Presbyterian Investment Fund

Annual Report
Year ended 30 June 2023

Together we can generate returns to support mission

Key points from the 2022 / 2023 year

- Account balances of $180 million
- $5.6m paid in interest
- Average On Call interest rate for the year of 3.1%
- On Call rate as at 1 July 2023 of 5.0%
- Long Term Interest for the year of 3.0%
- Long Term Inflation Interest for the year of 6.1%
- Long Term Reserve Interest for the year of -5.0%
- More loans to parishes (now $6.8m)
- Reserves gradually being rebuilt

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

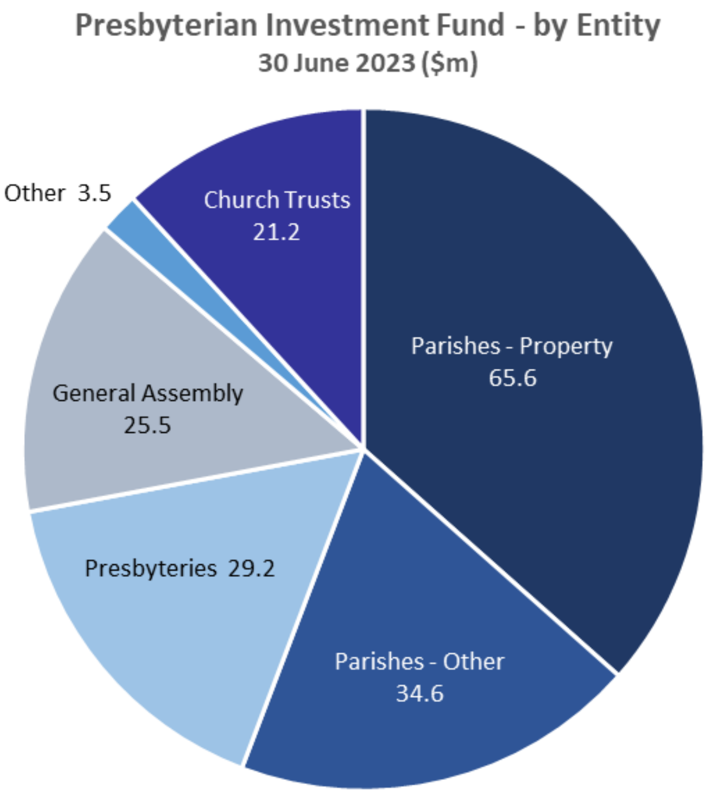
HOW IS THE PIF MADE UP?

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 provides a breakdown of the various groups that hold funds in the PIF. It shows that $65.6m is held as Property Capital (generated from the sales of properties) on behalf of parishes (last year $69.6m). Parishes hold a further $34.6m in the PIF (unchanged from last year at $34.6m).

Presbyteries hold $29.2m (last year $30.1m) and the General Assembly $25.5m (last year $24.0m). The Trustees hold $21.2m on behalf of the various trusts they administer (last year $22.6m). A further $3.5m is held on behalf of related entities.

Chart 1: PIF Account Breakdown as at 30 June 2023



Parish funds make up 56% of the PIF, with 37% held in property accounts

Account holders can invest in either or both the On Call Fund and the Long Term Fund.

Table 1 below provides a breakdown of the balances between the On Call and Long Term Funds over the last three years.

Table 1: Account balance comparison ($m)

	30 June 2021	30 June 2022	30 June 2023
On Call Fund	140.12	141.88	134.86
Long Term Fund	38.43	43.52	44.71
Total Accounts held	178.55	185.40	179.57
Reserves	8.62	3.85	5.52
Total Assets	187.17	189.25	186.10

The PIF fell in size over the year as funds were drawn down for property projects

ON CALL FUND

The PIF On-Call Fund provides an on-call facility that is invested in high quality, short-duration securities, predominantly managed by Harbour Asset Management. PIF loans to parishes make up the rest of the On Call Fund assets.

