Appendix 2

DUBBO REGIONAL COUNCIL

March

Investment Strategy

2024

Investment Strategy

Purpose

The annual Investment Strategy sets out Council’s investment goals and targets for the coming year. The aim of the strategy is to guide the management of Council’s investment portfolio over the short to medium term to:

- achieve a balanced and diversified portfolio, in terms of allowable investment products, credit ratings and maturation terms that will outperform the benchmark indices; and
- ensure liquidity when required for Council’s operational and capital expenditure needs.

This strategy has been prepared in consultation with Laminar Capital Pty Ltd.

Scope

The *Investment Strategy* applies to all managers and employees who actively manage investments or have responsibility for employees who actively manage investments.

This strategy should be read in conjunction with Councils *Investment Policy*.

Effective Date

This document replaces any previous Strategy document approved by Council.

The effective date of this Strategy is 21 March 2024 and will be reviewed in March each year or when a change in either regulation or market conditions necessitates a review.

Context

Council’s investment strategy is determined after taking into consideration a review of the following issues:

- global and domestic economic investment environments;
- investment policy and legislative constraints;
- current composition of Council’s investment portfolio;
- long, medium and short term financial plans.

Global and domestic investment environments

The global economy grew more strongly than expected through 2023 even with headwinds from high interest rates as most major central banks continued to lift interest rates to contain inflation. Supply chain issues from the Covid lockdown era and the beginnings of the Ukraine

War (2020-2022) started to resolve in 2023 allowing goods prices to moderate and helping to reduce inflation although it remained above central banks' targets in America, Europe and Australia at year-end.

Bond, credit and share markets were volatile through 2023 but ended the year on a strong note amid expectations that central banks would pivot and start reducing official interest rates in 2024. Those expectations of rate cuts have been pushed out early in 2024 amid signs that inflation is proving to be stickier than was thought likely late in 2023. A longer period of official interest holding at least as high as they are now (5.50% in the US; 4.0% in Europe; and 4.35% in Australia) is in prospect increasing the risk of recession down the track.

Australia lagged the US and Europe in experiencing declining inflation but started to catch up through 2023. The CPI inflation rate fell from over 7% in late 2022 to 4.1% in Q4 2023, but progress is likely to slow in 2024 with high wage growth (4% year on year) and low labour productivity (-2% year on year) meaning that is unlikely inflation will return inside the RBA's 2-3% target band before mid-2025 at earliest. The RBA is warning that a risk remains that it may need to hike the 4.35% cash rate. At the very least it seems likely that the cash rate will hold at 4.35% until late 2024 or early 2025.

Essentially labour markets remained much tighter for much longer than expected through 2023. In the US, the unemployment rate at 3.7% in January 2024 is still close to a 60-year low-point. In Europe, the unemployment rate at 6.4% is at a quarter-century low point. Australia's unemployment rate has started to rise to a two-year high 4.1% in January 2024 but remains low by historic comparison. In the decade before the Covid pandemic recession, a period regarded as one of a strong labour market, the average monthly unemployment rate was 5.5%. While labour market conditions remain very tight there is little likelihood that central banks can start cutting official interest rates as soon or as much as markets are expecting currently.

The RBA last hiked the cash rate back in November 2023 by 25bps to 4.35%. At its meetings in December 2023 and February 2024 it remained on hold although indicating it was a close call between staying on hold or hiking further at both meetings. Weakness in retail spending in December and the beginnings of a softer trend in the December and January labour force reports reduce the risk of further rate hikes this year but are far from weak enough to promote a rate cut. Conditions may permit a rate cut by the end of this year, but more likely in the first half of 2025.

Legislative environment

Council's investment opportunities are constrained by a combination of legislation, regulation and any directions and guidelines issued by the Minister or the Office of Local Government.
There has been no change to the investment legislative environment for a number of years and the most recent Ministerial Investment Order released in January 2011 continues to limit Council's investment options to:

- term and at-call deposits with Approved Deposit-taking Institutions (ADIs);
- other ADI senior ranked securities;

- investments with NSW Treasury Corporation including their investment management division (TCorp and TCorpIM);
- funds or securities issued or guaranteed by the Commonwealth or any State or Territory.

Composition of Council's investment portfolio

The conservative nature of Council's Investment Strategy is clearly reflected in the structure of the portfolio, where 95.3% of the portfolio is invested with Australian Prudential Regulation Authority (APRA) - regulated ADIs and 4.70% of the portfolio is invested in Northern Territory Government Bonds.

