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Date: 22 April 2016

Dear Member

**GOVERNANCE AND AUDIT COMMITTEE TRADING ACTIVITIES SUB - COMMITTEE -
WEDNESDAY, 27 APRIL 2016**

I am now able to enclose, for consideration at next Wednesday, 27 April 2016 meeting of the Governance and Audit Committee Trading Activities Sub - Committee, the following report that was unavailable when the agenda was printed.

Agenda Item No

6

Discovery Park Investment Fund - Development of the Fund and changes to governance structure TO FOLLOW (Pages 3 - 8)

Yours sincerely

A handwritten signature in black ink, appearing to read 'Peter Sass', is written in a cursive style.

Peter Sass
Head of Democratic Services

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By: Mark Dance
Cabinet Member for Economic Development

David Smith
Director, Economic Development

To: Governance and Audit Committee
Trading Activities Sub-Committee
27 April 2016

Subject: DISCOVERY PARK TECHNOLOGY INVESTMENT FUND:
DEVELOPMENT OF THE FUND AND CHANGES TO GOVERNANCE
STRUCTURE

Classification: Unrestricted

Summary

Following the Governance and Audit Trading Activities Sub-committee held on 20th November 2014, *“The Chairman asked for the Governance and Audit Committee Members to be notified of the eventual Member and Designated Member appointments as well as of any changes to the governance arrangements”*

This report provides details of the changes to the Governance structure of the Discovery Park Technology Investment Fund (The Fund).

It is proposed that the governance and structure of The Fund are changed to enable it to raise additional private capital and expand on investment.

This report sets out the business case for changing the structure of The Fund and details the proposed structure, the risks to KCC and how these will be mitigated; and the next steps in taking the proposed structure forward.

Recommendations

The Trading Activities Sub-Committee is recommended to:-

- a) ENDORSE the proposed Governance structure for The Fund.
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1. Introduction: Equity Investments

- 1.1 On 30th April 2013 the Expansion East Kent Investment Advisory Board approved amendments to the Investment Strategy to allow applicants the opportunity to apply for equity investment finance. The Expansion East Kent programme has offered equity investments from May 2013 to the present day. The aim of the investments from this Regional Growth Fund allocation to KCC is to bring forward products from the research and development stage to commercialisation. This finance enables companies to upscale their developments when loan finance is not appropriate or available.

- 1.2 The other two Regional Growth Fund programmes, TIGER and Escalate, have adopted the same strategy as the Expansion East Kent programme. All three programmes are under the same KCC governance arrangements.
- 1.3 The Governance and Audit Committee taking place on Wednesday, 27th April at 2.00 pm has been presented with a report on KCC's investment strategy in respect of equity investments from its Regional Growth Fund.

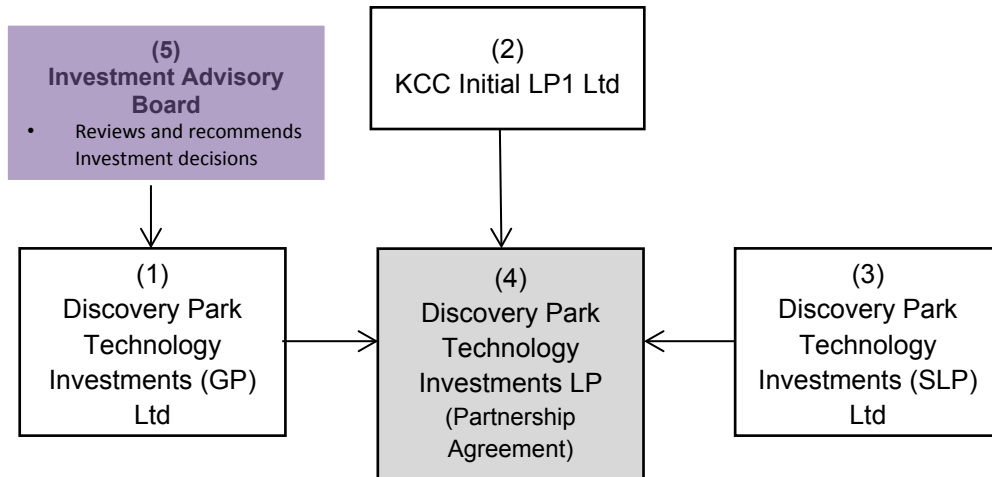
2. Expansion East Kent equity funding allocation

- 2.1. The Investment Advisory Board agreed in 2014 to allocate £5 million from the overall Regional Growth Fund allocation to offer equity investments in accordance with the EU regulations governing state aid for industry.
- 2.2. In September 2014, the Investment Advisory Board endorsed an application from Narec Capital Ltd. (a fund manager regulated by the Financial Conduct Authority) to advise and to manage KCC's investments from the £5 million allocation, with a view to leveraging additional private funding in future years. Following independent appraisal, the Leader of the Council approved the commitment of £5 million in October 2014 for equity investments under Narec Capital's management, subject to individual approval of each equity investment by Kent County Council.
- 2.3. As the proposal required the creation of special purpose companies by KCC. This was reported to and endorsed by the Trading Activities Sub-Committee in November 2014.
- 2.4. The investments are made in the name of Kent County Council and Narec Capital Ltd. is overseeing the management of these investments. By June this year, it is anticipated that all of the allocation will have been invested.