As a short-duration fund, the interest rate earned by the PIF's assets, and passed on to account-holders, is strongly linked to the Official Cash Rate (OCR). Unfortunately, in response to the Covid pandemic, the OCR fell to an all-time low of 0.25% p.a. in March 2020 and did not lift until October 2021, before rising sharply to reach 5.5% p.a. by 30 June 2023. The PIF On Call rate commenced the 2023 financial year at 1.75% p.a. and followed the OCR up, to finish at 5.0% p.a. as at 30 June 2023 (see Table 2).

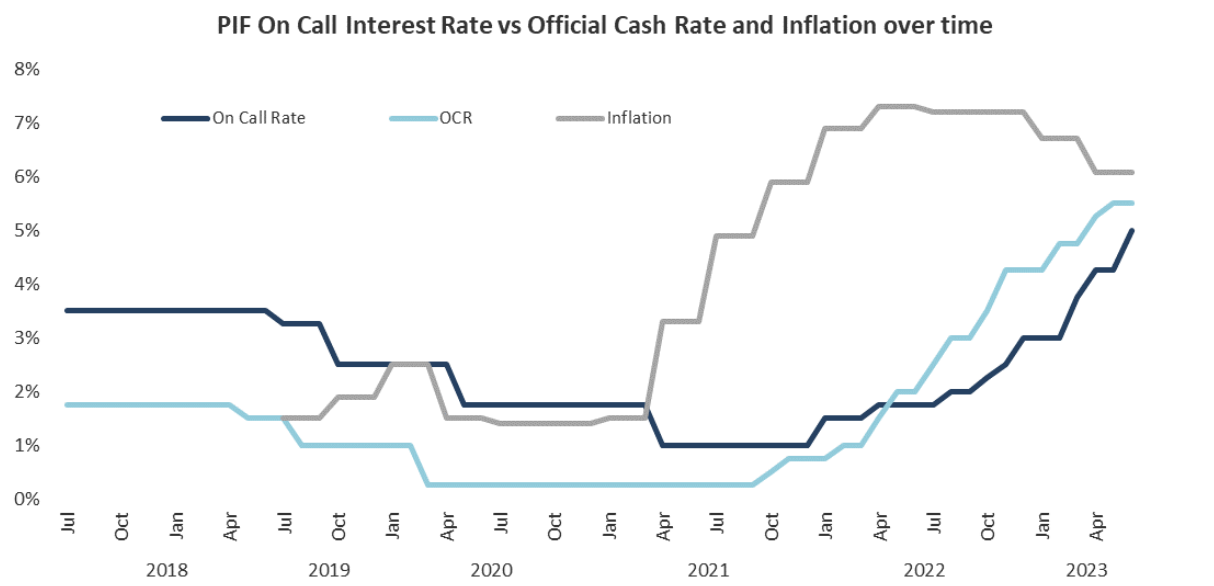
Table 2: On Call Fund Performance Summary:

	2021	2022	2023
Closing Interest Rate	1.00%	1.75%	5.00%
Average Interest rate	1.6%	1.3%	3.1%
Interest credited to accounts	$2,218,577	$1,825,445	$4,259,831
Transferred to / (from) Reserves	($342,066)	($4,779,926)	$1,673,433

While the Trustees expect to provide a return higher than the OCR (and more in line with 6-12 month term deposits) over the medium-term, the PIF rate might lag the OCR over short-term periods, particularly when the OCR rises sharply, as it did over 2022 and 2023. The Trustees elected to use some of the PIF's reserves to support the On Call rate when interest rates were at their lowest and as rates rose – and are now in the process of slowly replenishing reserves.

Chart 2 below tracks the PIF On Call Interest Rate with the Official Cash Rate (OCR) over the last five years, and inflation over the last four years. It illustrates how the On Call Fund interest rate did not fall as far as the Official Cash Rate. However, now that the OCR is climbing, the PIF rate, which lagged for a period, has just about caught up again.

Chart 2: Annual PIF Interest Rates versus the Official Cash Rate and Inflation



Interest rates might have peaked with signs that inflation is slowly coming down

PIF Lending

A lending facility was introduced within the PIF On Call Fund during the year ending 30 June 2020. This facility enables eligible PIF investors to also borrow from the PIF. The aim is to enhance returns to the PIF, while at the same time reducing the cost of borrowing for parishes and other church entities. Floating interest rates are set on a case-by-case basis. Loans must be secured by the first mortgage or a presbytery guarantee and fall within prudential limits set by the Trustees.

