Item: 4

Investments Sub-committee: 18 May 2023.

Temporary Loans.

Report by Head of Finance.

1. Purpose of Report

To advise of the status of the temporary loan portfolio as at 31 March 2023.

2. Recommendations

The Sub-committee is invited to note:

2.1.

The status of the temporary loan portfolio as at 31 March 2023, as detailed in section 3 of this report.

2.2.

That, for the period 1 April 2022 to 31 March 2023, the temporary loans portfolio made a return of £250,182.72 at an average interest rate of 1.75%.

The Sub-committee is invited to scrutinise:

2.3.

The temporary loans portfolio, detailed in sections 3 and 4 of this report, in order to obtain assurance that the Treasury Management Strategy is being adhered to by the Finance Service and the temporary loans portfolio is producing an acceptable rate of return.

3. Temporary Loan Portfolio

3.1.

The temporary loan portfolio as at 31 March 2023 totalled £10,515,440.13. Further details are provided in the Monthly Investment Analysis Review prepared by Link Asset Services, attached as Appendix 1 to this report.

3.2.

The following transactions have taken place since 31 March 2023:

- £600,000 recalled from Insight Liquidity Fund.
- £500,000 recalled from BlackRock Institutional Sterling Liquidity Fund.

- £600,000 invested with Aberdeen Standard Investments Liquidity Fund, with an average net yield of 4.14%.
- £100,000 recalled from BlackRock Institutional Sterling Liquidity Fund.
- £400,000 invested with Aberdeen Standard Investments Liquidity Fund, with an average net yield of 4.14%.
- £1,000,000 Debt Management Account Deposit Facility matured.
- £900,000 recalled from Aberdeen Standard Investments Liquidity Fund.
- £1,000,000 recalled from BlackRock Institutional Sterling Liquidity Fund.
- £200,000 recalled from Insight Liquidity Fund.
- £400,000 invested with Aberdeen Standard Investments Liquidity Fund, with an average net yield of 4.14%.
- £200,000 recalled from BlackRock Institutional Sterling Liquidity Fund.
- £2,000,000 Santander CD matured.
- £1,300,000 invested with BlackRock Institutional Sterling Liquidity Fund, with an average net yield of 4.13%.
- £600,000 invested with Aberdeen Standard Investments Liquidity Fund, with an average net yield of 4.14%.
- £800,000 recalled from Insight Liquidity Fund.
- £600,000 recalled from BlackRock Institutional Sterling Liquidity Fund.
- £800,000 recalled from Aberdeen Standard Investments Liquidity Fund.
- £400,000 invested with Bank of Scotland Treasury Call Account, with an average net yield of 4.16%.
- £400,000 recalled from Bank of Scotland Treasury Call Account.
- £500,000 invested with Debt Management Account Deposit Facility, with an average net yield of 4.12%.
- £300,000 recalled from BlackRock Institutional Sterling Liquidity Fund.

3.3.

The value of the temporary loans stood at £4,970,654 as at 30 April 2023.

4. Rate of Return

4.1.

For the period 1 April 2022 to 31 March 2023, the temporary loans returned an average interest rate of 1.75%, which equates to a return of £250,182.72.

4.2.

By comparison, the 30-day Backward Sterling Overnight Index Average (SONIA) Compounded of 1.93% is considered to be the target.

4.3.

For further comparison, the average interest rate returned on the temporary loans for the period 1 April 2021 to 31 March 2022 was 0.24%.

4.4.

With inflation quoted at 10.1% for March 2023 based on Consumer Price Index (13.5% Retail Price Index), the return on temporary loans equates to a relative loss in value of 8.9% in real terms.

5. Cash Balances

5.1.

The cash held in the temporary loans portfolio is for cashflow purposes and the key considerations are security of the funds, liquidity and then finally the rate of return.

5.2.

The Council operates a consolidated Loans Fund approach to manage its cash balances across all its Services. The main components of this include:

- The day-to-day flow of cash through the Council’s bank accounts.
- The actual level of reserves and earmarked balances that the Council holds.
- The capital financing activities of the Council.

5.3.

