

Management report to Council

Agenda item 6.1

Investment and Strategic Income Policy

Council

Presenter: Michael Tenace, Chief Financial Officer and General Manager Finance and Corporate

27 April 2021

Purpose and background

1. The purpose of this report is to seek endorsement on the Council Investment and Strategic Income Policy (Policy).
2. Section 102 of the *Local Government Act 2020 (Act)* provides that the Council must prepare and adopt financial policies that give effect to the financial management principles (as set out in section 101 of the Act). The policies must be adopted by 30 June 2021 to align with the new financial management and reporting requirements in the Act.
3. The last time the Policy was reviewed was November 2018, when it was known as the investment policy.

Key issues

4. The Policy covers the following:
 - 4.1 How Council will conduct investment in accordance with Section 103 of the Act.
 - 4.2 How Council will assess business cases for assets yielding strategic income (defined as income derived from Council's strategic assets/capital projects, such as the Council's beneficial enterprises and investment property).
5. The Policy has been presented to and incorporated the feedback from the Audit and Risk Committee.
6. The key changes that were made in this policy are:
 - 6.1. adjustments to the definition of investment to align with the Act, broadening it to cover both investment and strategic income as it relates to Council's strategic assets
 - 6.2. linking the Policy to Council's Borrowing Policy and associated business case principles and key metrics
 - 6.3. changes to reflect the Council's commitment to include the United Nation's Sustainable Development Goals and climate leadership through its investments.
7. The updated Policy has been benchmarked with that of other Councils where available.

Recommendation from management

8. That Council adopts the Investment and Strategic Income Policy (refer Attachment 2 to the management report).

Attachments:

1. Supporting Attachment (Page 2 of 12)
2. Investment and Strategic Income Policy (Page 3 of 12)

Supporting Attachment

Legal

1. Section 101 of the Act sets out the following financial management principles:
 - 1.1. revenue, expenses, assets, liabilities, investments and financial transactions must be managed in accordance with a Council's financial policies and strategic plans
 - 1.2. financial risks must be monitored and managed prudently having regard to economic circumstances
 - 1.3. financial policies and strategic plans, including the Revenue and Rating Plan, must seek to provide stability and predictability in the financial impact on the municipal community
 - 1.4. accounts and records that explain the financial operations and financial position of the Council must be kept.

The report accurately describes the requirements of the Act.

Finance

2. Investment and Strategic Income activities will be limited as per the Investment and Strategic Income Policy.

Conflict of interest

3. No member of Council staff, or other person engaged under a contract, involved in advising on or preparing this report has declared a material or general conflict of interest in relation to the matter of the report.

Health and Safety

4. In developing this proposal, no Occupational Health and Safety issues or opportunities have been identified.

Stakeholder consultation

5. In developing this documentation, Council has engaged the relevant stakeholders and incorporated appropriate feedback.

Relation to Council policy

6. The Investment and Strategic Income Policy adheres to the existing Council policies.

Environmental sustainability

7. The Investment and Strategic Income Policy states that:
 - 7.1. through this policy, Council is affirming its commitment to clean energy, the United Nation's Sustainable Development Goals, and climate leadership through its investments and strategic assets.
 - 7.2. the Council commits to not directly investing in any fossil fuel and gaming companies into the future.



Investment and Strategic Income Policy

Effective Date April 2021

1. Overview

The Investment and Strategic Income Policy outlines of the City of Melbourne's ("the Council") long-term strategic plan based on the analysis of the capital markets and the Council's financial position. In formulating this policy, the Council has sought to allow for sufficient flexibility to capture investment and strategic income opportunities as they occur, while maintaining reasonable parameters to ensure that prudence and care are exercised in the execution of the Council's investment and strategic income program within a prudential commercial framework

This Policy is intended to assist the Income and Investments Panel by ensuring the Council make investment-related decisions in a responsible manner. It outlines the underlying philosophies and processes for the selection, monitoring and evaluation of the investment and strategic income options utilised by the Council.

Specifically, this policy addresses the following issues with respect to the Council's investment portfolio and strategic income:

- a. The purpose of the Investment and Strategic Income Policy;
- b. Policy objectives;
- c. Asset class definitions, including specific types of permissible ownership within each asset class and any specific limitations or other considerations governing the investment of the funds; and
- d. Investment and strategic income guidelines.

To ensure the relevance of this Investment and Strategic Income Policy to the current market conditions and the regulations, this Policy will be reviewed at least annually.

