Item: 6

Investments Sub-committee: 24 September 2025.

Treasury Management – Monitoring.

Report by Head of Finance.

1. Overview

1.1. Regulation 21 of the Council's Financial Regulations confirms that the Council has adopted the key recommendations of the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in the Public Services (the Code).

1.2. The Code defines treasury management as including investment activities.

1.3. The Council's investment priorities can be summarised as maintaining:

- The security of capital.
- The liquidity of its investments.

1.4. The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of the Council is low in order to give priority to security of its investments. This is in keeping with the nature of the Strategic Reserve Fund, which is to provide for the benefit of Orkney and its inhabitants, whilst having regard to the Fund's long-term obligations in terms of the decommissioning of the Flotta Oil Terminal in the future.

1.5. The Financial Regulations refer to maintenance of the Treasury Management Policy Statement and Treasury Management Practices as the cornerstone for effective treasury management and the requirement to report annually on the Treasury Management function.

1.6. The CIPFA Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report ensures that the Council is implementing best practice in accordance with the Code of Practice.

1.7. An analysis of the Treasury Management Performance as at 30 June 2025, attached as Appendix 1 to this report, covers the following elements:

- Borrowing activity.
- Temporary loans.
- Strategic Reserve Fund

1.8. The conclusion of the analysis of performance is that existing treasury management practices have operated effectively over the first quarter of the current financial year.

2. Recommendations

2.1. It is recommended that members of the Sub-committee:

i. Note the quarterly report, attached as Appendix 1 to this report, prepared by Link Treasury Services, the Council's Treasury Adviser, which covers the following elements of treasury management:
   - An economic update for the quarter ended 30 June 2025.
   - Interest rate forecasts.
   - A review of the Treasury Management Strategy Statement and Annual Investment Strategy.
   - A review of prudential and treasury indicators for 2025/26, as at 30 June 2025.

ii. Note the status of the temporary loans portfolio as at 30 June 2025, as detailed in section 3 of this report.

3. Treasury Management Performance

3.1. As at 30 June 2025, the Council's debt portfolio stood at £50,000,000, with loan maturities ranging from 11 months to 45 years. Overall, this represents an average cost of borrowing of 3.93% per annum, with an average weighted duration of 30.8 years.

3.2. The cost of this debt is managed as part of the loan charges associated with the capital programme and has been offset in the short term with surplus funds placed on deposit for periods of up to one year.

3.3. The temporary loan portfolio as at 30 June 2025 totalled £17,949,095.53. Further details are provided in the Monthly Investment Analysis Review prepared by Link Asset Services, attached as Appendix 2 to this report.

3.4. For the period 1 April to 30 June 2025, the temporary loans returned an average interest rate of 4.33%, which equates to a return of £174,934.46.

3.5. By comparison, the equivalent 30-day backward looking Sterling Overnight Index Average rate of 4.36% is considered to be the target.

3.6. With inflation quoted at 3.6% for June 2025 based on Consumer Price Index (5.9% Retail Price Index), the return on temporary loans equates to a relative gain in value of 0.73% in real terms.

4. Benchmark Liability

4.1. CIPFA introduced the liability benchmark as a new Prudential Indicator to provide a measure of how well the existing loans portfolio matches planned borrowing needs:

- It is a projection of the amount of loan debt outstanding, that the Council needs each year into the future to fund its existing debt liabilities, planned prudential borrowings and other cash flows.
- The liability benchmark advocates a net book approach to treasury management, where borrowings and investments are netted down while maintaining appropriate investments for liquidity purposes, thereby reducing the treasury risks associated with running debt and investment portfolios at the same time.

4.2. The Liability Benchmark, attached as Appendix 3 to this report shows that the Council's liabilities are sitting below the benchmark.

For Further Information please contact:

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Implications of Report

1. **Financial:** The financial implications are contained within the body of the report.
2. **Legal:**
   Treasury Management arrangements help the Council meet its statutory obligation to secure best value.
   Section 40 of the Local Government in Scotland Act 2003 provides local authorities with the power to invest money. This power may be exercised in accordance with regulations made by Scottish Ministers under this section.

Section 95 of the Local Government (Scotland) Act 1973 states that every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer has responsibility for the administration of those affairs.

3. **Corporate Governance:** At its meeting held on 20 February 2024, the Policy and Resources Committee noted that, from 2024/25 onwards, the Investments Sub-committee would be responsible for ongoing monitoring and scrutiny of the approved Treasury Management Strategy Statement, including a mid-year review and annual review.
4. **Human Resources:** None directly related to the recommendations in this report.
5. **Equalities:** Equality Impact Assessment is not required for financial monitoring.
6. **Island Communities Impact:** Island Communities Impact Assessment is not required for financial monitoring.
7. **Links to Council Plan:** The proposals in this report support and contribute to improved outcomes for communities as outlined in the following Council Plan strategic priorities:

   ☐Growing our economy.

   ☐Strengthening our Communities.

   ☐Developing our Infrastructure.

   ☐Transforming our Council.
8. **Links to Local Outcomes Improvement Plan**: The proposals in this report support and contribute to improved outcomes for communities as outlined in the following Local Outcomes Improvement Plan priorities:

   ☐ Cost of Living.

   ☐ Sustainable Development.

   ☐ Local Equality.

   ☐Improving Population Health.
9. **Environmental and Climate Risk:** Environmental, Social and Governance factors are recognised as having the potential to impact the Fund.
10. **Risk:** Reviewing the performance quarterly ensures that the treasury management processes are being adhered to and provides assurance that associated risks are being managed effectively.
11. **Procurement:** None directly related to the recommendations in this report.
12. **Health and Safety:** None directly related to the recommendations in this report.
13. **Property and Assets:** None directly related to the recommendations in this report.
14. **Information Technology:** None directly related to the recommendations in this report.
15. **Cost of Living:** None directly related to the recommendations in this report.

List of Background Papers

Policy and Resources 18 February 2025 - Treasury Management Strategy Statement 2025/26.

Appendices

Appendix 1 – Treasury Management Update – Quarterly Report 2025/26.
Appendix 2 – Link Asset Services Monthly Investment Analysis Review for June 2025.
Appendix 3 – Liability Benchmark Chart.

Appendix 1

Classification: Confidential

Treasury Management Update

Quarterly Report

30TH JUNE 2025

MUFG Corporate Markets
A division of MUFG Pension & Market Services

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Treasury Management Update

Quarter Ended 30th June 2025

The CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management 2021 recommends that members be updated on treasury management activities at least quarterly. This report, therefore, ensures this Council is implementing best practice in accordance with the Code.

