Item: 5

Investments Sub-committee: 24 September 2025

Treasury Management – Annual Report

Report by Head of Finance

1. Overview

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

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

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

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

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

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

1.6. A detailed analysis of the Treasury Management Performance for financial year 2024/25, attached as Appendix 1 to this report, refers to the following activities:

- Capital Expenditure and Financing.
- The Council's Overall Borrowing Need.
- Treasury Position as at 31 March 2025.
- The Strategy for financial year 2024/25.
- Borrowing Outturn.
- Investment Outturn.

- Other Issues.

1.7. The conclusion of the analysis of performance is that existing treasury management practices have operated effectively over the previous financial year.

2. Recommendations

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

i. Note the Treasury Management Review for financial year 2024/25, attached as Appendix 1 to this report.

3. Treasury Management Performance

3.1. Re-profiling and slippage on the approved capital programme for financial year 2023/24 resulted in £8,646,000 being moved into financial year 2024/25 and beyond. All slippage on delivery of the approved capital programme delays the timescale over which the capital finance is required, and results in the Council holding higher than predicted cash balances.

3.2. On 18 June 2024, when reviewing the capital programme, the Policy and Resources Committee recommended that several projects that had not progressed, be removed from the capital programme.

3.3. The Council has established authorised limits for external debt of £85,000,000 for the two-year period 2024-2026, together with an operational boundary of £75,000,000 for the same period, as part of its Treasury Management Strategy for 2024/25.

3.4. The Council supports its capital financing requirement through a combination of borrowings and use of internal reserves. In determining this combination, the cost of raising additional finance or borrowing is compared against the opportunity cost of using internal reserves and balances, in that these funds could otherwise be generating an investment return for the Council. On the basis the capital financing requirement can be externalised through borrowings, and investment returns generated in excess of the cost of any borrowings to meet the requirements of the capital programme, the potential exists for a net saving to be realised by the treasury management function over the longer term.

3.5. Throughout the 2024/25 financial year, investment returns remained strong. The Bank of England implemented three 0.25% rate cuts in August, November, and February, bringing the Bank Rate down from 5.25% to 4.5%. However, despite expectations for further reductions in 2025/26, the yield curve remained unusually flat at year-end.

3.6. Initial forecasts for 2024/25 anticipated gradual reductions in the Public Works Loans Board borrowing rates across short, medium, and long-term durations. However, the projected pace and scale of rate cuts did not materialise due to persistent inflation concerns.

3.7. The Bank of England Base Rate continues to impact on borrowing, with the short-term debt having an average interest rate of 5.05%, however, the Council is well placed to benefit from savings on its longer-term loans, with an average interest rate of 3.03%.

3.8. As at 31 March 2025, the Council's debt portfolio stood at £50,000,000, with loan maturities ranging over periods from one to 50 years. Overall, this represents an average cost of borrowing of 4.04% per annum, with an average duration of 24.3 years.

3.9. 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 at an average rate of 4.98% for financial year 2024/25.

3.10. The prime objective for the managed funds remains to maintain or increase their real value over time, while at the same time generating an annual return which meets the targets set by the Council. These objectives normally require to be measured over a number of years while acknowledging that abnormal fluctuations in the short term do create a cause for concern.

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

   ☐Growing our economy.

   ☐Strengthening our Communities.

   ☐Developing our Infrastructure.

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

   ☐Cost of Living.

   ☐Sustainable Development.

   ☐Local Equality.

   ☐Improving Population Health.
9. **Environmental and Climate Risk:** Environmental, Social and Governance factors are recognised as having the potential to impact the Fund.
10. **Risk:** Reviewing the performance annually 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.

Appendix

Appendix 1 – Treasury Management Performance for 2024/25

Annual Treasury Management Review
2024/25

Orkney Islands Council

Contents

ABBREVIATIONS USED IN THIS REPORT

CE: Capital Economics - is the economics consultancy that provides MUFG Corporate Markets Treasury Limited, with independent economic forecasts, briefings and research.

CFR: capital financing requirement - the Council's annual underlying borrowing need to finance capital expenditure and a measure of the Council's total outstanding indebtedness.

CIPFA: Chartered Institute of Public Finance and Accountancy – the professional accounting body that oversees and sets standards in local authority finance and treasury management.

CPI: consumer price index – the official measure of inflation adopted as a common standard by the UK and countries in the EU. It is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

ECB: European Central Bank - the central bank for the Eurozone

EU: European Union

EZ: Eurozone -those countries in the EU which use the euro as their currency

Fed: the Federal Reserve System, often referred to simply as "the Fed," is the central bank of the United States. It was created by the Congress to provide the nation with a stable monetary and financial system.

FOMC: the Federal Open Market Committee – this is the branch of the Federal Reserve Board which determines monetary policy in the USA by setting interest rates and determining quantitative easing/tightening policy. It is composed of 12 members - the seven members of the Board of Governors and five of the 12 Reserve Bank presidents.

GDP: gross domestic product – a measure of the growth and total size of the economy.

G7: the group of seven countries that form an informal bloc of industrialised democracies - the United States, Canada, France, Germany, Italy, Japan, and the United Kingdom - that meets annually to discuss issues such as global economic governance, international security, and energy policy.

