

## South Ayrshire Council

### Report by Chief Financial Officer to South Ayrshire Council of 18 September 2025

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**Subject: Treasury Management Annual Report 2024/25**

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#### 1. Purpose

- 1.1 The purpose of this report is to present, in line with the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, the annual report of treasury management activities for 2024-25 (as attached at [Appendix 1](#)) and seek Members' consideration of its contents.

#### 2. Recommendation

- 2.1 It is recommended that the Council approves the Annual Treasury Management Report 2024/25, as attached at [Appendix 1](#).

#### 3. Background

- 3.1 The Council is required through regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury report reviewing treasury management activities and prudential and treasury indicators. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).
- 3.2 The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.
- 3.3 The Chief Financial Officer also confirms that the Council has complied with the requirements under the Code, to give prior scrutiny of treasury management reporting to the Council's Audit and Governance Panel prior to submitting the report to Cabinet.
- 3.4 Treasury management in this context is defined as:

***'The management of the local authority's cash flows, 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.'***

3.5 The Audit and Governance Panel of 25 June 2025 considered the Annual Treasury Management Report 2024/25 (attached at [Appendix 1](#)) and agreed that it be remitted to Council for approval.

#### 4. Proposals

4.1 The Treasury Management Annual Report for 2024/25 is submitted to the Council for approval in accordance with the requirements of the CIPFA Code of Practice on Treasury Management.

#### 4.2 *Executive Summary*

During 2024/25, the Council complied with its legislative and regulatory requirements. The key prudential indicators detailing the impact of capital expenditure activities during the year, with previous year comparators, are shown below.

<b><i>Actual Prudential and Treasury Indicators</i></b>	<b><i>2023/24 Actual £'000</i></b>	<b><i>2024/25 Actual £'000</i></b>
Capital Expenditure	<b>99,288</b>	<b>87,844</b>
Total Capital Financing Requirement (including other long-term liabilities)	534,409	623,441
PPP, Finance Lease and Right of Use Assets (ROU)	(88,023)	(126,607)
<b>Underlying Borrowing Requirement</b>	<b>446,386</b>	<b>495,503</b>
Gross External Debt	387,659	432,935
Under (Over) Borrowed	58,727	62,568
Cash/Investments	(26,384)	(14,065)
<b>Net External Debt</b>	<b>361,275</b>	<b>418,874</b>

4.3 The table above shows that the Council has an under-borrowed position on 31 March 2025 of £63,897m, c12.86%. This means the Council has used internal borrowing from cash/reserves to fund an element of its current capital expenditure requirements. It does not indicate that borrowing for the capital programme has not been undertaken; only that internal cash resource has been used as funding, opposed to external borrowing. The under borrowed position has increased in 2024/25 in part due to the high interest rates for external borrowing.

4.4 Although this is a prudent position in the current interest rate environment given the cost of external borrowing compared with cash investment rates, the Council's under-borrowed position is 6.71% of its overall under-lying borrowing requirement and is therefore manageable within the current strategy. The strategy for 2025/26 is expected to maintain an under-borrowed position whilst closely monitoring longer term PWLB and market rates in considering new borrowing.

4.5 Other prudential and treasury indicators are included in [Appendix 1](#) to this report. The Chief Financial Officer also confirms that any borrowing was only undertaken

for capital purpose and the statutory borrowing limit (the authorised limit) was not breached during 2024/25.

4.6 The financial year 2024/25 remained a challenging environment due to a volatile economic environment. Interest rates remained at a higher level than forecast but have decreased in-year.

## 5. Legal and Procurement Implications

5.1 There are no legal implications arising from this report.

5.2 There are no procurement implications arising from this report.

## 6. Financial Implications

### 6.1 General Services

6.1.1 **Interest on Revenue Balances Held** – the Council originally budgeted to receive £2.13m in interest income (based on a return of 5.00%) to the General Fund in 2024/25. Interest rates for investment remained higher throughout 2024/25, with the strategy outperforming budget return resulting in an investment surplus. Overall investments are lower in 24-25 as there has been less surplus to invest.

Investment income to the General Fund out turned at £2.216m, a surplus of £0.086m. Interest was also received to the Council’s Repairs and Renewals Fund and Capital Fund to the value of £0.055m.