Steps have been taken to improve delivery of the capital programme, including programme oversight, development of a project management approach and an updated Capital Project Appraisal process, implemented in January 2018, which sits in front of the capital programme. Work to improve monitoring and reporting procedures also remains ongoing. However, it should be noted that delivery of the capital programme over the last few years has been impacted by the pandemic and issues with shortages and delivery of materials.

5.4.

It should be noted that the cash balances have been reduced to very low levels to address the limited returns currently available on short term investments. However, in order to retain sufficient cash levels to cashflow the monthly spend incurred by the Council on staff payroll and payments for all other costs incurred, action was taken to top-up the cash balances by drawing down £5M of funds from the Strategic Reserve Fund in February 2023.

6. Corporate Governance

This report relates to the Council complying with its financial processes and procedures and therefore does not directly support and contribute to improved outcomes for communities as outlined in the Council Plan and the Local Outcomes Improvement Plan.

7. Financial Implications

7.1.

The Treasury Policy Statement is being adhered to by the Finance Service and is producing an acceptable rate of return.

7.2.

The effective management and control of risk are prime objectives of the Council's treasury management activities, with priority given to security and liquidity when investing funds.

8. Legal Aspects

Section 69 of the Local Government (Scotland) Act 1973 empowers a local authority to lend and invest surplus funds on a temporary basis where it is calculated to facilitate or is conducive or incidental to the discharge of any of their functions.

9. Contact Officers

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10. Appendix

Appendix 1: Link Asset Services Monthly Investment Analysis Review for March 2023.

Appendix 1

LINK Group

Orkney Islands Council

Monthly Investment Analysis Review

March 2023

Monthly Economic Summary

General Economy

The UK manufacturing PMI fell to 48 in March 2023 from 49.3 in February. This pointed to an eighth straight month of falling factory activity. In addition, the UK Services PMI fell to 52.8 in March 2023 from 53.5 in February, below market expectations of 53. New orders growth accelerated due to improved client confidence, resilient demand for consumer services and a boost to spending from falling inflationary pressures. Overall, while still comfortably in “expansion” territory (ie a reading above 50) the UK Composite PMI fell to 52.2 in March 2023 from the 8-month high of 53.1 in February. Elsewhere, UK Construction PMI rose to 54.6 in February 2023 from 48.4 in January, easily beating market expectations of 49.1. The latest reading pointed to the fastest pace of expansion in the construction sector since last May, as commercial construction increased the most in nine months and civil engineering works returned to growth.

The UK economy expanded by 0.1% on quarter in the final three months of 2022, revised from a first estimate of no growth and following a 0.1% contraction in the previous period. Household consumption grew by 0.2%, driven by higher spending on net tourism, transport, and housing and despite the stubbornly high inflation and rising borrowing costs. There was also higher investment spending and higher government consumption, which was partially offset by businesses de-stocking their levels of inventories and a decline in the volume of net trade.

The UK trade deficit narrowed to £5.86 billion in January 2023, down from £7.15 billion in the previous month, as imports tumbled 6.3% and exports fell at a softer 5.1%. Goods imports were down 8.7%, as purchases from the EU fell by 8.8% and those from non-EU countries declined by 8.7%. The decrease in imports from the EU was mainly the result of falling purchases of machinery and transport equipment, chemicals, and fuels.

UK employment rose by 65k in the three months to January 2023, above market forecasts of a 52k rise and following a 74k growth in the previous period. The unemployment rate in the UK came in at 3.7% in November 2022 to January 2023, largely unchanged compared with the previous three-month period and slightly below market consensus of 3.8%. The number of unemployed people rose by 5k to 1250k, while employment levels increased by 65k to 32840k, driven by part-time employees and self-employed workers. UK average weekly earnings, including bonuses, rose 5.7% y/y to £630 in the three months to January, the smallest increase since July, following an upwardly revised 6% rise in the last three months of 2022. In addition, regular pay which excludes bonus payment, went up 6.5% to £589, with the pace of growth slowing for the first time since late 2021. Adjusted for inflation, total pay declined 3.2%, the most since 2009 and regular pay was down 2.4%, as inflation continues to squeeze UK living standards. Meanwhile, retail sales in the UK unexpectedly rose 1.2% m/m in February, following an upwardly revised 0.9% rise in January. It is the biggest increase in four months.

