POLICY AND RESOURCES COMMITTEE 5 FEBRUARY 2025

TREASURY MANAGEMENT STRATEGY 2025/26

Report by Chief Financial Officer

PURPOSE

1.1 The purpose of the Report is to propose to Members' the Borrowing and Investment Strategies for 2025/26 and the estimated Prudential Indicators for 2025/26.

EXECUTIVE SUMMARY

2.1 This Report fulfils the Comhairle's legal obligations under the Local Government in Scotland Act 2003 and incorporates both the required Borrowing and Investment Strategies. It also takes into account the outlook for interest rates, the Comhairle's current treasury position and the Prudential Indicators the Comhairle is required to set for the next three years to ensure that total capital investment remains within sustainable limits.

2.2 The Comhairle borrows and invests substantial sums of money and therefore has potentially large exposures to financial risks including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Comhairle's Treasury Management Strategy.

2.3 There have been no changes to the Treasury Policy Statement, which was agreed by the Comhairle on 8 March 2012 and none are proposed.

2.4 The Comhairle will be asked to approve a revised Treasury Management Strategy should the assumptions on which this report is based, change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Comhairle's capital programme or in the level of its investment balances.

RECOMMENDATIONS

3.1 It is recommended that the:

(a) Investment Strategy, set out in Section 8 of the Report be approved;

(b) Borrowing Strategy, set out in Section 9 of the Report be approved;

(c) Prudential Indicators, detailed in Sections 11.2 and 11.4 of the Report, be adopted.

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Appendices:	1. Treasury Policy Statement 8 March 2012
	2. Comhairle nan Eilean Siar Permitted Investments
Background Papers:	1. CIPFA Revised Code of Practice for Treasury Management in Local Authorities
	2. CIPFA's Prudential Code for Capital Finance in Local Authorities
	3. The Local Government Investments (Scotland) Regulations 2010
	4. Treasury Policy Statement 8 March 2020

IMPLICATIONS

4.1 The following implications are applicable in terms of the Report.

Resource Implications	Implications/None
Financial	
Legal	Section 1 of The Local Government in Scotland Act 2003 Section 35 of The Local Government in Scotland Act 2003 Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition The Local Government Investments (Scotland) Regulations 2010
Staffing	
Assets and Property	
Strategic Implications	**Implications/None**
Risk	
Equalities	
Corporate Strategy	
Environmental Impact	
Consultation	

BACKGROUND

5.1 The Comhairle adopted the Code of Practice for Treasury Management in Local Authorities in 2002. In response to the financial crisis of 2008 CIPFA produced a revised edition of the Code in November 2009 which was also adopted and the Code was further revised in November 2011 and again in December 2017.

5.2 The 2003 Prudential Code for Capital Finance in Local Authorities introduced the requirements for making capital spending plans and was revised in November 2011. An addendum to the Prudential Code was issued in November 2012 and a new version of the Code was issued in December 2017. In April 2010 The Local Government Investments (Scotland) Regulations 2010 came into force. Together these form the requirement to produce an integrated Treasury Management Strategy that requires to be approved prior to the start of each financial year.

5.3 No Treasury Management activity is without risk. The successful identification, monitoring and control of risk is an important and integral element of Treasury Management activities. The main risks to the Comhairle's treasury activities are:

(a) Liquidity Risk (inadequate cash resources);
(b) Market or Interest Rate Risk (fluctuations in interest rate levels);
(c) Inflation Risk (exposure to inflation);
(d) Credit and Counterparty Risk (security of investments);
(e) Refinancing Risk (impact of debt maturing in future years); and
(f) Legal and Regulatory Risk (non-compliance with Code of Practice).

