Treasury Management Strategy Statement & Annual Investment Strategy

2023/24

Contents:

1. Introduction

Treasury management is an essential function of the Council that enables the delivery of day-to-day services and facilitates future investment in services. We are legally required to operate within a balanced budget each year, so it is essential that we balance the cash we receive during the year with the cash needed to pay for our planned revenue and capital expenditure.

The Treasury function plays an important role in planning and managing the Council's cash flows throughout the year, ensuring that sufficient cash is available when required. In addition to managing the Council's day-to-day cash flows, the Treasury function also manages our capital financing requirements and long-term investments, both of which are important elements and part of our annual revenue and capital budgets and our medium-term financial plan.

As a local authority, we have an obligation to comply with the Code of Practice for Treasury Management in the Public Services (the Code) by virtue of the Scottish Government Finance Circular 5/2010. The Code was first published in 2011 and was subject to revision in 2021, which is the current version in use across the local government sector.

The Council is also required to comply with the Prudential Code for Capital Finance in Local Authorities 2021 (the Prudential Code), which provides a framework to ensure capital investment plans are affordable, prudent and sustainable. Compliance with the Prudential Code is a requirement of the Local Government in Scotland Act 2003.

This document is intended to bring together all of the applicable policies, practices and strategies that govern how the Council manages its daily cash flows, short and long-term debt and investment activities. Part A of this document contains the policies, practices and strategies relating to our treasury management activities. Part B contains the policies, practices and strategies relating to our investment activities.

Part A

Treasury Management

2. Treasury Management Strategy

Treasury management is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) as '*the management of the local authority's borrowing, investments and cash flows, including its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks*'.

The Council's finance team is responsible for all treasury management activities, with a small treasury team that fulfils three main roles:

- Cash management and banking
- Debt management, and,
- Investment management
  (*NB investment activities are covered in Part B*)

Cash management and banking:
The treasury team is responsible for planning, forecasting and managing the Council's day-to-day cash flows through its various bank accounts. The team seeks to retain a daily working balance so that sufficient cash is available to meet liabilities as they fall due. Cash balances held in the Council's current account and earn interest, currently 3.95% per annum, however this is lower than the return that could be generated if invested with external fund managers. The team actively manage cash balances to avoid any excess cash balances in order to maximise the interest or return earned on those cash deposits.

The Council has an arranged overdraft facility that can be used to cover expenditure, on a short-term basis, if the current account cash balance is insufficient. The agreed limit of the overdraft facility is £800,000, however the Council seeks to avoid calling upon this facility in order to avoid any banking charges that arise from use of the facility.

Debt management:
The treasury team also manage the Council's debt management activities, which fall into two categories:

- short-term borrowing (for periods no longer than 364 days), or,
- longer-term borrowing (for periods of more than 1 year).

The Council undertakes borrowing, irrespective of length of borrowing period, in line with both the Borrowing Policy and Prudential Code. The Prudential Indicators, as set out in Annex 3, include provision for both short and long-term borrowing.

Local authorities are, at present, able to borrow from other local authorities on a short-term basis, at low rates. It may be more cost effective to meet any short-term cash flow needs (such as payment of monthly salaries) by seeking to borrow via this method rather than recall funding from the Council's long-term investments. The Executive Manager – Finance will determine if and when this may be the most appropriate course of action to take.

3. CIPFA Codes of Practice

The Council sets its annual revenue budget each year, allocating resources to Council departments in order to meet anticipated demand for services in the forthcoming financial year. At the same time, the Council sets an annual capital budget to facilitate investment in non-current assets that are central to the future provision of public services. Professional codes of practice have been developed to assist local authorities discharge their responsibilities in line with statutory requirements and best practice with regard to treasury management and capital financing. The two codes of practice are complementary to one another and summarised below.

i) Code of Practice for Treasury Management in the Public Services 2021:

The CIPFA Code of Practice for Treasury Management in the Public Services (the Code) sets out the key principles that underpins the Council's approach to managing its treasury functions:

Principle 1

Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

Principle 2

Policies and practices should make clear that the effective management and control of risk are prime objectives of the treasury management activities and that responsibility for these lies clearly within the organisation. The appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

Principle 3

The organisation should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of business and service objectives; and that within the context of effective risk management, treasury management policies and practices should reflect this.

The Code recommends the adoption of the following clauses:

1. This organisation will create and maintain, as the cornerstones for effective treasury management:
   - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
   - suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities
   - investment management practices (IMPs) for investments that are not for Treasury management purposes.

   The content of the policy statement and TMPs and IMPs will follow the recommendations contained in Sections 6,7 and 8 of the TM Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the TM Code's key principles.
2. Shetland Islands Council will receive reports on its treasury and investment management policies, practices and activities, including, as a minimum:
   - an annual strategy and plan in advance of the year (this document)
   - a mid-year review, and,
   - an annual report after its close, in the form prescribed in its TMPs and IMPs.
3. Shetland Islands Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Policy and Resources Committee, and for the execution and administration of treasury management decisions to the Section 95 Officer, who will act in accordance with the organisation's policy statement, TMPs and IMP's, and if a CIPFA member, CIPFA's Standard of

Professional Practice on Treasury Management.

4. This organisation nominates the Policy and Resources Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

The Council initially adopted the clauses above on 21 March 2012 (Minute reference: 25/12), however CIPFA recommend the clauses are reviewed and approved annually.

The Treasury Management Policy Statement can be found in Annex 1 and Treasury Management Practices can be found in Annex 2.

ii) Prudential Code for Capital Finance in Local Authorities (2021):

The Prudential Code for Capital Finance in Local Authorities 2021 (the Prudential Code) was established to assist local authorities with the development of capital investment plans that are central to the delivery of quality public services. The Prudential Code established a framework that supports:

- local strategic planning,
- local asset management planning, and,
- proper option appraisal, including ensuring that capital expenditure is in accordance with the corporate objectives of the authority.

Following the principles set out in the Prudential Code allows local authorities to demonstrate compliance with statutory requirements and best practice by ensuring:

- capital expenditure plans are affordable and proportionate,
- all external borrowing and other long-term liabilities are within prudent and sustainable levels,
- the risks associated with investments for service and commercial purposes are proportionate to their financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services, and,
- treasury management and other investment decisions are taken in accordance with professional good practice.

