



Rates to Returns

Key considerations for managing
council investment funds

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With close to \$3 billion in financial assets now being invested by local government authorities on behalf of ratepayers, it is becoming increasingly important that these funds are seen to be prudently managed.

In this report, we delve into the council investment fund sector and discuss how to successfully achieve the common objective of providing resilient funding of council services for current and future ratepayers.

Key council investment fund success factors include:



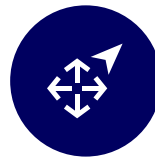
A defined purpose with clear objectives

To be successful and long-lasting, the fund purpose needs to be well-defined with objectives communicated to key stakeholders.



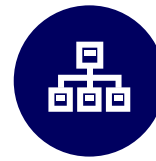
Best practice governance frameworks

Roles and responsibilities need to be clearly defined and well-understood for councils to be effective stewards of the assets.



Aligned investment strategy

The investment strategy and asset allocation must align with the council's purpose, with consideration of the required return, risk tolerance, and liquidity constraints.



Efficient implementation

With ratepayer money at stake, cost-effective and transparent implementation needs to be a foremost concern.



Introduction

As at June 2025, 14 councils have investment funds either established or in development, totalling approximately \$3 billion in assets¹. The funds date back to the early 90s and range in size from \$5 million to the recently announced \$1.3 billion Auckland Future Fund. Most of the funds were initially seeded through either the sale of electricity or infrastructure assets, or to a lesser extent through council reserves.

In many ways, the success factors for council investment programs are not different for those of other institutional investors. These include clearly defined fund purpose and objectives, fund governance and protection, an investment strategy aligned with objectives, and effective, cost-efficient implementation.

Capital costs accelerated substantially over 2021-2023 for councils. For example, cumulative inflation since 2020 is more than 25% across the capital costs that local government invests in (i.e., physical infrastructure and buildings). In addition, local government labour cost inflation has been stronger than other sectors, with the cumulative increase in operating costs estimated to be 19% over the last three years².

Considering the above, councils across NZ have been reviewing their balance sheet composition and considering the long-term implications of retaining legacy assets (including interests in ports, airports, lines companies, and forests). In particular, the significant capital investment these assets will require, their concentration—both by asset type and location—and the unpredictable nature of their income streams.

Proposed changes to the investment strategies have included partial or full divestments, asset leases, and/or other reorganisations of council balance sheets, so that councils can establish or increase the size of existing diversified, intergenerational investment funds.

Council funds, by the numbers³:

14

Number of councils that have established diversified investment funds.

\$3b

The amount invested in financial assets by councils on behalf of ratepayers.

2.8m

People living in the council regions supported by the investment funds.

¹ Includes the combined financial assets (listed equities, bonds, cash, and private equity) managed by councils through a specified diversified portfolio or fund structure.

² [Analysing increases in local government costs](#), Infometrics, February 2024.

³ Russell Investments analysis based on council websites, annual reports, and meeting minutes.

Defining the purpose and objectives of the fund

“If you don’t know where you are going, any road will get you there”.
–Lewis Carroll

Unless, of course, there isn’t money to pay for the roads.

That is why, like any individual or institution, the first step when investing is to clearly define the purpose or objective, as all the following decisions will stem from this.

The established council funds all have relatively similar objectives for their investment portfolios as detailed in the box below.

Common council investment fund objectives:

- Provide a resilient, sustainable income stream to the council
- Protect and grow the real value of the council’s asset base
- Provide emergency reserves to the council in case of a natural disaster
- Provide self-insurance for council assets
- Promote regional development
- Provide intergenerational equity between current and future ratepayers.

These investment objectives are clearly aligned with the fundamental purpose and mission of the respective councils. However, they are not always clearly articulated, which is vital to ensuring constituents know and understand why the fund exists and have confidence in it delivering on its objectives.

Whereas the overarching purpose is typically to improve the long-term financial resilience of the council, as detailed below, there are many reasons for establishing and managing a council investment fund.

Rationale for establishing a council investment fund



Income Stream

A diversified investment fund can provide a new, relatively stable revenue stream to fund council activities and offset rate increases.