5.4 Based on the above, the Treasury Management Strategy for 2024/25 covers the following areas:

(a) The outlook for interest rates section 6
(b) Balance sheet and treasury position section 7
(c) The investment strategy section 8
(d) The borrowing strategy section 9
(e) Debt rescheduling section 10
(f) Prudential Indicators section 11
(g) Policy on Repayment of Loans Fund advances section 12

(h) Other factors section 13

THE OUTLOOK FOR INTEREST RATES

6.1 Although the forecast for Base Rate is to reduce in a gradual manner, uncertainty remains.

Arlingclose View at January 2025	2024/25	2025/26				2026/27		
	Mar 2025	Jun 2025	Sep 2025	Dec 2025	Mar 2026	Jun 2026	Sep 2026	Dec 2026
Base Rate	4.50	4.25	4.00	3.75	3.75	3.75	3.75	3.75
5 year Gilt Yield	4.30	4.20	4.10	4.00	3.90	3.90	3.95	4.00
10 year Gilt Yield	4.55	4.45	4.30	4.20	4.20	4.20	4.20	4.25
20 year Gilt Yield	5.00	4.90	4.80	4.70	4.65	4.65	4.65	4.65
50 year Gilt Yield	4.70	4.60	4.50	4.40	4.35	4.35	4.35	4.35

6.2 **Underlying assumptions:**

a) **Economic background:** The Budget measures remain a concern for policymakers, for both growth and inflation. Additional government spending will boost demand in a constringed supply environment, whilst pushing up direct costs for employers. The short to medium-term inflationary effects will promote caution amongst policymakers.

b) **Growth:** UK GDP recovered well in the first half of 2024 from technical recession, but underlying growth has petered out as the year has progressed. While government spending should boost GDP growth in 2025, private sector activity appears to be waning, partly due to Budget measures. Private sector wage growth and services inflation remain elevated, wage growth picked up sharply in October. The increase in employers' NICs and minimum and public sector wage levels could have wide ranging impacts on private sector employment demand and costs, but the near-term impact will likely be inflationary as these additional costs get passed on to consumers.

c) **Interest Rate Forecast:** CPI inflation rates have risen due to higher energy prices and less favourable base effects. The current CPI rate of 2.6% could rise further in Q1 2025. The Bank of England estimates the CPI rate at 2.7% by the end of 2025 and to remain over target in 2026. The MPC re-emphasised that monetary policy will be eased gradually. Despite recent inflation related data moving upwards, the minutes suggested a significant minority of policymakers are at least as worried about the flatlining UK economy.

6.3 **Outlook:**

a) Expectation is for the MPC to start reducing rates in February 2025 followed by cuts to a low of 3.75%.

b) Long-term gilt yields have risen to reflect both UK and US economic, monetary and fiscal policy expectations and increases in bond supply. Volatility will remain elevated as the market digests incoming data for clues around the impact of policy changes.

BALANCE SHEET AND TREASURY POSITION

7.1 The underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) together with Balances and Reserves, are the core drivers of Treasury Management activity. The Comhairle's level of debt and investments is linked to these components of the Balance Sheet. The current portfolio position is set out below:

	31/03/24 Actual £'000	31/03/25 Estimate £'000
PWLB Fixed Rate	127,266	126,263
Market Fixed Rate	0	0
Local Bonds	131	136
	127,397	126,399
Investments	(33,007)	(25,000)
Net Borrowing	94,390	101,399
Earmarked Balances	22,700	16,500
Uncommitted Balances	3,500	3,500
Total Balances	26,200	20,000

7.2 The Comhairle's capital expenditure plans do not suggest any borrowing requirement throughout 2025/26. Investments will not fall until capital receipts and grants are used to finance capital expenditure and earmarked balances are spent.

INVESTMENT STRATEGY

8.1 The Comhairle holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. The Comhairle's average investments held during 2024/25 to date were £36m and at the time of writing investments of £37m are held. Investments are forecast to be in the region of £25m at 31 March 2025.

8.2 The Bank Recovery and Resolution Directive allows regulatory authorities to keep a failing bank open for essential business but passes the cost of that failure on to investors instead of taxpayers, via a 'bail-in'. Diversification will continue to be crucial to managing bail-in risk in addition to determining proportionate counterparty and maturity limits. The Comhairle's surplus cash is currently invested in short-term unsecured bank deposits, in building societies and with other local authorities. In accordance with the Local Government Investments (Scotland) Regulations 2010 the Permitted Investments, shown in Appendix 2, have been identified for use by the Comhairle.

