



Item: 5

Policy and Resources Committee: 3 March 2026

Strategic Reserve Fund – Budget Review and Long-Term Forecast

Report by Head of Finance

1. Overview

- 1.1. The purpose of the Strategic Reserve Fund is to support projects which provide benefit to the Orkney community as a whole such as the development of industrial estates, harbour infrastructure, and recreational projects, while supporting economic development activity in general across the Council area. The Strategic Reserve Fund is also required to support the long-term objective of managing the implications associated with declining oil related revenues on the economy of the islands and to contribute to the decommissioning costs of the Flotta terminal at the end of its life.
- 1.2. The Strategic Reserve Fund has been applied to supplement General Fund services on a restricted basis as part of a strategy, whereby the Council has pressed Scottish Government for equality of treatment in the finance settlement across the Island unitary authorities. More recently, this approach has been extended to support the delivery of income generation and efficiency saving plans.
- 1.3. The current income focused strategy for the Strategic Reserve Fund managed fund investments was adopted on the basis that it offered the prospect of more predictable returns for the Strategic Reserve Fund along with a lower risk profile achieved through improved diversification.
- 1.4. The ongoing reliance on the Strategic Reserve Fund as a means of balancing the General Fund budget as part of a long-term financial strategy, is not best practice, particularly given the levels of volatility that continue to impact on investment returns.
- 1.5. On 27 February 2024, when considering the level of disbursements from the Strategic Reserve Fund used to support General Fund Services and other Council priorities for financial year 2024/25 onwards, the Policy and Resources Committee recommended a contribution of up to £20,000,000 from the Strategic Reserve Fund to the General Fund for financial year 2024/25 with indicative contributions for 2025/26 and 2026/27 of £18,000,000 and £15,000,000 respectively. These values

were incorporated into the Investment Strategy review carried out by Hymans Robertson.

- 1.6. It was also recommended that the Strategic Reserve Fund allocation to General Fund services be notionally allocated to preventative services, and that a very prudent approach be taken when considering requests for future disbursements from the Strategic Reserve Fund, with the Strategic Reserve Fund being considered as a last resort funding source by Services.
- 1.7. The final draw on the Strategic Reserve Fund for 2025/26 was set at £18,431,000 – slightly above the indicative level of £18,000,000 previously targeted. Continued budget pressures for 2026/27 will unfortunately see the contribution level increase back to £20,000,000.
- 1.8. Allowing for all known distributions noted for financial year 2025/26 of £19,861,000, the value of the Strategic Reserve Fund usable reserves is estimated to increase by £4,719,000 to a forecast value of £212,610,000 as at 31 March 2026.
- 1.9. The existing distribution commitments of £62,484,000 for financial years 2026/27 to 2028/29, including the sum of £60,000,000 to support General Fund Services over the same period, are reflected in the 3-year budget and the 10-year forecast, attached as Appendices 1 and 2 respectively to this report. The £20,000,000 contribution from the Strategic Reserve Fund has been included constantly throughout the forecast period.

2. Recommendations

- 2.1. It is recommended that members of the Committee:
 - i. Agree that a financial contribution to General Fund Services of up to a maximum of £20,000,000 from the Strategic Reserve Fund be used as a planning assumption as part of the Council's budget setting process for financial year 2026/27.
 - ii. Agree that the Strategic Reserve Fund budget for financial year 2026/27, together with indicative budgets for 2027/28 and 2028/29, attached as Appendix 1 to this report, be approved.
 - iii. Agree that the long-term 10-year budget forecast for the Strategic Reserve Fund, attached as Appendix 2 to this report, be endorsed as a financial planning document.

- iv. Delegate powers to the Head of Finance, in consultation with the Chief Executive and Directors, to make any adjustments to the Strategic Reserve Fund contribution to the General Fund, taking account of the 2025/26 year-end position and ongoing budget pressures for 2026/27.

