PRESBYTERIAN INVESTMENT FUND

Together we can grow our funds

Annual Report

Year ended 30 June 2020

Highlights of the 2019 / 2020 year

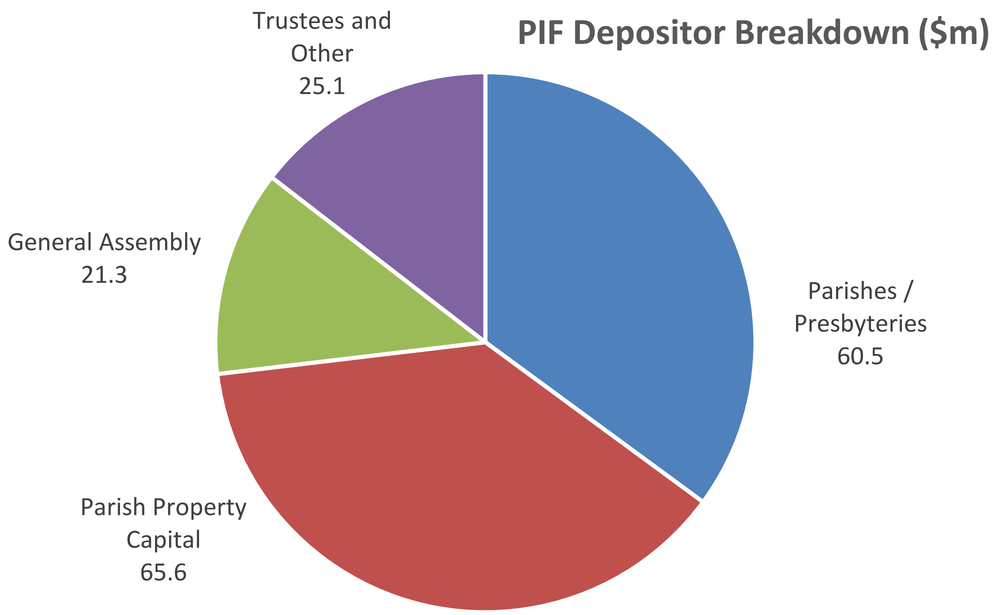
- $4.5 million in interest
- New Long Term Fund
- Now able to lend to parishes
- Fund growth to over $180m
- Reserves of $9.0 million

- ✓ Together we benefit from investing in bulk
- ✓ Two investment options
- ✓ Online access to funds without notice
- ✓ Attractive ‘on call’ interest rates
- ✓ Low operating expenses – only 0.30% of funds under management

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 $60.5m of general funds is held on behalf of parishes and Presbyteries and a further $65.6m of parish property capital is held.

Chart 1: PIF Depositor Breakdown (as at 30 June 2020)



Three quarters of the PIF is held for parishes and Presbyteries, half of which is Property Capital

Interest from the PIF is credited to accounts each quarter (calculated on daily balances). Reserves 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 2019	30 June 2020
Gross investment income	$6.37m	$4.98m
Interest paid	$5.84m	$4.54m
Deposit Accounts held	$167.56m	$172.41m
On Call Fund	$167.56m	$144.70m
Long Term Fund		$27.71m
Reserves	$8.58m	$8.96m

New 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 was 55% in growth assets (shares, property and infrastructure) and 45% in defensive assets (bonds and cash). From 1 September 2020, the target mix changed to 60% in growth assets and 40% in defensive assets. Mercer also manages the investment assets of the Beneficiary Fund.