2. Purpose of the Investment and Strategic Income Policy

The primary purpose of this Investment and Strategic Income Policy is to reduce the Council's reliance on rates income by improving the performance of its investment portfolio and strategic income assets. This is consistent with the following Financial Strategy Principles and Parameters of the Council:

- a. Financially sustainable
- b. Effective and efficient capital management
- c. Optimised assets and investment
- d. Prudent financial risk management

Investment is defined as placement of any money in accordance with Section 103 Investments of the Local Government Act 2020 (Appendix 1)

Strategic Income is defined as income derived from Council's strategic assets/capital projects, such as the Council's beneficial enterprises and investment property (Appendix 1)

3. Investment and Strategic Income Objectives

The Council has adopted this Investment and Strategic Income Policy to ensure that:

1. It reduces the Council's reliance on rating income by improving the performance of its investment portfolio and strategic income assets.
2. Investment and strategic income assets ownership decisions are based on three objectives:
 - a. being able to achieve an acceptable financial return on investment/ROI (mandatory);
 - b. to perform its role as a Council (mandatory); and
 - c. to meet the strategic development objectives of the Council (highly desirable)
3. Operating objectives are to reduce risk through diversification, manage liquidity and ensure returns are sufficient to meet budget.
4. If appropriate, seek approval from the Minister to invest in any other manner
5. Allows for conducting strategic projects that will deliver strategic income which are assessed on the basis of:
 - a. commercial returns
The hurdle rate for a strategic project is the annualised return of the relevant industry indices as listed in the ASX (if no relevant industry indices is available, then the ASX 200 index will be used) for the past 5 to 10 years (depending on the forecasting period). Hurdle rate benchmarks for strategic projects are specified in schedule 1. In the event indices result in a negative rate, higher rate between S&P ASX 200 10 Year Return Annualised (Price Return) or 150% of 10 year bond yield shall be used.
 - b. contribution to Council's strategic objectives i.e. Overall return of investment portfolio and strategic income assets to be the average 10 year Australian government bond yield plus 3.0% per annum measured over rolling five year periods;
The Council's investment strategy and strategic objectives is subject to annual review to ensure alignment with market movement
 - c. positive net present value from strategic projects within the forecast period of 10 years

For the purpose of the Council's business case analysis, the assessment framework above must be used.

6. Allows borrowing to be conducted in compliance with the Council's Borrowing Policy
For the purpose of assessing business cases of projects funded via borrowing, the assessment framework in point (5) above or any other more conservative assessment framework must be applied.
7. Affirms its commitment to clean energy, the United Nation's Sustainable Development Goals, and climate leadership through its investments and strategic assets
8. Provides for the divestment of investment or strategic income assets that have reached their maximum potential in achieving return and/or are not considered to be of strategic importance.

The investment and strategic income objectives are based on a long-term horizon of 10 years. It is important to remember that interim fluctuations should be viewed with this long-term perspective in mind. The investment and strategic income asset strategies aimed at achieving these objectives must therefore not be inconsistent or conflict with the above strategic directions of the Council.

4. Asset Allocation

The Council's asset class mix is based on the Council's risk and return profile. The investment and strategic income asset portfolio is a blend of cash, fixed interest, property and shares (including subsidiary and associate companies) designed to deliver the Council's accepted risk profile and return of the portfolio.

5. Asset Class Definitions

Broad definitions of the asset classes are as follows.

Investment Asset:

Cash

Cash invested in term deposits (with a term lower than one year) or at-call accounts generally provide a stable capital value and interest income. They are typically short-term investments, with a low risk of loss of capital.

Fixed Interest

Government securities of the Commonwealth and securities guaranteed by the Government of Victoria. They typically offer higher yields (returns) than cash. This category also includes fixed term deposits with a term greater than one year.

Any other manner of investment approved by the Minister

This can include any other asset classes (including assets under strategic income assets below) approved by the Minister

Strategic Income Assets:

Shares

Equity investments can either be listed or unlisted. Listed equity investments are publicly traded on an exchange. Unlike unlisted equity investments, listed equity offers greater liquidity and transparency of information and hence makes for a more attractive investment option. The Council commits to not directly investing in any fossil fuel and gaming companies into the future.

Fixed interest

Fixed interest investments that are issued by other government authorities (other than mentioned in the "Investment Asset" section above) and corporations. They typically offer higher yields (returns) than cash.

Property

Direct property investments largely include retail properties and car parks which provide rental income and capital growth but which can be illiquid.

Properties that are not listed in the Council's Investment Property list (as maintained in accordance to the AASB definition of Investment Property), do not form part of the strategic income assets portfolio. The property should generate an income and may experience capital growth.