6.1.2 **Capital Financing Costs** - the Council originally budgeted £17.610m for financing costs and expenses on debt for 2024/25. This budget consisted of £6.457m in loan principal, £10.979m in interest and £0.174m in expenses. During 2024/25, a pragmatic approach was taken when considering the borrowing requirements to fund capital expenditure. However, even with this the borrowing strategy during 2024/25 resulted in an overspend as under-noted:

	Budget £'000	Out-turn £'000	Variance £'000
Principal	6,457	6,397	60
Interest	10,979	13,504	(2,525)
Expenses	174	361	(187)
<b>Capital Financing costs</b>	<b>17,610</b>	<b>20,262</b>	<b>(2,652)</b>
<b>Investment income</b>	<b>(2,130)</b>	<b>(2,216)</b>	<b>86</b>
<b>Total Debt charges</b>	<b>15,480</b>	<b>18,046</b>	<b>(2,566)</b>

The borrowing strategy undertaken in 2024/25 resulted in an overall overspend to the General Services of £2.566m. This is due to interest rates remaining higher than forecast throughout 2024/25 due to higher inflation rates and the continued war in Ukraine and the Middle East. PWLB rates still remain reasonably high as do rates for short-term borrowing which overall has resulted in higher costs for borrowing. This is discussed further in the Economic Commentary. The overall overspend was reduced due to the investment strategy overperforming.

## 6.2 Housing Revenue Account (HRA)

6.2.1 **Interest on HRA Revenue Balances Held** – the HRA budgeted to receive investment income of £0.240m on its revenue balances in 2024/25 based on achieving an interest rate of 5.00%. Like the General Fund the investment strategy was able to out-perform budget resulting in a return of £0.245m in investment income a surplus of £0.005m.

6.2.2 **Capital Financing Costs** - the HRA budgeted £7.278m for financing costs on debt for 2024/25. This consisted of £2.443m in loan principal, £4.763m in interest and £0.072m in expenses.

	Budget £'000	Out-turn £'000	Variance £'000
Principal	2,443	2,443	0
Interest	4,763	4,737	26
Expenses	72	88	(16)
<b>Capital Financing costs</b>	<b>7,278</b>	<b>7,268</b>	<b>10</b>
Investment income	(240)	(245)	5
	<b>7,038</b>	<b>7,023</b>	<b>15</b>

The borrowing strategy undertaken in 2024/25 resulted in an overall underspend to the HRA of £0.015m.

6.3 In total, net debt financing costs were overspent by £2.642m, and when added to an over achievement in interest income of £0.092m resulted in an overall deficit of £2.549m which was reflected in the Council and HRA financial position at 2024/25.

## 7. Human Resources Implications

7.1 Not applicable.

## 8. Risk

### 8.1 Risk Implications of Adopting the Recommendations

8.1.1 There are no risks associated with adopting the recommendations.

### 8.2 Risk Implications of Rejecting the Recommendations

8.2.1 If the recommendations are rejected, then the Council will be non-compliant with the requirements contained in both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

## 9. Integrated Impact Assessment (incorporating Equalities)

9.1 The proposals in this report do not require to be assessed through an Integrated Impact Assessment.

## 10. Sustainable Development Implications

10.1 **Considering Strategic Environmental Assessment (SEA)** - This report does not propose or seek approval for a plan, policy, programme or strategy or document otherwise described which could be considered to constitute a plan, programme, policy, or strategy.

**11. Options Appraisal**

11.1 An options appraisal has not been carried out in relation to the subject matter of this report.

**12. Link to Council Plan**

12.1 The matters referred to in this report contribute to Priority 4 of the Council Plan: Efficient and effective enabling services.

**13. Link to Shaping Our Future Council** Yes  No

13.1 Not applicable.

**14. Results of Consultation**

14.1 There has been no public consultation on the contents of this report.

14.2 Consultation has taken place with Councillor Ian Davis, Portfolio Holder for Finance, Human Resources and ICT, and the contents of this report reflect any feedback provided.

