Presbyterian
Investment Fund

## *Together we can grow our funds*

## Annual Report

## Year ended 30 June 2021

### Highlights of the 2020 / 2021 year

- $6.6m million in interest
- Average interest paid of 3.7%
- Fund growth to over $188 million
- Nearly $40 million in the new Long Term Fund
- Reserves of $8.6 million

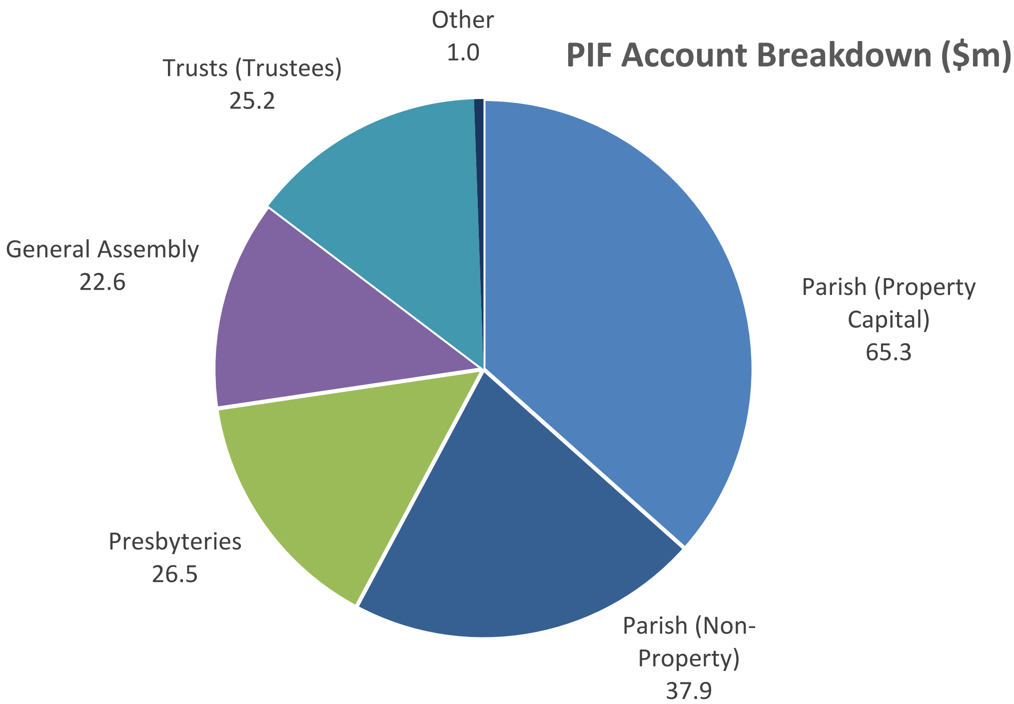
- ✓ Together we benefit from investing in bulk
- ✓ Two investment options
- ✓ Online access to funds without notice
- ✓ Attractive ‘on call’ interest rates
- ✓ Low operating expenses – less than 0.40% of funds

## Who makes up the PIF?

The Presbyterian Investment Fund (PIF) holds funds on behalf of parishes, Presbyteries, the General Assembly, The Presbyterian Church Property Trustees, and other entities associated with the Presbyterian Church of Aotearoa New Zealand. Property funds held on behalf of parishes are primarily held for property-related use.

Chart 1 below provides a breakdown of the various groups that hold funds in the PIF. It shows that $65.3m is Property Capital (generated from the sales of properties) held on behalf of parishes. Parishes hold a further $37.9m in the PIF, Presbyteries hold $26.5m, and the General Assembly $22.6m. The Trustees hold $25.2m on behalf of the various trusts they administer.

**Chart 1: PIF Account Breakdown (as at 30 June 2021)**




*Over a third of the PIF represents Property Capital*

Interest from the PIF is credited to accounts each quarter (calculated on daily balances). Reserves (which are invested in the On Call Fund) are used to smooth returns over time and insulate the PIF from extreme market events. Table 1 below provides some key comparative metrics for this year (and last year).

**Table 1: Key Figures from the Financial Statements**

| | 30 June 2020 | 30 June 2021 |
|---|---|---|
| Gross investment income | $5.02m | $6.94m |
| Interest paid | $3.92m | $6.58m |
| Deposit Accounts held | $172.41m | $178.55m |
| On Call Fund | $144.70m | $140.12m |
| Long Term Fund | $27.71m | $38.43m |
| Reserves | $8.96m | $8.62m |

*Interest paid to account holders was substantially higher this year*

## Long Term Fund

A new investment option, the Long Term Fund, was introduced in July 2019.

