HERTFORDSHIRE COUNTY COUNCIL

AUDIT COMMITTEE MEETING
WEDNESDAY, 30 NOVEMBER 2016 10.15 AM

Agenda Item No:
5

MID-YEAR REPORT ON THE TREASURY MANAGEMENT SERVICE AND PRUDENTIAL INDICATORS 2016/17

Report of the Chief Finance Officer

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Executive Member: C M Hayward, Resources & Performance

1. Purpose of Report

1.1. The 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 a mid-year report on performance against the prudential indicators which were specified in the Integrated Plan, Part E approved by the County Council on 23 February 2016.

1.3. The report provides a summary of treasury management performance and activity for the period to 30 September 2016.

2. Summary

2.1. The Council has been compliant with the prudential and treasury management indicators set out in the Integrated Plan.

2.2. A breach of the TMS occurred on Friday 30 April 2016 as a result of a failure by the authority's bankers Barclays. This did not result in any loss to the authority and actions to mitigate any future occurrence have already been taken by the bank.

2.3. The UK economy has experienced significant uncertainty as a result of the EU membership referendum in June 2016, this is analysed in further detail in section 6.

2.4. The Council has continued to operate a diverse investment portfolio. Pooled fund investments are held for the long-term due to capital volatility. Daily liquidity needs are met using a variety of instant-access bank and Money Market instruments, along with short term lending to and from other local authorities.

2.5. No further funds have been received for either of the Icelandic investments with Heritable and KSF. The recovery to date from these particular investments stands at 98.00% and 83.75% respectively.

2.6. No new long-term borrowing has been taken and no long-term borrowing has been repaid in the year.

2.7. Lender Option Borrower Option (LOBO) loans of £88.1m and a Range LOBO of £18m, all with Barclays Bank were converted into fixed rate commercial loans during the year. These changes are detailed in section 10 and remove a key risk to the authority from potential need to replace such borrowing at short notice.

2.8. Short-term borrowing was made during both the first and second quarters to cover cashflow requirements. £10m of short-term borrowing was in place at 30 September 2016.

3. Recommendations

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

4. Background

4.1. The 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 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. Breach of Strategy

5.1. The breach resulted from a failure within Barclays' online banking platform which meant it was not possible to make payments to investment counterparties within the timescales stipulated by those counterparties. Consequently there was a balance of £34.68m in the Barclays FIBCA interest bearing account across the Spring Bank Holiday weekend in excess of the £10m TMS limit for the counterparty.

5.2. Barclays have accepted full responsibility for this breach and have submitted a written explanation of the circumstances surrounding the failure. Barclays has also offered improved contingency arrangements to ensure payments can be made in line with the Council's standard operating controls in the event of a failure in the primary online banking platform, the set-up of which officers are actively pursuing.

6. Economic Review

6.1. The Council's Treasury management activities in this period were undertaken in an environment of significant political uncertainty and market volatility in the months leading up to, and following the EU membership referendum on June 23 2016.

6.2. Since the vote to leave the EU there has been a significant reduction in the value of Sterling and volatility in equity markets and gilt yields. Markets have now stabilised somewhat, but are expected to remain prone to sudden shocks as a result of political and economic developments.

6.3. Concerns about the possibility of an economic contraction resulting from the shock and uncertainty after the vote, prompted the Monetary Policy Committee of the Bank of England to reduce the official interest rate to 0.25% from 0.50% and increase asset purchases to £445bn, including £10bn of corporate bonds.

6.4. As a consequence of central bank interventions and market activity short-term investment returns have reduced considerably.

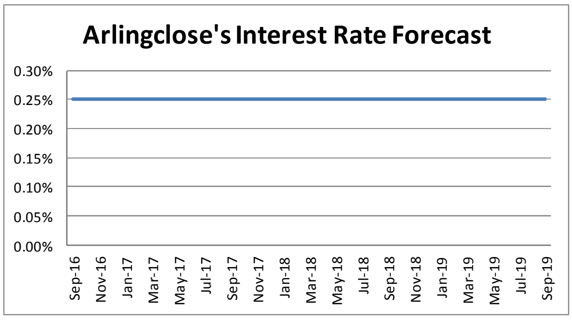
6.5. The UK economy has continued to grow – GDP growth has now been recorded for 14 consecutive quarters which indicates fundamental economic strength, although we note that the growth rate slowed to 0.4% in the second quarter, from 0.7% in the first quarter.

