SURREY
COUNTY COUNCIL

Audit & Governance Committee
2 December 2013

TREASURY MANAGEMENT HALF YEAR REPORT 2013/14

SUMMARY AND PURPOSE:

This report summarises the council's treasury management activity during the first half of 2013/14, required by CIPFA's Code of Practice for Treasury Management. This report also covers the council's Prudential and Performance Indicators for the first half of 2013/14, in accordance with the requirements of the Prudential Code.

RECOMMENDATIONS:

It is recommended that the Committee note the content of the Treasury Management Half Year Report for 2013/14.

BACKGROUND:

1. Treasury management is the management of the organisation's cash flows, banking, money market and capital market transactions, the effective management of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks.

TREASURY MANAGEMENT HALF YEAR REPORT 2013/14:

Key Prudential indicators and compliance issues

2. Under CIPFA's Prudential Code, the council is required to report on its actual Prudential indicators after the year end. Annex 1 Table 11 provides a schedule of all of the council's mandatory Prudential indicators, as agreed at the budget meeting of 12 February 2013. Key indicators that provide either an overview or a limit on treasury activity are summarised in the following paragraphs.

3. The Capital Financing Requirement (CFR) shows the council's underlying need to borrow for capital purposes. To ensure that, over the medium term, borrowing net of investments will only be for a capital purpose, net borrowing should not, except in the short-term, exceed the CFR for 2013/14. The council has complied with this requirement as shown in Table 1:

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Table 1: Borrowing position against CFR

	£m
Total Borrowing at 30th September 2013	261
Investments at 30th September 2013	249
Net borrowing position at 30 September 2013	**12**
CFR 2013/14	644
CFR 2014/15	688

4. The Authorised Limit is the council's "affordable borrowing limit" required by section 3(1) of the Local Government Act 2003. This represents the limit beyond which borrowing/external debt is prohibited. The limit reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. Table 2 demonstrates that during 2013/14, the council has maintained gross borrowing within its Authorised Limit.

5. The Operational Boundary is the probable external borrowing position of the council during the year. It is not a limit and actual borrowing could vary around this boundary for short times during the year. It acts as an indicator to ensure that the Authorised Limit is not breached.

Table 2: Borrowing against Authorised Limit & Operational Boundary

	£m
Authorised Limit	675
Operational Boundary	612
Highest gross borrowing position during 2013/14	345

6. Capital financing costs incurred by the council during 2013/14 are detailed as follows:

Table 3: Capital Financing Costs 2013/14

Description	Original Estimate £000	Year end Projection £000
Minimum Revenue Provision (MRP)	21,039	21,039
Interest on long-term borrowing	15,719	15,719
Net interest on short-term cashflow	(583)	(854)
Total	36,175	35,904

7. While setting the budget, the council assumed a level of interest rates on its borrowing, and when this borrowing would take place. As a precaution against this risk, £1m was included to cover the additional interest payments if borrowing was undertaken at an earlier time at a higher rate of interest. Officers are regularly monitoring the risk of interest rate rises in the near future and the possible impact on the UK gilt market, which directly affects PWLB rates.

8. Interest receivable is higher than budget due to many Government grants being received earlier in the year than originally envisaged, leading to higher cash balances on deposit.

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Treasury management activity during 2013/14

9. The treasury position at 30 September 2013 compared with the end of the last financial year is shown in Table 4. The council's credit rating criteria effective at 30 September 2013 are shown at Annex 2 Table 12.

Table 4: Investment and borrowing position 2013/14

	31 March 2013		30 September 2013	
	Principal £m	Average Rate	Principal £m	Average Rate
Fixed Interest Rate Debt*	305	4.20%	237	4.68%
Variable Interest Rate Debt**	-	-	-	-
Total Debt	**305**	**4.20%**	**237**	**4.68%**
Fixed Interest Investments	240	0.55%	249	0.41%
Variable Interest Investments**	-	-	-	-
Total Investments	**240**	**0.55%**	**249**	**0.41%**
NET BORROWING	**65**		**(12)**	

*Excludes Office of the Police and Crime Commissioner for Surrey debt

**No variable rate investments or borrowing held at 31 March 2013 or 30 September 2013

9. The treasury management gross borrowing position has reduced in 2013/14 as a result of the repayment of short-dated debt on September 30 and continuing the strategy of not borrowing up to the Capital Finance Requirement limit (use of internal borrowing). This has been possible since the council has sufficient cash balances to finance capital expenditure from internal sources in the short term. Cash balances are currently earning very little interest when placed on deposit. Therefore, a considerable saving has been achieved in borrowing internally. There remains enough cash to finance future capital expenditure in the short term.