The Council is required to set, monitor and revise (if necessary), a range of prudential indicators when setting its annual revenue and capital budget. This allows the Council to demonstrate compliance with the Prudential Code, or in other words, demonstrate that the Council's capital investment plans are affordable, prudent and sustainable and that the Council is managing its treasury activities in line with best practice.

The Council's prudential indicators for 2023/24 are contained in Annex 3.

From 2019/20, the Prudential Code has also required local authorities to set out a capital strategy. The aim of the capital strategy is to provide a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services. The capital strategy also considers how any associated risk is managed and how the implications of capital investment affect the Council's financial sustainability.

4. Capital Strategy

Purpose of the capital strategy:

The capital strategy is an overarching framework that provides an overview of how capital expenditure, capital financing and treasury management activity contributes to the delivery of public services. The strategy also considers how any associated risk is managed and how the implications of capital investment affect the Council's financial sustainability. This section provides a summary of the policies, practices and constitutional documents that govern how this Council manages its capital investment activity.

The Prudential Code requires the Council to consider its capital expenditure and investment plans with regard to the Council's overall organisational plans, strategies and resources and to ensure that decisions are made with sufficient regard to the long-term financial implications and potential risks to the Council.

The capital strategy aligns with 'Our Ambition' in that:
'We will become more financially sustainable and resilient, safeguarding public funds while achieving value for money. This will ensure we are well placed to respond to the significant funding uncertainties and pressures we face and to target our money to where it can make the most difference. We will continue with disciplined financial monitoring, working towards a smaller base budget from 2022 onwards.'

The Council's future plans for capital investment are shaped by the priorities set out in *Our Ambition,* which will require significant investment in new and existing infrastructure in order to achieve desired policy outcomes. The fundamental objective in the consideration of the affordability of the Council's capital plans is to ensure that the total capital investment of the Council remains within sustainable limits. The capital strategy will help ensure investment decisions are taken with regard to the Prudential Code.

Capital Expenditure:

The Council incurs annual revenue expenditure and longer term capital expenditure. The capital strategy is focused on long-term capital projects and corresponding expenditure required to finance those projects. The Council's financial regulations, part of the Council's wider library of constitutional documents, provides guidance for the planning of, and preparation of business cases for capital projects. The financial regulations require the preparation of an Asset Investment Plan (AIP).

The Council sets a rolling five-year AIP which provides a high level summary of individual projects that are to be undertaken in the next five year period, with planned expenditure profiled by financial year. The AIP is reviewed annually (including any reprioritisation that may be required) by the Policy and Resources Committee, who then recommend it to the full Council for approval. The Executive Manager – Assets, Commissioning and Procurement and Executive Manager – Finance have the responsibility to prepare the updated AIP each year.

Approval of the Asset Investment Plan by the full Council provides the authority for budget responsible officers (BROs) to incur capital expenditure, subject to any separate approvals being in place, as required by the Council's Gateway Process for the Management of Capital Projects.

The Council's current Asset Investment Plan can be found in the 2023/24 Budget Book.

Asset Investment Group:

The Council established an Asset Investment Group (AIG) which has a responsibility for overseeing the Council's capital investment plans, known as the Asset Investment Plan (AIP). The purpose of the AIG is to:

- Receive and assess proposals for new projects from Council services,
- Assess requests from Services to vary the scope or nature of existing projects,
- Make recommendations to Policy and Resources Committee on new and existing projects (including recommendation of prioritisation of projects if budgetary or capacity constraints exist), and,

- Review and report on the progress of the Asset Investment Plan and Property Asset Management Strategy.

The membership of the AIG comprises of:
- the Director of Corporate Services,
- the Executive Manager – Assets, Commissioning and Procurement (who also chairs the AIG),
- the Executive Manager – Finance, and
- the Executive Manager – Governance and Law.

Reports are prepared on a quarterly basis and presented to the Policy and Resources Committee by the Executive Manager – Asset, Commissioning and Procurement and the Executive Manager – Finance to provide Members with a progress report on the AIP and monitoring reports on capital expenditure for each capital project within the current financial year.

The Gateway Process for the Management of Capital Projects:

The Council has established a 'gateway' process to ensure that all capital projects put forward for consideration are supported by key stakeholders and that prospective projects contribute to the delivery of Council services and the corporate priorities as outlined in *Our Ambition*.

Appropriate use of assets can make the difference between good and poor service delivery. The gateway process provides a mechanism to effectively coordinate asset management and capital investment. The Council's gateway process has been developed around the HM Treasury Green Book approach, the 'Five-Case Model', and requires that five aspects of a project are evaluated or re-evaluated at a number of stages through the development of the project. The five cases that need to be evaluated are:
- Strategic
- Economic
- Commercial
- Financial, and
- Management

The gateway process allows the Council to follow the five case model when developing business cases in a proportionate and scalable way, irrespective of complexity or scale of the project.

The gateway process examines projects at key decision points in their lifecycle and looks ahead to provide assurance that they can progress successfully to the next stage. The overall objectives of the gateway process are to ensure that projects are delivered on time; to the right quality and to the right cost thus ensuring that they deliver value for money, and that the outcomes expected from the project are realised.

Projects put forward for inclusion in the AIP require a project sponsor, which is usually a senior officer from the originating service. The gateway process requires that the project sponsor demonstrates how the project fits with the Council's corporate plan, '*Our Ambition*', and the Shetland Partnership Plan. This helps to ensure that capital investment decisions of the Council are closely aligned to its agreed strategic objectives.

An important element of the gateway process is ensuring that proposed projects comply with the Council's Capital Expenditure Policy which is set out in Annex 4 to this document.

The Executive Manager – Finance has sole discretion to determine whether any element of expenditure is classified as capital expenditure.
If expenditure meets the definition of capital, there may be opportunities to finance the outlay from capital receipts, general or specific government grant or by spreading the cost over future year's revenues. Examples of eligible and ineligible costs can be found in the Council's Accounting Policy for Capital Assets (Non-Current Assets).

Any expenditure that does not qualify as capital expenditure will be charged to revenue expenditure in the period in which expenditure is incurred.

The Capital Expenditure Policy establishes that only projects where a robust estimate of costs have been undertaken are allowed to be included in the AIP. As part of any recommendations made by the AIG, the Executive Manager – Finance will determine how it is to be funded in accordance with the Prudential Code.

The funding sources available to the Executive Manager – Finance for capital projects is set out in the Council's Funding Policy in the Medium Term Financial Plan. As per this policy, various funding options may be available such as Scottish Government Capital Grants, capital receipts, capital funded from current revenue (CFCR) but if these options are not available then capital expenditure may be financed by borrowing.

