Department of Premier and Cabinet

Division of Local Government

Investment Policy Guidelines

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Disclaimer

These Investment Policy Guidelines have been prepared by the State of New South Wales through the DLG as an information source only.

While the DLG believes that this information will be of assistance, it is provided on the basis that you will not rely on this information without first making your own enquiries and obtaining your own professional advice specific to your council's particular circumstances.

1. INTRODUCTION

NSW councils were responsible for the management of over $5.7 billion of cash and investments as at 30 June 2009. To assist councillors, General Managers and the Responsible Accounting Officers of councils to invest surplus funds in a prudent and appropriate manner, all councils are required to develop an investment policy. These Investment Policy Guidelines have been developed to provide assistance with the preparation of a policy and the prudent and appropriate management of a council's surplus funds.

Investments are not considered to be a principal activity for councils, but the knowledge and skill required to manage investments can be quite specialised.

1.1 Background

In the past there have been some concerns within the local government sector that some investments when invested through a third party were not held in the council's name. As a result, a survey of councils was undertaken in 2005. Some deficiencies were highlighted during the survey. The Director General of the then Department of Local Government issued Circular to Councils 06-70 reminding councils and council officers of the need for councils to have an investment policy and the reporting requirements associated with investing council funds. Advice on investing through a third party was also included in the circular, along with information related to the credit ratings of investment products and what councils should do if investments no longer comply with the Ministerial Investment Order.

In NSW some councils have been investing in structured products and, in particular, collateralised debt obligations (CDOs). CDOs are defined as *"a type of structured Asset Backed Security (ABS) that gain exposure to the credit of a portfolio of fixed income assets and divides the credit risk among different tranches, each with a different level of risk and return:*

- *senior tranches (rated AAA),*
- *mezzanine tranches (AA to BB), and*
- *equity tranches (unrated)"* (Cole, April 2008).

In 2007 concerns were heightened in relation to the decline in the "sub-prime" mortgage market in the USA and possible exposure of some councils with structured investment products to losses.

In order to clarify the exposure of NSW councils to any losses, a review was conducted under the direction of a Steering Committee chaired by the then Department of Local Government (DLG) with representatives from the Department of Premier and Cabinet and NSW Treasury. Mr Michael Cole was engaged to conduct the Review.

The Review investigated the impact on councils that had invested in structured financial products. The recommendations from the Review included:

- amendments to the Ministerial Investment Order
- grandfathering existing investments that are excluded by the proposed changes to the Ministerial Investment Order

- excluding the manufacturers and distributors of investment products from acting as investment advisors to councils
- suspending investments with specific credit ratings until December 2009
- ensuring councils are more fully aware of their obligations under the *Local Government Act 1993* and the *Trustee Act 1925* (NSW) and
- issuing investment policy guidelines for councils.

The NSW Government has adopted all the recommendations from the report.

1.2 Objectives of investment policy guidelines

These guidelines are to apply to all general purpose and special purpose councils in New South Wales. They are issued under section 23A of the *Local Government Act 1993* (the Act).

The objectives of the guidelines are to:

- assist councils in investing funds in a prudent and appropriate manner
- outline legislation associated with the investment of surplus funds
- assist councils in preparing a suitable investment policy
- outline key issues when investing funds
- define duties and obligations of the council and council officers
- outline requirements for internal control procedures
- establish proper reporting and monitoring procedures.

1.3 What is an investment policy?

An investment policy is a governing document that guides the investment process. It should communicate the council's

- investment philosophy
- overall risk philosophy
- investment objectives and expectations
- identify the roles for those involved in the investment process, and
- detail the requirements for compliance with the policy's goals and procedures.

1.4 Who should use these investment policy guidelines?

Under section 8 of the Local Government Act 1993, the council's charter states that, among other things, a council must have regard to the long-term cumulative effects of its decisions. Councils are the custodians and trustees of public assets and are required to effectively account for and manage the assets for which they are responsible.

As the role of the elected council is to direct and control the affairs of the council in accordance with the Act, councillors should use these guidelines to ensure that the council:

- has an appropriate investment policy that guides the investment of ratepayers' funds in compliance with the council's charter
- approves the investment policy by resolution
- approves amendments to the investment policy by resolution
- reviews the policy each year, and

- has in place mechanisms to support the open and transparent reporting of council investments to the council and to the ratepayers.

The General Manager is responsible for the efficient and effective operation of the council's organisation and for ensuring the implementation of the decisions of the council. Therefore, the General Manager is responsible for implementing the council's decision in relation to the investment policy.

The Responsible Accounting Officer (RAO), as defined by the Local Government (General) Regulation 2005, is responsible for keeping the council's accounting records and ensuring that they are kept up to date and in an accessible form. Specifically in relation to investments, the RAO must provide reports to the council each month in relation to the money that council has invested, along with a certificate stating whether the investments have been made in accordance with the Act, the Regulations and the council's investment policy. It is therefore important that the RAO use these guidelines in the creation of the council's investment policy and in reporting to the council. Ultimately, however, it is the council that is responsible for the investments.

Council officers that are involved in selecting, reviewing and/or monitoring investment products should use these guidelines to ensure they understand the parameters, risks and expectations that councils are required to consider when developing an investment policy.

2. LEGISLATIVE FRAMEWORK

There are a number of legislative requirements that govern how a council may invest surplus funds. These include the *Local Government Act, 1993*, (the Act) the Local Government (General) Regulation 2005 (LGGR), and the Ministerial Investment Order (the Order).