1. Economics update

- The first quarter of 2025/26 (1st April to 30th June) saw:
  - A 0.3% m/m fall in real GDP in April – the first fall since October 2024
  - The 3myy rate of average earnings growth excluding bonuses fall from 5.5% to 5.2% in May
  - Core CPI inflation ease from 3.8% in April to 3.5% in May as temporary Easter-related effects faded
  - The Bank of England cut interest rates from 4.50% to 4.25% in May, holding them steady in June
  - The 10-year gilt yield fluctuate between 4.4% and 4.8%, and end the quarter at 4.50%
- The 0.3% m/m fall in real GDP in April was the first fall since October 2024 and the largest fall since October 2023. This is a significant shift from the 0.7% q/q rise in Q1 2025, probably as a result of the boosts from net exports and business investment unwinding. The decline in exports was mostly due to a reversal of US tariff front-running with export values to the US falling by 31% m/m after rising 34% in total in the five months to February. April's GDP figures also showed manufacturing output falling by 0.9% m/m along with the domestic economy showing signs of weakness in April. Despite construction output growing by 0.9% m/m, services output declined by 0.4% m/m, reversing all of March's 0.4% m/m rise. This weakness in services likely reflects higher labour costs from April's rise in National Insurance Contributions for employers. May's GDP may have fallen a bit further as the boosts in Q1 continued to unwind. Overall, GDP in Q2 is likely to have flatlined and the economy will probably be hindered by subdued overseas demand and domestic businesses cutting spending given a rise in costs due to April's increase in taxes. The Bank of England expects growth in 2025 to be around 0.8%.
- Despite the rise in the composite Purchasing Managers Index (PMI) from 50.3 in May to 50.7 in June, it is still below its level in March, prior to the rise in business taxes and Trump's Liberation Day tariffs. This rise was driven by increases in both the services and manufacturing output balances. Although the services PMI rose from 50.9 to 51.3, that is consistent with non-retail services output growth slowing from 0.5% 3m/3m in April to 0.3% 3m/3m in June.
- The sharp 2.7% m/m drop back in retail sales volumes in May adds to other evidence that the burst of economic growth in Q1 is over. The weakness was widespread with sales falling in all seven of the major categories. This decline was partly due to the unwinding of the previous boost from April's unusually warm and dry weather along with inflationary pressures prompting consumers to cut back. The latter would be a more persistent drag on retail spending. Looking ahead, the rise in the GfK measure of consumer confidence from -20 in May to -18 in June is consistent with the annual rate of real retail sales growth accelerating from -1.3% in May to around +0.5%.
- While the £17.7bn of public sector borrowing in May was higher than the Office of Budget responsibility (OBR) forecast of £17.1bn, borrowing was £2.9bn below the OBR's forecast in the first two months of the 2025/26 fiscal year. The current budget deficit was £12.8bn in May, a touch below the OBR's forecast of £13.0bn. Within that, government spending surprised to the downside. Central government expenditure was £0.5bn lower than the OBR's forecast in May, leaving it £1.6bn lower in April and May combined. That has been largely driven by debt interest payments, which were £1.1bn below the OBR's forecast in May. But if the rises in gilt yields since the Spring Statement in March are sustained, the OBR will revise up its forecast for debt interest payments in the years

ahead. That of itself would knock £1.0bn off the Chancellor's £9.9bn of headroom against her fiscal mandate and the subsequent Government U-turns on benefit and welfare spending and higher borrowing costs may mean to maintain her current £9.9bn buffer, Reeves has to raise upwards of £13bn later this year. And with the gilt market sensitive to significant increases in borrowing, all this means substantial tax rises are looking very likely.

- The weakening in the jobs market is gathering pace. May's 109,000 m/m fall in the PAYE measure of employment was the largest decline (barring the pandemic) since the data began and the seventh in as many months. The monthly change was revised lower in five of the previous seven months too, with April's 33,000 fall revised down to a 55,000 drop. Overall, the payroll measure of employment has now fallen by 276,000 since the announcement of the rise in payroll taxes and the minimum wage in the October Budget. The job vacancies data also portrays a rapidly weakening labour market. The number of job vacancies is now falling a bit faster, dropping from 760,000 in the three months to April to 736,000 in May. Capital Economics' seasonally adjusted measure of single-month vacancies declined sharply from 763,000 in April to 713,000 in May.
- A looser labour market is driving softer wage pressures. The 3myy rate of average earnings growth excluding bonuses fell from 5.5% to 5.2% in May. The rate for the private sector slipped from 5.5% to 5.1%, putting it on track to undershoot the Bank of England's Q2 forecast of 5.2%. And after rising in April as the 6.7% rise in the minimum wage took effect, the timelier PAYE median earnings measure fell back from 6.2% y/y in April to 5.8% in May. Softer wage growth is feeding through to lower services inflation, pointing to a slowdown from 4.7% in May to around 3.0% by the end of the year.
- CPI inflation fell slightly from 3.5% in April to 3.4% in May – close to consensus. The sharp falls in services inflation from 5.4% to 4.7% and in core inflation from 3.8% to 3.5% confirmed that the previous month's jumps partly reflected an Easter-related blip. Services inflation is expected to continue to fall as wage growth slows, supporting a view that CPI inflation will fall close to 2.0% by the start of 2027. An upside risk, however, in the near term is that higher oil/gas and food prices could trigger another bout of second-round effects on wages and inflation expectations, meaning CPI inflation stays above 3.0% for longer and causes the Bank to shift to an even slower rate cutting path. CPI is expected to peak at 3.8% in September.
- The yield on the 10-year gilt moved sideways in the second quarter of 2025. After rising from 4.4% in early April to 4.8% in mid-April following wider global bond market volatility stemming from the "Liberation Day" tariff announcement, gilt yields eased back as trade tensions began to de-escalate. By the end of April, the 10-year gilt yield had returned to 4.4%. In May, concerns about stickier inflation and shifting expectations about the path for interest rates led to another rise, with the 10-year gilt yield fluctuating between 4.6% and 4.75% for most of May. Thereafter, as trade tensions continued to ease and markets increasingly began to price in looser monetary policy, the 10-year yield edged lower, and ended Q2 at 4.50%. We expect this trend to continue over the next year. However, it is more difficult to be confident that the longer part of the curve will also see falls in yields, although that is still our central case, as that part of the curve is increasingly held by transient investors, such as foreign investors and hedge funds. Pension funds and insurance companies have more appetite in the short to medium part of the curve nowadays.
- The FTSE 100 fell sharply following the "Liberation Day" tariff announcement, dropping by more than 10% in the first week of April - from 8,634 on 1st April to 7,702 on 7th April. However, the de-escalation of the trade war coupled with strong corporate earnings led to a rapid rebound starting in late April. As a result, the FTSE 100 closed Q2 at 8,761, around 2% higher than its value at the end of Q1 and more than 7% above its level at the start of 2025.

MPC meetings: 8th May & 19th June 2025

- There were two Monetary Policy Committee (MPC) meetings this quarter. In May, the Committee cut Bank Rate from 4.50% to 4.25%, while in June policy was left unchanged. In June's vote, three MPC members (Dhingra, Ramsden and Taylor) voted for an immediate cut to 4.00%, citing loosening labour market conditions. The other six members were more cautious, as they highlighted the need to monitor for "signs of weak demand", "supply-side constraints" and higher "inflation expectations", mainly from food prices rising. By repeating the well-used phrase "gradual and careful", the MPC continued to suggest that rates will be reduced further.
- At the start of June, amid escalating tensions between Israel and Iran, oil prices surged to over $75 per barrel. However, following a ceasefire agreement near the end of the month, oil prices eased back to levels prior to the conflict. Given the drop back in energy prices and the relatively muted reaction to fears of a ceasefire violation, along with a large drop in the services PMI output prices balance, our central view is that once inflation begins to trend downwards in the final months of 2025, Bank Rate reductions can begin again from November (pause in August as inflation remains close to its peak), falling to a low of 3.5% in May 2026. However, if the conflict in the Middle East were to result in higher energy prices and/or domestic inflationary pressures grow stronger, there is a risk the Bank of England may skip cutting rates further.

2. Interest rate forecasts

The Council has appointed MUFG Corporate Markets as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. The PWLB rate forecasts below are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1st November 2012. For Housing Revenue Account authorities, the lower Housing Revenue Account (HRA) PWLB rate has also been available since 15 June 2023 (standard rate minus 60 bps) but is available for HRA borrowing only.

The latest forecast was provided on 11th August:

MUFG Corporate Markets Interest Rate View 11.08.25													
	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28	Jun-28	Sep-28
BANK RATE	4.00	4.00	3.75	3.75	3.50	3.50	3.50	3.50	3.25	3.25	3.25	3.25	3.25
3 month ave earnings	4.00	4.00	3.80	3.80	3.50	3.50	3.50	3.50	3.30	3.30	3.30	3.30	3.30
6 month ave earnings	4.00	3.90	3.70	3.70	3.50	3.50	3.50	3.50	3.30	3.30	3.40	3.40	3.40
12 month ave earnings	4.00	3.90	3.70	3.70	3.50	3.50	3.50	3.50	3.30	3.40	3.50	3.60	3.60
5 yr PWLB	4.80	4.70	4.50	4.40	4.30	4.30	4.30	4.20	4.20	4.20	4.20	4.10	4.10
10 yr PWLB	5.30	5.20	5.00	4.90	4.80	4.80	4.80	4.70	4.70	4.70	4.70	4.60	4.60
25 yr PWLB	6.10	5.90	5.70	5.70	5.50	5.50	5.50	5.40	5.40	5.30	5.30	5.30	5.20
50 yr PWLB	5.80	5.60	5.40	5.40	5.30	5.30	5.30	5.20	5.20	5.10	5.10	5.00	5.00

- Money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- The MUFG Corporate Markets forecast for average earnings are averages i.e., rates offered by individual banks may differ significantly from these averages, reflecting their different needs for borrowing short-term cash at any one point in time.

