**INVESTMENT DEBT REPAYMENT AND STANDSTILL 2024-25 AND 2025-26**

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| Meeting: | **Executive** |
| Date Of Meeting: | **5 December 2024** |
| Report Author(s): | **Stephen Fitzgerald and Kevin Foster** |
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| Date Published: | **2 December 2024** |

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| Will the decision be open for call in (i.e. is it a key decision)? | ☒ Yes ☐ No |
| Does the report contain confidential or exempt information? | ☐ Yes ☒ No |

## 1.0 Purpose of Report

1.1 This report provides an update on the Council's existing debt repayment standstill agreement with Thameswey and Victoria Square Woking Limited for 2024/25, a debt sweep against this agreement and recommends a further agreement for 2025/26.

## 2.0 Recommendations

2.1 The Executive is requested to:

**RECOMMEND TO COUNCIL THAT**

**(i) it be noted that the Council will be requesting Exceptional Financial Support for 2025/26 and this request will incorporate the interest and minimum revenue provision costs in relation to the loans made to companies and the debt standstill and debt sweep contained within the report;**

**(ii) a 2025/26 financial year investment debt repayment standstill on the Council's investment loans to the Thameswey group of companies and Victoria Square Woking Limited be approved (subject to the conditions and caveats set out in this report and subject to confirmation of Exception Financial Support from central government) for the financial year 2025/26 as set out in recommendation (i); and**

**(iii) a debt sweep for the period up to the end of December 2024 be approved and authority be delegated to the Strategic Director for Finance, the Strategic Director - Corporate**

**Resources, the Director of Legal and Democratic Services and the Chief Executive, in consultation with the Leader and Deputy Leader of the Council, following the application of the principles, assessments and assurances provided by the actions outlined within this report to determine the value of the sweep; and**

**(iv) the findings in the Part II report set out under Agenda Item 19 of the Executive agenda titled Investment Debt Repayment and Standstill 2024-25 and 2025-26 be noted.**

Reason for Decision

2.2 The proposals within this report form part of the Council's overall Improvement and Recovery Plan (IRP). The background to the Council's past investment decisions are set out in detail in Grant Thornton's report in the public interest that was considered by a special meeting of Council on 20th November 2024.

2.3 The debt standstill proposal supports the strategic aim within the IRP to "Release the council from unaffordable commitments, whilst protecting the public purse and optimising the value of existing assets" and "To take a strategic approach to reviewing the Council's lending to companies and borrowing for its property investment estate and medium term financial strategy."

## 3.0 Proposal and Outcome

3.1 The proposal is for a Council debt repayment standstill for Thameswey and Victoria Square Woking Limited to cover the financial year 2025/26 following on from the existing debt standstill in place for 2024/25. This is required because the companies have insufficient profits (Earnings before Interest, Taxation, Depreciation and Amortisation (EBITDA) to cover the interest and capital repayments due to the council. The debt standstill is therefore required to enable the Directors of these companies to continue to adopt the going concern basis in the preparation of their accounts and maintain the companies' solvent trading.

3.2 The Council has received requests from the Boards of both Thameswey and Victoria Square Woking Limited for a Debt Standstill agreement for 2025/26.

3.3 The debt standstill also allows time for the Council as the main lender, and the companies, to explore and action potentially better Value for Money investment debt management options than a formal insolvency process, including, for example, managed sale of the company shares/assets and/or financial restructuring.

3.4 The absence of an agreement between the Council as lender and the companies in relation to the treatment of debt would require the immediate consideration by the company directors to enter an insolvency process as part of their statutory responsibilities.

3.5 To support a debt standstill agreement the council has established a set of tests that need to be met as follows:

1. That maintaining the company (and its subsidiaries) as solvent entities continues to offer better value for money to the public purse versus the costs and impact of administration. This test was met as part of the business cases for approval to borrow for the completion of capital works (only), but needs to be confirmed for 2025/26.

2. The company shows an operational profit i.e. are EBITDA positive. This ensures that the Council is not providing borrowing for revenue purposes (other than the costs of interest).

3. The company demonstrates its cash solvency for the year in question, i.e. that is, they have sufficient working capital to sustain their costs other than those associated with servicing the debt and monitor and update this position to the Council on a quarterly basis, including external verification of the position.

4. Appropriate business cases for the year are submitted in a time and format agreed by the Council.

5. The costs of suspended interest is covered by the Capitalisation Directive agreed by DLUHC for WBC.

6. The support for the company continues to meet state subsidy control tests (a test for the Council met by its legal advice).

3.6 The ‘in principle’ decision by the majority lender (the Council) is required by Council at its meeting on 12th December 2024. Following this decision the Council will provide a response to the debt standstill requests from the companies. This response will need to give an appropriate level of comfort to the company directors to enable them and external auditors for the relevant companies to confirm that the companies can trade solvently for at least twelve months from their statutory accounts filing date of the 31 December 2024 and prepare their accounts on a going concern basis.