**15. Next Steps for Decision Tracking**

15.1 If the recommendations above are approved by Members, the Chief Financial Officer will ensure that all necessary steps are taken to ensure full implementation of the decision within the following timescales, with the completion status reported to the Cabinet in the 'Council and Cabinet Decision Log' at each of its meetings until such time as the decision is fully implemented:

Implementation	Due date	Managed by
No further action required	Not applicable	Not applicable

**Background Papers** CIPFA Code of Practice for Treasury Management in Local Authorities

Report to South Ayrshire Council of 6 March 2025 – [Treasury Management and Investment Strategy Mid-year Report 2024-25](#)

Report to Audit and Governance Panel of 25 June 2025 – [Treasury Management Annual Report 2024/25](#)

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Date: 9 September 2025

**South Ayrshire Council**  
**Treasury Management Annual Report 2024/25**

## Introduction

In accordance with the requirements of the CIPFA Code of Practice on Treasury Management in the Public Services, this report covers the following:

- Section 1 - The Council's Capital Expenditure and Financing 2024/25.
- Section 2 – The Council's overall borrowing need.
- Section 3 – Treasury Position as of 31 March 2025.
- Section 4 – The Strategy for 2024/25.
- Section 5 – The Economy and Interest Rates
- Section 6 – Borrowing Rates 2024/25
- Section 7 – Borrowing Outturn 2024/25
- Section 8 – Investment Outturn 2024/25
- Section 9 – Other Issues

## Section 1 The Council's Capital Expenditure and Financing 2024/25

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

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

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

**Table 1**

<i>Item</i>	<i>2023/24 Actual £'000</i>	<i>2024/25 Estimate per Strategy</i>	<i>2024/25 Actual</i>
General Fund capital expenditure	53,603	102,570	39,475
HRA capital expenditure	45,685	95,619	48,369
<b>Total</b>	<b>99,288</b>	<b>198,189</b>	<b>87,844</b>
Resourced by:			
Government Grant & Other	(23,910)	(16,939)	(21,280)
Other funding identified	(15,791)	(39,760)	(11,161)
<b>Borrowing :</b>	<b>59,587</b>	<b>141,490</b>	<b>55,403</b>

1.3 The reason for the movement between planned expenditure/funding and actual out-turns for 2024/25 can be found in the General Services and HRA 2024/25 capital monitoring reports presented to Cabinet throughout 2024/25. The largest examples (by value) of reprofiling of spend in to 2025/26 being:

- Hourstons Development - £2m
- Girvan Primary School – £14.5m
- Ayrshire Growth Deal - £27.2m
- Former Riverside Block - £3.5m
- LDP2 Unallocated New Builds - £6m
- Net Zero works - £2.6m
- Citadel Refurbishment - £2m
- Green Waste project – £6.6m
- HRA external fabric Upgrades - £3m
- HRA Partial Modernisation - £1.5m
- HRA Refurbishment - £1.9m

## Section 2 The Council's overall Borrowing Need

2.1 The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and resources used to pay for the capital spend. It represents the 2024/25 unfinanced capital expenditure (Table 1), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

2.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service manages the Council's cash position to ensure that sufficient cash is available to meet not only the capital plans but also to manage the daily cash flow requirements of funding its revenue commitments of payroll, suppliers, benefits etc.

2.3 This borrowing for capital expenditure may be sourced through external bodies such as the Government, through the Public Works Loan Board [PWLB] or the money markets) or utilising temporary cash resources within the Council (internal borrowing).

2.4 **Reducing the CFR** – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the scheduled debt amortisation as a loan repayment, to reduce the CFR. This is effectively a repayment of the borrowing need and differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge. The Council's 2024/25 prudent repayment policy, (as required by Scottish Government), was approved as part of the Treasury Management Strategy Report for 2024/25 on 6/03/2024.

2.5 The Council's CFR for the year is shown below and represents a key prudential indicator. It includes PFI, ROU and finance leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

The undernoted table shows the Council's underlying borrowing requirement, inclusive of PPP and Finance lease arrangements, as of 31 March 2025.

**Table 2**

<b><i>Capital Financing Requirement</i></b>	<b>31 Mar 2024 £'000</b>	<b>31 Mar 2025 £'000</b>
<b><i>Opening Balance</i></b>	<b>484,608</b>	<b>534,409</b>
Add unfinanced capital expenditure	59,587	57,957
Add new OLTL obligations (PPP/Finance & ROU)	0	49,001
Retrospective PPP adjustment	0	0
Less loans fund repayment	(7,935)	(8,840)
Less PPP/ finance & ROU lease repayment	(1,851)	(9,086)
<b><i>Closing Balance</i></b>	<b>534,409</b>	<b>623,441</b>

The borrowing activity is constrained by prudential indicators for gross borrowing, CFR, and by the authorised limit. The increasing CFR position reflects the Council's capital programme expenditure in 2024/25 and the resulting borrowing requirements to fund this investment.