3. Background

- 3.1. Historically the Strategic Reserve Fund had been applied largely for Economic Development purposes with expenditure charged directly to the Strategic Reserve Fund. The direct charging of expenditure to the Strategic Reserve Fund was not particularly transparent.
- 3.2. With pressure on General Fund budgets, there was a change in practice from 2002/03 with a direct contribution from the Strategic Reserve Fund to specific General Fund service areas, together with consolidation of budgets and spending. This contribution from Reserves enabled the Council to move from a budget overspend position to an underspend.
- 3.3. This practice persisted for a few years until a change in accounting requirements led to the Strategic Reserve Fund contribution being applied as a source of funds for the overall budget rather than directly attributed to a specific budget area.
- 3.4. The Strategic Reserve Fund contribution to General Fund services has more recently been “notionally” attached to specific areas of General Fund expenditure in order that the Orkney public can see more readily the benefit of the Strategic Reserve Fund and the additionality of service provision that it allows the Council to deliver.
- 3.5. The following table summarises the use of the Strategic Reserve Fund over the past five years:

	2021/22 (Actual)	2022/23 (Actual)	2023/24 (Actual)	2024/25 (Actual)	2025/26 (Prob)
	£'000s	£'000s	£'000s	£'000s	£'000s
General Fund Contributions	7,470	8,263	6,350	20,000	18,431
CDF				333	333
Cost of Living		492	22		
Strategic Projects	72	305	808	1,260	340
Island Games	6	100	133	747	607
North Isles Landscape Partnership	38	84	157		
Islands Deal				266	150
Total	7,586	9,244	7,470	22,606	19,861

3.6. The draw on Strategic Reserve Fund balances now far exceeds the cost of the specific budget areas historically identified for “notional” allocations. In effect, the Council is now protecting some General Fund statutory services not fully funded through the Scottish Government settlement. However, the “notional” budget allocation, totalling £20,000,000 for 2026/27, should continue to support discretionary service areas that fit with the theme of benefiting the quality of life and cultural heritage of Orkney. These functions are considered ‘preventative services’ which are central to encouraging social inclusion, participation and improving health and wellbeing.

4. Budget Review

4.1. The Strategic Reserve Fund managed funds have performed beyond expectations in financial year 2025/26 and are expected to return a prudent surplus of £22,000,000 on the year, which is £2,520,000 ahead of the budgeted surplus of £19,480,000. When time value of money is factored in, the overall reported position for the Fund in real terms is that of an anticipated surplus of £4,719,000, which is £4,974,000 better than the overall budgeted position for financial year 2025/26.

4.2. The main factors contributing towards the probable outturn position at 31 March 2026, and as set out in the budget statement, attached as Appendix 1 to this report, are as follows:

- Investment activities – timing differences around budget setting and changes in income recognition lines, i.e. the Harbour Dues passenger fees, Scapa Flow Oil Port activities and managed funds have increased income forecasts by approximately £2,800,000.
- Projected distributions have fallen by approximately £2,100,000 against budget, due mainly to reduction in General Fund contribution.

4.3. The value of the Strategic Reserve Fund usable reserves has been estimated at £212,610,000 as at 31 March 2026.

5. Forecast

5.1. The Investment Strategy Review carried out by Hymans Robertson, considered by the Investments Sub-committee on 18 September 2024, provided assurance that the current income focused investment strategy remained appropriate for the Strategic Reserve Fund managed fund investments. The modelling showed that the expected nominal return on investments is 7.7%, which is much higher than the previous projected return in 2021 (5.2%) and is driven by the risk-free rate of return on risk-free assets such as government bonds if held to maturity. However, it is noted that

the volatility on the returns has also increased to +/-10% (2021 +/-7.7%) in any one year.

