



Item: 3

Investments Sub-committee: 17 September 2026.

Treasury Management – Annual Report.

Report by Head of Finance.

1. Overview

- 1.1. This report presents performance of treasury management functions for financial year 2025/26, for scrutiny.
- 1.2. 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).
- 1.3. The Code defines treasury management as including investment activities.
- 1.4. The Council's investment priorities can be summarised as maintaining:
 - The security of capital.
 - The liquidity of its investments.
- 1.5. 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.
- 1.6. 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.
- 1.7. A detailed analysis of the Treasury Management Performance for financial year 2025/26, 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 2026.
- The Strategy for financial year 2025/26.
- Borrowing Outturn.
- Investment Outturn.
- Other Issues.

- 1.8. 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. Scrutinise the Treasury Management Review for financial year 2025/26, 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 2024/25 resulted in £1,719,000 being moved into financial year 2025/26 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. The Council established authorised limits for external debt of £95,000,000 for 2025/26, together with an operational boundary of £85,000,000 for the same period, as part of its Treasury Management Strategy for 2025/26.
- 3.3. 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.

- 3.4. Throughout 2025/26, investment returns remained strong. The Bank of England implemented three 0.25% rate cuts in May, August and December 2025, bringing the Bank Rate down from 4.5% to 3.75%. At the end of March 2026, the yield curve had turned positive, reflecting inflation concerns emanating from the on-going conflict in the Middle East.
- 3.5. Initial forecasts for 2025/26 anticipated gradual reductions in the Public Works Loans Board borrowing rates across short, medium, and long-term durations. However, the initial expectation of significant rate reductions across the whole curve did not transpire, primarily because inflation concerns were very elevated in March 2026.
- 3.6. The Bank of England Base Rate continues to impact on borrowing, with the short-term debt having an average interest rate of 4.76%. However, the Council is well placed to benefit from savings on its longer-term loans, with an average interest rate of 3.03%.
- 3.7. As at 31 March 2026, the Council's debt portfolio stood at £50,000,000, with loan maturities ranging over periods from one month to 44 years. Overall, this represents an average cost of borrowing of 3.9% per annum, with an average duration of 23.5 years.
- 3.8. 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 4.65% for financial year 2025/26.
- 3.9. 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:** An Equality Impact Assessment is not required for financial monitoring.
6. **Island Communities Impact:** An 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 Committee 18 February 2025 – Treasury Management Strategy Statement 2025/26.

Appendix

Appendix 1 – Treasury Management Performance for 2025/26

Annual Treasury Management Review 2025/26

Orkney Islands Council

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INTRODUCTORY GUIDANCE TO DOING YOUR ANNUAL REVIEW REPORT 2025/26

1. Derivatives

This template does not include any reference to the direct use of derivatives.

2. Non treasury management investments

Scottish local authorities. All non-treasury investments and financial guarantees, loans etc. are already required to be listed as part of the Annual Investment Strategy for Scottish authorities. However, the new Codes require greater explanation for the investment in non-financial assets as investments in such areas as their objectives, how they have been appraised, how they have been financed, and what powers were used to undertake them. This is in addition to the existing requirements in Finance Circular 5/2010. *(Please also see our other comments above).*

Non-treasury management investments in Scotland typically do not comprise a significant proportion of the total investment portfolio local authorities. However, local authorities may wish to consider writing some form of high-level summary report on non-treasury investments to include in, or append to, this annual treasury management review report, so as to give members an overview of the whole investment portfolio. Such a report would deal with significant purchases, their objectives, how they have been appraised, how they have been financed, and what powers were used to undertake these purchases.

Services provided by MUFG Corporate Markets. The provision of treasury management template reports currently falls within the main services that MUFG Corporate Markets provides to all clients taking our full treasury management service. We would be pleased to provide additional bespoke assistance to individual clients who require assistance in the area of non-treasury investments, formulating capital strategies etc. Please contact your CRM for further information on these services.

3. The search for higher investment returns

Some clients have pursued new investment options for generating higher returns. Such clients should consider adding in details of any changes in investment instruments used during the year in paragraph 6 e.g.: -

- Ultra-short Dated Bond Funds
- Corporate Bonds - direct, passive and active external management (including Short-Dated Bond Funds)
- Multi Asset Income Funds
- Property Funds
- Equity Funds

4. Significant variation of a prudential indicator

If there is a significant variation of a prudential indicator from the original figure, clients should consider whether a specific explanation should be added to this report.

