ANNEX II

INVESTMENT STRATEGY 2025/26

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1.0 Introduction

1.1 In preparing the annual investment strategy, the Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting)(England Regulations 2003, as amended, require the Council to 'have regard to the latest relevant guidance which is statutory guidance on Local Government Investments issued by Ministry of Housing, Communities and Local Government 2018, the Prudential Code issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) 2021 and the Treasury Management Code of Practice issued by CIPFA 2021.

1.2 The Treasury Management Code requires investments and investment income to be considered in three categories, relating to the investment purposes:

- **Treasury management investments -** These are held as part of treasury management activity. For example: managing cashflows or resulting from a borrowing strategy. These are considered in the Treasury Management Strategy.

- **Service investments -** These are held primarily as a direct part of delivering service objectives. For example: regeneration. The Council has deemed these to include the Strategic Property and the large commercial investments in the Thameswey group of companies and Victoria Square Woking Limited and subsidiaries.

- **Commercial investments -** These are taken or held primarily for financial return rather than as a part of direct service delivery. The Council previously maintained that its strategic property portfolio was not primarily for yield but was for regeneration purposes. They are however commercial investments by nature and rely on yield to meet associated borrowing costs and should be classed commercial investments in order to comply with the Code.

1.3 Local authorities are required approve an annual investment strategy as part of the budget setting process. The Investment Strategy Appendix strategy covers service and commercial investments also known collectively as 'non-treasury' investments (treasury related investment policy is set out in the Treasury Management Strategy at Annex III of this report).

2.0 Context and Background

2.1 The Council currently has the highest debt per head of population of any local authority in the UK with total investments of c£1.8 billion (please see details at paragraph 3) including a strategic property portfolio of commercial properties largely purchased by borrowing. The value of the Council's debt far exceeds the value of the assets and the Council's Investment Strategy is focused on asset rationalisation and debt reduction. The disproportionate level of debt means that, until a longer term solution is found, the Council requires Exceptional Financial Support from government to be able to set its annual budget and Council Tax.

2.2 The Government's External Assurance Review of May 2023 concluded that the Council's historic investment and borrowing decisions were disproportionate to its resources and that the Council lacked the commercial skills and capacity to identify a longer-term strategy to resolve its commercial arrangements[1]. This led to formal intervention in June 2023, closely followed by the issuing of a Section 114 notice[2]. The Section 114 notice stated that "the Council's historic investment strategy had resulted in unaffordable borrowing, inadequate steps to repay that borrowing (underprovided Minimum Revenue Provision) and significant shortfall between the value of the assets held the companies and the loans advanced to finance those assets." As a result the company loans have been impaired by £580 million in the Council's 2023/24 Accounts along with the further impairment of £155 million for loans assumed to be used for revenue purposes[3]. It is estimated that between £1.2 billion and £1.4 billion of the Council's debt is not backed by realisable assets.

2.3 As part of the government's Best Value intervention, an Improvement and Recovery Plan including a commercial workstream is in place[4]. This sets the framework for the exit route from the Council's commercial arrangements and the commercial property portfolio.

2.4 Finally, conditions attached to the government's Exceptional Financial Support for 2025/26 include the following:

- Continued development and delivery of a robust asset disposal plan to the satisfaction of Commissioners and government. This must be underpinned by a detailed assessment of options considering the associated risks and benefits, and a review of the council's companies' financial positions including detailed cashflows. 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. The plan, and the council's progress against that plan, should be subject to appropriate scrutiny, for example external experts.

- Continued development and delivery of a strict debt reduction plan to the satisfaction of Commissioners and government, linked to the options appraisal and agreed asset disposal plan.

- Robust programme management of the commercial workstream to ensure timely delivery and effective risk mitigation.

[1] Government intervention | Woking Borough Council
[2] Section 114 Notice | Woking Borough Council
[3] Woking Borough Council 2025/26 Statement of Accounts, page 5.
[4] Improvement and Recovery Plan (IRP) | Woking Borough Council

3.0 Current Investments

3.1 The Council has c£1.8 billion of investments including shareholding and loans to Council controlled companies and loans to third partes of c£1.4 billion and a commercial property portfolio of c£300 million.