6.6. Annual Consumer Price Index inflation rose to 1.0% in September 2016, up from 0.3% in August 2016. This increase was driven by a recovery in prices from earlier nil or negative inflation. Increased import prices and weaker wage growth and investment returns will further increase inflationary pressures during the next twelve months, as a consequence of the devaluation of Sterling.

6.7. The labour market has remained strong, with the headline unemployment rate at 4.9%. Employee pay has also continued to improve and increased by 2.3% (including bonuses) when comparing the three month period to July 2016 against the previous year.

6.8. Graph 1 (overleaf) provides the Arlingclose (the Council's treasury adviser) interest rate forecast for the period September 2016 to September 2019. This indicates their view that rates are likely to remain at historically low levels for the indeterminable future.

Graph 1: Arlingclose Interest Rate Forecast for base rate



7. Prudential and Treasury Management Indictors

7.1. 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.

7.2. 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.

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

8. Treasury Management Strategy

8.1. In setting the 2016/17 TMS, the Council approved a Lending Policy that continued to enable flexibility in use of investment instruments whilst maintaining security and liquidity of investments. The 2016/17 Lending Policy was amended to extend the range of investment instruments to include Peer to Peer lending but was otherwise unchanged.

8.2. 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.

8.3. Following the referendum vote to leave the EU, Fitch and Standard and Poor downgraded the UK's Sovereign credit rating to AA. The outlook for UK financial institutions was also downgraded. There was no overall impact to the Council's investment portfolio following these changes as all investments met the criteria set out in the Council's TMS and the advice of Arlingclose.

8.4. During the six months to 30September 2016, investments have been held in a range of instruments detailed in Table 1:

Table 1: Counterparties and investment instruments used To 30 September 2016

Counterparty	Investment Instruments
Local Authorities	Fixed Term
UK Banks / Building Society	Call / Notice Accounts, Fixed Term Deposit, Certificate of Deposit (CD)
Overseas Banks with AA+ Sovereign Rating	Call Accounts, Fixed Bonds, Floating Rate Notes (FRN
AAA rated Money Market Funds	Call / Notice
Pooled Fund – Property	Notice
Pooled Fund – Bond	Notice
Pooled Fund – Equity	Notice
Pooled Fund – Multi-asset	Notice

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

Table 2: Investment Activity as at 30 September 2016 and 31 March 2016

Counterparties	Investment Instrument	As at 31/3/2016		As at 30/9/2016	
		£m	%	£m	%
Local Authorities	Fixed Term	5.00	5.4	5.00	4.5
UK Banks / Building Society	Call / Notice	19.80	21.2	14.28	12.7
	CD	0	0.0	4.00	3.6
Overseas Banks	Call	0.00	0.0	0.00	0.0
	FRN	0.00	0.0	5.00	4.5
	Fixed Bond	0.00	0.0	8.90	7.9
Money Market Funds	Call / Notice	38.43	41.2	45.00	40.1
Pooled Fund – Property	Notice	10.00	10.7	10.00	8.9
Pooled Fund – Bond	Notice	10.00	10.7	10.00	8.9
Pooled Fund – Equity	Notice	6.00	6.4	6.00	5.3
Pooled Fund – Multi-asset	Notice	4.00	4.3	4.00	3.6
TOTAL		**93.23**	**100.0**	**112.18**	**100**

8.6. Table 2 reflects the diversified investment portfolio being operated by the council within the bounds of the TMS.

8.7. Table 3 shows the value and type of maturities and new investments made during the first half of the year:

Table 3: Value of Maturities and New Investments
1 April – 30 September 2016

Period	Instrument Type	Maturities £m	Investments £m
Quarter 1	60 Day Notice Account	(10)	0
	95 Day Notice Account	0	10
	Certificate of Deposit	0	4
	Quarter 1 Total	**(10)**	**14**
Quarter 2	Fixed Deposit – Other Authority	(5)	5
	Bond	0	8.9
	Floating Rate Note	0	5
	Quarter 2 Total	**(5)**	**18.9**
	2016-17 Total	**(15)**	**32.9**