3.7 The Council cannot formally confirm a debt standstill position for 2025/26 until it has confirmed Exceptional Financial Support from central government for the 2025/26 financial year. In 2024/25 this announcement was made on 27 February 2024 which was a few days prior to the setting of the Council budget and council tax. It is likely that the position could be similar this year.

## 4.0 Background

4.1 The Council went into formal intervention in May 2023 and subsequently issued a Section 114 notice largely driven by the high levels of unaffordable debt, inadequate steps to repay the debt and a high value of irrecoverable loans (when comparing loan values to asset values).

4.2 This led to the development of the Council’s Improvement and Recovery Plan (IRP) which includes the commercial and finance workstream objectives to ensure robust commercial governance and decision making, oversight of the development of the asset rationalisation and debt reduction plans and to manage an orderly exit from the Council’s commercial ventures.

4.3 The Provisional Exceptional Financial Support agreed for 2024/25 came with a series of conditions linked to the delivery of the IRP, in particular that the work is underpinned by a detailed assessment of options and a review of the Council's companies' financial positions within three months and a clear plan, supported by the advice from independent advisors to facilitate an orderly and timely exit from the Council's commercial arrangements with its companies. Importantly, "*the plan must balance appropriately the urgent imperative to reduce the levels of outstanding debt with the need to secure a managed exit from commercial arrangements and deliver optimal value for the public purse*".

4.4 The independent assessment and review of the options for the companies are included in Part II of this report and support the recommendation for extension of the debt standstill as a key option to consider for financial restructuring.

4.5 The Council is the majority lender and shareholder to the Thameswey group of companies (Rutland Woking Limited, Thameswey Central Milton Keynes Limited, Thameswey Developments Limited, Thameswey Energy Limited, Thameswey Housing Limited) and Victoria Square Woking Limited (with operating companies Victoria Square Residential Limited and Victoria Square Woking Hotel Limited).

4.6 The Council has provided substantial loan funding to these companies. The companies are not able to meet the obligations of these loan agreements through the profits generated, and the value of the fixed assets of the companies are less than their liabilities. The loan funding provided was funded from borrowing taken by the Council from the Public Works Loan Board (central government). Therefore, the Council has two distinct roles:

- The Council as <u>'Lender'</u>, including the Government as ultimate lender, overseeing decisions about the company's financial decisions. These decisions are Executive and Council decisions. Decisions with regard to the debt standstill are a Lender issue.

- The Council as <u>'Shareholder'</u>, overseeing the strategic direction of the companies and compliance with the Companies Governance Framework. This work is overseen by the Shareholder Executive Committee (SEC) chaired by the Leader of the Council.

4.7 The need for a debt standstill for Thameswey and VSWL arose alongside the s114 notice which terminated the Revolving Loan Facility that was provided by the Council through borrowing from the PWLB. This borrowing provided working capital and the ability for the companies to meet their interest and capital repayment obligations. At that point there were two choices that both Council and Commissioners had to make, with support from central government:

- Allow an insolvent run-off of the companies. This would take matters out of the Council (and Government's control) and risked additional costs of the insolvency process and a fire sale of assets, which would not maximize VFM for the public purse.

- Provide the companies with solvency support, but within an improved governance and monitoring process that allowed time for an orderly exit from the companies and a more orderly sale of assets that maximizes value for the public purse and avoided further costs.

4.8 For 2024/25 the latter course was adopted to ensure that best value for the public purse to be achieved through the disposal of the Council's assets, as articulated in the Council's Debt Reduction and Asset Rationalisation Plans. The investment debt standstill has been in place from May 2023 and was initially reviewed quarterly and then an investment debt repayment standstill was put in place in March 2024 for the 2024/25 financial year.

## 5.0 Progress During 2024/25

5.1 Considerable progress has been made:

- A Council company governance framework was agreed in November 2023.

- Company boards have been reconstituted with independent non-executive chairs and non-executive directors.

- The establishment of the Shareholder Executive Committee (SEC), referred to earlier in the report, to hold the companies to account under a new performance framework. These changes have properly separated Council and company governance and decision making. This ensures that Directors take proper decisions in accordance with their duties under the Companies Act and related company governance and ethical standards.

- The SEC is provided with monthly reporting on Company progress against their Business Plan and their immediate financial position, meaning the Council has up to date and relevant oversight and the Companies can be held to account for their performance.

- The Companies are also being supported to ensure that their own governance and decision making is robust and effective. The internal auditors Mazars have carried out a review of the governance arrangements and additional arrangements are being put in place to support governance, compliance and a project management approach to help ensure all the changes required are delivered. In line with the Company Governance Framework an annual self-assessment of the review of their internal governance arrangements is required and it is the 2024/25 review will be completed for January SEC to provide additional assurance.