8.3 Risk Assessments and Credit Ratings are obtained and monitored by the Comhairle's Treasury Advisors who will continue to notify changes as they occur. No investment will be made with an organisation if there are substantive doubts about its credit quality even though it may meet the credit rating criteria. Assessment of credit quality will include:

- credit default swap prices;
- financial statements;
- information on potential government support; and
- reports in the financial press.

8.4 If the Royal Bank of Scotland, currently the Comhairle's banker, falls below the Comhairle's minimum acceptable criteria it will continue to be used but only for short-term liquidity requirements and business continuity arrangements.

8.5 In any period of significant stress in the markets, the default position will be to continue to place investments with the UK Government, via the Debt Management Agency Deposit Facility (D.M.A.D.F.). Funds placed with the D.M.A.D.F. will normally attract lower interest rates but this is considered to be an acceptable trade-off for the guarantee that the Comhairle's capital is secure.

8.6 The Chief Financial Officer, under delegated powers, will undertake the most appropriate form of investments in keeping with investment objectives, income and risk management requirements and prudential indicators.

BORROWING STRATEGY

9.1 The Balance Sheet forecast indicates that the Comhairle does not expect to borrow long-term funds during 2025/26. Consequently, as loans mature, they will not be replaced, and long-term debt will reduce.

9.2 In addition, the Comhairle's capital expenditure plans do not imply any need to borrow over the coming year. Investments are forecast to fall as capital receipts are used to finance capital expenditure and loan charge savings and reserves are used to finance the revenue budget**.**

DEBT RESCHEDULING

10.1 The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. It is not anticipated that it will be possible for any rescheduling to take place throughout 2025/26. However, should debt rescheduling be undertaken it will be reported to the Policy and Resources Committee.

PRUDENTIAL INDICATORS FOR 2023/24 TO 2026/27

11.1 The following capital prudential indicators are relevant for the purposes of setting an integrated Treasury Management Strategy.

(a) **Capital Expenditure:** It is a statutory duty, under the Local Government in Scotland Act 2003 and supporting Regulations, for the Comhairle to decide and to keep under review how much it can afford to allocate to capital expenditure and how much it can afford to borrow. Capital expenditure must remain within sustainable limits.

(b) **Financing Costs to Net Revenue Stream:** Financing costs comprise the interest and expenses elements of the loan charges and are expressed as a percentage of the revenue funding of the Comhairle which is the sum of General Revenue Grant, Non-Domestic Rates and Council Tax. This identifies the proportion of the revenue budget required to meet financing costs.

(c) **Capital Financing Requirement:** In accordance with best professional practice, the Comhairle does not associate borrowing with particular items or types of expenditure and has, at any point in time, a number of cash flows both positive and negative. In day-to-day cash management, no distinction can be made between revenue cash and capital cash and external borrowing arises as a consequence of all of the financial transactions of the Comhairle. In contrast, the capital financing requirement measures the authority's underlying need to borrow for a capital purpose.

(d) **Gross Debt and the Capital Financing Requirement:** This indicator of prudence ensures that over the medium-term debt will only be for a capital purpose and so debt should not, except in the short term, exceed the total capital financing requirement (CFR) in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

(e) **Authorised Limit and Operational Boundary for External Debt:** The Comhairle has an integrated treasury management strategy and overall borrowing will therefore arise as a consequence of all financial transactions of the Comhairle and not just those arising from capital spending reflected in the CFR.

(i) **Authorised limit for external debt**

The authorised limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003. It is based on the estimate of the most likely and prudent, but not worst-case, scenario with sufficient headroom over and above this to allow for operational management, such as unusual cash movements.

(ii) **Operational boundary for external debt**

The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom included within the authorised limit. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at only one point in time.