- 5.2. The Review reflected the indicative future drawdowns of £18,000,000, £15,000,000, and £11,000,000 in financial years 2025/26, 2026/27 and 2027/28 respectively required from the Strategic Reserve Fund to support General Fund services.
- 5.3. The modelling also looked at the length of time required for the Fund to return to its starting position of £240.4 million as at 30 June 2024 (post the £20 million contribution required for 2024/25), dependent on how much is drawn down to support the revenue budgets over the coming years and the rates of return on the investments. The results of this analysis varied considerably but in the worst-case scenarios the value of the Fund never fully recovers and continues to decline.
- 5.4. The conclusions provided by Hymans Robertson were:
 - Assuming the SRF reverted to a lower level of distribution (from the elevated short term funding plans) the current strategy would be expected to generate sufficient returns to rebuild and grow the value of the Fund. However, these are simple deterministic projections that assume a fixed level of return over time.
 - If distributions were kept at higher levels of around £10 million per annum. longer term then it will take the Fund longer to get back on target and any meaningful reduction in the expected levels of return would impact on the sustainability of the Fund value.
 - Simple stress tests carried out show that any short-term negative returns can have a significant impact on outcomes and therefore while the focus of the analysis was primarily on returns, also need to be mindful of the volatility of returns and the potential for them to impact on outcomes and the ability to meet desired cash funding plans.
- 5.5. The Review recommended that the current expected return of 7.7% per annum can support the current short term spending plans and longer-term distributions of £6.35 million per annum.
- 5.6. The market may perform better or worse than forecast, and while less extreme market volatility is being experienced currently, uncertainty remains within the global political and economic outlook and therefore instability can be anticipated from investment returns over the short to medium term.
- 5.7. Investigation into the expected returns from managed funds was carried out for the three years 2026/27 to 2028/29. Based on the following table, the returns in the forecast have been limited to 6% in 2027/28 and 3.5% in 2028/29.

Year	Global equities (MSCI ACWI proxy)	US equities (S&P 500 proxy)	UK equities (FTSE All-Share proxy)
2026/27	~ 6-12% base case	~ 5-11% base case	~ 4-9% base case
2027/28	~ 5-10%	~ 4-9%	~ 4-8%
2028/29	~ 4-8%	~ 3-7%	~ 3-7%

(Cited houses 12-18 month views, earnings estimates, and valuation context, expressed as indicative total return ranges in local currency for each region.)

- 5.8. The forecast cashflow requirements, as detailed in Appendix 1 to this report, indicates a requirement to draw down £60,000,000 over the 3-year period 2026 to 2029 to support General Fund services. In simple terms, this level of disbursement of funds over the three-year period translates into a loss of compounded income from the Fund of approximately £9,700,000, based on a long-term investment target return of 7.7%.
- 5.9. In addition to the General Fund contribution, there are several other commitments on the Strategic Reserve Fund that are also expected to be drawn down over the next three years, including the following contributions totalling £2,484,000:
- £1,011,000 towards Strategic Projects.
 - £539,000 towards Islands Growth Deal projects.
 - £334,000 towards Community Development Fund projects.
 - £600,000 towards the Empty Homes Support Scheme.
- 5.10. This list of commitments/disbursements only reflects current decisions and excludes any potential additional requests. The Strategic Reserve Fund is likely to be considered as a funding source for other decisions, further reducing the balance of useable reserves.
- 5.11. In assessing the sustainability of the Strategic Reserve Fund, it is considered good practice to review the impact of the current financial arrangements over the longer term. Appendix 2 to this report provides a 10-year projection or forecast for the Fund.
- 5.12. In assessing any financial projection or forecast over the longer term, it is helpful to remember that the information is only ever as good as the underlying assumptions behind the figures. Also, the longer-term financial forecast should be considered in the context that much uncertainty remains within both the UK and global economies over the short term such that the level of underlying risk of error is likely to increase significantly as the timeline of any forecast is extended out beyond the short-term.

5.13. The long-term forecast is based on the following assumptions using both local experience, government forecasts, and investment advisor modelling:

- Investment income – managed funds – 7.7%.
- SRF contribution to General Fund Services remaining at £20.0m from 2027/28.
- Investment income – local investments – 0.0% to 5.5%.
- Inflation – Consumer Price Index reverting to 2.0% from 2028/29.

5.14. The success or failure of the Strategic Reserve Fund, in terms of financial performance, comes from investment activities, primarily through externally managed fund investments but also to a lesser extent through local investments. To balance the investment returns and the associated risks, the strategies for local investments and externally managed fund investments are reviewed regularly. For example, the review in September 2024 agreed an increase in high quality investment Corporate Bonds as liquid assets and a potential income source to meet the cash flow needs of the Council. More liquid investments are likely to have a lower return.

5.15. In terms of local investments, a potential significant local investment is the Orkney Community Wind projects. Quanterness is anticipated to start generating revenues in 2028/29. The three projects themselves have different risk/return profiles and are subject to individual decisions based on their unique business cases. The business decisions for the two other sites, Hoy and Faray, are still being developed.