10. The increase in investment balances reflects the higher cash balances held mid-year, compared with year end. This is generally because grant money from Central Government has been received early in the year.

11. The average interest rate paid on the remaining debt portfolio has increased as a result of the repayment of cheap short-dated debt (£68m) on 30 September 2013.

Borrowing position

12. The interest rates payable on PWLB debt can be found in table 5

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Table 5: Interest rate paid on PWLB debt

Financial Year	% Interest on Debt
2009/10	4.20
2010/11	4.20
2011/12	4.20
2012/13	4.20
2013/14*	4.20

* half year to 30 September 2013

13. The PWLB rate will change for the full year 2013/14 report as the loan of £68m was repaid on 30 September 2013. The new average rate on the remaining PWLB borrowing post 30 September 2013 will be 4.68%.

14. All of the council's current long-term borrowing has been taken from the Public Works Loan Board (PWLB), whose purpose it is to provide loans to local authorities in order to finance capital expenditure, apart from a £10m market loan taken from Barclays. A summary on the movement of long-term borrowing during 2012/13 and 2013/14 is as follows:

Table 6: Long-term borrowing position

Long-term Borrowing	1 April 2012 to 31 March 2013 £000	1 April 2013 to 30 September 2013 £000
Total debt outstanding at 1 April	305,230	305,230
Loans raised	0	0
Loans repaid	0	67,983
Total debt at period end	**305,230**	**237,247**

15. The interest rate available on new borrowing (50 years) during 2013/14 started at 4.02%, rising to 4.38% at the start of July and settling at 4.29% at the end of September. The 50-year rate at 21 November 2013 is 4.35%.

16. The council is able to undertake temporary borrowing for cash-flow purposes, although none has been required for this purpose at any time during 2013/14 to date. The council also manages cash on behalf of the Office of the Police and Crime Commissioner for Surrey, which is classified as temporary borrowing as detailed below.

Table 7: Temporary borrowing position

Temporary Borrowing at 30 September 2013	£000
Short-term borrowing for cash-flow purposes	-
Office of the Police and Crime Commissioner for Surrey	24,128
Total	**24,128**

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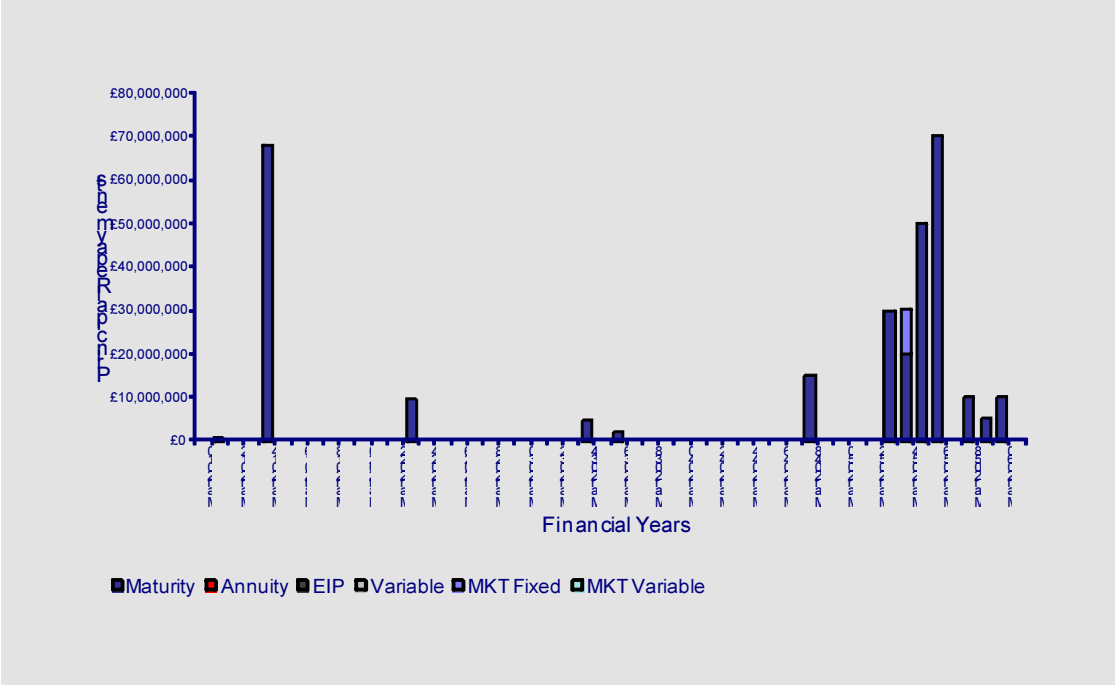
17. The council has limited its exposure to large fixed rate loans maturing in any one year by setting gross limits for its maturity structure of borrowing in accordance with the Prudential Code.

