

Investment Policy

city of villages

Resolution of Council

14 FEBRUARY 2011

**ITEM 6.4 REVIEW OF THE INVESTMENT POLICY AND STRATEGY FOR THE
MANAGEMENT OF COUNCIL'S SURPLUS FUNDS (S081153)**

It is resolved that Council adopt the revised Investment Policy and Investment Strategy for the Management of Surplus Funds, as shown at Attachments A and B to the subject report.

Carried unanimously.

The Investment Policy, as adopted by Council, is as follows:

PURPOSE

The Investment Policy stipulates the mandatory requirements for the management of Council's cash and investment portfolio, and requires that all investment activities be exercised with the care, diligence and skill of a prudent person, and not for speculative purposes.

The policy is designed to safeguard the City's cash and investments portfolio, achieve appropriate earnings and manage council's cash resources to ensure sufficient liquidity to meet Council's business objectives over the long, medium and short term. The policy reinforces Council's ongoing commitment to maintain a conservative risk / return portfolio, an important component of its ongoing prudent financial management practices.

The policy is supported by a separate Investment Strategy that considers Council's current investment portfolio, its financial position and financial commitments, current legislative constraints, the global investment environment, and specifies our investment goals for the forthcoming year.

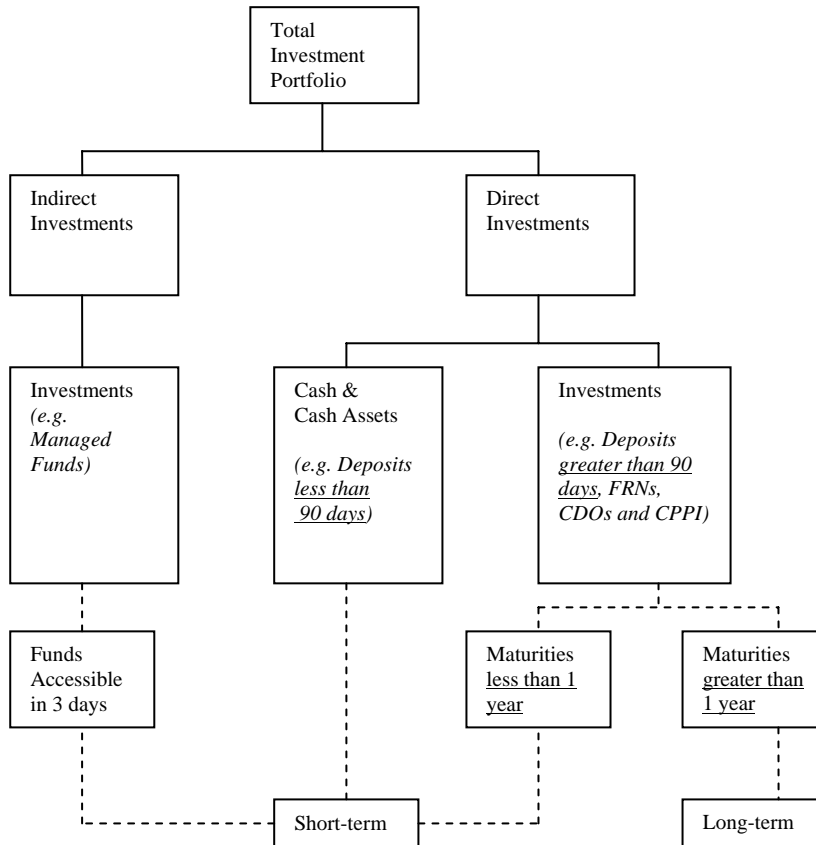
The City of Sydney's financial policies are developed to ensure that the City satisfies legislative requirements and follows "best practice" in its business operations, with due consideration for the effective and efficient management of the resources utilised within that business.

SCOPE

Investment of surplus funds is carried out primarily within the Finance Unit and this policy applies to all managers and employees who actively manage the investment of surplus funds or have the responsibility for employees who actively manage the investment of surplus funds.

