HERTFORDSHIRE COUNTY COUNCIL

AUDIT COMMITTEE MEETING
21 JUNE 2016

Agenda Item No:
7

END OF YEAR REPORT ON THE TREASURY MANAGEMENT SERVICE AND PRUDENTIAL INDICATORS 2015/16

Report of the Director of Resources

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1. Purpose of Report

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and CIPFA Code of Practice for Treasury Management in the Public Sector require the Council to set an annual Treasury Management Strategy (TMS) and assess performance indicators and the treasury function throughout the year.

1.2 This report fulfils the requirement to provide an end of year report on performance against the prudential indicators which were specified in the Integrated Plan, Part C approved by the County Council on 24 February 2015.

1.3 The report provides a summary of treasury management performance and activity for the period to 31 March 2016.

2. Summary

2.1 The County Council has been compliant with the prudential and treasury management indicators set out in the Integrated Plan and there have been no breaches of the Treasury Strategy in the year.

2.2 The UK economy has continued to recover, albeit at a reducing rate reflecting an uneven global recovery, with stable news from the US alongside concerns about China and the Eurozone. UK monetary policy remains unchanged with no expectation of a rate rise until 2018 (see section 5, below).

2.3 The introduction of the bail-in regime for banks and other institutions has been more positive than previously predicted and enabled continued investment in banks. During the first half of the year the Council has diversified its investment portfolio further into a range of pooled funds, which provide high income returns but are intended to be held long-term due to capital volatility.

2.4 Further funds were received for both the Heritable and KSF Icelandic investments bringing the recovery to date from these particular investments to 98.00% and 83.75% respectively.

2.5 No new long-term borrowing has been taken and no long-term borrowing has been repaid in the year. Short-term borrowing was used briefly to cover cashflow requirements during the year.

3. Recommendations

3.1 Members are invited to note the Treasury Management end-of-year report.

4. Background

4.1 The County Council operates its treasury management function in accordance with the CIPFA Prudential Code and the CIPFA Code of Practice for Treasury Management in the Public Sector. The Codes require the County Council to set prudential indicators for its capital expenditure and treasury management activities prior to the start of each financial year.

4.2 The Codes also require that regular reports are provided reviewing performance and compliance at the end of each financial year and on a half-yearly basis. In addition to these reports, performance against the prudential indicators and treasury management activities are reported to Cabinet as part of the quarterly budget monitoring report.

5 Economic Review

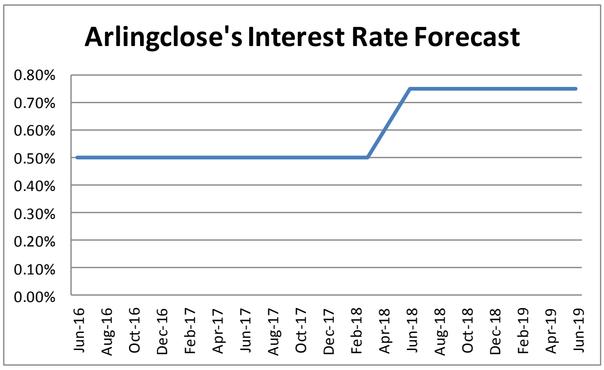
5.1 The Council's treasury activities have been undertaken within an improving economy for the UK but globally the economic recovery has been uneven. The UK economy has grown annually by 2.3% with twelve consecutive quarters of GDP growth indicating stability of growth. Annual Consumer Price Index inflation rose to 0.5% at the end of the year, having remained around 0.0% for most of the year. The late increase reflected the declining impact of lower oil prices on the headline rate, and the impact of an early Easter weekend driving higher air-fares.

5.2 The labour market has continued to improve, with the headline unemployment rate falling to 5.1%. Employee pay has also continued to improve and increased by 1.8% (including bonuses) when comparing the three month period to February 2016 against the previous year.

5.3 There was no change to UK monetary policy with official interest rates and asset purchases remaining at 0.5% and £375bn respectively. Despite the improvements in the UK economy, discussed above, the majority of the Monetary Policy Committee continued to vote against a rate rise. This has pushed interest rate rises out beyond market expectations, and there is uncertainty about the timing of a future interest rate rise. The following graph provides Arlingclose's (the Council's treasury adviser) interest rate forecast for the period June 2016 to

June 2019. This indicates rates gradually rising from 0.50% in June 2016 to 0.75% by June 2019.