Table 8: Debt maturity profile as at 30 September 2013

Maturity Profile	Upper Limit	Lower Limit	Actual
Under 12 months*	50%	0%	0.0%
1 year and within 2 years	50%	0%	0.0%
2 years and within 5 years	50%	0%	0.0%
5 years and within 10 years	75%	0%	4.0%
10 years and above	100%	25%	96.0%

* Includes balances held on behalf of the Office of the Police and Crime Commissioner for Surrey, and Trust Funds.

18. The debt maturity profile of the council's long-term debt is shown on the following chart:



Investment position

19. Rates of return have continued to fall, with rates available in the market remaining depressed in 2013/14.

Table 9: % Return on investments

Financial Year	% Return on Investments
2009/10	1.01
2010/11	0.75
2011/12	0.70
2012/13	0.55
2013/14	0.41

20. Due to the Bank of England's Funding for Lending Scheme reducing demand for local authority cash, It is likely that rates will remain low over the remainder of this year and probably next year, and will lead to overall returns for the year being lower than 2012/13 (around 0.40%).

21. All cash held by the council is aggregated for the purpose of treasury management and any daily surpluses are invested temporarily until required to meet daily outgoings. For 2013/14, such monies include funds held on behalf of schools and the Office of the Police and Crime Commissioner for Surrey. Since 1 April 2011, the Pension Fund balances have been held in a separate bank account and are no longer comingled with the council and Office of the Police and Crime Commissioner for Surrey funds for investment purposes.

22. In 2013/14, nearly 330 schools chose to have their cash balances incorporated within the council's balances, thus earning interest on an agreed basis. Under this arrangement these schools received interest on their balances at a rate of 0.50% below base rate.

23. In 2013/14, the council applied the average return of its whole investment portfolio to all of the funds that were held on behalf of the Office of the Police and Crime Commissioner for Surrey (as per the current service level agreement).

24. Money brokers are used to facilitate investment dealing and loans are only made to institutions that meet the council's approved counterparty criteria. In addition to dealing through brokers, short-term investments are also made by dealing direct with some approved institutions, including banks, building societies and money market funds.

25. Due to frequent action on the part of credit ratings agencies, the council's credit rating criteria, investment limits and resultant counterparty list have been under continual scrutiny. The counterparty list within the current Treasury Management Strategy was last updated at the Audit and Governance meeting of 12 February 2013. The credit rating criteria and investment limits effective at 30 September 2013 are shown at Annex 2.

26. The current counterparty list that reflects these criteria has been updated to November 2013, and can be found in Annex 3.

27. In the first half of 2013/14, the council maintained an investment portfolio with a daily average balance of £370m (£307m in 2012/13) and received an average return of 0.41%. The comparable performance indicator is the average 7-day LIBID rate, which was 0.36% for the period. The council therefore outperformed its benchmark by 0.05%.

Icelandic Deposits

28. The Council placed £20m deposits with two failed Icelandic banks, Glitnir and Landsbanki. Of this £20m, the Council's exposure is £18.5m with the balance attributable to the Office of the Police and Crime Commissioner for Surrey. The Audit & Governance Committee receives regular reports on the prospects for recovery of the deposits that are at risk and the efforts being made by the Local Government Association (LGA) and its legal advisors in this regard.

29. To be prudent, the Council has impaired £1.5m based upon latest estimates in the guidance from CIPFA.

30. On 28 October 2011, the Supreme Court of Iceland upheld the District Court judgment in favour of local authority depositors, deciding by a 6-1 majority that local authorities' claims are deposits that qualify in full for priority in the bank administrations. These decisions are now final and there is no further right of appeal.

