INVESTMENT

Policy Objective

This policy's objectives are to provide a framework to help Council optimise its return on investment of surplus funds in a prudent and measurable manner. Specifically:

- The use of investment types which comply with Legislative Requirements.
- Establishment of Risk Management Guidelines based upon credit rating, limited exposure to individual institutions and term to maturity limits.
- Use of appropriate benchmark for investment performance measurement.

Legislative Requirements

- Local Government Act 1993, Section 412 & 625;
- Local Government Act 1993 – Order (of the Minister) Circular No: 05/03 dated 23 September 2005;
- The Trustee Amendment (Discretionary Investments) Act 1997 - Sections 14A (2), 14C (1) & (2).
- Local Government (General) Regulation 2005 – Clause 212.

Refer to Schedule 3 for extracts of legislation.

Risk Management Guidelines

Investments obtained are to comply with three key criteria relating to:

a) **Portfolio Credit Framework:** limit overall credit exposure of the portfolio.

b) **Counterparty Credit Framework:** limit exposure to individual counterparties/institutions.

c) **Term to Maturity Framework:** limits based upon maturity of securities.

a) Portfolio Credit Framework

To control the credit quality on the entire portfolio, the following credit framework limits the percentage of the portfolio exposed to any particular credit rating category (refer to Schedule 2 for rating definitions):

Overall Portfolio Credit Limits			
Long-Term Credit Ratings	**Short-Term Credit Ratings**	**Direct Inv's Maximum**	**Managed Funds Maximum**
AAA Category	A-1+	100%	100%
AA Category	A-1	100%	100%
A Category or below	A-2	60%	80%
BBB Category or below	A-3	20%	-
Unrated	Unrated	10%	10%

- Percentage limits are based upon Council's average core portfolio balance

b) Counterparty Credit Framework

Exposure to an individual counterparty/institution will be restricted by their credit rating so that single entity exposure is limited, as detailed in the table below:

Individual Counterparty Limits			
Long-Term Credit Ratings	**Short-Term Credit Ratings**	**Direct Inv's Maximum**	**Managed Funds Maximum**
AAA Category	A-1+	25%	50%
AA Category	A-1	20%	45%
A Category or below	A-2	15%	40%
BBB Category or below	A-3	10%	-
Unrated	Unrated	5%	10%

- Investments with counterparties below A Category (Long Term) and below A-1 (Short Term) are to be restricted to **Authorised Deposit Taking Institutions** (ADI's – such as banks, building societies and credit unions) regulated by, and subject to the prudential standards of, the Australian Prudential Regulation Authority (APRA).

- Investments that are Unrated, with ADI institutions, are restricted to those with a minimum total Asset Size of $1 billion.

- For non-ADI direct investments, above A Category (Long Term) and above A-1 (Short term) (e.g. CDOs, mortgage backed securities, and other structured deals), both capital and coupons (interest payments) are to be rated.

- Investments with the non-rated LGFS and NSW T-Corp will be regarded in terms of the respective investments' "shadow rating" as advised by those institutions.

- The short-term credit rating limit will apply in the case of discrepancies between short and long-term ratings.

- In the event that a credit rating of a security or of the company/body issuing the security falls below the required minimum, as set out in the Minister's Order, Council will make all necessary arrangements to withdraw deposits as soon as practical.

- Percentage limits are based upon Council's average core portfolio balance.

c) Term to Maturity Framework

The Investment portfolio is to be invested within the following maturity constraints:

Overall Portfolio Term to Maturity Limits	
Portfolio % <1 year	100% max; 40% min
Portfolio % >1 year	60%
Portfolio % >3 years	35%
Portfolio % >5 years	25%
Individual Investment Maturity Limits	
Authorised Deposit Taking Institution (ADI) issues	10 years
Non ADI issues rated A or above	5 years*

* *For mortgage and asset backed securities this will be the weighted average life (WAL) of the security.*

- To provide adequate liquidity all tradeable securities purchased will have, subject to market conditions, the ability to be liquidated within five working days.