Graph 1: Arlingclose Interest Rate Forecast for base rate



5.4 Over the first six months of the year there was significant turmoil in the Eurozone with the possibility of a Greek exit from the Eurozone. In July a bail-out deal was agreed with tax increases, pension reforms and privatisations being agreed by the Greek government. These reforms continue to be implemented and Greece remains in a difficult economic situation. Yields remain low in the Eurozone and Quantitative Easing (QE) by the European Central Bank (ECB) continued throughout the year. In March 2016 the ECB increased efforts to stimulate the economy by increasing QE and introducing negative deposit rates to encourage lending.

5.5 Globally, China saw a 43% fall in the Shanghai composite index in less than 3 months. However this has followed significant growth of 50%+ since the beginning of 2015. This caused global shocks and concerns about the strength of Chinese markets.   Intervention by the Chinese authorities to stabilise currency and equity markets led to high market volatility. Chinese stocks have recovered marginally and at year end were trading at a similar level to the beginning of the year. Concerns remain about slowing growth and potential deflationary effects.

5.6 The US economy has remained strong after a slowdown early in the year with annualised growth in quarter 2 of 2015 of 3.9% slowing to 1.4% in quarter 4. The US Federal Reverse raised interest rates by 0.25% to 0.50% in December 2015, indicating that further quarterly rate rises would follow in 2016. Despite this, slowing growth has resulted in the Federal Reserve choosing to defer any subsequent rate increase.

5.7 During the first half of the year the economic market has seen significant volatility in both equity and bond prices with market turmoil created by the Greek negotiations followed by Chinese stock drops and a slowdown in growth in emerging economies. Markets have stabilised following these events.

6 Prudential and Treasury Management Indictors

6.1 The Prudential Code requires the Council to set and monitor a range of prudential indicators relating to borrowing. The objectives of the Prudential Code are to ensure, within a clear framework, that capital investment plans for local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

6.2 The Council measures and manages its exposure to treasury management risks using a range of indicators related to interest rate exposure, refinancing risk and liquidity risk. In addition, treasury activity is measured against a range of performance indicators related to security, liquidity and yield.

6.3 Appendix A provides evidence of compliance with the prudential and treasury management indicators and reports on treasury activity performance indicators.

7. Treasury Management Strategy

7.1 In setting the 2015/16 Treasury Management Strategy, the Council approved a Lending Policy that increased flexibility to enable greater diversification of investment portfolio. These changes introduced greater flexibility in use of investment instruments whilst continuing to maintain security and liquidity of investments.

7.2 The Lending Policy continued to reflect the on-going risks in the wider economy and banking institutions. The primary considerations when placing investments continues to be the security and liquidity of the Council's funds and only once both of these factors have been taken into account will the yield on investment be considered. Long term borrowing is only considered when it becomes necessary to avoid a prolonged short term overdraft position.

7.3 All three credit ratings agencies reviewed their ratings in the first six months of the year to reflect the loss of government support for most financial institutions and the potential for loss where countries apply new bail-in regimes in the event of defaults. Despite reductions in government support many institutions have seen upgrades due to an improvement in their underlying strength and a positive assessment that the level of loss in the event of a default is low. At the end of July, Arlingclose advised an extension of recommended durations for unsecured investments in certain UK and European institutions following improvements in the global economic situation and the receding threat of another Eurozone crisis. A similar extension was advised for some non-European banks in September, and certain non-rated UK building societies were also extended. The only direct impact on the Council's investments was on the reduced limit of £5m placed on investments in Barclays (the Council's bank) in February 2015, as a result of Barclays being placed on CreditWatch with negative implications. When the credit rating was confirmed in July 2015 and the CreditWatch negative therefore removed, the strategy allowed the investment limit to be raised back to £10m. The Council also reduced the risk of bail-in legislation and associated downgrades by diversifying the portfolio away from traditional banking investments into pooled funds and corporate bonds.