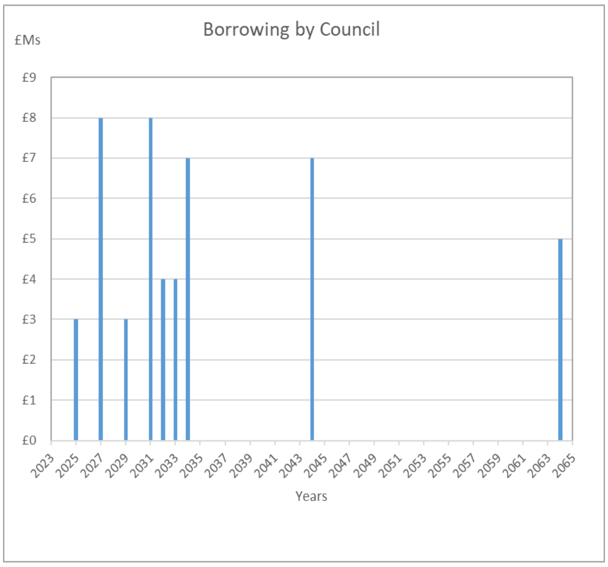
There are certain requirements before borrowing can be used, where interest rates on borrowing must be lower than the return on long term investments, and the service benefitting from the capital asset will be required to make sufficient revenue savings to free up budget to pay for the cost of capital (interest charges plus capital).

With effect from 1 April 2020, operating leases for which the Council is a lessee are required to be recognised as 'right of use' asset and related lease liability, unless the lease terms is 12 months or less or the underlying asset has a low value. The implications of this change in accounting policy has been factored into the prudential indicator calculations.

The Council has approved a borrowing policy and a set of prudential indicators which set the financial parameters for borrowing. The Executive Manager – Finance as Section 95 Officer is the only Officer of the Council who may recommend a decision to borrow to the Council.

When a decision to proceed to borrow has been taken by Council, the Executive Manager – Finance will determine the institution, the type, the timing, and the length of the loan after seeking advice from external Treasury Management specialists as to the most economically advantageous transaction.

All external borrowing to date has been from the Public Works Loan Board (PWLB) on a Maturity basis, where the money borrowed is repaid back at the end of the loan period. As at the 31st December 2022 the Council has borrowed a total of £49 million from the PWLB. The graph below shows the Council's current borrowing from the PWLB, the value of each loan and the year when the loan will mature and be repaid.



Within the Prudential Indicators set out in Annex 3, there are annual borrowing limits for the Council. The proposed limits for 2023/24 are:

- £98 million of external debt for the Council
- Authorised limit for external debt for the Council of £117 million

These figures and other authorised limits can be found in Annex 3 to this document.

Treasury Management:

As set out earlier in section 2 of this document, the Council's finance team is responsible for all treasury management activities, including:

- Cash management and banking
- Debt management, and,
- Investment management

The Council has adopted the revised CIPFA Code of Practice for Treasury Management in Public Services 2021, and the key principles of the Code are set out earlier in this document, in section 3.

To meet the requirements of the Code the Council has policies and strategies in place to manage its investment and treasury management activities, which include:

- Treasury management strategy (Part A of this document),
- Treasury Management Policy Statement (Annex 1 to this document)
- Treasury Management Practices (Annex 2 to this document)
- Annual Investment Strategy (Part B of this document)
- Borrowing Policy (Annex 5 to this document)

Risk within Capital Projects:

The prime policy objectives of local authority investment activities are the security and liquidity of funds, and authorities should avoid exposing public funds to unnecessary or unquantified risks. However, all treasury management activity is subject to risk. The Council's Financial Regulations include governance arrangements for capital projects, which help to manage and reduce risks to the capital strategy.

The Council's governance arrangements, require regular capital financial monitoring reports be presented to the Council's Policy and Resources Committee on a quarterly basis. These reports also review risk data and narrative which enables the Council to effectively monitor and manage the overall risks of the capital programme. Risk registers are maintained and managed by relevant senior officers and are considered within the Council's risk management arrangements and relevant committee.

Risk management is carried out by the treasury team, in line with policies approved by the Council in the Investment Strategy Statement covered in Part B. The Treasury Management Practice 1 (TMP1) as set out in Annex 2 details the mitigation in place to manage the following risks:

- Credit and counterparty risk,
- Liquidity risk,
- Interest rate risk,
- Exchange rate risk,
- Inflation risk,
- Refinancing risk,
- Legal and regulatory risk,
- Operational risk, including fraud, error and corruption, and
- Market risk management.

Commercial Activity:

The Council manages a large estate, including a number of properties that are leased on a commercial basis that generates rental income. The generation of income from these properties is actively managed by the Council's Assets, Commissioning and Procurement service.

The Council has a history of lending to businesses in order to deliver on its Economic Development objectives. This was further extended by the transfer of the Shetland Development Trust (SDT) assets to the Council in the months leading up to the formal winding up of the Trust in February 2015. The Council has a portfolio of local investments, predominantly in the form of loans to local businesses to support local economic development. These however only account for a small percentage of the overall investments of the Council. Loans awarded under this scheme are subject to the following criteria:

- The loan will generate a rate of return that is at least equal to the 20 year average fund manager investment returns (net of fees and inflation) in which the Council currently invests, and
- Due diligence work has been undertaken to ensure that any loan granted is at an acceptable risk level to the Council.

In addition to lending to businesses the SDT assets include fishing quota which is managed on behalf of the Council by the Shetland Fish Producers Organisation (SFPO).

Borrowing Policy:

The Council introduced a borrowing policy to enable greater flexibility in the financing of capital projects and as an additional tool within its treasury management arrangements. The borrowing policy is contained in Annex 5.

Internal Borrowing versus External Borrowing:

The decision to secure external borrowing or to use the Council's investments to finance capital expenditure is essentially a question of what is the most economically advantageous option. In other words, it is down to whether interest rates are higher or lower than the long term average return on the Council's external investments (with fund managers).

If interest rates are higher than the long term rolling average return on the Council's investments (currently 5.2%) then it means the cost of borrowing is higher than the lost income forgone by using the Council's investments, so it would make financial sense to use the investments for capital expenditure.