- Percentage limits are based upon Council's average core portfolio balance.

Performance Benchmark

The performance benchmark for Tweed Shire Council's investment portfolio is the industry standard UBS 90 day Bank Bill Index.

Investment Strategy

An Investment Strategy will run in conjunction with the investment policy. The Strategy will be formulated annually with quarterly reviews. The Strategy will outline:

- Council's cash flow expectations
- Optimal target allocation of investment types, credit rating exposure, and term to maturity exposure
- Appropriateness of overall investment types for Council's portfolio.
- And determine the investment portfolio level for the forthcoming year.

The Investment Strategy will fully comply with legislative requirements and the investment policy.

Review of Investment Policy

The policy will be reviewed annually.

Schedules

Schedule 1 – Investment Instrument Descriptions;
Schedule 2 – Standard's & Poor's Ratings Description;
Schedule 3 – Copies of Relevant Legislation

Schedule 1

Investment Instrument Description

11am call deposits

Cash invested on an overnight basis. Funds can be recalled or re-invested before 11am on the following business day.

Term Deposit

Funds invested with a financial institution at a predetermined rate that applies to the duration of the deposit. The principal is held on deposit for a fixed term with interest payable at maturity. It is not a tradeable security and the investor is penalised when funds are prepaid.

Bank Bill

Bank-accepted bills are bills of exchange drawn by a company or individual (borrower) usually for periods between 30 and 180 days. The bill is accepted by the bank, which in turn accepts the liability for payment at maturity. It is a short-term investment issued at a discount to the face value and is of a very high credit standing, consequently trades at the lowest yields of all commercially issued bills.

Negotiable Certificate of Deposit (NCD)

These are short-term bearer securities issued by banks for up to 180-days. They are sold at a discount to face value and are highly liquid discount securities; representing the bank's debt, therefore trade at similar yields to bank bills. Creditworthiness of the bank will determine where the bank's NCD trades, relative to the BBSW.

Promissory Note (PN) / Commercial Paper (CP)

A negotiable instrument evidencing an unsecured obligation (promise) the issuer has to repay a certain amount of money at a future date, usually for up to six months. CP is a highly liquid discount security that is traded on a yield to maturity basis. To be marketable, a credit rating must be obtained from a ratings agency eg Standard & Poor's. Major issuers include industrial corporations, securitised vehicles and finance companies. It has a higher risk of default than a bank and hence trades at a higher yield.

Floating Rate Note (FRN)

The FRN is a longer-term debt security issued for a fixed period of time but has a variable (floating) coupon on a monthly or quarterly basis. The coupon reflects current interest rates, which is determined as a margin over the BBSW rate set. FRN's appeal to investors who are reluctant to commit funds to fixed interest investments for longer periods in times of fluctuating interest rates. Typical issuers are banks, corporates, financial institutions and securitised vehicles.

Residential Mortgage Backed Securities (RMBS)

RMBSs are specific type of securitised asset (investment products that convert an income stream of multiple receivables into a security paying regular coupon payments). RMBSs are backed by a pool of residential mortgages. These securities are structured into different classes with varying security characteristics. The majority of RMBS are “passthroughs” where the cash flows (principal and interest) received from the underlying mortgages that make up the pool are passed directly through to the holders of the RMBS.

Asset Backed Securities (ABS)

Another form of securitised asset backed by assets other than residential mortgages. Such alternative assets include automobile loan receivables, commercial mortgages, equipment lease receivables, and credit card receivables. ABS can be either fixed or floating rate securities.

Fixed Interest Securities (Bonds)

Securities issued by Commonwealth, State or corporate institutions that pay a fixed rate of interest (coupon) and mature at a fixed point in time. The interest (coupon) is paid at regular intervals (semi-annually, but can be paid monthly, quarterly, or annually). These securities are generally issued for a period of greater than one year.