The Discovery Park Technology Investment Fund

- 2.5. The **Discovery Park Technology Investment Fund (The Fund)** was formally agreed between KCC and Narec Capital Limited in December 2015. This structure has required the creation of three special purpose companies and a partnership agreement, the details of which are as follows:-

Fig. 1: Current Governance Structure



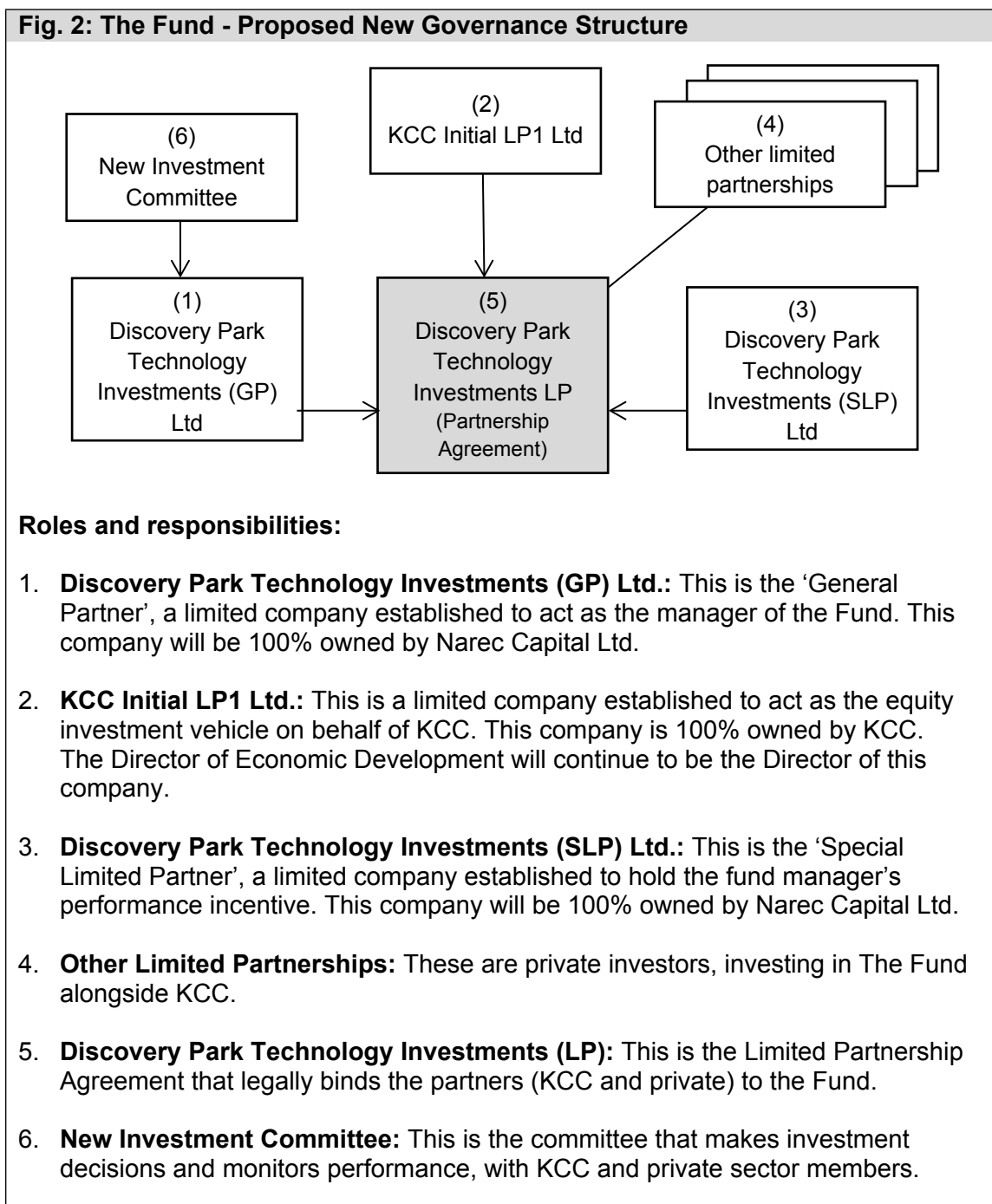
Roles and responsibilities:

1. **Discovery Park Technology Investments (GP) Ltd:** This is the ‘General Partner’, a limited company established to act as the manager of the Fund. This company is 100% owned by KCC, with investment advice provided by Narec Capital Ltd. The Director of Economic Development is the sole director of this company.
2. **KCC Initial LP1 Ltd:** This is a limited company established to act as the equity investment vehicle on behalf of KCC. This company is 100% owned by KCC. The Director of Economic Development is the sole director of this company.
3. **Discovery Park Technology Investments (SLP) Ltd.:** This is the ‘Special Limited Partner’, a limited company established to hold the fund manager’s performance incentive. This company is 100% owned by KCC. The Director of Economic Development is the sole director of this company.
4. **Discovery Park Technology Investments (LP):** This is the Limited Partnership Agreement that legally connects the Companies (1, 2 & 3 above) and a separate agreement sets out the arrangements between Narec Capital and KCC.
5. **Investment Committee:** This is the Expansion East Kent Investment Advisory Board, chaired by the Leader. The IAB considers and recommends possible investments. Kent County Council is the accountable body.

3. The Discovery Park Technology Investment Fund: Proposed Changes

- 3.1. It is proposed as of 1st May 2016 that the governance of the Fund is changed, so that it can become open to external private investors, as well as KCC. The proposed structure is illustrated below. The structure is designed to preserve KCC’s interests in respect of its RGF investment, while providing a legal framework which is familiar to private investors. We have been advised by Hogan Lovells that this structure is the same as that adopted by Venture Capital and other equity funds.

- 3.2. In order to open the fund to external investors, the ownership of the General Partner (1 above), responsible for fund management, and the Special Limited Partner (SLP) (3 above) will transfer from KCC to Narec Capital Ltd.
- 3.3. KCC will retain 100% ownership of KCC Initial LP1 Ltd., which holds KCC's investment in The Fund. Other limited partnerships can then invest in The Fund, alongside KCC, as investment agreements are reached with Discovery Park Technology Investments LP (see 5 below).
- 3.4. A new Investment Committee will be established to look after the interests of all limited partners, including (but not exclusively) KCC.
- 3.5.



- 3.6. As The Fund will no longer be in the sole ownership of KCC, it is intended that Narec Capital will report into a new, independent, Investment Committee. The Leader will nominate two

members for this Committee. In total, the Committee will be made up of up to five members, with a chairman who has a successful background in venture capital.

- 3.7. The members appointed by KCC will have veto rights over any investment made using KCC funds, and will report back to the Investment Advisory Board (or other structures that KCC may establish) to monitor KCC's investment portfolio.
- 3.8. Narec Capital Ltd. has initiated a recruitment process to appoint members of the Investment Committee. It is envisaged that private sector members of the Committee will receive remuneration, with a view to incentivising sustainable fund growth. This is likely to mean that remuneration will be based on a combination of monthly retainer, success fees for raising additional capital and equity carry.
- 3.9. The terms of reference for the Investment Committee will include assessing and making decisions on investments, ensuring that the Fund operates within FCA and other regulatory principles and ensuring regular performance reports.
- 3.10. Currently, Narec Capital Ltd. is required to provide monitoring reports on the investment portfolio to KCC via the Investment Advisory Board at least twice a year and the KCC members will report to the Investment Advisory Board and the Leader.
- 3.11. While KCC's representation on (and control over) the Investment Committee will be diluted, this will be compensated by the enhanced venture capital expertise that the Investment Committee is likely to attract, and by private sector investors joining The Fund. KCC will retain control in the new structure of decisions relating to those investments that are made utilising KCC funds.
- 3.12. As the Fund is structured as a limited company, it will be required to file publicly available audited accounts. The arrangements also require it to produce regular management accounts. It will also be required to procure an independent audit of all of its activities in accordance with company law.

4. Legal, procurement and matters relating to KCC's wider corporate responsibility

- 4.1. The proposed structure has been developed with advice from KCC Legal, Geldards (acting on KCC's behalf) and Hogan Lovells, a corporate law specialist. Prior to the transfer of ownership that the proposed new structure envisages, detailed terms of reference and operating procedures will be developed with KCC Legal and with Procurement advice.

5. Recommendation

- 5.1. The Trading Activities Sub-Committee is recommended to:-

- a) ENDORSE the proposed governance structure for The Fund.

Report author

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5 April 2016

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