Liquidity

A fund comprised of listed equities and bonds, will have minimal transaction costs, provide almost instant liquidity, and can be fractionally sold down. Whereas other council assets (i.e., ports, forestry, etc.) are 'lumpy', making them difficult to liquidate or receive income from on a regular basis, and/or have large transaction or ongoing maintenance costs.



Geographic Diversification

A fund allows councils to reduce the geographic concentration of its assets. Councils' income generating assets (such as ports, airports, forestry) are all exposed to the same localised risks. For example, a natural disaster can impair assets at a time when the council will have to be funding recovery efforts. In addition, having income generating assets concentrated in one region means a local downturn may have a greater impact than if the assets are globally diversified.



Asset Class Diversification

During the Covid-19 pandemic, some councils were particularly negatively impacted as revenue streams from airports and ports dried up as tourism and trade ground to a halt. A diversified investment fund spreads the risk amongst various assets, ultimately reducing the volatility of returns.



Risk Tolerance

An investment fund allows councils to invest in line with their risk appetite. Existing council assets may deliver returns that are highly volatile, whereas the level of risk can be controlled through an investment portfolio.



Cost Reduction

Traditional council assets typically require large ongoing maintenance and insurance costs, whereas a diversified fund is significantly cheaper to manage.



Disaster Reserve Or Self-Insurance

A fund can provide an emergency reserve for the council in the case of a natural disaster or provide the deductible or excess layer as part of a self-insurance program. See the case study for more information on self-insurance funds.



Public Confidence

As councils compete for new residents, prudent future planning and the ability to control future rate increases can provide confidence in the long-term prospects of a region.

Best practice governance and protection frameworks

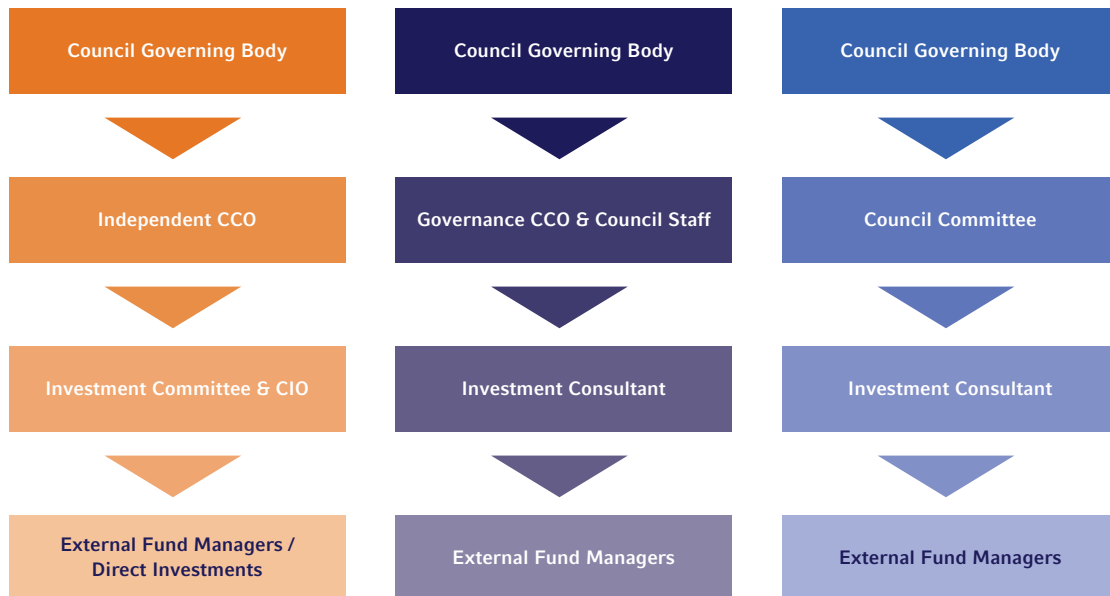
As a starting but fundamental point, the Local Government Act 2002, Part 6 section 101 Financial Management states that *“a local authority must manage its revenue, expenses, assets, liabilities and investments prudently, in a manner that promotes the current and future interests of the community”*⁴.

With \$3 billion currently invested by councils on behalf of ratepayers, prudent management through governance best practices is more critical than ever. While it is widely accepted that the strategic asset allocation is the key determinant of investment returns, we would argue that more wealth has the potential to be destroyed through poor governance than any other factor.