2.1 Local Government Act, 1993

Section 625 of the Act refers to how a council may invest. It states that a council may invest money that is not, for the time being, required for any other purpose and that it may only be invested in a form that is notified by order of the Minister as published in the NSW Government Gazette.

Also an order of the Minister notifying a form of investment for the purposes of section 625 must not be made without the approval of the NSW Treasurer. A discussion on the order is included in section 4 – Types of Investments.

The acquisition of a controlling interest in a corporation or an entity within the meaning of section 358 of the Act (participation in the formation of corporations and other entities) is not an investment for the purposes of section 625.

Section 413 of the Act outlines the reporting requirements of councils in regard to their annual financial reports. Councils should recognise, measure and disclose their investments in accordance with the publications issued by the Australian Accounting Standards Board. For further guidance refer to the Local Government Code of Accounting Practice and Financial Reporting (the Code) and Australian Accounting Standards AASB 7 – Financial Instruments: Disclosures, AASB 132 – Financial Instruments: Presentation, AASB136 Impairment of Assets and AASB 139 Financial Instruments Recognition and Measurement.

Further, section 12 of the Act outlines the information councils are required to make publicly available, including a register of investments and copies of business papers and minutes for council and committee meetings that record information on investments.

It should be noted that it is considered good practice for a council's investment policy to be available to the public on the council's website.

2.2 Local Government (General) Regulation 2005(LGGR)

The LGGR at clause 212 provides further direction in relation to council investments in relation to reports. It states that:

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.

2.3 Trustee Act 1925

Section 14 of the *Trustee Act 1925* (NSW) states that a trustee must exercise the care, diligence and skill that a prudent person would exercise in managing the affairs of another person. The Trustee Act also refers to matters a trustee should have regard to when exercising a power of investment. They include:

- the purposes of the trust and the needs and circumstances of the beneficiaries
- the desirability of diversifying trust investments
- the nature of, and the risk associated with existing trust investments and other trust property
- the need to maintain the real value of the capital or income of the trust
- the risk of capital or income loss or depreciation
- the potential for capital appreciation
- the likely income return and the timing of income return
- the length of the term of the proposed investment
- the probable duration of the trust
- the liquidity and marketability of the proposed investment during, and on the determination of, the term of the proposed investment
- the aggregate value of the trust estate
- the effect of the proposed investment in relation to the tax liability of the trust
- the likelihood of inflation affecting the value of the proposed investment or other trust property
- the costs (including commissions, fees, charges and duties payable) of making the proposed investment
- the results of a review of existing trust investments in accordance the Trustee Act.

As councils are acting as custodians when investing public assets, they should take into account the matters detailed above when investing. Ultimately each council is responsible for its investment decisions.

2.4 Division of Local Government (DLG) Circulars

The DLG periodically issues circulars on matters of importance to councils. Circulars have been issued in the past providing directives and guidance in relation to council investments.

3. DEVELOPING AN INVESTMENT POLICY

Councils should maintain an investment policy that complies with the Act, the LGGR, and the Ministerial Investment Order and ensure it or its representatives exercise care, diligence and skill that a prudent person would exercise in investing council funds.

In implementing an investment policy, councils should plan and understand their future cash flow requirements, which should be reflected in their long term financial plans. Councils should adopt a holistic approach to managing their finances, including developing strategic plans and long term financial plans, planning for long term asset management, determining cash flow requirements and identifying surplus funds that can be invested. Developing accurate strategic plans and long term financial plans is essential for determining when surplus funds are required.

Councils should develop appropriate monitoring systems to establish and forecast their cash requirements. Councils require a small cash balance of liquid funds to meet day-to-day operational expenditure, including a contingency amount that is also available to met unforeseen commitments.

Most councils have an overdraft facility, which is a fluctuating credit facility provided by a bank that allows a council's operating account to go into debit up to an agreed limit. However, it is important to note that councils will generally incur additional fees to access this facility.

When considering an investment in the capital markets or the long term financial markets, councils should consider the risks and their cash flow requirements. While a normal yield curve may suggest that councils will receive a greater return on their investments in the long term, there is also is a greater interest rate risk when investing.

Before investing any funds councils should establish an investment policy. As a minimum, an investment policy must comply with the Act, the LGGR and the Order and should:

- set the objectives of investing
- outline the legislative requirements
- ascertain authority for implementation and management of the policy
- establish the capital, liquidity/duration and return expectations
- determine the diversity of the investment portfolio
- define the risk profile
- establish legal title
- set benchmarks
- establish monitoring and reporting requirements
- define duties, obligations and required skills of the council and council officers, and
- set a date for the policy to be reviewed.

Each of these considerations is discussed in more detail in this section.

3.1 Objectives

In setting the objectives of an investment policy, councils will need to examine the amount of funds available for investing, the timeframes, the level of risk aversion and the capability of the council to manage and protect the investments. By providing a clear statement, consistency in the development of the investment policy and the implementation of the policy should follow.

3.2 Legislation

The investment policy should include references to the specific parts of the Act, LGGR, Ministerial Order, Local Government Code of Accounting Practice and Financial Reporting (the Code), Australian Accounting Standards, DLG circulars and any other legislation that influences how a council manages its investments.

