

STRATEGY AND POLICY REVIEW COMMITTEE 7 APRIL 2008	POLICY AND PLANNING
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A6	INVESTMENT POLICY
LOCATION/ADDRESS:	
RESPONSIBLE EXECUTIVE DIRECTOR:	SALLY CALDER, EXECUTIVE DIRECTOR ORGANISATIONAL SYSTEMS AND SUPPORT
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FILE NO.:	
ATTACHMENTS:	INVESTMENT POLICY

1. EXECUTIVE SUMMARY

- 1.1. Council's investment policy (for surplus cash funds) has been reviewed.
- 1.2. The revised policy has been presented to the Audit Committee and subjected to external review by the Treasury Corporation of Victoria (TCV). Both the Audit Committee and TCV are satisfied with the policy from a risk perspective, TCV have however indicated that the use of the 90 day bank bill rate for the purpose of setting investment benchmarks may be unrealistic and that the official bank rate as set by the Reserve Bank is a more appropriate baseline.
- 1.3. The revised policy incorporates a risk management framework as the basis for within which the Council may undertake its investments. The following risks have been taken into account in the development of these guidelines:
 - 1.3.1. Market risk
 - 1.3.2. Counterparty risk
 - 1.3.3. Liquidity risk
 - 1.3.4. Maturity risk
- 1.4. The policy proposes different investment approaches for categories of Council's surplus cash holdings ie:
 - 1.4.1. Working Capital has been broken down into three categories, day to day funds which are governed by the liquidity management policy, funds held over the annual seasonal cash flow governed by the cash management policy and funds linked to longer term funding requirements (capital works) governed by the longer term investment policy.
 - 1.4.2. Long Service Leave funds may be invested in accordance with the liquid assets policy (15% of funds) and a longer term investment policy that allows for equity investments.

- 1.5. The policy provides for Council to invest in a range of cash deposits, money market instruments (bonds, commercial paper) and equity investments or equity related interest bearing investments. The policy sets caps on amounts that may be placed in these different securities as well as maturity guidelines that restrict the maturity dates of these securities.
- 1.6. The policy proposes a range of different benchmarks for the various components of Council's investment portfolio. The policy has been amended on the recommendation of TCV to reflect the RBA discount rate as the baseline for assessing performance rather than the 90 day bank rate.
- 1.7. The proposed policy does permit Council to invest directly in equities through a managed fund and therefore exposes it to potential risk. This risk is mitigated by the fact that only funds held for the long term (long service leave funds) may be invested in this manner and that the maximum exposure of approximately \$2m equates to some 5% of the total cash and investments portfolio.

2. BACKGROUND AND CONTEXT

- 2.1. An investment policy that sets out guidelines and principles to be followed by Council officers when placing funds on investment with financial institutions was developed and adopted by Council after review by the Audit Committee in March 2006.
- 2.2. One of the requirements of this policy was for it to be reviewed by the Audit Committee every two years.
- 2.3. The sub prime lending practices triggered a number of shocks in international financial markets during the latter half of 2007, including a contraction of lending by banks as they adopted more conservative lending practices. This had a resultant impact on the investment performance of a number of investment grade collateralized debt obligations (CDO's) that were issued on behalf of USA companies. One of the major issuers of related securities to the local government sector was Grange Investments (now Lehman Bros) who in addition to direct sub prime investments also marketed a Cash enhanced fund that contained exposure to a basket of CDO's.
- 2.4. The City of Port Phillip had invested \$5M in the Grange Cash Enhanced Fund in 2006. This investment met the criteria of the investment policy and had been performing in line or marginally better than its other investments until July 2007 when it recorded a negative 1.7% return. While it recovered in August subsequent returns underperformed relative to its other investment holdings. This investment has now been redeemed by Council with all its capital and accumulated interest intact.

- 2.5. Another shortcoming of the existing investment policy is that it does not allow for Council to invest any of its funds in equities either directly or indirectly. The Local Government Act permits councils to invest indirectly in Australian equities through a managed fund or the Victorian Funds Management Corporation (VFMC).
- 2.6. While investments in listed equities are significantly riskier in the short term, they have historically outperformed other asset classes over the long term. Council is required by legislation to set aside an amount that will cover its long service leave provision.
- 2.7. In this context a decision was taken to bring forward the review of Council's investment policy and an external expert, Guy Manuell of Barrington Treasury Services was engaged to carry out this review.
- 2.8. As part of the brief for the policy review, Barrington were provided with an analysis of Council's cash and investment holdings which were broken down into three categories;
 - 2.8.1. liquid cash investments – that enable Council to meet the day to day cash commitments of its operation (approximately \$5M).
 - 2.8.2. short term investments - that are required to enable Council to manage its uneven and seasonal cash cycle (approximately \$10M)
 - 2.8.3. longer term investments – typically funds that will be required by Council to meet the cash commitments that will arise as it progresses its capital works program, this includes the funding of the capital works roll over (approximately \$20M).
- 2.9. Barrington were also asked to develop a policy for the investment of Long Service Leave funds (approximately \$5M). In formulating a policy for these funds an assumption of 15% required to meet immediate commitments with the balance being invested for the long term was applied.
- 2.10. The proposed policy is attached to this report – Attachment 1.
- 2.11. This policy has been presented to the Audit Committee who have recommended that it be taken to Council for formal adoption.
- 2.12. An independent external review of the policy has also been undertaken by the Treasury Corporation of Victoria (TCV).