Of the 15 existing investment funds, approximately half are administered by a council-controlled organisation (CCO), with the remaining overseen by a council committee (e.g., Finance or Risk committee etc.).

Typically, larger funds and/or the more complex portfolios have necessitated a CCO, due to the need for greater investment expertise and resources or the presence of other strategic assets in the portfolio, such as ports, buildings, land, etc. In Exhibit 1, we show the most common governance structures.

Exhibit 1: Council investment fund governance structures



⁴ [Local Government Act 2002](#)

Governance structures and processes need to be well defined. It is vital that those involved know who is responsible for each decision and where that takes place within the investment management process. See Exhibit 2, for an illustrative decision-making matrix.

Exhibit 2: Typical council investment fund decision-making matrix

	Governance Objectives, Risk	Strategic Asset Allocation	Investment Strategy	Fund Manager Selection	Security Selection
Council	Decide	Decide	Oversee	Oversee	
CCO or Committee	Recommend	Recommend	Decide	Decide	
Investment Consultant	Advise	Advise	Recommend	Recommend	Oversee
Fund Managers					Decide

Source: Russell Investments.

In addition to the structure, best practice suggests that there should be independent directors or committee members, preferably with investment experience. For example, the Auckland Council Future Fund and New Plymouth District Council have CCOs with 100% independent directors, while the Hawkes Bay Regional Council’s investment CCO, HBRIC, has three independent directors and two councillors on the board. A council investment committee (or similar) normally has at least one independent committee member with investment expertise who is often the chair.

Finally, with ratepayers’ money at stake, ‘ring fencing’ or intergenerational protections are important for instilling trust that the money will not be frittered away over time by councillors who see the intergenerational portfolio as a pot of money to be used to fund pet projects. In Exhibit 3, we have outlined the most common protection measures.

Exhibit 3: Council investment fund protection mechanisms





Aligning the investment strategy with fund objectives

The investment purpose and objective(s) of a fund drives how it will be invested and managed. Achieving the investment objectives involves balancing the factors in Exhibit 4 and aligning them with the investment strategy.

Exhibit 4: Council investment fund objectives and investment considerations

Objective	Details	Investment consideration
Distribution to council	Funding services and infrastructure is a council's reason for being, so the ability to support this is critical to the fund's success	Required rate of return, and Distribution policy
Capital preservation	The fund will not survive if it erodes its asset base	Risk level, and Distribution policy
Intergenerational equity	The fund's ability to finance council activities for current and future ratepayers	Time horizon, Inflation, and Population growth
Emergency or disaster reserve	To provide emergency funding in the event of a natural disaster	Liquidity

Most council funds have the objective of paying a distribution or dividend to council whilst maintaining or growing the capital base.

Therefore, councils pursue a specified real investment return (i.e., inflation-adjusted return), through either explicitly or implicitly factoring in inflation. For example, the New Plymouth Perpetual Investment Fund targets the Consumer Price Index (CPI) +3.3%⁵. Environment Southland, on the other hand, recently set a nominal target of 5.5% based on the assumption that inflation will be 2.5% over the long-term⁶.

This approach makes sense; however, there is data to support the fact that CPI generally understates the cost increases faced by local government authorities. Therefore, in absence of using the Local Government Cost Index (LGCI) which is not widely available, a $CPI + \alpha$ + required distribution amount might be more appropriate, where α = the expected differential between CPI and LGCI.

Turning to the required return to achieve the objectives, there is general agreement in the investment community that the strategic asset allocation has the greatest impact on returns. Therefore, the most important allocation decision is the proportion of the portfolio to be allocated between growth assets (e.g. listed equities, property, and infrastructure) and income assets (e.g. bonds and cash), i.e., the 'growth-income split'. This decision will typically have the greatest impact on both returns and the investment risk borne by a council.