31. The current position is that 55% of Landsbanki and over 84% of Glitnir deposits have been repaid, with expected recovery rates. The balance owed on each is: deposit is shown in the table below.

Counterparty	Period	Principal £000	Rate	Principal Repaid £000	Principal Outstanding £000
Glitnir	364	5,000	6.25%	4,192	808
Glitnir	366	5,000	6.20%	4,193	807
Landsbanki	732	10,000	5.90%	5,520	4,480
		20,000		13,906	6,094

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Member and Officer Training

32. Officers and members involved in the governance of the council's treasury management function are required to participate in training. Officers are also expected to keep up to date with matters of relevance to the operation of the council's treasury function. Officers continue to keep abreast of developments via the CIPFA Treasury Management Forum as well as through two local authority networks. Sector provides daily, weekly and quarterly newsletters and update meetings are held with Sector twice a year. In addition, a number of members of Audit & Governance Committee and Council attended treasury management training in July and October 2013. Further member training events will be provided as required.

Treasury Management Advisors

33. The Council uses Sector as its treasury management advisers. The company provides a range of services including:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies.

34. A development in the revised CIPFA Code on Treasury Management, which is intended to improve the reporting of treasury management activities, is the consideration, approval and reporting on security and liquidity benchmarks. Yield benchmarks are already widely used to assess investment performance, while discrete security and liquidity benchmarks are new reporting requirements.

Yield: The Council currently reports the overall return in interest against the 7-Day LIBID rate. In the first six months of 2013/14, the overall return on deposits was 0.41%, compared with the benchmark of 0.36%, a margin of 0.05%.

Security: The Council analyses the investment portfolio at year end against historic default rates to estimate the maximum exposure to default as follows:

Table 10: Benchmarking deposits against default rates at 30 September 2013

	Amount	Historical experience of default	Adjustment for market conditions	Est maximum exposure to default
	£000	%	%	£000
Deposits with banks and financial institutions	(a)	(b)	(c)	(a x c)
AAA-rated counterparties*	90,375	0.00%	0.00%	0
AA-rated counterparties	120,000	0.03%	0.03%	36
A-rated counterparties	32,250	0.08%	0.08%	26
Other counterparties**	6,094	0.00%	0.00%	0
Total	**248,719**			**62**

* includes £50.4m with other Local Authorities that do not have credit ratings but are backed by central government.
** includes £6m of deposits placed in Icelandic institutions whose credit ratings have reduced since the date of placing the deposit.

Liquidity: The Council currently restricts termed deposits to less than one year, and ensures the minimum level of cash available each day stands above £15m. This provides a safety margin to help ensure the Council does not need to borrow to fund treasury activity. During 2013/14, available cash balances did not fall below the £15m minimum level.

Value for Money

35. SCC participates in CIPFA's Treasury Management Benchmarking Club, which compares the performance of 68 local authorities. The report for 2012/13 shows that the average interest received by Surrey CC was below the benchmarking club average (0.57% compared to a benchmarking club average of 1.10%). This was mainly due to the council holding high balances and a very risk averse strategy, which resulted in large amounts being held in shorter-term, low interest rate deposits, or with the Debt Management Office at 0.25%. On interest paid, Surrey CC outperformed the average, paying average interest on the debt portfolio of 4.2% compared with the peer average of 4.5%.

36. The survey also compares the costs of maintaining a treasury management function. The Council significantly outperforms the peer group average in terms of the costs per £m investments managed, with costs of £100 per £m invested (£120 per £m in 2012/13) compared to a peer group average of £600 per £m invested (£930 per £m in 2011/12). The decrease in costs per £m invested over the previous year was due to the council holding higher average balances in 2012/13 compared to 2011/12 (while the actual costs remained the same over the two years). For debt management in 2012/13, Surrey CC had a cost of £20 per £m borrowed (the same as 2011/12), compared to an average of £140 per £m. This shows that the Treasury Management Team is providing the council good value for money.

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Regulatory Framework, Risk and Performance

37 The council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2013/14);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the council's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8 November 2007.

38 The council has complied with all of the above relevant statutory and regulatory requirements, which require the council to identify and, where possible, quantify the levels of risk associated with its treasury management activities. The adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management ensures that capital expenditure is prudent, affordable and sustainable, and treasury practices demonstrate a low risk approach.