DEFINITIONS

The following diagram illustrates the structure of the City's investment portfolio and identifies the relationship of terms referred to within this policy:



POLICY CONTENT

Legislative Authority for Investments

All investments are to be made in accordance with:

- Local Government Act 1993 - Section 625
- Local Government (General) Regulation 2005 –Clause 213
- Minister’s Investment Order (gazetted)
- NSW Trustee Act 1925 – Sections 14A(2), 14C(1) and (2)
- Division of Local Government Investment Circulars
- Division of Local Government
 - Code of Accounting Practice & Financial Reporting
- Division of Local Government Investment Guidelines

Investment Governance (Internal Controls)

Summary of Internal Control Practices

The following internal control practices are in place to ensure adequate governance, and allow transparent and clear performance measurement, for the management of the City’s cash and investment portfolio:

- Financial Planning and Cash-flow Management
- Delegated Authorities
- Measurement of Investment Performance
- Performance Benchmarks
- Monthly Reporting
- Investment Policy & Strategy Review
- External and Internal Audit oversight

Financial Planning and Cash-flow Management

Funds that are surplus to Council's immediate cash requirements will be managed in accordance with the long, medium and short-term financial cash requirements of the City.

Long term financial plans are developed to ensure the long term financial sustainability of Council. These plans will incorporate forecast future cash inflows and outflows to estimate cash surpluses and shortages in future periods, and identify the longer and medium term investment horizon for surplus funds.

Shorter term financial plans are used to predict funds availability and monitor the council's cash management needs throughout the year. These cash flow models are monitored daily to facilitate informed investment decisions and to ensure that sufficient liquidity exists to satisfy Council's financial commitments.

Delegated Authorities

The following officers have delegated authority to invest surplus funds in accordance with the Investment Policy and Investment Strategy:

- Chief Executive Officer (CEO)
- Chief Operating Officer (COO)
- Chief Financial Officer (CFO)
- other senior financial officers (as per the Delegations manual)

Investment recommendations are prepared in accordance with the Policy and Strategy, forecast cash requirements, and consider alternative investments with comparable risk, liquidity and maturity profiles to ensure that best value is achieved. A minimum of two price quotations are obtained for the acquisition of all market investments.

Each investment recommendation is approved by two authorised signatories, with appropriate delegation limits, and retained on file as a permanent record.

Any single investment exceeding \$5M requires one of the two authorised signatories to be either the CEO, the COO, or the CFO. Where more than one investment is listed in a single recommendation, this requirement has application to the amount of any individual investment and not to the total amount of all investments on the recommendation.

Investments in non-ADIs, and/or investments with maturity terms (or initial call dates) that exceed 5 years, require the written authority by any two of the CEO, COO and CFO.

Officers shall not engage in activities that would conflict with the proper execution and management of Council's investment portfolio. Any potential conflicts should be appropriately disclosed in accordance with Council's Code of Conduct.

Measurement of Investment Performance

Investment performance includes both interest returns and any change in the underlying capital value of the investments.

Indirect investments with fund managers are repriced monthly to account for investment returns and movements in capital value. Council receives a revised monthly valuation of its overall holding in each fund which is used as the measure of their monthly investment performance.

Direct investments are acquired with the intention of holding them through to maturity, and cash liquidity requirements are managed to ensure that Council is not in a financial position that will require a forced sale of these assets. On this basis, interim fluctuations of capital value are excluded from the monthly measurement of investment performance.

Notwithstanding the above position, changes in capital value are important and Council's quarterly investment reports will therefore provide Council with indicative market valuations of each investment. In the event that the capital value of any investment becomes permanently impaired, or a capital loss or gain is actually realised (through disposal), the loss or gain of value will be recognised within that month's financial accounts.

In accordance with the requisite accounting standards, all investments are required to be "marked to market value" at year end and a full provision will therefore be recognised for the net changes in the indicative market values of all direct investments at the end of each financial year.

Performance Benchmarks

Investment performance will be measured monthly, in relation to both current month and 12-month rolling returns, against relevant benchmarks.

The investment portfolio's performance should be compared to mandatory benchmarks as determined by the Division of Local Government and other indices that are relevant, independently determined and publicly available (e.g. RBA Indices).

