the majority of Council’s CDOs continue to maintain their AA credit rating; however, as flagged in the November report, the Kakadu CDO has now experienced a one notch downgrade in its credit rating from AA to AA-. This downgrade reflects the ongoing global credit market volatility surrounding corporate credit borrowings, and the performance of the corporate debt specifically included within this CDO. Kakadu is an actively managed CDO which allows the managers of this product to continue to look for opportunities to swap individual corporate credits within the portfolio to mitigate the risks of further credit rating migration.
11. While this is the only downgrade at this stage, market advice has also indicated that the Quartz CDO faces a probable downgrade from AA to A as a result of changes to the ratings of some underlying corporate entities.
12. Staff continue to actively investigate alternative opportunities within the market to ensure that returns are maximised within acceptable risk parameters and to further diversify the portfolio and improve the total portfolio return.
13. During December, Council acquired three long-term sustainable investments (total value \$6m). These investments are related to funds and corporations that actively manage their climatic change impact (ANZ-SAM Climate Fund), use and promote renewable energy and water resource management (Westpac-Dandelion Note), or adopt and promote ethical practices and policies (Longreach-Perpetual Wholesale SRI Fund). The acquisition of these investments accords with the City’s Investment Policy and Strategy and our commitment to the ‘Sustainable Investments for Local Government’ Project.
14. These long-term sustainable investments have capital protection on maturity and, while the values of these investments and the returns thereon may vary over the term of the investments, they are expected to deliver above benchmark returns over the duration of the investment. Where CDOs are linked to the credit markets, these investments are linked to the long-term performance of the equities market, to further diversify the portfolio.

KEY IMPLICATIONS

15. Council’s investments accord with Council’s Investment Policy and Strategy which is currently under review.

16. The presentation of the revised Policy and Strategy to Council remains on hold as representatives from the Department of Local Government have recommended that it would be more appropriate to officially revise the Policy after they release their report and recommendations in respect to Local Government Investments, which is expected to be available early in 2008.

FINANCIAL IMPLICATIONS

17. Council's investments earned interest of \$2.6M for December 2007, contributing to YTD earnings of \$13.3M which is \$2.5M above a YTD budget of \$10.8M. This favourable result reflects continued earnings above benchmark, a significantly higher opening cash balance as a result of a shortfall in the forecast 2006/07 capital expenditure than budgeted and a higher than expected net surplus.
18. The full year forecast at December is \$25.5M which is \$3.5M above the budget of \$22.0M

RELEVANT LEGISLATION

19. Council is authorised to invest its surplus cash under Section 625 of the Local Government Act 1993.
20. 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

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

PUBLIC CONSULTATION

22. 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

Director Corporate Services

Bill Carter, Finance Manager