Gilts: gilts are bonds issued by the UK Government to borrow money on the financial markets. Interest paid by the Government on gilts is called a coupon and is at a rate that is fixed for the duration until maturity of the gilt, (unless a gilt is index linked to inflation); while the coupon rate is fixed, the yields will change inversely to the price of gilts i.e., a rise in the price of a gilt will mean that its yield will fall.

HRA: housing revenue account.

IMF: International Monetary Fund - the lender of last resort for national governments which get into financial difficulties.

MPC: the Monetary Policy Committee is a committee of the Bank of England, which meets for one and a half days, eight times a year, to determine monetary policy by setting the official interest rate in the United Kingdom, (the Bank of England Base Rate, commonly called Bank Rate), and by making decisions on quantitative easing/tightening.

PFI: Private Finance Initiative – capital expenditure financed by the private sector i.e., not by direct borrowing by a local authority.

PWLB: Public Works Loan Board – this is the part of H.M. Treasury which provides loans to local authorities to finance capital expenditure.

QE/QT: quantitative easing – is an unconventional form of monetary policy where a central bank creates new money electronically to buy financial assets, such as government bonds, (but may also include corporate bonds). This process aims to stimulate economic growth through increased private sector spending in the economy and also aims to return inflation to target. These purchases increase the supply of liquidity to the economy; this policy is employed when lowering interest rates has failed to stimulate economic growth to an acceptable level and to lift inflation to target. Once QE has achieved its objectives of stimulating growth and inflation, QE will be reversed by selling the bonds the central bank had previously purchased, or by not replacing debt that it held which matures. This is called quantitative tightening. The aim of this reversal is to ensure that inflation does not exceed its target once the economy recovers from a sustained period of depressed growth and inflation. Economic growth, and increases in inflation, may threaten to gather too much momentum if action is not taken to 'cool' the economy.

RPI: the Retail Price Index is a measure of inflation that measures the change in the cost of a representative sample of retail goods and services. It was the UK standard for measurement of inflation until the UK changed to using the EU standard measure of inflation – Consumer Price Index. The main differences between RPI and CPI is in the way that housing costs are treated and that the former is an arithmetical mean whereas the latter is a geometric mean. RPI is often higher than CPI for these reasons.

SONIA: the Sterling Overnight Index Average. Generally, a set of indices for those benchmarking their investments. The benchmarking options include using a forward-looking (term) set of reference rates and/or a backward-looking set of reference rates that reflect the investment yield curve at the time an investment decision was taken.

TMSS: the annual treasury management strategy statement reports that all local authorities are required to submit for approval by the Full Council before the start of each financial year.

Annual Treasury Management Review 2024/25

Purpose

This Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2024/25. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

During 2024/25 the minimum reporting requirements were that the Full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Policy and Resources Committee 20/02/2024).
- a mid-year, (minimum), treasury update report (Investment Sub-committee 21/11/2024).
- an annual review following the end of the year describing the activity compared to the strategy, (this report).

In addition, this Council has received quarterly treasury management update reports on the following dates:

- Quarter 1 (Investment Sub-committee 18/09/2024
- Quarter 3 (Investment Sub-committee 27/02/2025

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Policy and Resources Committee before they were reported to the Full Council.

Executive Summary

During 2024/25, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Prudential and treasury indicators	31.3.2024 Actual £000	2024/25 Original £000	31.3.2025 Actual £000
Capital expenditure			
• Non-HRA	15.888	17.908	14.542
• HRA *(if applicable)*	2.399	1.346	2.994
• **Total**	**18.287**	**19.254**	**17.536**
Capital Financing Requirement:			
• Non-HRA	55.569	64.928	58.094
• HRA *(if applicable)*	8.508	10.351	8.317
• **Total**	**64.077**	**75.279**	**66.411**
Gross borrowing	**6.537**	**(1.612)**	**5.127**
External debt	**45.029**	**55.000**	**50.000**
Investments			
• Longer than 1 year	0.000	0.000	0.000
• Under 1 year	10.172	12.000	11.679
• **Total**	**10.172**	**12.000**	**11.679**
Net borrowing	**34.857**	**43.000**	**38.321**

Other prudential and treasury indicators are to be found in the main body of this report. The Head of Finance also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit, (the authorised limit), was not breached.

Introduction and Background

This report summarises the following:-

- Capital activity during the year;
- Impact of this activity on the Council’s underlying indebtedness, (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Summary of interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

1. The Council's Capital Expenditure and Financing

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m General Fund	31.3.2024 Actual £000	2024/25 Budget £000	31.3.2025 Actual £000
Capital expenditure	**15.888**	**17.908**	**14.542**
Financed in Year by Grants, Receipts and Contributions	9.721	20.665	10.471
Financed by Borrowings	**6.167**	**(2.757)**	**4.071**

£m HRA *(where relevant)*	31.3.2024 Actual £000	2024/25 Budget £000	31.3.2025 Actual £000
Capital expenditure	**2.399**	**1.346**	**2.994**
Financed in Year by Grants, Receipts and Contributions	2.029	0.201	1.938
Financed by Borrowings	**0.370**	**1.145**	**1.056**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2024/25 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, (such as the Government, through the Public Works Loan Board [PWLB], or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's (non HRA) underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, the statutory repayment of loans fund advances (prudent repayment), to reduce the CFR. This is effectively a repayment of the non-Housing Revenue Account (HRA) borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources, (such as unapplied capital receipts); or
- charging more than the statutory revenue charge.

