Item: 4

Investments Sub-committee: 26 February 2025

Treasury Management – Monitoring

Report by Head of Finance

ORKNEY ISLANDS COUNCIL

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 (CIPFA) Code of Practice for Treasury Management in the Public Services (the Code).

1.2. The Code defines treasury management to include 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 for financial year 2024/25, as at 31 December 2024, 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 scrutinise:

i. 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, in order to obtain assurance that the Treasury Management Practices are operating effectively:

- An economic update for the quarter ended 31 December 2024.
- Interest rate forecasts.
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy.
- A review of prudential and treasury indicators for 2024/25, as at 31 December 2024.

ii. The status of the temporary loans portfolio as at 31 December 2024, as detailed in section 3 of this report, in order to obtain assurance that the Treasury Management Practices are operating effectively and the portfolio is producing an acceptable rate of return.

3. Treasury Management Performance

3.1. As at 31 December 2024, the Council's debt portfolio stood at £55,000,000, with loan maturities ranging from 2 months to 45 years. Overall, this represents an average cost of borrowing of 6.98% per annum, with an average weighted duration of 27.8 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 31 December 2024 totalled £22,670,557.32. 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 31 December 2024, the temporary loans returned an average interest rate of 5.06%, which equates to a return of £623,399.13.

3.5. By comparison, the equivalent 30-day backward looking Sterling Overnight Index Average rate of 4.71% is considered to be the target.

3.6. With inflation quoted at 2.5% for December 2024 based on Consumer Price Index (3.9% Retail Price Index), the return on temporary loans equates to a relative gain in value of 2.56% 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:** The Council has previously agreed 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.
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 20 February 2024 - Treasury Management Strategy Statement 2024/25.

Appendices

Appendix 1 – Treasury Management Update – Quarterly Report 2024/25.
Appendix 2 – Link Asset Services Monthly Investment Analysis Review for December 2024.
Appendix 3 – Liability Benchmark Chart.

Treasury Management Update

Quarterly report

31st December 2024

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Treasury Management Update
Quarter Ended 31st December 2024

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 third quarter of 2024/25 (October to December) saw:
  - GDP growth contracting by 0.1% m/m in October following no growth in the quarter ending September;
  - The 3myy rate of average earnings growth increase from 4.4% in September to 5.2% in October;
  - CPI inflation increase to 2.6% in November;
  - Core CPI inflation increase from 3.3% in October to 3.5% in November;
  - The Bank of England cut interest rates from 5.0% to 4.75% in November and hold them steady in December.
  - 10-year gilt yields starting October at 3.94% before finishing up at 4.57% at the end of December (peaking at 4.64%).
- The 0.1% m/m fall in GDP in October was the second such decline in a row and meant that GDP would need to rise by 0.1% m/m or more in November and December, for the economy to grow in Q4 as a whole rather than contract. With on-going concern over the impact of the October budget and drags from higher interest rates and weak activity in the euro zone, our colleagues at Capital Economics have revised down their forecast for GDP growth in 2025 to 1.3% (it was initially 1.8% in the immediate wake of the Budget.)
- This quarter saw the composite activity Purchasing Manager Index (PMI) dip below the level of 50 that separates expansion from contraction for the first time since October 2023. Although December's composite PMI came in above this level, at 50.5, this was still consistent with the 0% rise in real GDP in Q3 being followed by a flat-lining, or potential contraction, in the final quarter of 2024. However, the economy is unlikely to be quite as weak as that given that the PMIs do not capture rises in government spending, but the data does underline the continued divergence in trends between the manufacturing and services sectors. The manufacturing PMI fell for its fourth consecutive month in December, from 48.0 in November to 47.3. That's consistent with manufacturing output falling by 1.5% q/q in the final quarter of 2024 after flatlining through the summer months. This weakness in the manufacturing sector was offset by a rebound in the services sector. The services PMI rose from 50.8 in November to 51.4 in December, which is consistent with non-retail services output growth increasing from +0.1% q/q to +0.3% for October - December. This suggests that more of the recent slowdown in GDP is being driven by the weakness in activity overseas rather than just domestic factors. Additionally, the services output prices balance rose for the third consecutive month, from 55.4 in November to 56.9, showing signs that price pressures are reaccelerating.
- After rising by 1.4% q/q in July - September, the retail sector had a difficult final quarter of the year. Indeed, the bigger-than-expected 0.7% m/m fall in retail sales in October (consensus forecast -0.3% m/m) suggested that households' concerns about expected tax rises announced in the Budget on 30th October contributed to weaker retail spending at the start of the quarter. The monthly decline in retail sales volumes in October was reasonably broad based, with sales in five of the seven main sub sectors slipping. However, the potential for seasonally adjusted sales to rise in November - if October's figures were impacted by the timing of the school half term – combined with a rebound in consumer confidence and rising real incomes, points to some promise to the final quarter of 2024
- The Government's October budget outlined plans for a significant £41.5bn (1.2% of GDP) increase in taxes by 2029/30, with £25bn derived from a 1.2% rise in employers' national insurance contributions. The taxes are more than offset by a £47bn (1.4% of GDP) rise in current (day-to-day) spending by 2029/30 and a £24.6bn (0.7% of GDP) rise in public investment, with the latter being more than funded by a £32.5bn (1.0% of GDP) rise in public borrowing. The result is that the Budget loosens fiscal policy relative to the previous government's plans - although fiscal policy is still being tightened over the next five years – and that GDP growth is somewhat stronger over the coming years than had previously been forecasted. By way of comparison, the Bank of England forecasts four-quarter GDP growth to pick up to almost 1¾% through 2025 (previously forecast to be 0.9%) before falling back to just over 1% in 2026.