Table 3 provides a summary of loan activity over the last two years. As at 30 June 2023 there were 5 loans outstanding to three congregations and one loan to the Clark Estate Trust, totalling $6.8m.

Table 3: PIF Lending Summary

PIF Lending	2022	2023
Number of loans		
New loans	2	3
Loans at close	2	5
Value of loans	**$**	**$**
New loans (principal)	2,500,000	4,215,000
Loans (principal) repaid	-	6,406
Loans at close (incl. interest)	2,522,491	6,769,534
Loan interest rate	**%**	**%**
Close	2.66	6.89

The PIF made more loans during the year

LONG TERM FUND

The Long Term Fund's objective is to provide a higher rate of return, whilst also providing growth to maintain the real inflation-adjusted value of the invested capital. The Fund is designed for those congregations and other investors who possess capital that they expect to hold for a lengthy period (at least five years).

As at 30 June 2023, 19 congregations have invested in the Long Term Fund (7 more than two years ago), alongside the Trustees (on behalf of a number of trusts), the General Assembly (via a number of accounts), and one Presbytery.

The investments generate a volatile return (principally as share prices rise and fall). The Fund pays interest broken down into three components: Regular; Inflation; and Reserve. The Inflation component allows accountholders to inflation-proof their capital. The Regular interest component provides accountholders with a stable stream of income available for spending. The Reserve component fluctuates as investment market returns fluctuate. When market returns exceed Regular plus Inflation interest, Reserve interest will be positive. When market returns are not sufficient to match Regular plus Inflation Interest, Reserve interest will be negative.

Investment Market Performance

The Long Term fund invests in the Mercer Socially Responsible Investment Balanced Fund. This Fund has a target exposure to growth assets (shares, property and infrastructure) of 60%, with the remaining 40% in bonds and cash. The Fund incorporates exclusions to those sectors considered unethical by the Church. In addition, it seeks to invest in companies with a positive impact on society and the environment – and actively engages with directors and management to drive good outcomes. Mercer has committed to making its investment portfolios net zero carbon emissions by 2050 with material reductions in emissions by 2030. This approach cost the Fund somewhat in the year to June 2023 as it excluded well-performing oil and energy stocks.

After a strong performance in the year to 30 June 2021, when the Long Term Fund paid a total of 14.1%, the 2022 financial year was a different story. In addition to unusually high inflation, which increased the earning's hurdle for the Fund, investment markets suffered sharp losses. In a rare event, both shares and bonds fell in value, leading to a total loss in the Long Term Fund for the year to 30 June 2022 of -5.2%. Fortunately, as interest rates approached their peak and inflation started to moderate, investment markets generated reasonable returns through to 30 June 2023. The total Long Term return for the year to was 4.1%, although the effective rate was higher at 4.75%, as inflation interest is allocated on initial capital (that excludes the impact of negative reserve interest).

Table 4: Long Term Fund Performance Summary:

	2021	2022	2023
Closing Interest Rate	3.00%	3.00%	3.00%
Average Interest rate	3.03%	3.03%	3.03%
Long Term Fund Interest	$939,183	$1,348,568	$1,303,715
Inflation Interest Rate	3.34%	7.30%	6.08%
Long Term Fund Inflation Interest	$1,040,690	$3,036,515	$2,936,226
Reserve Interest Rate	7.75%	-15.50%	-5.00%
Long Term Fund Reserve Interest	2,377,400	($7,399,075)	($224,691)
Total Long Term Interest Rate	12.77%	-5.17%	4.11%

Despite the tough return environment, the Long Term Fund has helped account-holders inflation-proof their capital holdings by 17.5% over the last three years, while still providing income available for spending.

Why does the Long Term Fund have three different types of interest?

The Long Term Fund provides three different types of interest to help account-holders manage the natural variability of returns from this type of investment.

Because the Fund is invested in a diversified fund, investment returns will vary quarter to quarter and year to year. If the PIF was to provide a single interest amount each quarter, this would also vary, making it difficult for parishes to know how much of the interest they could spend.

