Item: 4

Investments Sub-committee: 25 February 2026.

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 (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 2025/26, as at 31 December 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. Scrutinise 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, to obtain assurance that the Treasury Management Practices are operating effectively:

   - An economic update for the quarter ended 31 December 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 31 December 2025.

ii. Scrutinise the status of the temporary loans portfolio as at 31 December 2025, as detailed in section 3 of this report, 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 2025, the Council's debt portfolio stood at £50,000,000, with loan maturities ranging from 5 months to 45 years. Overall, this represents an average cost of borrowing of 3.90% per annum, with an average weighted duration of 23.8 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 2025 totalled £22,276,347.67. 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 2025, the temporary loans returned an average interest rate of 4.44%, which equates to a return of £627,150.77.

3.5. By comparison, the equivalent 30-day backward looking Sterling Overnight Index Average rate of 4.17% is considered to be the target.

3.6. With inflation quoted at 3.4% for December 2025 based on Consumer Price Index (4.2% Retail Price Index), the return on temporary loans equates to a relative gain in value of 1.04% 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 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 Committee, 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 December 2025.
Appendix 3 – Liability Benchmark Chart.

Appendix 1

Classification: Confidential

Treasury Management Update

Quarterly Report

31ST DECEMBER 2025

MUFG Corporate Markets
A division of MUFG Pension & Market Services

Contents

Treasury Management Update

Quarter Ended 31st December 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 third quarter of 2025/26 saw:
  - A -0.1% m/m change in real GDP in October, leaving the economy no bigger than at the start of April.
  - The 3myy rate of average earnings growth excluding bonuses fall to 4.6% in October, having been as high as 5.5% earlier in the financial year.
  - CPI inflation fall sharply from 3.6% to 3.2% in November, with core CPI inflation easing to 3.2%.
  - The Bank of England cut interest rates from 4.00% to 3.75% in December, after holding in November.
  - The 10-year gilt yield fluctuate between 4.4% and 4.7%, ending the quarter at 4.5%.
- From a GDP perspective, the financial year got off to a bumpy start with the 0.3% m/m fall in real GDP in April as front-running of US tariffs in Q1 (when GDP grew 0.7% on the quarter) weighed on activity. Despite the underlying reasons for the drop, it was still the first fall since October 2024 and the largest fall since October 2023. However, the economy surprised to the upside in May and June so that quarterly growth ended up 0.3% q/q (subsequently revised down to 0.2% q/q). Nonetheless, the 0.0% m/m change in real GDP in July, followed by a 0.1% m/m increase in August and a 0.1% decrease in September will have caused some concern (0.1% q/q). October's disappointing -0.1% m/m change in real GDP suggests that growth slowed to around 1.4% in 2025 as a whole.
- Sticking with future economic sentiment, the composite Purchasing Manager Index (PMI) for the UK rose from 51.2 in November to 52.1 in December, suggesting the economy may be benefitting somewhat from pre-Budget uncertainty fading. This may also reflect a diminishing drag from weak overseas demand. While the services PMI rose from 51.3 to 52.1, the improvement in the manufacturing output balance from 50.3 to 51.8 was larger. Indeed, the manufacturing sector has been more exposed to the recent weakness of external demand and has lagged the services sector since the end of last year.
- Turning to retail sales volumes, and the 1.5% year-on-year rise in September, accelerating from a 0.7% increase in August, marked the highest gain since April. Nonetheless, the 0.1% m/m fall in retail sales volumes in November built on the 0.9% m/m drop in October, suggesting the longer-lasting effects of weak employment and slowing wage growth are impacting. Moreover, the decline in the GfK (a market research institute) measure of consumer confidence from -17 in October to -19 in November suggests that consumers are not that optimistic at present.
- Prior to the November Budget, the public finances position looked weak. The £20.2 billion borrowed in September was slightly above the £20.1 billion forecast by the OBR. For the year to date, the £99.8 billion borrowed is the second highest for the April to September period since records began in 1993, surpassed only by borrowing during the COVID-19 pandemic. The main drivers of the increased borrowing were higher debt interest costs, rising government running costs, and increased inflation-linked benefit payments, which outweighed the rise in tax and National Insurance contributions.
- Following the 26 November Budget, the Office for Budget Responsibility (OBR) calculated the net tightening in fiscal policy as £11.7bn (0.3% of GDP) in 2029/30, smaller than the consensus forecast of £25bn. It did downgrade productivity growth by 0.3%, from 1.3% to 1.0%, but a lot of that influence was offset by upgrades to its near-term wage and inflation forecasts. Accordingly, the OBR judged the Chancellor was going to achieve her objectives with £4.2bn to spare. The Chancellor then chose to expand that headroom to £21.7bn, up from £9.9bn previously.

- Moreover, the Chancellor also chose to raise spending by a net £11.3bn in 2029/30. To pay for that and the increase in her headroom, she raised taxes by £26.1bn in 2029/30. The biggest revenue-raisers were the freeze in income tax thresholds from 2028/29 (+£7.8bn) and the rise in NICs on salary-sacrifice pension contributions (+£4.8bn). The increase in council tax for properties worth more than £2.0m will generate £0.4bn.
- After the Budget, public net sector borrowing of £11.7bn in November was comfortably below last November's figure of £13.6bn and was the lowest November borrowing figure since 2021, mainly due to tax receipts being £5.4bn higher, largely because of the hike in employer NICs in April 2025. Cumulative borrowing in the first eight months of 2025/26 was still £10bn above last year's total. However, lower inflation and a disposal of assets ahead of the Budget should mean borrowing in 2025/26 comes in below last year's total.
- The weakening in the jobs market looked clear in the spring. 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. More recently, the 38,000 fall in payroll employment in November was the tenth monthly decline in the past 13 months, causing the annual growth rate to slow further, from -0.5% to -0.6%. The number of job vacancies in the three months to November 2025 stood at 729,000 (the peak was 1.3 million in spring 2022) but the less reliable Labour Force Survey data showed that employment fell by 16,000 in the three months to October, with the unemployment rate rising further, from 5.0% to 5.1%. All this suggests the labour market continues to loosen, albeit at a slow pace.
- A looser labour market is driving softer wage pressures. The 3myy growth rate of average earnings including bonuses eased from 4.9% in September to 4.7% in October. And excluding bonuses, the 3myy rate slowed from 4.7% to 4.6%. Regular private sector pay growth continued to slow from 4.2% to 3.9%. That left it broadly on track to meet the Bank's end of December prediction of 3.5%.
- CPI inflation fell sharply in November, easing from 3.6% in October to 3.2%. This was the third consecutive softer-than-expected inflation outturn and suggests that disinflation is well underway. There was a widespread easing in price pressures with inflation slowing in 10 of the 12 main categories. Core inflation fell from 3.4% to 3.2% and services inflation dipped from 4.5% to 4.4%. However, a great deal will depend on the adjustments to regulated and indexed prices scheduled for next April. Capital Economics forecast CPI inflation to drop from 3.2% in March to 2.0% in April, thereby leaving inflation on track to settle at the 2.0% target, or below, by the end of 2026.
- An ever-present issue throughout recent months has been the pressure being exerted on medium and longer dated gilt yields. The yield on the 10-year gilt moved sideways in the second quarter of 2025, rising from 4.4% in early April to a high of c4.8%, before ending June at 4.50%,
- More recently, the yield on the 10-year gilt rose from 4.46% to 4.60% in early July as rolled-back spending cuts and uncertainty over Chancellor Reeves' future raised fiscal concerns. Although the spike proved short lived, it highlighted the UK's fragile fiscal position. In an era of high debt, high interest rates and low GDP growth, the markets are now more sensitive to fiscal risks than before the pandemic. During August, long-dated gilts underwent a particularly pronounced sell-off, climbing 22 basis points and reaching a 27-year high of 5.6% by the end of the month. While yields have since eased back, the market sell-off was driven by investor concerns over growing supply-demand imbalances, stemming from unease over the lack of fiscal consolidation and reduced demand from traditional long-dated bond purchasers like pension funds. For 10-year gilts, by late September, sticky inflation, resilient activity data and a hawkish Bank of England kept yields elevated over 4.70% although, subsequently, gilt yields fell back after the Budget, supported by a tighter fiscal plan, fewer tax hikes required following a smaller-than-expected downgrade to the OBR's fiscal forecast, and a favourable shift in bond issuance away from long-dated debt. Gilt yields hovered around 4.5% at the end of the quarter.
- 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 1 April to 7,702 on 7 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 ended June at 8,761, around 2% higher than its value at the end of March and more than 7% above its level at the start of 2025. Since then, the FTSE 100 has enjoyed a further significant jump in value. The stock market hit new record highs above 9,900 in Mid-November, driven by a global rebound on hopes of a US government-shutdown resolution, expectations of a December