5. Control of interest rate risk – borrowing and investing

The 2017 CIPFA Code of Practice on Treasury Management abolished the treasury indicators on limits for fixed and variable rate exposure. However, this was on the basis that authorities would explain in words how they control interest rate risk. The borrowing and investing paragraphs therefore include material to cover this requirement.

ABBREVIATIONS USED IN THIS REPORT

This is an optional area which clients may wish to include in their report if they feel that members would appreciate having this list of abbreviations and definitions.

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 Authority's annual underlying borrowing need to finance capital expenditure and a measure of the Authority'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 2025/26

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 2025/26. 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 2025/26 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 18/02/2025).
- a mid-year, (minimum), treasury update report (Investment Sub-committee 20/11/2025).
- 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 24/09/2025).
- Quarter 3 (Investment Sub-committee 26/02/2026).

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 2025/26, 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	31.3.2025 Actual £000	2025/26 Original £000	31.3.2026 Actual £000
Capital expenditure			
• Non-HRA	14.542	14.865	16.107
• HRA (<i>if applicable</i>)	2.994	0.000	4.426
• SRF – Windfarms	0.000	10.000	2.220
• Finance Leases	0.000	2.000	1.536
• Total	17.536	26.865	24.289
Capital Financing Requirement:			
• Non-HRA	58.094	65.096	63.549
• HRA (<i>if applicable</i>)	8.317	8.421	8.077
• Total	66.411	73.517	71.626
Gross borrowing	5.127	18.025	7.506
External debt	50.000	65.000	50.000
Investments			
• Longer than 1 year	0.000	0.000	0.000
• Under 1 year	11.679	26.000	24.339
• Total	11.679	26.000	24.339
Net borrowing	38.321	39.000	25.661

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	31.3.2025 Actual £000	2025/26 Budget £000	31.3.2026 Actual £000
Capital expenditure	14.542	14.865	18.327
Financed in year	10.471	8.840	11.732
Unfinanced capital expenditure	4.071	6.025	6.595

£m HRA (<i>where relevant</i>)	31.3.2025 Actual £000	2025/26 Budget £000	31.3.2026 Actual £000
Capital expenditure	2.994	0	4.426
Financed in year	1.938	0	3.515
Unfinanced capital expenditure	1.056	0	0.911

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 2025/26 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 2025/26 prudent repayment policy (as required by Scottish Government) was approved as part of the Treasury Management Strategy Report for 2025/26 on 18/02/2025.

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

CFR (£m): General Fund	31.3.2025 Actual £000	2025/26 Budget £000	31.3.2026 Actual £000
Opening balance	58.427	59.224	58.996
Add unfinanced capital expenditure (as above)	4.071	6.025	6.595
Less Statutory Repayment*	(4.404)	(2.153)	(2.042)
Closing balance	58.094	63.096	63.549

CFR (£m): HRA	31.3.2025 Actual £000	2025/26 Budget £000	31.3.2026 Actual £000
Opening balance	8.508	8.733	8.318
Add unfinanced capital expenditure (as above)	1.056	0	0.911
Less Statutory Repayment	(1.247)	(0.312)	(1.152)
Closing balance	8.317	8.421	8.077

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 (2024/25) plus the estimates of any additional capital financing requirement for the current (2025/26) 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 2025/26. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31.3.2025 Actual £000	2025/26 Budget £000	31.3.2026 Actual £000
Gross borrowing position	50.000	65.000	50.000
CFR	66.411	71.517	71.626
Under / over funding of CFR	16.411	6.517	21.626

The authorised limit - the authorised limit is that required by s6 of the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2025/26 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.