The Council's 2024/25 prudent repayment policy (as required by Scottish Government) was approved as part of the Treasury Management Strategy Report for 2024/25 on 20/02/2024.

The Council's CFR for the year is shown below, and represents a key prudential indicator.

CFR (£m): General Fund	31.3.2024 Actual £000	2024/25 Budget £000	31.3.2025 Actual £000
Opening balance	**51.358**	**70.191**	**58.427**
Add unfinanced capital expenditure (as above)	6.167	(2.757)	4.071
Less Statutory Repayment*	(1.783)	(2.506)	(4.404)
Closing balance	**55.742**	**64.928**	**58.094**

CFR (£m): HRA	31.3.2024 Actual £000	2024/25 Budget £000	31.3.2025 Actual £000
Opening balance	**8.990**	**9.992**	**8.508**
Add unfinanced capital expenditure (as above)	0.370	1.145	1.056
Less Statutory Repayment	(0.851)	(0.419)	(1.247)
Closing balance	**8.509**	**10.718**	**8.317**

Borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2023/24) plus the estimates of any additional capital financing requirement for the current (2024/25) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allowed the Council some flexibility to borrow in advance of its immediate capital needs in 2024/25. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31.3.2024 Actual £000	2024/25 Budget £000	31.3.2025 Actual £000
Gross borrowing position	45.029	55.000	50.000
CFR	64.251	75.646	66.411
Under / over funding of CFR	**19.222**	**20.646**	**16.411**

The authorised limit - the authorised limit is the "affordable borrowing limit" required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2024/25 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - this indicator identifies the trend in the cost of capital, (borrowing and other long term obligation costs net of investment income), against the net revenue stream.

	2024/25 £000
Authorised limit	85.000
Maximum gross borrowing position during the year	65.778
Operational boundary	75.000
Average gross borrowing position	53.496
Financing costs as a proportion of net revenue stream - General Fund HRA	0.58% 29.6%

3. Treasury Position as of 31st March 2025

The Council's treasury management debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the end of 2024/25 the Council's treasury position was as follows:

DEBT PORTFOLIO	31.3.2024 Principal £000	Rate/ Return	Average Life yrs	31.3.2025 Principal £000	Rate/ Return	Average Life yrs
Fixed rate funding:						
-PWLB	40.000			50.000		
-Local Authority	5.000			0.000		
-Salix Finance Ltd	0.029			0.000		
Total debt	**45.029**	**3.37%**	**27.53**	**50.000**	**4.04%**	**24.32**
CFR	**64.251**			**66.411**		
Over / (under) borrowing	**(19.222)**			**(16.411)**		
Total investments	**10.918**			**11.679**		
Net debt	**34.111**			**38.321**		

The maturity structure of the debt portfolio was as follows:

	31.3.2024 Actual £000	31.3.2025 Actual £000
Under 12 months	0.029	10.000
12 months and within 24 months	0.027	10.000
24 months and within 5 years	0.000	0.000
5 years and within 10 years	0.000	0.000
10 years and within 20 years	0.000	0.000
20 years and within 30 years	0.000	0.000
30 years and within 40 years	0.000	20.000
40 years and within 50 years	30.000	10.000

INVESTMENT PORTFOLIO	31.3.2024 Actual £000	31.3.2024 Actual %	31.3.25 Actual £000	31.3.25 Actual %
Treasury investments				
Banks	1.218	0.4%	0.979	0.4%
Building societies - rated	0.000	0.0%	0.000	0.0%
Local authorities	0.000	0.0%	0.000	0.0%
DMADF (H M Treasury)	0.000	0.0%	0.500	0.2%
Money Market Funds	8.700	3.2%	10.200	3.9%
Certificate of Deposits – UK Banks	1.000	0.4%	0.000	0.0%
Total managed in house	**10.918**	**4.03%**	**11.679**	**4.43%**
Equity Fund	102.883	38.0%	101.714	38.6%
Bond funds	41.608	15.4%	42.726	16.2%
Property funds	22.858	8.4%	24.111	9.1%
Diversified Growth Funds	29.651	10.9%	21.858	8.3%
Credit Strategies Funds	32.222	11.9%	31.672	12.0%
Alternative Income Funds	30.757	11.4%	29.813	11.3%
Total managed externally	**259.979**	**95.97%**	**251.894**	**95.57%**
TOTAL TREASURY INVESTMENTS	**270.897**	**100%**	**263.573**	**100%**