For Further Information please contact:

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Implications of Report

- 1. Financial** - Detailed throughout the report.
- 2. Legal** - Section 69 (3)(e) of the Orkney County Council Act 1974 permits the Council to apply any reserves established thereunder for any purpose which in the opinion of the Council is solely in the interests of the County or its inhabitants.
- 3. Corporate Governance** – None.
- 4. Human Resources** - None
- 5. Equalities** – N/A
- 6. Island Communities Impact** – N/A
- 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** – N/A
- 10. Risk** - The risk for future budget efficiency exercises of not notionally attaching the Strategic Reserve Fund contribution to specific General Fund service areas is that those areas which are likely to be non-statutory or discretionary areas of spend are likely to be the natural choice of proposed efficiencies as the Council continues to face significant budget constraints.
- 11. Procurement** – N/A
- 12. Health and Safety** – N/A
- 13. Property and Assets** – N/A
- 14. Information Technology** – N/A
- 15. Cost of Living** – N/A

List of Background Papers

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Appendices

Appendix 1: Strategic Reserve Fund – Draft 3 Year Budget for financial years 2025/26, 2026/27 and 2027/28.

Appendix 2: Strategic Reserve Fund – 10 Year Long Term Budget Forecast.

SRF Draft 3 year budget - 2026/29	2025/26 Budget Actual £000's	2025/26 Budget Outturn £000's	2026/27 Budget Estimate £000's	2027/28 Budget Estimate £000's	2028/29 Budget Estimate £000's
Investment Activities - local investments	(350)	(500)	(500)	(400)	(400)
- managed funds	(19,480)	(22,000)	(20,144)	(16,000)	(9,000)
- loans fund	686	843	922	813	717
- other, including strategic projects	893	1,075	1,347	1,167	971
Property Investments	(934)	(803)	(803)	(803)	(803)
Renewable Energy	(138)	(331)	(275)	(275)	(275)
Scapa Flow Oil Port	(489)	(2,032)	(489)	(489)	(489)
County Fund	(2,000)	(773)	(2,000)	(2,000)	(2,000)
Wind Farm	0	0	0	0	(2,300)
Loan Charges - interest and debt management	(52)	(67)	(67)	(67)	(67)
Loan Charges - CFCR	119	0	119	119	119
Other	9	8	9	9	9
Net budget surplus	(21,736)	(24,580)	(21,881)	(17,926)	(13,518)
	2.3%	2.6%	3.0%	2.5%	2.0%
less allocation to protect value of fund @ CPI	4,709	5,754	6,112	5,658	4,479
Balance available for disbursement	(17,027)	(18,826)	(15,769)	(12,268)	(9,039)
Disbursements:					
General Fund Services	18,000	17,658	18,000	18,000	18,000
County Fund - passenger harbour dues	2,000	773	2,000	2,000	2,000
Community Development Fund (CDF)	333	333	334	0	0
Contribution to the Island Games	392	607	0	0	0
Islands Deal	266	150	200	200	139
Strategic Projects	1,000	340	1,011	0	0
Empty Homes Support Scheme	0	0	200	200	200
	21,991	19,861	21,745	20,400	20,339
Deficit/(Surplus) on SRF (in real terms)	4,964	1,035	5,976	8,132	11,300
Deficit/(Surplus) on SRF (actual)	255	(4,719)	(136)	2,474	6,821
Cashflow - Opening Balance	(15,964)	(22,469)	(26,346)	(25,025)	(23,884)
Surplus/(Deficit) on year	(255)	4,719	136	(2,474)	(6,821)
Less: Non-cash - Managed Funds Income	(19,480)	(22,000)	(20,144)	(16,000)	(9,000)
Fund Transfers - Inflow/(Outflow)	19,735	12,281	20,008	18,474	15,821
Other Movements	(1,367)	1,123	1,321	1,141	945
Cashflow - Closing Balance	(17,331)	(26,346)	(25,025)	(23,884)	(22,939)
	2025/26	2025/26	2026/27	2027/28	2028/29
	Budget	Budget	Budget	Budget	Budget
	Actual	Outturn	Estimate	Estimate	Estimate
	£000's	£000's	£000's	£000's	£000's
SRF Balance Sheet					
Investment Properties	19,465	23,006	23,125	23,244	23,363
Local Investments	8,822	9,766	9,726	9,686	9,646
Managed Funds Investments	234,022	261,612	261,748	259,274	252,453
OIC Loans Fund Deposit/(Advance)	(17,331)	(26,346)	(25,025)	(23,884)	(22,939)
Provisions	(42,209)	(42,416)	(43,688)	(44,780)	(45,676)
Net Accruals	966	421	421	421	421
Net Assets	203,735	226,043	226,307	223,961	217,268
Less: Unusable Reserves	9,883	13,433	13,561	13,689	13,817
	193,852	212,610	212,746	210,272	203,451
Represented by: Useable Reserves					
Strategic Reserve Fund	182,946	204,675	204,639	202,017	195,076
Flotta Terminal Decline Fund	8,930	5,720	5,892	6,040	6,160
Conservation Fund	198	218	218	218	218
Travel Fund	107	118	118	118	118
Talented Performers Fund	63	68	68	68	68
Orkney Memorial Fund	434	456	456	456	456
Talented Young Persons Fund	9	8	8	8	8
Capital Receipts Reserve	1,165	1,347	1,347	1,347	1,347
	193,852	212,610	212,746	210,272	203,451
Target Minimum Balance or "Floor" for SRF	269,524	269,245	277,322	284,255	289,940
Useable Headroom	(75,672)	(56,635)	(64,576)	(73,983)	(86,489)
	-39.0%	-26.6%	-30.4%	-35.2%	-42.5%