Collateralised Debt Obligations (CDO)

While nearly every CDO structure can be slightly different, a “plain vanilla” structure typically has 75 – 150 underlying entities (a range of global companies diversified by industry sector) with credit ratings ranging from BBB to AAA. The CDO itself is then split into various “tranches” each with different amounts of subordination (i.e. collateral) which results in the higher subordinated tranches receiving higher credit ratings from the rating agencies. When an underlying entity has a credit event a portion of the subordination is eroded. CDOs are highly leveraged instruments which can have large fluctuations in their mark-to-market valuations, and very possibly their credit rating, when an underlying entity has encountered a “credit event”, such as bankruptcy. Depending on the particular structure, the security can typically sustain between 6 - 8 credit events before the investor’s capital is in jeopardy.

Pooled Managed Funds

- **Sector Specific Funds**
  These funds invest in one particular asset sector. Council’s Cash Plus and Cash Enhanced Fund are examples of Sector Specific Funds as they predominately invests in a range of short dated cash-type securities with the aim of outperforming the UBS 90 day Bank Bill Index benchmark. They are designed to enhance returns on short-term holdings as an alternative to short-dated bank bill and term deposit portfolios. They provide easy access to holdings and can be redeemed within 24 to 48 hours.

- **Diversified Funds**
  These funds invest in a pre-determined range of asset classes including cash, fixed interest, property, and Australian & international shares. The weighting among the various asset classes will differ depending upon the type of diversified fund chosen, e.g. Conservative Funds (TCorp’s Medium Term Growth) have a higher weighting in cash and fixed interest than Balanced Funds (TCorp’s Long Term Growth) that have higher weightings in growth assets such as property and shares.

SCHEDULE 2

Standard & Poor's Ratings Description

Credit Ratings

Standard & Poor's (S&P) is a professional organisation that provides analytical services. An S&P rating is an opinion of the general creditworthiness of an obligor with respect to particular debt security or other financial obligation — based on relevant risk factors.

Credit ratings are based, in varying degrees, on the following considerations:

- Likelihood of payment.
- Nature and provisions of the obligation.
- Protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganisation or other laws affecting creditors' rights.

The issue rating definitions are expressed in terms of default risk.

Short-Term Obligation Ratings are:

A-1
This is the highest short-term category used by S&P. The obligor's capacity to meet its financial commitment on the obligation is strong. Within this category, certain obligations are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitment on these obligations is extremely strong.

A-2
A short-term obligation rated A-2 is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rating categories. However, the obligor's capacity to meet its financial commitment on the obligation is satisfactory.

A-3
A short-term obligation rated A-3 exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

Long-Term Ratings are:

AAA
An obligation/obligor rated AAA has the highest rating assigned by S&P. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

AA
An obligation/obligor rated AA differs from the highest rated obligations only in a small degree. The obligor's capacity to meet its financial commitment on the obligations is very strong.

A
An obligation/obligor rated A is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations/obligor in higher rated categories. However, the obligors capacity to meet its financial commitment on the obligation is still strong.

BBB
An obligation/obligor rated BBB exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity to the obligor to meet its financial commitment on the obligation.

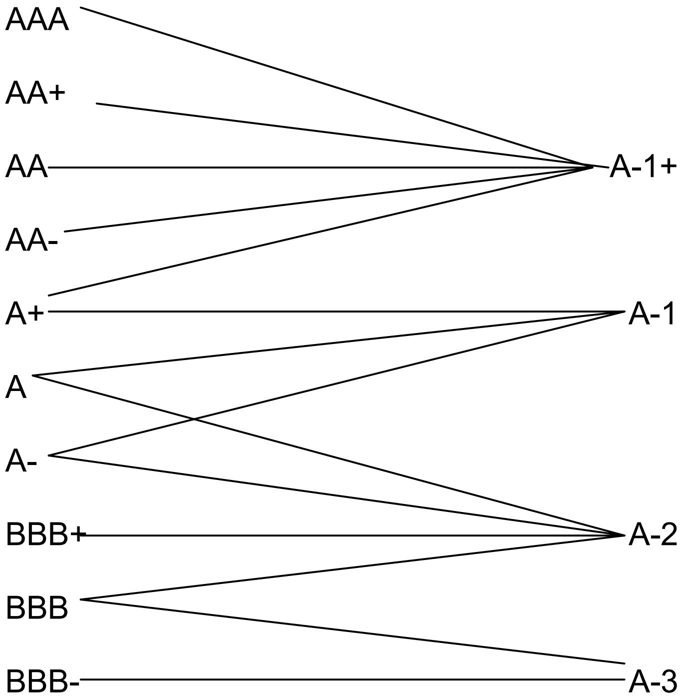
Plus (+) or Minus (-): The ratings from "AA" to "BBB" may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