7.4 During the year to 31st March2016, investments have been made in a range of instruments detailed in Table 1.

Table 1: Counterparties and investment instruments used to 31st March 2016

Counterparty	Investment Instruments
Local Authorities	Fixed Term
UK Banks / Building Society	Call / Notice Accounts
UK Banks / Building Society	Fixed Term
Overseas Banks with AA+ Sovereign Rating	Call
AAA-rated Money Market Funds	Call / Notice
Corporate Bond Issuers	Fixed Term
Pooled Fund – Property	Notice
Pooled Fund – Bond	Notice
Pooled Fund – Equity	Notice
Pooled Fund – Multi-asset	Notice

7.5 Table 2 provides a summary of the value of investment instruments outstanding as at 30 September 2015 and 31st March 2016 and the percentage of investment instruments compared to the overall investment portfolio.

Table 2: Investment Activity as at 30th September 2015 and 31st March2016

Counterparties	Investment Instrument	As at 30/9/2015		As at 31/3/2016	
		£m	%	£m	%
Local Authorities	Fixed Term	5.00	3.5	5.00	5.4
UK Banks / Building Society	Call / Notice	15.50	11.5	19.80	21.2
Overseas Banks	Call	10.00	7.4	0.00	0.0
Money Market Funds	Call / Notice	72.40	53.7	38.43	41.2
Corporate Bond Issuers	Fixed Term	6.10	4.5	0.00	0.0
Pooled Fund – Property	Notice	10.00	4.4	10.00	10.7
Pooled Fund – Bond	Notice	6.00	4.4	10.00	10.7
Pooled Fund – Equity	Notice	6.00	7.0	6.00	6.4
Pooled Fund – Multi-asset	Notice	4.00	3.0	4.00	4.3

TOTAL	**135.0**	**100.0**	**93.23**	**100.0**

7.6 Table 2 shows that at 31st March, the investment portfolio has further diversified with the implementation of the Treasury Management Strategy to invest in longer term pooled funds. During the second quarter, £6.1m of investments were made with Corporate Bond issuers to take advantage of cash available for slightly longer periods.

7.7 Pooled fund investments have also been made; in the first quarter two multi-asset funds were opened, followed in the second quarter with the opening of two bond funds and one equity fund. By the end of the fourth quarter all planned pooled fund investments had been completed. These pooled funds provide greater diversification and significantly improved returns, however capital values are variable and therefore these investments are intended to be held longer-term.

7.8 As planned, a total of £30m has been invested in pooled funds. At 31 March 2016 the net movement in market value across these funds had reduced by approximately £423k. This is deemed not to represent a permanent impairment and the capital value is expected to recover in the long term.

7.9 Cash balances have decreased by £41.77m in the second half of the year, reflecting the cashflow profile for the financial year. Short term cash has therefore been held in more liquid investments and no new fixed term investments were made during the year.

7.10 Interest rates for investments have ranged between 0.40% to 1.07% for fixed terms up to 364 days and 1.08% for two year investment. Interest rates on variable investments have varied from 0.39% to 0.62% throughout the year.

7.11 Table 3 provides a summary of the treasury activity in the period April 2015 to March 2016.

Table 3: Treasury Activity - 1 April 2015 to 31 March 2016

Measure	April 2015 to March 2016
Average size of portfolio (excluding Iceland investments)	£127.5m
Weighted average term (fixed term only)	71 days
Average rate earned	1.47%
Interest earned	£1.658m

7.12 The total rate of return has increased from 0.88% in Q1 to 1.64% in Q4. The main impact is the investment in further pooled fund investments. The return on pooled fund investments in the fourth quarter was equivalent to 5.27% per annum.

7.13 The rate of return for the fourth quarter (1.64%) includes underlying returns of 0.63% for the investment portfolio excluding the pooled fund investments. The

0.63% rate compares to 0.58% achieved in the first quarter and exceeds the 7-day LIBID benchmark of 0.36% by 0.27%.,

7.14 The total interest earned on treasury investments during the year is £1.658m, which is under the budget of £1.777m. This £120k under recovery of income is the net effect of a delay in investing in the bond pooled funds due to market volatility and fund prices which resulted in a reduction of £250k in income against forecast. This was offset by an additional £130k of interest earned on pooled fund investments which exceeded the 4% target return.