39 The council is aware of the risks of passive management of the treasury portfolio and, with the support of Sector, the council's advisors, has proactively managed the debt and investments over the year so far. The council has previously utilised historically low borrowing costs and has complied with its internal and external procedural requirements. There is little risk of volatility of costs in the current debt portfolio, as it consists of predominantly fixed long-term loans, with the capacity for repayment of any shorter dated debt. Shorter term variable rates and likely future movements in these rates predominantly determine the council's investment return. These returns can be volatile and, whilst the risk of loss of principal is minimised through the annual investment strategy, accurately forecasting future returns can be difficult.

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IMPLICATIONS:

A) Financial
There are no direct financial implications.

B) Equalities
There are no direct equality implications.

C) Risk management and value for money
See paragraphs 34 to 36.

WHAT HAPPENS NEXT:

i. The Pension Fund & Treasury Team will monitor the UK and overseas banking sector and will continue to update this Committee as appropriate.

ii. In line with the requirements of CIPFA's Code of Practice for Treasury Management, this committee will receive a full-year report on the council's treasury management position for 2013/14 at the meeting in June 2014.

iii. The Pension Fund & Treasury Team will prepare the annual Treasury Management Strategy, which will be presented as part of the MTFP presented to Council in February 2014.

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Sources/background papers:
Capital Budget and Treasury Management Strategy 2012/13
Prudential Indicators and Treasury Management Strategy 2013/14
CIPFA Code of Practice for Treasury Management in the Public Services (Revised)
CIPFA Treasury Management Benchmarking Club Report 2012/13

Table 11: Summary of Prudential Indicators for 2013/14

Prudential Indicator	Position as at 30 September 2013 £000	2013/14 Limit £000
Maximum net borrowing incurred against the Capital Financing Requirement (CFR)	78,617	664,027
Maximum gross borrowing incurred against the Authorised Limit	344,724	675,616
Maximum gross borrowing incurred against the Operational Boundary	344,724	612,284
Maturity structure of fixed rate borrowing		
Under 12 months	0%	0% - 50%
12 months to 2 years	0%	0% - 50%
2 years to 5 years	0%	0% - 50%
5 years to 10 years	4.0%	0% - 75%
10 years and above	96.0%	25% - 100%
Maximum principal funds invested for more than 365 days	(0%)	35% of value of investments held

In addition to the above the council is required as a Prudential Indicator to:

i) Adopt the CIPFA Code of Practice.
ii) Ensure that over the medium term borrowing will only be for a capital purpose (i.e. net external borrowing is less than the CFR).

Annex 2

Table 12: Effective Counterparty Limits

	Fitch				Moody's			S&P			
Type	ST	LT	VIA*	Sup	ST	LT	FSR	ST	LT	Max Value	Max Term
Bank/Building Society	F1	A-	bb+	3	P-1	A3	C-	A1	A-	£20m	3 months
Bank/Building Society	F1	A-	bb+	3	P-1	A3	C	A1	A-	£20m	1 year
Bank/Building Society	F1+	AA-	a-	2	P-1	Aa3	B	A1+	AA-	£25m	1 year
Bank/Building Society	F1+	AA	a-	1	P-1	Aa2	B	A1+	AA	£35m	1 year
Money Market Funds	AAA				AAA			AAA		£20m	1 year
Enhanced cash/bond funds	AAA / v1				Aaa-bf			AAAf / s1		£20m	1 year
Debt Management Office	-				-			-		Unlimited	1 year
Supranational	-				-			-		£10m	1 year
Local Authority	-				-			-		£20m	1 year

* Fitch Viability rating replaced the Individual Strength rating in December 2011

i) Deposits are permitted with UK banks that do not comply with the council's credit rating criteria subject to the following:

a) That they have been nationalised or part nationalised by the UK government and/or

b) That they have signed up to the UK government financial support package.

ii) The use of money market funds is restricted to funds with AAA ratings (from each of the agencies) up to a maximum of £100m (with a maximum of £20m per money market fund).

iii) An additional £20m (per call account) is made available to invest in overnight high interest call accounts with both RBS and Lloyds (making a total of £60m limit with each). This will be maintained while they remain part nationalised.