8.8. A total of £30m continues to be invested over the long term in a number of diversified pooled funds. At 30 September 2016, the net market value of the investment in these funds was approximately £30.08m. This represents an increase of approximately £500k on the valuation at 31 March 2016. The changes in market value are fluid depending on market conditions and are therefore not recognised as gains or losses in the financial statements.

8.9. Cash balances have increased by £20m between 31 March and 30 September 2016. This is due to timing differences between receipts and payments, and short term borrowing of £10m held during the second quarter in order to mitigate the impact of forecast cashflow volatility.

8.10. Interest rates for investments have ranged between 0.32% and 0.68% for fixed durations of up to 364 days. Interest rates on variable investments were as high as 0.52% at the start of the year and are now as low as 0.29%. Rates have fallen as a result of the Bank of England decision to reduce the bank rate, and market reaction to the EU Referendum result.

8.11. Table 4 provides a summary of the treasury activity in the period April 2016 to September 2016:.

Table 4: Treasury Activity - 1 April 2016 to 30 September 2016

Measure	April 2016 to September 2016
Average size of portfolio (excluding Iceland investments)	£107.64m
Weighted average term (fixed term only)	69 days
Average rate earned	1.48%
Interest earned	£0.867m

8.12. The total rate of return has reduced from 1.77% in Q1 to 1.48% in Q2. This is due to a combination of the impact of lower short-term interest rates now offered and the maturity of fixed-term investments secured at historical higher rates. The pooled fund investments continue to make a significant contribution to overall interest income. The return on pooled fund investments in the second quarter was equivalent to 4.75% per annum.

8.13. The rate of return for the second quarter (1.48%) includes underlying returns of 0.33% for the investment portfolio excluding the pooled fund investments. The 0.33% rate compares to 0.70% achieved in the first quarter and exceeds the 7-day LIBID benchmark of 0.20% by 0.13%.

8.14. The total interest forecast on treasury investments during the year is £1.658m, which is in line with the budget. Whilst interest rates for short-term deposits have meant weak returns on liquid investments, this has been offset by stronger performance of the pooled funds, which are delivering returns exceeding the 4% target level.

8.15. The pooled funds have experienced some variations in capital value during the year. This variability is expected as the nature of these types of investments in bond, equity and multi-asset funds means that income yield and fund values are influenced by market movements. It is important to recognise the long-term nature of these investments in mitigating this expected volatility.

As at the 31 March 2016 a small capital loss was reported. As at 30 September 2016 a small capital gain was reported. Appendix A, Section 3 provides more details of how the Council intends to utilise and balance these instruments alongside its existing investments with regard to management of security, liquidity and yield.

8.16. 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.

9. Icelandic deposits

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

9.2. As of 30 September 2016 repayments for the investments in Heritable total 98.0p in the £. The Administrators, Ernst and Young (EY), 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.

9.3. An additional repayment of 0.50p in the £ was announced by the administrator for the investments in Kaupthing, Singer & Friedlander during October 2016. This is expected to be paid in November 2016. EY estimate that the total return will be between 85.5 to 86.5p in the £. Recovery as at 30 September 2016 stood at 83.75p in the £.

9.4. Table 4 provides details of dividends received to 30 September 2016 together with current information about the anticipated value and percentage recovery for Icelandic investments.

Table 4: Icelandic bank deposits at 30 September 2016
Outstanding Claims

Bank	Original Deposit	Accrued Interest	Recovered at 30/9/2016	Total expected distribution		Claim Status
	£m	£m	£m	£m	%	
Heritable Bank	7.00	0.022	6.88	6.88	98.00	Open
Kaupthing, Singer & Friedlander	4.00	0.102	3.44	3.53	86.00	Open
TOTAL	**28.00**	**0.124**	**26.60**	**26.69**	**95.32**	

10. Borrowing

Long Term Borrowing

10.1. Table 5 (overleaf) shows total long term borrowing outstanding at 30 September 2016, the future maturity profile of borrowing and an analysis of sources of borrowing shown as a percentage of the total.