3.2 In managing these assets, it is critical that the Council protects its security, achieves best consideration as part of asset rationalisation and debt reduction work and maximises the yield of assets held.

Shares, Loans and Company Assets

3.3 The table below sets out the Council's current investment in shares and third party loans. The highest value loans are to the Thameswey group of companies and Victoria Square Woking Limited.

Body/Company	Shares* 31/03/2024 £'000	Loans* 31/03/2024 £'m	Loans** 2024/25 £'m
Thameswey Limited (and group companies)	**31,193**	**625**	**26**
Victoria Square Woking Limited	**14**	**714**	**12**
Greenfield School		13.1	
Rutland (Woking) Limited		1.6	
Wolsey Place		1.6	
Freedom Leisure		1.5	
Kingfield Community Sports Centre Limited	500	1.5	
Woking Necropolis and Mausoleum Limited	6,000		
Municipal Bonds Agency	50		
SurreySave Credit Union	50		
Woking Town Centre Management	1		
Other Investments	**6,601**	**19**	**-**
Total Investments	**37,808**	**1,359**	**38**

*Values are at cost. Please note the shares and third party loans have been impaired in the Council's 2023/24 Statement of Accounts to reflect the fact that, for example, the potential realisable value of the company assets are substantially lower than the value of the loans.

**Potential value of loans to complete the Victoria Square scheme and phases of the Thameswey group's Sheerwater scheme to maximise asset values.

3.4 Appendix One sets out the detail on the two main groups of companies and the work that has been carried out to improve governance and provide more financial assurance.

3.5 Company accounts are filed (as required under the Companies Act) with Companies House. The latest audited accounts for the Thameswey group of companies (company number 03702545) and Victoria Square Woking Limited (company number 08005542) confirm that the companies are balance sheet insolvent with the value of assets materially below their liabilities. The Thameswey group of companies held balance sheet fixed assets with a value c£490 million on 31 March 2023[5]. Victoria Square Woking Limited held balance sheet fixed assets of £143 million on 31 March 2023[6]. The Council has not produced group accounts to consolidate these interests, including commercial companies wholly owned and controlled by the Council, since 2019/20[7].

3.6 The two groups of companies make positive earnings before interest payments, taxation, depreciation and amortization (EBITDA) but they are not earning enough to meet their full interest and principal payment liabilities. The interest due to the Council from the

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[5] Annual Report and Financial Statements for the year ending 31 March 2023 Thameswey Limited (page 11).

[6] Financial Statements for the year ending 31 March 2023 Victoria Square Woking Limited

[7] Statement of Accounts 2019-20 Draft (pages 91 -101).

Thameswey group of companies and Victoria Square Woking Limited is c£46 million per annum.

Commercial Property Portfolio

3.7 The Council's commercial property portfolio was largely acquired through borrowing and has a Statement of Accounts balance sheet valuation of £300 million at 31 March 2024[8]. This is a snapshot fair value valuation for balance sheet purposes only and as such does not constitute a realisable sale value.

3.8 The commercial property portfolio includes over 60 assets. Significant Council assets include investment in the Wolsey Place shopping centre, local industrial estates and town centre office buildings. Whilst the assets contribute rental income to the Council's budget, this is currently insufficient to service financing and holding costs. The operational impact of managing the loss of income from voids alongside the associated increase in costs to the landlord (the Council) for service charges and business rates has had a significant impact on the General Fund.

General Fund and Debt Modelling

3.9 A ten year debt model is in place, supporting the Medium Term Financial Plan and the request for government Exceptional Financial Support. This will enable the Council to understand the impact that the estimated capital receipts from the asset rationalisation and debt reduction work will have on reducing the outstanding debt and associated costs to the revenue budget. If no solution is found to the high level of debt held, over the life of the model, even if all commercial assets (commercial property portfolio and company holdings) are disposed of the Council's General Fund budget will still have a cash deficit of an average of £65 million per annum largely driven by the debt interest costs.

