EXECUTIVE – 24 MARCH 2022

MEDIUM TERM FINANCIAL STRATEGY (MTFS)

SUPPLEMENTARY REPORT

INVESTMENT STRATEGY – INVESTMENT IN GROUP COMPANIES AND JOINT VENTURES

1. Introduction

1.1 Following questions arising from the publication of the MTFS, the purpose of this supplementary report is to provide further background and contextual information on the relationship between the Council and the companies in which it has an interest and has provided loan funding.

1.2 The information provided has been extracted from business plans and loan approvals that have previously been approved at meetings of The Council.

1.3 As covered in the MTFS report, business plans are currently being refreshed and updates will be brought forward in the summer, in time for the next MTFS report to the Executive on 14 July 2022 and Council on 21 July 2022. A series of briefings will be arranged for Councillors in advance of the MTFS report to the Executive on 14 July to include:

- Update to business plan forecasts
- Proposed governance arrangements for companies
- Consideration of financing arrangements

2. Borrowing

2.1 Section 6, points 6.9 and 6.10 of the MTFS report highlights the Council's current and forecast borrowing to 2025/26.

2.2 In summary, in total as of 28 February 2022, the Council had £1,839m in loans of which:

- **£1,140m** are for loans to group companies and joint ventures
- **£699m** are for loans for capital expenditure on operational and strategic council assets, Housing Revenue Account investment and loans to local organisations supporting council priorities.

2.3 The Investment Programme to 2025/26 was approved at the February meeting of Council. The table below has been extracted from the Capital Strategy report which was also approved at this meeting.

2.4 This table shows the cumulative borrowing net of the Minimum Revenue Provision and Capital Payments that have been made against this debt.

It should be noted in Table 4 below:

- Capital Investments represents loans to companies and joint ventures
- General Fund Services represents loans for operational and strategic council assets
- HRA represents loans for investment in council housing

Table 4: Estimate of Capital Financing Requirement (CFR)

	2020/21 Actual £m	2021/22 Forecast £m	2022/23 Budget £m	2023/24 Budget £m	2024/25 Budget £m	2025/26 Budget £m
General Fund Services	510	519	581	590	586	581
Council Housing (HRA)	146	153	156	158	160	161
Capital Investments	1,095	1,390	1,489	1,592	1,648	1,722
TOTAL CFR	1,751	2,062	2,227	2,341	2,394	2,464

2.4 The most significant projects within this, are:

- Acquisition of Victoria Square Car Park in 2022/23, £58m (further details below)
- Investment in Thameswey Housing Ltd £159m
- Investment in Thameswey for Sheerwater £165m

3. Investment Strategy

3.1 The Council has an investment Strategy which the Investment Programme turns in to programmes of activity, supported by estimates of the funds required to deliver. The strategy is contained within section 6 of the MTFS and is therefore not repeated in this supplementary report.

4. Delivery of Investment Strategy through loans to Companies and Joint Ventures

Overview of the approach

4.1 The delivery of the Council's regeneration ambitions has largely been through establishing group companies and joint ventures. The specific details for each of these is highlighted further in this section.

4.2 All companies in which the Council have an interest were established following the agreement of detailed business cases. All these business cases forecast profits in the long-term and recovered the full costs of the finance invested over the long term.

4.3 For each and all these companies and joint ventures, they make losses for a number of years before they are forecast to make **operating profits**. An **operating profit** is when the company generates a level of income (sales and rentals) that is greater than, the cost of those sales (or rentals) plus the operating costs and overheads, of the company.

4.4 Out of the **operating profit** the companies then need to cover the interest costs on any loans, repay loan debt and give any shareholder a dividend return. The companies and joint ventures in which the Council has an interest are almost totally funded by loans with very little shareholder capital provided.

4.5 Once the companies have started to generate an **operating profit** it takes a significant number of additional years before they are able to generate a level of operating profit that is sufficient to also cover the loan interest and repayment costs.

4.6 For the years in the business plans where the profits are not sufficient to meet operating costs and loan repayment costs, the companies take further loan advances to enable them to cover operating costs and make loan repayments. This is provided through a revolving loan agreement.

4.7 The full amount of the revolving loan facility is approved following approval of a business case. The draw down of loans from this loan facility is done incrementally, on approval from the Council, as the loan provision is required. This means that the Council has a further level of control through making the loan draw down incremental as opposed to making the full amount of the loan facility immediately available to the company.