The new Long Term Fund invests in the Mercer Socially Responsible Investment Balanced Fund. This Fund invests in a globally diversified mix of shares, property, infrastructure, bonds and cash. The target asset allocation mix is 60% in growth assets (shares, property and infrastructure) and 40% in defensive assets (bonds and cash). Mercer also manages the investment assets of the Beneficiary Fund.

Mercer not only invests the money with the objective of providing good returns, but in accordance with the Trustees' expectations regarding environmental, social and governance practices. Climate change is now a particular point of focus. Mercer has recently committed to transitioning to a net zero carbon investment portfolio by 2050. In addition to excluding companies associated with fossil fuels, it also actively invests in a number of renewable energy companies.

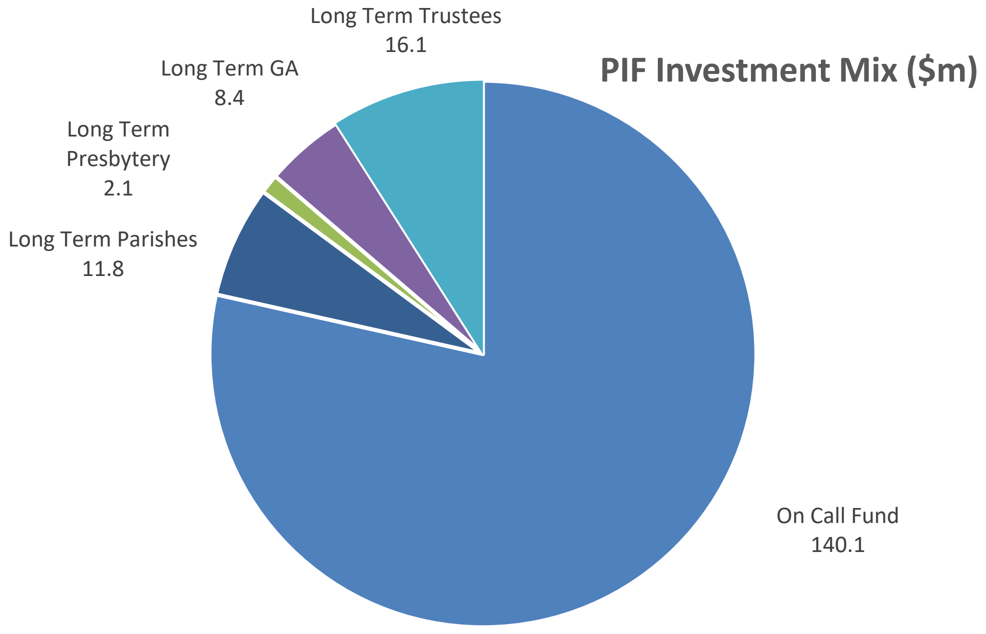
The Long Term Fund pays a higher rate of interest than the On Call Fund, plus inflation. Inflation interest is allocated separately to allow parishes to maintain the spending-power value of their capital. If capital is not maintained in line with inflation, income will fall each year in real (inflation-adjusted) terms. The Long Term Fund ended the year paying 3.0% p.a. plus inflation interest of 3.3% p.a., compared to the (average) On Call rate of 1.55% p.a.

However, it is worth noting that the Long Term Fund will not be suitable for all PIF users. There is a risk of short-term capital loss, so only investors that can tolerate possible losses are suitable for the Long Term Fund. The Long Term Fund will most suit those who intend to hold their capital in the PIF for the long term (say 10 years) and only draw down on the income.

Whereas, the Long Term Fund suffered from investment market losses last year (as share prices falling sharply as Covid-19 took hold), the Fund benefited from strong investment returns in the current year. In fact, the Long Term Fund paid bonus Reserve Interest (the name was changed from Capital Adjustment) in three of the four quarters over the period.

As at 30 June 2021, a growing number of Presbyteries and parishes had taken advantage of the new investment option, along with some of the money under the auspices of the General Assembly and the Church Property Trustees, as illustrated in Chart 2 below.