11.2 Capital Indicators

Prudential Indicator	**2023/24 Actual £000**	**2024/25 Estimate £000**	**2025/26 Estimate £000**	**2026/27 Estimate £000**	**2027/28 Estimate £000**
Capital Expenditure					
Gross Expenditure	16,292	16,820	23,095	13,785	5,340
Less income	(17,650)	(14,987)	(5,237)	(5,000)	(5,000)
Net Expenditure funded by borrowing	(1,358)	1,833	17,858	8,785	340
Financing costs to net revenue stream	6.40%	6.45%	6.13%	6.35%	6.14%
Capital Financing Requirement	147,403	144,193	154,357	155,737	148,970
Estimated gross external debt	127,266	126,264	124,927	119,580	119,580
Authorised limit for external debt	167,000	166,000	164,000	162,000	156,000
Operating Limit for external debt	167,000	166,000	164,000	162,000	156,000

11.3 The following treasury prudential indicators are relevant for the purposes of setting an integrated Treasury Management Strategy:

(a) **Adoption of the CIPFA Treasury Management Code**

This indicator demonstrates that the Comhairle has adopted the principles of best practice in Treasury Management. The Code was adopted by the Comhairle and the changes from the revised Code have been incorporated into its treasury policies, procedures and practices.

(b) **Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure**

These indicators allow the Comhairle to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure has been set to ensure that the Comhairle is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

(c) **Maturity Structure of Fixed Rate Borrowing**

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years. It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

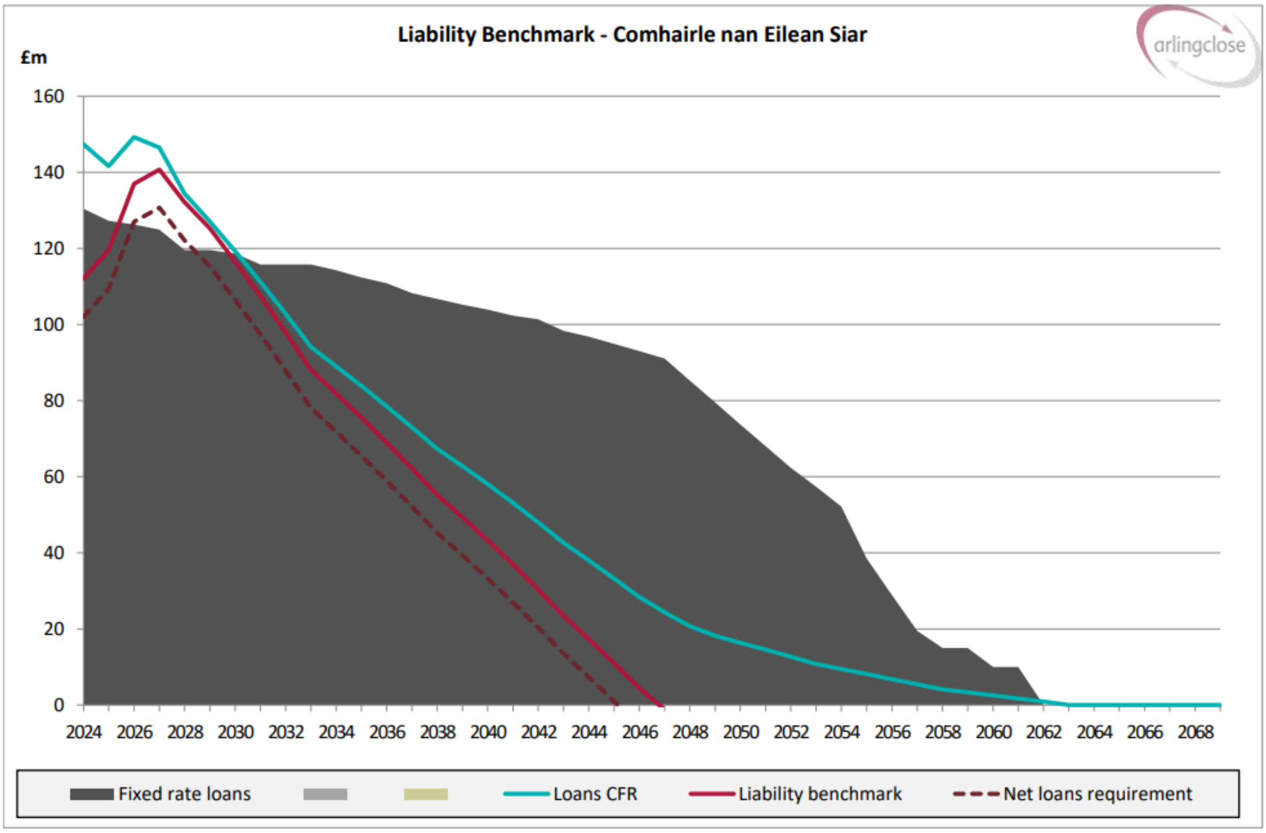
(d) **Credit Risk**

The Comhairle considers security, liquidity and yield, in that order, when making investment decisions. Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Comhairle's assessment of counterparty credit risk. The Comhairle also considers alternative assessments of credit strength, information on corporate developments and market sentiment towards counterparties.