For example, if interest rates were 10% for a £1m loan:
Annual interest payable on £1m at 10% = £100,000
Investment income of 5.2% generated on £1m = £52,000

In this example to borrow would cost £100,000 a year, and to use investments would present an opportunity cost of £52,000 in lost investment income. In this example, using investments would present a saving of £48,000 per year over using borrowing.

However, the reverse is true if interest rates are lower than the long term average return on the Council's investments (currently 5.2%). For example if interest rates were 2% for a £1m loan -

Annual interest payable on £1m at 2% = £20,000
Investment income of 5.2% generated on £1m = £52,000

In this example, to borrow would cost £20,000 a year and to use investments would present an opportunity cost of £52,000 in lost investment income. In this example borrowing would save the Council £32,000 per year.

Therefore when interest rates are lower than long term investment returns, the default position of the Council should be to borrow as it is more cost effective.

The Cost of Borrowing:

Shetland Islands Council has been in the unique position of having significant investments which in the past it has used to fund its capital expenditure. This has in effect meant that from a service perspective point of view, new assets were paid for outright at the beginning without any recurring revenue implications. When borrowing is used to finance capital expenditure, the service is required to make a provision for servicing the associated debt (principal debt repayment and interest costs), which is a significant difference to the previous practice for General Fund capital expenditure where no service paid for its assets financing costs. This should be borne in mind when a decision to borrow is taken.

In order to demonstrate Best Value in the financing of capital expenditure, the Council should use its statutory powers to consider borrowing as an option to finance its capital investments. In order to regulate and monitor Council borrowing, the Council has a borrowing policy which is set out in Annex 5, and sets prudential indicators which include specific indicators which define the financial parameters for borrowing. The prudential indicators can be found in Annex 3.

Knowledge, Skills and Training:

The Council has access to a wide range of knowledge and skills, both in house, and from external consultants. The Council use external consultants that specialise in cash and debt management to assist and advise on the funding of the capital strategy.

It is the responsibility of the Executive Manager – Finance to ensure that all staff under their authority receives the level of training appropriate to their duties. Training is provided by external advisors as well as on the job training. Further details are included in the Council's Treasury Management Practices as set out in Annex 2.

PART B

Annual Investment Strategy

Long Term Investments:

The long term investments are assets of the Council and represent money given to fund managers to manage on its behalf for sustainable long term benefits. At 31 December 2022 the Council's long term investments had a value of £377 million, and were invested on behalf of the Council with three fund managers:

- Baillie Gifford
- BlackRock
- Partners

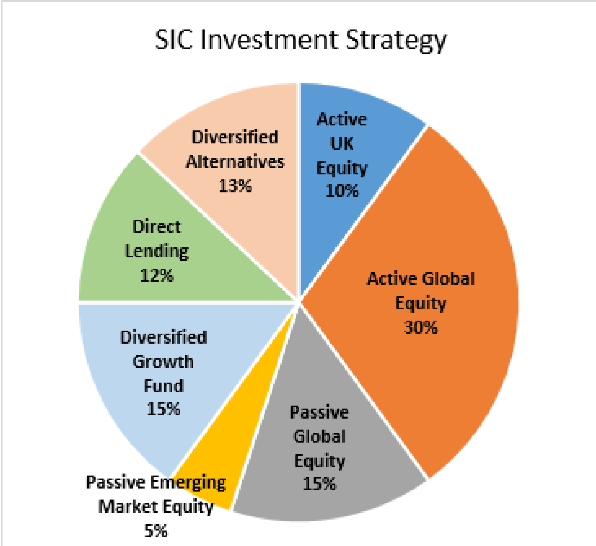
The Council undertook a review of its Investment Strategy during 2018. Investment consultants KPMG (now called Isio) conducted the review which resulted in a new investment strategy being approved by the Council in August 2018 (Min Ref: 45/18). The new investment strategy complements '*Our Medium-Term Financial Plan 2022-2028*'.

The new investment strategy aims to achieve gross investment returns of 7.3% per annum over the long term, through a mix of growth seeking and long term income returning assets. The strategy offers increased protection against any negative impact of market change due to the diversity of the investments and fund managers.

Two new mandates were required in Direct Lending and Diversified Alternatives, both are long term between 5 and 10 year investment periods that produce a steady income. Two tender process were carried out by KPMG that resulted with the Council awarding the two new mandates to fund managers in January 2019 (Min Ref: 01/19).

The reorganisation of assets from the previous asset allocation into the new investment strategy was completed in May 2022 when the Diversified Alternatives mandate became fully funded.

The investment strategy has the following asset allocation:



The Council's investment strategy is reviewed by external investment consultants every five years to ensure the investment strategy is still appropriate for the Council's requirements and future expectations.

As the last review of the investment strategy was undertaken in 2018, a review of the current investment strategy will be conducted during 2023 by the council's external consultants.

The movement of large sums of money between fund managers or between funds are coordinated by the Council's Treasury Service with the involvement of fund managers and the Council's custodian.

Current Investment Position:

The current percentage of funds under management for each fund manager at 31 December 2022 (unaudited) was:

Council Investments	**%**
Active UK Equities – Baillie Gifford	10.3

Active Global Equities – Baillie Gifford	30.5
Passive Global Equities – BlackRock	16.7
Passive Emerging Market Equities – BlackRock	5.9
Diversified Growth Fund – Baillie Gifford	15.8
Direct Lending - Partners	9.8
Diversified Alternatives Fund - BlackRock	11.0

All long-term investments that are managed externally by fund managers are held for the purpose of achieving an investment return. To this end all investments are managed in a way that minimises the risk to the capital sum and optimises the return on the investment consistent with those risks. This involves setting benchmarks for each fund and for each unitised product within the funds. These benchmarks (market indexes, cash plus a percentage return) are used to evaluate the performance of each investment against their investment market or set return, with large deviations both above and below these benchmarks questioned similarly.

All of the long-term investments with active mandates require the fund manager to have an investment return target above the benchmark return. The target is a level of outperformance above the benchmark that is seen as achievable with a low level of measured risk on a given mandate. The Manager will actively seek to produce investment returns in order to achieve the stated target. Performance at or above target is desirable but any returns above the benchmark will add value to the fund above the market return.

Short Term Investments

Short–term investments are held in cash, either with the Council's bank or on short-term deposits. These are managed by the Council's Treasury function on a daily basis and reviewed monthly to ensure the efficient operation of Council activities.