	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34	2034/35	2035/36
	Budget									
	Estimate									
	£000's									
SRF Balance Sheet										
Investment Properties	23,125	23,244	23,363	23,482	23,601	23,720	23,839	23,958	23,958	24,077
Local Investments	9,726	9,686	9,646	9,006	8,366	8,366	8,366	8,366	8,366	8,366
Managed Funds Investments	261,748	259,274	252,453	256,480	260,850	265,590	270,716	276,358	276,815	282,495
OIC Loans Fund Deposit/(Advance)	(25,025)	(23,884)	(22,939)	(21,385)	(19,813)	(18,863)	(17,894)	(16,905)	(16,905)	(15,896)
Provisions	(43,688)	(44,780)	(45,676)	(46,590)	(47,522)	(48,472)	(49,441)	(50,430)	(50,430)	(51,439)
Net Accruals	421	421	421	421	421	421	421	421	421	421
Net Assets	226,307	223,961	217,268	221,414	225,903	230,762	236,007	241,768	242,225	248,024
Less: Unusable Reserves	13,561	13,689	13,817	13,936	14,055	14,174	14,293	14,412	14,412	14,531
	212,746	210,272	203,451	207,478	211,848	216,588	221,714	227,356	227,813	233,493
Represented by: Useable Reserves										
Strategic Reserve Fund	204,639	202,017	195,076	198,980	203,224	207,836	212,831	218,340	218,797	224,341
Flotta Terminal Decline Fund	5,892	6,040	6,160	6,283	6,409	6,537	6,668	6,801	6,801	6,937
Conservation Fund	218	218	218	218	218	218	218	218	218	218
Travel Fund	118	118	118	118	118	118	118	118	118	118
Talented Performers Fund	68	68	68	68	68	68	68	68	68	68
Orkney Memorial Fund	456	456	456	456	456	456	456	456	456	456
Talented Young Persons Fund	8	8	8	8	8	8	8	8	8	8
Capital Receipts Reserve	1,347	1,347	1,347	1,347	1,347	1,347	1,347	1,347	1,347	1,347
	212,746	210,272	203,451	207,478	211,848	216,588	221,714	227,356	227,813	233,493
Target Minimum Balance or "Floor" for SRF	277,322	284,255	289,940	295,739	301,654	307,687	313,841	320,118	320,118	326,520
Useable Headroom	(64,576)	(73,983)	(86,489)	(88,261)	(89,806)	(91,099)	(92,127)	(92,762)	(92,305)	(93,027)
	-30.4%	-35.2%	-42.5%	-42.5%	-42.4%	-42.1%	-41.6%	-40.8%	-40.5%	-39.8%