Paper for: The LEP Board
Title: Agenda Item 7 – Investment Opportunity Life Sciences Fund 2
Date: 20th January, 2021
Strategic Purpose: Delivery of Strategic Objectives
Resource Implications: None
Board: Decision required on whether to invest in Life Sciences Fund 2

1. Executive Summary

In 2015 Cheshire and Warrington LEP invested £10m of Local Growth Funding into the Greater Manchester and Cheshire Life Science Fund. The fund which totalled £32m in value and which is run by Catapult Ventures will close to new applications in April.

The LEP has been approached by Bruntwood and Greater Manchester to contribute to another Life Sciences fund, with aim of a new fund being operational by late spring to dovetail with end of the investment period of the existing fund.

Recognising the importance of Life Science within the Local Industrial Strategy and the region generally, the opportunity to further enhance the growing reputation of the region as place to do Life Science and the economic benefits of a strong Life Science sector, the aim is to create a second fund of at least £25m, with the potential to increase it with funding from the British Business Bank.

The request is for the LEP to commit £10m to the new fund, which is expected to run for 15 years.

Key questions for the board are how this can be funded and the wider implications arising from tying up resources in this way. The LEP contribution is not expected until 2024-25 and is likely to be introduced in instalments over several years (in the investment and follow-on periods). GM and Bruntwood would be happy to introduce their funding first but require the commitment from the LEP at the outset. Funding is expected to come from ringfencing and recycling any returns from the existing fund, which will move into its' realisation phase from 2025 onwards. On this basis, there is a likelihood that requirements to contribute into the new fund run ahead of the realisations, and a risk that the combined returns achieved do not meet the full commitment. While the business case refers to the possible use of a future capital fund, this will not be an option. Once the commitment is made, there is no incentive for the Department to "switch" the funding source. Therefore, the secure alternative would be to ensure resource is available from the Growing Places Fund (GPF) to cover any timing differences or shortfall. If realisations from the first fund are weighted heavily towards its' end date in 2030, timing differences may extend to 3 or 4 years, whereas a shortfall would only be repaid when the second fund enters its realisation phase in 2031-36.

Committing the returns from the first fund and GPF now in this way removes opportunities for the board to deploy GPF on other priorities. The disadvantage to the LEP may not be as great as first appears. As illustrated in section 11.2, GPF has rarely been fully invested, and often had more than £6M of available funds. In the two years, 2019 and 2020, when it was fully deployed this was to support investments in EZ, since redeemed by the EZ loans. Looking ahead, Cheshire East Council is making budget provision for investment in the Growth Corridor. This makes it less likely we will need to revert to GPF for investment in the Growth Corridor in the foreseeable future. In addition, GPF will remain available in the short term, though only for loans repayable by 2023-24.

Beyond that, all the GPF may be required for 3-4 years until the realisations in the first fund materialise. In the worst case, there is a risk that first fund may yield very little or nothing. That said, it is hoped, and can reasonably be expected, the existing fund investments will begin realisations from 2025 to avoid an unmanageable number of exit transactions in the final year or two of the fund which, in turn, should reduce the full commitment on GPF to a shorter period.

2. Recommendations / Actions / Decisions Required:

The Board is asked to:

- Review the contents of the Business Case and the evaluation described in this paper.
- The recommendation is that we proceed with this investment, on the grounds that there is a reasonable prospect of 50% of the funding being achieved by the liquidation of the first Life Sciences Fund. Taken in isolation, the project has sufficient merit to recommend it, but the executive is drawing the board directors' attention to the two key considerations:
    - The proposed funding sources are not guaranteed and, if they do not materialise as expected, may require the use of, in a worst case, the entire available balance of the GPF.
    - Unless other funding comes forward, the commitment could significantly reduce the Board's opportunities to finance other investments or sectors for several years. In the short-term commitment to Life Sciences 2 will constrain any other use of GPF until liquidation proceeds of the first fund are clearer.
- If approved, to authorise the LEP executive to complete the establishment of a new partnership and fund agreements in conjunction with Greater Manchester and Bruntwood and commit £10m of LEP funding and £20k of revenue funding to meet the legal and procurement costs of establishing a new fund. Also, to delegate signing of any associated legal agreements to the Chair and Deputy Chair of the LEP.