	2025/26 £000
Authorised limit	100.000
Maximum gross borrowing position during the year	70.569
Operational boundary	90.000
Average gross borrowing position	57.601
Financing costs as a proportion of net revenue stream - General Fund	3.70%
HRA	26.90%

3. Treasury Position as of 31st March 2026

The Council's treasury management debt and investment position is organised by the treasury management service 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 2025/26 the Council's treasury position was as follows:-

DEBT PORTFOLIO	31.3.2025 Principal £000	Rate/ Return	Average Life yrs	31.3.2026 Principal £000	Rate/ Return	Average Life yrs
Fixed rate funding:						
-PWLb	50.000			50.000		
-Local Authority	0.000			0.000		
-Salix Finance Ltd	0.000			0.000		
Total debt	50.000	4.04%	24.32	50.000	3.90%	23.53
CFR	66.411			71.626		
Over / (under) borrowing	16.411			(21.626)		
Total investments	11.679			24.339		
Net debt	38.321			25.661		

The maturity structure of the debt portfolio was as follows:

	31.3.2025 Actual £000	31.3.2026 Actual £000
Under 12 months	10.000	20.000
12 months and within 24 months	10.000	0.000
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	20.000	20.000
40 years and within 50 years	10.000	10.000

INVESTMENT PORTFOLIO	31.3.2025 Actual £000	31.3.2025 Actual %	31.3.2026 Actual £000	31.3.2026 Actual %
Treasury investments				
Banks	0.979	0.4%	0.349	0.1%
Building societies - rated	0.000	0.0%	0.800	0.3%
Local authorities	0.000	0.0%	10.000	3.5%
DMADF (H M Treasury)	0.500	0.2%	0.000	0.0%
Money Market Funds	10.200	3.9%	10.400	3.6%
Certificate of Deposits – UK Banks	0.000	0.0%	0.000	0.0%
Total managed in house	11.679	4.43%	21.549	7.53%
Equity Fund	101.714	38.6%	118.584	41.4%
Bond funds	42.726	16.2%	44.260	15.5%
Property funds	24.111	9.1%	25.238	8.8%
Diversified Growth Funds	21.858	8.3%	15.343	5.4%
Credit Strategies Funds	31.672	12.0%	31.469	11.0%
Alternative Income Funds	29.813	11.3%	29.833	10.4%
Total managed externally	251.894	95.57%	264.727	92.47%
TOTAL TREASURY INVESTMENTS	263.573	100%	286.276	100%

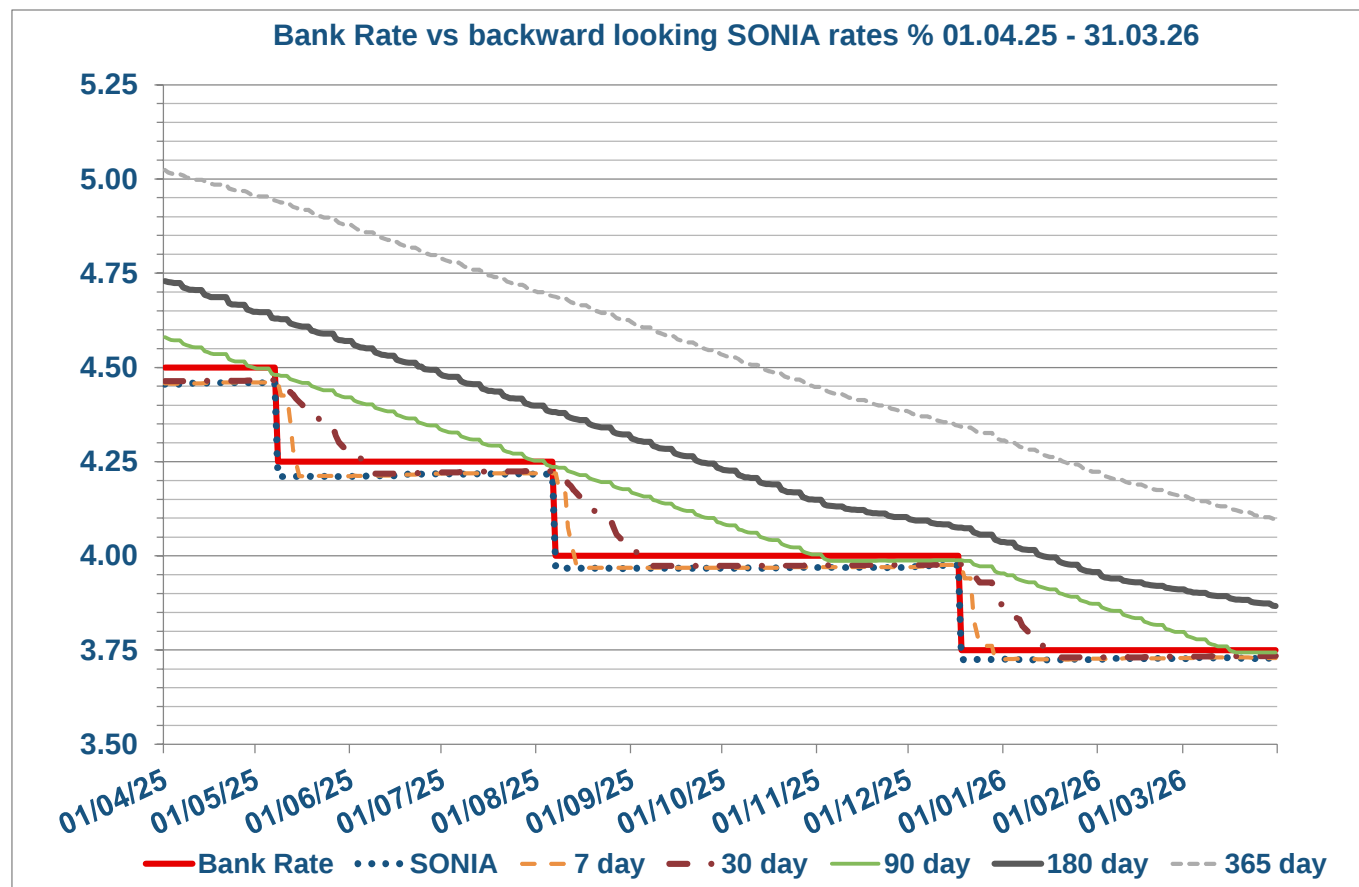
Non-Treasury investments				
Fishing Quota	4.512	51.13%	2.922	40.44%
Private Companies	4.300	48.73%	4.300	59.52%
Other	0.013	0.15%	0.003	0.04%
TOTAL NON-TREASURY INVESTMENTS	8.825	100%	7.225	100%