rate-cut, and strong corporate earnings. Despite some jitters around Budget time, the FTSE 100 closed Q4 at 9,931, 5% higher than at the end of September and 22% higher since the start of 2025.

MPC meetings: 8 May, 19 June, 7 August, 18 September, 6 November, 18 December 2025

- There were six Monetary Policy Committee (MPC) meetings held between April and December. 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 rising food prices. By repeating the well-used phrase "gradual and careful", the MPC continued to suggest that rates would be reduced further.
- In August, a further rate cut was implemented. However, a 5-4 split vote for a rate cut to 4% laid bare the different views within the Monetary Policy Committee, with the accompanying commentary noting the decision was "finely balanced" and reiterating that future rate cuts would be undertaken "gradually and carefully". Ultimately, Governor Bailey was the casting vote for a rate cut but with the CPI measure of inflation expected to reach at least 4% later this year, the MPC was wary of making any further rate cuts until inflation begins its slow downwards trajectory back towards 2%.
- With wages still rising by just below 5%, it was no surprise that the September meeting saw the MPC vote 7-2 for keeping rates at 4% (Dhingra and Taylor voted for a further 25bps reduction). Moreover, the Bank also took the opportunity to announce that they would only shrink its balance sheet by £70bn over the next 12 months, rather than £100bn. The repetition of the phrase that "a gradual and careful" approach to rate cuts is appropriate suggested the Bank still thought interest rates will fall further.
- At the 6 November meeting, Governor Bailey was once again the deciding vote, keeping Bank Rate at 4% but hinting strongly that a further rate cut was imminent if data supported such a move. By 18 December, with November CPI inflation having fallen to 3.2%, and with Q2 GDP revised down from 0.3% q/q to only 0.2% q/q, and Q3 GDP stalling at 0.1%, the MPC voted by 5-4 to cut rates further to 3.75%. However, Governor Bailey made it clear that any further reductions would require strong supporting data, and the pace of any further decreases would be slow compared to recent months. The markets expect Bank Rate to next be cut in April.

2. Interest rate forecasts

The Authority has appointed MUFG Corporate Markets as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. MUFG Corporate Markets provided the following forecasts and commentary on 22 December 2025. These are forecasts for Bank Rate, average earnings and PWLB certainty rates, gilt yields plus 80 bps.

MUFG Corporate Markets Interest Rate View 22.12.25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28	Jun-28	Sep-28	Dec-28	Mar-29
BANK RATE	3.75	3.50	3.50	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25	3.25
3 month ave earnings	3.80	3.50	3.50	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30	3.30
6 month ave earnings	3.80	3.50	3.50	3.40	3.30	3.30	3.30	3.40	3.40	3.40	3.40	3.40	3.40
12 month ave earnings	3.90	3.60	3.60	3.50	3.40	3.50	3.50	3.50	3.50	3.50	3.60	3.60	3.60
5 yr PWLB	4.60	4.50	4.30	4.20	4.10	4.10	4.10	4.10	4.10	4.10	4.10	4.10	4.10
10 yr PWLB	5.20	5.00	4.90	4.80	4.80	4.70	4.70	4.70	4.70	4.60	4.60	4.60	4.70
25 yr PWLB	5.80	5.70	5.60	5.50	5.50	5.40	5.30	5.30	5.30	5.20	5.20	5.20	5.20
50 yr PWLB	5.60	5.50	5.40	5.30	5.30	5.20	5.10	5.10	5.10	5.00	5.10	5.00	5.00

- *Our last interest rate forecast update was undertaken on 11 August. Since then, a combination of tepid growth (0.2% q/q GDP for Q2 and 0.1% q/q GDP for Q3), falling inflation (currently CPI is 3.2%), and a November Budget that will place more pressure on the majority of households' income, has provided an opportunity for the Bank of England's Monetary Policy Committee to further reduce Bank Rate from 4% to 3.75% on 18 December.*

- *Surprisingly, to most market commentators, the recent steep fall in CPI inflation in one month from 3.6% to 3.2% did not persuade most "dissenters" from the November vote (Lombardelli, Greene, Mann and Pill) to switch to the rate-cutting side of the Committee. Instead, it was left to Bank Governor, Andrew Bailey, to use his deciding vote to force a rate cut through by the slimmest of margins, 5-4.*

- *Given the wafer-thin majority for a rate cut it was not unexpected to hear that although rates would continue on a "gradual downward path", suggesting a further rate cut or cuts in the offing, MPC members want to assess incoming evidence on labour market activity and wage growth. Indeed, with annual wage growth still over 4.5%, the MPC reiterated that the case for further rate cuts would be "a closer call", and Governor Bailey observed there is "limited space as Bank Rate approaches a neutral level".*

- *Accordingly, the MUFG Corporate Markets forecast has been revised to price in a rate cut in Q2 2026 to 3.5%, likely to take place in the wake of a significant fall in the CPI inflation reading from 3% in March to 2% in April (as forecast by Capital Economics), followed by a short lull through the summer whilst more data is garnered, and then a further rate cut to 3.25% in Q4.*

- *As in August, nonetheless, threats to that central scenario abound. What if wage increases remain stubbornly high? There are, after all, several sectors of the domestic economy, including social care provision and the building/construction industries, where staff shortages remain severe. Moreover, by May 2026, following the local elections, we will have a better handle on whether or not the Starmer/Reeves team is going to see out the current Parliament or whether they face a Leadership challenge from within their own party If so, how will gilt markets react to these variables…and will there be additional geo-political factors to also bake in, particularly the Fed's monetary policy decisions in 2026 and the ongoing battle to lower rates whilst inflation remains close to 3%.*