6. Asset Diversification

A prudent asset allocation strategy encompasses a certain level of diversification, which produces risk reduction. In terms of level of impact, diversification should be considered along the following lines:

- a. asset classes (shares, property, fixed interest, and cash);
- b. geography/country;
- c. industry, and
- d. maturity.

Consequently, the strategic asset allocation underpinning this Investment and Strategic Income Policy is constructed, and will be maintained, to provide prudent diversification among the asset classes. Within each asset class, there shall be prudent diversification with regard to the concentration of holdings in individual countries, industries, and maturities.

7. Investment and Strategic Income Asset Guidelines

The Council recognises that risk (i.e. the uncertainty of future events), volatility (i.e. the potential for variability of asset values), and the possibility of loss in purchasing power (due to inflation) are present to some degree in all types of investment and strategic income asset vehicles. While high levels of risk are to be avoided, the assumption of risk is warranted as long as it is compensated in order to allow the investment managers the opportunity to achieve satisfactory long-term results consistent with the objectives and fiduciary character of the investment and strategic income portfolio.

Section 103 of the LGA 2020 specifies that money may be invested in fixed securities and with an ADI.

Unique needs

- The Council does not pay any income tax and is exempt from most other taxes. This implies that the Council will not benefit from dividend imputation credits that may arise from investing in Australian shares. While this means fully franked shares do not offer any added benefit, unfranked shares may still be beneficial.
- The Council is also exempt from Stamp Duty on the sale of property.
- The concept of Socially Responsible Investment appeals to the Council where practical as part of its strategic objectives

Socially Responsible Investment is defined by the United Nations Principles for Responsible Investment (UNPRI 2014) as an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance factors, and of the long-term health and stability of the market as a whole.

Risk Tolerance

- The Council is reasonably risk averse and any investment taken shall deliver a satisfying risk-adjusted return to the Council. All investment must be taken prudently having regards to the risk.

8. Key Constraints

- Without the approval of the Minister, the Council is restricted from investing in manners other than specified in Section 103 (Investment) items (a) to (e) of the Local Government Act 2020

- Council currently holds shares in unlisted Subsidiary Companies (Citywide Services Pty Ltd, Queen Victoria Market Pty Ltd) and associates (Regent Management Pty Ltd and Procurement Australasia Pty Ltd). Any proposed changes to the operation/investment of these companies shall follow the constitutions of the each subsidiary/associates and the Local Government Act 2020 section 110 and 111.

9. Constrained Target Portfolio

Section 10 will be suspended while the QVM redevelopment is underway due to the impact of the project on the asset allocation mix. On completion of the QVM redevelopment project the asset allocation ranges will be reviewed.

Currently suspended.

[The Target Portfolio will continue to hold investments in asset classes which are aimed at spreading the risk across the portfolio so as to achieve the low risk profile objective. The asset classes will be similar to those of the previous policy; however the asset allocation will be determined from time to time depending on the strategic opportunities Council wishes to pursue. The portfolio will still be constrained to the extent that Council is limited in where it can invest its funds but will comprise the following asset classes:

	Asset Allocation Range %
Car Parks	3.0 – 10.0
Unlisted Subsidiary Companies	28.0 – 47.0
Cash	17.5 – 40.0
Australian Fixed / including long term deposits with a maturity > one year	6.5 – 12.5
Direct Property	10.0 – 25.0

10. Compliance with the Governance Principles

Section 9(1) of the Local Government Act 2020 requires Council to give effect to the overarching governance principles. Section 9(2) of the Act specifies the governance principles as follows:

- a) Council decisions are to be made and actions taken in accordance with the relevant law **(Compliance with the law);**
- b) Priority is to be given to achieving the best outcomes for the municipal community, including future generations **(Achieve best outcomes for the community);**
- c) The economic, social and environmental sustainability of the municipal district, including mitigation and planning for climate change risks, is to be promoted **(Promote the sustainability of the municipality);**
- d) The municipal community is to be engaged in strategic planning and strategic decision making **(Engage the community in strategic planning and decision making);**
- e) Innovation and continuous improvement is to be pursued **(Strive for innovation and continuous improvement);**
- f) Collaboration with other Councils and Governments and statutory bodies is to be sought **(Collaborate with all other levels of government and government agencies);**
- g) The ongoing financial viability of the Council is to be ensured **(Secure the ongoing financial viability of Council);**
- h) Regional, state and national plans and policies are to be taken into to account in strategic planning and decision making **(Strategic planning and decision making must take into account plans and policies in operation at all levels);**

- i) The transparency of Council decisions, actions and information is to be ensured (**Council decisions, actions and information must be transparent**).