The forecast has proved robust over the period since February, setting out a central view that short and long-dated interest rates will start to fall once it is evident that the Bank of England has been successful in squeezing excess inflation out of the economy, despite a backdrop of stubborn inflationary factors. Nonetheless, the longer dated part of the forecast also reflects the increased level of Government borrowing over the term of the current Parliament and the weakness in the public finances, with the Government struggling to deliver on the efficiencies detailed in the 30th of October Budget.

Moreover, there is still on-going debate as to when, and if, the Government's policies will lead to a material uptick in growth given their reliance on the logistics of fast-tracking planning permissions, identifying sufficient skilled labour to undertake a resurgence in building, and an increase in the employee participation rate within the economy.

Overall, our central view is that monetary policy is sufficiently tight at present to cater for some further moderate loosening, the extent of which, however, will continue to be data dependent. We forecast the next reduction in Bank Rate to be made in November and for a pattern to evolve whereby rate cuts are made quarterly and in keeping with the release of the Bank's Quarterly Monetary Policy Reports (February, May, August and

November). Any movement below a 4% Bank Rate will, nonetheless, be very much dependent on inflation data releases in the coming months.

International factors could also impact the prospect for longer dated gilt yield falls. President Trump's "big, beautiful bill" has successfully made its way through the House of Representatives in July and given that it will signal a continued large budget deficit position in the US finances, any uptick in Treasury yields will likely impact other developed economies markets too. There will also be a keen focus on whether US-driven tariff policies result in upward pressures on inflation.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2025/26, which includes the Annual Investment Strategy, was approved by the Council on 18 February 2025. In accordance with the CIPFA Treasury Management Code of Practice, it sets out the Council's investment priorities as being:

- Security of capital
- Liquidity
- Yield

The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity, aligned with the Council's risk appetite. In the current economic climate, over and above keeping investments short-term to cover cash flow needs, there is a benefit to seeking out value available in periods up to 12 months with high credit rated financial institutions, using the MUFG Corporate Markets suggested creditworthiness approach, including a minimum sovereign credit rating and Credit Default Swap (CDS) overlay information.

As shown by the charts below and the interest rate forecasts in section 2, investment rates have started to taper downwards during the first quarter of 2025/26 and are expected to fall back further if inflation falls through 2025 and 2026 and the MPC loosens monetary policy more substantially.

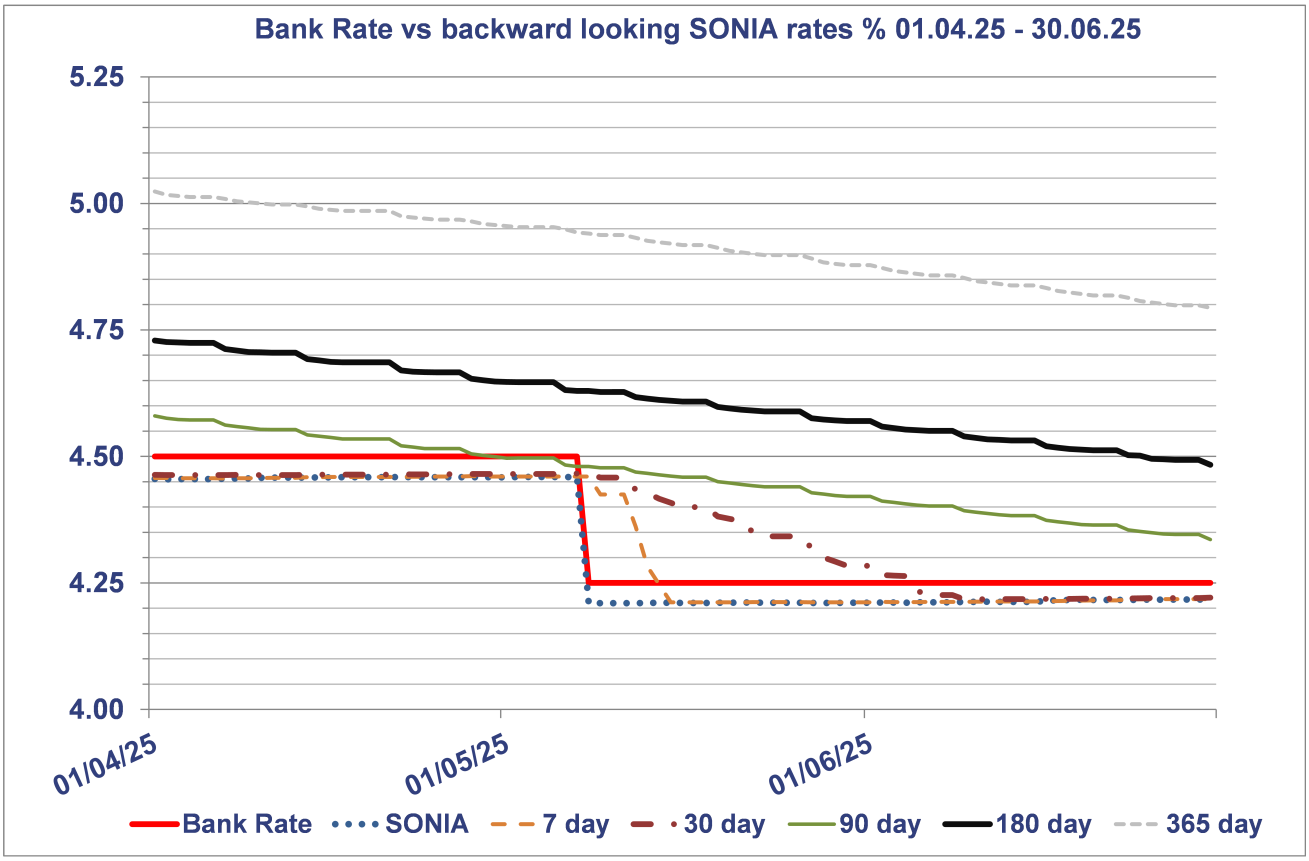
Creditworthiness.
There have been few changes to credit ratings over the quarter under review. However, officers continue to closely monitor these, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

Investment counterparty criteria
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

CDS prices
For UK and international banks, these have remained low, and prices are not misaligned with other creditworthiness indicators, such as credit ratings. Nevertheless, it remains important to undertake continual monitoring of all aspects of risk and return.

Investment balances
The average level of funds available for investment purposes during the quarter was £14.749m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

Investment performance year to date as of end-June 2025



FINANCIAL YEAR TO QUARTER ENDED 30/06/2025							
	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	4.50	4.46	4.46	4.47	4.58	4.73	5.02
High Date	01/04/2025	07/05/2025	28/04/2025	06/05/2025	01/04/2025	01/04/2025	01/04/2025
Low	4.25	4.21	4.21	4.22	4.34	4.48	4.79
Low Date	08/05/2025	08/05/2025	15/05/2025	09/06/2025	30/06/2025	30/06/2025	30/06/2025
Average	4.35	4.31	4.33	4.36	4.46	4.61	4.91
Spread	0.25	0.25	0.25	0.25	0.24	0.25	0.23

The Council’s internally managed investments underperformed the benchmark (30-day backward looking SONIA) shown above by 3 bps.

Fund investments – as at 30 June 2025

Treasury Investments – Managed In House	Principle (£m)	Interest Rate	Maturity Date
Debt Management Account Deposit Facility (DMADF)	*1.700*	*4.220*	*15/07/2025*
Debt Management Account Deposit Facility (DMADF)	*0.900*	*4.210*	*15/07/2025*
Bank of Scotland	*0.400*	*4.220*	*23/07/2025*
Debt Management Account Deposit Facility (DMADF)	*2.700*	*4.215*	*15/08/2025*
Aberdeen Standard Investments Money Market Fund	*4.000*	*4.3027*	*Call*
Blackrock ICS Heritage Shared Money Market Fund	*4.100*	*4.2837*	*Call*
Insight Liquidity Funds PLC	*4.000*	*4.3066*	*Call*
Royal Bank of Scotland	*0.149*	*2.25*	*Call*
Total Investment – In House	***17.949***		

The Strategic Reserve Fund has outperformed the benchmark over the quarter to 30 June 2025, returning a gain 4.2% over the period, against a target of 3.3%.