3.3 Authority

The investment policy should clearly state if the council has delegated the authority to implement such a policy to the General Manager and whether the General Manager has delegated the day-to-day management of the council's portfolio to the RAO or another council officer.

3.4 Capital Security, Liquidity and Maturity

A council's main objective in investing funds should be to preserve the capital, ie, prevent any loss to the amount invested, while gaining the most advantageous rate of return with minimum risk. Councils should be familiar with the concept of the "time value of money". A dollar expected some time in the future is not equivalent to a dollar held today because of the time value of money. The dollar available today can be invested to earn interest so it will increase in value to more than one dollar in the future.

Councils will also need to consider the cash flow implications of investments and how the council will maintain liquidity to meet requirements as and when they fall due. A process for regularly identifying council's liquidity requirements should be included in the investment policy. Determining liquidity requirements provides direction on the term of investments to be placed.

3.5 Diversification

Councils should examine the need to diversify their investments, including setting limits to the amounts invested with a particular financial institution or government authority to reduce credit risk. A prudent risk management strategy is to diversify the allocation of funds across different financial institutions and government authorities, based on credit ratings. A credit rating is the opinion of a credit rating agency of the creditworthiness of the financial institution.

The investment policy should set maximum and minimum investment limits for each financial institution and government authority.

3.6 Risk Management

There are risks associated with all investments. Generally, the higher the rate of return, the higher the risk and the greater the variability of returns. Each council should recognise all risks and include its understanding, tolerance and permitted exposure to risks in its investment policy. When investing, councils should be primarily aware of their interest rate risks and credit default risks.

Councils are exposed to interest rate risk. Interest rate risk is the sensitivity of the value of assets, liabilities and future cash flows to a change in interest rates. The council will need to take into consideration the term structure of interest rates, having regard to the shape and the slope of the yield curve. The term structure of interest rates is the relationship between interest rates and term to maturity for debt instruments in the same risk class.

Council's interest rate risk management strategies and techniques need to be sufficiently robust to be able to respond to change as it occurs, especially if investing in the capital markets or longer term financial markets.

Credit default risk occurs when the institution (counterparty) that a council has invested in fails to pay the interest and or repay the principal of an investment. To minimise this risk, councils should ensure that the investment policy outlines the credit worthiness of the counterparties. Within the investment policy councils should provide a list of acceptable counterparties and suitable investment limits. In establishing a list of acceptable counterparties councils should consider:

- the credit ratings of the counterparty (if they have a rating)
- the type of institution within a credit rating band
- types of credit ratings applicable in the investment policy
- limits for related counterparties, and
- capitalisation restrictions.

Some other common risks when investing include market, liquidity and maturity risks.

Market risks are those risks associated with changes in the market prices and include changes in interest rates, currency and commodity prices. When undertaking investment decisions, councils should have a good understanding of the changes in the business cycle and its effect on interest rates.

Liquidity risks result from a lack of willing buyers in the market for the investment. As a result the investor is unable to realise the investments at a fair price in a timely period.

Maturity risks relate to the length of the term to maturity of the investment. The longer the term of the investment, the greater the length of the exposure (including greater exposure to interest rate, market and liquidity risks).

3.7 Legal Title
When a user of funds obtains finance from the provider of funds, the user must prepare a document that clearly defines the contractual arrangement that has been agreed. This is known as a 'financial instrument'. When councils enter into a financial instrument, it is important that the financial instrument clearly shows it is held in the name of the council.

3.8 Benchmarks
Performance benchmarks need to be established to be able to evaluate the investment outcomes against the investment objectives. Benchmarks show how well investments are matched to the rate of return expectations and the risk. Benchmarks can also be used to see whether the expectations set are reasonable or not. When

establishing benchmarks, councils must make sure that they are appropriate for the particular types of investments and can be easily measured.

The council's investment policy should establish a suitable benchmark for the council to review the returns on its portfolio. A widely used benchmark rate for financial instruments is the Australian Financial Markets Association (AFMA) Bank-Bill Reference Rate (BBSW). The bank bill interest rate is the wholesale interbank rate within Australia and is published daily in newspapers such as the *Australian Financial Review* and is also available on the internet. A comparison between council's benchmark and the return on council's portfolio should be included in the monthly report to council from the Responsible Accounting Officer.

3.9 Monitoring and reporting

A council's investment policy should establish guidelines in relation to monitoring and reporting on the council's investments.

Regular monitoring and review of investments will help ensure that the council's investment objectives are achieved. It should establish the performance of individual or pooled investments, monitor exposure to movements in markets, monitor movement against set benchmarks and certify that the investments are in accordance with the various legislation and council's investment policy.

The council's investment policy should set a minimum review of the investments each month.

The RAO is required to prepare a written report on the council's investments each month (clause 212, LGGR). The council's investment policy should include information on what is required to be presented to the council each month. The appendices to the guidelines incorporate a sample monthly report to council.

Any additional requirements, such as a quarterly report, should be set out in the council's investment policy.

Councils are also required to account for their investments in their annual financial statements. Each year the DLG produces the Local Government Code of Accounting Practice and Financial Reporting (the Code). The Code sets the minimum requirements set by the Australian Accounting Standards Board and the DLG in relation to all financial reporting matters. Councils should include a reference to the investment reporting as part of the annual financial statements in their investment policies.