7.15 The return on pooled fund investments in the fourth quarter was equivalent to 5.27% per annum and these investments have experienced a small overall capital loss at 31 March 2016 as a result of global market volatility during the year. The nature of these types of investments in bond, equity and multi-asset funds is that income yield and fund values can be volatile and will be influenced by market movements. It is important to recognise the long-term nature of these investments in mitigating this expected volatility. See Appendix A, Section 3 for more details of how the County Council intends to utilise and balance these instruments alongside its existing investments with regards to management of security, liquidity and yield.

7.16 All treasury management activity undertaken during the period complied with the approved treasury management strategy, the CIPFA Code of Practice for Treasury Management and the relevant legislative provisions.

8. Icelandic deposits

8.1 Of the original four Icelandic banks with which the County Council had deposits, the outstanding Landsbanki claim was sold in 2013/14 resulting in a total recovery of 92% and the outstanding Glitnir claim was resolved in February 2015 resulting in a total recovery of 101% of the amounts originally deposited.

8.2 Since 31 March 2015 repayments have been received for the investments in Heritable of 3.98p in the £ bringing the total recovery to 98%. Ernst and Young, the Heritable administrators are not forecasting any additional distribution to creditors. The claim cannot be closed as a reserve has been retained to cover administrator costs and expenses until outstanding legal matters are resolved.

8.3 A repayment of 1.25p in the £ was received for the investments in Kaupthing, Singer & Friedlander during March 2016. The Administrator, Ernst and Young expect that that the total estimated return will be between 85.5 to 86.5p in the £.

8.4 Table 4 provides details of dividends received to 31 March 2016 together with current information about the anticipated value and percentage recovery for Icelandic investments.

Table 4: Icelandic bank deposits at 31st March

Bank	Original deposits	Recovered at 31/03/16	Total expected distribution		Claim status
	£m	£m	£m	%	
Heritable Bank	7.00	6.88	6.88	98.00	Open
Kaupthing, Singer & Friedlander	4.00	3.44	3.53	86.00	Open
Glitnir	7.00	7.05	7.05	100.69	Closed
Landsbanki	10.00	9.23	9.23	92.30	Closed
TOTAL	**28.00**	**26.60**	**26.69**	**95.32**	

9. Borrowing

9.1 Long Term Borrowing

Table 5 overleaf shows total long term borrowing outstanding at 31 March 2016, the future maturity profile of borrowing and an analysis of sources of borrowing shown as a percentage of total borrowing.

Table 5: Borrowing maturity profile at 31 March 2016

	Total		Sources of Borrowing			
			PWLB [1]		LOBO [2]	
	£m		£m	%	£m	%
Borrowing at 30 September 2015	258.8		103.3	39.9	155.5	60.1
Maturing in 2015/16	0.0		0.0	0.0	0.0	0.0
Maturing in 2016/17	0.0		0.0	0.0	0.0	0.0
Maturing later	258.8		103.3	39.9	155.5	60.1
Average interest rate	4.78%			5.36%		4.39%

[1] PWLB = Borrowing sourced from the government’s Public Works Loans Board
[2] LOBO = Borrowing sourced from commercial banks

9.2 At 31 March there was a total of £258.8m long term borrowing outstanding. £103.3m (40%) was sourced from the government’s Public Works Loan Board and £155.5 (60%) was sourced from commercial banks. The average rate of interest for total borrowing was 4.78%, the average rate for PWLB borrowing was 5.36% and the average rate for borrowing from commercial banks was 4.39%.

9.3 The long term borrowing portfolio is kept under review in consultation with the Council’s treasury advisor Arlingclose to identify opportunities to reduce borrowing costs by restructuring existing loans.

9.4 The difference between planned capital expenditure and capital funding (from revenue or capital receipts and specific capital grants) is known as the Capital Financing Requirement (CFR), and is met via borrowing. Borrowing can be funded from externally sourced loans, for example from the Public Works Loans Board, or internally from the council's own resources.

9.5 Because the cost of long term borrowing remains significantly higher than the return on short-term investments, the County Council has made prudent use of its resources to fund an element of its borrowing requirement from surplus cash balances held in respect of its reserves. This has allowed the Council to maintain a lower level of external borrowing, which has in turn minimised the pressure on revenue budgets from interest payments.