Permitted Investments

Every mandate the Council awards to a fund manager is finalised by both the Council and the fund manager entering into an Investment Management Agreement. This agreement covers all aspects of the mandate, including the type of investments to be held and the minimum and maximum investment levels allowed. Any breach of these set levels must be reported immediately by the fund manager and rectified as soon as practical. No rebasing of the asset class allocation split shall take place during 2023/24 unless with the approval of the Council.

On an annual basis each fund manager makes available their internal controls report. These reports are produced by their respective external auditors, and review all aspects of the fund manager's operating controls, with any concerns and weaknesses reported. The reports are reviewed by Treasury within Finance annually, with any concerns or issues identified that may impact on the Council reported accordingly.

The Council does not impose ethical views on fund managers within the Investment Management Agreement. The Council does not place constraints on a fund manager in relation to actual investment decisions, as it would affect the long-term projected investment returns, and the budget set by the Council. The fund manager, within the criteria stated in the Investment Management Agreement, makes investment decisions.

The Council's current investment strategy sets general investment asset class levels, though these are flexible due to money movements and investment returns.

Responsible Investment

Whilst the fund managers have delegated powers for the acquisition and realisation of investments, fund managers will be expected as part of their investment process to consider all factors, including the social, environmental and ethical policies of companies in which they may invest, to the extent that these may materially affect the long term prospects of such companies. The fund managers will also be expected to enter into dialogue with companies in which they invest, in relation to the pursuance of socially responsible business practices, and report on these activities.

Corporate Governance is a key responsibility for institutional shareholders and as a matter of principle the Council will seek to exercise all of its voting rights in respect of its shareholdings. It is recognised however that in practical terms this may not always be possible for overseas holdings. However for UK stocks all voting rights will be exercised in a positive fashion, i.e. no abstentions.

The fund managers, who will act in accordance with this policy, will exercise voting.

All of the Council fund managers have signed up to the United Nations Principles on Responsible Investment. The principles reflect the view that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, and therefore must be given appropriate consideration by investors, if they are to fulfil their fiduciary (or equivalent) duty. The Principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices, and so better align their objectives with those of society at large.

Risk Management

The authority's investments and financial 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 measures as interest rates and stock market movements
- Foreign Exchange risk – the possibility that financial loss might arise as a result of currency movements on overseas investments

The authority's overall risk management focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the resources available to fund services. Risk management is carried out by the Treasury Service, under policies approved by the Council in the Investment Strategy Statement.

Credit risk arises from deposits with banks and financial institutions, as well as credit exposures to the authority's customers. Deposits are not made with banks or financial institutions unless they meet one of the following categories:

- A Bank or Building Society with at least an A- long term Fitch rating
- Bank of Scotland – Council's own bank
- Any bank which is a wholly owned subsidiary of the above
- Any Local Authority

The A- long term rating is defined by Fitch as "High credit quality with a low expectation of default risk. The capacity for payment of financial commitments is considered strong." An approved lending list of the financial institutions that meets the criteria will be maintained in Treasury.

In addition the following guidelines will apply:

- No more than £3 million to be lent to any single organisation from one account, apart from the Council's own bank.

- No more than £6 million to be lent to any one organisation in total from all accounts, apart from the Council's own bank.

At the 31 December 2022 the Council had deposits with the Council's own bank, amounting to £14.3 million. The Council's exposure to credit risk on these current deposits is very low based on the last five financial years' experience, where no default or loss has occurred.

Liquidity risk is reduced due to the authority's external investments with fund managers, amounting to £377 million at the 31 December 2022. The authority has access to these funds, so there is no significant risk that it will be unable to meet its daily operating commitments.

The authority is exposed to various market risk in terms of its exposure to cash interest rates, currencies, bond markets, commodity markets but mainly the equity markets. Movements in interest rates, currencies, bond values, commodity values and share prices have a complex impact on the authority's investments. To limit the effect of these movements the investment portfolio is diversified to reduce exposure to any one market. The investment portfolio at the 31 December 2022 was diversified between the following main asset classes:

UK Equities
Overseas Equities
Emerging Market Equities
Direct Lending
Cash

The Diversified Growth Fund with Baillie Gifford was invested in 16 different asset classes at 31 December 2022.

The Diversified Alternatives Fund with BlackRock was invested in 5 different investment sectors at 31 December 2022, these were infrastructure debt, infrastructure equity, real estate debt, private credit and real estate equity.

The largest investment asset is equities, which made up about 63% of the Council's investments at 31 December 2022, but this is diversified between four funds over two fund managers.

The Council is exposed to foreign exchange risk through its overseas equities, denominated in foreign currencies, when traded by the fund managers. The exposure to risk of loss in adverse movements in exchange rates can be reduced by the fund managers, through the use of currency hedging strategies to specifically negate any currency movement impact.

Annex 1: Treasury Management Policy Statement

1. The Shetland Islands Council defines its treasury management activities as: ‘*The management of the authority’s borrowing, investments and cash flows, including its banking, money market and capital market transactions; the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks*’.

2. The Shetland Islands Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage these risks.

3. The Shetland Islands Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

4. The Prudential Code removed limits on Council’s on borrowing to finance capital expenditure, though this is balanced by additional responsibility to act prudently, and to take account of affordability when making decisions on borrowing. The Shetland Islands Council has set borrowing indicators in accordance with the Prudential Code, which are set out in Annex 3 to this document.

5. All investments are held for the purpose of achieving an investment return. To this end all investments are managed in a way that minimises the risk to the capital sum, and optimises the return on the investments consistent with those risks.

Annex 2: Treasury Management Practices

CIPFA recommends the following Treasury Management Practices (TMPs) where they are relevant to an organisation's treasury management powers and/or the scope of its treasury management activities. The following TMPs are relevant to the treasury management activities undertaken by Shetland Islands Council:

TMP1: Treasury Risk Management

The Executive Manager – Finance will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the Council's objectives in this respect, all in accordance with the procedures set out in TMP6: *Reporting Requirements and Management Information Arrangements*.

In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the schedule to this document.

i) Credit and Counterparty Risk Management
The risk of failure by a counterparty to meet its contractual obligations to the Council under an investment, borrowing, capital project or partnership financing, particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the Council's capital or current (revenue) resources.
This Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 Approved Instruments Methods and Techniques and listed in the schedule to this document.

ii) Liquidity Risk Management
The risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the Council's business/service objectives will be thereby compromised.

This Council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives.