Treasury Strategic Reserve Fund – Managed Externally	Actual (£m)	Performance Quarter Ending 30/06/25	Benchmark
Equity Portfolio	51.984	5.4%	5.4%
Global Equity Portfolio	57.387	9.5%	5.7%
Diversified Growth Fund	18.705	4.5%	1.8%
High Yield Credit Strategies Fund	25.616	2.2%	2.3%
Private Loan Fund	6.053	1.8%	1.5%
UK Property Fund	24.357	1.3%	1.5%
Secured Income Fund	29.813	n/a	n/a
Corporate Bonds Fund	43.743	2.4%	2.5%
Total Investment – External	**257.7**	**4.2%**	**3.3%**

*No performance figures are provided where full drawdown of the Council's commitment has not been concluded.

Approved limits
Officers can confirm that the approved limits within the Annual Investment Strategy were not breached during the quarter ended 30th June 2025.

4. Borrowing

Due to the overall financial position and the underlying need to borrow for capital purposes (the Capital Financing Requirement - CFR), new external borrowing of £10m was undertaken in April 2025 from the PWLB at a rate of 4.81%.

PWLB maturity Certainty Rates 1st April to 30th June 2025
Heading into the second quarter of 2025/26 markets seem to be comfortable with a central case of gradual monetary policy easing, leading to Bank Rate and gilt yields out to c10 years trending downwards. That part of the curve has broadly acted in line with our forecasts, unchanged since February.

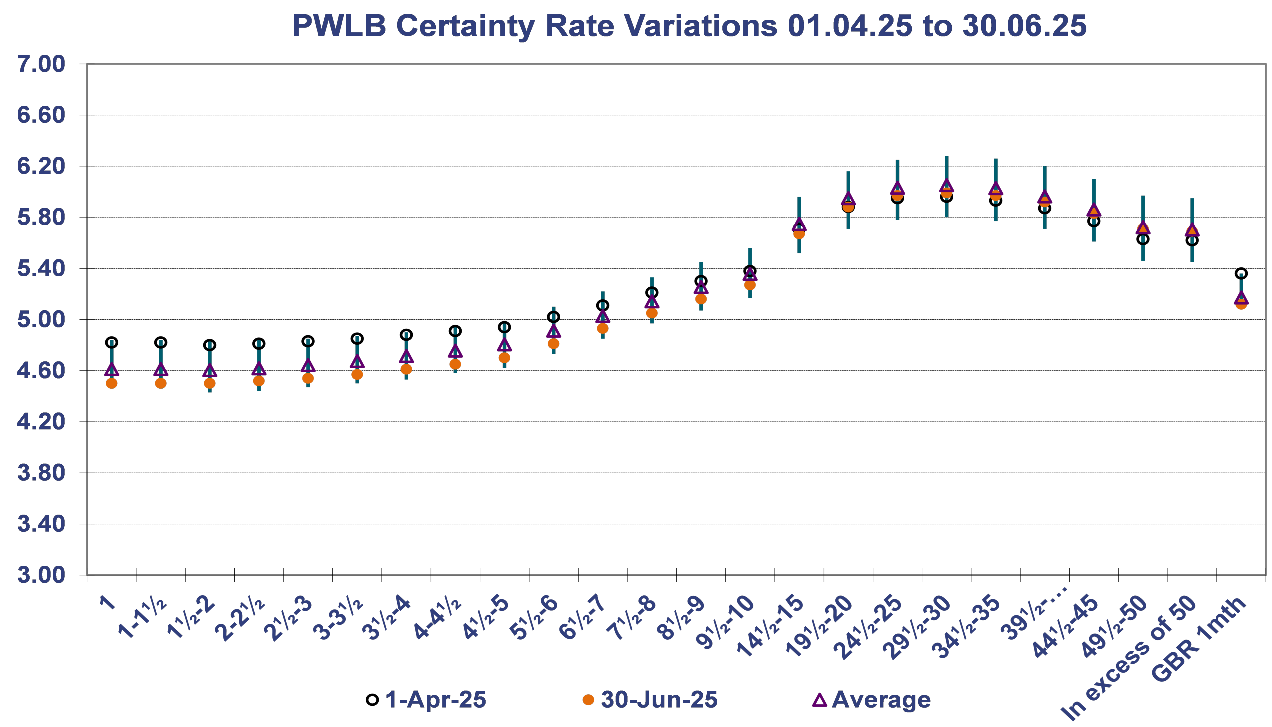
However, the Government's difficulty in convincing the market that it can work within its self-imposed fiscal parameters has meant there has continued to be a somewhat fragile confidence in the medium to longer dated part of the curve. The worst of this sentiment was reflected on 21st May, but as recently as the first week of July has provided a reminder that markets will be quick to sell-off if they feel there is anything to prejudice the Chancellor's stated aim of not raising the headline tax rates nor boost borrowing to greater than has already been reported. The markets have also indicated that they would prefer Chancellor Reeves to stay in post even if the fiscal landscape has deteriorated since the Autumn.

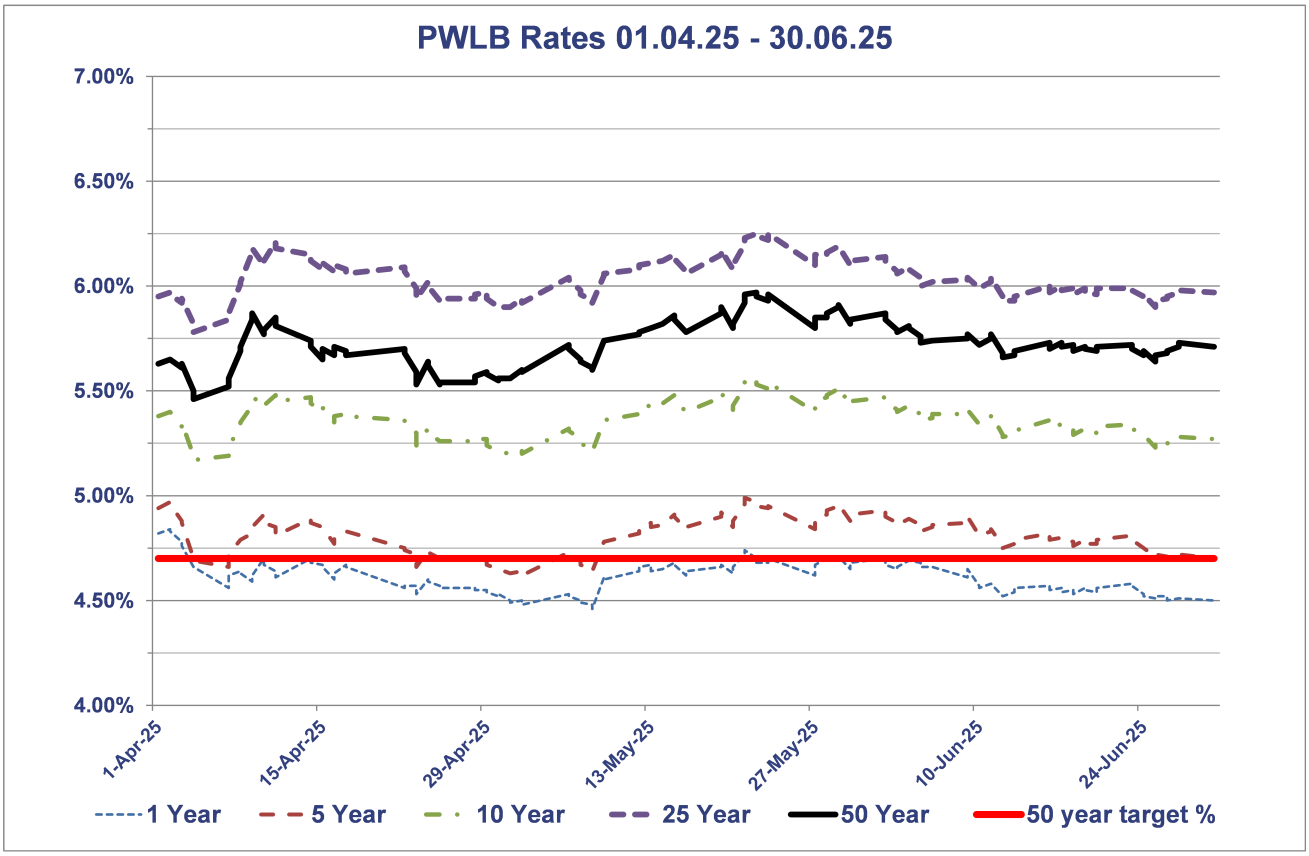
The Bank of England has remained cautious in stating that any Bank Rate cuts must be undertaken gradually, and the inflation outlook remains a little opaque with the CPI measure of inflation not expected to peak until September (possibly 3.8%) before falling back towards 2% by the start of 2027. Annual wage increases also remain at 5% y/y, even though the seasonally adjusted job vacancies number has fallen to 712k. Nonetheless, both the 5-year and, albeit to a lesser extent, 10-year PWLB Certainty Rates have trended lower through the quarter.