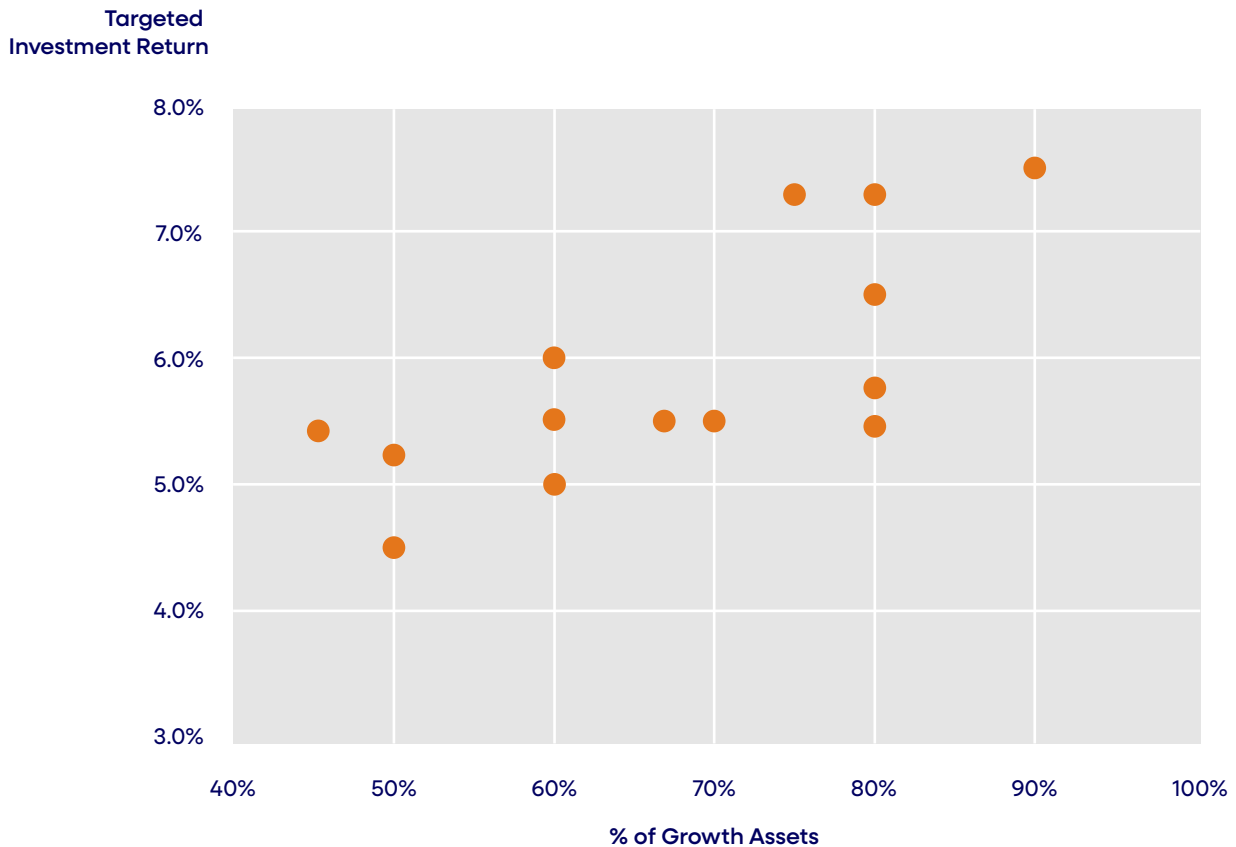
⁵ [New Plymouth District Council Long Term Plan 2024-2034](#)

⁶ [Statement of Investment Policy and Objectives for Environment Southland's Investment Portfolio](#) (February 2024)

To illustrate the trade off, in Exhibit 5, we have provided the growth asset proportion of council funds mapped against their investment return targets.

As you would expect, there is a consistent acceptance that a higher return target equals a higher proportion of growth assets.

Exhibit 5: Council investment funds target returns and percentage of growth assets



Source: Russell Investments analysis based on council annual reports, SIPOs, Treasury policies. To standardise return targets, we have assumed a 2.5% inflation rate and 3% OCR.