Mandatory benchmarks would provide transparency and facilitate the active monitoring and comparability of performance measurement across NSW councils. At this time, no such mandatory benchmark exists, however, councils commonly measure their performance against the UBSA Bank Bill Index.

Benchmarks that better reflect the profile of the total portfolio in respect of liquidity, maturity and risk profile, and whether council actively trades its direct investments provide a more useful comparison of Council's performance. Council's portfolio performance is therefore also compared against the 30 day Bank Bill Rate, which is an index that provides a fair indicator of the risk free rate of return, so that Council can understand the return that has been earned from diversifying its investment portfolio and accepting conservative levels of risk.

The use of independently determined benchmarks will be approved by the CFO or the COO. Where Council changes independently determined benchmarks, monthly reports for the month of change and the next five months thereafter shall contain reporting of investment returns against benchmark for both the following;

- the benchmark that is being replaced, and
- the new benchmark, backdated on a twelve month basis

Monthly Reporting

The Local Government (General) Regulation 2005 (clause 213) requires a monthly report on investments to be provided to Council.

The monthly report to Council will include:

- the total value of the portfolio
- a complete schedule of all investments within the total portfolio
- full disclosure of all investments by type, current credit rating and face value
- net investment income for the month (actual against budget)
- the weighted average investment returns for the current month and the last 12 months rolling period (actual against benchmark)
- informative commentary on portfolio compliance and performance, current economic investment environment, and any change to current strategy
- a certificate to the effect that investments accord with the Act, regulations and council's investment policies.

Each calendar quarter, the monthly report will also include:

- indicative market valuations of Councils investments
- analysis of the portfolio's liquidity (maturity) profile
- analysis of the portfolio's risk profile (credit ratings)
- analysis of the portfolio's product diversification (investment types)

Investment Policy & Strategy Review

The Code of Accounting Practice & Financial Reporting requires Council to undertake an annual review of its Investment Policy and Investment Strategy.

If there are any significant changes to the Act, Regulations, issued guidelines, or if the market changes to a degree that warrants an earlier review, the Policy and/or Strategy will be brought back to Council for its consideration.

Audit

The City's external auditors will require independent certification from the relevant financial institutions (banks, fund managers, etc) to confirm the balance of investment held on Council's behalf at the end of the financial year, and the adequacy of their internal control procedures.

Internal Audit will also periodically review the adequacy of the Investment Policy, Strategy and management's internal controls as part of its audit review program.

Investment Criteria

This section stipulates the underlying criteria for investments to be considered for inclusion within the City’s portfolio. There are general criteria which all investments must satisfy, and specific criteria for direct and indirect investments of different types.

The criteria differentiate investments on the basis of whether or not they are proposed to be held with an Approved Deposit-taking Institution (ADI) as it acknowledges the additional assurance that arises from their regulation by the Australian Prudential Regulation Authority (APRA). The legislation allows Councils to invest directly in Australian banks or branches of foreign owned banks, credit unions and/or building societies as these institutions have the safeguard of being regulated and are required to maintain significant capital reserves.

General Investment Criteria - All Investments

- Investments must comply with the legislative authorities as described in the Legislative Authority for Investments paragraph of this policy.
- Investments must be denominated in Australian Dollars.
- Investments must be held in the City of Sydney’s name.
- Credit ratings apply to both products and institutions, however, this policy requires the rating applicable to the institution responsible for the product (eg, guarantor) to be taken as the relevant rating given this represents the underlying risk to the City.
- Credit ratings must be independently reviewed regularly to ensure ongoing compliance. Investments with credit ratings downgraded to an extent that they no longer comply will be divested as soon as practicable, subject to the risks of default and prevailing market liquidity (refer the grandfathering provisions set out in Section 8).

Investment Criteria – Cash and Cash Assets

- Cash and cash assets for the purpose of this policy comprise physical cash and cash holdings in the form of cash call accounts (eg, 11AM, 24HR and 7 Day) and term deposits up to 90 days.
- These assets may only be invested with APRA regulated ADIs or with the New South Wales Treasury Corporation (Tcorp).
- Investments in ADIs including banks, credit unions or building societies that do not have a credit rating must have total net assets of \$300M or greater.