- December's pay data showed a rebound in wage growth that will likely add to the Bank of England's inflationary concerns. The 3myy rate of average earnings growth increased from 4.4% in September (revised up from 4.3%) to 5.2% in October (consensus forecast 4.6%) and was mainly due to a rebound in private sector pay growth from 4.6% to 5.4%. Excluding bonuses, public sector pay stagnated in October and the 3myy rate fell from 4.7% to 4.3%.
- The number of job vacancies also fell again from 828,000 in the three months to October to 818,000 in the three months to November. This marks the first time it has dropped below its pre-pandemic February 2020 level of 819,000 since May 2021. Despite this, the Bank of England remains concerned about the inflationary influence of high wage settlements as well as the risk of a major slowdown in labour market activity.
- CPI inflation has been on the rise this quarter, with the annual growth rate increasing from 1.7% in September to 2.3% in October, before rising further to 2.6% in November. Although services CPI inflation stayed at 5.0% in November, the Bank had expected a dip to 4.9%, while the timelier three-month annualised rate of services CPI rose from 5.0% to 5.1%. That shows that there currently isn't much downward momentum. Moreover, the wider measure of core CPI inflation rose from 3.3% to 3.5% in November. Both services and core inflation are currently at rates well above those consistent with the 2.0% target and are moving in the wrong direction. Capital Economics forecast that after dipping to 2.5% in December, CPI inflation will rise further in January, perhaps to 2.8%. Although CPI inflation is expected to be back at close to the 2.0% target by the end of 2025, given that a lot of the rise in inflation in the coming months will be due to base effects that won't persist, the potential for a broader set of tariffs to arise from the US as well as the constant threat of geo-political factors to impact energy and food prices suggest risks remain very much to the upside.
- Throughout the quarter gilt yields have risen. The 10-year gilt yield increased from 3.94% at the start of October to 4.57% by the year end (and has subsequently risen to 4.64% early in 2025). As recently as mid-September 10-year gilt yields were at their low for the financial year, but since then, and specifically after the Budget at the end of October, yields have soared. Overall, the reaction to the UK Budget highlights how bond markets are both fragile and highly attentive to news about the fiscal outlook.
- The FTSE 100 started off this quarter at 8,276, before finishing up at 8,121. In particular, UK markets have continued to fall further behind US equities, a trend which has accelerated since Trump's election victory in November, partly due to the UK stock market being less exposed to AI hype, and it being weighed down by its relatively large exposure to the energy and materials sectors.

MPC meetings: 7th November & 18th December 2024

- On 7 November, Bank Rate was cut by 0.25% to 4.75%. The vote was 8-1 in favour of the cut, but the language used by the MPC emphasised "gradual" reductions would be the way ahead with an emphasis on the inflation and employment data releases, as well as geo-political events.
- At the 18 December meeting, another split vote arose. Members voted 6-3 to keep Bank Rate on hold at 4.75%, but dissenters (Dhingra, Ramsden and Taylor) were keen for rates to be cut further as concerns over the slowing down of the UK economy took root, despite near-term inflation fears remaining.
- The MPC again stated that "a gradual approach" to rate cuts "remains appropriate" and that policy will "remain restrictive for sufficiently long".

2. Interest rate forecasts

The Council has appointed Link Group 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, updated on 11th November, sets out a view that both 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 and a tight labour market.

Following the 30th October Budget, the outcome of the US Presidential election on 6th November, and the 25bps Bank Rate cut undertaken by the Monetary Policy Committee (MPC) on 7th November, we significantly revised our central forecasts for the first time since May. In summary, our Bank Rate forecast is now 50bps – 75bps higher than was previously the case, whilst our PWLB forecasts have been materially lifted to not only reflect our increased concerns around the future path of inflation, but also the increased level of Government borrowing over the term of the current Parliament.

If we reflect on the 30th October Budget, our central case is that those policy announcements will be inflationary, at least in the near-term. The Office for Budgetary Responsibility and the Bank of England concur with that view. The latter have the CPI measure of inflation hitting 2.5% y/y by the end of 2024 and staying sticky until at least 2026. The Bank forecasts CPI to be 2.7% y/y (Q4 2025) and 2.2% (Q4 2026) before dropping back in 2027 to 1.8% y/y.

The anticipated major investment in the public sector, according to the Bank, is expected to lift UK real GDP to 1.7% in 2025 before growth moderates in 2026 and 2027. The debate around whether the Government's policies lead to a material uptick in growth primarily focus 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.

There are inherent risks to all the above. The worst-case scenario would see systemic blockages of planning permissions and the inability to identify and resource the additional workforce required to deliver large-scale IT, housing and infrastructure projects. This would lead to upside risks to inflation, an increased prospect of further Government borrowing & tax rises, and a tepid GDP performance.

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 February 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 in the second half of 2025.

Regarding our PWLB forecast, the short to medium part of the curve is forecast to remain elevated over the course of 2025, and the degree to which rates moderate will be tied to the arguments for further Bank Rate loosening or otherwise. The longer part of the curve will also be impacted by inflation factors, but there is also the additional concern that with other major developed economies such as the US and France looking to run large budget deficits there could be a glut of government debt issuance that investors will only agree to digest if the interest rates paid provide sufficient reward for that scenario.

Moreover, Donald Trump's victory in the US President election paves the way for the introduction/extension of tariffs that could prove inflationary whilst the same could be said of any further tax cuts and an expansion of the current US budget deficit.

Invariably the direction of US Treasury yields in reaction to his core policies will, in all probability, impact UK gilt yields. So, there are domestic and international factors that could impact PWLB rates whilst, as a general comment, geo-political risks abound.

In summary, regarding PWLB rates, movement in the short-end of the curve is expected to reflect Link's Bank Rate expectations to a large degree, whilst medium to longer-dated PWLB rates will remain influenced not only by the outlook for inflation, domestically and globally, but also by the market's appetite for significant gilt issuance (£200bn+ for each of the next few years). As noted at the Link November Strategic Issues webinars, there is upside risk to that part of our forecast despite the Debt Management Office skewing its issuance to the shorter part of the curve.

Link Group Interest Rate View	11.11.24												
	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27
BANK RATE	4.75	4.50	4.25	4.00	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50
3 month ave earnings	4.70	4.50	4.30	4.00	4.00	4.00	3.80	3.80	3.80	3.50	3.50	3.50	3.50
6 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
12 month ave earnings	4.70	4.40	4.20	3.90	3.90	3.90	3.80	3.80	3.80	3.50	3.50	3.50	3.50
5 yr PWLB	5.00	4.90	4.80	4.60	4.50	4.50	4.40	4.30	4.20	4.10	4.00	4.00	3.90
10 yr PWLB	5.30	5.10	5.00	4.80	4.80	4.70	4.50	4.50	4.40	4.30	4.20	4.20	4.10
25 yr PWLB	5.60	5.50	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.50
50 yr PWLB	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.60	4.50	4.40	4.30	4.30

- Money market yield forecasts are based on expected average earnings by local authorities for 3 to 12 months.
- The Link 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.

3. Annual Investment Strategy

The Treasury Management Strategy Statement (TMSS) for 2024/25, which includes the Annual Investment Strategy, was approved by the Council on 20 February 2024. 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 Link 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 remained relatively elevated during the third quarter of 2024/25 but are expected to fall back in due course if inflation falls through 2025 and the MPC loosens monetary policy more substantially.