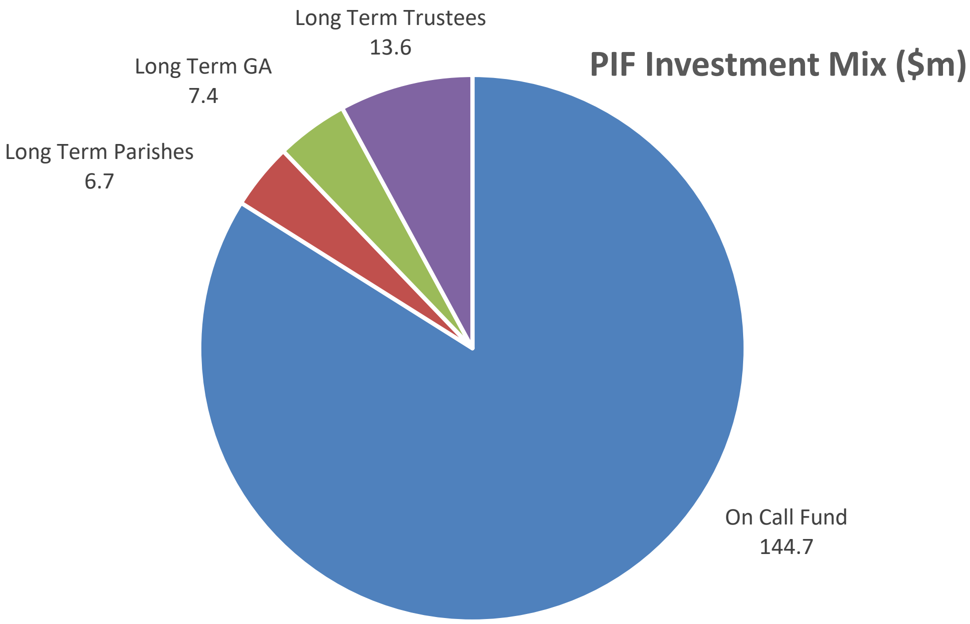
The Long Term Fund pays a higher rate of interest than the On Call Fund, plus inflation. Inflation income is allocated separately to allow parishes to maintain the spending-power value of their capital. If capital is not maintained in line with inflation, income will fall each year in real (inflation-adjusted) terms. The Long Term Fund ended the year paying 3.0% p.a. plus inflation of 1.5% p.a., compared to the On Call rate of 1.75% 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.

As it happened, the Long Term Fund did suffer from investment market losses during the year with share prices falling sharply as Covid-19 took hold. Markets have since recovered and it is expected that the Long Term Fund will record a capital gain before December 2020.

As at 30 June 2020, a small number of 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 2020)



The vast majority of the PIF remains invested in the On Call Fund

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 church 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. One loan was made during the year.

Interest rates feel the impact of Covid

The PIF On Call rate started the year at 3.50% p.a. and ended the year at 1.75%, following falls in the Official Cash Rate. Interest Rates, which have been low ever since the Global Financial Crisis, fell even further as the Reserve Bank of New Zealand tried to encourage investors to move their money from the relative safety of banks to more risky investments that contribute to economic growth. As at 30 June 2020, the OCR sat at 0.25% p.a., its lowest ever rate.

The PIF Long Term interest rate started at 4.0% p.a. (plus inflation), but also drifted lower over the course of the year, finishing at 3.0% p.a. (plus inflation). Inflation income is paid quarterly, based on Statistics New Zealand's Consumer Price Index.