3. RECOMMENDED OPTION

- 3.1. It is recommended that Council adopt the proposed investment policy which builds on the existing policy and incorporates separate approaches to investing working capital and long service leave funds as well as recommended benchmarks for reporting investment performance.

3.2. Sustainability Assessment

SUSTAINABILITY ASSESSMENT

The proposed investment policy provides for the majority of Council's surplus funds to be placed in cash investments and money market instruments with a small proportion of funds (5%) exposed to equities.

SOCIAL EQUITY

Social Pillar	Council now has an option to place a portion of its investment portfolio in an ethical managed share fund.
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Objective– what the Council is trying to achieve under this pillar

To build a just, resilient, healthy and inclusive city with equitable access to responsive and relevant services and resources.

ECONOMIC VIABILITY

Economic Pillar	The proposed policy will enable Council to optimise its investment performance by enabling it to access different asset classes (including equities) and a range of different money market instruments (bank bills, bonds and commercial paper).
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Objective – what the Council is trying to achieve under this pillar

To promote effective stewardship of the council's assets and promote positive economic development within Port Phillip that also supports the council's social, cultural and environmental goals.

ENVIRONMENTAL RESPONSIBILITY

Environmental Pillar	Council now has an option to place a portion of its investment portfolio in an ethical managed share fund.
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Objective – what the Council is trying to achieve under this pillar

To foster a liveable and attractive urban environment that uses fewer finite resources

CULTURAL VITALITY

Cultural Pillar	Council now has an option to place a portion of its investment portfolio in a managed share fund.
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Objective– what the Council is trying to achieve under this pillar

To foster conditions that allow communities within Port Phillip to express, experience and enjoy diversity of values, beliefs and aspirations

3.3. Policy and legislative implications

Section 143 of the Local Government Act defines the investment types that are permitted for Victorian councils to place surplus funds. These are:

- Bank accepted / endorsed bank bills
- Bank Negotiable Certificate of Deposits (NCD's)
- Bank interest bearing deposits
- Victorian State of Commonwealth Government Bonds
- Other authorized deposit taking institutions
- On deposit with an eligible money market dealer within the meaning of the Corporations Act.
- Any other manner approved by the Minister, including investments in managed funds and trusts which have a rating of AAm or AAf from Standards and Poor's Australian ratings. It has been confirmed that investments in managed equity funds or the Victorian Funds Management Corporation (VFMC) will normally be approved by the Minister.

3.4. Risk implications

In developing the policy a risk management framework has been established within which Council may undertake its investments. The investment guidelines have considered the following:

- Market risk – the risks associated with volatility in interest rates, exchange rates, equity prices and commodity prices.
- Counterparty risk – the risk of default
- Liquidity risk – the inability to redeem investments for cash quickly.
- Maturity risk – longer term assets carry more risk than short term assets.

The investment policy has also set different thresholds for investment classes, restrictions on maturity date and rating requirements for issuers or counterparties.

3.5. Resource implications

The implementation of this policy will not have a direct cost to Council. It is expected that this policy will enable an improvement in the performance of its investment portfolio over time and achievement of the proposed benchmarks should result in it earning some \$200K more in interest revenue (based on average funds invested of \$40M).

4. PARTICIPATION AND ENGAGEMENT

4.1. Internal

4.1.1. The people who have been engaged with in relation to this issue are:

- Chief Executive Officer
- Executive Director, Organisational Systems and Support

4.2. External

4.2.1. The external people and/or organisations who have been engaged with in relation to this issue are:

- Audit Committee
- Treasury Corporation of Victoria
- Barrington Treasury Services

5. RECOMMENDATION

That the Strategy and Policy Review Committee recommend to Council:

- 5.1. That the Council adopt the revised investment policy set out in Attachment 1 to this report.
- 5.2. That the Manager, Finance & Investments be given delegated authority to exercise investment decisions on behalf of Council that are in accordance with this policy.
- 5.3. That Council receive a quarterly report on the performance of its investment portfolio against the proposed benchmarks.