In developing the Investment and Strategic Income Policy the requirements of the governance principles have considered as summarised below:

	Governance Principle	Considerations
(a)	Compliance with the law	All relevant legal requirements have been considered in developing this policy
(b)	Achieve best outcomes for the community	Refer to the comments under (g) below
(c)	Promote the sustainability of the municipality	Refer to the comments under (g) below
(d)	Engage the community in strategic planning and decision making	Not applicable for this policy
(e)	Strive for innovation and continuous improvement	Not applicable for this policy
(f)	Collaborate with all other levels of government and government agencies	Not applicable for this policy
(g)	Secure the ongoing financial viability of Council	Security of Council's financial viability has been the primary consideration in the development of this policy.
(h)	Strategic planning and decision making must take into account plans and policies in operation at all levels	Not applicable for this policy
(i)	Council decisions, actions and information must be transparent	This policy relates to internal management of Council's finances and has met all of the relevant requirements of transparency within Council's management and decision making processes.

Appendix 1. References LGA 2020

Local Government Act 2020 provides Councils the power to invest and participate in beneficial enterprise

Section 101 Financial Management Principles states that

- (1) *The following are the financial management principles –*
- a. *Revenue, expenses, assets, liabilities, investments and financial transactions must be managed in accordance with a Council's financial policies and strategic plans*
 - b. *Financial risks must be monitored and managed prudently having regard to economic circumstances*
 - c. *Financial policies and strategic plans, including the Revenue and Rating Plan, must seek to provide stability and predictability in the financial impact on the municipal community*
 - d. *Accounts and records that explain the financial operations and financial position of the Council must be kept*

- (2) *For the purposes of the financial management principles, financial risk includes any risk relating to the following:*
- a. *The financial viability of the Council*
 - b. *The management of current and future liabilities of the Council*
 - c. *The beneficial enterprises of the Council*

Section 102 Financial Policies states that

- (1) *A Council must prepare and adopt financial policies that give effect to the financial management principles*
- (2) *A financial policy must include any matters prescribed by the regulations*

Section 103 Investments states that

A Council may invest any money:

- a. *In a Government securities of the Commonwealth; and*
- b. *In securities guaranteed by the Government of Victoria; and*
- c. *With an ADI; and*
- d. *With any financial institution guaranteed by the Government of Victoria; and*
- e. *On deposit with an eligible money market dealer within the meaning of the Corporations Act; and*
- f. *In any other manner approved by the Minister, either generally or specifically, to be an authorised manner of investment for the purposes of this section*

110 Beneficial enterprises states that

- (1) *For the purpose of performing its role, a Council may participate in any of the following beneficial enterprises—*
 - a. *become a member of a corporation;*
 - b. *participate in the formation of a corporation, trust or other body;*
 - c. *acquire shares in a corporation, trust or other body;*
 - d. *enter into a partnership or joint venture with any other person or body.*
- (2) *If by virtue of any participation, subscription or acquisition under subsection (1), a Council has the right to appoint some person to be a director of or hold office in or under the corporation, trust, partnership or other body, the Council may appoint a Councillor, member of Council staff or other person to that office.*
- (3) *For the purposes of subsection (1)(a), (b) or (c), a Council may nominate a person to hold the shareholding or unit holding on behalf of the Council and the person nominated is to be treated as being the shareholder or unit holder of the shares or units.*

111 Process before participating in beneficial enterprises states that

- (1) *A Council must in participating in a beneficial enterprise under section 110—*
 - a. *assess the total investment involved and the total risk exposure and ensure that its total risk exposure does not exceed its total investment; and*
 - b. *if section 110(1)(a), (b) or (c) applies, ensure that the corporation is a limited corporation; and*
 - c. *have regard to the risks involved; and*
 - d. *establish risk management arrangements; and*
 - e. *implement regular performance monitoring and reporting arrangements in relation to the beneficial enterprise; and*
 - f. *ensure that any changes to the operation or purpose of the beneficial enterprise are reported to the Council; and*

- g. identify and manage any risks associated with any changes to the operation or purpose of the beneficial enterprise.*
- (2) A Council must report on the operations and performance of each beneficial enterprise in its annual report.*

Schedule 1

#	Investment category	Benchmark
1	Cash	Bloomberg Ausbond Bank Bill Index
2	Property	S&P ASX 200 A-REIT 10 Year Return Annualised (Price Return)
3	IT	S&P ASX 200 Information Technology 10 Year Return Annualised (Price Return)
4	Infrastructure	CPI (average forecast 4 years as per the Vic Govt) + 5% (as per VFMC benchmark)
5	Other industries	S&P ASX 200 10 Year Return Annualised (Price Return)