The annual consumer inflation rate in the UK unexpectedly rose to 10.4% in February from 10.1% in January, the first increase in four months and compared to forecasts of a decline to 9.9%. The biggest upward pressure came from cost of food and non-alcoholic beverages. On the other hand, a slowdown was seen in prices for transport, particularly motor fuels; furniture; housing and utilities; and recreation and culture. Elsewhere, the GfK Consumer Confidence indicator rose to -36 in March 2023 from -38 in February, pointing to

The public sector net borrowing (PSNB ex) in February 2023 was £16.7 billion, £9.7 billion more than February 2022 and the highest February borrowing since monthly records began in 1993, largely because of substantial spending on energy support schemes. The Bank of England raised Bank Rate by 25bps to 4.25% during the March meeting, in line with expectations, and pushing borrowing costs to fresh 2008-highs, aiming to bring inflation back to the 2% target.

In the US the unemployment rate edged up to 3.6% in February up from a 50-year low of 3.4% seen in January. The number of unemployed people increased by 242k to 5940k, and employment levels rose by 177k to 160320k. The US economy expanded an annualised 2.6% on quarter in the last three months of 2022, slightly less than initial estimate of 2.7%. The annual inflation rate in the US slowed to 6% in February, the lowest since September 2021, in line with market forecasts. The Fed raised the Fed Funds Rate by 25bps to 4.75%-5% in March, matching the February increase, and pushing borrowing costs to new highs since 2007.

The Eurozone economies failed to grow in the final quarter of 2022, compared with preliminary estimates of 0.1% growth and an upwardly revised 0.4% expansion in the previous three-month period. GDP grew in the Netherlands, Spain, and France, but contracted in Germany and Italy. The annual inflation rate in the Euro area eased to 6.9% year-on-year in March, its lowest level since February 2022 and slightly below market consensus of 7.1%. The European Central Bank raised interest rates by another 50 bps to 3.5% at its March meeting, as previously promised, further pushing borrowing costs to the highest level since late 2008, to help temper the region's stubbornly high inflation.

Housing

The Nationwide House Price Index in the UK declined by 3.1% y/y in March, the biggest annual drop since July of 2009. Compared to the previous month, house prices in the UK were down 0.8%, a seventh consecutive fall and compared to forecasts of a 0.3% decrease. The Halifax house price index rose by 2.1% from a year earlier in February 2023, the same pace as in the previous two months.

Currency

Stronger than expected GDP and inflation data saw Sterling appreciate slightly against the US dollar and the Euro during March.

March	Start	End	High	Low
GBP/USD	\$1.2007	\$1.2365	\$1.2381	\$1.1838
GBP/EUR	€1.1251	€1.1381	€1.1432	€1.1217

Forecast

Bank Rate was raised to 4.25% at the Monetary Policy Committee's meeting in March, with both Link and Capital Economics pencilling in rates to peak at 4.50% by Q2 2023.

Bank Rate	Now	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26
Link Group	**4.25%**	4.50%	4.50%	4.25%	4.00%	3.50%	3.25%	3.00%	2.75%	2.75%	2.50%	2.50%	2.50%
Capital Economics	**4.25%**	4.50%	4.50%	4.50%	4.25%	4.00%	3.50%	3.00%	-	-	-	-	-

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 (£)
MMF BlackRock	2,300,000	4.06%		MMF	AAAm		
MMF Insight	2,800,000	3.97%		MMF	AAAm		
MMF Aberdeen Standard Investments	900,000	3.95%		MMF	AAAm		
The Royal Bank of Scotland Plc (RFB)	415,439	1.00%		Call	A	0.000%	1
Bank of Scotland Plc (RFB)	1,100,001	4.16%		Call	A+	0.000%	1
DMO	1,000,000	4.00%	23/03/2023	14/04/2023	AA-	0.001%	0
Santander UK PLC	2,000,000	3.86%	20/01/2023	20/04/2023	A	0.002%	49
Total Investments	**£10,515,440**	**3.87%**				0.001%	£51

Note: An historic risk of default and expected credit loss are only provided if a counterparty has a counterparty credit rating and are not provided for an MMF or USDBF, for which the rating agencies provide a fund rating. The portfolio's historic risk of default and expected credit loss therefore measure the historic risk of default and expected credit loss attached only to those investments for which a counterparty has a counterparty credit rating and also do 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 1990-2022 for Fitch, 1983-2022 for Moody's and 1981-2022 for S&P.