Investment Criteria - Direct Investments

- Direct investments include term deposits exceeding 90 days, Floating Rate Notes (FRNs), Transferable Certificates of Deposit (TCDs), Collateralised Debt Obligations (CDOs) and Capital Protected Securities (CPPIs), although note that many of these products may no longer be acquired.
- The term to maturity of specific direct investments may not exceed the periods shown below:

<u>ADIs:</u>	Maximum term
Investments- Fixed Rate Term deposits	2 years
Investments	10 years

Non-ADIs:
Investments

7 years

- Investments in ADIs including banks, credit unions or building societies that do not have a credit rating must have total net assets of \$300M or greater.

Investment Criteria - Indirect Investments (Managed Funds)

- Managed Funds must have a credit rating of A- or higher.
- Funds must be available to the City within 1 to 3 days notice without penalty.
- Fund managers must provide the following information within 7 days of month-end:
 - total value of the fund,
 - total value of the City's investment holdings,
 - the gross and net (after management fees) return for
 - the current month;
 - financial year to date; and
 - the last 12 months (rolling).

Investment Portfolio Parameters

Investment portfolio parameters are risk-management tools used to manage credit risk by diversifying the portfolio to avoid a narrow concentration of investments, and to ensure liquidity needs are maintained:

Credit risk parameters are established at 3 levels for the portfolio:

- cash and cash assets, and short term liquid investments (<90 days);
- short (maturing between 90 to 365 days) and long term liquid investments, and indirect investments (e.g. managed funds); and
- non-liquid investments

to take into account both the maturity date of investments and their liquidity.

Liquid investments for the purposes of this policy comprise investments with well established and active secondary markets that are independent of the issuer of the investment product (e.g. FRNs). Non-liquid investments comprise investments for which no ready secondary market exists (e.g. CDOs).

Credit risk investment parameters are based on credit rating bands as published by the credit rating agencies (e.g. S&P, Moodys, Fitch). Short-term ratings are also published for certain financial institutions and these may be applied to their investment products which have a maturity date of less than 12 months.

Where the principal amount and accrued interest of any investment with a financial institution are directly guaranteed by the Australian Federal Government for full repayment, the parameters in the tables below may be exceeded as follows:

- exposures to single institutions may exceed the stated limits provided that the excess amount comprises only guaranteed investments, and
- exposures of the total portfolio to credit ratings lower than AAA may be exceeded provided that the excess amount comprises only guaranteed investments.

As a result, investments directly guaranteed by the Australian Federal Government may comprise the total investment portfolio. Management should ensure that exposures to any underlying institutions that are in excess of the parameters specified in the tables below can be managed back to within the specified parameter levels prior to the expiration of any guarantee.

The following credit risk parameters apply to the investment portfolio:

Cash and Cash Assets, and Short Term Liquid Investments (less than 90 days)

Maximum Thresholds – Portfolio Percentage Limits		
Credit Rating	Direct Investment Products (as a % of Total Portfolio)	Exposure to a Single Institution (as a % of Total Portfolio)
AAA	100%	30%
AA	100%	25%
A	30%	20% (Maximum of \$20M)
Below A (APRA Regulated ADIs only)	10%	10% (Maximum of \$5M)

Liquid Investments – Short Term (maturing between 90 to 365 days), Long Term and Indirect Investments (Managed Funds)

Maximum Thresholds – Portfolio Percentage Limits				% of Total Fund	
Credit Rating	Investment Products (as a % of Total Portfolio)				Exposure to a Single Institution (as a % of Total Portfolio)
	Direct	Indirect	Total	Max % with a single institution ADIs Non-ADIs	Max % with a single Managed Fund

AAA	80%	100%	100%	30%	Yes	Yes	30%
AA	80%	80%	100%	25%	Yes	Yes	30%
A	30%	70%	70%	20%	Yes	Yes	20%
Below A							
(APRA Regulated ADIs only)	20%	N/A	20%	10% (Max of \$5M)	Yes	No	N/A

Non-Liquid Investments

Maximum Thresholds – Portfolio Percentage Limits		
Credit Rating	Direct Investment Products (as a % of Total Portfolio)	Exposure to a Single Institution (as a % of Total Portfolio)
AAA	10%*	2%*
AA	10%*	2%*
A	10%*	2%*
Below A	The policy prohibits the acquisition of below A rated non-liquid investments, but allows their retention through the grand-fathering	

	provisions as outlined in section 8.
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* Represents the maximum combined threshold for this type of investment, regardless of individual credit rating.