Treasury investments (in house)	4.512	51.13%	21.549	7.34%
Non-Treasury investments (external)	4.300	48.73%	264.727	90.20%
Non-Treasury investments	0.013	0.15%	7.225	2.46%
TOTAL OF ALL INVESTMENTS	8.825	100%	293.501	100%

4. The Strategy for 2025/26

4.1 Investment strategy and control of interest rate risk

Investment Benchmarking Data – Sterling Overnight Index Averages (Backward-looking) 2025/26



FINANCIAL YEAR TO QUARTER ENDED 31/03/2026							
	Bank Rate	SONIA	7 day	30 day	90 day	180 day	365 day
High	4.50	4.46	4.46	4.47	4.58	4.73	5.02
High Date	01/04/2025	07/05/2025	28/04/2025	06/05/2025	01/04/2025	01/04/2025	01/04/2025
Low	3.75	3.72	3.73	3.73	3.74	3.87	4.09
Low Date	18/12/2025	22/12/2025	22/01/2026	21/01/2026	18/03/2026	31/03/2026	31/03/2026
Average	4.04	4.01	4.02	4.05	4.13	4.26	4.55
Spread	0.75	0.74	0.74	0.74	0.84	0.86	0.93

Investment returns remained robust throughout 2025/26 despite Bank Rate reducing steadily through the course of the financial year (three 0.25% rate cuts in total), and at the end of March the yield curve had turned positive, reflecting inflation concerns emanating from the on-going conflict in the Middle East.

Bank Rate reductions of 0.25% occurred in May, August and December, bringing the headline rate down from 4.50% to 3.75%. Two of the Bank Rate cuts occurred in the same month as the Bank of England publishes its Quarterly Monetary Policy Report, therein providing a clarity over the timing of potential future rate cuts.

As of early April 2026, market sentiment has been heavily influenced by the Middle East conflict. Commentators anticipate a growing risk of inflation, meaning interest rates will not be cut for some time, and may increase to counteract inflationary pressures arising from steepening energy costs. Growth will also be impacted in many regions of the world. UK GDP is projected by the Office for Budget Responsibility (3 March 2026) to be 1.1% in 2026 before

picking up to 1.6% in 2027 and 2028. But the likelihood is that there is downside risk to this forecast given events in the Middle East through March and still on-going.