3.10 Duties and responsibilities of the council officers

Council officers should act with the duty of care, skill, prudence and diligence that a prudent person would exercise when investing and managing their own funds. The "prudent person" principle is set out in section 14 of the Trustee Act.

The council's investment policy should communicate the duties, responsibilities and required skills of the council officers involved in investing council funds and timeframes for those particular duties. It is essential to provide a clear statement to guide council officers in exercising their investment duties. Council officers with investment responsibilities should have regard to the requirements of a trustee under the Trustee Act.

When exercising the power of investment councils should consider, but not be limited by, the risk of capital or income loss or depreciation, the likely income return and the timing of income return, the length of the term of the proposed investment, the liquidity and marketability of the proposed investment, the likelihood of inflation affecting the value of the proposed investment and the costs (including commissions, fees, charges and duties payable) of making the proposed investment.

One such duty that should be included is the requirement to maintain a separate record of money council has invested under section 625 of the Act. The record (investment register) must specify:

- the source and the amount of money invested
- particulars of the security or form of investment in which the money was invested
- the term of the investment (ie, placement and maturity dates where applicable), and
- if appropriate, the rate of interest to be paid, and the amount of money that the council has earned, in respect of the money invested.

The market value of investments should be included in the council's monthly investment report. The frequency of the revaluation of investments is a matter for councils depending upon the investments they hold and the risks that prices have moved materially since the last market revaluation.

In determining the duties and responsibilities of council officers, the council's internal controls should be taken into consideration. Adequate controls should be in place to safeguard council assets, such as the separation of duties in relation to authorising and executing transactions and reporting on the investments.

The investment policy should contain a statement to the effect that council officers should have the appropriate skills to undertake the investment functions of council and not engage in activities that would conflict with the proper implementation and management of the council's investments.

3.11 Review of Investment Policy and Investments

Council's investment policy should include a clause stating that the policy is to be reviewed at least on an annual basis and be amended as required. Amendments should be approved by a resolution of the council.

Good corporate governance requires councils to arrange a review of their investments by the internal audit committee of council to verify:

- that new investment types/products comply with the council's investment policy
- the value of investments held against set benchmarks at least monthly, and
- that investments have been placed in accordance with the council's investment policy.

Councils may also wish to seek expert financial advice from an investment advisor, who is licensed by the Australian Securities and Investment Commission, when undertaking this review.

Council's external auditor is also required to review council's investments as part of the audit of the Annual Financial Reports.

If a breach of council's investment policy occurs, council should be notified at its next ordinary meeting by council's RAO. Council should also consider notifying the DLG of any such breaches.

4. TYPES OF INVESTMENTS

The Ministerial Investment Order prescribes the types of investments that councils may invest in under section 625 of the Local Government Act. The Order applies to all investments from the date of signing by the Minister.

4.1 Investments held under a previous Ministerial Investment Order

Councils may continue to hold to maturity, redeem or sell investments that comply with previous Ministerial Investment Orders. Any new investments must comply with the most recent Order.

This provision, known as “grandfathering”, also applies to dividends from investments that are considered to be non-complying where councils had made arrangements prior to the release of the amended Order to reinvest the income stream into the now non-complying investment as part of a dividend reinvestment plan.

It should be noted that any restructure or switch to new investment products must comply with the current Order and be on a market value basis.

5. EXTERNAL INDEPENDENT REVIEW

A well written investment policy with clear objectives should make it easier for a review to be conducted. A review by council's internal audit committee can act as an intermediary to confirm that the investments clearly line up with the investment policy.

Council officers should ensure that before new investments are made, they establish whether a product complies with the investment policy and, where necessary, obtain independent financial advice in writing on the nature and risk of the financial product.

When obtaining investment advice, councils should make sure that the provider is a licensed advisor by the Australian Securities and Investment Commission. The advisor must not have any conflicts, or perceived conflicts, of interest in relation to the investment products being reviewed. Councils may also request further information from the advisor, such as, whether they are engaged in any legal disputes or are aware of any pending legal action against them.

Councils should obtain written confirmation from their independent investment advisors that they do not have any actual or potential conflicts of interest in relation to the investments they are recommending or reviewing, including that they are not receiving any commissions or other benefits in relation to the investments they are recommending or reviewing.

Councils should be undertaking separate reference checks of advisors and not solely relying on the information provided by an advisor.

6. APPENDICES

6.1 Definitions

ADI
Authorised Deposit-Taking Institutions (ADI) are corporations that are authorised under the *Banking Act 1959* (Cwth) to take deposits from customers.

Bill of Exchange
A bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a sum certain in money to or to the order of a specified person, or to bearer.

Credit Risk
Credit risk is the risk of loss to an investor due to the failure of the institution/entity with which an investment is held to pay the interest and/or repay the principal of an investment.

Debentures
A debenture is a document evidencing an acknowledgement of a debt, which a company has created for the purposes of raising capital. Debentures are issued by companies in return for medium and long-term investment of funds by lenders.

DLG
NSW Division of Local Government, Department of Premier and Cabinet

Grandfather Clause
Grandfather clause is a legislative clause, which, in prohibiting a certain activity, exempts those who were already engaged in the activity at the time the legislation was passed.

Interest Rate Risk
Interest rate risk is the risk that the fair value or future cash flows of an investment will fluctuate because of changes in market interest rates.

Investment Portfolio
The total pool of all of the council's investments.