- *Accordingly, our updated central forecast is made with several hefty caveats. We are confident, as we have been for some time, that our forecast for Bank Rate and the 5-year PWLB Certainty Rate is robust, and we have marginally brought forward the timing of the next rate cut(s). But for the 10-, 25- and 50-years part of the curve, the level of gilt issuance, and the timing of its placement, will be integral to achieving a benign trading environment. That is not a "given", and additionally, the inflation outlook and political factors domestically and, crucially, in the US, are also likely to hold sway. Matters should be clearer by June in the UK, but the US mid-term elections are scheduled for November.*

- *Our revised PWLB rate forecasts are based on the Certainty Rate (the standard rate minus 20 bps) which has been accessible to most authorities since 1 November 2012. Please note, the lower Housing Revenue Account (HRA) PWLB rate started on 15 June 2023 for those authorities with an HRA (standard rate minus 60 bps) and is set to prevail until at least the end of March 2026. Hopefully, there will be a further extension to this discounted rate announced in January.*

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

Gilt yields and PWLB rates

The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, but the risks to our forecasts are generally to the upsides. Our target borrowing rates are set ***two years forward*** *(as we expect rates to fall back) and the current PWLB (certainty) borrowing rates are set out below: -*

PWLB borrowing	***Current borrowing rates as at 22.12.25 p.m.*** *%*	***Target borrowing rate now (end of Q4 2027)*** *%*	***Target borrowing rate previous (end of Q4 2027)*** *%*
5 years	*4.81*	*4.10*	*4.20*
10 years	*5.39*	*4.70*	*4.70*
25 years	*6.01*	*5.30*	*5.30*
50 years	*5.78*	*5.10*	*5.10*

Borrowing advice: *Our long-term (beyond 10 years) forecast for the neutral level of Bank Rate remains at 3.5%. As all PWLB certainty rates are still above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve (<5 years PWLB maturity/<10 years PWLB EIP) and short-dated fixed LA to LA monies should also be considered. Temporary borrowing rates will, generally, fall in line with Bank Rate cuts.*

*Our suggested **budgeted earnings rates for investments** up to about three months' duration in each financial year are set out below.*

Average earnings in each year	*Now %*	*Previously %*
2025/26 (residual)	*3.80*	*3.90*
2026/27	*3.40*	*3.60*
2027/28	*3.30*	*3.30*
2028/29	*3.30*	*3.50*
2029/30	*3.50*	*3.50*
Years 6-10	*3.50*	*3.50*
Years 10+	*3.50*	*3.50*

We will continue to monitor economic and market developments as they unfold. Typically, we formally review our forecasts following the quarterly release of the Bank of England's Monetary Policy Report but will consider our position on an ad-hoc basis as required.

Our interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

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 final quarter of 2025 and are expected to fall back further if inflation falls through 2026 and the MPC loosens monetary policy further.

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.

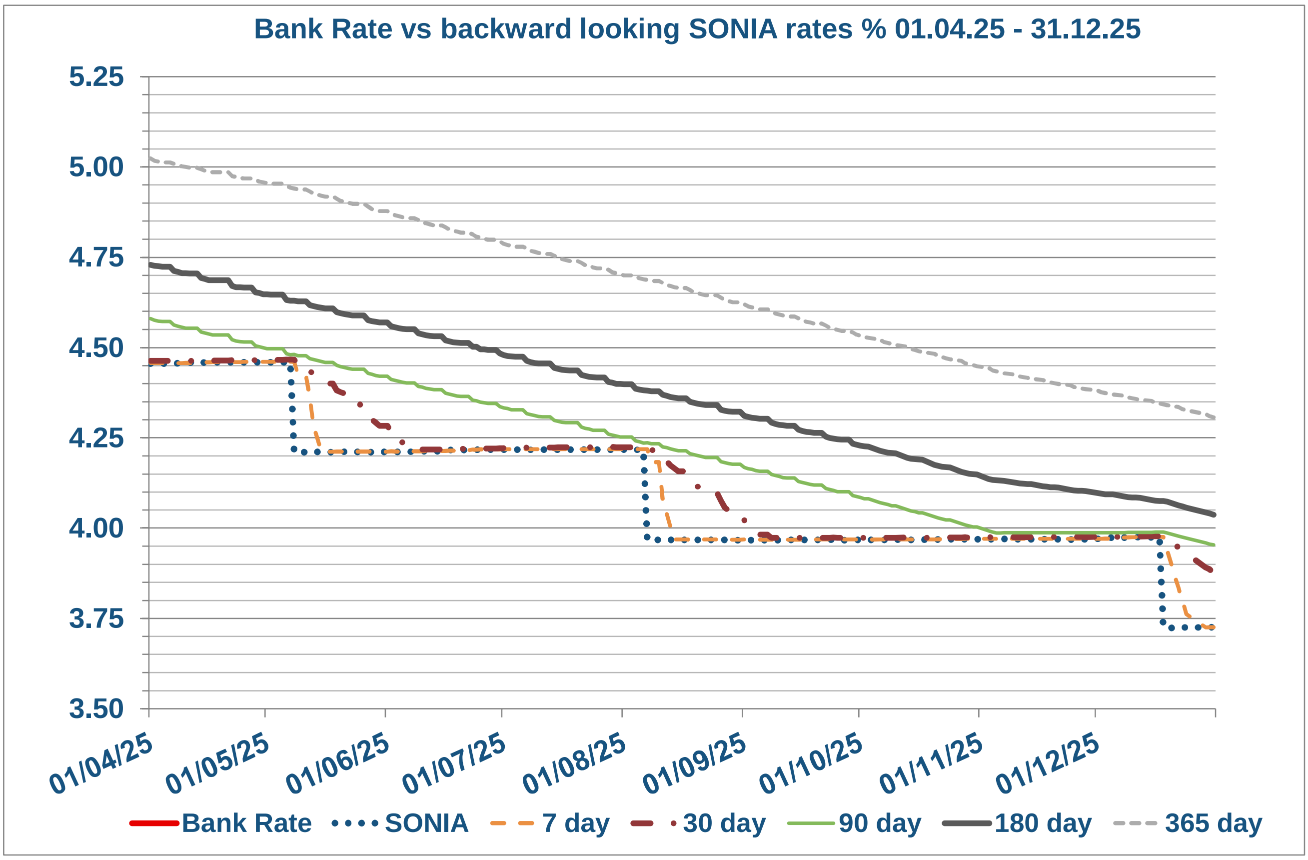
Investment counterparty criteria
The current investment counterparty criteria selection approved in the TMSS is meeting the requirement of the treasury management function.