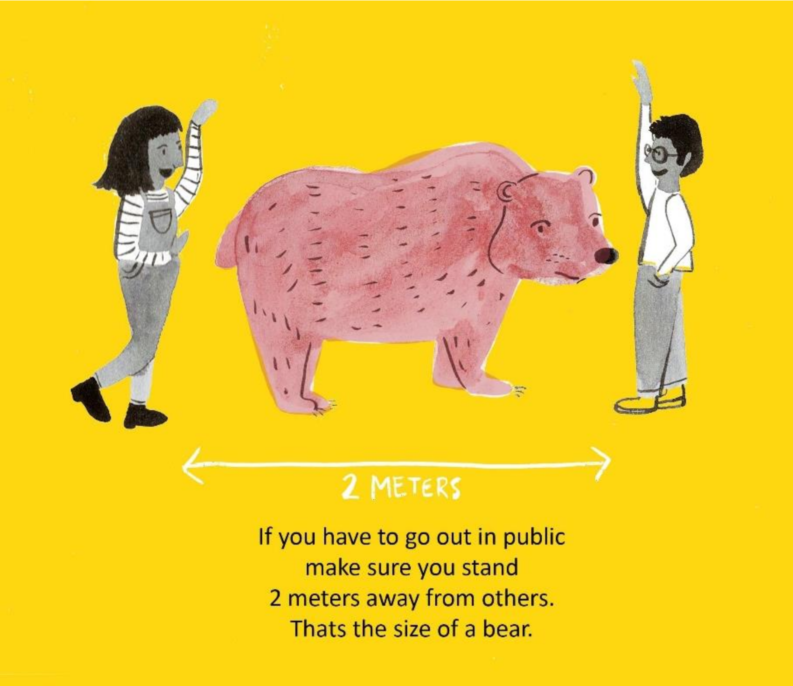
**Chart 2: PIF Investment Mix (as at 30 June 2021)**




***The Long Term Fund now represents nearly a quarter of the PIF***

## Interest rates feel the ongoing impact of Covid

The PIF On Call rate started at 1.75% p.a. and ended the year at 1.00%, reflecting the record low Official Cash Rate, which remained at 0.25% for the whole year. Interest Rates, which have been low ever since the Global Financial Crisis, were anchored at their lowest rate ever as the Reserve Bank of New Zealand tried to stimulate economic growth in the face of Covid-19 challenges. That said, it's worth noting that the RBNZ was expecting negative interest rates over the period. Better than expected economic growth, despite Covid-19, meant this was not necessary.




The PIF Long Term interest rate started and finished the year at 3.0% p.a. (plus inflation). Inflation income is paid quarterly, based on Statistics New Zealand's Consumer Price Index. Despite Covid-19, and in some cases, because of it, inflation rose 3.3%, boosted by the household construction boom and global supply bottlenecks.

The strong economic growth and rising share prices helped produce a strong return for the Long Term Fund. As a result, the Long Term Fund was able to provide extra Reserve Interest payments in three quarters in the year. By the time we compound the standard Long Term interest rate of 3.0% with the Inflation Interest of 3.3% and the Reserve Interest of 7.75%, the Long Term Fund generated a return of 14.5% for account holders over the year.

Table 2 below details the changes in rates over the course of the year. It highlights the relatively stable interest rates for both PIF Funds, the building inflationary pressure of the year, and the strong excess returns for the Long Term Fund (shown as Reserve Interest).

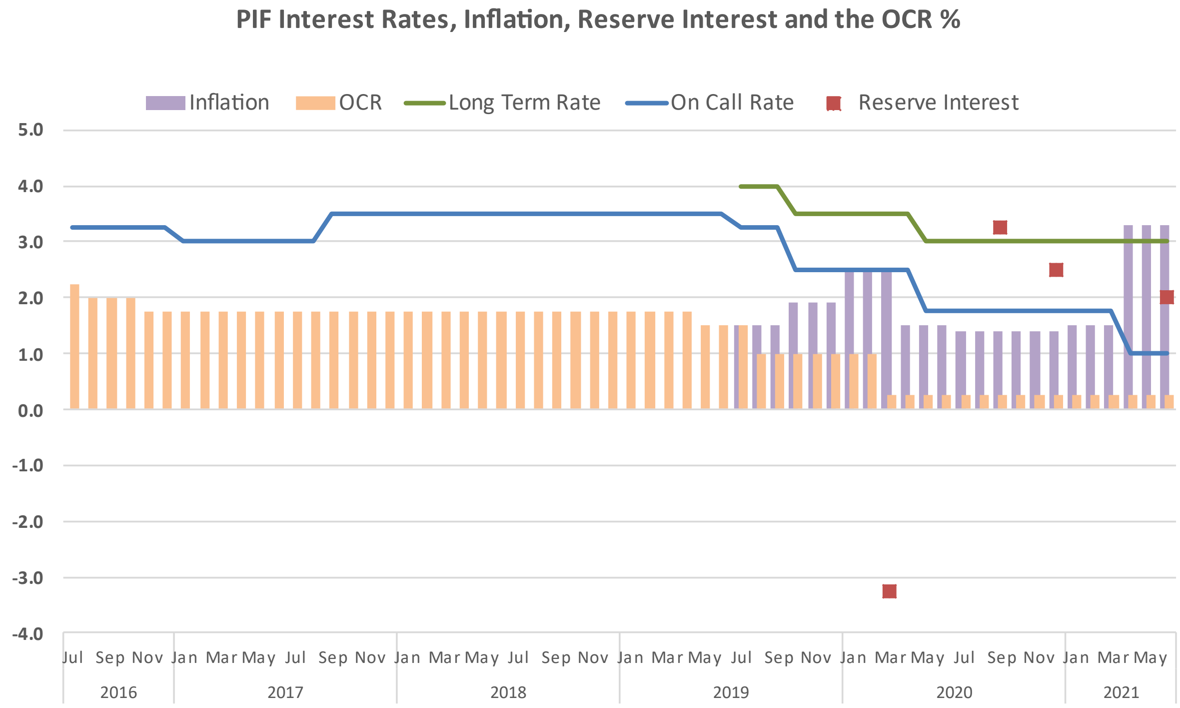
**Table 2: PIF Rate Changes Over the year**

