Policy 43 – Cash Management

TRIM Ref:	**DOC/19/7110**
Adopted:	**16 July 2012** **Minute 103/12**
Version:	**5**
Reviewed Date:	**15 July 2019**
Council Minute No:	**116/19**
Statutory Authority:	**Local Government Act 1993 – Section 75**

OBJECTIVE

The purpose of the Cash Management policy is to:

- Guide how Council should manage its investment portfolio with consideration to Council's objectives;
- Proactively manage our investment portfolio to ensure there are sufficient liquid cash reserves available to meet Council's commitments and obligations as and when they fall due; and
- Manage the risk in regards to Council cash reserves.

POLICY

PURPOSE:

Dorset Council recognises the importance of obtaining the best rate of return on funds invested, whilst ensuring the security of these funds to support provision of services to the community.

SCOPE:

This policy applies to all surplus Council funds.

DEFINITIONS:

- Asset Class – is a group of securities that exhibits similar characteristics, behave similarly in the marketplace and are subject to the same laws and regulations. An example of asset classes are equities, fixed interest or bonds.
- Surplus Council Funds – are funds that are not required to be expended in the course of normal Council operations.
- Cash – includes money in hand, petty cash, money held in bank accounts, customer cheques and term deposits.
- Fixed Interest – fixed interest and fixed income are used interchangeably within investment circles. Council will refer to this investment type as fixed interest. A fixed interest investment is typically referred to as bonds. A bond is a fixed income instrument that represents a loan made by an investor to a borrower

(typically corporate or governmental). Bonds are utilised by these organisations to finance projects and operations.

- Authorised deposit taking institution (ADI) – a body corporate in relation to which an authority under subsection 9 (3) of the Banking Act (No. 6 of 1959 as amended) is in force.
- Investment arrangement – an arrangement that relates to acquiring, consolidating, dealing with, or disposing of certificates of deposits, bonds, bills or notes issued or proposed to be issued.
- Managed Fund – an investment fund managed for a number of clients by an organisation which involves a combination of investments.
- Morningstar Rating – is a ranking given to managed funds by the investment research firm Morningstar. The ratings range from one to five stars, with five being the best rating. The rating is based on each fund's past performance consistency.
- Index Fund – a type of managed fund with a portfolio constructed to follow or track the components of an index e.g. Standard & Poor's 500 Index (S&P 500) or the All Ordinaries. Also referred to as a passive fund as the fund will buy the required shares and hold them. This hold strategy results in a cheaper fee structure.
- Active Fund – a managed fund where the portfolio management strategy is to make specific investments with the goal of outperforming an investment benchmark index. These funds actively buy and sell shares and due to this activity usually charge higher fees than a passive or index fund.
- Allowable Range – The Council approved percentages that stipulate the amount of dollars that Council may invest surplus council funds in any of the allowable asset classes.
- Consumer price index (CPI) - a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.
- Official cash rate (OCR) – the rate of interest which the central bank charges on overnight loans to commercial banks

PRINCIPLES:

The principles of Council's Investment of Surplus Council Funds Policy are:

- A sufficient cash balance will be maintained in Councils bank accounts to meet outgoings as and when they fall due.
- Cash investments with BBB rated ADI's cannot exceed more than 20% of Council's total investments and no more than 10% for any single BBB rated ADI.
- Fixed interest investments will be held either directly in Australian Government bonds or a fixed interest managed fund. Both must be rated AA or higher.
- Fixed interest investments in AA rated or higher Australian Government bonds cannot exceed more than 40% of Council's total investments, including a maximum of 30% in fixed interest managed funds and 10% in direct Government bond holdings.