Looking back through 2025/26, investors were able to achieve returns generally in a range of 4.5% - 5% for periods ranging from 1 month to 12 months in the spring of 2025. By the end of March 2026 deposit rates were somewhat volatile, regaining some traction as the Middle East conflict suggested energy driven inflation may lead to higher interest rates than would otherwise have been the case. Where liquidity requirements were not a drain on day-to-day investment choices, extending duration through the use of "laddered investments" paid off.

Heading into 2026/27, UK inflation is likely to increase to over 4% in the coming months as oil prices, for example, remain close to \$100 per barrel, over 50% higher than before the Middle East conflict started.

4.2 Borrowing strategy and control of interest rate risk

During 2025/26, 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 near-term investment rates have generally been lower than medium to long-term borrowing costs. The latter are expected to fall a little through 2026 and 2027 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 (>5%) and has focused on a policy of internal and temporary borrowing, supplemented by short-dated borrowing (<5 years on a maturity loan structure/<10 year on an EIP loan structure) 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:

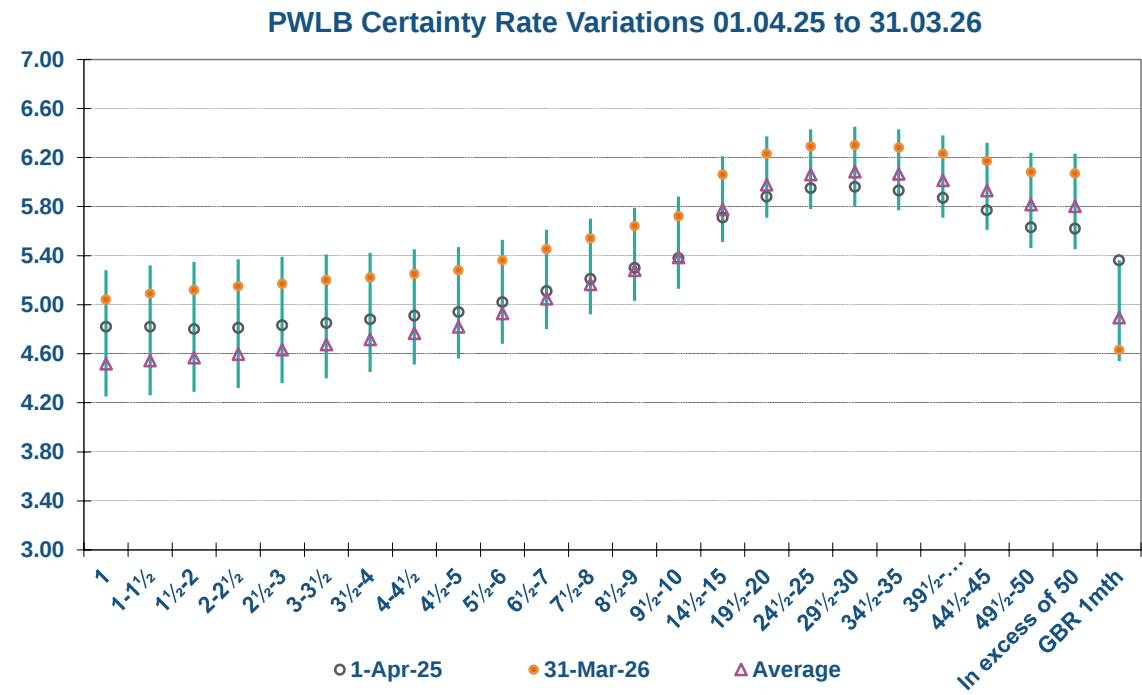
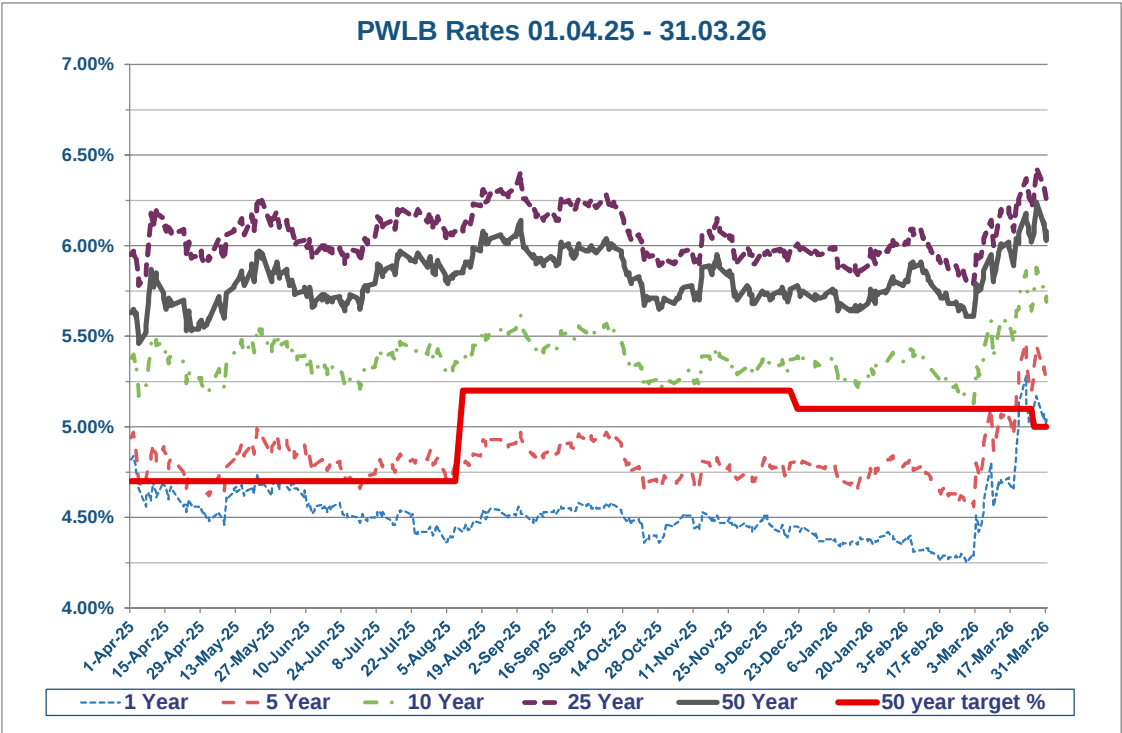
- if it had been felt that there was a significant risk of a sharp FALL in long and short-term rates, (e.g., due to a marked increase of risks around a relapse into recession or of risks of deflation), then long-term borrowings would have been postponed, and potential rescheduling from fixed rate funding 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 2025/26. Bank Rate did reduce to 3.75% as anticipated, but the initial expectation of significant rate reductions across the whole curve did not transpire, primarily because inflation concerns were very elevated in March 2026. At the start of April 2026, the market expected Bank Rate to increase over the coming months to 4% or 4.25%, from 3.75%, whilst all parts of the curve have also risen substantially through March. 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 2025/26 were as follows:

MUFG Corporate Markets Interest Rate View 10.02.25													
	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28
BANK RATE	4.50	4.25	4.25	4.00	3.75	3.75	3.75	3.50	3.50	3.50	3.50	3.50	3.50
3 month ave earnings	4.50	4.30	4.30	4.00	3.80	3.80	3.50	3.50	3.50	3.50	3.50	3.50	3.50
6 month ave earnings	4.40	4.20	4.20	3.90	3.70	3.70	3.50	3.50	3.50	3.50	3.50	3.50	3.50
12 month ave earnings	4.40	4.20	4.20	3.90	3.70	3.70	3.50	3.50	3.50	3.50	3.50	3.50	3.60
5 yr PWLB	5.00	4.90	4.80	4.70	4.60	4.50	4.40	4.40	4.30	4.20	4.20	4.10	4.00
10 yr PWLB	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.70	4.60	4.50	4.50	4.40	4.40
25 yr PWLB	5.80	5.70	5.60	5.50	5.40	5.30	5.20	5.10	5.00	5.00	4.90	4.90	4.80
50 yr PWLB	5.50	5.40	5.30	5.20	5.10	5.00	4.90	4.80	4.70	4.70	4.60	4.60	4.50

PWLB RATES 2024/25



HIGH/LOW/AVERAGE PWLB RATES FOR 2025/26

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.25%	4.56%	5.13%	5.78%	5.46%
Date	27/02/2026	27/02/2026	02/03/2026	04/04/2025	04/04/2025
High	5.28%	5.47%	5.88%	6.43%	6.24%
Date	23/03/2026	23/03/2026	27/03/2026	27/03/2026	27/03/2026
Average	4.52%	4.82%	5.38%	6.06%	5.81%
Spread	1.03%	0.91%	0.75%	0.65%	0.78%

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.