So, the PIF breaks down Long Term Interest into:

1. Inflation Interest – by separating this amount out, we know how much we need to increase the balance by to maintain the real spending power of the capital. As the capital balance increases over time, so does the regular Interest.
2. Regular Interest – is set at 3%, which is the expected average return (after inflation) from the

Long Term Fund's investments over the long term (at least 7 years). This is the amount we believe parishes can spend each year.

3. Reserve Interest – is the difference between what the investments deliver and how much is paid out in regular Interest and Inflation Interest. When market returns are higher, Reserve Interest will be positive. When market returns are lower, Reserve Interest will be negative. We recommend parishes treat this movement much like an unrealised gain or loss: it is only really relevant if and when the parish decides to withdraw the balance.

The Long Term Fund requires patient investing.
There will be ups and downs along the way,
But we expect account-holders will be rewarded for their patience.

WHERE TO FROM HERE FOR INTEREST RATES?

In last year's report we noted that markets were forecasting that the Official Cash Rate could reach 5.5% in 2023. It's a rare thing when market forecasts prove accurate! Markets now believe that interest rates have probably reached their peak, with a small chance that the Official Cash Rate will go up again. However, even if interest rates don't increase, no one is expecting rates to fall anytime soon. Some are not expecting the Official Cast Rate to start falling until early 2025.

That's generally good news for PIF On Call account-holders. On this basis, you can expect the On Call interest rate to remain at or above 5.0% for most if not all of the year to 30 June 2024. Of course, interest rates will remain high while inflation is elevated, and high inflation eats into the spending power of money. We need to think about the 'real' rate of return, which is the interest rate we earn, less inflation. If the PIF On Call interest rate is 5.0% p.a. and inflation is 3.0% p.a., the real rate of return is 2.0% p.a.

Long Term returns

The Long Term regular interest rate will likely remain at 3% plus inflation. The key question for Long Term Fund account-holders is, what will investment returns do? This will determine whether or not Reserve Interest will be positive or negative. If inflation falls quickly, it will be easier for investment returns to cover inflation, provide 3.0% interest, and maybe even recover some of the 2022 losses.

The outcome will likely depend on the sort of 'economic landing' we experience. Central Banks have lifted interest rates to slow economic growth and therefore slow inflation. This exercise is a bit like walking a tightrope. If the economy slows too quickly, we get a recession – which won't be good for companies and share prices – but will be good for bonds (as interest rates will fall). If the economy doesn't slow quickly enough, there is a risk that interest rates will have to rise even further. This would see a repeat of the tough conditions, and poor returns, we experienced in 2022.

The upshot is that Long Term investors need to remain patient. Market returns are volatile, but we still expect the Long Term Fund will deliver returns of 3% plus inflation over a seven year period (which means recovering losses experienced over 2022).

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. The Trustees' Office also carries out day to day administration of the Fund and oversees the loan portfolio.

Administration and management expenses rose over the year (from $688,026 to $717,862), but have remained relatively constant over time.

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

Appendix - PIF Interest Rates

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 where possible.

Table 5 below details the changes in rates over the course of the year.

Table 5: PIF Rate Changes over the year

	Official Cash Rate p.a.	On Call Interest Rate p.a.	Long Term Fund p.a.	Quarterly Inflation p.a.	Reserve Interest p.a.
As at 30 June 2022	2.00%	1.75%	3.00%		
July	2.50%				
August	3.00%	2.00%			
September				2.20%	-5.00%
October	3.50%	2.25%			
November	4.25%	2.50%			
December		3.00%		1.43%	
January					
February	4.75%				
March		3.75%		1.25%	
April	5.25%	4.25%			
May	5.50%				
June 2023		5.00%		1.07%	
As at 30 June 2023	5.50%	5.00%			
		Return for the year	3.03%*	6.08%*	-5.00%

* Compound interest

The PIF On Call Interest Rate rose seven times over the year, matching the number of times the OCR also rose.

Enquiries to:
Russell Garrett, Executive Officer
The Presbyterian Church Property Trustees
PO Box 9049 Wellington
(04) 381 8296
trustees@presbyterian.org.nz

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