3.10 In order to manage the General Fund budget impact a 'business as usual' budget has been established which supports a deemed level of affordable debt (benchmarked at £75 million plus any new borrowing for the capital programme). This excludes other capital financing costs, the costs of supporting intervention, delivering the commercial workstream and costs and income associated with the commercial property estate. This provides a target sustainable budget envelope to work to over the Medium Term Financial Plan.

4.0 Investment Strategy Approach and Prudential Indicators

4.1 The Council is under direction from the Secretary of State to implement a strict debt reduction plan, which in turn means divesting of assets (both commercial investments and property), balancing 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.

4.2 For non-treasury investments, the Council will continue to follow a strategy of divestment and not take on any further investment subject to any current contractual obligations.

Borrowing in Advance of Need

4.3 Under the revised version of the Prudential Code, CIPFA has reinforced its definition of 'borrowing in advance of need'. This concept prohibits Councils from borrowing prior to cash being required and then invested purely to generate a financial return. The 2021 Prudential Code clarifies that all 'debt for yield' activity is considered as borrowing in advance of need, as borrowing purely to undertake a commercial investment does not meet one of the

[8] Woking Borough Council Statement of Accounts 2023/24, Balance Sheet, page 18.

exceptions above, nor does it meet any service objective. Continuing with the asset disposal strategy will mean that the Council is not borrowing in advance of need.

Loans to third parties, Shareholdings, and Loans to Limited Companies and Joint Ventures

4.4 Such investments may be treated as capital expenditure for prudential borrowing purposes even though they do not create physical assets in the Council's accounts, meeting the definition of capital expenditure as set out in Regulation 25 of the 2003 Regulations.

4.5 A loan to a third party towards expenditure which would, if incurred by the authority, be capital expenditure also meets the definition of capital expenditure for the Council. An estimated £155 million of the investments were subsequently found not to have met the requirement to be accounted for as capital and were therefore reclassified as revenue. These investments are contrary to the regulations and provision has been made in the Capitalisation Direction to impair the loans and enable the borrowing to be repaid.

4.6 All decisions relating to company assets will be assessed using the Commercial Protocol (see paragraph 6.3 below) and informed by:

- The need to pay down debt whilst maximising receipts/protecting the value of the assets (protecting the public purse). The legal duty to achieve best consideration must be met.
- The imperative to act quickly given the financial position of the companies. Financial and legal considerations will be regularly reassessed, including subsidy control implications.
- Social and economic considerations, including the role of Thameswey Housing in providing affordable housing for residents and the need to maintain the security of energy supply for the commercial and residential properties supplied by Thameswey Energy.
- Should assets be retained (this is most likely to be some or an element of the housing stock), there will be a financial restructuring to ensure the level of performing debt is maximised and the Council receives interest and repayments due.

4.7 The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. An independent security review has been undertaken of the loans to Victoria Square Woking Limited and Thameswey groups of companies and identified the need to ensure that security is perfected for the lending to Thameswey in order to mitigate the financial impact of any loan default.

4.8 Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment.

4.9 In order to protect the Council's position to enable a coherent asset rationalisation approach to be implemented, a further debt standstill with the Thameswey and Victoria Square Woking Limited groups of companies was agreed at 12 December 2024 Council. The debt standstill is subject to the companies meeting the following tests:

- Maintaining the company (and its subsidiaries) as solvent entities (with a positive EBITDA as per below) continues to offer better value for money to the public purse versus the costs and impact of administration.
- 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).
- 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.

- Appropriate business plans for the year are submitted in a time and format agreed by the Council.
- The costs of suspended interest and minimum revenue provision are expected to be addressed by the Capitalisation Direction agreed by government (Ministry of Housing, Communities and Local Government, MHCLG) which is to be confirmed in March 2025.
- Support provided to the company continues to meet state subsidy control tests.
- For the Thameswey group of companies, this is also contingent on the Council perfecting security on its loans.