9.6 Short Term Borrowing

In the first half of the year short-term borrowing was required in April to cover a short-term cashflow requirement. £16.7m borrowing was sourced through brokers from other local authorities at rates varying from 0.33% to 0.38% (including brokerage fees) for durations of 5 to 34 days. This borrowing was all repaid at 31 March 2016.

10. Hertfordshire Police and Crime Commissioner – Treasury Management

10.1 The Police and Crime Commissioner (PCC) contracts with Hertfordshire County Council to deliver its Treasury Management services.

10.2 A separate treasury management strategy is maintained for the PCC. Data concerning the Police's cashflow is provided to the Council's treasury officers and any surplus cashflow is invested in accordance with the investment criteria outlined in the PCC's Treasury Management Strategy. The Police's cashflow and investment portfolio is maintained separately from the Council's funds.

10.3 The reporting arrangements for the PCC are similar to the Council's. An annual treasury management strategy is prepared before the start of each financial year, with mid-year and end-year reports subsequently delivered on treasury management activities and delivery of the strategy. Quarterly reports are also provided according to the schedule of meeting dates provided by the PCC.

APPENDIX A: PRUDENTIAL INDICATORS 2015/2016 – 31 March 2016

1. Capital financing Indicators

	Indicator	Description	Integrated Plan Ref.	2015/16 Budget	2015/16 Q1	2015/16 Q2	2015/16 Q3	2015/16 Q4
	Indicators 1 to 3 demonstrate the affordability and sustainability of the capital programme. The projections for financial years 2015/16 to 2017/18 are set out in the Integrated Plan at the reference shown in the table below.							
1	Capital Expenditure	Monitors capital expenditure for 2015/16 against the projections set out in the Integrated Plan.	2.4 Table 1	200.04m	179.05m	148.56m	146.57m	147.77m
2	Capital Financing Requirement (CFR)	Monitors the Council's underlying need to borrow for capital purposes for 2015/16 against the projections set out in the Integrated Plan	2.10 Table 3	532.08m	522.34m	518.23m	519.21m	518.23m
3	Ratio of financing costs to net revenue stream	Monitors the percentage of revenue budget set aside to service capital financing costs (borrowing costs net of lending income) for 2015/16 against projections set out in the Integrated Plan.	2.11 Table 4	1.30%	1.32%	1.32%	1.32%	1.31%
	Treasury Position: **The Treasury Management Prudential Indicators are set to contain lending and borrowing activities within approved limits. The indicators are set at a level that will provide enough flexibility for effective treasury management whilst managing the risk of a negative impact on the Council's overall financial position in the event of adverse movements in interest rates or**							

	Indicator	Description	Integrated Plan Ref.	2015/16 Budget	2015/16 Q1	2015/16 Q2	2015/16 Q3	2015/16 Q4
	borrowing decisions. The indicators are also used to demonstrate that Net Borrowing does not exceed the Capital Financing Requirement. The projections for financial years 2014/15 to 2016/17 are set out in the Integrated Plan.							
4 A	Net Borrowing	Monitors actual borrowing less actual lending			131.49m	124.49m	125.09m	144.38m
4 B	Net Borrowing Less than CFR	Comparison of net borrowing to CFR			✓	✓	✓	✓
	Borrowing: Indicators 5 and 6 control the overall level of borrowing. The limits for 2015/16 to 2017/18 are set out in the Integrated Plan.							
5	Authorised Limit *(against maximum position)*	Monitors the borrowing limit for 2015/16 beyond which borrowing is prohibited without Member approval.	6.5 Table 10	415m	415m	415m	415m	415m
6	Operational Boundary	Monitors the estimated external debt for the financial year 2015/16. This is not a limit and actual borrowing can vary. This estimate acts as an indicator to ensure the authorised limit is not breached.	6.5 Table 10	385m	385m	385m	385m	385m