LGGR
Local Government (General) Regulation 2005 (NSW)

Liquidity Risk
Liquidity risk is the risk an investor is unable to redeem the investment at a fair price within a timely period.

Market Risk
Market risk is the risk that the fair value or future cash flow of an investment will fluctuate due to changes in market prices.

Maturity Risk
Maturity risk is the risk relating to the length of term to maturity of the investment. The larger the term, the greater the length of exposure and risk to market volatilities.

Preservation of Capital
Preservation of capital refers to an investment strategy with the primary goal of preventing losses in an investment portfolio's total value.

Prudent person standard
Prudent person standard is a legal standard restricting the investing and managing of a client's account to what a prudent person seeking reasonable income and preservation of capital might exercise for his or her own investment.

Responsible accounting officer
Responsible Accounting Officer (RAO) of a council means a member of the staff of the council designated by the General Manager, or if no such member has been designated, the General Manager. (LGGR, clause 196)

Securities
For financial markets these are the many types of financial instruments (ie, documents) that are traded in financial markets (except futures contracts), eg, bonds and shares.

6.2 Sample Investment Policy

Objectives

To provide a framework for the investing of Council's funds at the most favourable rate of interest available to it at the time whilst having due consideration of risk and security for that investment type and ensuring that its liquidity requirements are being met.

While exercising the power to invest, consideration is to be given to the preservation of capital, liquidity, and the return of investment.

- Preservation of capital is the principal objective of the investment portfolio. Investments are to be placed in a manner that seeks to ensure security and safeguarding the investment portfolio. This includes managing credit and interest rate risk within identified thresholds and parameters.
- Investments should be allocated to ensure there is sufficient liquidity to meet all reasonably anticipated cash flow requirements, as and when they fall due, without incurring the risk of significant costs due to the unanticipated sale of an investment.
- Investments are expected to achieve a market average rate of return in line with the Council's risk tolerance.

Legislative Requirements

All investments are to comply with the following:

- *Local Government Act 1993*;
- *Local Government (General) Regulation 2005;*
- *Ministerial Investment Order;*
- *Local Government Code of Accounting Practice and Financial Reporting,;*
- Australian Accounting Standards; and
- Division of Local Government Circulars.

Delegation of Authority

Authority for implementation of the Investment Policy is delegated by Council to the General Manager in accordance with the *Local Government Act 1993.*

The General Manager may in turn delegate the day-to-day management of Council's Investment to the Responsible Accounting Officer or senior staff, subject to regular reviews.

Officers' delegated authority to manage Council's investments shall be recorded and required to acknowledge they have received a copy of this policy and understand their obligations in this role.

Prudent Person Standard

The investment will be managed with the care, diligence and skill that a prudent person would exercise. As trustees of public monies, officers are to manage Council's investment portfolios to safeguard the portfolio in accordance with the spirit of this Investment Policy, and not for speculative purposes.

Ethics and Conflicts of Interest

Officers shall refrain from personal activities that would conflict with the proper execution and management of Council's investment portfolio. This policy requires officers to disclose any conflict of interest to the General Manager.

Independent advisors are also required to declare that they have no actual or perceived conflicts of interest.

Approved Investments

Investments are limited to those allowed by the most current Ministerial Investment Order that has been issued by the NSW Minister for Local Government.

Prohibited Investments

In accordance with the Ministerial Investment Order, this investment policy prohibits but is not limited to any investment carried out for speculative purposes including:

- Derivative based instruments;
- Principal only investments or securities that provide potentially nil or negative cash flow; and
- Stand alone securities issued that have underlying futures, options, forwards contracts and swaps of any kind.

This policy also prohibits the use of leveraging (borrowing to invest) of an investment.

Risk Management Guidelines

Investments obtained are to be considered in light of the following key criteria:

- Preservation of Capital – the requirement for preventing losses in an investment portfolio's total value (considering the time value of money);
- Diversification – setting limits to the amounts invested with a particular financial institution or government authority to reduce credit risk;
- Credit risk – the risk that a council has invested in fails to pay the interest and or repay the principal of an investment;

- Market Risk - the risk that the fair value or future cash flows of an investment will fluctuate due to changes in market prices;
- Liquidity Risk - the risk an investor is unable to redeem the investment at a fair price within a timely period; and
- Maturity Risk - the risk relating to the length of term to maturity of the investment. The larger the term, the greater the length of exposure and risk to market volatilities.

Investment Advisor

The Council's investment advisor must be approved by Council and licensed by the Australian Securities and Investment Commission. The advisor must be an independent person who has no actual or potential conflict of interest in relation to investment products being recommended and is free to choose the most appropriate product within the terms and conditions of the investment policy.

The independent advisor is required to provide written confirmation that they do not have any actual or potential conflicts of interest in relation to the investments they are recommending or reviewing, including that they are not receiving any commissions or other benefits in relation to the investments being recommended or reviewed.

Measurement

As Council continues to hold grandfathered investments such as Collateralised Debt Obligations (CDOs), the investment returns for the portfolio is to be regularly reviewed by an independent financial advisor by assessing the market value of the portfolio. The market value is to be assessed at least once a month to coincide with monthly reporting.

Benchmarking

Performance benchmarks need to be established and should be based on sound and consistent methodology.

Investment	Performance Benchmark
Cash	11am Cash Rate
Direct Investments	AFMA BBSW Rate: Average Mid - 90 day

Reporting and Reviewing of Investments

Documentary evidence must be held for each investment and details thereof maintained in an investment Register.