Further out, however, rates have either finished close to their starting point for the quarter, if not a little higher. It remains problematic that historic buyers of longer-dated gilts – pension funds and insurance companies – have preferred the shorter-dated maturities of late, whilst there is anecdotal evidence that both foreign investors and hedge funds, who are not natural long-term holders of long-dated debt gilt issuance, as a rule, may be more active in this part of the market currently than has previously been the case. Their presence, arguably, adds even greater volatility to the equation. Consequently, and pulling all these factors together, and it is clear that any signs of public finance weakness could put even greater upward pressure on medium and longer dated gilts and, therein, PWLB rates.

Additionally, US Treasury yields have also remained elevated because markets are unclear as to the relative impact of President Trump's tariffs, deportation and tax-cutting policies. Given the effect US markets have globally, this is another contributing factor to the stubbornness of medium to long-dated gilt yields to fall back.

PWLB RATES 01.04.25 - 30.06.25





HIGH/LOW/AVERAGE PWLB RATES FOR 01.04.25 – 30.06.25

	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2025	4.82%	4.94%	5.38%	5.95%	5.63%
30/06/2025	4.50%	4.70%	5.27%	5.97%	5.71%
Low	4.46%	4.62%	5.17%	5.78%	5.46%
Low date	08/05/2025	02/05/2025	02/05/2025	04/04/2025	04/04/2025
High	**4.84%**	**4.99%**	**5.56%**	**6.25%**	**5.97%**
High date	02/04/2025	21/05/2025	21/05/2025	21/05/2025	22/05/2025
Average	4.61%	4.81%	5.36%	6.03%	5.72%
Spread	0.38%	0.37%	0.39%	0.47%	0.51%

5. Debt rescheduling

Debt rescheduling opportunities have remained a possibility in the current quarter for those authorities with significant surplus cash and a flat or falling Capital Financing Requirement in future years. Members will be advised if there is value to be had by rescheduling or repaying a part of the debt portfolio.

6. Compliance with Treasury and Prudential Limits

The prudential and treasury Indicators are shown in Appendix 1.

It is a statutory duty for the Council to determine and keep under review the affordable capital expenditure limits. During the *quarter ended* 30th June 2025, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2025/26. The Head of Finance reports that no difficulties are envisaged for the current or future years in complying with these indicators.

All treasury management operations have also been conducted in full compliance with the Council's Treasury Management Practices.

7. Other

1. Changes in risk appetite

The 2021 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g., for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy should be brought to members' attention in treasury management update reports.

APPENDIX 1: Prudential and Treasury Indicators for 2025-26 as of 30th June 2025

Treasury Indicators	2025/26 Budget £'000	31.03.25 Actual £'000
Authorised limit for external debt	95,000	95,000
Operational boundary for external debt	85,000	85,000
Gross external debt	65,000	50,000
Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	0% / 30%	10%
12 months to 2 years	0% / 30%	30%
2 years to 5 years	0% / 30%	0%
5 years to 10 years	0% / 30%	0%
10 years to 20 years	0% / 50%	0%
20 years and above	30% / 100%	60%

APPENDIX 2: Investment Portfolio

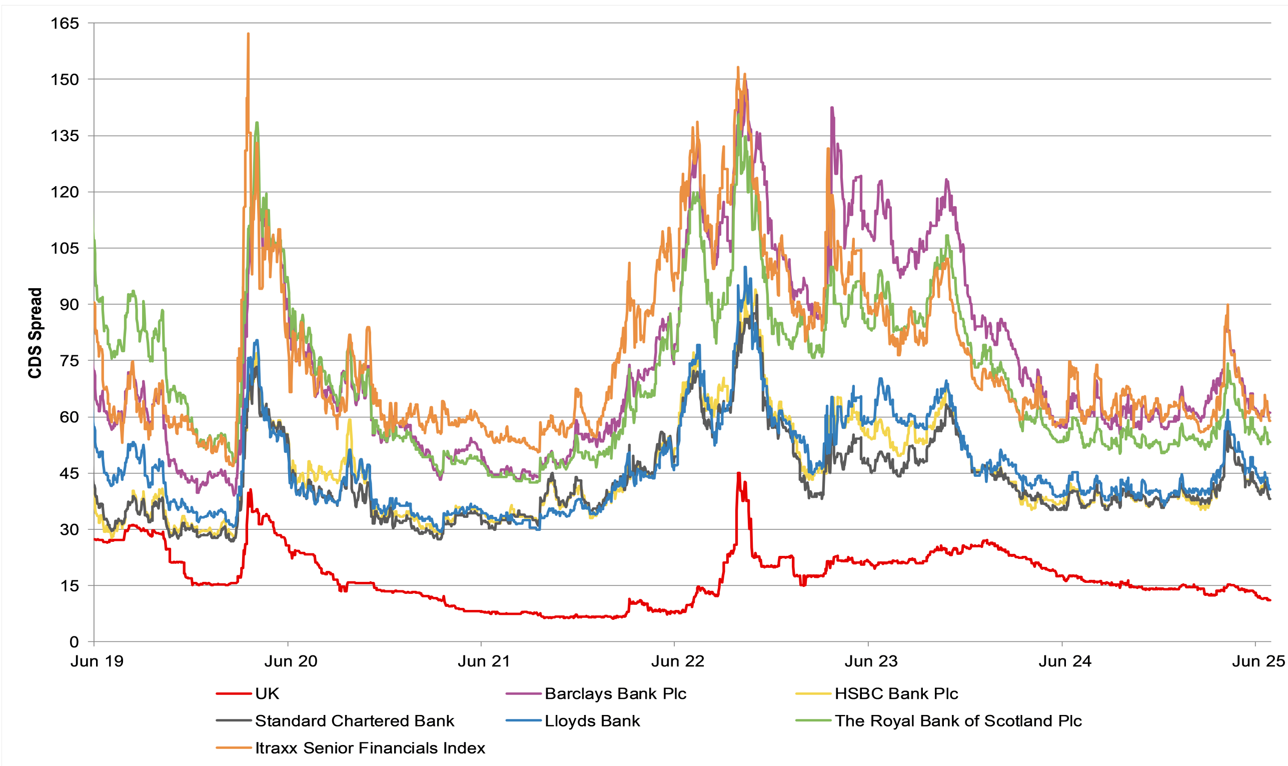
Investments held as of 30th June 2025 compared to our counterparty list:

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest LT / Fund Rating	Historic Risk of Default	Expected Credit Loss (£)
The Royal Bank of Scotland Plc (RFB)	149,096	2.25%		Call	A+	0.000%	0
MMF Aberdeen Standard Investments	4,000,000	4.29%		MMF	AAAm		
MMF BlackRock	4,100,000	4.27%		MMF	AAAm		
MMF Insight	4,000,000	4.29%		MMF	AAAm		
DMO	1,700,000	4.22%	30/05/2025	15/07/2025	AA-	0.001%	0
DMO	900,000	4.21%	25/06/2025	15/07/2025	AA-	0.001%	0
Bank of Scotland Plc (RFB)	400,000	4.22%	23/06/2025	23/07/2025	A+	0.003%	12
DMO	2,700,000	4.22%	04/06/2025	15/08/2025	AA-	0.003%	0
Total Investments	**£17,949,096**	**4.25%**				0.002%	£12