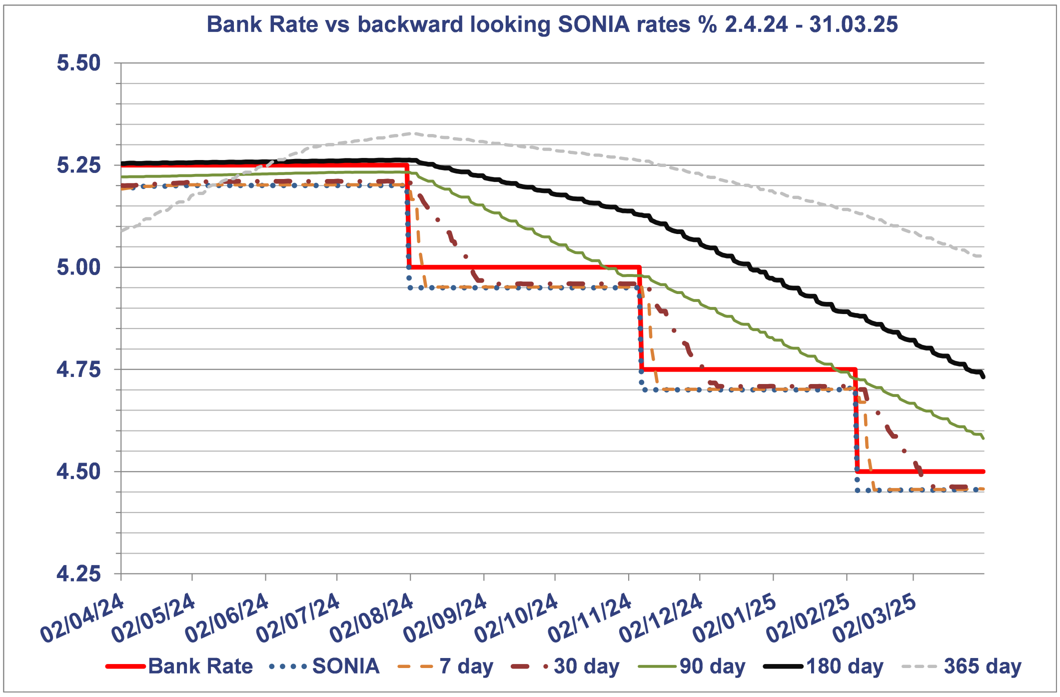
Non-Treasury investments				
Fishing Quota	3.816	43.22%	4.512	51.13%
Private Companies	5.000	56.63%	4.300	48.73%
Other	0.013	0.15%	0.013	0.15%
TOTAL NON-TREASURY INVESTMENTS	**8.829**	**100%**	**8.825**	**100%**

Treasury investments (in house)	3.816	43.22%	4.512	51.13%
Non-Treasury investments (external)	5.000	56.63%	4.300	48.73%
Non-Treasury investments	0.013	0.15%	0.013	0.15%
TOTAL OF ALL INVESTMENTS	**8.829**	**100%**	**8.825**	**100%**

4. The Strategy for 2024/25

4.1 Investment strategy and control of interest rate risk

Investment Benchmarking Data – Sterling Overnight Index Averages (Backward-looking) 2024/25



FINANCIAL YEAR TO QUARTER ENDED 31/03/2025							
	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	4.50	4.45	4.46	4.46	4.58	4.73	5.02
Low Date	06/02/2025	12/02/2025	13/02/2025	12/03/2025	31/03/2025	31/03/2025	31/03/2025
Average	4.95	4.90	4.91	4.94	5.02	5.11	5.22
Spread	0.75	0.75	0.75	0.75	0.65	0.53	0.30

Investment returns remained robust throughout 2024/25 with Bank Rate reducing steadily through the course of the financial year (three 0.25% rate cuts in total), and even at the end of March the yield curve was still relatively flat, which might be considered unusual as further Bank Rate cuts were expected in 2025/26.

Bank Rate reductions of 0.25% occurred in August, November and February, bringing the headline rate down from 5.25% to 4.5%. Each of the Bank Rate cuts occurred in the same month as the Bank of England publishes its Quarterly Monetary Policy Report, therein providing clarity over the timing of potential future rate cuts.

As of early April 2025, market sentiment has been heavily influenced of late by President Trump's wide-ranging trade tariffs policy. Commentators anticipate a growing risk of a US recession, whilst UK GDP is projected by the Office for Budget Responsibility to remain tepid, perhaps achieving 1% GDP growth in 2025/26.

Looking back to 2024/25, investors were able to achieve returns in excess of 5% for all periods ranging from 1 month to 12 months in the spring of 2024 but by March 2025 deposit rates were some 0.75% - 1% lower. Where liquidity requirements were not a drain on day-to-day investment choices, extending duration through the use of ‘’laddered investments’’ paid off.

That is not to say that investment choices were straight-forward. Concerns over rising inflation after the Autumn Statement in October led to reduced expectations for Bank Rate to fall. Indeed, the CPI measure of inflation is expected to reach c3.75% by the autumn of 2025, which could provide some presentational issues for a Bank whose primary mandate is to ensure inflation is close to 2% on a two-to-three-year timeframe. At the end of March, only two further rate cuts were priced into the market for 2025 (4% at December 2025). A week later and sentiment has changed dramatically in the wake of the equity market sell-off to the extent that markets now expect three Bank Rate reductions between May and December 2025 (Bank Rate to fall to 3.75%).