2. Treasury Management Indicators

	Indicator	Description	Integrated Plan Ref.	2015/16 Budget	2015/16 Q1	2015/16 Q2	2015/16 Q3	2015/16 Q4
	Interest Rate Exposure: Indicators 7 and 8 limit the Council's exposure to both fixed and variable interest rate movements. The limits for 2015/16 to 2017/18 are set out in the Integrated Plan.							
7	Upper limit on fixed interest rates *(against maximum position)*	Monitors the limits set for 2015/16 for the volume and value of the (lending) /borrowing portfolios that may be committed for fixed interest rate investments or borrowing	6.7 Table 11	315.00m	235.78m	229.68m	234.32m	235.77m
8	Upper limits on variable interest rates *(against maximum position)*	Monitors the limits set for 2015/16 for the volume and value of the (lending) /borrowing portfolios that may be committed for variable interest rate investments or borrowing	6.7 Table 11	94.50m	118.53m	105.90m	88.81m	70.23m
	Maturity structure of fixed rate borrowing (against maximum position): Indicator 9 limits the Council's exposure to large fixed rate sums falling due for refinancing in the same period. The indicators are set relatively high to give the council enough flexibility to respond to opportunities to repay or reschedule debt during the financial year, while remaining within the parameters set by the indicators.							
9 A	Under 12 months		6.8 Table 12	50.00%	0.00%	0.00%	0.00%	0.00%
9 B	12 months to 2 years		6.8 Table 12	50.00%	0.00%	0.00%	0.00%	0.00%

	Indicator	Description	Integrated Plan Ref.	2015/16 Budget	2015/16 Q1	2015/16 Q2	2015/16 Q3	2015/16 Q4
9 C	2 years to 5 years		6.8 Table 12	60.00%	0.10%	0.10%	0.10%	0.10%
9 D	5 years to 10 years		6.8 Table 12	80.00%	3.24%	3.24%	3.24%	3.24%
9.E	10 years to 20 years		6.8 Table 12	85.00%	9.08%	9.08%	9.08%	9.08%
9.F	20 years to 30 years		6.8 Table 12	90.00%	12.34%	12.34%	12.34%	12.34%
9 G	30 years and above		6.8 Table 12	100.00%	75.24%	75.24%	75.24%	75.24%
	Investments greater than 364 days (against maximum limit): Indicator 10 measures the Council's exposure to investing for periods greater than one year. This indicator is required to ensure that the Council is aware of the cashflow implications for long term investments. This includes deposits at risk in Icelandic Banks.							
10	Investments greater than 364 days (Maximum Limit)		6.9 Table 13	50.00m	20.01m*	31.73m*	31.73m*	35.68m*

*Includes Pooled Fund investments, which can be withdrawn in less than one year but the intention is to hold for the long-term to minimise the risk of capital value volatility, as agreed at Full Council on the 25th November 2014.

3. Treasury Management Performance and Activity Measures

	Indicator	Description	Integrated Plan Ref.	2015/16 Q1	2015/16 Q2	2015/16 Q3	2015/16 Q4
	The CIPFA Treasury Management Code of Practice requires the Council to set performance indicators to assess the treasury function. Group A measures performance for "Security, Liquidity and Yield" and Group B measures the performance of "Operational Activities"						
	GROUP A: Security, Liquidity and Yield						
	Average Investment Portfolio	Monitors the average amount HCC has had invested in third parties.	7.3 Table 15	127.30m	134.27m	133.69m	114.39m
	Average borrowing portfolio	Monitors the average amount HCC has as long term borrowing during the quarter	6.3 Table 9	258.78m	258.78m	258.78m	258.78m
	Security Indicator: Average Credit Rating of Investments held	Measured on a 1 to 10 scale, where 1 is a very good Credit Rating, i.e., government guaranteed	Section 6.10	3.31	4.45	5.20	5.58
	Liquidity Indicator: Weighted Average Maturity of investments held	Measures the liquidity/accessibility of investments in average days	Section 6.10	19 days	21 days	19 days	16 days
	Yield Indicator: Interest Earned	Monitors the interest earned on HCC investments. Shown as both an actual amount and a percentage of amount invested	7.3 Table 15	0.88%* 0.280m	1.35%* 0.451m	1.37%* 0.458m	1.64%* 0.468m
	Yield Indicator: Interest Paid	Monitors the interest paid on HCC borrowing. Shown as both an actual amount and a percentage of amount borrowed	7.2 Table 14	4.73% 3.05m	4.73% 3.08m	4.75% 3.09m	4.75% 3.06m