(e) **Upper Limit for total principal sums invested for longer than 364 days**

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Comhairle having to seek early repayment of the sums invested.

11.4 **Liability Benchmark:** The liability benchmark is a projection of the amount of loan debt outstanding that the Comhairle requires each year into the future to fund its existing debt liabilities. The benchmark shows the gap between the Comhairle's existing loans and the need for borrowing.



REPAYMENT OF LOANS FUND ADVANCES 2025/26

12.1 Repayment of Loans Fund advances are required to be made in line with Scottish Government statutory guidance on Loans Fund Accounting. The Comhairle's annual accounts will also be required to include a disclosure of details on Loans Fund activities.

12.2 The broad aim of prudent repayment is to ensure that the Comhairle's unfinanced capital expenditure is financed over a period of years in which that expenditure is expected to provide a benefit and that each year's repayment amount is reasonably commensurate with the period and pattern of benefits.

12.3 The statutory guidance requires the Comhairle to approve a policy on Loans Fund repayments each year and recommends a number of options for calculating prudent repayments. The policy operated by the Comhairle is that charging the expenditure over the expected useful life of the relevant asset.

12.4 Loans fund advances consist of:

- the Comhairle's capital expenditure;
- grants to third parties and expenditure on third party assets which would be classified as capital expenditure by the Comhairle;
- loans to third parties; and
- expenditure for which a borrowing consent has been issued by the Scottish Government.

12.5 The following table shows the estimates of the loans fund repayments for the four years from 2024/25 to 2027/28:

YEAR	Advances to General Fund £'000	Instalment from General Fund £'000
2023/24 Actual	(1,358)	(6,766)
2024/25 Estimate	27,045	(6,483)
2025/26 Estimate	4,905	(6,785)
2026/27 Estimate	(639)	(6,470)
2027/28 Estimate	(2,519)	(6,144)

OTHER FACTORS

13.1 **Treasury Advisors:** Arlingclose, the Comhairle's Treasury Advisors, provide a full range of advisory services on treasury matters including specific advice on investment, debt and capital finance issues. In addition, Arlingclose provide regular workshops and training events for treasury staff. The Comhairle maintains the quality of the service with its advisors by holding regular meetings and tendering the service periodically.

13.2 **Training:** CIPFA's Code of Practice requires the responsible officer to ensure that all those tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Arlingclose provide this training as part of their service to the Comhairle and the CIPFA Treasury Management Forum hold bi-annual residential training workshops and regular meetings throughout the year for practitioners.

13.3 **Soft Loans:** Where a loan is advanced at less than a market interest rate there could be an associated loss of investment return which would otherwise have been earned on these monies. While the Comhairle has made short-term loans to charitable bodies for cash flow purposes there has been no material associated income loss.

13.4 **Embedded Derivatives:** In the absence of any legal power to do so, the Comhairle will not use standalone derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments may be used and the risks that they present will be managed in line with the overall treasury risk management strategy.

13.5 **Financial Implications:** The budget for debt interest in 2025/26 is £9.75m based on outstanding debt at the start of the year of £126m. As base rate has increased, investment interest rates have increased though with base rate expected to reduce through 2025/26 investment levels will fall. Treasury Management performance continues to improve in absolute terms.

13.6 **Markets in Financial Instruments Directive:** The Comhairle has opted up to professional client status with its providers of financial services allowing access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Comhairle's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

CONCLUSION

14.1 During these unprecedented times the Comhairle will reappraise its strategies in response to evolving economic, political and financial events and report this to the Policy and Resources Committee.