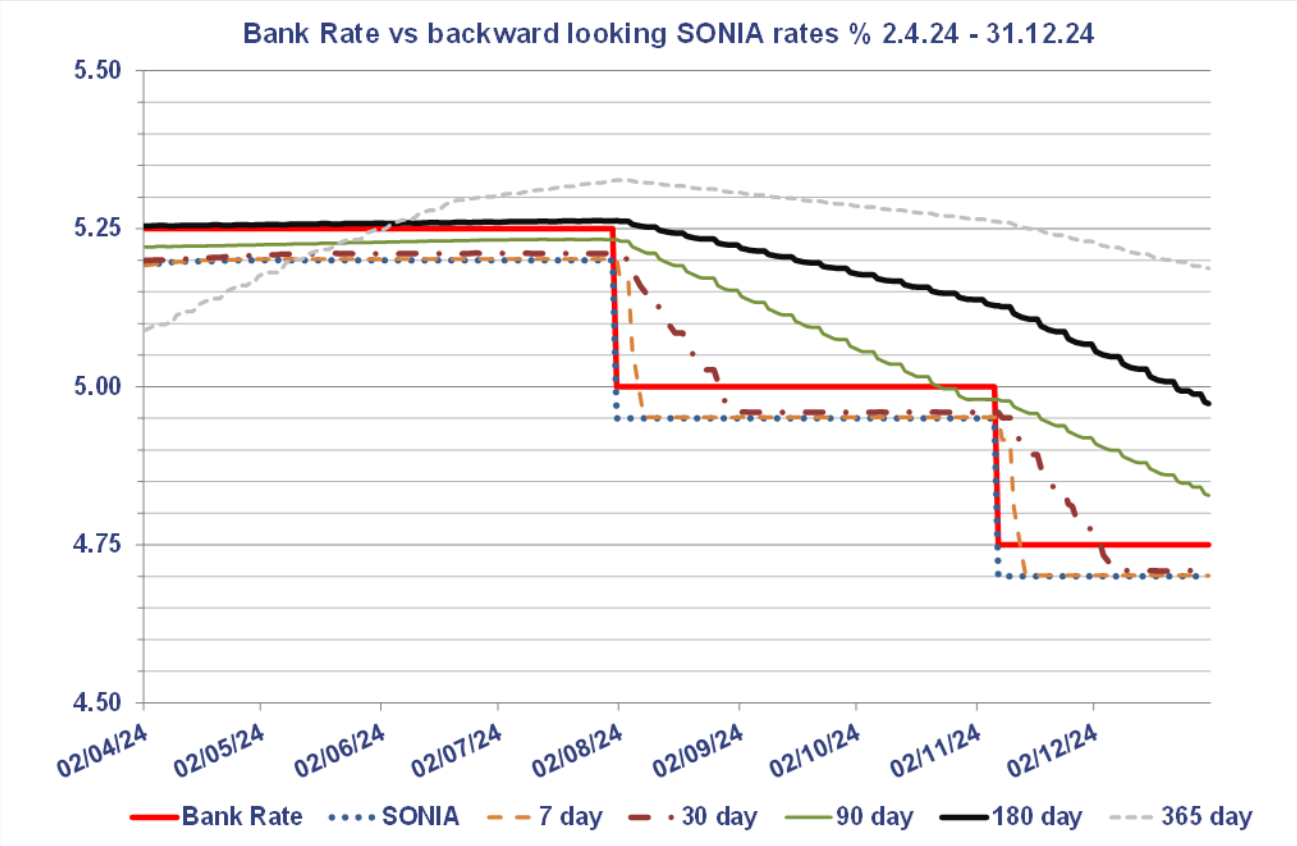
Creditworthiness.
There have been few changes to credit ratings over the quarter under review. However, officers continue to closely monitor these, and other measures of creditworthiness to ensure that only appropriate counterparties are considered for investment purposes.

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 in the current circumstances.**

Investment balances
The average level of funds available for investment purposes during the quarter was **£18.292m**. 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-December 2024



FINANCIAL YEAR TO QUARTER ENDED 31/12/2024							
	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	5.25	5.20	5.20	5.21	5.23	5.26	5.33
High Date	02/04/2024	03/05/2024	13/05/2024	26/06/2024	26/07/2024	26/07/2024	01/08/2024
Low	4.75	4.70	4.70	4.71	4.83	4.97	5.09
Low Date	07/11/2024	07/11/2024	27/12/2024	11/12/2024	31/12/2024	31/12/2024	02/04/2024
Average	5.06	5.01	5.02	5.05	5.12	5.20	5.25
Spread	0.50	0.50	0.50	0.50	0.41	0.29	0.24

The Council's internally managed investments performance matched the benchmark (30-day backward looking SONIA) shown above.

Fund investments – as at 31 December 2024

Treasury Investments – Managed In House	Principle (£m)	Interest Rate	Maturity Date
Debt Management Account Deposit Facility (DMADF)	*2.000*	*4.70%*	*15/01/2025*
Bank of Scotland	*1.100*	*4.75%*	*15/01/2025*
Bank of Scotland	*1.000*	*4.75%*	*15/01/2025*
Bank of Scotland	*1.000*	*4.75%*	*15/01/2025*
London Borough of Barking & Dagenham	*5.000*	*5.15%*	*19/02/2025*
Aberdeen Standard Investments Money Market Fund	*5.200*	*4.78%*	*Call*

Blackrock ICS Heritage Shared Money Market Fund	*5.000*	*4.75%*	*Call*
Insight Liquidity Funds PLC	*0.900*	*4.75%*	*Call*
Royal Bank of Scotland	*1.471*	*2.75%*	*Call*
Total Investment – In House	***22.671***		

The Strategic Reserve Fund has underperformed the benchmark over the quarter to 31 December 2024, returning a gain 1.5% over the period, against a target of 3.1%.

Treasury Strategic Reserve Fund – Managed Externally	Actual (£m)	Performance Quarter Ending 31/12/24	Benchmark
Equity Portfolio	49.900	2.40%	6.40%
Global Equity Portfolio	56.200	3.90%	6.70%
Diversified Growth Fund	26.800	1.20%	2.00%
High Yield Credit Strategies Fund	24.800	1.30%	2.60%
Private Loan Fund	7.000	n/a	n/a
UK Property Fund	23.700	1.30%	2.40%
Secured Income Fund	29.900	n/a	n/a
Corporate Bonds Fund	42.300	-0.90%	-0.80%
Total Investment – External	**260.600**	**1.50%**	**3.10%**

*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 31st December 2024.

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 **£5m** was undertaken in October 2024 from the PWLB at a rate of 4.84%.