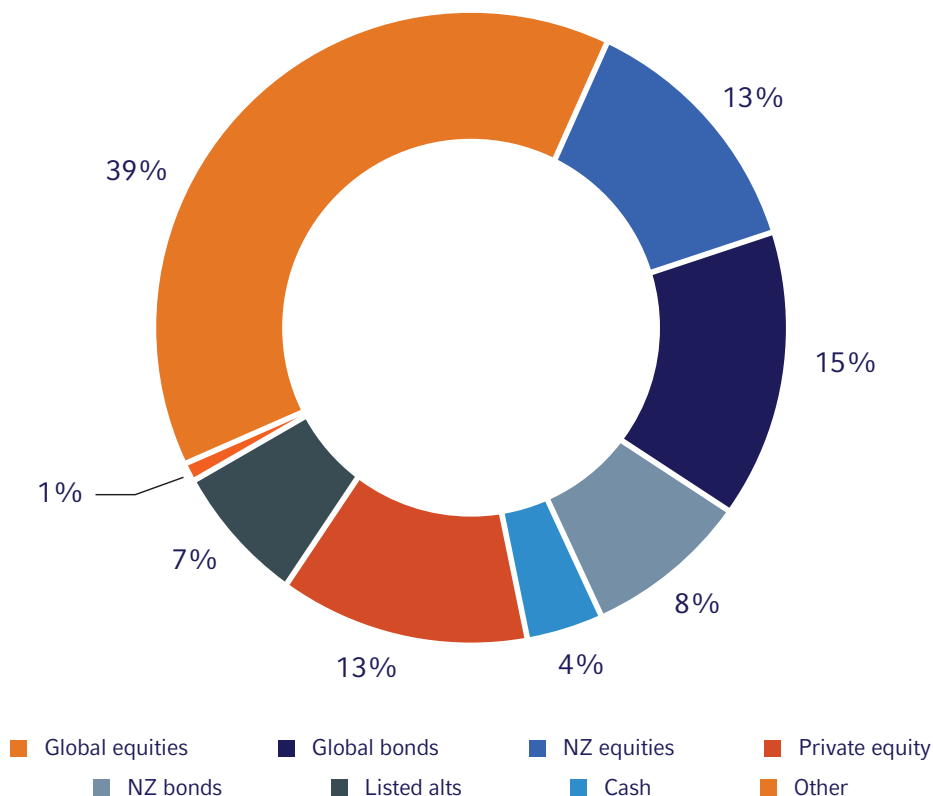
Once the appropriate growth-income asset class split is determined, the next decision is to determine the optimal mix of potential asset classes, such as bonds, listed equities, real assets, private equity, and cash, factoring in liquidity, diversification, and cost considerations.

It is important to ensure that there are sufficient assets in the portfolio that are both defensive in nature and highly liquid to meet the cash flow requirements of the fund, whether these are expected (i.e., annual distributions) or unexpected (i.e., natural disasters).

However, this constraint needs to be balanced against the fact that the funds are designed to be perpetual in nature and therefore may be well placed to take on additional risk, including liquidity risk, in anticipation of higher long-term returns.

Diversification serves to reduce the volatility of returns, aligning with the objective of protecting the capital base. In Exhibit 6, we show the combined asset allocation of the existing council investment funds.

Exhibit 6: Combined council investment fund asset class split



Source: Russell Investments analysis. Data sourced from council annual reports, committee meeting notes. Excludes the Auckland Future Fund as that has not been invested as at the time of writing.

Exhibit 6 demonstrates suitable diversification by asset class. However, in many cases, geographic diversification of risk will have been a key factor in the decision to set up a Council investment fund. It follows therefore that having a significant proportion of the portfolio invested outside the region and outside New Zealand is crucial to ensuring that the council does not continue to be over-exposed to local risks.

Currently, council funds have a domestic asset allocation between 0% to 45%, excluding cash, with an average of 25%. A home bias is hard to justify if the purpose is financial resilience. For example, NZ equities, bonds, and private equity are all susceptible to a NZ natural disaster or economic downturn, which could impair council assets or hinder the ability to increase rates.

Finally, while we believe in the diversification benefits of private or unlisted assets, such as infrastructure and private equity, they tend to be less liquid and with higher fees, greater administrative needs, and a higher level of understanding required. For these reasons, they tend to be confined to the larger portfolios.

Effective and cost-efficient implementation

There is no one-size-fits-all approach to managing council investment funds. The most appropriate approach for each individual council will depend on the financial and human resources available to them.