Procedures in relation to breaches of any particular thresholds are contained in the section of this policy entitled Grandfathering of Investments.

Liquidity parameters group the maturity dates of the investments into certain maturity bands as shown in the following tables.

Within each maturity band, thresholds are set to control:

- the maximum percentage of the total portfolio that may be held within the specific maturity band, and
- the minimum amount or percentage of the total portfolio that is required to be held within each maturity band, (or cumulatively in an earlier maturity period).

Maximum thresholds are set to control the proportion of the total portfolio that can be invested into longer term investments to ensure that Council has adequate access to short and medium term liquidity to satisfy its business objectives. The maximum thresholds reduce as the maturity horizon extends further into the future.

	1 month	2 to 12 months	1 to 3 Years	3 to 5 Years	> 5 Years
Maximum % of Total Portfolio	100%	80%	40%	35%	10%

Minimum thresholds are set to ensure that there will always be an adequate amount of liquidity available in earlier maturity bands before funds may be committed to longer term investments. The minimum thresholds are obviously higher in the shorter term when liquidity is of the greatest concern.

	1 month	2 to 12 months	1 to 3 Years	3 to 5 Years	> 5 Years
Cumulative Minimum % of Total Portfolio	10% or \$40M	40%	55%	90%	Nil

As investments with shorter term maturities are always able to be re-invested into investments with slightly longer maturities, the policy acknowledges that where investment levels in early maturity bands exceed minimum thresholds, those excess levels may be applied to meeting the minimum thresholds of succeeding maturity bands.

The minimum requirement for very short term access are set to \$40M to ensure adequate liquidity to meet council’s working capital requirements.

Procedures in relation to breaches of any particular thresholds are contained in the section of this policy entitled Grandfathering of Investments.

Investment Strategy

The City will prepare an annual Investment Strategy to guide the management of its surplus cash and investments within the requirements of this Policy.

The Investment Strategy will document all key objectives relating to management of cash and investment assets over the short to medium term in the context of prevailing market conditions at the time. The strategy will consider Council’s current investment portfolio, its financial position and financial commitments, current legislative constraints, the global investment environment, and specifies our investment goals and targets for the forthcoming year.

Mandatory components of Councils Investment Strategy will comprise the management of the following aspects of the investment portfolio:

- Risk Profile
- Liquidity/Maturity
- Return/Income
- Environmentally and Socially Responsible Investments

Requirements in respect of each component are detailed below.

Risk Profile

The City’s risk profile in relation to investing Surplus Funds is to be relatively prudent, conservative and risk averse. The profile will be achieved by effectively managing within the investment portfolio:

- the diversity of the investments, and
- the creditworthiness of the investments

Diversity is achieved by placing limits on the maximum exposure the City may have to individual:

- Funds or financial institutions and
- Credit rating bands.

Creditworthiness of investments is primarily determined using Industry Standard Credit Ratings. The City will use Standard & Poors (S&P) long and short term credit and fund ratings (or Moody’s or Fitch equivalents). The S&P ratings are broadly defined as follows:

AAA	Extremely strong capacity to repay
AA+, AA, AA-	A very strong capacity to repay
A+, A, A-	A strong capacity to repay
BBB+, BBB, BBB-	Adequate protection and adequate capacity to pay
BB+, BB, BB-	Less vulnerable to non payment however adverse economic conditions could lead to inadequate capacity to meet financial obligations

CCC

Vulnerable to non payment and requires positive economic conditions to meet its financial obligations

Liquidity/Maturity

The cash requirements of the City will be satisfied by monitoring and structuring the total maturity profile of the investment portfolio.