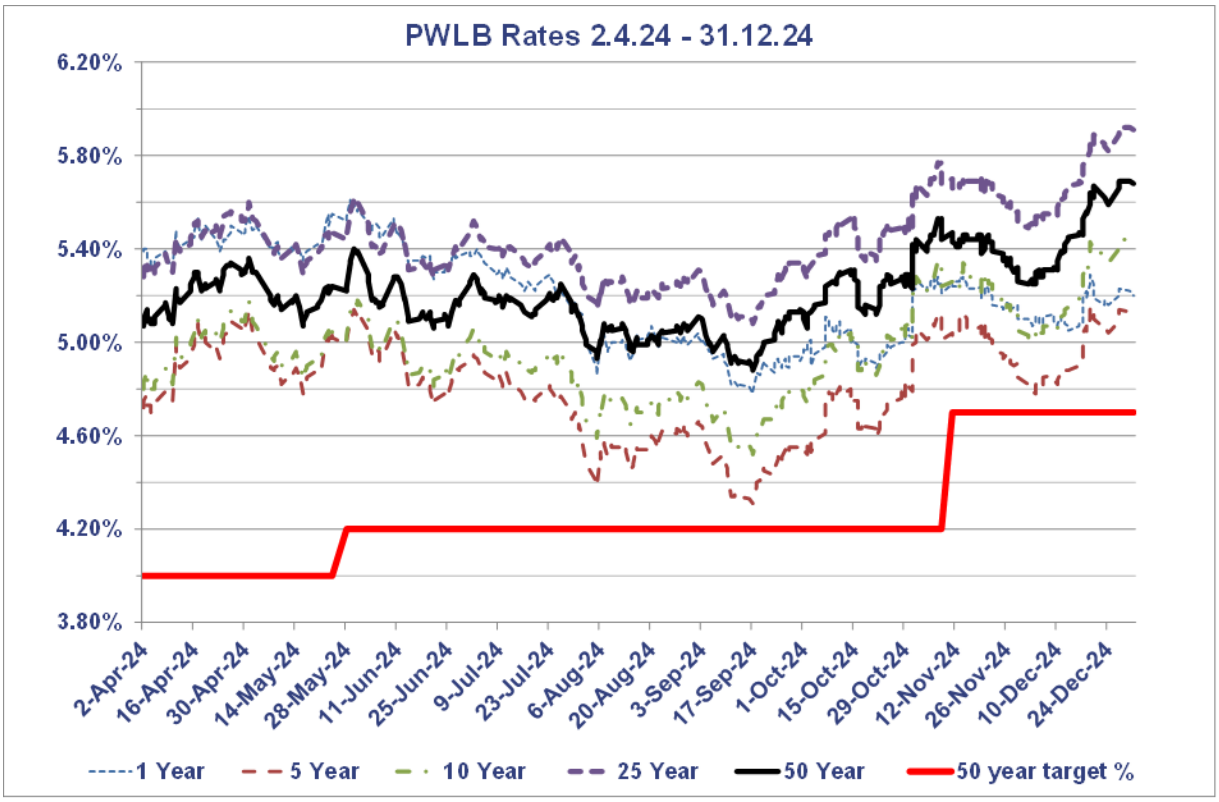
PWLB maturity Certainty Rates 1st April to 31st December 2024
Medium and longer-dated gilt yields, and therein PWLB rates, have moved significantly higher over the course of the financial year, culminating in long-term rates approaching levels last seen in 1998. The rise in medium to long-term yields has arisen because of several factors. Namely, the inflation outlook has become stickier than the market anticipated earlier in the year, with wages remaining somewhat elevated (currently increases are c5% y/y) and the labour market tight (unemployment a little above 4% and job vacancies more than 800,000).

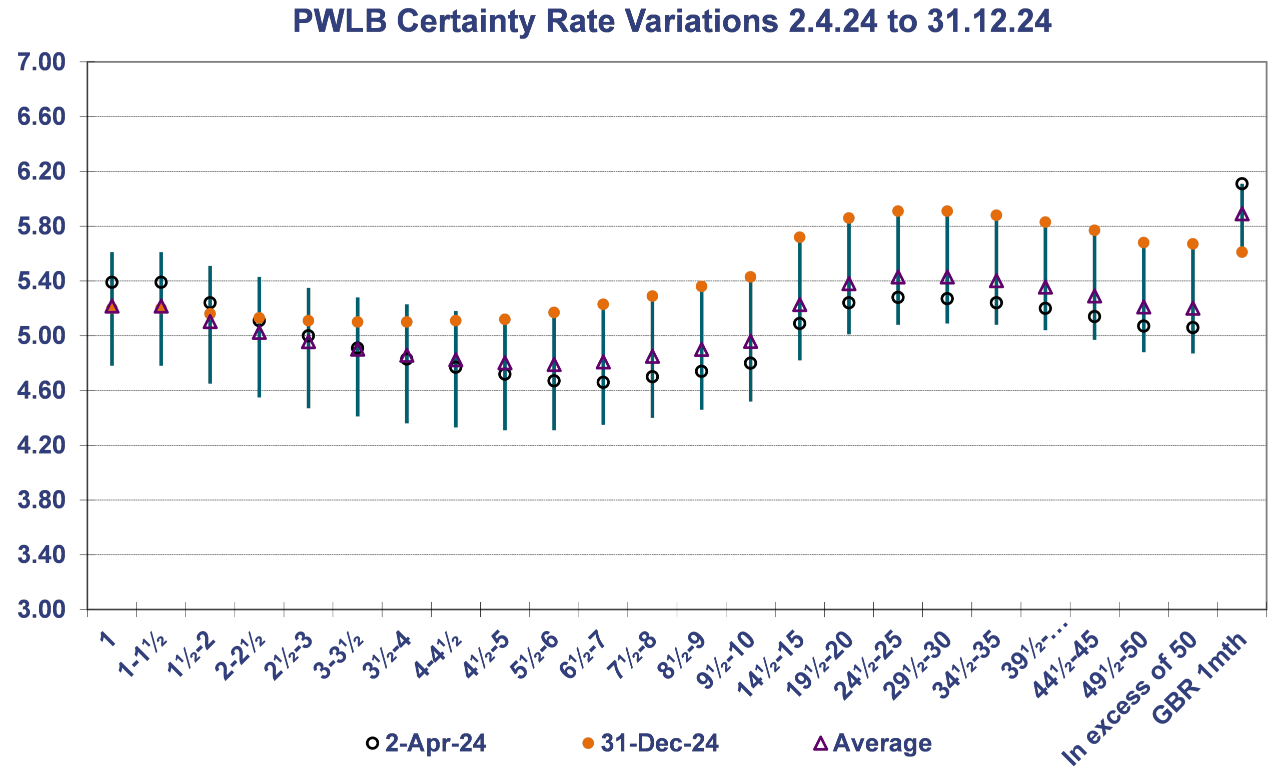
Moreover, the Government has not fully convinced the markets that the UK economy is about to undergo a material increase in productivity and growth. The quarter ending 30th September saw UK GDP stagnate and the prospects for 2025 are somewhat opaque at present. With the UK public finances seemingly under pressure too (as of 7th January, it is estimated that the Chancellor's October Budget contingency is less than £1bn following the recent rise in gilt yields), and historic buyers of longer-dated gilts – pension funds and insurance companies – targeting shorter-dated maturities of late, it is not that great a surprise that yields have risen in the longer dates even as the Debt Management Office has sought to issue debt with shorter durations than might normally have been the case.