4.10 To ensure that any funds that are available to service the debt are paid to the Council, a cash sweep has also been implemented. Any surplus cash in excess of an agreed cash buffer will be paid to the Council on a quarterly basis. This is to be supported by the submission of monthly cashflow and management accounts to the Council's Shareholder Executive Committee. All payments received from the debt standstill will be used to pay down the interest due from the companies.

Other Issues

4.11 During 2025/26 a business case for the Woking Necropolis and Mauseleum Ltd will be produced to inform the future strategy for the companies.

4.12 Work is also underway reviewing the loans to other commercial entities including reviewing the organisation's financial position, assessing what security is available to secure the loans and that the maximum level of security is achieved, loan agreements are reviewed by our legal team to ensure that they are legally compliant and includes any safeguards for the Council.

4.13 Where loans are restructured the rate of interest charged must reflect the risk of the project and potential for default and subsidy control rules taken into account.

4.14 A Council may invest in the shares of its subsidiaries, its suppliers, and local businesses to support local public services and stimulate local economic growth. The Council has £37.8m invested in shares. One of the risks of investing in shares is that they can fall in value meaning that the initial outlay may not be recovered. This is likely to be the case for VSWL and TW Group of Companies and the other shareholdings will need to be reviewed during 2025/26.

Commercial Property Portfolio

4.15 Historically there has been limited due diligence on land and property acquisitions and a poor understanding of their hold costs versus the financial return. Since the start of intervention, work has been completed to implement a new asset management system and to proactively manage assets and develop profit and loss accounts for each asset to understand the true financial position.

4.16 Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. A three-year divestment programme is now underway, supported by the appropriate external advisors to ensure that best value is achieved. Each commercial property asset, along with those held for sale or surplus, have been appraised using the Commercial Protocol and Net Present Value analysis to inform hold or dispose decisions. These appraisals were completed in Summer 2024.

4.17 Only those assets that achieved a hurdle rate of 10% will be retained. The performance of the investment estate will be regularly reviewed.

Investment Strategy 2025/26

Cashflow Management

4.18 The Council covers its liquidity for working capital and cash flow by holding cash in its Money Market Fund and being able to borrow short term loans from the Public Works Loan Board.

4.19 All capital receipts achieved from the divestment strategy will be used to pay down debt/avoid future borrowing. The Council's Treasury Management Strategy (Annex III of this report) sets out the Council's approach to future borrowing/refinancing and how this will be aligned to the anticipated capital receipts from the asset rationalisation work.

Future Borrowing

4.20 No further proposals for non-treasury investments are proposed in the 2025/26 budget.

4.21 In line with the Capital Principles agreed as part of the 2024/25 budget setting process and reconfirmed in the 2025/26 Capital Strategy, borrowing for the General Fund capital programme will be limited to the following: essential health and safety and regulatory works; strategic asset management asset lifecycle planning; essential investment in ICT where there is a robust business case, or to deliver evidenced revenue savings.

Prudential Indicators

4.15 The Council's prudential indicators set limits for non-treasury investment and compare forecast investment income with net revenue budget.

Prudential Indicator: Non-treasury investment limits

	2024/25 £m	2025/26 £m	2026/27 £m	2027/28 £m	2028/29 £m
Shares (at cost)	38	38	38	38	38
Loans (at cost)*	1,400	1,400	1,400	1,400	1,400
Investment property**	300	300	300	300	300
Total limit	1,738	1,738	1,738	1,738	1,738
Analysis	The Council's investment purchases have been disproportionate. The limit has been maintained at existing levels pending decisions about future investment reductions. The aim is that no further investments will be made.				
Objective	To ultimately substantially reduce the level of investments over the medium term, to reduce investment exposure and repay debt.				

* No assumption is made on the value or timing of the repayment of investment associated loans.

**This is the latest balance sheet valuation for investment properties (31 March 2024) and assumes that the investment assets were largely funded from borrowing.