CreditWatch highlights an emerging situation, which may materially affect the profile of a rated corporation and can be designed as positive, developing or negative. Following a full review the rating may either be affirmed or changed in the direction indicated.

A Rating Outlook assesses the potential direction of an issuer's long-term debt rating over the intermediate-to-long term. In determining a Rating Outlook, consideration is given to possible changes in the economic and/or fundamental business conditions. An outlook is not necessarily a precursor of a ratings change or future CreditWatch action. A "Rating Outlook – Positive" indicates that rating may be raised. "Negative" means a rating may be lowered. "Stable" indicates that ratings are not likely to change. "Developing" means ratings may be raised or lowered.

S & P Ratings Correlations

The standard correlation of short-term ratings with long-term ratings is shown below:



SCHEDULE 3:

Excerpts of Legislative Requirements

LOCAL GOVERNMENT ACT 1993 - SECT 412 & 625

Section 412 Accounting Records

(1) A council must keep such accounting records as are necessary to correctly record and explain its financial transactions and its financial position.

(2) In particular, a council must keep its accounting records in a manner and form that facilitate:

(a) the preparation of financial reports that present fairly its financial position and the results of its operations, and
(b) the convenient and proper auditing of those reports.

Section 625 How May Councils Invest?

(1) A council may invest money that is not, for the time being, required by the council for any other purpose.

(2) Money may be invested only in a form of investment notified by order of the Minister published in the Gazette.

(3) An order of the Minister notifying a form of investment for the purposes of this section must not be made without the approval of the Treasurer.

(4) The acquisition, in accordance with section 358, of a controlling interest in a corporation is not an investment for the purposes of this section.

dlg | circular to councils

Circular No. 05-53
Date 23 September 2005
Doc ID. A29843

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FORMS OF INVESTMENT - MINISTER'S ORDER

Attached is a copy of an Order of the Minister notifying forms of investment for the purposes of section 625 (2) of the *Local Government Act 1993*. The Order was published in the Government Gazette on 29 July 2005 and takes effect on and from that date. The Order replaces the previous Order published in the Government Gazette of 24 November 2000.

The new Order notifies three changes to the investment powers of councils compared with the previous Order. Items (k) and (l) have been amended to include Fitch Ratings as a prescribed rating agency. Item (p) Shares in the Inland Marketing Corporation Limited has been removed.

In addition, council's attention is drawn to Update 13 of the Code of Accounting Practice and Financial Reporting that contains a policy direction that states, "councils must maintain an investment policy". That investment policy must comply with the legislation and investment guidelines.

In keeping with existing arrangements it is the responsibility of each individual council to determine that its investments are authorised in terms of the listed securities.

Garry Payne
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LOCAL GOVERNMENT ACT 1993 – INVESTMENT ORDER

(Relating to investments by councils)

I, David Campbell, MP, Acting Minister for Local Government, in pursuance of section 625 (2) of the Local Government Act 1993 and with the approval of the Treasurer, do, by this my Order, notify for the purposes of section 625 of that Act that a council may only invest money (on the basis that all investments must be denominated in Australian Dollars) in the following forms of investment:

(a) any public funds or Government stock or Government securities of the Commonwealth or any State of the Commonwealth;

(b) any debentures or securities guaranteed by the Government of New South Wales;