The documentary evidence must provide Council legal title to the investment.

Certificates must be obtained from the financial institutions confirming the amounts of investments held on the Council's behalf as at 30 June each year and reconciled to the Investment Register.

All investments are to be appropriately recorded in Council's financial records and reconciled at least on a monthly basis.

A monthly report will be provided to Council. The report will detail the investment portfolio in terms of performance, percentage exposure of total portfolio, maturity date and changes in market value.

This Investment Policy will be reviewed at least once a year or as required in the event of legislative changes. The Investment Policy may also be changed as a result of other amendments that are to the advantage of that Council and in the spirit of this policy. Any amendment to the Investment Policy must be by way of Council resolution

6.3 Investment Policy Checklist

General Products Check List

General questions to consider when investing in simple products that are straight forward such as bank deposit, bills of exchange, bonds, etc.

1) Have you found out how the funds will be invested, how will they generate returns and how will these be paid to the council? (Could you describe to others how this product works?)

Yes ☐ No ☐

2) Are you clear on the conditions associated with this type of investment and their level of risk?

Yes ☐ No ☐

3) Does the investment meet the council's financial objective and complies with its investment policy?

Yes ☐ No ☐

4) Are your product issuers licensed by the Australian Security and Investment Commission?

Yes ☐ No ☐

5) Do you know if/how the investment may be affected by a major shift in the economy and market sentiment?

Yes ☐ No ☐

6) Could the investment be liquidated in a timely manner without loss or penalty? i.e. can the council quickly get its money back out of this product if it needs to? Are there any fees to get out early?

Yes ☐ No ☐

Note: If you answered No to any of the above questions, do your research and consult your financial adviser. If necessary, review your investment decision.

Investment Policy Check List

Include general items that should be incorporated into your council's investment policy. Have you included the following as part of your investment policy?

1) Clearly stipulated the investment objective.

Yes ☐ No ☐

2) Specify the level of risk the Council is prepared to accept.

Yes ☐ No ☐

3) Prohibit the
i) purchase of speculative financial instruments &
ii) use of leveraging of an investment portfolio.

Yes ☐ No ☐

4) Identified the legislative requirements.

Yes ☐ No ☐

5) List the allowable investments and/or prohibited investments.

Yes ☐ No ☐

6) Specify investment parameters including the overall portfolio limits, counterparty credit framework and term to maturity framework.

Yes ☐ No ☐

7) If applicable, require independent valuation of investments in order to reflect the current market prices.

Yes ☐ No ☐

8) State the appropriate benchmarks for evaluating investment performance.

Yes ☐ No ☐

9) Require a monthly report of the status and performance of investment portfolio.

Yes ☐ No ☐

10) Require independent financial assessments of the value of the investment portfolio.

Yes ☐ No ☐

Sample Monthly Investment Report as at 31 July 20_

Purpose
To report the balance of investments held as at 31 July 20__.

Report
The investment returns for July 20__ exceeded the respective benchmarks and the budget for the month.

Included in this report are the following items that highlight Council's investment portfolio performance for the month to 31 July 20__ and an update of the investment environment:

a) Council's Investments as at 31 July 20__
b) Application of Investment Funds
c) Investment Portfolio Performance
d) Investment Commentary

Financial Impact
The actual interest income to 31 July 20__ is $655,695 and compares favourably with the budget for the month of $476,732.

Policy Impact
The Investment Policy is due for review in 20__ by the Director of Finance.

a) Council Investments as at 31July 20__.

Pooled Managed Investment Group					
As at Date	Current Yield	Managed Fund	Rating	Purchase Price	Market Value
31/7/__	8.3200	T-Corp Hour Glass Facility – Strategic Cash	NA	2,000,000	2,891,137.87
31/7/__	8.6800	Citibank Fixed Out-Performance Cash Fund	AA-	20,000,000	20,878,914.81
			Sub total		**23,770,052.68**
Floating Rate Note Investment Group					
As at Date	Current Rate	Borrower	Rating	Principal Value	Market Value
31/7/__	8.0783	ANZ senior debt	AA-	3,000,000	3,010,990
31/7/__	8.1200	NAB senior debt	AA-	4,500,000	4,502,340.15
31/7/__	9.9850	CBA senior debt	AA-	2,000,000	2,003,240.00
			Sub total		**9,516,570.15**
Bank Bill Investment Group					
Roll over Date	Current Rate	Borrower	Rating	Principal Value	Market Value
10 Sep __	8.0300	National Bank of Australia	A-1+	3,961,112	3,966,364.58
11 Oct __	7.9500	Commonwealth Bank of Australia	A-1+	3,990,001	3,991,168.92
			Sub total		**7,957,533.50**
Term Investment Group					
Rollover Date	Current Yield	Borrower	Rating	Principal value	Market Value
18 Sep __	8.1700	Bank of Queensland	A-2	2,000,000	2,000,000.00
22 Sep __	8.3000	IMB Limited	A-2	5,000,000	5,000,000.00
3 Jan __	8.3400	Bank of Western Australia	A-1+	3,500,000	3,500,000.00
			Sub total		**10,500,000.00**
Term Investment Group & Cash Deposit Account					
Rollover Date	Current Rate	Borrower	Rating		Value
Cash Account	7.1500	CBA (Business Saver)	A-1+		3,400,000.00
22 Nov __	7.9700	NAB (loan offset)	AA-		2,392,324.57
			Sub total		**5,792,324.57**
			Total		**$67,536,480.90**