The Council will not borrow earlier than required to meet cash flow needs unless there is a clear business case for doing so and will only do so for the current capital programme, to fund future debt maturities, or to ensure an adequate level of short-term investments to provide liquidity.

iii) Interest Rate Risk Management
The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the Council's finances, against which the Council has failed to protect itself adequately.
This Council will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with TMP6 reporting requirements and management information arrangements.
It will achieve this by the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be subject to the consideration and, if required, approval of any policy or budgetary implications.

iv) Exchange Rate Risk Management
The risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.
This Council will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

v) Inflation Risk Management
The risk that the Council's future income or cash flow will not have the same level of purchasing power as at present. Increased inflation could create unexpected or unbudgeted burden on the organisation's assets, liabilities and affect its investments, against which the Council has failed to protect itself adequately.
The Council will manage this risk by keeping under review the sensitivity of its assets and liabilities to inflation, and will seek to manage the risk accordingly in the context of the whole organisation's inflation exposures.

vi) Refinancing Risk Management
The risk that maturing borrowings, capital, project or partnership financings cannot be refinanced on terms that reflect the provisions made by the Council for those refinancings, both capital and revenue, and/or that the terms are inconsistent with prevailing market conditions at the time.
This Council will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the Council as can be reasonably be achieved in the light of market conditions prevailing at the time.
The Council will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid overreliance on any one source of funding if this might jeopardise achievement of the above.

vii) Legal and Regulatory Risk Management
The risk that the Council itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the Council suffers losses accordingly.
This Council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. The Council will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the Council, particularly with regard to the duty of care and fees charged.
This Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the Council.

viii) Operational Risk, including Fraud, Error and Corruption
The risk that a Council fails to identify the circumstances in which it may be exposed to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings, and fails to employ suitable systems, procedures and maintain effective contingency management arrangements to these ends. It includes the area of risk commonly referred to as operational risk.
This Council will ensure that it has identified the circumstances that may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.

ix) Market Risk Management
The risk that, through adverse market fluctuations in the value of the principal sums an organisation

borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.
This Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect the Council from the effects of such fluctuations.

TMP2 Performance Measurement

This Council is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its Treasury Management Policy Statement.
Accordingly, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the Council's stated service objectives. There will be regular review of the scope for potential improvements.

TMP3 Decision-Making and Analysis

This Council will maintain full records of its major treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time. The issues to be addressed and processes and practices to be pursued in reaching decisions are detailed in the schedule to this document.

TMP4 Approved Instruments, Methods and Techniques

This Council will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in the schedule to this document, and within the limits and parameters defined in TMP1 Treasury Risk Management.
The Council has reviewed its classification with financial institutions under MiFID II and has set out in the schedule to this document those organisations with which it is registered as a professional client.

TMP5 Organisation, Clarity and Segregation of Responsibilities and Dealing Arrangements

This Council considers it essential, for the purposes of effective control and monitoring of its treasury management activities, for the reduction of risk of fraud and error and for the pursuit of optimum performance that these activities are structured and managed in a fully integrated manner and that there is at all times clarity of treasury management responsibilities.
The principle on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with the implementing and controlling of these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions and the audit and review of the treasury management function.
If the Council intends as a result of lack of resources or other circumstances to depart from these principles, the Executive Manager – Finance will ensure that the reasons are properly reported in accordance with TMP6 *Reporting Requirements and Management Information Arrangements*, and the implications properly considered and evaluated.
The Executive Manager – Finance will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management and the arrangements for absence cover. They will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out. The present arrangements are detailed in the schedule to this document.
The Executive Manager – Finance will ensure there is proper documentation for all deals and

transactions, and that procedures exist for the effective transmission of funds. The present arrangements are detailed in the schedule to this document.

The delegations to the Executive Manager – Finance in respect of treasury management are set out in the schedule to this document. They will fulfil all such responsibilities in accordance with the Council's policy statement and TMPs and, if a CIPFA member, the Standard of Professional Practice on treasury management.

TMP6 Reporting Requirements and Management Information Arrangements

This Council will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and the transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.

As a minimum the Executive Committee will receive:

- An annual report on the strategy and plan to be pursued in the coming year.
- A mid-year review.
- An annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the Council's Treasury Management Policy Statement and Treasury Management Practices.

The Policy and Resources Committee will receive regular monitoring reports on treasury management activities and risks.

TMP7 Budgeting, Accounting and Audit Arrangements

The Executive Manager – Finance will prepare, and this Council will approve and, if necessary, from time to time will amend, an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at a minimum be those required by statute and regulation, together with such information as will demonstrate compliance with TMP1 Treasury Risk Management, TMP2 Performance Measurement, and TMP4 Approved Instruments, Methods and Techniques.

The Executive Manager – Finance will exercise effective controls over this budget and will report upon and recommend any changes required in accordance with TMP6 Reporting Requirements and Management Information Arrangements.
This Council will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force.

This Council will ensure that its auditors, and those charged with regulatory review, have access to all information and papers supporting the activities of the treasury management function as necessary for the proper fulfilment of their roles, and that such information and papers demonstrate compliance with external and internal policies and approved practices.

TMP8 Cash and Cash Flow Management

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of the Council will be under the control of the Executive Manager – Finance, and will be aggregated for cash flow and investment management purposes. Cash Flow projections will be prepared on a regular and timely basis to ensure that these are adequate for the purposes of monitoring compliance with TMP1 ii) Liquidity Risk Management. The present arrangements for preparing cash flow projections, and their form, are set out in the schedule to this document.

TMP9 Money Laundering
This Council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this are properly trained. The present arrangements, including the name of the officer to whom reports should be made, are detailed in the schedule to this document.

TMP10 Training and Qualifications
The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

Training may also be provided on the job and it will be the responsibility of the Executive Manager – Finance to ensure that all staff under their authority receives the level of training appropriate to their duties. This will also apply to those staff who, from time to time cover for absences from the treasury management team. The Executive Manager – Finance will recommend and implement the necessary arrangements.
The Executive Manager – Finance will ensure that Council members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities. Training records are maintained for Council members.

TMP11 Use of External Service Providers
This Council recognises that responsibilities for treasury management decisions remain with the organisation at all times. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such services providers, it will ensure it does so for reasons which will have been submitted to a full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods by which their value will be assessed and properly agreed, documented, and subjected to regular review. It will ensure, where feasible and necessary, that a spread of service providers is used, to avoid over reliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the Executive Manager – Finance, and details of the current arrangements are set out in the schedule to this document.