2.6 ***Gross Borrowing and the CFR*** - to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2024/25) plus the estimates of any additional capital financing requirement for the current (2025/26) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure.

This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs 2024/25.

The table below highlights the Council's gross borrowing position against the CFR.

**Table 3/**

**Table 3**

<i>Item</i>	<b>31 March 2024 £'000</b>	<b>31 March 2025 £'000</b>
Capital Financing Requirement (CFR)	534,409	623,441
Gross External Borrowing Position (including PPP, ROU and finance Lease)	475.683	560,873
<b>Net Under/ (Over) Borrowed Position</b>	<b>58,726</b>	<b>62,568</b>

The table above shows the CFR in an under-borrowed position on 31 March 2025 of £31.155m. This means the Council has used internal borrowing from cash/ reserves to fund an element of its current capital expenditure requirements.

This is a prudent position in the current interest rate environment given the cost of external borrowing compared with cash investment rates. The current strategy for 2024/25 is expected to maintain this under-borrowed position whilst closely monitoring longer term PWLB and market rates and consideration of potentially re-financing some of the temporary loan debt with longer term.

## 2.7 ***Borrowing Prudential Indicators***

- **The Authorised Limit – Table 4** - the authorised limit is the “affordable borrowing limit” required by s3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2024/25 the Council has maintained gross borrowing within its authorised limit.
- **The Operational Boundary – Table 4** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.
- **Actual Financing Costs as a Proportion of Net Revenue Stream – Table 5** - this indicator identifies the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream of the Council.

**Table 4**

<i>Item</i>	<b>2023/24 £'000</b>	<b>2024/25 £'000</b>
<b>Authorised Borrowing Limit External Debt</b>	<b>579,408</b>	<b>663,098</b>
Borrowing	387,659	432,935
Other Long-Term Liabilities	88,023	127,938
<b>Total</b>	<b>475,682</b>	<b>560,873</b>
<b>Operational Boundary External Debt</b>	<b>525,683</b>	<b>620,873</b>
Borrowing	387,659	432,935
Other Long-Term Liabilities	88.023	127.938
<b>Total</b>	<b>475.682</b>	<b>560.873</b>

**Table 5**

<i>Ratio of Financing Costs to Net Revenue Stream</i>	<i>Actual 2023/24</i>	<i>Estimated 2024/25</i>
General Services	5.23%	6.75%
HRA	12.36%	20.44%
<b>Total</b>	<b>5.95%</b>	<b>8.06%</b>

### Section 3 Treasury Position as of 31<sup>st</sup> March 2025

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

At the end of 2024/25 the Council's treasury, (excluding borrowing by PFI and ROU and finance leases), position was as follows:

**Table 6**

	<i>Borrowing position as at 31 March 2024</i>		<i>Borrowing position as at 31 March 2025</i>		<i>Change in year</i>
	<i>£'000</i>	<i>Average interest rate %</i>	<i>£'000</i>	<i>Average interest rate %</i>	<i>£'000</i>
<b>Long Term Borrowing</b>					
Public Works Loans Board	239,459	3.64	279,235	3.79	39,776
Market – Fixed	44,000	3.72	49,000	4.51	5,000
LOBO (Option Loans)	33,200	4.52	33,200	4.58	0
<b>Total Long-Term Borrowing</b>	<b>316,659</b>		<b>361,435</b>		<b>44,776</b>
Short Term Borrowing	71,000	4.92	71,500	5.24	500
<b>Total External Borrowing</b>	<b>387,659</b>	<b>3.96</b>	<b>432,935*</b>	<b>4.18</b>	<b>45,276</b>
CFR (underlying borrowing need)	446,273		464,090		47,374
Over (Under) Borrowing	<b>(58,614)</b>		<b>(31,155)</b>		<b>(2,098)</b>
Investments	<b>(26,384)</b>	<b>5.37</b>	<b>(14,065)</b>	<b>4.90</b>	

\* The carrying amount of loans on the Council's balance sheet as of 31 March 2025 is £440,315m. The difference between this figure and the external borrowing shown in Table 6 above is £6,577m of accrued interest and £0.803m of equivalent interest rate accounting adjustments required by the Code of Practice on local authority accounting.