- The companies current financial position and five year forecast performance have been independently assured by Interpath Advisory Ltd to determine the robustness of the medium term (5 year) cash flow forecasts and cash available to service the debt. Whilst the individual companies in the Thameswey and Victoria Square groups have variable levels of cash generation, at an aggregate level each group demonstrates positive earnings (EBITDA) before debt costs are applied.

5.2 Interpath's analysis of both company groups demonstrates that if debt charges are applied at the levels agreed before the current investment debt standstill both groups of companies would become cash flow insolvent in the very near term. This would precipitate a formal insolvency process by the company directors in the immediate term.

5.3 A process for assessing the level of the cash sweep of any funds not required by the companies to manage their cashflow requirements and working capital has also been in place as part of the debt standstill agreement for 2024/25. This assessment has been completed covering the period up to the end of December 2024. The next assessment of the debt sweep will be undertaken for the period up to the end of March 2025.

5.4 Both companies have made proposals for a level of debt sweep for the period up to the end of December 2024. The Council, through the Section 151 officer, is currently assessing these proposals in order to confirm the level of debt sweep it wants the companies to make.

5.5 The Section 151 Officer will be mindful of the need to ensure that the companies retain sufficient funds to enable their continued solvent operations and support the principle of a manged exit by the Council from its commercial arrangements with the delivery of optimal value for the public purse.

5.6 This report requests the Council approves a debt sweep for the period up to the end of December 2024 and delegates the decision on the value of this sweep to the Strategic Director of Finance, the Strategic Director - Corporate Resources, the Director of Legal and Democratic Services and the Chief Executive, following the application of the principles, assessments and assurances provided by the actions outlined within this report. The details of the financial review of the companies from which this delegated decision will be applied are included within Part 2 of this report.

## 6.0 Options Considered for 2025/26

6.1 The interest on the debt owed by the companies is still accruing and to provide assurance the Council is acting reasonably it is important to be able to demonstrate that the support will provide a better outcome than an insolvency managed process that would sell assets and settle outstanding debts. The work commissioned by Interpath provides both the underpinning financial advice to give that assurance and the basis for agreeing a contribution from the companies towards the debt costs that are within the debt standstill agreement. Interpath are also reviewing potential financial restructuring options, alongside a more strategic assessment of the future of the companies which is due to be considered by Members early in the New Year.

6.2 The financial review and assessment of restructuring options review that has been undertaken by Interpath for Thameswey and Victoria Square Woking Limited are included as part of the part 2 section of this report.

6.3 At this point, there remains two short term options available to the Council.

### 1) Do Nothing

6.4 At the end of the current investment debt standstill (31 March 2025) the Council reinstates debt collection. The financial position of the companies (balance sheet and revenue insolvent) would mean that the Council collecting debt principal and interest repayments would automatically force the companies into an administration process. Typically, it is the directors of the company who initiate the administration proceedings, though it can sometimes be company shareholders that start this process. The administrator/s would be required to sell the businesses assets expediently. A forced short notice sale of commercial assets would be detrimental to current asset valuations and unlikely to achieve value for money.

6.5 The administration process would prevent the Council from enforcing repayment of its debts as was scheduled before the current standstill through an administrator-controlled debt moratorium. A standstill of some form is therefore inevitable regardless of the Council's choice. Thereafter, following a sale of assets, and distribution of funds the Council would have to crystallise the 'unsecured' debt value (the difference between the value of the assets and the value of the debt) which is substantial. At this stage in the exploration of options this is clearly not a desirable outcome.

**2) Continue the Investment Debt Repayment Standstill (and associated cash sweep) for the 2025/26 Financial Year**

6.6 The continuation of the investment debt repayment standstill should give the Directors of the Companies a reasonable expectation that the companies have adequate resources to continue in operational existence for the foreseeable future.

6.7 The Council has taken advice in relation to the legislation around subsidy control as it relates to the treatment of the Council's public investment into the companies in order to ensure these proposals represent what a commercial lender would seek to undertake in order to achieve the best return and outcomes from its investment. The standstill allows time to review options and potentially restructure the companies to maximize returns to the Council as lender and to consider the interests of the Council as shareholder (and time for a full review consideration of the proposals in the two recent Interpath consultancy reports).

6.8 The companies are required to file their accounts with Companies House for the 2023/24 year by 31st December 2024. The external auditors will carry out their 'Going Concern' assessment and it is critical that means are put in place to give the Company Directors and Auditors sufficient assurance of ongoing support in the form of the Debt Standstill. The Council is unable to give full assurance until the formal budget setting meeting in March when the Exceptional Financial Support (EFS) that is the basis of the Council's own going concern and legal budget setting has been confirmed in principle by Government and accepted by the Council. However, this report is intended to give in principle assurance to support a 'going concern' opinion.