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 **£21.888m**. 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 01.04.25 to 31.12.25



FINANCIAL YEAR TO QUARTER ENDED 31.12.25

	SONIA	7 day	30 day	90 day	180 day	365 day
High	4.46	4.46	4.47	4.58	4.73	5.02
High Date	07/05/2025	28/04/2025	06/05/2025	01/04/2025	01/04/2025	01/04/2025
Low	3.72	3.73	3.87	3.95	4.04	4.31
Low Date	22/12/2025	29/12/2025	31/12/2025	31/12/2025	31/12/2025	31/12/2025
Average	4.12	4.14	4.17	4.25	4.39	4.69
Spread	0.74	0.74	0.59	0.63	0.69	0.72

The Council's internally managed investments outperformed the benchmark (30-day backward looking SONIA) shown above by 27 bps.

Fund investments – as at 31 December 2025

Treasury Investments – Managed In House	Principle (£m)	Interest Rate	Maturity Date
CIC	4.000	4.170	04/02/2026
London Borough of Barking & Dagenham	5.000	4.150	13/03/2026
BlackRock ICS Heritage Shares MMF	1.000	3.885	Call
Aberdeen Standard Investments Money Market Fund	5.600	3.967	Call
Insight Liquidity Funds PLC	5.600	3.940	Call
Royal Bank of Scotland	1.076	2.000	Call
Total Investment – In House	**22.276**		

The Strategic Reserve Fund has underperformed the benchmark over the quarter to 31 December 2025, returning a gain 1.8% over the period, against a target of 2.3%.

Treasury Strategic Reserve Fund – Managed Externally	Actual (£m)	Performance Quarter Ending 31/12/25	Benchmark
Equity Portfolio	60.419	6.1%	3.3%
Global Equity Portfolio	62.415	-0.6%	4.0%
Diversified Growth Fund	20.235	2.1%	1.2%
High Yield Credit Strategies Fund	26.348	1.0%	1.4%
Private Loan Fund	5.620	n/a	n/a
UK Property Fund	24.766	0.7%	1.0%
Secured Income Fund	29.995	n/a	n/a
Corporate Bonds Fund	27.885	2.2%	2.4%
Buy and Maintain Fund	17.082	0.5%	0.5%
Total Investment – External	**274.765**	**1.8%**	**2.3%**

*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 31st December 2025.

4. Borrowing

No borrowing was undertaken during the quarter ended 31st December 2025. It is anticipated that further borrowing will not be undertaken during this financial year.

PWLB maturity Certainty Rates 01.04.25 to 31.12.25
Overall, the journey for PWLB Certainty rates in 2025/26 has been somewhat circular, with the only net movement of substance over the nine months under review occurring at the shortest part of the curve. Nonetheless, there has been a degree of volatility driven by movements in US Treasuries as well as domestic factors, the most negative of which impacted markets in early September.

Throughout the period under review, markets have reacted to Government fiscal messaging, yields rising when concerns emerged over the ability of the Government to keep net spending under control ahead of the 26 November Budget, and then easing back to rates similar to those at the start of the financial year once markets felt reassured by the steps the Chancellor had taken to manage public spending and to also bolster her fiscal headroom.

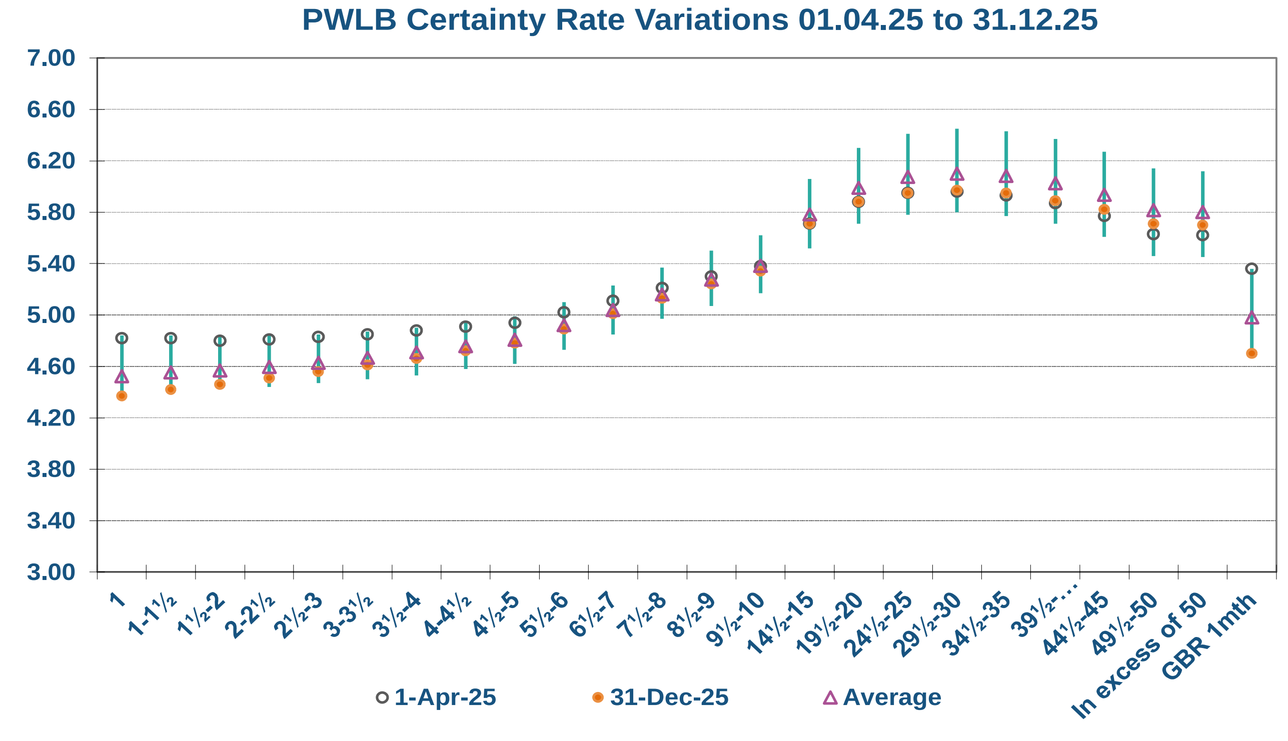
Accordingly, 1-year PWLB Certainty rates started the financial year at 4.82% and finished 2025 at 4.37%, whilst the 5-year part of the curve started at 4.94% and finished at 4.78%. Rates never got above 5% throughout the nine months under review.