Where Link Group have provided a return for a property fund, that return covers the 12 months to December 2022, which are the latest returns currently available.

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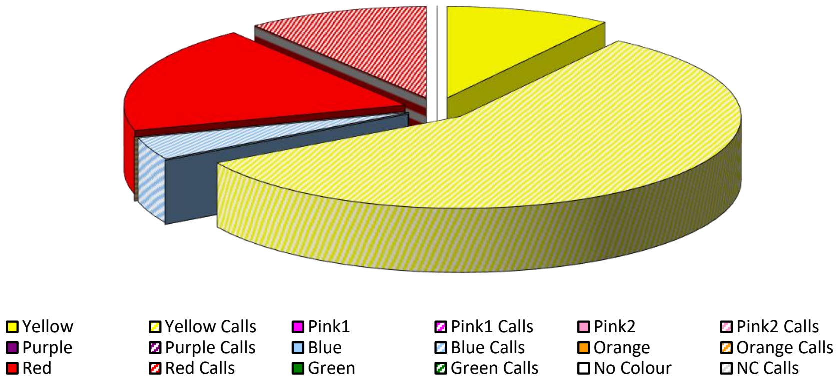
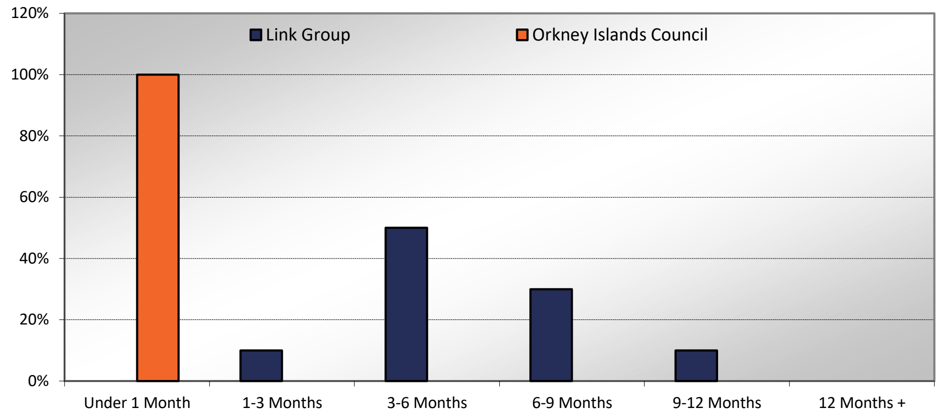
Portfolio Composition by Link Group's Suggested Lending Criteria



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 = 2.26

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	66.57%	£7,000,000	85.71%	£6,000,000	57.06%	4.00%	2	3	14	22
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	3.95%	£415,439	100.00%	£415,439	3.95%	1.00%	0	0	0	0
Orange	0.00%	£0	0.00%	£0	0.00%	0.00%	0	0	0	0
Red	29.48%	£3,100,001	35.48%	£1,100,001	10.46%	3.97%	13	58	20	90
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%	**£10,515,440**	**71.47%**	**£7,515,440**	**71.47%**	**3.87%**	**5**	**19**	**18**	**67**