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 war in 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. More recently, the Middle East conflict is likely to see inflation spike higher from late spring 2026 through to early 2027

Gilt yields have been volatile through 2025/26. The low point for long-term rates of 25 and 50 years' duration was reached early in April 2025 whilst the low points for short and medium dated rates were reached in early 2026, prior to the outbreak of the Middle East conflict.

At the close of 31 March 2026, the 1-year PWLB Certainty rate was 5.04% whilst the 5, 10, 25 and 50 year rates were 5.28%, 5.72%, 6.29% and 6.08% respectively.

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) – available through The National Wealth Fund
- **HRA Borrowing rate** is gilt plus 40 basis points (G+40bps)

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.

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	£10.000m	Fixed Interest Rate	4.61%	1 year 7 months

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 10/05/2025 the Council repaid a £10.00m PWLB loan at an average rate of 5.48% using investment balances.

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 18 February 2025. 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)	31.3.2025 £000	31.3.2026 £000
Fund Balances/Reserves – managed in-house	22.834	26.951
Strategic Reserve Fund – externally managed	206.544	213.388
Capital Receipts	2.283	2.413
Provisions	41.341	42.831
Other – Repairs and Renewals Fund and Capital Fund	9.844	20.881
Total	282.846	306.464

Investments held by the Council

- The Council maintained an average balance of £18.475m of internally managed funds.
- The internally managed funds earned an average rate of return of 4.65%.
- The comparable performance indicator is the average 30-day Backward Sterling Overnight Index Average (SONIA) rate, which was 3.7337%.
- Total investment income was £0.860m.

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 2026 was:

Fund Manager	Investments Held £000	Return	Benchmark*
Equity Portfolio	62.156	28.80%	17.70%
Global Equity Portfolio	56.428	7.10%	25.10%
Dynamic Diversified Growth Fund	15.343	10.50%	6.00%
Global High Yield Credit Strategies Fund	26.203	4.50%	7.40%
Global Private Loan Fund 3	5.266	4.70%	4.50%
UK Property Fund	25.238	4.00%	4.70%
Secured Income Fund	29.833	5.50%	5.80%
Passive Bonds Fund	44.26	3.60%	3.90%
Total	264.727	10.10%	11.70%

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

As with 2024/25, UK inflation has proved somewhat stubborn throughout 2025/26. Having started the financial year at 3.5% y/y (April), the CPI measure of inflation peaked at 3.8% from July to September, before dipping to 3% in January and February. Core inflation picked up to 3.2% in February, from 3.1%, and the recent upward pressure on energy costs could see CPI inflation breach 4.5% later this year.

Against this backdrop, the continued lack of progress in ending the Russian invasion of Ukraine, and the potentially negative implications for global growth as a consequence of the implementation of US tariff policies, Bank Rate reductions look limited for the remainder of 2026 (as they do in the euro-zone). Bank Rate currently stands at 3.75%.

Moreover, borrowing has becoming more expensive in 2025/26. Gilt yields have risen materially in March 2026, more than reversing the falls earlier in the financial year. Additionally, the public finances have remained under pressure. The higher-than-expected public net sector borrowing of £14.3bn in February was £2.2bn above last February's outturn. But that borrowing overshoot was mainly due to timing effects relating to the £13.0bn government debt interest payment. That came in as the highest payment since June 2025, causing a 12.3% y/y jump in spending. On the flip side, sitting at £8.1bn, tax revenues were also higher than last February, largely on the back of solid growth in self-employment incomes in 2024/25, boosting self-assessment income tax receipts and stronger capital gains tax receipts.