4.8 The Council is not able to defer the costs of financing company regeneration investments as it must make immediate payments to the Public Works Loan Board (PWLB) to cover the loan interest and must make provision for the repayment of the loan (known as principal).

4.9 Managing this regeneration investment into the Borough through companies and joint ventures enables the Council to take a long-term view and spread initial losses over the term of the business plan.

4.10 This approach does mean that in the years until the companies make an overall profit (known as profit before tax), i.e., when they are still in the loss-making stages of the business plan, they do take additional loans to cover the cost of paying some of the existing and outstanding loan interest and principal payments. The additional loans are however within the limit of the approved loan facility and therefore within the overall level of borrowing agreed as part of the business plan.

4.11 In addition, the Council does make a margin on some of these loan arrangements as highlighted in the table at 6.11 of the MTFS report. The primary purpose is to be able to spread the benefit that the regeneration scheme has for the residents of Woking over the life of the scheme rather than only providing a benefit towards the end of the scheme when profits are made.

4.12 The margin is used to support the General Fund and the provision of services to the Borough's residents aligned to the priorities within the Woking for all Strategy. The table in 6.12 of the MTFS strategy report highlights the value of this margin.

4.13 The Council's Financial Interests were reviewed by the professional services firm EY as part of the Comprehensive Statement that was reported to the Overview and Scrutiny Committee at its meeting on 24 January 2022. This review provided a Company Viability Assessment for all companies in which the Council had an interest using the Cabinet Office Financial Viability Model.

4.14 In this review EY recognised that company losses were forecast in the short-term reflecting the long-term nature of the business plans and / or the Development being undertaken. The review also recognised that companies had differing strategic purposes and are in different phases of maturity, meaning the relationship with the Council is not just a contractual one.

4.15 From the EY Company Viability Assessment analysis, it was Thameswey Central Milton Keynes (TCMK) that was highlighted as being a going-concern risk. This is therefore being prioritised for reviewing the business plan and stress testing sales forecasts and margins.

4.16 For reference, the full and independent Comprehensive Statement which covers the Council's asset position, borrowing position and financial interests can be found at Agenda for Overview and Scrutiny Committee on Monday, 24th January, 2022, 7.00 pm (woking.gov.uk) under agenda item 7 Financial Review OSC22-006.

Overview of the Finances

4.17 Table 1 below brings together information from the latest approved company and joint venture business plans alongside information provided in the MTFS and the Green Book performance monitoring.

4.18 It should be noted that company business plans are approved by The Council on an annual basis at their meeting in December. However due to the covid pandemic the refresh of these plans was deferred for the December 2020 and 2021 updates although the refresh provided to December 2019 (for the Thameswey group of companies) did include forecasts at that stage for the years up to 2022/23.

4.19 The MTFS report identifies the work to refresh the business plans to be presented to the December 2022 meeting of The Council to cover the next 3-year period 2023/24 – 2025/26 and the work underway to implement new company governance arrangements.

4.20 The information provided within this supplementary report is from existing published reports. The business plans for companies are being refreshed as part of the ongoing work referred to earlier and will be incorporated into the next report on the MTFS to the July meeting of the Executive and will be the subject of Councillor briefings running up to this.

4.21 The business plan refresh will not only update the financial forecast figures presented in this supplementary report but will also provide further related information to cover details for each company on:

- When the company is forecast to achieve a profit before tax (i.e., can cover the annual interest and repayment (principal) on the loans)
- Amount of peak debt and the year in which this occurs
- Date when the loans are fully repaid