There is also anecdotal evidence that hedge funds, who are not long-term holders of long-dated debt issuance, as a rule, may be more active in this part of the market than has normally been the case. Their presence, arguably, adds volatility to the equation. Consequently, and pulling all these factors together, and it is clear that any signs of public finance weakness could lead to elevated yields from time to time.

Additionally, US Treasury yields have also risen prior to Donald Trump's inauguration as US President on 20th January. Markets are nervous as to what the effect of deportation, tariff and tax-cutting policies will have on inflation. Given the impact US markets have globally, this is another contributing factor to the near-term rise in UK yields. The hope is that when the "unknowns" become known, markets will behave in a calmer fashion and yields fall back. But that is not certain.

PWLB RATES 02.04.24 - 31.12.24 (note: the 1st April was a bank holiday)





HIGH/LOW/AVERAGE PWLB RATES FOR 02.04.24 – 31.12.24

	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2024	5.39%	4.72%	4.80%	5.28%	5.07%
31/12/2024	5.20%	5.12%	5.43%	5.91%	5.68%
Low	4.78%	4.31%	4.52%	5.08%	4.88%
Low date	17/09/2024	17/09/2024	17/09/2024	17/09/2024	17/09/2024
High	**5.61%**	**5.16%**	**5.44%**	**5.92%**	**5.69%**
High date	29/05/2024	19/12/2024	19/12/2024	19/12/2024	27/12/2024
Average	5.22%	4.80%	4.96%	5.43%	5.21%
Spread	0.83%	0.85%	0.92%	0.84%	0.81%

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* 31st December 2024, the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement for 2024/25. 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 2024-25 as of 31st December 2024

Treasury Indicators	2024/25 Budget £'000	31.12.24 Actual £'000
Authorised limit for external debt	85,000	85,000
Operational boundary for external debt	75,000	75,000
Gross external debt	60,000	55,000

Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	25% / 25%	36.4%
12 months to 2 years	0% / 10%	9.1%
2 years to 5 years	0% / 15%	0%
5 years to 10 years	0% / 0%	0%
10 years to 20 years *1	0% / 0%	0%
20 years to 30 years *1	0% / 0%	0%
30 years to 40 years *1	0% / 0%	36.4
40 years to 50 years *1	50% / 75%	18.1%

APPENDIX 2: Investment Portfolio

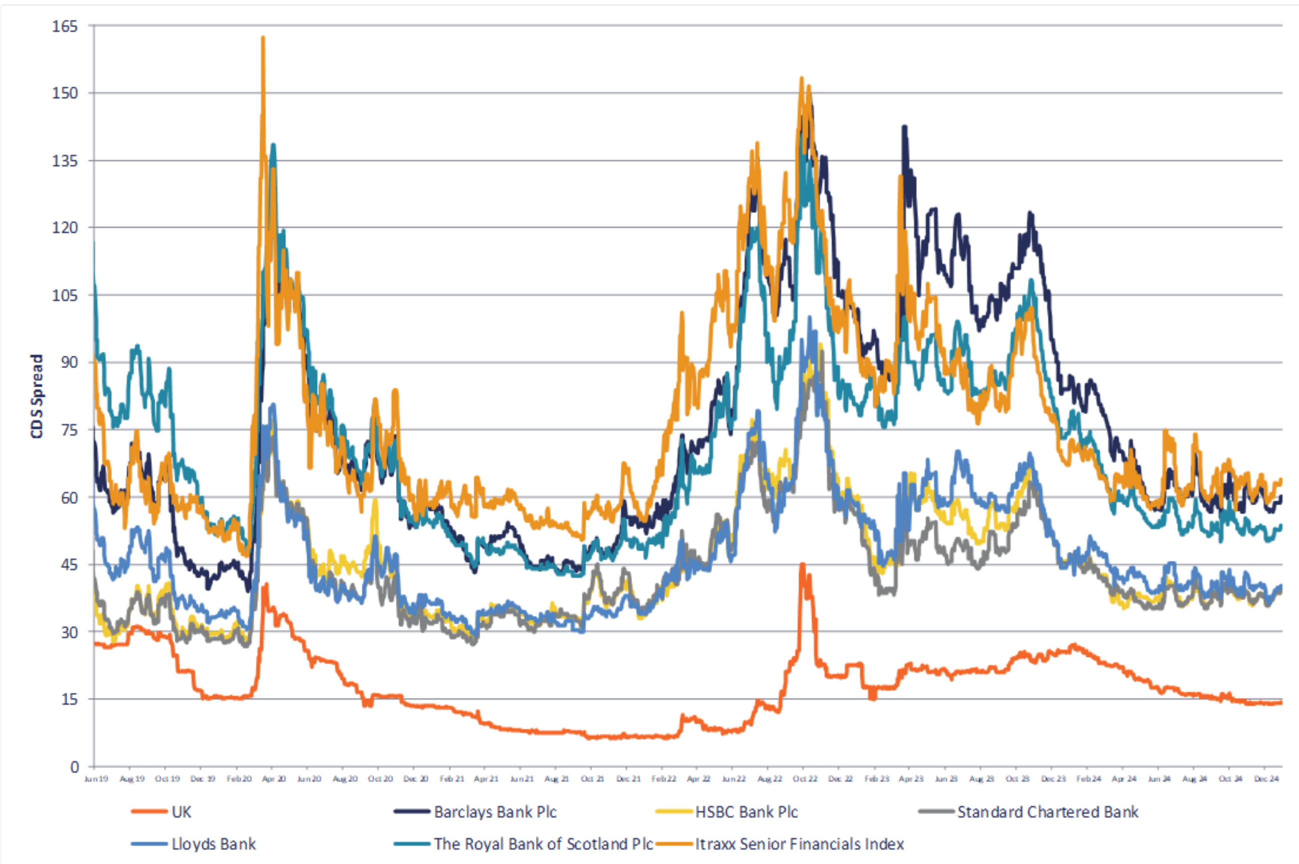
Investments held as of 31st December 2024 compared to our counterparty list:

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)	1,470,557	2.75%		Call	A+	0.000%	2
MMF Aberdeen Standard Investments	5,200,000	4.77%		MMF	AAAm		
MMF BlackRock	5,000,000	4.76%		MMF	AAAm		
MMF Insight	900,000	4.76%		MMF	AAAm		
Bank of Scotland Plc (RFB)	1,100,000	4.75%	10/12/2024	15/01/2025	A+	0.002%	21
Bank of Scotland Plc (RFB)	1,000,000	4.75%	17/12/2024	15/01/2025	A+	0.002%	19
Bank of Scotland Plc (RFB)	1,000,000	4.75%	19/12/2024	15/01/2025	A+	0.002%	19
DMO	2,000,000	4.70%	11/11/2024	15/01/2025	AA-	0.001%	0
London Borough of Barking & Dagenham	5,000,000	5.15%	19/11/2024	19/02/2025	AA-	0.003%	0
Total Investments	**£22,670,557**	**4.71%**				**0.002%**	**£61**

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 1990-2023 for Fitch, 1983-2023 for Moody's and 1981 to 2023 for S&P.
Where Link Group have provided a return for a property fund, that return covers the 12 months to September 2024, which are the latest returns currently available.