However, the combination of some energy price support and pressures from higher inflation amid the ongoing energy price shock, higher interest rates and a weaker economy will ultimately put borrowing on an upward trend. With the rise in energy prices possibly pushing the Retail Prices Index inflation up to a peak of 5.7%, debt interest repayments will increase by about £10bn. A weaker growth profile, higher inflation, higher interest rates and gilt yields could erode about £11bn of the Chancellor's £23.6bn headroom.

The loosening in the labour market continues to bear down on wage growth. The 3myy growth rate of average earnings including bonuses slowed from 4.2% in December to 3.9% in January. Meanwhile, excluding bonuses, private earnings growth continued to fall from 3.4% to 3.3%.

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 driven largely by the US administration.

	UK	Eurozone	US
Bank Rate	3.75%	2.0%	3.5%-3.75%
GDP	0.1%q/q Q4 (1.0%y/y)	+0.2%q/q Q4 (1.2%y/y)	0.7% Q4 Annualised
Inflation	3.0%y/y (Feb)	1.9%y/y (Feb)	2.4%y/y (Feb)
Unemployment Rate	5.2% (Jan)	6.2% (Jan)	4.4% (Feb)

The Bank of England sprung no surprises in their March meeting, leaving Bank Rate unchanged at 3.75% by a vote of 9-0, but suggesting rates may need to rise if inflation picks up markedly. The vote could best be described as moderately hawkish. The MPC stated it "stands ready to act as necessary" and "is alert to the increased risk of domestic inflationary pressures through second-round effects in wage and price-setting". Even so, we suspect the committee is likely to put equal weight on higher inflation and weaker growth, particularly the poor macroeconomic backdrop prior to the energy shock, keeping interest rates at 3.75% this year.

10-year Gilt yields have been exceptionally volatile in the final weeks of 2025/26, troughing at around 4.23% in late February before shooting up to 5.00% (and well through that on an intraday basis). That spike was driven by the outbreak of war in the Middle East, which prompted a dramatic reassessment of investors' Bank of England policy rate expectations. Having been pricing in rate cuts in late-February, as many as four rate *hikes* were discounted by late-March. The 10-year yield ended the quarter at 4.92% with around 65bp of rate hikes priced in over the coming

year. In addition to more hawkish monetary policy expectations, part of this increase in yields probably reflected an increase in term premia amid concerns that the government may react by loosening the fiscal purse strings.

As for equity markets, the FTSE 100 experienced another volatile quarter, surging to an all-time high of around 10,900 in late February, leaving it up 10% from the start of 2026, before giving back most of those gains in March after the outbreak of the Middle East conflict. That pullback leaves the index at around 10,176 at the end of the quarter. For context it was at 8,582 at the start of April. The £ has stayed relatively resilient also at \$1.33, strengthening from \$1.29 back in April.

US Economy

Despite a weak finish to 2025, the US economy has generally been the strongest among the developed economies, but with uncertainties growing surrounding President Trump's central economic tenet of being able to apply tariffs on an ad-hoc basis, and bend the FOMC Fed Funds rate decision-making to his will, there is something of a stalemate in place at present over when, and if, rates will be cut further in 2026.

Inflation is currently stuck at around 2.5%, unemployment is only a little above 4%, and tax refunds are in the process of being facilitated for many households. But will those refunds be – at least partially – offset by higher gasoline prices?

The S&P500 started April 2025 at 5,633 and finished March 2026 at 6,528 having peaked at just over 7,000. The 10-year Treasury yield finished March at 4.30% having been 4.17% back at the start of April, and during the year has been both above 4.50% and below 4.00%.

EZ Economy

The Eurozone economy has run pretty much in parallel with that of the UK. A slightly stronger finish to 2025 (GDP of 0.2% q/q) than that of the UK cannot hide the fact that the economy has been negatively impacted by German economic stagnation until late in 2025. France has also struggled against a difficult political backdrop, but managed to post GDP growth of 0.3% q/q for October to December.

With Eurozone headline inflation close to 2%, the ECB has been able to reduce its Deposit Rate to 2%. Whether it rises from that low point will very much be driven by how energy prices trend over the coming months. The Euro has appreciated against the dollar from 1.08 at the start of April 2025 to 1.16 at the end of March.

8. Other Issues

The Council'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 2025/26 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 £271.952m of investments as at 31 March 2026 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.