TMP12 Corporate Governance
This Council is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.
This Council has adopted and has implemented the key principles of the CIPFA Code. This, together with the other arrangements detailed in the schedule to this document, are considered vital to the achievement of proper corporate governance in treasury management, and the Executive Manager – Finance will monitor and, if and when

necessary, report upon the effectiveness of these arrangements.

Annex 3: Prudential Indicators

It is proposed that the Prudential Indicators for Shetland Islands Council for 2022/23 to 2025/26 should be as follows:

1. Ratio of Financing Costs to Net Revenue Stream

Definition:

- General Fund - The proportion of the General Fund income from the Council's General Revenue Grant (including NNDR) and Council Tax to fund the debt financing costs (interest and principal repayments) of the planned capital expenditure programme.
- Housing Revenue Account - The proportion of income to the HRA (substantially housing rents) to fund the debt financing costs (interest and principal repayments) of the planned capital expenditure programme.
- Harbour Account - The proportion of Harbour Account income (mainly fees & charges) to fund the debt financing costs (interest and principal repayments) of the planned capital expenditure programme.

Ratio of Financing Costs to Net Revenue Stream					
	2021/22 Actual	**2022/23 Estimate**	**2023/24 Estimate**	**2024/25 Estimate**	**2025/26 Estimate**
General Fund	5.7%	6.1%	7.1%	6.9%	7.1%
HRA	27.6%	27.4%	26.2%	25.5%	24.6%
Harbour Account	6.7%	7.5%	7.2%	6.9%	6.7%

2. Capital Expenditure

Definition:

Actual capital expenditure for 2021/22 and estimated capital expenditure for the current year and the next three years, as set out in the Council's Asset Investment Plan 2023-2028.

Capital Expenditure					
	2021/22 Actual £000	**2022/23 Estimate £000**	**2023/24 Estimate £000**	**2024/25 Estimate £000**	**2025/26 Estimate £000**
General Fund	11,496	11,344	12,857	21,971	18,431
HRA	2,355	2,926	9,065	7,514	7,487
Harbour Account	3,863	542	379	389	324
Total	**17,714**	**14,812**	**22,301**	**29,874**	**26,242**

3. Debt and the Capital Financing Requirement:

Definition:

The Capital Financing Requirement (CFR) reflects the authority's underlying need to finance capital expenditure by borrowing or other long-term liability arrangements. As the Council should only borrow for a capital purpose, the debt should not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

Capital Financing Requirement					
	2021/22 Actual £000	**2022/23 Estimate £000**	**2023/24 Estimate £000**	**2024/25 Estimate £000**	**2025/26 Estimate £000**
General Fund	68,300	67,232	84,319	86,717	88,487
HRA	8,392	7,584	8,477	7,669	6,861
Harbour Account	15,845	15,593	14,799	14,007	13,215
Total CFR	**92,537**	**90,409**	**107,595**	**108,393**	**108,563**
Gross External Debt	**90,743**	**89,442**	**97,610**	**97,085**	**98,874**

4. Operational Boundary for External Debt

Definitions:

A boundary for total external debt based on the estimate of total projected external debt to be monitored against during the year. It may be breached temporarily for variations in cash flow but a sustained or regular breach would require investigation.

Operational Boundary for External Debt			
	2023/24 £000	**2024/25 £000**	**2025/26 £000**
Borrowing	49,048	49,029	51,496
Other Long Term Liabilities	48,562	48,056	47,378
Total	**97,610**	**97,085**	**98,874**

5. Authorised Limit for External Debt

Definitions:

Limit for total external debt that should not be breached. This excludes investments and is based on future capital plans and variations in cash flow.

Authorised Limit for External Debt			
	2023/24 £000	**2024/25 £000**	**2025/26 £000**
Total	**117,144**	**126,890**	**131,433**

6. Actual External Debt at 31 March 2022

Definition

The actual external debt taken from the Balance Sheet as at 31st March 2022.

Actual External Debt	
	31 March 2022
	£000
Borrowing	49,072
Other Long Term Liabilities	40,252
Total	**89,324**

7. Upper limit on Interest Rate Exposures

Definition:

Ranges within which the Council will manage its exposures to fixed and variable rates of interest. Whilst the Council could obtain more favourable interest rates with a variable rate, it increases the longer term risk of rates rising beyond a fixed rate.

It is calculated as a percentage of total net outstanding principal sums of debt.

	2021/22 Actual £'000	2022/23 Indicative £'000	2023/24 Indicative £'000	2024/25 Indicative £'000	2025/26 Indicative £'000
Fixed interest rate exposures	100%	100%	100%	100%	100%
Variable interest rate exposures	0%	40%	40%	40%	40%

8. Maturity Structure of Borrowing

Definition:

Upper and lower limits to assist the Council to avoid large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time. This is the fixed rate debt maturing in each period as a percentage of total projected borrowing that is fixed rate.

	2021/22 Actual	Lower Limit	Upper Limit
Under 12 months	0.05%	0%	25%
12 months and within 24 months	6.15%	0%	30%
24 months and within 5 years	16.36%	0%	50%
5 year and within 10 years	30.57%	0%	70%
10 years and above	46.87%	0%	100%