4.2 Borrowing strategy and control of interest rate risk

During 2024/25, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council’s reserves, balances and cash flow was used as an interim measure. This strategy was prudent as although near-term investment rates were equal to, and sometimes higher than, long-term borrowing costs, the latter are expected to fall back through 2025 and 2026 in the light of economic growth concerns and the eventual dampening of inflation. The Council has sought to minimise the taking on of long-term borrowing at elevated levels (>4%) and has focused on a policy of internal and temporary borrowing, supplemented by short-dated borrowing (<5 years) as appropriate.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Head of Finance therefore monitored interest rates in financial markets and adopted a pragmatic strategy based upon the following principles to manage interest rate risks*:*

- if it had been felt that there was a significant risk of a sharp FALL in long and short-term rates, (e.g., due to a marked increase of risks around a relapse into recession or of risks of deflation), then long term borrowings would have been postponed, and potential rescheduling from fixed rate funding into short term borrowing would have been considered.
- if it had been felt that there was a significant risk of a much sharper RISE in long and short-term rates than initially expected, perhaps arising from the stickiness of inflation in the major developed economies, then the portfolio position would have been re-appraised. Most likely, fixed rate funding would have been drawn whilst interest rates were lower than they were projected to be in the next few years.

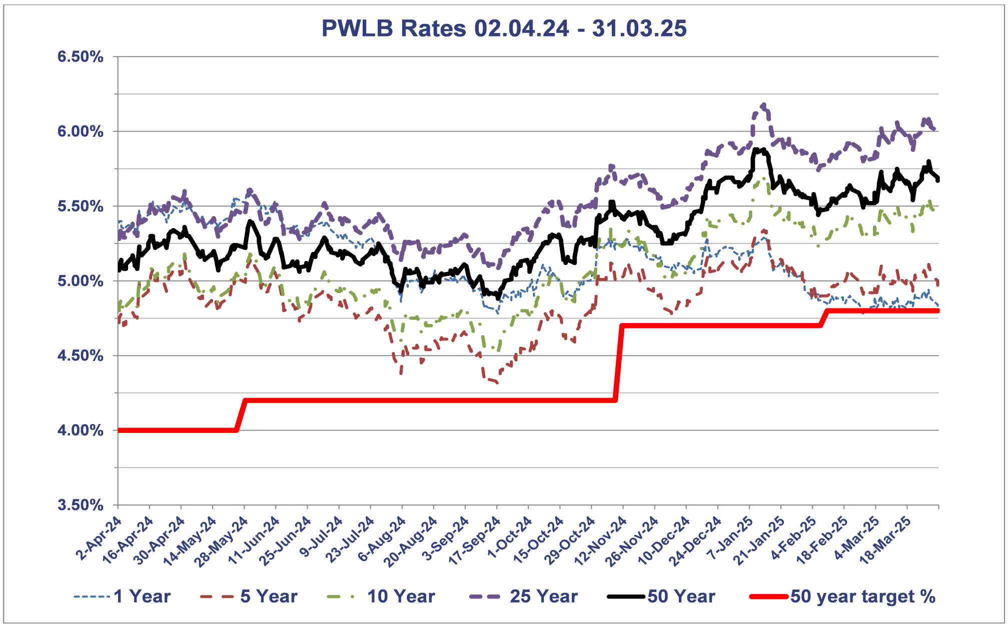
Interest rate forecasts initially suggested gradual reductions in short, medium and longer-term fixed borrowing rates during 2024/25. Bank Rate did peak at 5.25% as anticipated but the initial expectation of significant rate reductions did not transpire, primarily because inflation concerns remained elevated. Forecasts were too optimistic from a rate reduction perspective, but more recently the forecasts look more realistic.

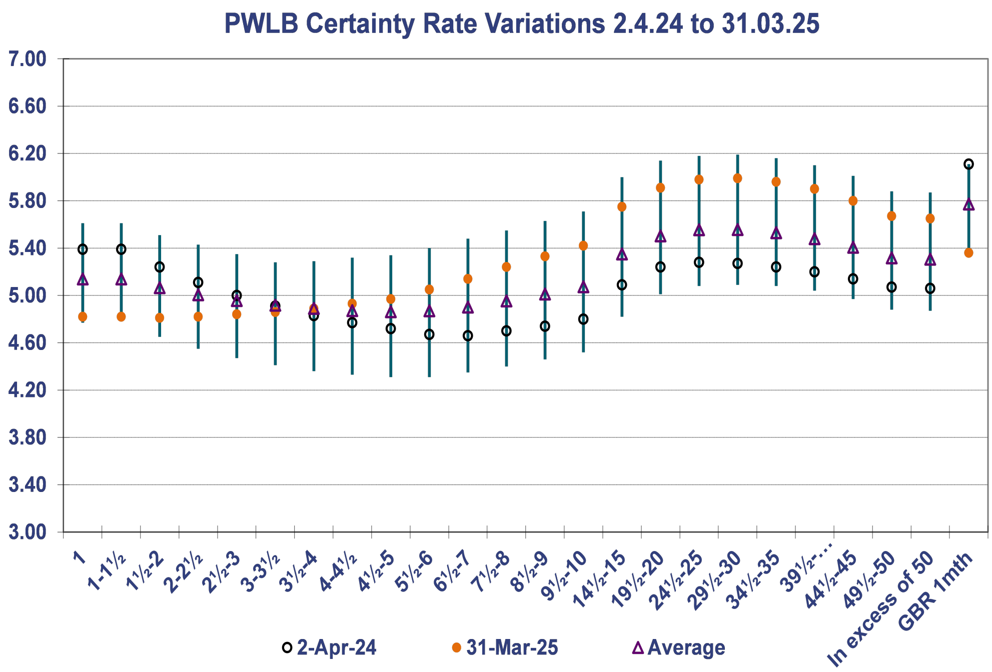
At the start of April 2025, following the introduction of President Trump’s trade tariffs policies, the market now expects Bank Rate to fall to 3.75% by the end of December 2025, pulling down the 5- and 10-year parts of the curve too. This should provide an opportunity for greater certainty to be added to the debt portfolio, although a significant fall in inflation will be required to underpin any material movement lower in the longer part of the curve.