(c) any debentures or securities, issued by a public or local authority, or a statutory body representing the Crown, constituted by or under any law of the Commonwealth, of any State of the Commonwealth or of the Northern Territory or of the Australian Capital Territory and guaranteed by the Commonwealth, any State of the Commonwealth or a Territory;

(d) any debentures or securities issued by a Territory and guaranteed by the Commonwealth;

(e) any debentures or securities issued by a council (within the meaning of the Local Government Act 1993);

(f) mortgage of land in any State or Territory of the Commonwealth;

(g) purchase of land (including any lot within the meaning of the Strata Schemes Management Act 1996) in any State or Territory of the Commonwealth;

(h) interest bearing deposits in a bank authorised to carry on the business of banking under any law of the Commonwealth or of a State or Territory of the Commonwealth;

(i) interest bearing deposits with a building society or credit union.

(j) any bill of exchange which has a maturity date of not more than 200 days; and if purchased for value confers on the holder in due course a right of recourse against a bank, building society or credit union as the acceptor or endorser of the bill for an amount equal to the face value of the bill;

(k) any securities which are issued by a body or company (or controlled parent entity either immediate or ultimate) with a Moody's Investors Service, Inc. credit rating of ``Aaa", ``Aa1", ``Aa2", ``Aa3", "A1" or "A2" or a Standard & Poor's Investors Service, Inc credit rating of ``AAA", ``AA+", ``AA", ``AA-"; "A+", or "A" or a Fitch Rating credit rating of "AAA", "AA+", "AA", "AA-", "A+" or "A";

(l) any securities which are given a Moody's Investors Service Inc credit rating of ``Aaa", ``Aa1", ``Aa2", ``Aa3","A1"; "A2" or ``Prime-1" or a Standard and Poor's Investors Service, Inc credit rating of "AAA", "AA+", "AA", "AA-", "A+"; "A"; "A1+" or "A1" or a Fitch Rating credit rating of "AAA", "AA+", "AA", "AA-", "A+" or "A";

(m) any debentures or securities issued by a bank, building society or credit union;

(n) a deposit with the Local Government Investment Service Pty Ltd;

(o) a deposit with the New South Wales Treasury Corporation or investments in an Hour-Glass investment facility of the New South Wales Treasury Corporation.

Dated this 15TH day of JULY 2005

Hon DAVID CAMPBELL MP
Acting Minister for Local Government

Investment Guidelines

(These were initially introduced in "Forms of Investment - Minister's Order and Investment Guidelines" Circular to Councils no.00/16 dated 28/3/00. Points below are amended to reflect subsequent repeals/enactments of regulations referred to in the Guidelines).

- Councils must comply with clause 212 of the Local Government (General) Regulation 2005 that provides for reporting on council investments by the responsible accounting officer.

- The Code of Accounting Practice and Financial Reporting require councils to maintain a separate record of money it has invested under section 625 of the Act. The record must specify:

(a) the source and the amount of money invested; and
(b) particulars of the security or form of investment in which the money is invested; and
(c) if appropriate, the rate of interest to be paid, and the amount of money that the council has earned, in respect to the money invested.

- A council or entity acting on its behalf should exercise the care, diligence and skill that a prudent person would exercise in investing council funds. A prudent person is expected to act with considerable duty of care, not as an average person would act, but as a wise, cautious and judicious person would. (Ref: Trustee Amendment (Discretionary Investments) Act 1997 section 14 A (2)).

- A council should develop an investment strategy as part of its overall financial plan. The strategy should, as a minimum consider the desirability of diversifying investments and the nature and risks associated with the investments. (For guidance see: Trustee Amendment (Discretionary Investments) Act 1997 section 14 c (1) "matters to which trustee is to have regard when exercising power of investment").

- A council should at least once in each year, review the performance (individually and as a whole) of council investments and review its investment strategy.