*includes Pooled Fund investment returns some of which are estimated, see Yield section below for further information for rate excluding Pooled Funds

Security, Liquidity and Yield

Exposure to Risk

The Treasury Management Strategy was approved on 24th February 2015 as Part E of the Integrated Plan. This introduced additions to the types of investment used following on from changes already made in year in 2014/15 to enable greater diversification of the investment portfolio. These changes introduced greater flexibility in use of investment instruments whilst continuing to maintain security and liquidity of investments.

The following diagrams illustrate the credit rating breakdown of all investment instruments by credit rating grade and investment type for the Council's investment portfolio as at 31st March 2016.

Diagram 1: Summary of Credit Risk of Investment Portfolio as at 31st March 2016

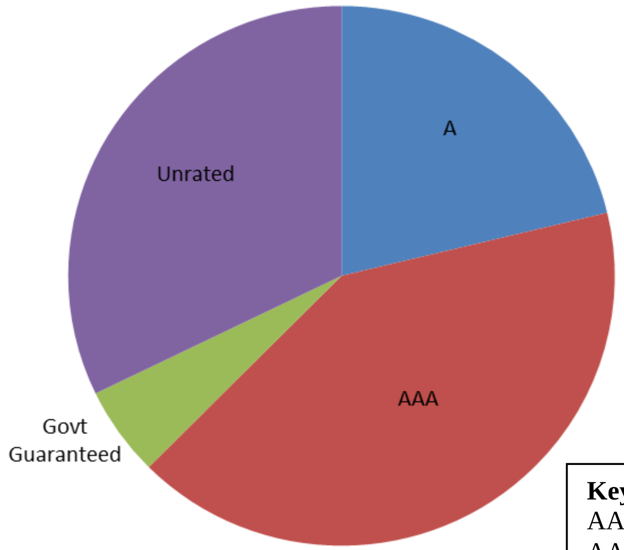
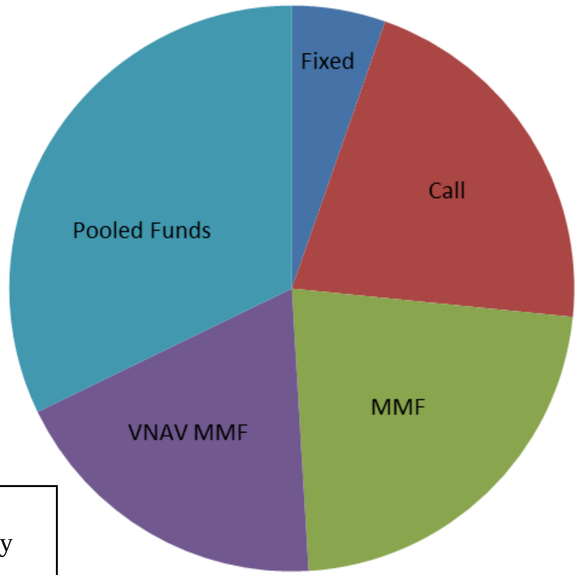


Diagram 2: Summary by Investment type as at 31st March 2016



Key:

AAA and AA	Very High Credit Quality
AA-, A+ and A	High Credit Quality

NB: Unrated counterparties are those who do not pay agencies for a rating - such as some smaller building societies and the pooled funds in which the Council has invested. The credit rating is only one of a range of indicators considered when deciding to invest, and if an investment with such a counterparty were to being considered it would be with regard to other provisions and limits within the strategy for assessing the viability of the counterparty, including advice from Arlingclose.