- Council may invest in managed funds up to the allowable ranges.
- This policy will manage the risk in regards to investments in managed funds:
  - Investments cannot exceed more than 25% of Surplus Council Funds.
  - Diversification will be by fund providers (ensuring we do not just invest in one managed fund), by geography (ensuring we do not just invest in one country or region) by asset class (protect Council from fluctuations that may be experienced in single asset classes) and by time (holding managed funds for the long term and / or staggering purchase dates to take advantage of falling prices).
  - As a minimum, at least four different fund providers with a different asset class focus need to be invested in at any one time to diversify funds as a mitigation to market and asset class fluctuations. Fixed interest managed funds invested in AA rated or higher Australian Government bonds do not form part of the four different fund providers.
  - No more than 50% of the cash that Council is allowed to be invested in managed funds may be with one fund.
  - The chosen managed funds must not have investments in the other chosen funds to ensure true diversification is achieved.
  - At least 50% of the managed fund invested dollar value must be in a low fee structure index fund.
  - Index funds fees should be lower than 0.5% of the total invested value by Council in that respective fund.
  - Active fund fees should be lower than 1.5% of the total invested value by Council in that respective fund. A higher fee may be accepted by Council if a managed fund is a proven long-term performer. An active fund with proven performance should ideally only charge a low base management fee and then charge additional management charges for out-performance of a market or index e.g. all managed funds align their investment portfolio with a market index that they attempt to better, some high performing funds take a small performance fee when they out-perform an index.
  - Priority will be given to wholesale managed funds due to their lower fee structure compared to retail funds.
  - All returns from the managed funds will be reinvested within the fund and ideally held for a period of 7-10 years to take advantage of compound returns. Any managed fund changes need to adhere to this policy.
  - Council will only invest in managed funds with a Morningstar Rating of four stars or more (five star rating system) evidencing sustained performance and the funds must have existed for at least five years.The star rating in itself is not a sole determinant of whether a managed fund is an appropriate investment for Council.
  - The majority of markets move up over time, however short-term (usually less than 1 year) volatility can be experienced. Council will ensure adequate funds are kept in cash to realise budget estimate and Long Term Financial Plan needs to ensure market losses are not realised in declining markets.
- The selling of managed fund units at a lower value than for what they were purchased for can only be carried out after a unanimous decision by Council.
- Council will ensure that sufficient liquid assets are held, to meet Councils obligations as and when they fall due as well as any unexpected cash flow needs.

- Council will have appropriate internal controls to ensure the level of Council funds available for investment is reviewed at least monthly. During the review process cash inflows and outflows for the immediate future will be assessed. This review will include ensuring the allowable ranges are adhered to.
- Where surplus funds are available:
  - Council will review the allowable ranges to ascertain the appropriate asset class Council should invest in. The allowable ranges need to be reviewed in the context of upcoming budgetary needs and the Long Term Financial Plan needs.
  - When choosing cash or fixed interest arrangements, not less than (2) quotations shall be obtained from ADIs, direct bond holders or fromfixed interest managed funds..
  - Quotations shall be assessed on risk, amount, rate of return and time to maturity;
    - Where possible individual investment arrangements shall be:
      - Equal or greater than $0.5m;
      - Provide a rate of return greater than CPI and 50 basis points above the prevailing OCR;
      - For a term of up to 24 months, however investments greater than 12 months must show a materially better return than investments that are 12 months or less.
- Current business and economic conditions will also be considered in assessing the most desirable term for the investment;
- Selected investment arrangements shall be endorsed by any two of the following Council officers; General Manager, the Director - Corporate Services and the Finance Manager.
- It has been determined that the following spread of investments are appropriate for the Council. The strategic ranges will be reviewed regularly as circumstances change:

Council Surplus Funds Allocation		
Asset Class	Strategic %	Allowable Range %
Cash and term deposits	35	10 – 100
Fixed Interest (Government Bonds – Direct Holdings)	10	0-10
Fixed Interest (Managed Funds – Diversified Holdings)	30	0-30
Managed Funds	25	0 - 25

*Standard & Poor's Long-term credit ratings	
Rating	**Commentary**
AAA	An obligor rated 'AAA' has extremely strong capacity to meet its financial commitments. 'AAA' is the highest issuer credit rating assigned by Standard & Poor's. As at March 2019 Australia was rated as AAA as a whole while the USA was rated AA.
AA	An obligor rated 'AA' has very strong capacity to meet its financial commitments. It differs from the highest-rated obligors only to a small degree.
A	An obligor rated 'A' has strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.
BBB	An obligor rated 'BBB' has adequate capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments. Many Australian ADIs are at BBB or above

*** Council may only invest in investment grade investments BBB rated or higher**

REVISION HISTORY:

This document is identified as the Cash Management Policy. The policy will be reviewed on an annual three year basis, and a new version will be issued whenever changes occur.

Version	Review Date	Original Author	Reviewer
v.5	15 July 2019	John Marik	Tim Watson
v.4	17 September 2018	John Marik	Tim Watson
v.3	16 January 2017	Matthew Ranson	Guy Jetson