Note: An historic risk of default is only provided if a counterparty has a counterparty credit rating and is not provided for an MMF or USDBF, for which the rating agencies provide a fund rating. The portfolio's historic risk of default therefore measures the historic risk of default attached only to those investments for which a counterparty has a counterparty credit rating and also does not include investments which are not rated.
The Historic Risk of Default column is based on the lowest long term rating. If clients are using this % for their Expected Credit Loss calculation under IFRS 9, please be aware that the Code does not recognise a loss allowance where the counterparty is central government or a local authority since relevant statutory provisions prevent default. For these instruments, the Expected Credit Loss will be nil. Please note that we are currently using Historic Default Rates from 1990-2024 for Fitch, 1983-2024 for Moody's and 1981-2024 for S&P.
Where MUFG Corporate Markets have provided a return for a property fund, that return covers the 12 months to March 2025, which are the latest returns currently available.

UK Banks 5 Year Senior Debt CDS Spreads as of 30th June 2025

The chart below shows the cost in basis points of ensuring against the prospect of default on 5 year "paper" issued by major UK banks v the ITRAXX Senior Financials Index.



APPENDIX 3: Approved countries for investments as of 30th June 2025

Based on lowest available rating:

AAA

- Australia
- Denmark
- Germany
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- Qatar

AA-

- France
- **U.K.**

A+

- Belgium *(Please note that Belgium had its Fitch sovereign rating lowered to A+ from AA- on 13th June. However, it is still rated Aa3 {AA- equivalent} by Moody's and AA by Standard & Poor's, thus meets the minimum "AA-" criteria applied by the Council {change as appropriate}).*

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Appendix 2

Orkney Islands Council

Monthly Investment Analysis Review

June 2025

Monthly Economic Summary

General Economy

The S&P Global UK Manufacturing PMI rose to 47.7 in June 2025 from 46.4 in May, surpassing market expectations of 46.6 and, indicating the lowest pace of contraction in five months. Despite the improvement, the sector continued to face headwinds, with another decline in export orders. Largely driven by the impact of US tariffs, heightened geopolitical uncertainty, and strong global price competition. On the cost side, input prices continued to rise sharply, though the pace of increase eased and business sentiment remained among the weakest in over two and a half years. Meanwhile, the UK Services PMI rose to 51.3 in June 2025, from 50.9 in May and in line with forecasts, according to flash estimates. The latest data indicated another expansion in the country's dominant sector that was the strongest in three months. There was a rebound in new business intakes, but the rise was only slight, while exports continued to fall. Consequently, the S&P Global UK Composite PMI rose to 50.7 in June of 2025 from 50.3 in the previous month, slightly above market expectations of 50.5 to mark the second consecutive period of expansion in British private sector activity, according to the flash estimate.

The British economy contracted by 0.3% mom in April 2025, marking the first decline in six months and the sharpest drop since October 2023. This follows a 0.2% expansion in March and exceeded expectations of a 0.1% decline. Several factors contributed to the downturn in April, including higher energy bills and regulated service costs, the implementation of increased employers' National Insurance contributions, a rise in Stamp Duty Land Tax rates. On a broader basis the announcement of US import tariffs also weighed, having previously seen companies expand operations to front-run their imposition earlier in the year. Elsewhere, the UK's trade deficit widened sharply to £7.03 billion in April 2025 from £3.70 billion in March, marking the largest trade gap since June 2022, as exports fell while imports rose. Again, this reflected the reversal of activity by UK exporters when the tariffs were first mooted in early 2025.

The UK recorded an 89k rise in employment in the three months to April, following a 112k rise in the previous period. This marked the smallest employment gain so far this year, attributed to moderating wage growth following significant increases in payroll taxes and a 6.7% hike in the national minimum wage. Meanwhile, average weekly earnings (including bonuses) rose 5.3% y/y to £720 per week in the three months to April 2025, the least in seven months, compared with 5.6% in the previous period and forecasts of 5.5%.

The Bank of England voted 6-3 to keep the Bank Rate steady at 4.25% at its June meeting, navigating a challenging backdrop of heightened global uncertainty and persistent inflationary pressure. Three members favoured a 0.25 percentage point cut to 4%, while investors had expected a 7-2 split. The central bank noted that consumer price inflation is likely to remain broadly at current rates for the rest of the year before easing back toward the target next year.

The Consumer Price Index in the United Kingdom increased 0.2% m/m in May 2025, following a 1.2% rise in the previous month and matching market forecasts. The headline annual rate edged down to 3.4% in May, from 3.5% previously, also matching expectations. The largest downward contribution came from transport prices (0.7% vs 3.3%), reflecting falls in air fares (-5%) largely due to the timing of Easter and the associated school holidays, as well as falling motor fuel prices.

In the retail sector, overall sales dropped by 2.7% month-over-month in May 2025, a sharper decline than the expected 0.5% fall, following an upwardly revised 1.3% increase in April. This was the steepest monthly drop since December 2023, driven largely by a 5% fall in food store sales—the biggest decline since May 2021—due to reduced supermarket sales. Meanwhile, the GfK Consumer Confidence Index for the United Kingdom increased by 2 points to -18 in June 2025, marking its second consecutive monthly gain after readings of -23 in April and -20 in May. Elsewhere, public sector net borrowing (excluding public sector banks) in the UK rose to £17.7 billion in May 2025, slightly above £17.0 billion a year earlier and exceeding market expectations of £17.1 billion. Total public sector spending increased by £6.4 billion from a year ago, driven by higher spending on public services and benefits, partially offset by a £0.7 billion reduction in debt interest.

US Economy
The US economy added 139K in May 2025, a small slowdown from April's downwardly revised 147K, but slightly above forecasts of 130K. Meanwhile, the US economy contracted at an annualised rate of 0.5% in Q1 2025, a sharper decline than the second estimate of a 0.2% drop and the first quarterly contraction in three years. The weaker GDP figure was largely driven by significant downward revisions to consumer spending and exports.
Finally, the annual inflation rate in the US rose for the first time in four months to 2.4% in May 2025 from April's 2.3%, the lowest since 2021, but came in below expectations of 2.5%.

EU Economy
The annual inflation rate in the Eurozone confirmed at 1.9% year-on-year in May 2025, down from 2.2% in April and dipping below the European Central Bank's 2.0% target for the first time since September 2024. Meanwhile, the core inflation rate, which excludes volatile food and energy prices, fell to 2.3% in May 2025 from 2.7% in the previous month, aligned with preliminary estimates and below the initial market expectations of 2.5%. The Eurozone economy expanded 1.5% year-on-year in the first quarter of 2025, higher than 1.2% in the previous estimates, and the strongest annual performance since Q4 2022. It follows a 1.2% rise in Q4 2024. Gross fixed capital formation rebounded (1.9% vs -1.8%) and both exports (2.3% vs 1.2%) and imports (3.3% vs 1.3%) rose faster. In contrast, a small slowdown was seen for household (1.3% vs 1.6%) and government (2.1% vs 2.4%) spending. Among the bloc's largest economies, the German GDP stalled, but expansions were recorded in France (0.6%), Italy (0.7%), Spain (2.8%), and Netherlands (2%).

Housing
The Halifax House Price Index in the UK increased 2.5% y/y in May 2025, the smallest gain in ten months, easing from a 3.2% rise in April. The Nationwide House Price Index rose by 3.5% y/y in May 2025, following a 3.4% increase in April and above market expectations of a 2.9% rise.

Currency
Sterling appreciated against the Dollar, but depreciated against the Euro.

June	Start	End	High	Low
GBP/USD	$1.3554	$1.3704	$1.3734	$1.3427
GBP/EUR	€1.1852	€1.1674	€1.1877	€1.1674

Interest Rate Forecasts
MUFG Corporate Markets and Capital Economics maintained their current forecasts.