Return/Income

Investment returns are closely correlated to the risk profile of the underlying investments. Appropriate benchmark rates of return will be set in relation to the risk profile and returns will be required to meet or exceed benchmark rates.

Environmentally and Socially Responsible Investments

Subject to compliance with legislation, investment policy objectives and parameters, the City supports investment securities that are Environmentally and Socially Responsible Investments (SRI) that meet the compliance criteria of an SRI and any other desirable criteria as listed in this policy. These criteria may be applied to the individual investments, or the issuers of the investments, or both.

Environmentally and Socially Responsible Investments will be assessed on the same basis as other investment opportunities and the City will select the investment that best meets its overall investment selection criteria.

The criteria relating to an SRI are those which:

- Direct investment towards the socially and environmentally productive activities listed below, and/or
- Avoid investment in the socially and environmentally harmful activities listed below.

The criteria for SRI are all desirable and not mandatory requirements.

Socially and Environmentally Productive Activities are considered to be:

- Environmentally

- Resource efficiency-especially water and energy
- Renewable energy
- Production of environmentally friendly products
- Recycling, and waste and emissions reduction

- Socially

- Fair trade and provision of a living wage
- Human health and aged care
- Equal Opportunity Employers, and those that support the values of communities, indigenous peoples and minorities
- Provision of housing, especially affordable housing

Socially and Environmentally Harmful Activities are considered to be:

- Environmentally

- Production of pollutants, toxins and greenhouse gases
- Habitat destruction, especially destruction of forests and marine eco-systems.
- Desalination works
- Nuclear power
- Uranium mining

- Socially

- Abuse of Human Rights and Labour Rights
- Involvement in bribery/corruption
- Production or supply of armaments
- Manufacture of alcohol, tobacco or gambling products

Grandfathering of Investments

This Policy imposes limits and thresholds in relation to the acquisition and holding of investments. However, situations may occur where inadvertent breaches of these limitations or thresholds arise other than from the acquisition of investments, such as:

- Amendments to regulatory directives or legislation, and
- Changes in the total amount of Council's investment portfolio over time and the consequent changes to threshold limits which are determined as ratios of that total amount.

When limitations or thresholds are breached due to amendments to regulatory directives or legislation, the investment portfolio must be managed in accordance with the respective amendments. Where the amendments enable retention and grandfathering of existing investments, Council may continue to actively manage those investments within the portfolio in accordance with all other regulations and policies applicable to such investments. This includes a strategy of holding or divesting such investments in accordance with regular investment considerations.

Where limitations or thresholds are breached due to a change in the overall size of the total investment portfolio, the following process will apply:

- Immediate forced sale of the investments in breach of the limits or thresholds will not be required.
- An immediate freeze is imposed on the acquisition of new investments in the relevant category until the portfolio can be effectively managed back to accord with the requirements of this policy.
- The portfolio must be managed back in accord with the policy limits within 3 months from the date the portfolio first exceeds the threshold, subject to any adversity created by market liquidity, current valuations of these investments and the risks of default.

REFERENCES

Related policies and procedures

- The Code of Conduct
- The Disciplinary Policy & Procedures
- The Fraud & Corruption Prevention Policy
- The Risk Management Policy
- The Investment Strategy for the Management of Surplus Funds

Relevant Legislation

- Local Government Act 1993 - Section 625
- Local Government (General) Regulation 2005 –Clause 213
- Minister’s Investment Order (gazetted)
- NSW Trustee Act 1925 – Sections 14A(2), 14C(1) and (2)
- Division of Local Government Investment Circulars
- Division of Local Government
 - Code of Accounting Practice & Financial Reporting
- Division of Local Government Investment Guidelines

APPROVAL AND REVIEW

Review Period

The Code of Accounting Practice & Financial Reporting requires Council to undertake an annual review of its Investment Policy and Investment Strategy.

Next Review Date

February/March 2012

TRIM Reference Number

Document number: 2010/095055

AUTHORISATION

Approved by resolution of Council on 14 February 2011