Deposits with foreign banks are permitted, on the condition that they meet our minimum criteria, and that the country in which the bank is domiciled is AAA-rated with any of the three ratings agencies (Fitch, Moody's and Standard and Poor's).

MMF = Money Market Fund

DMADF = Debt Management Account Deposit Facility at the Bank of England

ST = Short-Term

LT = Long-Term

Via = Viability Rating

Sup = Support Rating
FSR = Financial Strength Rating

F1 Indicates the strongest capacity for timely payment of financial commitments; an added "+" denotes any exceptionally strong credit feature.
P-1 Indicates superior credit quality and a very strong capacity for timely payment of short-term deposit obligations. No enhanced rating available.
A-1 Indicates a strong capacity to meet financial commitments; an added "+" denotes a capacity to meet financial commitments as extremely strong.

Annex 3

Table 13: Counterparty List as at 01 November 2013 (to be updated before final draft)

	Fitch Ratings				Moody's Ratings			S&P Ratings	
	S/T	L/T	Viab.	Supp	S/T	L/T	Str.	S/T	L/T
UK		AAA				AAA			AAA
HSBC	F1+	AA-	A+	1	P1	AA3	C	A1+	AA-
Lloyds	F1	A	BBB+	1	P1	A2	C-	A1	A
Royal Bank of Scotland	F1	A	BBB	1	P2	A3	D+	A1	A
Nationwide Building Society	F1	A	A	1	P1	A2	C	A1	A
Barclays	F1	A	A	1	P1	A2	C-	A1	A
Santander (UK)	F1	A	A	1	P1	A2	C-	A1	A
Australia		AAA				AAA			AAA
Australia & NZ Banking Group	F1+	AA-	AA-	1	P1	AA2	B-	A1+	AA-
Commonwealth Bank of Australia	F1+	AA-	AA-	1	P1	AA2	B-	A1+	AA-
National Australia Bank	F1+	AA-	AA-	1	P1	AA2	B-	A1+	AA-
Westpac Banking Corporation	F1+	AA-	AA-	1	P1	AA2	B-	A1+	AA-
Canada		AAA				AAA			AAA
Canadian Imperial Bank	F1+	AA-	AA-	1	P1	AA3	C-	A1	A+
Bank of Montreal	F1+	AA-	AA-	1	P1	AA3	C+	A1	A+
Bank of Nova Scotia	F1+	AA-	AA-	1	P1	AA3	B-	A1	A+
Royal Bank of Canada	F1+	AA	AA	1	P1	AA3	C+	A1+	AA-
Toronto-Dominion Bank	F1+	AA-	AA-	1	P1	AA1	B	A1+	AA-
Finland		AAA				AAA			AAA
Nordea Bank	F1+	AA-	AA-	1	P1	AA3	C	A1+	AA-
Germany		AAA				AAA		A+	AAA
DZ Bank	F1+	A+		1	P1	A1	C-	A1+	AA-
Deutsche Bank	F1+	A+	A	1	P1	A2	C-	A1	A+
KfW	F1+	AAA		1	P1	AAA		A1+	AAA
Landswirtschaftliche Rentenbank	F1+	AAA		1	P1	AAA		A1+	AAA
Netherlands		AAA				AAA			AAA
ING Bank	F1+	A+	A	1	P1	A2	C-	A1	A+
Bank Nederlandse Gemeemten	F1+	AAA			P1	AAA	A	A1+	AAA
Norway		AAA							
DnB NOR Bank	F1	A+	A+	1	P1	A1	C-	A1	A+
Singapore		AAA				AAA			AAA
Development Bank of Singapore	F1+	AA-	AA-	1	P1	AA1	B	A1+	AA-
Oversea Chinese Banking Corp	F1+	AA-	AA-	1	P1	AA1	B	A1+	AA-
United Overseas Bank	F1+	AA-	AA-	1	P1	AA1	B	A1+	AA-
Sweden		AAA				AAA			AAA
Skandinaviska Enskilda Banken	F1	A+	A+	1	P1	A1	C-	A1	A+
Svenska Handelsbanken	F1+	AA-	AA-	1	P1	AA3	C	A1+	AA-
Swedbank AB	F1	A+	A+	1	P1	A2	C-	A1	A+
Switzerland		AAA				AAA			AAA
UBS AG	F1	A	A-	1	P1	A2	C-	A1	A

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