UK Banks 5 Year Senior Debt CDS Spreads as of 31st December 2024

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 31st December 2024

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-
- Belgium
- France
- **U.K.**

Orkney Islands Council

Monthly Investment Analysis Review

December 2024

Monthly Economic Summary

General Economy

The S&P Global UK Manufacturing PMI fell to 47 in December 2024 from 48 in the previous month, revised lower from the preliminary estimate of 47.3 and firmly below the initial market expectations of 48.2. The result confirmed the fastest contraction in activity in 11 months, pressured by a second consecutive period of lower output by factories and an accelerated decline in new orders. Producers noted customer destocking and the impact of weaker demand from European clients, which led to the fastest reduction in overall export sales since October 2023. Meanwhile, the UK Services PMI rose to 51.4 in December from 50.8, slightly above forecasts of 51, preliminary data showed. The modest acceleration was driven by rising business activity and reduced backlogs of work amid limited pressure on operations. However, service providers reported a sharp drop in employment at year-end, largely due to the non-replacement of voluntary leavers in response to rising employment costs. The S&P Global UK Construction PMI rose to 55.2 in November 2024, up from 54.3 in October and beating market expectations of a drop to 53.5. The upturn was driven by the sharpest rise in commercial work in 2-½ years, helping offset the steepest decline in residential work since June. New orders across the sector grew for the tenth consecutive month, though the growth rate slowed to its weakest since June. Employment rose marginally, but the rate of job creation eased to a three-month low.

The UK economy contracted by 0.1% m/m in October, following a similar decline in September and falling short of market forecasts of a 0.1% expansion. The largest downward contribution came from production which fell 0.6%, due to manufacturing, mostly pharmaceutical products and preparations, machinery, equipment, and chemicals. Further, GDP for Q3 was revised lower to show no growth in its final reading.

The UK recorded a 173k rise in employment in the three months to October, easing from an upwardly revised 253k advance in the previous period. The reading defied market expectations of a 5k increase and marked the seventh consecutive three-month period of job growth. The unemployment rate was unchanged at 4.3%, while wage growth surprised to the upside, with total pay and that excluding bonuses rising to 5.2% in October as prior readings were also revised higher.

The Consumer Price Index increased 0.1% m/m in November 2024, following a 0.6% rise in October and in line with expectations. The annual inflation rate in the UK edged up for a second month to 2.6% in November 2024 from 2.3% in October, also matching forecasts. It is the highest inflation rate in eight months, with prices rising at a faster pace for recreation and culture, mostly admission fees to live music events and theatres and computer games; housing and utilities, particularly actual rents for housing; and food and non-alcoholic beverages.

Retail sales in the UK edged up 0.2% m/m in November 2024, rebounding from a 0.7% fall in October but below forecasts of 0.5%. Growth in sales at food stores, mostly supermarkets and other non-food stores was partly offset by a fall in clothing retailers, which pushed volumes to their lowest level since January 2022, with retailers reporting that economic factors were affecting sales. Meanwhile, the GfK Consumer Confidence Index rose by 1 point to -17 in December 2024, marking the second consecutive month of improvement. Elsewhere, public sector net borrowing, excluding public sector banks in the UK, decreased to £11.25 billion in November 2024, down from an upwardly revised £18.22 billion in October and below the expected £13.0 billion. This marked the lowest November borrowing since 2021 and £3.4 billion less than in November last year on lower interest costs. This left total public sector spending for the fiscal year to date up by £0.1 billion from a year earlier to £101.4 billion, with higher spending on public services and benefits nearly offset by reduced debt interest payments. Finally, the Bank of England's Monetary Policy Committee kept Bank Rate at 4.75% at its final meeting of the year. However, while the decision was in line with market expectations, the vote was not, with the 6-3 outcome providing a dovish twist to the outcome. The three members who voted for an immediate cut cited concerns over the economic outlook, which could pull inflation below target over the medium term.

US Economy

The US economy added 227K jobs in November 2024, marking a strong recovery from the upwardly revised 36K gain in October, which was heavily influenced by Boeing strikes and the disruptions caused by Hurricanes Helene and Milton. Meanwhile, the US economy expanded an annualised 3.1% in the third quarter of 2024, higher than 2.8% in the second estimate and above 3% in Q2. It is the biggest growth rate so far this year. Finally, the annual inflation rate in the US rose for a 2nd consecutive month to 2.7% in November 2024 from 2.6% in October, in line with expectations. Despite the more positive economic backdrop, the Federal Reserve cut its policy rates by 0.25% at its December meeting.

EU Economy

The annual inflation rate in the Eurozone increased to 2.2% in November 2024 from 2% in October, but below 2.3% in the preliminary estimate. Meanwhile, the core rate, excluding food and energy prices, remained at 2.7%. GDP in the bloc expanded 0.4% on q/q in the three months to September 2024, the strongest growth rate in two years, following a 0.2% rise in Q2 and in line with the previous estimates. Household spending (0.7%), gross fixed capital formation and inventories were the main contributors while government spending also increased. Among the largest economies, GDP in Germany, France, and Spain expanded, whereas Italy and Netherlands stalled. Finally, as widely expected and signalled by speakers in the run-up to the decision, the European Central bank cut its policy rates by 0.25% at its December meeting.

Housing

The Halifax House Price Index in the UK increased 4.8% y/y in November 2024, the most in two years, following an upwardly revised 4% rise in October and higher than forecasts of 3.6%. The Nationwide House Price Index in the United Kingdom rose by 4.7% y/y in December 2024, the fastest pace since October 2022, following a 3.7% increase in November and exceeding forecasts of 3.8%.

Currency

Sterling appreciated against the Euro, however it depreciated against the Dollar over the month.

December	Start	End	High	Low
GBP/USD	$1.2629	$1.2524	$1.2798	$1.2511
GBP/EUR	€1.2062	€1.2095	€1.2148	€1.2018

Interest Rate Forecasts

Capital Economics revised its forecasts during the month, while Link Group maintained its previous position. Both expect Bank Rate to fall to a low of 3.50%.