6.9 In addition, as the group companies are cash solvent, the Council has already in place a cash sweep arrangement alongside the debt standstill so that any surplus cash not required to keep the companies operational is paid over to the Council and applied to the outstanding debt costs. This will potentially provide an ongoing reduction in the Council's (and the companies) liabilities. This would not happen if the companies became formally insolvent.

## 7.0 Conditions and Caveats

7.1 The extension of investment debt standstill by the Council as a lender is subject to the following conditions (which have, for example, and will continue to be jointly developed and agreed with the relevant company boards). These conditions are met or sufficient met to support the extension.

- There is a clear rationale for extending the investment debt standstill.

- Robust company governance and financial administration must be in place. The work underway between the Council and the company boards moves consistently towards this and this is underpinned by the new Council Companies section in the Constitution.

- Central government (namely the Ministry for Housing Communities and Local Government, MHCLG and UK Government Investments, UKGI) are supportive of the approach. Both entities are observers on the Lender Board to which papers on the principles and rationale for the debt standstill and associated cash sweep have been presented and discussed.

- The Council acknowledges the potential impact of the debt standstill in budget setting. The Council's 2024/25 budget setting report to full Council 4 March 2025 included an early proposal on the principles for company debt repayment.

- The appropriate legal and financial advice has been taken.

- That the Council makes the standstill conditional on reaching an agreement on being provided with overarching loan security against the assets for the Thameswey group of companies which is currently not the case. This will be included in the Section 151 Officer formal notification to the Thameswey group of companies if the recommendation is agreed. The Victoria Square Woking Limited debt is secured against its assets.

7.2 If the debt standstill recommendation is agreed then (as was the case for the 2024/25 debt standstill) a Section 151 Officer letter with full conditions and caveats will be sent to the companies after appropriate review.

## 8.0 Decision Type/Scope

8.1 The contents of this report are a key decision for the Council. The decision to continue the suspension of the payment of interest from the two major Council companies and associated debt sweep are intrinsic to the whole Woking financial situation including the associated exceptional financial support application.

## 9.0 Implications

<u>Legal</u>

9.1 In respect of the proposals set out in this report the Council has sought external legal advice.

9.2 The Council has power under section 12 of the Local Government Act 2003 (LGA 2003) to invest for any purpose relevant to its functions under any enactment, or for the purposes of the prudent management of its financial affairs (subject to any risk mitigation directions made under section 12A of the LGA 2003). Statutory guidance issued under section 15 of the LGA 2003 makes it clear that the definition of "investment" includes loans made by the Council to a wholly owned company or associates, a joint venture, or a third party.

9.3 In relying on this power, the Council must have proper regard to various guidance, regulations and codes, including:

- Statutory Guidance on Local Government Investments which can be found at the following address:

  https://assets.publishing.service.gov.uk/media/5a74512440f0b646ce8d9b0e/Guidance_on_local_government_investments.pdf

- The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003;

- Various guidance issued by CIPFA (and given statutory footing by the Secretary of State).

9.4 In addition, section 111 of the Local Government Act 1972 (LGA 1972) provides the Council with an incidental power, which states that the Council may, subject to the provisions of any other enactment, do anything (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of property or rights) which is calculated to facilitate, or is conducive or incidental to, the discharge of its functions.

9.5 The Council must also comply with its fiduciary duty to taxpayers when managing and expending public funds. In this respect the Council must conduct its administration in a fairly business-like manner with reasonable care, skill and caution, and a due and alert regard to the interests of those taxpayers.

9.6 In exercising its powers, the Council must act for proper purposes and in good faith, and must exercise those powers properly and in a reasonable manner.

9.7 The Council must also be satisfied that it has taken appropriate external advice from advisors who are suitably qualified to advise on the financial, accounting and tax implications of the proposals set out in this report.

9.8 Subject to compliance with the above, it should be possible for the Council to agree to a standstill on the investment debt repayments, as well as the cash sweep arrangement as set out in this report, in reliance on the powers under section 12 of the LGA 2003 and section 111 of the LGA 1972.

Finance

9.9 The report deals entirely with financial issues and is critical to the management of the of the position in working towards a sustainable solution to a resolution of the long-term financial issues associated with the Council's major companies.

Risks and Mitigation

9.10 The risks and mitigations are set out in the body of this report and have been considered in detail by the Lender Board.

Consultation, Equality Impact Assessments

9.11 There is no direct equality impact of this decision.

Environment and Climate Change

9.12 There is no direct environment of climate change impact of this decision.

**Report Ends**