Table 5: Borrowing maturity profile at 30 September 2016

	Total	Sources of Borrowing					
		PWLB [1]		LOBO [2]		Commercial [3]	
	£m	£m	%	£m	%	£m	%
Borrowing at 30 September 2016	258.8	103.3	39.9	49.4	19.1	106.1	41.0
Maturing in 2016/17	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Maturing in 2017/18	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Maturing later	258.8	103.3	39.9	49.4	19.1	106.1	41.0
Average interest rate	4.61%		5.36%		4.37%		4.43%

PWLB = Borrowing sourced from the government's Public Works Loans Board
LOBO = Borrowing sourced from commercial banks
Commercial = Fixed rate loans from commercial banks

10.2. At 30 September 2016 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.

10.3. The average rate of interest for total borrowing was 4.61%, the average rate for PWLB borrowing was 5.36% and the average rate for borrowing from commercial banks was 4.41%.

10.4. The LOBO portfolio of £155.5m at the start of the year included £106.1m of loans from Barclays bank. One of these loans was a Range LOBO product, a loan with underlying derivatives.

10.5. In June Barclays decided to waive its future options to vary the rate on the LOBO loans. Consequently £88.1m of LOBO loans have been reclassified as Fixed Rate commercial loans. There was no change to the interest payable.

10.6. Barclays also offered an opportunity to negotiate a change to the terms of the £18m Range LOBO. Agreement was reached to convert this loan to a fixed rate instrument and in doing so the rate of interest payable changed from 4.70% to 4.625% with no penalty. This equates to a reduction in interest payable of £13,500 per annum.

10.7. 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.

10.8. 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.

10.9. Because the cost of long term borrowing remains significantly higher than the return on short-term investments, the 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.

11. Short Term Borrowing

11.1. Short term borrowing was required on multiple occasions during the first half of the year, due to differences in timing between receipts and associated payments. Maximum short term borrowing during the period was £50m.

11.2. This was sourced through direct contact or external brokers, from other local authorities, at rates varying from 0.53% to 0.20% (including brokerage fees of between 0.03% - 0.04%) for durations of 4 to 181 days.

11.3. £10m of short term borrowing was still in place as at 30 September 2016.

12. Hertfordshire Police and Crime Commissioner – Treasury Management

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

12.2. 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.

12.3. 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 2016/17 – 30 September 2016

1. Capital financing Indicators

	Indicator	Description	Integrated Plan Ref.	2016/17 Budget	2016/17 Q1	2016/17 Q2	2016/17 Q3	2016/17 Q4
	Indicators 1 to 3 demonstrate the affordability and sustainability of the capital programme. The projections for financial years 2016/17 to 2018/19 are set out in the Integrated Plan at the reference shown in the table below.							
1	Capital Expenditure	Monitors capital expenditure for 2016/17 against the projections set out in the Integrated Plan.	2.4 Table 1	£162.26m	£193.32m	£183.49m		
2	Capital Financing Requirement (CFR)	Monitors the Council's underlying need to borrow for capital purposes for 2016/17 against the projections set out in the Integrated Plan	2.10 Table 3	£518.81m	£528.95m	£517.21m		
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 2016/17 against projections set out in the Integrated Plan.	2.11 Table 4	1.32%	1.35%	1.35%		
	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.	2016/17 Budget	2016/17 Q1	2016/17 Q2	2016/17 Q3	2016/17 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			£184.45m	£160.29m		
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 2016/17 to 2017/18 are set out in the Integrated Plan.							
5	Authorised Limit *(against maximum position)*	Monitors the borrowing limit for 2016/17 beyond which borrowing is prohibited without Member approval.	6.5 Table 10	£425m	£318.78m	£308.78m		
6	Operational Boundary	Monitors the estimated external debt for the financial year 2016/17. 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	£395m	£318.78m	£308.78m		