b) *Application of Investment Funds*

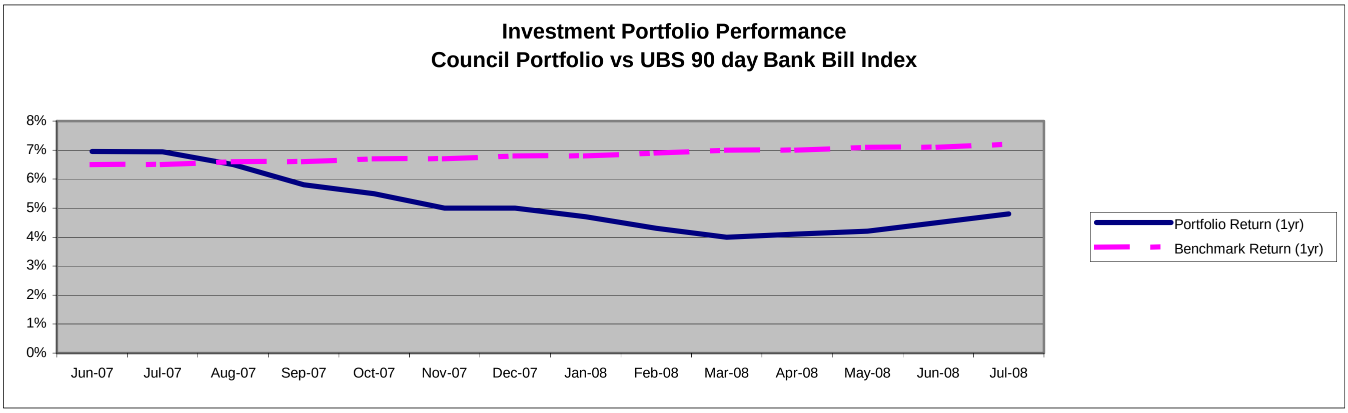
	Description	Value ($)
Restricted Funds:		
Loan Offset Facility NAB Loan Offset Facility CBA		2,392,325 490,000
Externally Restricted	Section 94 Old Plan Section 94A Plan Contributions	10,236,578 5,524,149
	Water Supply	11,662,124
	Sewerage Services	19,084,000
	Sportsfields, Domestic Waste, Unexpended grants	7,441,979
Internally Restricted Reserves*	Funds held for future at the discretion of the Council	5,070,725
Unrestricted Funds:	Funds Allocated to meet Current Budgeted Expenditure	5,634,600
	Total	**67,536,480**

* Externally & Internally Restricted Reserve figures are as at 31 July 20__ and are subject to final adjustment and external audit.

c) *Investment Portfolio Performance*

Investment Performance vs. Benchmark

	Investment Portfolio Return (%pa)*	Benchmark: UBS 90 day Bank Bill Index	Cash Fund Performance	Benchmark: 11am Cash Rate**
1 month	8.5	8.15	8.32	7.25
3 months	8.54	8.03	8.03	7.25
6 months	6.32	7.92	7.92	7.21
FYTD	8.57	8.15	8.32	7.25
12 months	4.69	7.49	7.37	6.92



d) *Investment Commentary*

The investment portfolio decreased by $1.46m for the month. The decrease was due to additional expenditure over income for the July period. During July, various income was received totalling $3.1m, including rate payments amounting to $1.39m, while payments to suppliers and staff costs amounted to $3.88m.

The investment portfolio is diversified across a number of investment types. This includes term deposits and on-call accounts.

The investment portfolio is regularly reviewed in order to maximise investment performance and minimise risk. Council's investment portfolio has been reviewed and rebalanced in favour of investments not subject to share market volatility. Comparisons are made between existing investments with available products that are not part of Council's portfolio. Independent advice is sought on new investment opportunities.

A revised Ministerial Order was released by the DLG on 18 August 2008 in response to the recommendations of the Cole Report and with transitional provisions to provide for existing investments. As at 31 July 20__, the portfolio included one non-compliant cash fund and its holdings are being reduced as opportunities to transfer arise.

Certification- Responsible Accounting Officer

I hereby certify that the investments listed in the attached report have been made in accordance with Section 625 of the *Local Government Act 1993*, clause 212 of the *Local Government (General) Regulation 2005* and Council's Investments Policy number POL 08/52.

Responsible Accounting Officer

RECOMMENDATION OF RESPONSIBLE ACCOUNTING OFFICER

A. That the report indicating Council's Fund Management position be received and noted.

B. That the Certificate of the Responsible Accounting Officer be noted and report adopted.

6.5 Investment Advisor Selection Criteria

(Weightings are indicative and could be adjusted to suit individual Council preferences)