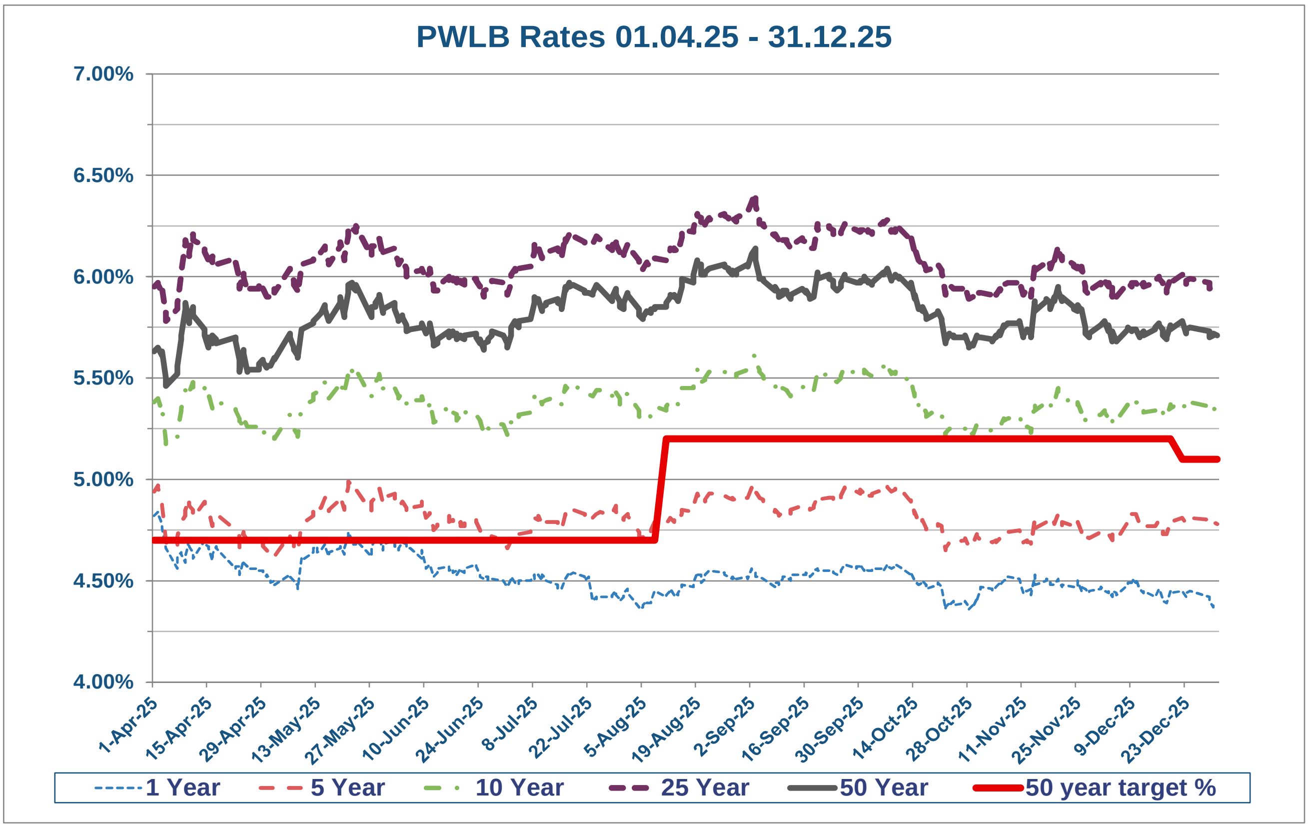
It was a different story for the longer part of the curve, and in recent weeks the Debt Management Office has confirmed that it will seek to issue less gilts in the longer part of the curve and seek to focus on the short to medium part of the curve, where investors are more willing to purchase. That may alter in due course if the CPI measure of inflation falls to 2% by the spring of 2026, having been "sticky" at much higher levels for much of 2025.

10-year PWLB Certainty rates started April at 5.38% and finished 2025 at 5.34%. On 3 September, rates hit a peak of 5.62%.

The story was repeated for the 25- and 50-year parts of the curve. 25-year PWLB Certainty rates started April at 5.95% and finished the year at the same level but touched a peak of 6.41% on 3 September. While the 50-year Certainty rate started at 5.63% in April and finished the year at 5.71%, peaking at 6.14% also on 3 September.

PWLB RATES 01.04.25 - 31.12.25





HIGH/LOW/AVERAGE PWLB RATES FOR 01.04.25 – 31.12.25

	1 Year	5 Year	10 Year	25 Year	50 Year
01/04/2025	4.82%	4.94%	5.38%	5.95%	5.63%
31/12/2025	4.37%	4.78%	5.34%	5.95%	5.71%
Low	4.36%	4.62%	5.17%	5.78%	5.46%
Low date	04/08/2025	02/05/2025	02/05/2025	04/04/2025	04/04/2025
High	4.84%	4.99%	5.62%	6.41%	6.14%
High date	02/04/2025	21/05/2025	03/09/2025	03/09/2025	03/09/2025
Average	4.52%	4.81%	5.38%	6.08%	5.82%
Spread	0.48%	0.37%	0.45%	0.63%	0.68%

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 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 31st December 2025

Treasury Indicators	2025/26 Budget £'000	31.12.25 Actual £'000
Authorised limit for external debt	100,000	100,000
Operational boundary for external debt	90,000	90,000
Gross external debt	65,000	50,000
Maturity structure of fixed rate borrowing - upper and lower limits		
Under 12 months	30%	40%
12 months to 2 years	30%	0
2 years to 5 years	30%	0
5 years to 10 years	30%	0
10 years to 20 years	50%	0
20 years and above	100%	60%

APPENDIX 2: Investment Portfolio

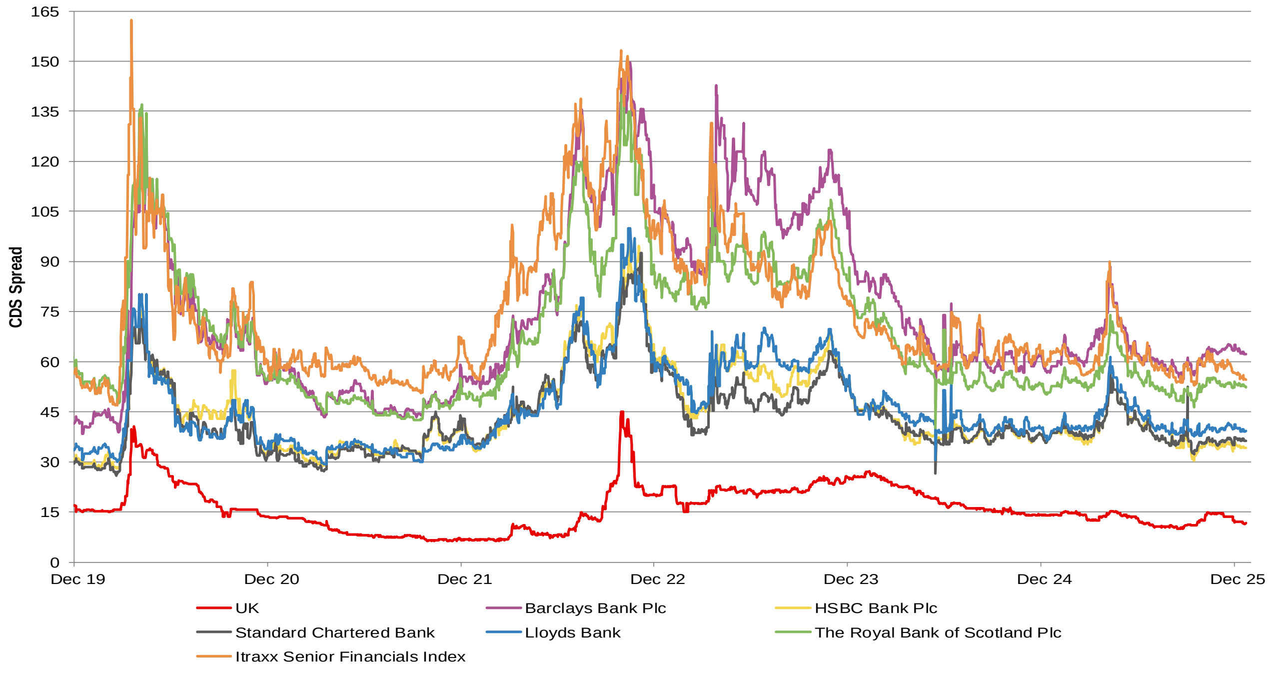
Investments held as of 31st December 2025 compared to our counterparty list:

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)	1,076,348	2.00%		Call	A+	0.000%	1
MMF Aberdeen Standard Investments	5,600,000	3.99%		MMF	AAAm		
MMF BlackRock	1,000,000	3.94%		MMF	AAAm		
MMF Insight	5,600,000	3.98%		MMF	AAAm		
Credit Industriel et Commercial	4,000,000	4.17%	04/08/2025	04/02/2026	A+	0.004%	177
London Borough of Barking & Dagenham	5,000,000	4.15%	04/12/2025	13/03/2026	AA-	0.004%	0
Total Investments	**£22,276,348**	**3.96%**					**£178**

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 September 2025, which are the latest returns currently available.

UK Banks 5 Year Senior Debt CDS Spreads as of 31st December 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 31st December 2025

Based on lowest available rating:

AAA

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

AA+

- Canada
- U.S.A.

AA

- Abu Dhabi (UAE)
- Finland
- Qatar

AA-

- **U.K.**

A+

- Belgium
- France

Appendix 2

MUFG

Orkney Islands Council

Monthly Investment Analysis Review

December 2025

Monthly Economic Summary

General Economy

The UK Manufacturing PMI rose to 50.6 in December, up from 50.2 in November, revised down from the preliminary estimate of 51.2 but ahead of expectations of 50.4. It was the second consecutive expansion after a year of contraction. Output rose for a third month with broad increases in consumer, intermediate, and investment goods sectors, supported by new work intakes, which expanded for the first time in 15 months. The UK Services PMI rose to 52.1 in December from 51.3 in November, exceeding forecasts of 51.6 and marking the 9th straight month of growth. However, employment fell for the 15th consecutive month amid cost pressures. Input costs rose at the fastest pace since May, pushing prices charged to their highest since August.

Combining the above, the UK Composite PMI picked up to 52.1 in December from November's 51.2, surpassing forecasts of 51.6. This was the eighth consecutive month of private sector expansion. On a less positive note, the UK Construction PMI fell to 39.4 in November (released on a one-month lag) from 44.1 in October, pointing to the steepest downturn in five-and-a-half years amid challenging conditions. New orders decreased to the greatest extent since May 2020, with respondents citing weak client confidence and delayed spending decisions linked to uncertainty ahead of the late-November Budget. Employment declined at the steepest rate since August 2020 and optimism was the weakest since December 2022.

UK GDP fell 0.1% in October, following a similar decline in September and missing expectations for a 0.1% expansion, marking the fourth consecutive month without growth. Services output declined 0.3% after a 0.2% gain in September, and construction fell 0.6% from a 0.2% rise. Conversely, production rose 1.1%, rebounding from a 2% plunge. The trade deficit widened to £4.82 billion in October from £1.09 billion in September, its largest gap since February. Exports fell 0.3% m/m to £77.00 billion, while imports rose 4.5% to £81.82 billion. Goods exports fell 0.8% to £30.96 billion, while goods imports rose 6.8% to £53.51 billion.

Employment fell by 16k in October after a 22k decrease in September, driven by fewer full-time positions. Average weekly earnings including bonuses rose 4.7% y/y to £739 in the three months to October, slowing from 4.9% but beating expectations of 4.4%. Private sector wage growth fell to 4.0% from 4.4%, the weakest since Dec 2020–Feb 2021, while public sector pay accelerated to 7.7%, the highest since Jul–Sep 2023. Adjusted for inflation, total earnings rose 0.6%, down from 0.7%, the lowest since May–Jul 2025.

Consumer prices fell 0.2% m/m in November, the first decrease since January and the biggest since July 2024, versus forecasts of flat. Annual inflation eased to 3.2%, the lowest in eight months, from 3.6% in October and below forecasts of 3.5% and the BoE's 3.4% prediction. The largest downward contribution came from food and non-alcoholic items, particularly bread and cereals. Prices also slowed for alcohol and tobacco, transport, and housing and utilities. Services inflation eased to 4.4% from 4.5%, below the BoE forecast. Clothing and footwear costs fell, while recreation and culture prices rose 2.9%, unchanged from October. Core inflation eased to 3.2% from 3.4%.

The GfK Consumer Confidence Index rose to -17 in December from -19 in November, beating forecasts of -18. Public sector net borrowing eased to £11.7 billion in November from £21.2 billion in October, below last year's £13.6bn and the lowest November reading since 2021. Receipts rose £5.9 billion y/y on higher tax revenues and National Insurance contributions, while expenditure rose £4.0 billion on public services and social benefits. Public sector net debt excluding banks stood at 95.6% of GDP.

As expected, the Bank of England cut Bank Rate by 25bps from 4.00% to 3.75% at its December meeting. The voting split was 5-4, with falling inflation persuading Governor Bailey to support a cut.

US Economy

Nonfarm payrolls rose by 64k in November, compared with a 105k loss in October and market expectations of a 50k increase. Headlining gains were health care and construction sectors, while federal government continued to lose jobs as the shutdown weighed with declines also seen in transportation and warehousing. US GDP advanced an annualised 4.3% in Q3 2025, the most in two years compared to 3.8% in Q2, and forecasts of 3.3%, the delayed estimate showed. The growth mainly reflected increases in consumer spending, exports, and government spending. Meanwhile the annual inflation rate in the US came in at 2.7% in December 2025, the lowest since July, below forecasts of 3.1% and 3% reported for September as energy prices rose 4.2% on the year, while food was a more modest 2.6% higher and shelter costs up 3%. Annual core inflation fell to 2.6% in November 2025, the lowest since March 2021 and below market expectations of 3%.

The FOMC cut the Federal Funds rate by 25bps at its December meeting, bringing it to the 3.50 - 3.75% range, albeit with three dissenting voters (two voted for no change, and one for a 50bps cut) as the committee remains divided. The accompanying statement signalled a pause for the near-term, in line with Governor Powell's press conference whereby he confirmed the Fed is "well positioned to wait and see how the economy performs from here."

EU Economy

The annual inflation rate in the Eurozone was revised down to 2.1% in November from a preliminary of 2.2%, matching the October reading. Services inflation accelerated to 3.5% from 3.4%, marking its highest level since April, while energy prices declined at a slower pace. The annual core inflation rate, which excludes prices of food, energy, and tobacco, was at 2.4% for the third consecutive month. Overall, the report was aligned with commentary from European Central Bank (ECB) Governing Council members suggesting that the central bank is unlikely to deliver more rate cuts under the current macroeconomic backdrop, with the members also voting to keep policy rates unchanged at their December meeting – as widely expected. The Eurozone economy grew 1.4% y/y in Q3 of 2025, compared to the 1.6% expansion recorded in both the first and second quarters, and broadly in line with the initial estimate. Spain led the major economies, expanding 2.8%, followed by the Netherlands at 1.6%. Among the bloc’s other largest economies, GDP expanded 0.9% in France, 0.6% in Italy but just by 0.3% in Germany.