Bank Rate	Now	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28
MUFG Corporate Markets	**4.25%**	4.25%	4.00%	3.75%	3.75%	3.75%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
Capital Economics	**4.25%**	4.00%	3.75%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%	-

Orkney Islands Council

Current Investment List

Borrower	Principal (£)	Interest Rate	Start Date	Maturity Date	Lowest LT / Fund Rating	Historic Risk of Default	Expected Credit Loss (£)
The Royal Bank of Scotland Plc (RFB)	149,096	2.25%		Call	A+	0.000%	0
MMF Aberdeen Standard Investments	4,000,000	4.29%		MMF	AAAm		
MMF BlackRock	4,100,000	4.27%		MMF	AAAm		
MMF Insight	4,000,000	4.29%		MMF	AAAm		
DMO	1,700,000	4.22%	30/05/2025	15/07/2025	AA-	0.001%	0
DMO	900,000	4.21%	25/06/2025	15/07/2025	AA-	0.001%	0
Bank of Scotland Plc (RFB)	400,000	4.22%	23/06/2025	23/07/2025	A+	0.003%	12
DMO	2,700,000	4.22%	04/06/2025	15/08/2025	AA-	0.003%	0
Total Investments	**£17,949,096**	**4.25%**				0.002%	£12

Note: An historic risk of default is only provided if a counterparty has a counterparty credit rating and is not provided for an MMF or USDBF, for which the rating agencies provide a fund rating. The portfolio's historic risk of default therefore measures the historic risk of default attached only to those investments for which a counterparty has a counterparty credit rating and also does not include investments which are not rated.
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Where MUFG Corporate Markets have provided a return for a property fund, that return covers the 12 months to March 2025, which are the latest returns currently available.

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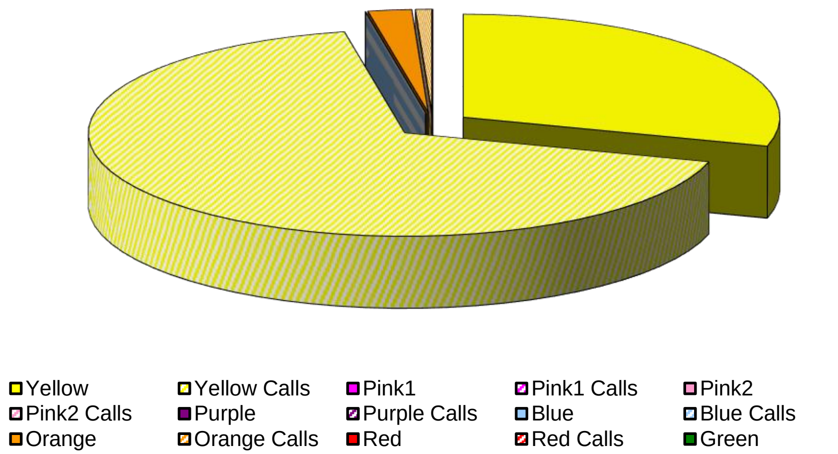
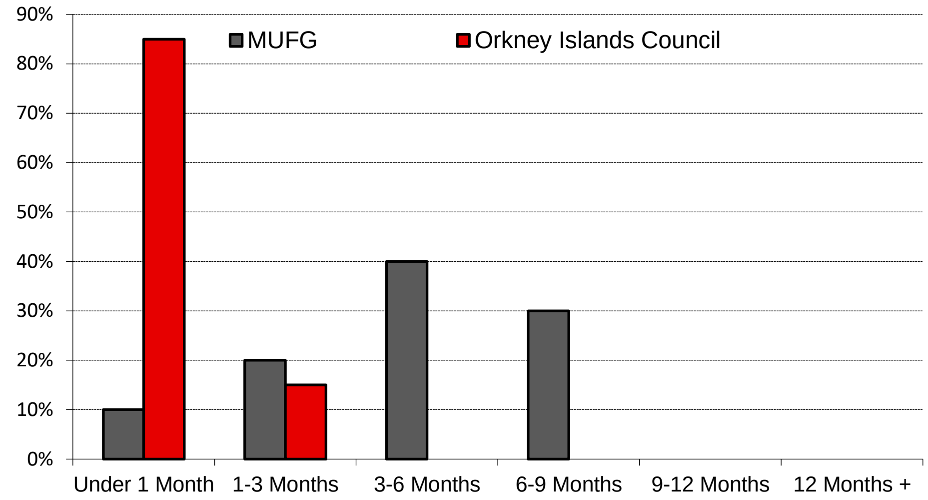
Portfolio Composition by MUFG's Suggested Lending Criteria



Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour



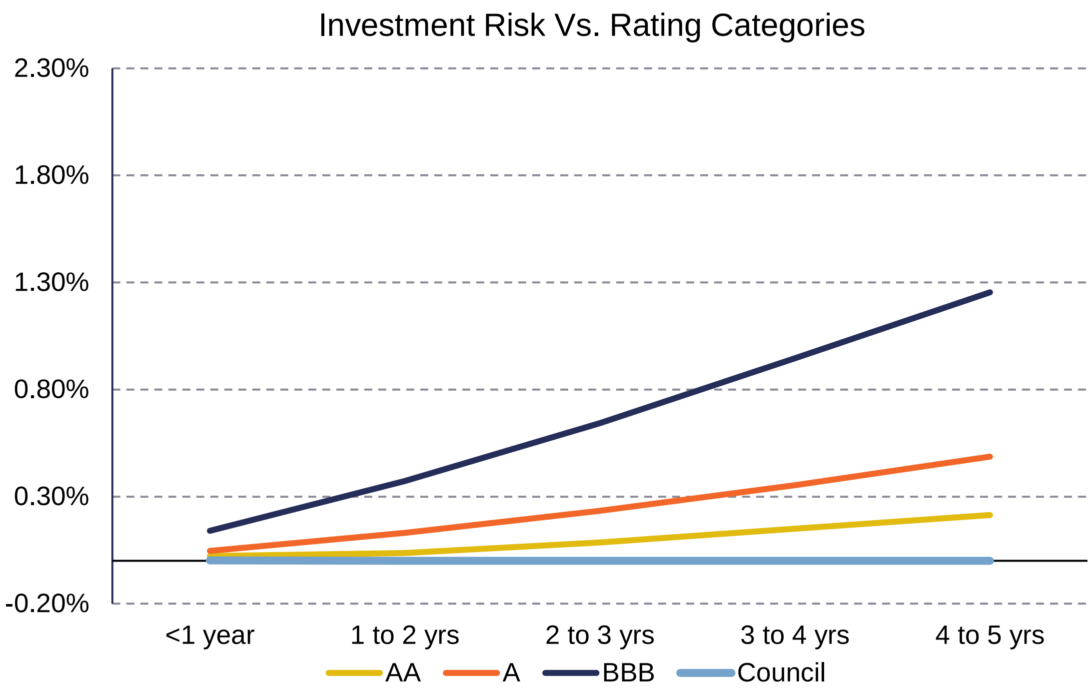
Portfolios weighted average risk number = 1.09

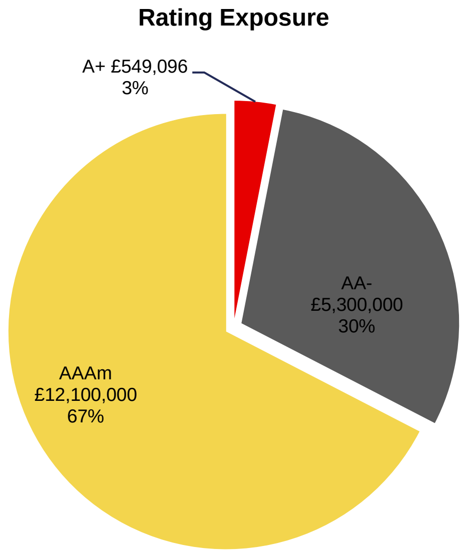
WARoR = Weighted Average Rate of Return
WAM = Weighted Average Time to Maturity