Council's current portfolio is as follows (as at the end of January 2024)

Investment	Split
Big Four banks	42.4%
Australian mid-tier banks	47.6%
Foreign controlled Australian based ADIs	4.60%
Unrated – Local ADI	0.70%
Total APRA-regulated ADIs	**95.3%**
Northern Territory Government Bonds	4.70%
Total Investment Composition	**100.00%**

Investment strategy

Council's investment portfolio will continue to be prudently managed in accordance with:

- Council's *Investment Policy* and related legislative and regulatory requirements;
- documented Internal control Practices to preserve capital; and
- Council's operational and capital funding requirements.

Objectives

Council's investment strategy for the period is to maintain the highly secure profile of the portfolio, provide liquidity and deliver competitive investment returns commensurate with the portfolio structure.

Risk profile

The risk profile for Council's investment portfolio is based on the principles of being prudent, conservative and risk averse. This is achieved by managing the diversity and creditworthiness of investments in accordance with the *Investment Policy* and other relevant requirements.

Current investments are with APRA regulated financial institutions and Northern Territory Government Bonds so that credit risk remains minimal.

The maturity profile of the investments is adequately spread to ensure that liquidity and maturity risks are also kept to a minimum.

Council hold at call funds to meet cash flow liquidity requirements and invest excess funds to maximise returns. Council has historically held Floating Rate Notices (FRNs) to maturity; however a change in exit point would be considered if this would optimise the investment.

Liquidity / Maturity

The majority of Council's cash and investments portfolio is held as restricted reserves to satisfy legislative responsibilities and funding commitments contained within the *Dubbo 2040 Community Strategic Plan*.

To ensure Council has available funds to meet these short-term commitments, the following liquidity targets are set in accordance with the *Investment Policy*.

Investment Horizon Description	Investment Horizon - Maturity Date	Minimum Allocation	Maximum Allocation
Working capital funds	0-3 months	10%	100%
Short term funds	3-12 months	20%	100%
Short-Medium term funds	1-2 years	0%	70%
Medium term funds	2-5 years	0%	50%
Long term funds	5-10 years	0%	25%

Council's capital funding requirements will continue to increase over the next few years. Major capital expenditures in 2024 are anticipated to be approximately $87 million.

Additional requirements for capital expenditure are being funded from restricted assets which impacts the overall cash available for investment. The maturity profile of the investment portfolio has become more concentrated in the short and medium term rather than the longer term.

Council's liquidity will be monitored on an ongoing basis to ensure cash requirements are met and that liquidity parameters remain within allowable limits set out in the *Investment Policy*.

The Strategy

Investments are to be placed with the advantageous rate to Council and within the limits as set in the tables included in the *Investment Policy* and the Investment Strategy as listed below;

- Investment Policy - Performance Benchmark Table
- Investment Policy - Credit Rating Structure and Tenor Limits
- Investment Strategy – Investment Horizon Description

To maximise performance, the intention is to pursue the following actions during this strategy period;

- Maintain current cash holdings due to forecasts predicting the cash rate will remain static with the potential to slightly decrease towards the end of 2024.
- Increase fixed term deposits past 12 months as comparable term deposit rates are predicted to have peaked and have the potential to fall towards the end of 2024.
- Take advantage of longer tenor specials available.
- Prioritise investments by highest ratings when the variance in interest rates is marginal.
- Purchase secondary market FRNs where investment can be optimised reducing the liquidity risk and interest rate risk while having no impact on credit risk of the portfolio.
- Maintain a well-structured portfolio with a mix of maturities laddered across tenors.

Environmentally and Socially Responsible Investments

Council's ability to acquire environmentally and socially responsible investments within the current investment and policy environment remains limited, as:

- the structure of many of these investments remains prohibited under the current Ministerial Investment Order; and
- the global financial crisis caused significant declines in the valuation of the financial assets that comprise many of these investments.

Council will, however, continue to explore opportunities for supporting environmentally and socially responsible investments within these constraints. The investment climate is changing over time and Council notes that many large scale renewable projects are expected to evolve, which may offer sustainable investment opportunities in the future *via* co-investments. Council will continue to encourage and give preference to these investments where they comply with the Ministerial Investment Order and satisfy Council's policy and investment objectives.

References

Laws and standards	• *Local Government Act 1993;* • *Local Government (General) Regulation 2021*; • Ministerial Investment Order; • Local Government *Code of Accounting Practice and Financial Reporting;* • Australian Accounting Standards; • Office of Local Government Circulars.
Policies and procedures	• Investment Policy