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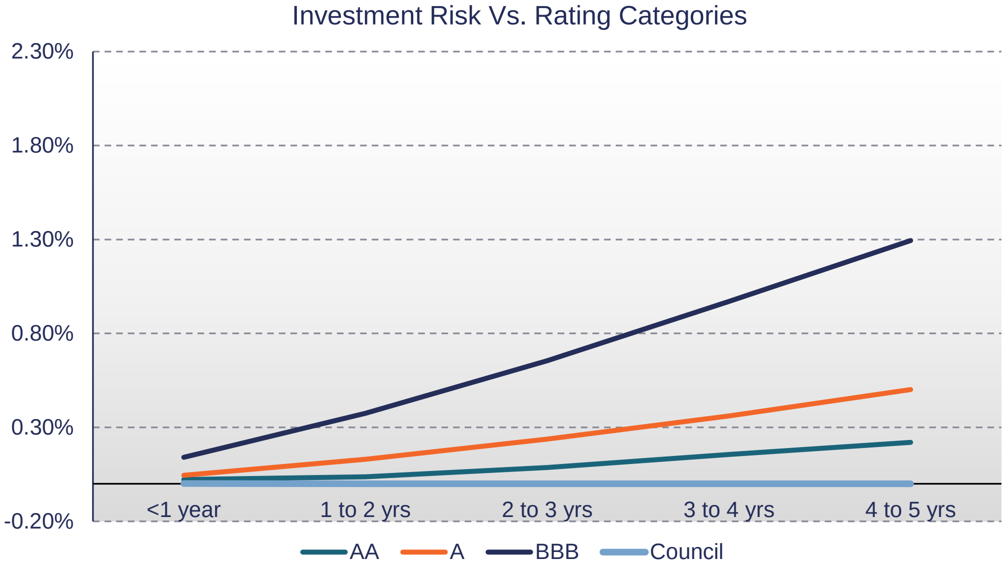
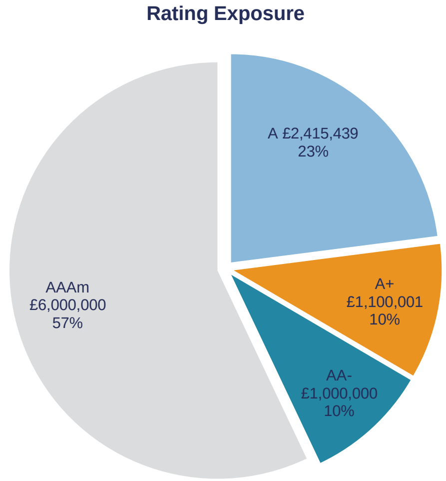
Investment Risk and Rating Exposure





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%	0.16%	0.22%
A	0.05%	0.13%	0.24%	0.36%	0.50%
BBB	0.14%	0.38%	0.65%	0.97%	1.29%
Council	0.001%	0.000%	0.000%	0.000%	0.000%

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.

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Monthly Credit Rating Changes
FITCH

Date	Update Number	Institution	Country	Rating Action
02/03/2023	1952	Close Brothers Ltd	United Kingdom	The Outlook on the Long Term Rating was changed to Negative from Stable.
07/03/2023	1953	Bayerische Landesbank	Germany	The Viability Rating was upgraded to 'bbb+' from 'bbb'.
07/03/2023	1954	Landesbank Baden-Wuerttemberg	Germany	The Viability Rating was upgraded to 'bbb+' from 'bbb'.
13/03/2023	1955	Belgium Sovereign Rating	Belgium	The Outlook on the Sovereign Rating was changed to Negative from Stable.
21/03/2023	1958	UBS AG	Switzerland	The Outlook on the Long Term Rating was removed and placed on Negative Watch. At the same time the Short Term Rating and Viability Rating were placed on Negative Watch
28/03/2023	1962	Qatar Sovereign Rating	Qatar	The Outlook on the Sovereign Rating was changed to Positive from Stable.

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Monthly Credit Rating Changes
MOODY'S

Date	Update Number	Institution	Country	Rating Action
13/03/2023	1956	Barclays Bank PLC (NRFB)	United Kingdom	The Outlook on the Long Term Rating was changed to Stable from Negative.
21/03/2023	1957	UBS AG	Switzerland	The Outlook on the Long Term Rating was changed to Negative from Stable.
24/03/2023	1960	Swedbank AB	Sweden	The Outlook on the Long Term Rating was changed to Stable from Negative.
24/03/2023	1961	Norddeutsche Landesbank Girozentrale	Germany	The Outlook on the Long Term Rating was changed to Positive from Stable.

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Monthly Credit Rating Changes
S&P

Date	Update Number	Institution	Country	Rating Action
23/03/2023	1959	Commerzbank AG	Germany	The Long Term Rating was upgraded to 'A-' from 'BBB+'.