2. Treasury Management Indicators

	Indicator	Description	Integrated Plan Ref.	2016/17 Budget	2016/17 Q1	2016/17 Q2	2016/17 Q3	2016/17 Q4
	Interest Rate Exposure: **Indicators 7 and 8 limit the Council's exposure to both fixed and variable interest rate movements.** **The limits for 2016/17 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 2016/17 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	£325m	£258.77m	£227.86m		
8	Upper limits on variable interest rates *(against maximum position)*	Monitors the limits set for 2016/17 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	97.50m	-£50.26m	-£71.28m		
	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.**							

	Indicator	Description	Integrated Plan Ref.	2016/17 Budget	2016/17 Q1	2016/17 Q2	2016/17 Q3	2016/17 Q4
9 A	Under 12 months		6.8 Table 12	50.00%	0.00%	0.00%		
9 B	12 months to 2 years		6.8 Table 12	50.00%	0.00%	0.00%		
9 C	2 years to 5 years		6.8 Table 12	60.00%	1.22%	1.22%		
9 D	5 years to 10 years		6.8 Table 12	80.00%	2.13%	2.13%		
9 E	10 years to 20 years		6.8 Table 12	85.00%	9.08%	9.08%		
9 F	20 years to 30 years		6.8 Table 12	90.00%	12.34%	12.34%		
9G	30 years and above		6.8 Table 12	100.00%	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	£30.68M	£30.68M		

*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.	2016/17 Q1	2016/17 Q2	2016/17 Q3	2016/17 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 16	£99.69m	£115.5m		
	Average borrowing portfolio	Monitors the average amount HCC has as long term borrowing during the quarter	6.3 Table 10	£258.78m	£275.79m		
	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	6.70	5.16		
	Liquidity Indicator: Weighted Average Maturity of investments held	Measures the liquidity/accessibility of investments in average days	Section 6.10	27 days	43 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 16	1.77% £0.440m	1.48% £0.427m		
	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 15	4.33% £3.08m	4.59% £3.07m		

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

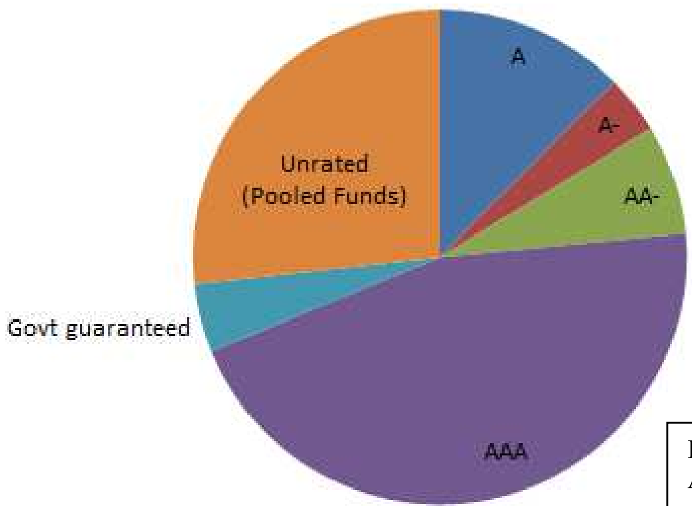
Security, Liquidity and Yield

Exposure to Risk

The Treasury Management Strategy was approved on 23 February 2016 as Part E of the Integrated Plan. This maintained the range of investment types approved for use in 2016/17, and added P2P lending as an approved instrument. The approved instruments were previously changed 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 30 September 2016.

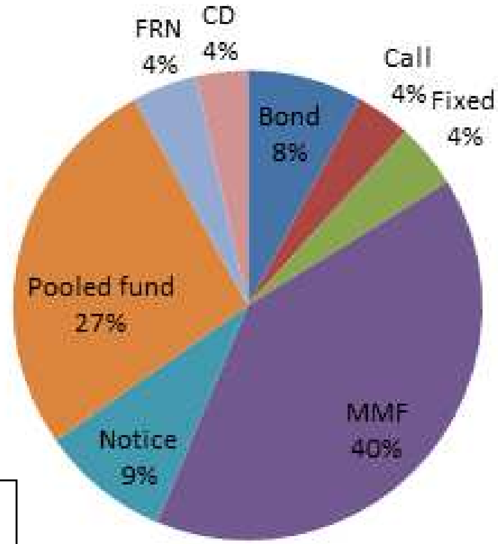
Diagram 1: Summary of Credit Risk of Investment Portfolio as at 30 September 2016



