Memorandum on Scottish Government Capital Borrowing and Bonds

December 2023

Scottish Government
Riaghaltas na h-Alba

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Capital borrowing under the Fiscal Framework between the Scottish and UK Governments

Under the Fiscal Framework Agreement,[1] the Scottish Government can borrow up to £3 billion cumulatively for capital expenditure, with an annual limit of £450 million in 2023-24. These limits will now grow in line with inflation from next year, using 2023-24 as the baseline year.

The Scottish Government can, with the approval of the UK Treasury, borrow commercially or issue bonds for capital investment purposes, or use the National Loans Fund as its source of capital borrowing.

Fiscal policy context

In taking annual capital borrowing decisions, the Scottish Government considers:

- Short to medium term capital funding outlook
- Funding requirements for the budget
- Affordability of ongoing debt repayments
- Current and forecast debt levels versus the cumulative fiscal framework debt limit

Under the limits set by the previous fiscal framework in order to sustain a constant level of borrowing capacity each year, the Scottish Government could borrow £250-£300 million per annum at a tenor of fifteen years without breaching its cumulative borrowing debt limit.

Borrowing via the National Loans Fund structures available to the Scottish Government ensures cost-effective borrowing. These structures have a low interest rate spread and, with regular repayment of principal, have ensured Scottish Government borrowing headroom could be managed effectively over time. However, the same structures also create a budget burden over the medium term as principal repayments as well as interest payments reduce *resource* (RDEL) funding available to the Scottish Government.

Future approach to capital borrowing

With the £3 billion limit now increasing with inflation, the dynamics of Scottish Government borrowing have changed. It is therefore appropriate to review the options available for capital borrowing to consider value for money, resource cost impact and maximising the use of the Fiscal Framework limits that are operational from April 2024-25.

The immediate priority for capital borrowing is to support the constrained capital funding outlook resulting from severe real terms cuts to capital funding through the core block grant. For these reasons it is currently necessary to use the additional flexibility secured through the fiscal framework review to maximise capital borrowing for the 2024-25 Scottish Budget. As the technical annex (below) details this can be accommodated within the revised cumulative fiscal framework limits.

Borrowing plans, by necessity, remain subject to change and final plans will be based on the precise requirements of in-year budget management. This ensures that any underspends which emerge late in the financial year will reduce borrowing requirements, rolling forward the borrowing capacity released to be utilised in future years with no loss of spending power.

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[1] Fiscal framework: agreement between the Scottish and UK Governments - gov.scot (www.gov.scot)

In the medium term it is important that the Scottish Government has access to alternative sources of capital borrowing. Diversification through bond issuances or other sources may provide options for infrastructure financing to be structured more effectively for the specific requirements of future Scottish Budgets, subject to appropriate due diligence.

Investor Panel recommendation

The First Minister set out in October 2023 that "subject to due diligence and market testing – the Scottish Government will go directly to the bond market for the first time in our own right". This intention was supported by the Investor Panel's Report,[2] which highlighted the importance of attracting capital investment to Scotland to support the transition to net zero.

The Panel's report highlights some of the barriers preventing investment in Scotland, and published 31 recommendations for the Scottish Government. On investor engagement, the Panel recommended that "Although it will involve additional costs, Scotland's profile could be significantly raised in the international capital markets by using existing devolved powers to issue debt. This will provide a motivation for regular engagement by investors and an opportunity to market Scotland's investment story. It would also allow the development of relationships with providers of debt, a track record and credit rating."

The Scottish Government agrees that it is important that we consider all means to raise Scotland's profile, engage with investors and attract investment. Our Global Capital Investment Plan sets out some of the work to attract capital investment to support the transition to net zero, something we are committed to delivering through our National Strategy for Economic Transformation.

Strategic aims of the bond programme

With our borrowing limits changing, it is prudent to review our borrowing policies. This includes consideration of how these can be used effectively to encourage further investment in Scotland. The Scottish Government is considering the options for a bond issuance in the latter half of 2025-26 in light of these changes. The bond issuance programme will have three strategic aims which will drive the work going forward.

1. To ensure the Scottish Government can access diverse and cost-effective sources of capital funding and enhance Scotland's fiscal sustainability;
2. To raise Scotland's profile to financial investors; and
3. To develop Scotland's institutions and fiscal disciplines.

Further information will be included in the next update to the Medium Term Financial Strategy.

[2] Investor Panel recommendations: Scottish Government response - gov.scot (www.gov.scot)

Technical annex

This table discloses all Scottish Government capital borrowing drawn down from the National Loans Fund up to 2022-23 and forecast future borrowing reflected in the 2024-25 Scottish Budget plans.

£million	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**	**2022-23**	**2023-24**	**2024-25**	**2025-26**	**2026-27**	**2027-28**	**2028-29**	**2029-30**	**2030-31**
Debt Stock at start of Year	607	1,036	1,258	1,617	1,744	1,814	2,026	2,377	2,715	2,823	2,910	2,982	3,038	3,089
New Borrowing in year (incurred)	450	250	405	200	150	300								
New Borrowing in year (forecast)							450	458	250	250	250	250	250	250
Principal Repayments	-	7	26	52	60	67	79	88	89	91	92	94	82	70
Interest Repayments	-	8	11	13	14	16	24	24	23	22	20	19	17	16
Resource Cost of Borrowing Incurred	**-**	**15**	**37**	**64**	**74**	**83**	**103**	**112**	**112**	**112**	**112**	**112**	**99**	**86**
Principal Repayments	-	-	-	-	-	-	-	11	33	51	66	80	96	112
Interest Repayments	-	-	-	-	-	-	-	18	38	48	58	66	75	83
Resource Cost of Forecast Borrowing	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**29**	**71**	**100**	**123**	**147**	**171**	**195**
Projected Total Resource Cost	**0**	**15**	**37**	**64**	**74**	**83**	**103**	**141**	**183**	**212**	**235**	**259**	**270**	**281**
Notional Borrowing Repayments	21	21	21	21	21	21	21	21	21	21	21	21	21	21
Debt Stock at end of Year	1,036	1,258	1,617	1,744	1,814	2,026	2,377	2,715	2,823	2,910	2,982	3,038	3,089	3,137
Debt Cap	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,050	3,102	3,152	3,209	3,269	3,335	3,402
Percentage of Debt Cap	35%	42%	54%	58%	60%	68%	79%	89%	91%	92%	93%	93%	93%	92%
Headroom	1,964	1,742	1,383	1,256	1,186	974	623	335	279	242	227	232	245	264

- Prior year figures here differ from the Scottish Budget document. This table reflects outturn borrowing whereas all prior year comparatives in the budget document state the original funding assumptions for each year as approved by parliament.
- This forecast assumes continued use of the existing National Loans Fund structures as the source of borrowing, this will continue to be the case until any changes to borrowing sources or structures are certain to occur.
- For these reasons, regular repayment of principal repayments will continue to be included in the resource cost of borrowing and reflected in budget and spending review forecasts.
- Interest rate assumptions use forward Gilt curves (06/12/2023) adjusted for National Loans Fund annuity structures. A further premium of 50 basis points is added for prudence to reflect the volatility in both forward rates, and the feasible differential between date of request of funds and date of receipt when interest rates are applied.
- The Scottish Government will not speculate on the future interest rate attached to any potential bond issuance.
- Any future Scottish Government bond issuance will be under the terms of the Scotland Act 2016 and the revised fiscal framework agreement.

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