Bank Rate	Now	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27
Link Group	**4.75%**	4.50%	4.25%	4.00%	4.00%	3.75%	3.75%	3.75%	3.50%	3.50%	3.50%	3.50%	3.50%
Capital Economics	**4.75%**	4.50%	4.25%	4.00%	3.75%	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)	1,470,557	2.75%		Call	A+	0.000%	2
MMF Aberdeen Standard Investments	5,200,000	4.77%		MMF	AAAm		
MMF BlackRock	5,000,000	4.76%		MMF	AAAm		
MMF Insight	900,000	4.76%		MMF	AAAm		
Bank of Scotland Plc (RFB)	1,100,000	4.75%	10/12/2024	15/01/2025	A+	0.002%	21
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Total Investments	**£22,670,557**	**4.71%**				0.002%	£61

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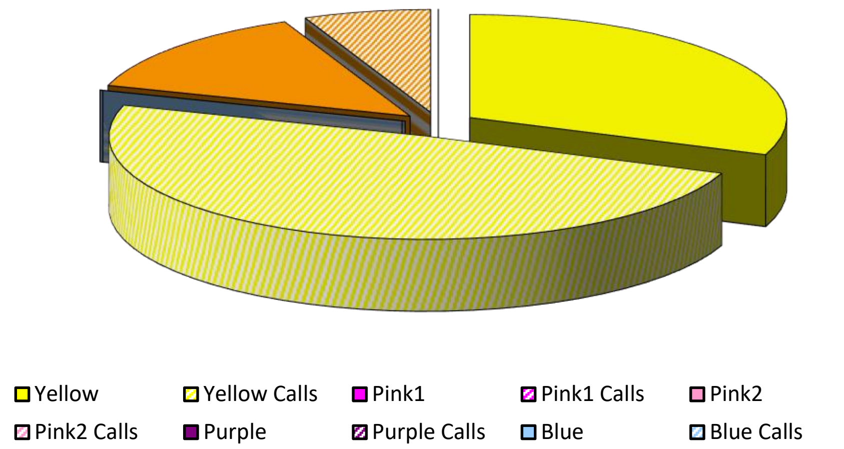
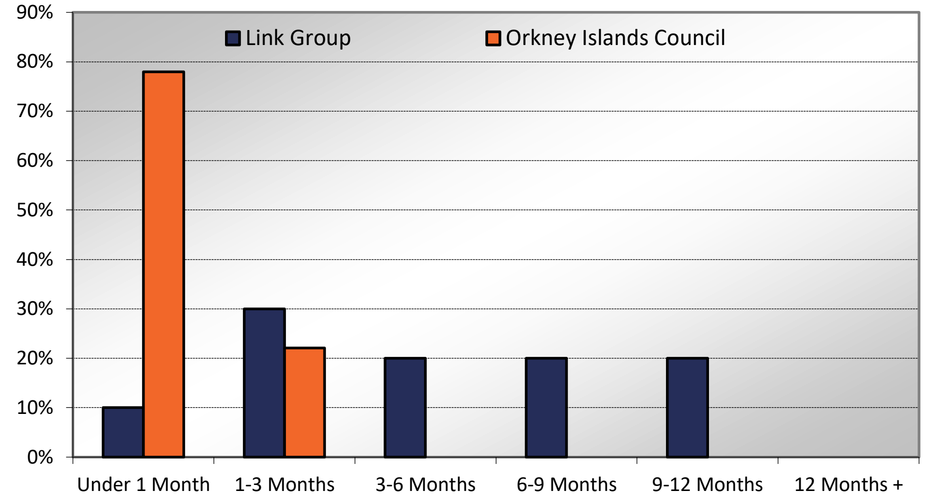
Portfolio Composition by Link Group's Suggested Lending Criteria



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



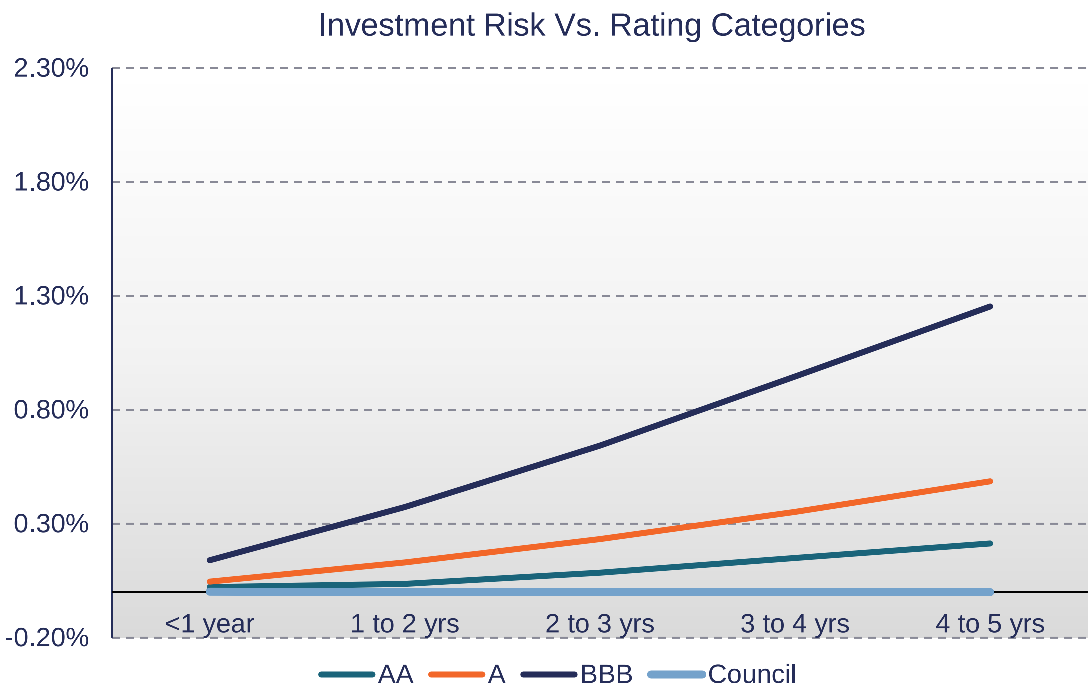
Portfolios weighted average risk number = 1.60

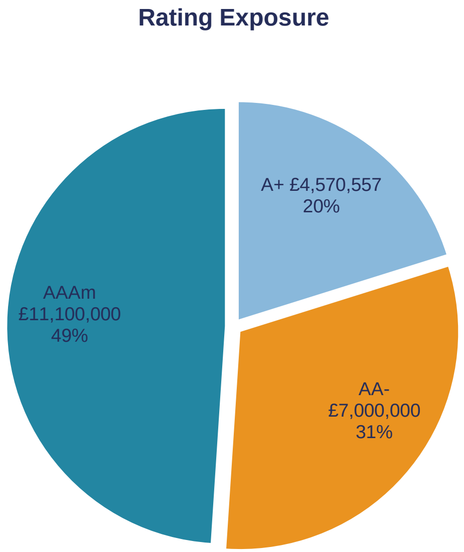
WARoR = Weighted Average Rate of Return
WAM = Weighted Average Time to Maturity

	% 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	Excluding Calls/MMFs/USDBFs WAM at Execution
Yellow	79.84%	£18,100,000	61.33%	£11,100,000	48.96%	4.86%	15	33	40	84
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	20.16%	£4,570,557	32.17%	£1,470,557	6.49%	4.11%	10	21	15	31
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%	**£22,670,557**	**55.45%**	**£12,570,557**	**55.45%**	**4.71%**	**14**	**30**	**32**	**68**

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
16/12/2024	2065	Landesbank Hessen-Thueringen Girozentrale	Germany	A Viability Rating of bbb was assigned.