| | On Call Fund p.a. | Official Cash Rate p.a. | Long Term Fund p.a. | Quarterly Inflation | Reserve Interest |
|---|---|---|---|---|---|
| As at 30 June 2020 | 1.75% | 0.25% | 3.00% | | |
| September 2020 | | | | 0.67% | 3.25% |
| December 2020 | | | | 0.47% | 2.50% |
| March 2021 | | | | 0.85% | |
| April 2021 | 1.00% | | | | |
| June 2021 | | | | 1.31% | 2.00% |
| As at 30 June 2021 | 1.00% | 0.25% | 3.00% | 3.34% | 7.75% |

***PIF interest rates were relatively stable over the year***
***– although the Long Term Fund Inflation and Reserve Interest rates varied***

Chart 3 below tracks the PIF On Call Interest Rate with the Official Cash Rate (OCR) over the last five years. It also shows PIF Long Term rate, the rate of inflation (the Consumer Price Index) and the Reserve Interest amounts. It highlights how the On Call Fund return is now below inflation.

**Chart 3: Annual PIF Interest Rates versus the Official Cash Rate and Inflation**




***Cash rates are at record lows while inflation has surged***

## PIF Loans

The PIF is now able to lend to parishes for major capital projects. Applications are considered by the Investment Committee, with security taken over parish property. Interest is charged on a floating rate basis, set for each loan according to risk, but hopefully at a rate that enhances returns for the PIF and reduces borrowing costs for the parish. There was one parish loan in place at the beginning of the year, which was repaid in full during the year. There were no loans in place as at 30 June 2021, although two parishes had received approval to take-out loans and these are expected to be drawn down in the coming year.

## Where to from here for interest rates?

It would seem that interest rates are on the way back up. The RBNZ lifted the Official Cash Rate from 0.25% to 0.50% in October 2021 and the market expects rates to continue to climb above 1% in 2022 and above 2% in 2023.

Significant uncertainties remain - mostly relating to Covid-19. The exact path of interest rates will depend on inflation. Right now, inflation is rising sharply, but it is not clear if current price rises are transitory or more embedded in the economy. It seems unlikely that many global economies will return to lockdowns, but another Covid shock could slow things down again. On the other hand, if prices continue to go up, interest rates could rise even more quickly.

The PIF On Call Fund interest rate is inextricably linked to short-term interest rates. It is, therefore, likely that the PIF On Call interest rate will follow cash rates up, albeit with a lag (in the same way that the PIF rate dropped much later than the OCR).

The Long Term interest rate is not expected to move around anywhere near as much as the On Call rate. This is because, in part, the rate is set based on long-term return expectations, and in part because the Reserve Interest facility provides a mechanism to deliver better than expected (or worse than expected) returns to account holders.

As a result, the Long Term rate will likely remain at 3% plus inflation. However, as noted, the inflation interest rate could be higher than the expected 2% p.a.  On the one hand, this means a higher return for Long Term Fund account holders. On the other hand, if inflation continues to outstrip expectations, Long Term Fund returns may struggle to keep up. If this were to happen, there may need to be negative Reserve Interest adjustments (to partially offset higher inflation).

One thing is for sure: we do not expect the Long Term Fund to provide a total compound return of 14.5% again this coming year. In fact, as the average total return over the long term is expected to be 5% p.a. (3% interest plus 2% inflation), the high return over the past year increases the prospects of a lower than average return at some point in the future.

## Service Providers

The Trustees have outsourced the provision of various PIF services to a range of specialist organisations. Harbour Asset Management (HAM) has managed the PIF’s On Call Fund investment assets since July 2016 under a ‘segregated mandate’, which is tailored to our specific requirement that a high level of security and liquidity in the PIF’s assets be maintained (along with our responsible investment requirement). Assets in the Long Term Fund are managed by Mercer. Trustees Executors Limited acts as custodian for the PIF, holding the investment assets in safekeeping, and providing accounting services. Booster provides account administration and online access for parishes and other account holders from the Presbyterian family. Ernst and Young are the Fund’s auditors.

Thank you to all the account holders and our service providers for another successful year for the Presbyterian Investment Fund.

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**Full accounts are available at:**
The Presbyterian Church Property Trustees: www.presbyterian.org.nz