Forecasts at the time of approval of the treasury management strategy report for 2024/25 were as follows:

MUFG Corporate Markets Interest Rate View 08.01.24	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

PWLB RATES 2023/24





HIGH/LOW/AVERAGE PWLB RATES FOR 2024/25

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.77%	4.31%	4.52%	5.08%	4.88%
Date	26/02/2025	17/09/2024	17/09/2024	17/09/2024	17/09/2024
High	**5.61%**	**5.34%**	**5.71%**	**6.18%**	**5.88%**
Date	29/05/2024	13/01/2025	13/01/2025	13/01/2025	09/01/2025
Average	5.14%	4.86%	5.07%	5.56%	5.32%
Spread	0.84%	1.03%	1.19%	1.10%	1.00%

PWLB rates are based on gilt (UK Government bonds) yields through HM Treasury determining a specified margin to add to gilt yields. The main influences on gilt yields are Bank Rate, inflation expectations and movements in US treasury yields. Inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation and the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last 30 years. Indeed, in recent years many bond yields up to 10 years in the Eurozone turned negative on expectations that the EU would struggle to get growth rates and inflation up from low levels. In addition, there has, at times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

However, since early 2022, yields have risen dramatically in all the major developed economies, first as economies opened post-Covid, then because of the inflationary impact of the Russian invasion of Ukraine in respect of the supply side of many goods. In particular, rising cost pressures emanating from shortages of energy and some food categories have been central to inflation rising rapidly. Furthermore, at present the Fed, ECB and Bank of England are all being challenged by levels of persistent inflation that are exacerbated by tight labour markets and high wage increases relative to what central banks believe to be sustainable.

Gilt yields have been volatile through 2024/25. Indeed, the low point for the financial year for many periods was reached in September 2024. Thereafter, and especially following the Autumn Statement, PWLB Certainty rates have remained elevated at between c5% - 6% with the exception of the slightly cheaper shorter dates.

At the close 31 March 2025, the 1-year PWLB Certainty rate was 4.82%, whilst the 25-year rate was 5.98%- and 50-year rate was 5.67%.

Regarding PWLB borrowing rates, the various margins attributed to their pricing are as follows:

- **PWLB Standard Rate** is gilt plus 100 basis points (G+100bps)
- **PWLB** Certainty **Rate** is gilt plus 80 basis points (G+80bps)
- **Local Infrastructure Rate** is gilt plus 60 basis points (G+60bps)
- **HRA Borrowing** rate is gilt plus 40 basis points (G+40bps)

There is likely to be a fall in gilt yields and PWLB rates across the whole curve over the next one to two years as Bank Rate falls and inflation (on the Consumer Price Index measure) moves lower.

As a general rule, short-dated gilt yields will reflect expected movements in Bank Rate, whilst medium to long-dated yields are driven primarily by the inflation outlook.

The Bank of England is also continuing a process of Quantitative Tightening. The Bank's original £895bn stock of gilt and corporate bonds will gradually be sold back into the market over several years (currently c£623bn). The impact this policy will have on the market pricing of gilts, while issuance is still markedly increasing, and very high in historic terms, is an unknown at the time of writing.

5. Borrowing Outturn

Borrowing - loans were drawn to fund the net unfinanced capital expenditure and naturally maturing debt.

The loans drawn were:

Lender	Principal £000	Type	Interest Rate	Maturity
PWLB	£10.000	Fixed interest rate	5.48%	1 year
PWLB	£5.000m	Fixed Interest rate	4.84%	1.5 years
PWLB	£5.000m	Fixed Interest rate	5.50%	1.5 years

Borrowing in advance of need

The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

Rescheduling

No rescheduling was done during the year as the approximate 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Repayments

On 10/10/2024 the Council repaid a £5.00m local authority loan at an average rate of 5.70% and on 10/03/2025 the Council repaid a £10.00m PWLB loan at an average rate of 5.44% using investment balances. A further £0.0.29 payment was made as the final repayment against the 8-year interest free loan with Salix Finance Ltd, which was borrowed for LED street lighting replacement.