TABLE 1	**Forecasted Information Provided to Council in December 2019 in the Thameswey Business Plans for 2020-2023**				**Updated Information Provided in the 2022/23 – 2025/26 MTFS Report to the 24th of March 2022 Executive**					
Company	**A** **Forecast operating profit** **Forecast 2022/23**	**B** **Net Finance costs (interest) Forecast 2022/23**	**C** **Profit/(loss) Before Tax .** **Forecast 2022/23**		**D** **Loan Balance at 28th** **February 2022**	**E** **Net Finance Costs (Interest Due) 2022/23**	**F** **Loan Repayment (Principal Due)** **2022/23**	**G** **Interest and Principal Total (Col. E+F) 2022/23**		**H** **Margin the Council makes on Loan Facility 2022/23**
Thameswey Housing Limited (THL)	£7.2m	(£13.8m)	(£6.6m)		£315.9m	(£13.6m)	(£1.7m)	(£15.3m)		£5.38m
Thameswey Energy Limited (TEL)	£0.1m	(£1.3m)	(£1.2m)		£49.5m	(£1.8m)	(£0.9m)	(£2.7m)		£0.49m
Thameswey Developments Limited (TDL)	£1.9m	(£0.1m)	£1.8m		£13.8m	(£0.2m)	(£3.2m)	(£3.4m)		£0.12m
Thameswey Central Milton Keynes (TCMK)	£0.4m	(£2.1m)	(£1.7m)		£35.3m	(£1.9m)	(£1.4m)	(£3.3m)		£1.01m
THL – Sheerwater Regeneration	–	–	–		£86.7m	(£1.8m)	(£11.7m)	(£13.5m)		£0.36m
Victoria Square Woking Limited (VSWL)	–	–	–		£636.0m	(£15.4m)	£-	(£15.4m)		£-
TOTALS	**£9.6m**	**(£17.3m)**	**(£7.7m)**		**£1,137.2**	**(£34.7m)**	**(£18.9m)**	**(£53.6m)**		**£7.36m**

4.19 The key points to note from Table 1 are:

- Sheerwater (THL) and Victoria Square Woking Limited (VSWL) are in the stage of building the assets and are not in the operating phase where they are generating trading performance

- All the companies that were trading were forecast to generate an operating profit in 2022

- THL, TEL and TCMK, were forecast to generate a Loss Before Tax in 2022 and were therefore drawing down further loan facility to cover these losses and refinance existing loan arrangements through approved loan facility

- Thameswey Developments Limited were forecast to generate a Profit Before Tax in 2022

4.20 It should be noted that the companies generating a loss need the further loan facility to cover their cash position rather than their accounting loss position and therefore the loan required for this is not as high.

5. Victoria Square Car Park

5.1 The loans provided by the Council to Victoria Square Woking Limited (VSWL) include the costs of constructing the car park.

5.2 Currently VSWL owns the car park and would repay the Council the interest costs on the loan that financed its construction. They would also repay the Council for the underlying debt.

5.3 The Council's Investment Programme includes a loan facility of £700m to VSWL and in addition to this gave approval for the Council to purchase the car park back from VSWL. The Council will borrow £58m to acquire the car park from VSWL and will operate the car park and receive all the income from its use.

5.4 From this transaction VSWL will have a £58m capital receipt from which they will repay the loan facility provided for its construction and therefore reduce its overall level of outstanding loans. As VSWL have an approved revolving loan facility of £700m, the sale of the car park will enable them to request a further draw down of loans, to the maximum value of the receipt for the car park and up to the £700m approval, to cover the operating costs of the company for a number of years whilst it is making a loss and requires cash to fund the companies operating costs.

5.5 In the interim transitional period in advance of the Council acquiring the asset, the Council will pay VSWL a management fee (equivalent to the financing costs) and will manage the car park and receive and retain all the income.

6. Risks

6.1 The Council reviewed its Risk Management Policy in summer 2021 and agreed a revised and updated policy in September 2021. An annual review report of Risk Management and Business Continuity is reported to Council annually in July each year.

6.2 The Risk Management Policy has a framework for risk management covering strategic, directorate, service and project risk monitoring and reporting. The framework is part of the integrated service and financial planning approach. The Woking for all Corporate Strategy sets out the strategic objectives for the Council for the next five years and the MTFS provides the financial strategy that aligns the resourcing and funding decisions to support the delivery of the strategic objectives.

6.3 Within the MTFS the Council has adopted a Financial Resilience approach which defines a framework of key indicators of good performance that we will use to manage our approach to ensuring we have the right components of the MTFS in place to deliver annual savings and manage significant financial risks while still pursuing our ambitious regeneration goals.

6.4 As part of this Financial Resilience approach the Council has worked with the professional services firm EY to produce a short, medium and long-term Financial Resilience Assessment and set of recommendations. This assessment and recommendations are contained within the MTFS report at section 8 and form an integral approach to our MTFS and risk management policy.