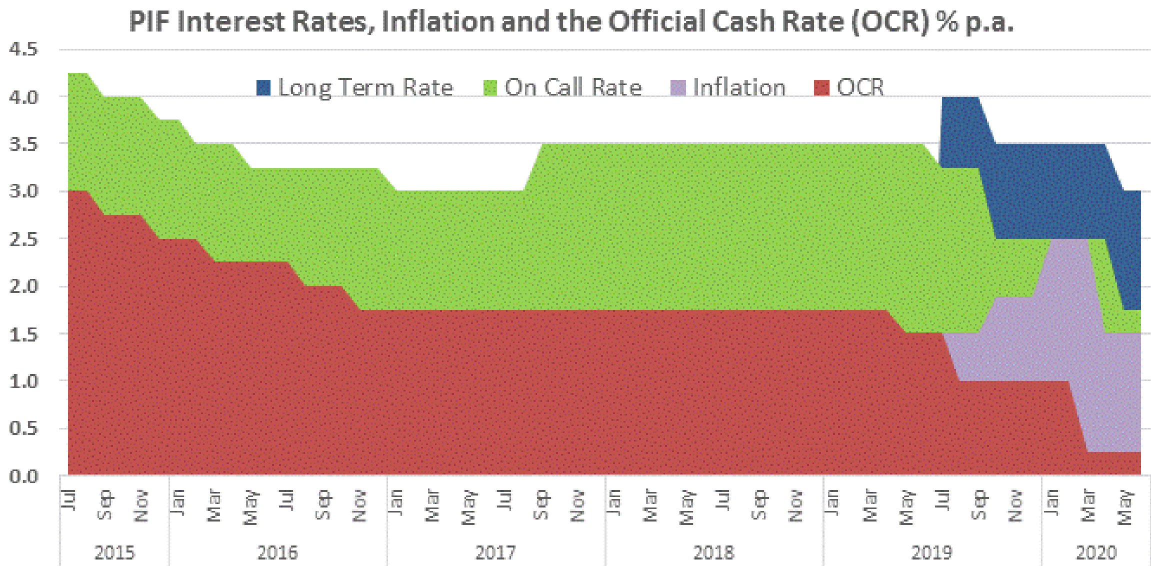
Table 2 below details the changes in rates over the course of the year. It highlights the way interest rates for both PIF Funds fell, the variable nature of quarterly inflation, and the capital loss for the Long Term Fund. The Long Term Fund capital loss reflects Covid's adverse impact on share prices earlier in 2020.

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	Capital Gain/Loss
As at 30 June 2019	3.50%	1.50%			
July 2019	3.25%	1.50%	4.00%		
August 2019		1.00%			
September 2019				0.70%	
October 2019	2.50%		3.50%		
December 2019				0.50%	
March 2020		0.25%		0.80%	
May 2020	1.75%		3.00%		
June 2020				-0.50%	-3.25%
As at 30 June 2020	1.75%	0.25%	3.00%		

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 and the rate of inflation (the Consumer Price Index). It highlights how the On Call Fund return is now barely ahead of inflation.

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



Rates have fallen over the last five years to record lows

Where to from here for interest rates?

The Reserve Bank has indicated that it expects negative interest rates in 2021 as it attempts to boost economic activity. While negative rates might only apply to financial institutions, it is likely to mean that term deposit rates available to parishes will continue to fall.

The PIF On Call Fund interest rate is inextricably linked to short-term interest rates. While the Fund invests in a mix of assets in an effort to provide a reasonable return, it is likely that the PIF On Call interest rate will fall also. Whereas the PIF has been able to hold its rate as term deposit rates have fallen (as at October 2020, most term deposit rates now sit around 1.0% p.a.) it is unrealistic to expect that the PIF will be able to maintain the current rate if the OCR moves into negative territory.

The Long Term interest rate has also fallen as interest rates have come down, although not by as much. Lower interest rates mean lower returns from the bonds that make up about 40% of the Long Term Fund. They also mean that Long Term returns from shares will come down, despite the short-term boost to share prices as investors chase higher returns. That said, we do not expect to lower the Long Term Fund interest rate, even if the OCR moves into negative territory.

Lower returns mean less income for parishes that rely on PIF returns to support their mission. However, the Trustees are not keen to chase higher returns by taking more risk – which is the only way to secure higher returns.

The Trustees are focused on ensuring that all On Call funds will be available whenever parishes need them. As a result, the Trustees are prudent in the risks they are prepared to take with the Fund's investments. They could seek higher returns by locking up the funds for longer periods, but this would compromise the ability of parishes to withdraw funds without notice. They could also seek a higher return by reducing the quality of the investments, but this might result in capital losses.

The Long Term Fund is available for those parishes that want to keep their capital as a source of income-generation and want to earn a higher rate of return. However, as we witnessed during the early days of the Covid pandemic, this Fund is not immune from market volatility.

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 depositors from the Presbyterian family.

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