Key:

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

Diagram 2: Summary by Investment type as at 30 September 2016



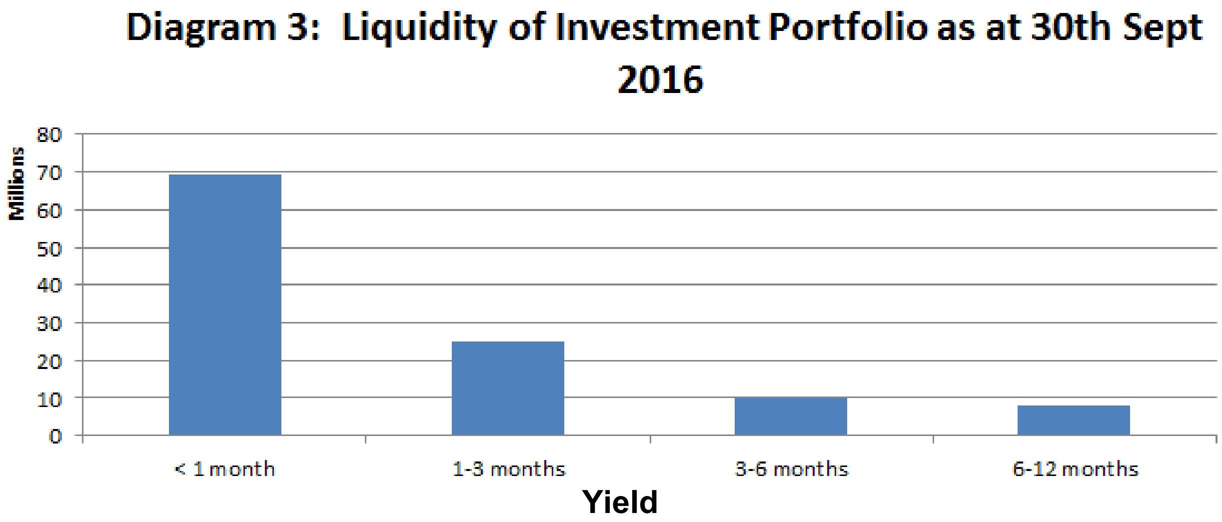
The greatest percentage of deposits is held in money market funds and call accounts. This reflects the need to ensure adequate liquidity in the management of cash balances to meet daily cashflow requirements.
Investments in pooled funds consist of the CCLA Property Fund, two bond funds, two multi asset funds and one equity fund.

A new fixed term investment with Worthing Borough Council has been made for 6 months.
Two new bond investments were made with Dutch bank BNG, for 5 months, and Swedish bank Svenska Handelsbanken, for 357 days.
A short-dated floating rate note with National Australia Bank was also purchased during the period, following its final reset – this matures during the third quarter.

Liquidity

Reducing investment balances mean that opportunities to make fixed-term investments are more limited than in previous years.
The potential capital volatility of the pooled fund investments means that they are intended to be held for 3-5 years, but in the graph below these investments are shown on the basis of their accessibility.
These funds are all classified as “liquid”, except the Property Fund which accessible on 30 days’ notice.

Diagram 3 provides a graph showing the liquidity of the Council’s investments portfolio as at 30 September 2016.



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, any subsequent long duration pooled fund investments will also be excluded, as 7 day LIBID benchmark is more relative to short-term investments.

Having been unchanged for a number of periods, LIBID fell to 0.20% from 0.36% during the second quarter in response to the base rate cut. The return excluding pooled fund interest reduced from 0.70% to 0.33%. This is a sharper reduction than the change in LIBID, which reflects the maturity of higher-yielding instruments priced when the market expectation was for rate increases along with the very low rate of return paid on shorter duration instruments.