3.2 **Table 7** below details the profile of the Council's loan maturity periods as of 31 March 2025.

**Table 7**

<b>Maturity analysis of Debt Outstanding at 31 March 2025</b>	<b>PWLB £'000</b>	<b>Market £'000</b>	<b>LOBO (Option) £'000</b>	<b>Temp Borrowing</b>	<b>Total £'000</b>
Maturing within 1 year	2,896	29,000	0	71,500	103,396
Maturing 1 to 2 years	7,396	5,000	0	0	12,396
Maturing 2 to 5 years	28,088	15,000	3,000	0	46,088
Maturing 5 to 10 years	56,966	0	0	0	56,966
Maturing 10 to 20 years	33,220	0	5,500	0	38,720
Maturing 20 to 30 years	29,504	0	10,000	0	39,504
Maturing 30 to 40 years	48,665	0	0	0	48,665
Maturing 40 to 50 years	72,500	0	9,700	0	82,200
Maturing > 50 years	0	0	5,000	0	5,000
<b>Total</b>	<b>279,235</b>	<b>49,000</b>	<b>33,200</b>	<b>71,500</b>	<b>432,935</b>

3.3 **Loans fund** - where a local authority has a Housing Revenue Account, the HRA should be reported separately from the General Fund. The reporting on the commitment to repay loans fund advances is for repayments only and does not include any interest costs. The Loans Fund balances are set out in Table 8 and Table 8(a) below:

**Table 8** – Loans Fund Advances to General Fund

<b>Loans Fund</b>	<b>31 March 2024 (£'000)</b>	<b>31 March 2025 (£'000)</b>
Opening Balance	289,526	314,765
Add advances	31,500	22,480
Less repayments	(6,261)	(6,397)
Closing Balance	<b>314,765</b>	<b>330,848</b>

**Table 8(a)** – Loans Fund Advances to HRA

<b>Loans Fund</b>	<b>31 March 2024 (£'000)</b>	<b>31 March 2025 (£'000)</b>
Opening Balance	76,839	103,325
Add advances	28,160	33,210
Less repayments	(1,674)	(2,443)
Closing Balance	<b>103,325</b>	<b>134,092</b>

## **Section 4 Strategy for 2024/25**

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

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

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

Looking back to 2024/25, investors were able to achieve returns in excess of 5% for all periods ranging from 1 month to 12 months in the spring of 2024 but by March 2025 deposit rates were some 0.75% - 1% lower.

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

## **Section 5 Economy and Interest Rates**

### **5.1 UK Economy**

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

Against that backdrop, and the continued lack of progress in ending the Russian invasion of Ukraine, as well as the potentially negative implications for global growth as a consequence of the implementation of US tariff policies by US President Trump in April 2025, Bank Rate reductions have been limited. Bank Rate currently stands at 4.25% after the Monetary Policy Commission (MPC) on 8 May 2025, despite the

Office for Budget Responsibility reducing its 2025 GDP forecast for the UK economy to only 1% (previously 2% in October).

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

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

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

The Bank of England sprung no surprises in their March meeting, leaving Bank Rate unchanged at 4.5% by a vote of 8-1, suggesting further reductions would be gradual. The. This suggested that as inflation rises later in the year, the Bank cuts rates even slower, but the initial impact of President Trump's tariff policies in April 2025 on the financial markets underpin our view that the Bank will eventually reduce rates to 3.50%.

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

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

As for equity markets, the FTSE 100 has recently fallen back to 7,700 having hit an all-time intra-day high 8,908 as recently as 3<sup>rd</sup> March. The movement on the £ has

also been volatile as it hit a peak of \$1.34 before dropping to \$1.22 in January and then reaching \$1.27 in early April 2025.

## 5.2 USA Economy

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

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

## 5.3 EZ Economy

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

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

## Section 6 Borrowing Rates in 2024/25

### 6.1 Public Works Loan Board (PWLB) Borrowing Rates -

#### HIGH/LOW/AVERAGE PWLB RATES FOR 2024/25

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

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

times, been an inversion of bond yields in the US whereby 10-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession.