Housing

The Halifax House Price Index in the UK was flat from a month earlier in November 2025, following a 0.5% rise in October and missing expectations of a 0.2% gain. Meanwhile, the UK Nationwide House Price index unexpectedly fell 0.4% from a month earlier in December 2025, defying market expectations of a 0.1% increase and reversing a 0.3% rise in the prior period, marking the first monthly decline in four months, due to seasonal effects.

Currency

Sterling appreciated against the Dollar and the Euro.

December	Start	End	High	Low
GBP/USD	$1.3253	$1.3451	$1.3508	$1.3203
GBP/EUR	€1.1395	€1.1453	€1.1472	€1.1375

Interest Rate Forecast

MUFG Corporate Markets revised its forecast down 25bps from Q2 2026 to Q2 2027, maintaining an expected Bank Rate trough of 3.25% by Q4 2026. Capital Economics also revised its forecast down 25bps for Q2 2026 and Q3 2026, maintaining an expected trough of 3% by Q4 2026.

Bank Rate	NOW	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28	Jun-28	Sep-28	Dec-28	Mar-29
MUFG Corporate Markets	3.75%	3.75%	3.50%	3.50%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%
Capital Economics	3.75%	3.50%	3.50%	3.25%	3.00%	3.00%	3.00%	3.00%	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 (£)
The Royal Bank of Scotland Plc (RFB)	1,076,348	2.00%		Call	A+	0.000%	1
MMF Aberdeen Standard Investments	5,600,000	3.99%		MMF	AAAm		
MMF BlackRock	1,000,000	3.94%		MMF	AAAm		
MMF Insight	5,600,000	3.98%		MMF	AAAm		
Credit Industriel et Commercial	4,000,000	4.17%	04/08/2025	04/02/2026	A+	0.004%	177
London Borough of Barking & Dagenham	5,000,000	4.15%	04/12/2025	13/03/2026	AA-	0.004%	0
Total Investments	**£22,276,348**	**3.96%**					£178

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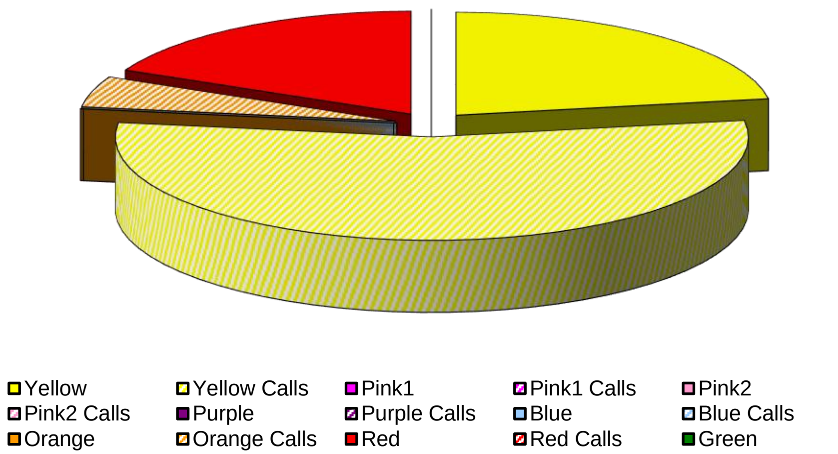
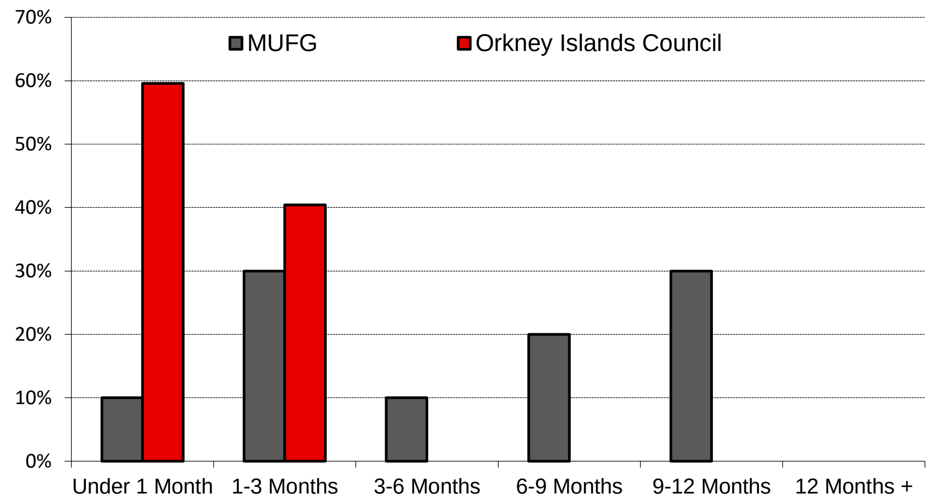
Where MUFG Corporate Markets have provided a return for a property fund, that return covers the 12 months to September 2025, which are the latest returns currently available.

Orkney Islands Council

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



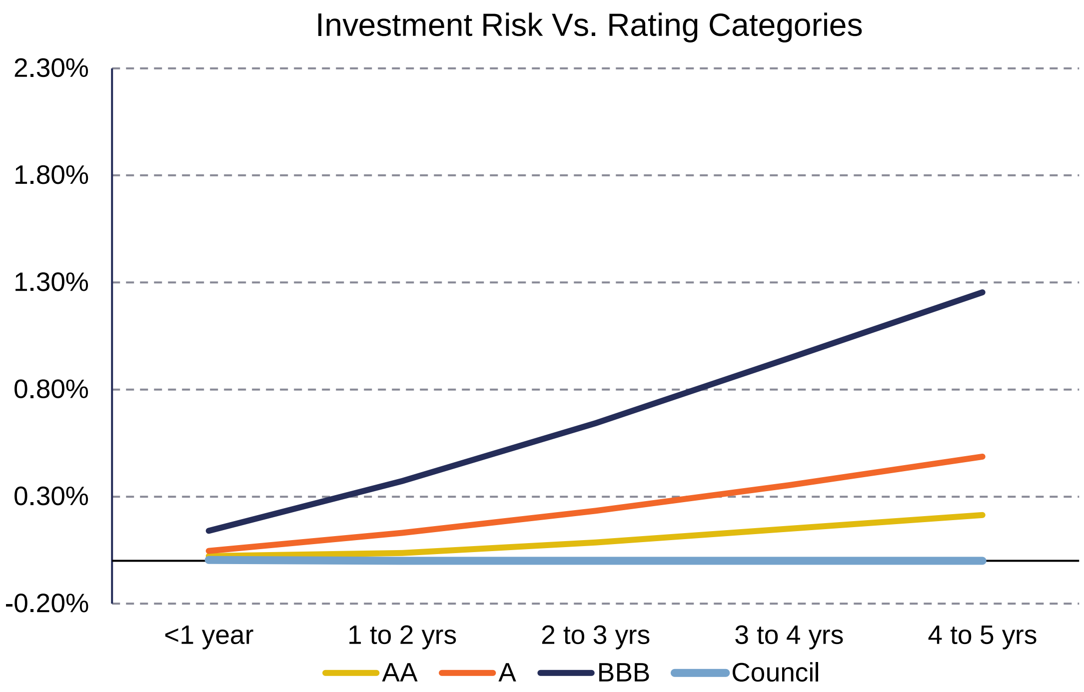
Portfolios weighted average risk number = 1.86