Ideal Investment Adviser Attributes	**Desired?**	**Weight**
Independence	✓	**35**
All remuneration comes directly from the client, not via commission, securities trading margin, or fees on related party products	✓	
Does not recommend related party investments – removing a major potential conflict of interest	✓	
Rebates all fees and commissions from product providers and issuers to client	✓	
Interests are aligned with those of client – adviser operates as a fiduciary	✓	
Transparency		**5**
All revenues relating to transactions, both direct and related are clearly disclosed. (Includes margins on securities trades, related party product fees etc)	✓	
Provides full detail of underlying securities in managed investments upon request	✓	
Commercial Model / Experience		**20**
Provides advice on all rated managed funds and any eligible direct security offering	✓	
Offers payment options to suit client (percentage fee, flat fee)	✓	
Provides access to institutional pricing on direct securities	✓	
Has established track record as a provider of advice services to Local Government	✓	
Personnel have significant experience / expertise in investment research and advice	✓	
Provides consulting on overall risk management relating to investments incl. operational risks	✓	
Each client has dedicated adviser/relationship manager and backup person	✓	
Taking all fees into account, both direct and indirect, the adviser provides real value for money	✓	
Research & Advice		**25**
Carries out original research on managed funds	✓	
Carries out original research on direct securities	✓	
Assists with development of investment policy	✓	
Provides advice from a total portfolio perspective	✓	
Is accountable for risk / return outcomes on *total* portfolio	✓	
Monitors market events and impact on client portfolios on a proactive basis	✓	
Makes a real endeavour to educate clients as well as provide research on specific securities	✓	
Portfolio Administration & Transactions		**15**
Provides client efficiency through online managed fund transactions	✓	
Provides client efficiency through online reporting in managed funds	✓	
Daily valuations of managed funds	✓	
Provides consolidated reporting of managed funds and direct securities in council friendly format	✓	
TOTAL		**100**

6.6 Recommendations from the Review of NSW Local Government Investments

Recommendation 1: All investment instruments (debentures, securities, stocks and deposits, but excluding discount instruments such as bills of exchange) in the Investment Order be defined to include both principal and investment income.

Recommendation 2: All existing investments by NSW Councils that may be excluded by any proposed changes to the Investment Order are to be grandfathered. For the avoidance of doubt, existing securities that become ultra vires under the proposed amendments to the Investment Order can continue to be held to maturity, redeemed or sold, but new investments must comply with the amended Investment Order. Note that investment portfolio restructurings / switches currently being offered by product manufacturers or advisors are specifically excluded from consideration if the switch investments are outside the amended Investment Order. If the proposed switch investment is within the amended Investment Order all transactions must be on a market value basis. Book value transactions are explicitly prohibited.

Recommendation 3: Product manufacturers / distributors should be excluded from being appointed investment advisors to Councils.

Recommendation 4: Investments specified in k) and l) of the Investment Order be suspended for the period to 31/12/2009 and be subject to a further review after this period to determine the relevance of using a credit ratings based approach to determining authorised investments, particularly in light of the current CDO credit experience. It should consider whether to restore the current investment powers under k) and l). Any such review should have specific regard to the trade-off between the cost of Government monitoring and Council compliance which would be required, and the prospective incremental investment return.

Recommendation 5: It is recommended that the current partial deregulation model operating in New South Wales be retained with the modifications suggested in Points 4.13, 4.15, 4.18 and 4.30 of this report, as well as the minor modifications set out in Points 4.39 and 4.41. Consistent with the existing Investment Order, interest income and capital growth investment options will continue to be available through the TCorp Hour-Glass Investment Facilities. This outcome provides a number of the advantages highlighted in the centralised model in section 6.19.

Recommendation 6: It is most important that the Councils' fiduciary responsibility in relation to investment activities under the *Local Government Act 1993*, should be reinforced strongly. All participants should be made explicitly aware of the obligations under the *Trustee Act 1925(NSW),* and be requested to sign to acknowledge the same. Inclusion of the relevant sections of the Trustee Act in the Investment Order may also assist in this regard. In particular, it is important that long term assets including Section 94 funds are invested in a manner consistent with meeting future liabilities, on the basis that the nominal return sought is consistent with an acceptable level of investment risk.

Recommendation 7: With regards to the Investment Order section (m), permitted investments in securities should explicitly exclude subordinated obligations. The permitted investments under (m) must rank pari passu with deposits of the same group entities; under (f) mortgages over land should be restricted to first mortgages with a Loan to Value ratio of no greater than 60%, and under (g), permitted land investments are to explicitly exclude ASX listed property trust investments.

Recommendation 8: The NSW Department of Local Government should give consideration to releasing a document, similar in content to the Western Australian Department of Local Government and Regional Development, Investment Policy – Local Government Operational Guidelines- Number 19, February 2008 (refer Appendix C). Further as noted in this document, there are deemed to be significant benefits from external monitoring: "a well constructed investment policy with clear objectives will facilitate an external review. The review should act as an intermediary to confirm that the investments explicitly align with the investment policy."(7-3/92)

7. REFERENCES

1. Australian Financial Management Association - http://www.afma.com.au

2. Australian Securities and Investments Corporation - http://www.asic.gov.au

3. Best Practice Guide – Investments. LG Solutions, October 2005.

4. *Bills of Exchange Act 1909* (Cwth)

5. Investment Policy Guidelines - Queensland Government – Department of Local Government, Sport and Recreation.

6. Investment Policy. Local Government Operational Guidelines – Number 19 February 2008. Department of Local Government and Regional Development. Government of Western Australia.

7. *Local Government Act 1993* (NSW)

8. Local Government (General) Regulation 2005

9. Macquarie Dictionary, 3rd edn.

10. NSW Local Government Investments Best Practice Guide, NSW Local Government Finance Professionals

11. Review of NSW Local Government Investments – Final Report. Michael Cole, April 2008.

12. *Trustee Act 1925* (NSW)