9. Net Income from Commercial and Service Investment Income to Net Revenue Stream

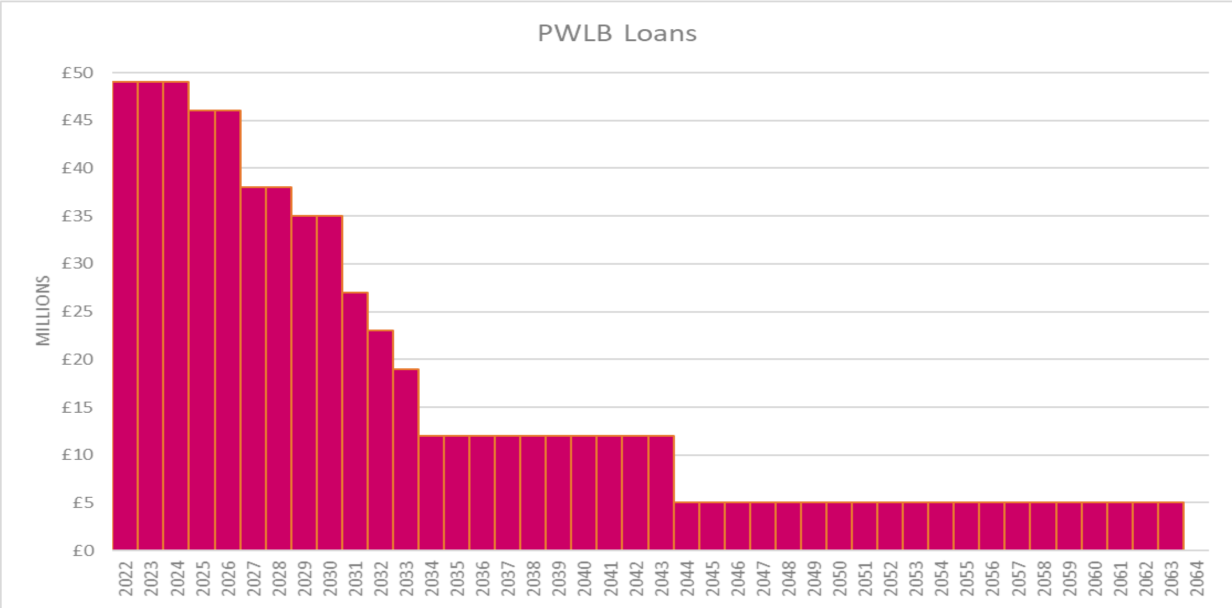
Definition:

This indicator shows the financial exposure of the Council to the loss of its non-treasury investment income. This is primarily commercial income and Development income.

	2021/22 Actual £'000	2022/23 Indicative £'000	2023/24 Indicative £'000	2024/25 Indicative £'000	2025/26 Indicative £'000
Ratio of net income from commercial & service investments	1.5%	1.6%	1.6%	1.6%	1.6%

10. Liability Benchmark

Definition: This is to ensure the Council has a strong grasp of its existing loan portfolio and its maturity profile. The Council currently has long term borrowing from the Public Works Loan Board (PWLB) totaling £49 million. The level of debt and maturity profile can be shown as follows:



Annex 4: Capital Expenditure Policy and Capital Funding Policy

Capital Expenditure Policy:

To reflect the significant anticipated financial pressure on the Council, as identified in the Medium-Term Financial Plan, the following policy is recommended:

- No growth in the asset base;
- All capital expenditure to be focused on maintaining the existing assets;
- A gateway process will ensure strategic fit is demonstrated early and decisions are taken at key stages. This will be supported by a full business case, including projected future demand, and options and investment appraisal process before a project can be considered for inclusion on the Asset Investment Plan;
- No project will be considered for inclusion on the Asset Investment Plan, and existing projects will be removed, unless they have a robust financial estimate of cost. The Executive Manager – Finance will determine whether the financial estimate of cost is robust;
- All capital projects must clearly demonstrate the revenue consequences arising from a capital spending decision to assist Councillors in understanding the full financial impact and funding arrangements; and
- The focus will be on effective asset management, driven forward through the Asset Strategy and Implementation Plan. This will ensure that the Council occupies a reduced number of properties in the future.
- The Executive Manager – Asset, Procurement and Commissioning will determine the opportunities for the maximisation of income from the Council's property estate, which may be in the form or revenue income or capital receipts.

Capital Funding Policy:

To reflect the limited availability of capital funding and the cost associated with the use of capital the following policy is recommended:

- Scottish Government Capital Grant will be applied initially to short life assets (e.g. vehicles, ICT, certain maintenance);
- Capital Receipts will be targeted at core capital maintenance costs;
- Capital Funded from Current Revenue (CFCR) will be used were appropriate to fund low value, shorter life capital expenditure;
- Where available and determined as appropriate by the Executive Manager – Finance, other assets may be funded from Capital Grants, Capital Receipts and CFCR;
- All other capital expenditure will be financed by borrowing. If interest rates are lower than the return on long-term investments as described in the Internal Borrowing versus External Borrowing section in Part A of this report, external borrowing will be undertaken. If interest rates are higher than investment returns, internal borrowing will be undertaken;
- The Service(s) that benefit from the capital asset will be required to make sufficient revenue savings to free up budget to pay for the cost of capital (interest charges and principal repayment of debt). This will be calculated based on the amount borrowed. Revenue implications of the capital project also require to be funded by the relevant Service;
- Capital financing products are affected by external and financial market factors and can develop in a way that may enable the Council to achieve its Corporate Plan outcomes through alternative means. Where new capital financing opportunities arise, such as Scottish Government initiatives like the National Housing Trust models, then the Executive Manager – Finance will give consideration to such products, subjecting them to financial viability, affordability and risk tests, and make a recommendation prior to proceeding.
- The level of borrowing required to finance the Asset Investment Plan is called the Capital Financing Requirement (CFR). The Council will be able to manage limits for borrowing based on what it thinks is prudent, affordable and sustainable through annually agreeing Prudential Indicators as part of the Annual Borrowing & Investment Strategy.

Annex 5: Borrowing Policy

The Council's borrowing policy is as follows:

- Borrowing should only be considered as a financing option when the interest rate obtainable is lower than the 20-year average return on the Council's external investments (i.e. Fund Manager returns).
- Borrowing will only be undertaken for capital projects, with a presumption against funding of short life assets (i.e. assets with less than a 5 year useful economic life).
- Borrowing should only be considered for priority capital projects that are supported by a full business case.
- Members must be fully advised of the ongoing revenue implications arising from each recommendation to borrow before a decision is taken by Council.
- If Members decide to borrow, they must also agree how the relevant Council directorate will be able to fund the borrowing costs (i.e. interest and principal repayments) within its existing Target Operating Budget as set out in the Medium Term Financial Plan.
- Borrowing can only be undertaken within the parameters of the Prudential Framework and the Prudential Indicators which will be agreed annually by Council.
- Borrowing may be undertaken up to 2 years in advance of its deployment to finance agreed capital expenditure if expectations on future versus current interest rates make it financially advantageous for the Council to do so.
- The Council will never borrow for the purposes of investing to make a profit.
- The Executive Manager – Finance as Section 95 Officer is the only officer of the Council who may recommend a decision to borrow to Council.
- When a decision to proceed to borrow has been taken by Council, the details of the loan(s) will be delegated to the Executive Manager – Finance who will determine the institution, the type, the timing, and the length of the loan after seeking advice from external Treasury Management specialists as to the most economically advantageous transaction.