Net income from non-treasury investments

	2024/25 £m	2025/26 £m	2026/27 £m	2027/28 £m	2028/29 £m
Cash sweep payments from Thameswey and VSWL*	3	0	0	0	0
Other interest and dividends	1	1	1	1	1
Strategic Property Portfolio**	10	8	0	0	0
Total net income	**13**	**9**	**1**	**1**	**1**
Suspended interest from Thameswey and VSWL	46	46	46	46	46

*Debt sweep payments are not assumed for future years

** Net income before staffing and financing costs. This makes assumptions about investment income losses as a result of planned asset disposals.

Prudential indicator: Net income from non-treasury investments

	2024/25 £m	2025/26 £m	2026/27 £m	2027/28 £m	2028/29 £m
Net income from non-treasury investments	13	9	1	1	1
Net revenue budget	19	21	21	21	21
investment income as a % of net revenue budget	67%	41%	4%	4%	4%
Analysis	Investment income excluding the suspended commercial company interest is still significant risk to the Council and is under review by the Commercial workstream.				
Objective	to keep investments within a level where a plausible loss of income could be managed without major disruption to services.				

5.0 Risk Management

5.1 The Council's borrowing for commercial loans and property investment should be subject to the same risk criteria as for specified investment, namely, security, liquidity and yield in that order. There was limited attention given to assessment of security and liquidity before making the investments and as a result the Council is exposed to the following risks:

- Interest Rate risk because of the high level of short-term borrowing, there is an exposure to any volatility in interest rates;

- Yield risk because by borrowing to finance the investments imposed a hurdle rate which had to be exceeded before the investments would yield a positive rate of return. The hurdle rate is the cost of finance and comprises MRP and interest on borrowing. Given that interest rates are currently around 5%, the hurdle rate for making a positive return is in excess of 10%.

- Security risk in that no thought was given to the risk of loss in terms of the capital invested;

- Regulatory risk through excluding the expenditure on the commercial investments from the requirement to charge MRP contrary to statutory requirements. Consequently, the Council has not only required to correct this going forwards, but also make a provision for past years in which it did not do so;

- Regulatory risk from borrowing for some loans which were for a revenue purpose. A Council cannot, without the express permission of Government, use borrowing to undertake anything other than capital expenditure and was therefore in breach of statutory requirements.

- Proportionality risk in that the scale of the borrowing far exceeded the financial capacity of the Council to support the high level of debt or the level of expertise required to manage such a large and complex portfolio.

5.2 As a high level of risk has materialised, and the Council is now pursuing a policy of disinvestment and debt reduction.

5.3 To improve the overall approach to risk, a risk management framework has been implemented, covering Improvement and Recovery Plan activity, including the non-treasury investments dealt with in the Commercial Theme. A specific commercial risk register has been implemented to support the Commercial Governance Board to ensure more effective risk management and mitigation. This is part of the corporate risk management arrangements whereby risks requiring escalation will be shared with the Executive as part of quarterly programme updates.

6.0 Capacity, Skills and Culture

6.1 The Council recognises that when the major commercial investments were made, it did not access sufficient expertise either in house or externally to plan or manage such investments. Expert advice has now been brought in, largely through the procurement of experienced consultants. Access to specialist financial, legal and commercial skills will continue to be required to deliver the Improvement and Recovery Plan and this has been recognised in the inclusion of funding for capacity support in the ESF request.

6.2 The Improvement and Recovery Plan/Programme has an Organisation and Service Design workstream is overseeing the activity to transition from the current resourcing model to a stabilised council that has the skills and capacity required. Ensuring the new commercial governance function is adequately resourced and establishing an integrated Programme Management Office to oversee the delivery of the Commercial Workstream are key priorities.

6.3 The Council has implemented a Commercial Protocol and Company Governance Framework that are being integrated into core competencies of managers. Associated learning and development events, like contract management skills, are being developed and rolled out. The Council has also reviewed its committee structure and developing Member briefings and training.