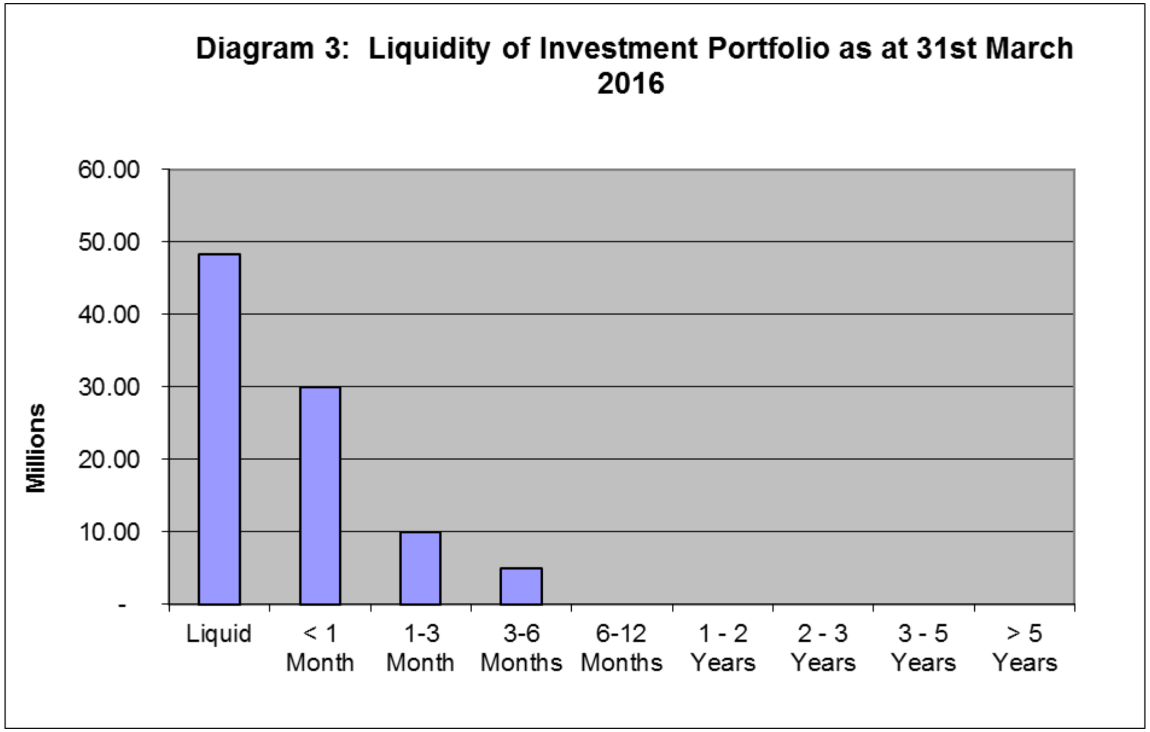
The greatest percentage of deposits are held in money market funds and call accounts, this reflects the reduction in cash balances since 2014/15 and the need to therefore hold a greater proportion of the portfolio in liquid investments to meet daily cashflow requirements. The Pooled Funds category now comprises the CCLA property fund, two multi-asset funds, two bond funds and one equity fund. The remaining fixed term is a two year investment with Dumfries and Galloway local authority.

Liquidity

Diagram 3 provides a graph showing the liquidity of the Council's investments portfolio as at 31st March 2016.

The majority of the investment portfolio is held in instant access Money Market Funds and call accounts. Due to reducing investment balances there are less fixed term investments than were held at the end of 2014/15.

The Council's Pooled Funds are shown on this graph based on their accessibility, which is less than 1 month. The intention, however, is to hold these funds for 3-5 years due to the potential capital volatility.



Yield

The benchmark used for assessing the performance of return on lending is the 7-Day London Interbank Bid Rate (LIBID). Diagram 4 shows yield against the benchmark for the last four quarters. In reporting on yield the return on pooled funds has been excluded from benchmarking against 7 day LIBID, as 7 day LIBID benchmark is more relative to short-term investments.

Since quarter 1, 7 day LIBID has stayed the same (at 0.36%), but the return excluding pooled fund interest (0.63%) has increased due to new investments in short dated corporate bonds paying good yields.

Performance on the Pooled funds is difficult to analyse at this early stage due to the long-term nature of these investments, and the short period of time of investment so far. The Pooled Fund performance exceeded the 4% target during 2015/16, returning 4.96%. Overall performance of the pooled fund investments also reflects capital movements. Due to global market conditions values have fallen across the board over this short time period resulting in a -1.3% loss over the year to 31st March 2016. Capital values were always expected to be volatile on these funds and this is why they are intended to be held for the long-term to smooth out this volatility.