- An investment adviser or investment dealer acting on behalf of a council, should be licensed by the Australian Securities and Investment Commission. Ref: www.asic.gov.au

- Where a council invests in banks; building societies and credit unions it should know that these institutions are regulated as authorised deposit taking institutions by the Australian Prudential Regulation Authority (APRA) under the Banking Act 1959 Ref. www.apra.gov.au Note, however, that whilst APRA has power to require financial institutions to observe prudential standards (such as appropriate capitalisation, liquidity and governance) and to intercede if it believes that depositors', policyholders' or members' interests are at risk, it provides no guarantee of the performance of the financial institution.

- Credit ratings are a guide or standard for an investor, which indicate the ability of a debt issuer or debt issue to meet the obligations of repayment of interest and principal. Credit rating agencies such as Moody's and Standard and Poor's make these independent assessments based on a certain set of market and non-market information. Ratings in no way guarantee the investment or protect an investor against loss. Prescribed ratings should not be misinterpreted by councils as an implicit guarantee of investments or entities that have such ratings. Even given this challenge, ratings provide the best independent information available.

- In the event that a credit rating of a security or the credit rating of the company or body issuing the security falls below the required minimum, as set out in the Minister's Order, a council must make all the necessary arrangements to withdraw the deposit as soon as practicable.

- Note that in choosing a NSW Treasury Corporation hour-glass investment the choice of the facility should be based on the nature of the underlying commitments for which the council is holding funds. For example, funds required in the short term must be invested with a short-term profile rather than with exposure to more volatile asset classes such as property and shares.

THE TRUSTEE AMENDMENT (DISCRETIONARY INVESTMENTS) ACT 1997 – SECTIONS 14A(2), 14C (1) & (2)

14A (2) Duties of trustee in respect of power of investment

A trustee must, in exercising a power of investment:

(a) if the trustee's profession, business or employment is or includes acting as a trustee or investing money on behalf of other persons, exercise the care, diligence and skill that a prudent person engaged in that profession, business or employment would exercise in managing the affairs of other persons, or

(b) if the trustee is not engaged in such a profession, business or employment, exercise the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons.

14C Matters to which trustee is to have regard when exercising power of investment

(1) Without limiting the matters that a trustee may take into account when exercising a power of investment, a trustee must, so far as they are appropriate to the circumstances of the trust, if any, have regard to the following matters:

(a) the purposes of the trust and the needs and circumstances of the beneficiaries,

(b) the desirability of diversifying trust investments,

(c) the nature of, and the risk associated with, existing trust investments and other trust property,

(d) the need to maintain the real value of the capital or income of the trust,

(e) the risk of capital or income loss or depreciation,

(f) the potential for capital appreciation,

(g) the likely income return and the timing of income return,

(h) the length of the term of the proposed investment,

(i) the probable duration of the trust,

(j) the liquidity and marketability of the proposed investment during, and on the determination of, the term of the proposed investment,

(k) the aggregate value of the trust estate,

(l) the effect of the proposed investment in relation to the tax liability of the trust,

(m) the likelihood of inflation affecting the value of the proposed investment or other trust property,

(n) the costs (including commissions, fees, charges and duties payable) of making the proposed investment,

(o) the results of a review of existing trust investments in accordance with section 14A (4).

(2) A trustee may, having regard to the size and nature of the trust, do either or both of the following:

(a) obtain and consider independent and impartial advice reasonably required for the investment of trust funds or the management of the investment from a person whom the trustee reasonably believes to be competent to give the advice,

(b) pay out of trust funds the reasonable costs of obtaining the advice.

Local Government (General) Regulation 2005 - Clause 212

212 Reports on council investments

(1) The responsible accounting officer of a council:

(a) must provide the council with a written report (setting out details of all money that the council has invested under section 625 of the Act) to be presented:

i) if only one ordinary meeting of the council is held in a month, at that meeting, or

(ii) if more than one such meeting is held in a month, at whichever of those meetings the council by resolution determines, and

(b) must include in the report a certificate as to whether or not the investment has been made in accordance with the Act, the regulations and the council's investment policies.

(2) The report must be made up to the last day of the month immediately preceding the meeting.

Note. Section 625 of the Act says how a council may invest its surplus funds.