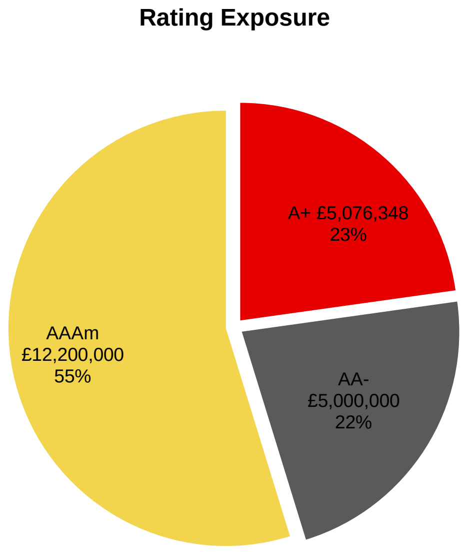
WARoR = Weighted Average Rate of Return
WAM = Weighted Average Time to Maturity

	% 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	77.21%	£17,200,000	70.93%	£12,200,000	54.77%	4.03%	21	29	72	99
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	4.83%	£1,076,348	100.00%	£1,076,348	4.83%	2.00%	0	0	0	0
Red	17.96%	£4,000,000	0.00%	£0	0.00%	4.17%	35	184	35	184
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%	**£22,276,348**	**59.60%**	**£13,276,348**	**59.60%**	**3.96%**	**22**	**55**	**56**	**137**

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.

Monthly Credit Rating Changes
FITCH

Date	Update Number	Institution	Country	Rating Action
05/12/2025	2109	Credit Industriel et Commercial	France	The Outlook on the Long Term Rating was changed to Negative from Stable.

Orkney Islands Council

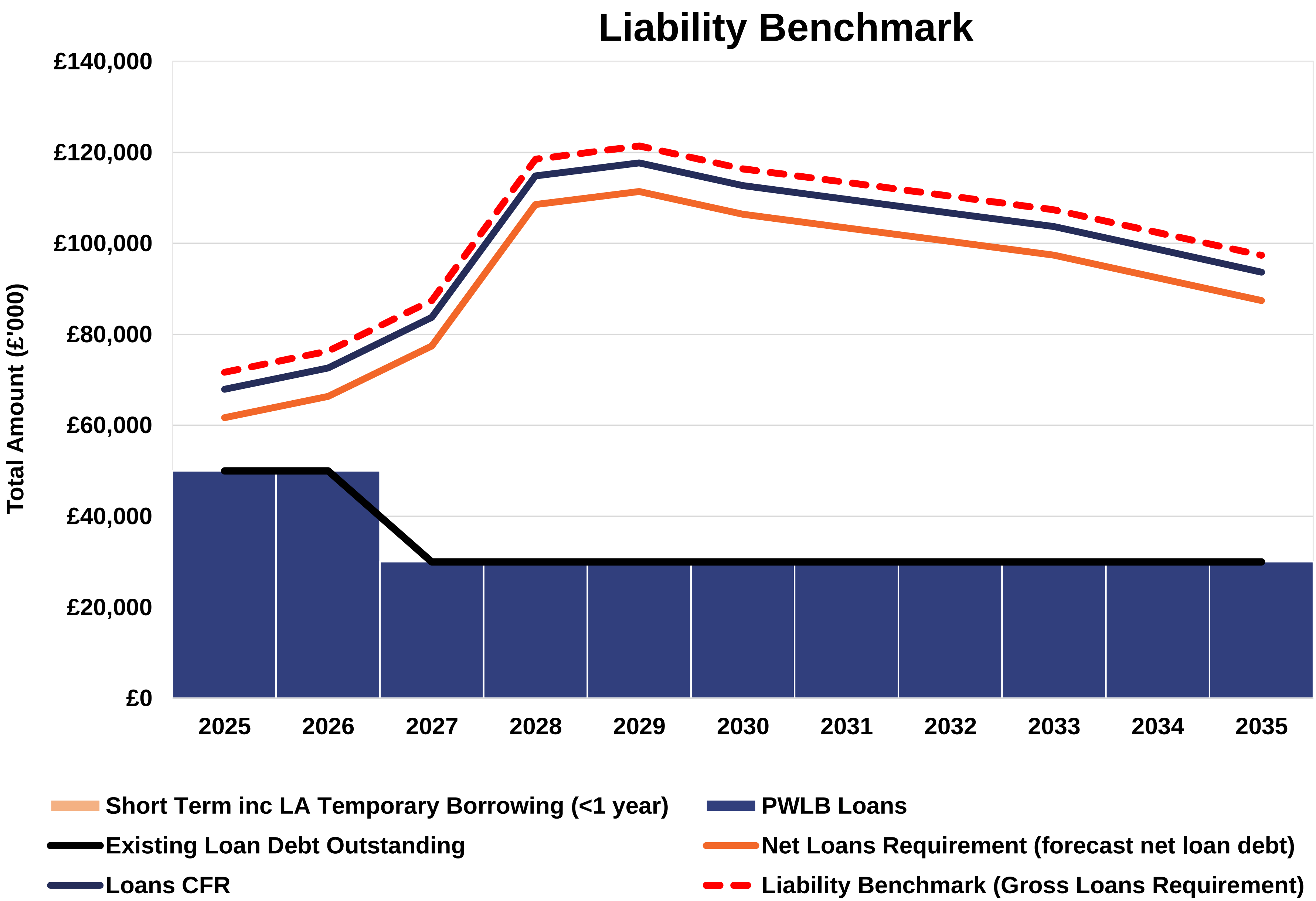
Monthly Credit Rating Changes
S&P

Date	Update Number	Institution	Country	Rating Action
05/12/2025	2110	Commerzbank AG	Germany	The Outlook on the Long Term Rating was changed to Positive from Stable.
05/12/2025	2111	Deutsche Bank AG	Germany	The Outlook on the Long Term Rating was changed to Positive from Stable.
12/12/2025	2112	ABN AMRO Bank N.V.	Netherlands	The Outlook on the Long Term Rating was changed to Positive from Stable.

Orkney Islands Council

Monthly Credit Rating Changes
MOODY'S

Date	Update Number	Institution	Country	Rating Action
				There were no rating actions to report.


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
Short Term inc LA Temporary Borrowing (<1 year)
PWLB Loans
Existing Loan Debt Outstanding
Net Loans Requirement (forecast net loan debt)
Loans CFR
Liability Benchmark (Gross Loans Requirement)