6. Investment Outturn

Investment Policy – the Council's investment policy is governed by Scottish Governance investment guidance, which has been implemented in the annual investment strategy approved by the Council on 20 February 2024. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's cash balances comprise revenue and capital resources and cash flow monies. The Council's core cash resources comprised as follows:

Balance Sheet Resources (£m)	31.3.2024 £000	31.3.2025 £000
Fund Balances/Reserves – managed in-house	23.029	22.834
Strategic Reserve Fund – externally managed	221.101	206.544
Capital Receipts	2.100	2.283
Provisions	39.977	41.341
Other – Repairs and Renewals Fund and Capital Fund	7.157	9.844
Total	293.364	282.846

Investments held by the Council

- The Council maintained an average balance of £16.893m of internally managed funds.
- The internally managed funds earned an average rate of return of 4.98%.
- The comparable performance indicator is the average 30-day Backward Sterling Overnight Index Average (SONIA) rate, which was 4.46%.
- Total investment income was £0.841m.

Investments held by fund managers

The Council employs specialist external fund managers to invest the Strategic Reserve Fund cash balances across 8 separate mandates. The performance of the managers compared against the benchmark returns for the 12 months ending 31 March 2025 was:

Fund Manager	Investments Held £000	Return	Benchmark*
Equity Portfolio	49.345	3.50%	6.40%
Global Equity Portfolio	52.369	-3.40%	7.50%
Dynamic Diversified Growth Fund	21.858	5.20%	8.20%
Global High Yield Credit Strategies Fund	25.068	7.50%	10.40%
Global Private Loan Fund 3	6.604	7.00%	4.50%
UK Property Fund	24.111	5.50%	6.40%
Secured Income Fund	29.813	2.10%	4.50%
Passive Bonds Fund	42.726	2.30%	2.20%
Total	251.894	2.50%	5.90%

This compares with a budget assumption of 5.2% investment return. Performance during the year has been positive in absolute terms however lagged behind the benchmark.

7. The Economy and Interest Rates

UK Economy

UK inflation has proved somewhat stubborn throughout 2024/25. Having started the financial year at 2.3% y/y (April), the CPI measure of inflation briefly dipped to 1.7% y/y in September before picking up pace again in the latter months. The latest data shows CPI rising by 2.8% y/y (February), but there is a strong likelihood that figure will increase to at least 3.5% by the Autumn of 2025.

Against that backdrop, and the continued lack of progress in ending the Russian invasion of Ukraine, as well as the potentially negative implications for global growth as a consequence of the implementation of US tariff policies by US President Trump in April 2025, Bank Rate reductions have been limited. Bank Rate currently stands at 4.5%, despite the Office for Budget Responsibility reducing its 2025 GDP forecast for the UK economy to only 1% (previously 2% in October).

Moreover, borrowing has becoming increasingly expensive in 2024/25. Gilt yields rose significantly in the wake of the Chancellor's Autumn Statement, and the loosening of fiscal policy, and have remained elevated ever since, as dampened growth expectations and the minimal budget contingency (<£10bn) have stoked market fears that increased levels of borrowing will need to be funded during 2025.

The table below provides a snapshot of the conundrum facing central banks: inflation pressures remain, labour markets are still relatively tight by historical comparisons, and central banks are also having to react to a fundamental re-ordering of economic and defence policies by the US administration.

	UK	Eurozone	US
Bank Rate	4.50%	2.5%	4.25%-4.5%
GDP	0.1%q/q Q4 (1.1%y/y)	+0.1%q/q Q4 (0.7%y/y)	2.4% Q1 Annualised
Inflation	2.8%y/y (Feb)	2.3%y/y (Mar)	2.8%y/y (Feb)
Unemployment Rate	4.4% (Jan)	6.2% (Feb)	4.1% (Feb)

The Bank of England sprung no surprises in their March meeting, leaving Bank Rate unchanged at 4.5% by a vote of 8-1, but suggesting further reductions would be gradual. The Bank of England was always going to continue its cut-hold-cut-hold pattern by leaving interest rates at 4.50% but, in the opposite of what happened at the February meeting, the vote was more hawkish than expected. This suggested that as inflation rises later in the year, the Bank cuts rates even slower, but the initial impact of President Trump's tariff policies in April 2025 on the financial markets underpin our view that the Bank will eventually reduce rates to 3.50%.

Having said that, the Bank still thinks inflation will rise from 2.8% in February to 3¾% in Q3. And while in February it said "inflation is expected to fall back thereafter to around the 2% target", this time it just said it would "fall back thereafter". That may be a sign that the Bank is getting a bit more worried about the "persistence in domestic wages and prices, including from second-round effects". Accordingly, although we expect a series of rate cuts over the next year or so, that does not contradict the Bank taking "a gradual and careful" approach to cutting rates, but a tepid economy will probably reduce inflation further ahead and prompt the Bank to cut at regular intervals.

From a fiscal perspective, the increase in businesses' national insurance and national minimum wage costs from April 2025 is likely to prove a headwind, although in the near-term the Government's efforts to provide 300,000 new homes in each year of the current Parliament is likely to ensure building industry employees are well remunerated, as will the clamp-down on immigration and the generally high levels of sickness amongst the British workforce. Currently wages continue to increase at a rate close to 6% y/y. The MPC would prefer a more sustainable level of c3.5%.