7.0 Governance

7.1 Significant improvements have been made (and continue to be made) to the Council's investment related governance arrangements including greater clarity on governance and decision making for the Council both as:

- Shareholder - setting the strategic direction for the companies as per the company's Articles of Association with formal decision making and oversight is through the Shareholder Executive chaired by the Leader of the Council and as

- Lender - overseeing the financial arrangements for the companies with formal decision making via the Executive and Council.

7.2 The Council's Commercial Governance Board acts as the gateway for decision making and ensures the Constitution including the Commercial Protocol and Company Governance Framework are followed and that statutory officer input and independent external advice has been both obtained and considered. In addition, improvements to company governance include strengthened company board and executive leadership and removal of conflicts of interest.

7.3 As the Improvement and Recovery Plan Commercial workstream moves into the delivery stage, further improvements are planned such as more robust member governance, better stakeholder communications and the establishment of a Programme Management Office and Board to ensure robust oversight.

Investment Strategy 2025/26

Appendix One - Company Structures and Improvement Work

Victoria Square Woking Limited and its subsidiaries hold The Marches (residential), the Hilton Hotel, the commercial units (Henry Plaza and Commercial Way) and the Red and Green car parks. There are two subsidiary companies - the operating company for the residential assets and the operating company for the hotel.

The Thameswey group of companies includes Thameswey Limited (the parent company), Thameswey Housing Limited which provides private sector rented housing, Thameswey Development Limited which retains all commercial properties, Thameswey Energy Limited which owns and operates three energy centres and heat networks, Thameswey Milton Keynes which owns and operates an energy centre and private wire and heating networks and Thameswey Central Limited which employs all staff within the group. The group also includes Rutland (Woking) Limited which is a joint venture with Rutland Properties Limited.

A full review of the companies and their assets has been carried out with the summary timeline shown below:

June 2023	Section 114 notice issued. Company related Revolving Credit Facility terminated.
August 2023	Commercial Governance Board established.
November 2023	Commercial Protocols and Company Governance Framework agreed.
August/September 2023	Initial option appraisal completed. Decision to avoid administration and provide financial support to finalise incomplete assets (hotel completion and Sheerwater Yellow phase).
April 2024	New company chairs appointed and recruitment to experienced non executive directors followed soon after. Debt suspension for 2024/25 agreed.
May 2024	Agreed principles for cash sweep enacted.May 2024 – Council Shareholder Executive Committee established to oversee Shareholder interest
September 2024	Appointment of turnaround specialist.
June 2024	Lender Board established – led by Commercial Commissioner, with UKGI and MHCLG as observers to oversee the Lender interest in the companies.
November 2024	External advisor Medium Term Cash Flow analysis completed along with advice on financial restructuring options. Entity business case work completed to inform strategic options for the companies.
December 2024	Single chair appointed by Victoria Square Woking Limited and Thameswey group of companies Boards which will help align strategy and approach. Debt sweep for 2025/26 agreed subject to government Exceptional Financial Support being in place
February 2025	Shareholder Executive presented with a direction of travel for company decisions and potential disposal for the next 23 months. The work will be informed further by findings of current reviews being undertaken on the Hilton Hotel cladding remediation works and Thameswey Energy Limited.

The Victoria Square scheme and phases of the Thameswey group Sheerwater scheme are being completed to maximise asset values to protect the Council's investment interests. These works are all due to be completed by the end of March 2025. As debt is still accruing there is now an imperative to complete the divestment strategy at pace. Issues which may have a potentially material impact on divestment values include the recent cladding failure on the Victoria Square Woking Limited hotel and the need to improve commercial management of the energy companies.

Medium term cashflow analysis and financial restructuring advice has been received and outline business cases are in place. The work to complete the full business cases to support the asset rationalistion and debt reduction work is due to complete at the end of the financial year and will determine the next steps in the asset rationalisation work. To provide time to deliver the above a debt standstill for Thameswey and Victoria Square Working Limited has been in place from 2024/25 and was formally agreed by 12 December 2024 Council.