The three most adopted models by local councils are: internal management, advice-only with third-party fund managers, or using an implemented consultant.

For most councils, building an internal investment capability which is responsible for conducting manager research (including operational due diligence), constructing portfolios and managing day-to-day investment and administrative functions, is not practical. Therefore, some form of outsourcing is likely to be required. In Exhibit 7, we have outlined the most common implementation approaches.

Exhibit 7: Council investment fund implementation approaches

	Internal Management	Advice-only + Fund Managers	Implemented Consultant
Description	The board or investment committee (normally of the CCO) selects securities and/or fund managers.	A consultant provides advice, either on an ongoing or project basis, but the Council retains responsibility for manager selection, portfolio implementation, and rebalancing.	An investment manager provides both strategic advice and investment management, primarily through their own multi-manager funds.
Considerations	Most resource intensive model and requires a high-level of internal investment expertise.	Since the Council retains responsibility for many investment decisions, internal investment expertise is desirable.	Least resource intensive as all investment management tasks are outsourced. Administration activities, such as managing cash flows and account opening (e.g., AML) are less burdensome on council staff.

As with any investment portfolio, it is the net return that matters. Therefore, the higher the fees and costs paid for managing the fund, such as those paid to independent directors, investment consultants, fund managers, lawyers and accountants, the higher the required returns. In Exhibit 8, we have separated the investment fund cost considerations into three areas.

Exhibit 8: Council investment fund costs

	Investment Management Costs	Administration Costs	Governance Costs
Description	Fees paid to investment consultants and fund managers. Typically charged as a percentage of the assets under management.	Council staff’s time to administer the portfolio. A fixed cost; however, can be difficult to separate out from other duties.	Independent committee member/directors’ fees, reporting, legal, and audit costs. A fixed cost.
Considerations	Cost will depend on asset classes (listed vs unlisted), investment style (active or passive), and the total portfolio size, and the allocation per fund (fees are discounted for higher balances, therefore, having more money with fewer managers can be more cost effective).	More complex portfolios, such as those invested with a high number of different fund managers or asset classes, or in private assets, will most likely require more council resources to manage.	Costs increase as the structure moves from a council committee to a full CCO with independent directors and staff.

It is important to remember the adage ‘returns are not guaranteed, costs are’, when establishing and implementing a council investment portfolio, as costs can be a significant drag on investment returns, ultimately impacting the amount of capital available to provide services and products for ratepayers.





Case Study: Self-Insurance Investment Funds

Councils are facing rising insurance costs stemming from the increased frequency and severity of natural disasters, and higher asset values due to higher replacement costs, among other factors. This has led to councils needing to make difficult decisions about what they 'self-insure' through increased deductibles, lowered sum insureds, or not procuring insurance at all.

However, rather than leaving the council balance sheet exposed, some councils are establishing self-insurance investment funds to balance risk and cost savings.

How it works

- The council self-insures smaller insurance policies; and for larger policies, the deductible is increased to a higher level and/or the sum insured is lowered.
- The premium savings are re-invested back into the fund.
- In the event of a claim below the deductible and/or above the excess, a drawdown is made from the fund.

Benefits

- Insurance premium profit margins are captured by the council.
- The council becomes a strategic purchaser (rather than transactional buyer) of insurance, retaining more or less risk depending on the state of the insurance market.
- Investment gains reduce the financial burden on ratepayers.
- The fund can potentially grow large enough to cover larger events.
- Easier to establish and less costly than other alternative risk financing methods (i.e., establishing a captive).

What to consider

- The fund should be invested in assets that returns are uncorrelated to a NZ natural disaster.
- Will need robust governance and protection mechanisms so as not to be used for other purposes.
- Investment and insurance expertise is required, so some aspects will need to be outsourced if not available internally.

List of councils with investment funds (as at 30 June 2025)

Auckland Council*

Napier City Council*

Bay of Plenty Regional Council

New Plymouth District Council

Carterton District Council

Northland Regional Council

Clutha District Council

South Taranaki District Council

Dunedin City Council

Tasman District Council*

Environment Southland

Taupō District Council

Hawkes Bay

Waikato Regional Council

* These councils are in the process of establishing a fund.



QUESTIONS?

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