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

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

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

MUFG Corporate Markets Interest Rate View 28.05.24												
	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
<b>BANK RATE</b>	5.25	5.00	4.50	4.00	3.50	3.25	3.25	3.25	3.25	3.00	3.00	3.00
3 month ave earnings	5.30	5.00	4.50	4.00	3.50	3.30	3.30	3.30	3.30	3.00	3.00	3.00
6 month ave earnings	5.30	4.90	4.40	3.90	3.50	3.30	3.30	3.30	3.30	3.10	3.10	3.20
12 month ave earnings	5.10	4.80	4.30	3.80	3.50	3.40	3.40	3.40	3.40	3.20	3.30	3.40
5 yr PWLB	4.90	4.70	4.50	4.30	4.10	4.00	3.90	3.90	3.90	3.90	3.90	3.80
10 yr PWLB	5.00	4.80	4.60	4.40	4.30	4.10	4.10	4.10	4.00	4.00	4.00	3.90
25 yr PWLB	5.30	5.20	5.00	4.80	4.70	4.50	4.50	4.40	4.40	4.40	4.30	4.30
50 yr PWLB	5.10	5.00	4.80	4.60	4.50	4.30	4.30	4.20	4.20	4.20	4.10	4.10

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

## 6.2 Borrowing strategy and control of interest rate risk

During 2024/25, the Authority maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Authority's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as although near-term investment rates were equal to, and sometimes higher than, long-term borrowing costs, the latter are expected to fall back through 2025 and 2026 in the light of economic growth concerns and the eventual dampening of inflation. The Authority has sought to minimise the taking on of long-term borrowing at elevated

levels (>5%) and has focused on a policy of internal and temporary borrowing, supplemented by short-dated borrowing (<5 years) as appropriate.

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

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

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

At the start of April 2025, following the introduction of President Trump's trade tariffs policies, the market now expects Bank Rate to fall to 3.75% by the end of December 2025, pulling down the 5- and 10-year parts of the curve too.

This should provide an opportunity for greater certainty to be added to the debt portfolio, although a significant fall in inflation will be required to underpin any material movement lower in the longer part of the curve.

## **Section 7    Borrowing Outturn**

- 7.1 During 2024/25 the Council funded part of the capital borrowing requirement in the short-term market, with temporary borrowing of £71.500m, by March 2025. However, additional long-term borrowing (PWLB) of £42.000m was also undertaken, taking advantage of any lower interest rates and gaps in the borrowing maturity profile. The Council were in an under-borrowed position of £31,155m for 2024/25. The Council has not borrowed more than, or in advance of its needs, purely to profit from the investment of the extra sums borrowed.
- 7.2 During 2025/26 focus will be on monitoring longer term rates and looking to borrow longer term to meet the CFR when appropriate and at the same time consider some short-term borrowing where rates are suitable.
- 7.3 During 2024/25 the actual borrowing and repayments of external debt transacted are shown in Table 10 below. This shows temporary borrowing slightly increased and

mid-term borrowing has increased. Longer-term borrowing has been undertaken when rates have allowed, a prudent position in the current interest rate environment. The Council's policy was to ensure that not more than 25% of long-term loans are due to mature within any financial year. The indicator for maturing debt of 23% (within one year) is 2% below the maturity limit indicator in 2024/25.

**Table 9**

Loan Type	Borrowed 2024/25 £'000	Repaid 2024/25 £'000	Net £'000
PWLB	42,000	(2,225)	39,775
Market Loans	15,000	(10,000)	5,000
Temporary borrowing	73,500	(73,000)	500
	<b>130,500</b>	<b>(85,225)</b>	<b>45,275</b>

7.4 **Debt Re-scheduling** – no external debt was re-scheduled during 2024/25 as the average differential of 1% between PWLB new borrowing rates and premature redemption rates made early repayment of loans expensive and unviable due to the premiums that would be payable.

## Section 8 Investment Out-turn, and Policy in 2024/25

8.1 The Council's investment policy is governed by Scottish Government investment regulations, which have been implemented in the annual investment strategy approved by the Council on 6th March 2024. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data, (such as rating outlooks, credit default swaps, bank share prices etc.).