	% of Portfolio	Amount	% of Colour in Calls	Amount of Colour in Calls	% of Call in Portfolio	WARoR	WAM	WAM at Execution	Excluding Calls/MMFs/USDBFs WAM	WAM at Execution
Yellow	96.94%	£17,400,000	69.54%	£12,100,000	67.41%	4.26%	9	17	31	55
Pink1	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Pink2	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Purple	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Blue	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Orange	3.06%	£549,096	27.15%	£149,096	0.83%	3.69%	17	22	23	30
Red	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Green	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
No Colour	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
	100.00%	**£17,949,096**	**68.24%**	**£12,249,096**	**68.24%**	**4.25%**	**10**	**17**	**30**	**53**

Orkney Islands Council

Investment Risk and Rating Exposure





Historic Risk of Default

Rating/Years	<1 year	1 to 2 yrs	2 to 3 yrs	3 to 4 yrs	4 to 5 yrs
AA	0.02%	0.04%	0.09%	0.15%	0.21%
A	0.05%	0.13%	0.23%	0.35%	0.49%
BBB	0.14%	0.37%	0.64%	0.95%	1.25%
Council	0.00%	0.00%	0.00%	0.00%	0.00%

Historic Risk of Default
This is a proxy for the average % risk for each investment based on over 30 years of data provided by Fitch, Moody's and S&P. It simply provides a calculation of the possibility of average default against the historical default rates, adjusted for the time period within each year according to the maturity of the investment.

Chart Relative Risk
This is the authority's risk weightings compared to the average % risk of default for “AA”, “A” and “BBB” rated investments.

Rating Exposures
This pie chart provides a clear view of your investment exposures to particular ratings.

Note: An historic risk of default is only provided if a counterparty has a counterparty credit rating and is not provided for an MMF or USDBF, for which the rating agencies provide a fund rating. The portfolio’s historic risk of default therefore measures the historic risk of default attached only to those investments for which a counterparty has a counterparty credit rating and also does not include investments which are not rated.

Orkney Islands Council

Monthly Credit Rating Changes
FITCH

Date	Update Number	Institution	Country	Rating Action
03/06/2025	2080	Deutsche Bank AG	Germany	The Short Term Rating was upgraded to F1 from F2.
12/06/2025	2081	Clydesdale Bank PLC	United Kingdom	The Stable Outlook on the Long Term Rating was removed and the Long Term Rating was placed on Positive Watch.
16/06/2025	2082	Belgium (Sovereign)	Belgium	The Sovereign Rating was downgraded to A+ from AA-.
27/06/2025	2084	National Westminster Bank PLC	United Kingdom	The Long Term Rating was upgraded to AA- from A+ and the Short Term Rating was upgraded to F1+ from F1. The Outlook on the Long Term Rating also was changed to Stable from Positive.
27/06/2025	2084	Natwest Markets Plc	United Kingdom	The Long Term Rating was upgraded to AA- from A+ and the Short Term Rating was upgraded to F1+ from F1. The Outlook on the Long Term Rating also was changed to Stable from Positive.
27/06/2025	2084	The Royal Bank of Scotland Plc	United Kingdom	The Long Term Rating was upgraded to AA- from A+ and the Short Term Rating was upgraded to F1+ from F1. The Outlook on the Long Term Rating also was changed to Stable from Positive.
30/06/2025	2085	Clydesdale Bank PLC	United Kingdom	The Long Term Rating was upgraded to A from A-. The Positive Watch on the Long Term Rating was removed and the Long Term Rating was placed on Stable Outlook.

Orkney Islands Council

Monthly Credit Rating Changes
S&P

Date	Update Number	Institution	Country	Rating Action
				No changes to report.

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Monthly Credit Rating Changes
MOODY'S

Date	Update Number	Institution	Country	Rating Action
18/06/2025	2083	Principality Building Society	United Kingdom	The Outlook on the Long Term Rating was changed to Positive from Stable.

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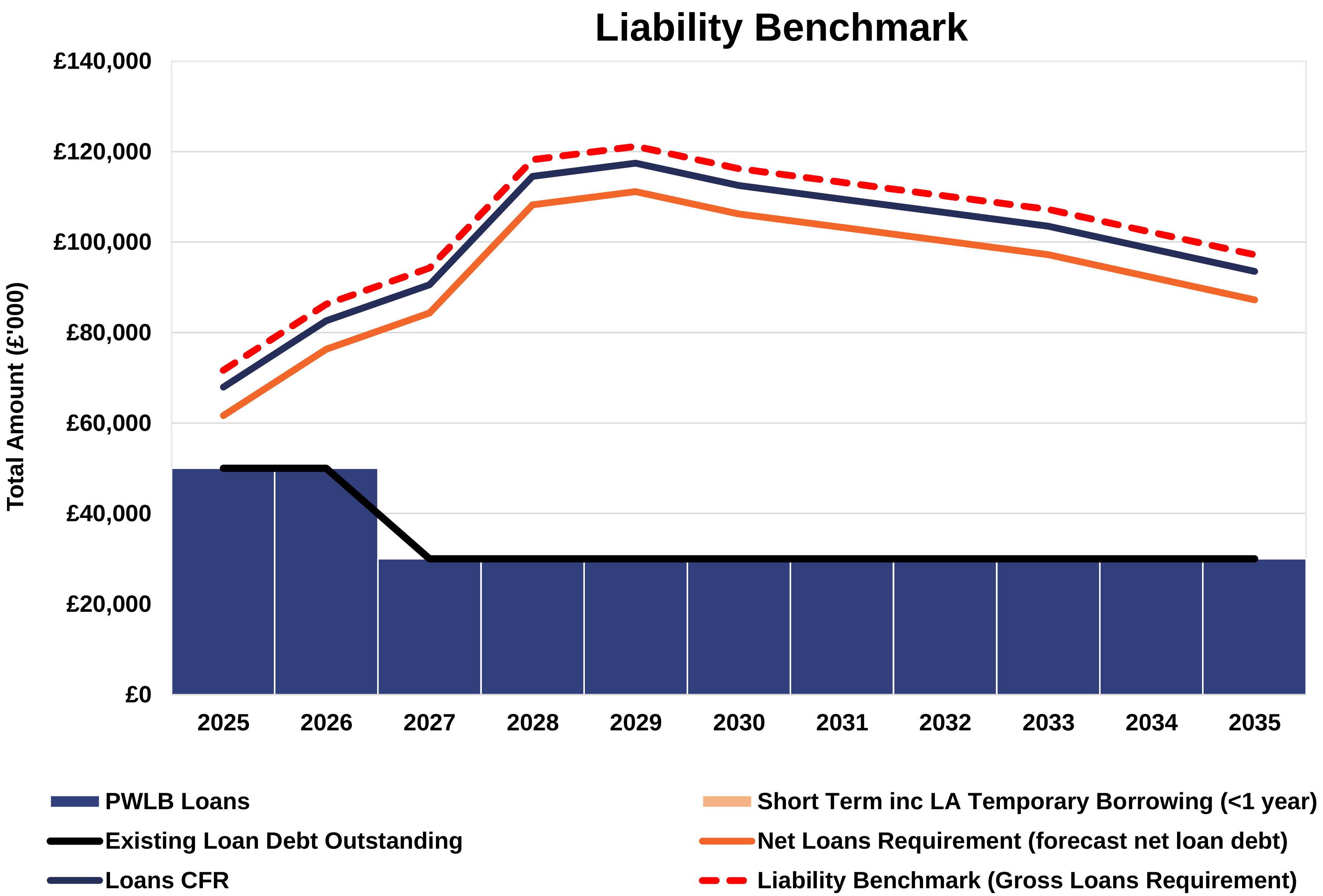
Liability Benchmark
£140,000
£120,000
£100,000
£80,000
£60,000
£40,000
£20,000
£0
Total Amount (£'000)
2025
2026
2027
2028
2029
2030
2031
2032
2033
2034
2035
PWLB Loans
Short Term inc LA Temporary Borrowing (<1 year)
Existing Loan Debt Outstanding
Net Loans Requirement (forecast net loan debt)
Loans CFR
Liability Benchmark (Gross Loans Requirement)