As for equity markets, the FTSE 100 has recently fallen back to 7,700 having hit an all-time intra-day high 8,908 as recently as 3rd March. The £ has also endured a topsy-turvy time, hitting a peak of $1.34 before dropping to $1.22 in January and then reaching $1.27 in early April 2025.

USA Economy.

Despite the markets willing the FOMC to repeat the rate cut medicine of 2024 (100 basis points in total), the Fed Chair, Jay Powell, has suggested that the Fed. Funds Rate will remain anchored at 4.25%-4.5% until inflation is under control, and/or the economy looks like it may head into recession as a consequence of President Trump's tariff policies.

Inflation is close to 3% and annualised growth for Q4 2024 was 2.4%. With unemployment just above 4%, and tax cuts in the pipeline, the FOMC is unlikely to be in a hurry to cut rates, at least for now.

EZ Economy.

The Eurozone economy has struggled throughout 2024 and is flat lining at present, although there is the promise of substantial expenditure on German defence/infrastructure over the coming years, which would see a fiscal loosening. France has struggled against a difficult political backdrop, but with a large budget deficit it is difficult to see any turn-around in economic hopes in the near-term.

With GDP currently below 1% in the Euro-zone, the ECB is likely to continue to cut rates, although the headline inflation rate is still above 2% (2.3% February 2025). Currently at 2.5%, a further reduction in the Deposit Rate to at least 2% is highly likely.

8. Other Issues

The Authority's activities expose it to a variety of financial risks:

- Credit risk – the possibility that other parties might fail to pay amounts due to the Authority.
- Liquidity risk – the possibility that the Authority might not have funds available to meet its commitments to make payments.
- Market risk – the possibility that financial loss might arise for the Authority as a result of changes in such measure as interest rates and stock market movements.

The Council's management of treasury risks actively works to minimise the Council's exposure to the unpredictability of financial markets and to protect the financial resources available to fund services. The Council has fully adopted CIPFA's Code of Treasury Management Practices and has written principles for overall risk management as well as written policies and procedures covering specific areas such as credit risk, liquidity risk and market risk.

Credit Risk

Credit risk arises from the short-term lending of surplus funds to financial institutions and local authorities, as well as credit exposures to the council's customers.

The risk is minimised through the Annual Investment Strategy.

Credit Risk Management Practices

The Council's credit risk management practices are set out in the Annual Investment Strategy. It is the policy of the council to place deposits only with a limited number of high-quality banks, building societies and money market funds whose credit rating is independently assessed as sufficiently secure by the Council's treasury advisers and to restrict lending to a prudent maximum amount for each entity.

Deposits are not made with banks and financial institutions unless they are rated independently with minimum score of A1/P1/F1 short term debt ratings with Moodys, Standard & Poors or Fitch. The authority has a policy of not lending more than 25% of its surplus balances to individual institutions at any one time.

No credit limits were exceeded during the financial year 2024/25 and the Council expects full repayment on the due date of deposits placed with its counterparties.

Liquidity risk

The authority has a cash flow management system that seeks to ensure that cash is available as needed. If unexpected movements happen, the authority has ready access to borrowings from the money markets and the Public Works Loans Board. There is no significant risk that it will be unable to raise finance to meet its commitments under financial instruments. Instead, the risk is that the authority will be bound to replenish a significant proportion of its borrowings at a time of unfavourable interest rates. The authority sets limits on the proportion of its fixed rate borrowing during specified periods.

Market risk: interest rate risk

The Authority is exposed to risk in terms of its exposure to interest rate movements on its borrowings and investments. Movements in interest rates have a complex impact on the authority. For instance, a rise in interest rates would have the following effects:

- Borrowings at variable rates – the interest expense charged to the Surplus or Deficit on the Provision of Services will rise.
- Borrowings at fixed rates – the fair value of the liabilities borrowings will fall.
- Investments at variable rates – the interest income credited to the Surplus or Deficit on the Provision of Services will rise.
- Investments at fixed rates – the fair value of the assets will fall.

The authority's investment strategy aims to manage interest rate risk by maintaining a number of discrete investment mandates or portfolios which are managed by specialist external fund managers. The diversification across equities, multi-asset pooled funds and bond investments in this way effectively minimises the Council's exposure to interest rate movements. The risk of loss remains with the authority.

Market risk: price risk

The authority held £260.719m of investments as at 31 March 2025 in the form of equities, multi-asset pooled funds and bonds, including £1.268m in a local wind energy company and £4.300m in fishing quota. The authority is consequently exposed to losses arising from movement in the price of the shares.

The authority's investment strategy limits its exposure to price movements by diversifying its investment portfolio through the use of external fund managers, investment guidelines, benchmarks and targets.

These clearly defined shares are mainly classified as Fair Value through Profit or Loss with the investment in the local wind energy company and fishing quota classified as Fair Value Other Comprehensive Income, meaning that all movements in price will impact directly on the Surplus or Deficit in the Provision of Services.