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

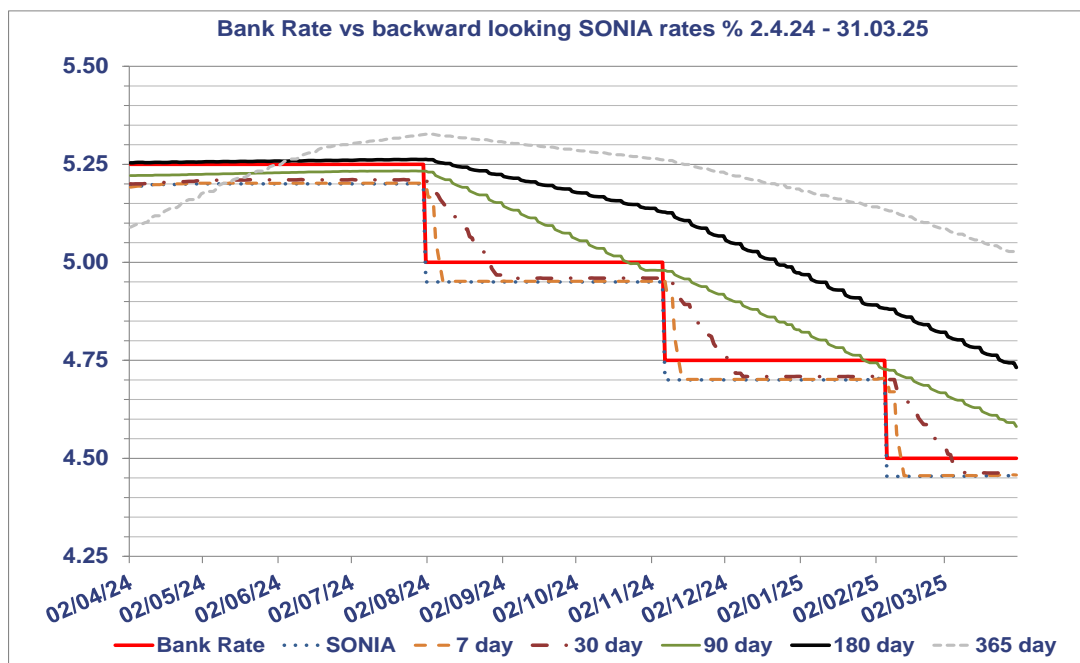
8.2 **Investment Out-turn** – the Council maintained an average balance of £18,225m of internally managed investment funds. The internally managed funds earned an average rate of return of 5.085%.

The comparable performance indicator is the 90d backward Sterling Overnight Index Average (SONIA) compounded rate which was 5.015%.

**Table 10**

	<b>Average Value of Investments Held</b>	<b>Rate of Return</b>	<b>Benchmark Return*</b>
Investments	£18,225m	5.085%	5.015%

\*The benchmark return used is the SONIA compounded rate of 5.015%.



8.4 **Investment Policy** – the Council’s investment policy is governed by Scottish Government investment regulations which have been implemented in the Annual Investment strategy approved by the Council on 6 March 2025. This policy sets out the approach for choosing investment counterparties and is based on credit ratings provided by the three main credit rating agencies, supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

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

#### 8.5 Current Council Investments held on 31 March 2025

Table 11

Class	Type	Start Date	Maturity Date	Counterparty	Profile	Rate	Principal £000
Deposit	MMF	01/12/17	-	Federated Prime Rate Sterling Liquidity 3		4.53%	2,400
Deposit	MMF	30/06/20	-	Aberdeen Liquidity Fund - Sterling Fund Class L-1		4.54%	6,000
<b>MMF Total</b>							<b>8,400</b>
Deposit	VNAV	27/04/23	-	Federated Sterling Cash Plus Fund GBP 3 Acc		6.10%	29.9
<b>VNAV Total</b>							<b>29.9</b>
Deposit	Variable	10/05/16	-	Bank of Scotland (Call A/c)	Variable	4.45%	5,635
<b>Call Total</b>							<b>5,635</b>
<b>Overall Total</b>							<b>14,064.9</b>

## **Section 9 Other Issues**

- 9.1 **Sources of borrowing** - Although PWLB remains a low-risk source of long-term borrowing, due to recent rate changes and the ongoing consultation with local authorities on the future of PWLB borrowing other borrowing institutions may be looked at to remove the reliance on PWLB for long term borrowing needs.
- 9.2 **Changes in risk appetite** - The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. South Ayrshire Council has a low-risk appetite and as such would look at all aspects before making any changes to the current strategy and members would be made fully aware of any such changes.
- 9.3 **IFRS 16** - The implementation of IFRS 16 bringing currently off-balance sheet leased assets onto the balance sheet has been implemented during 2024/25. Right of Use Assets (ROU) are now included in the Capital Financing requirement (CFR) figures for year end 2024-25.