Orkney Islands Council

Monthly Credit Rating Changes
MOODY'S

Date	Update Number	Institution	Country	Rating Action
16/12/2024	2064	France	France	The Sovereign Rating was downgraded to Aa3 from Aa2 and the Outlook on the Sovereign Rating was changed to Stable from Negative.
17/12/2024	2066	National Bank of Canada	Canada	The Long Term Rating was upgraded to Aa2 from Aa3 and the Outlook on the Long Term Rating was changed to Stable from Positive Watch.
18/12/2024	2067	BNP Paribas	France	The Long Term Rating was downgraded to A1 from Aa3 and the Outlook on the Long Term Rating was changed to Stable from Negative.
18/12/2024	2067	Credit Agricole S.A.	France	The Long Term Rating was downgraded to A1 from Aa3 and the Outlook on the Long Term Rating was changed to Stable from Negative.
18/12/2024	2067	Credit Agricole Corporate and Investment Bank	France	The Long Term Rating was downgraded to A1 from Aa3 and the Outlook on the Long Term Rating was changed to Stable from Negative.
18/12/2024	2067	Credit Industriel et Commercial	France	The Long Term Rating was downgraded to A1 from Aa3 and the Outlook on the Long Term Rating was changed to Stable from Negative.
19/12/2024	2068	Co-operative Bank PLC (The)	United Kingdom	The Long Term and Short Term Ratings were upgraded to A3 from Baa3 and to P-2 from P-3 respectively. The Outlook on the Long Term Rating was changed to Stable from Positive Watch.
19/12/2024	2068	Coventry Building Society	United Kingdom	The Long Term and Short Term Ratings were downgraded to A3 from A2 and to P-2 from P-1 respectively. The Outlook on the Long Term Rating was changed to Stable from Negative Watch.

Orkney Islands Council

Monthly Credit Rating Changes
S&P

Date	Update Number	Institution	Country	Rating Action
02/12/2024	2063	KBC Bank N.V.	Belgium	The Outlook on the Long Term Rating was changed to Positive from Stable.

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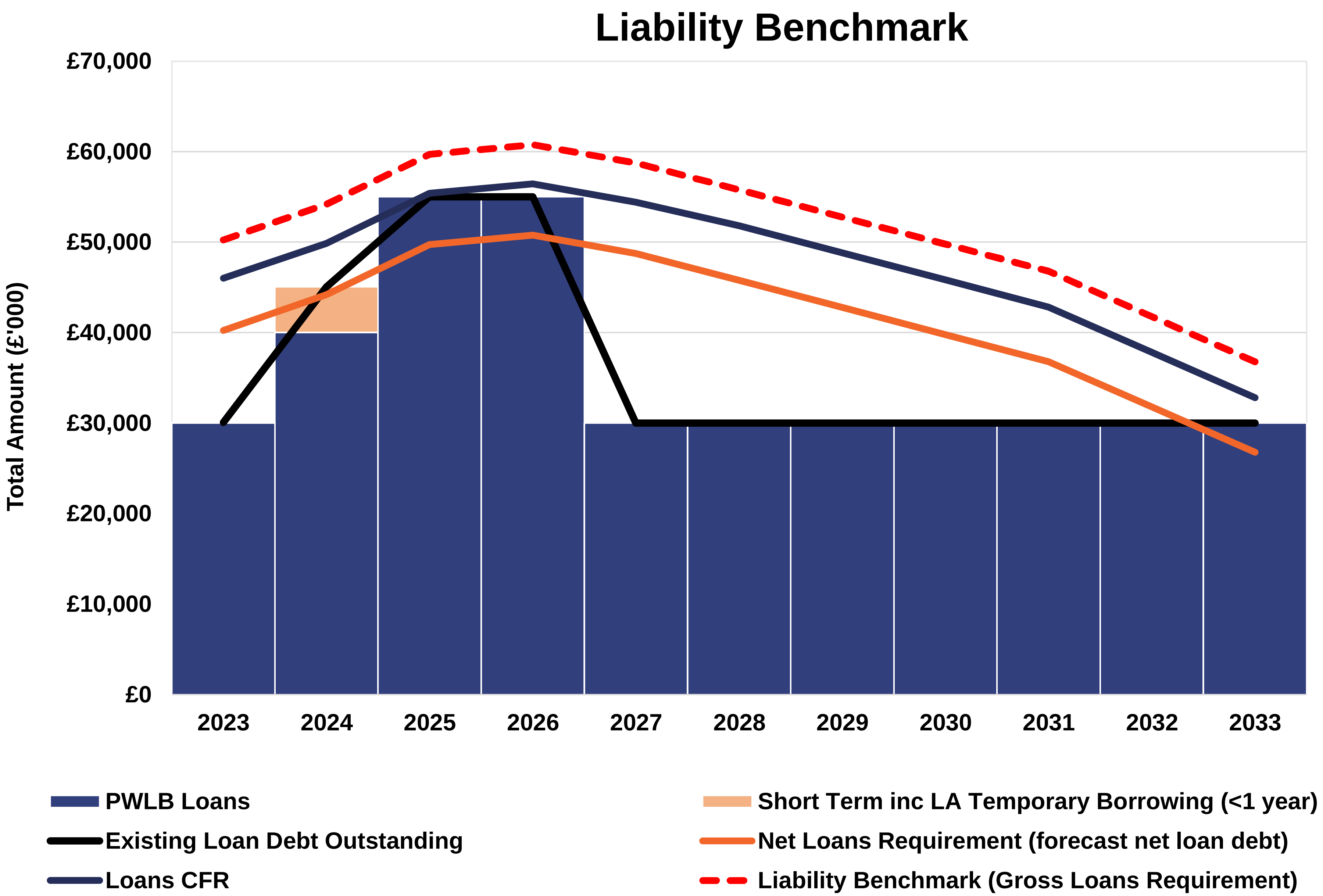
Liability Benchmark
Total Amount (£'000)
£70,000
£60,000
£50,000
£40,000
£30,000
£20,000
£10,000
£0
2023
2024
2025
2026
2027
2028
2029
2030
2031
2032
2033
PWLB Loans
Short Term inc LA Temporary Borrowing (<1 year)
Existing Loan Debt Outstanding
Net Loans Requirement (forecast net loan debt)
Loans CFR
Liability Benchmark (Gross Loans Requirement)