3. Background

The Greater Manchester and Cheshire Life Science fund was launched in October 2015. Catapult Ventures were appointed fund managers. The fund followed on from a £25m North West bio-medical fund run Spark Ventures and funded through the North West Fund. The fund was the first sector specific regional fund of its type. This fund set the early foundations for establishing the North West as place to do bio-medical investments, where investments usually restricted to Oxford, Cambridge and London.

The fund was significantly over-subscribed and was awarded an additional £5m of funding. This fund exceeded all its KPIs in terms of investments made and jobs created. The success of the fund in financial terms is still being measured, but one investment for instance did recently list on the AIM stock exchange.

The Greater Manchester and Cheshire Life Science fund was established with contributions from the following partners:

Cheshire and Warrington LEP	£10m
Greater Manchester CA	£10m
Cheshire East BC	£5m
Alderley Park Holdings	£5m
Private investors	£1m
Total	**£31m**

This fund has seen significant demand showing that there clearly is a gap in the market which is not being met by banks or institutional investors. Evidence from fund managers in the region is that this gap has widened further as the result of the pandemic.

The fund has been successful so far in attracting proposals and private match on investments made. The fund has invested £20.3m into 33 companies to date and is expected to make up to five more investments before the end of April. The remaining funding will be used to make follow on investments. The fund is at the early stage of its investment cycle, so returns are not expected for a number of years, but there are some very promising investments. One for instance is valued at £5m, 2.5x what was invested. The overall portfolio is currently valued at 107% of costs and has secured a total of £32m of private sector match at an investment level.

4. Scheme Proposal

The proposal is for CWLEP to invest £10m into a new fund, which the business case assumes will be made up of £5m of expected returns from the existing fund and £5m of new funding. The merits of these assumptions are evaluated in the financial case. There are risks and to mitigate the funding risks, the proposal includes using the Growing Places Fund to underwrite the investment commitment.

The funding would not be needed for approximately four years as Bruntwood and GMCA have said they would be happy for their funding to be drawn first. Without this arrangement, the LEP would find it challenging to cashflow its investment. However, commitment to the fund is required at the outset in order for the fund management procurement documents to be drafted and issued as soon as all the necessary approvals are in place.

5. Objectives

The objectives of the project are to:

- Promote Alderley Park and Manchester Science Park/Oxford Road Corridor as key Life Sciences hubs for the region

- Attract and retain Life Sciences companies in the region, contributing to the growth of this key sector both in terms of jobs and GVA
- Provide a specialist, regional Life Sciences VCT that can provide funding from seed through to Series A.
- Increase the size of the Fund to over £50m through the attraction of fund level private sector leverage (NB. Public sector pension funds are generally considered as private sector given their independent governance and operational models).

6. Strategic Case

The project has many positive attributes. Notably, a strong strategic fit with the Draft Local Industrial Strategy and the Strategic Economic Plan at a local level while at a regional level it helps to support the Northern Powerhouse agenda and nationally fits with the UK Industrial Strategy. Life Sciences is one of the key sectors identified in the plans. The availability of funding for businesses located in, or to locate in, Cheshire and Warrington will support the growth of the developing cluster and continue to bring high value, high productivity jobs to the sub-region. Choosing not to invest in this opportunity might be perceived as a lack of commitment to the plans which may have political ramifications.

It would help drive income levels to the EZ as more businesses decided to locate at AP to make use of the facilities and it would complement facilities at Manchester, Liverpool and Daresbury, helping to firmly cement the reputation of the North West as a place to make bio-medical investments.

Concentrating on helping small to medium sized businesses (SMEs) would enable more products and services to be bought to market, creating jobs not just within those businesses but within the supply chain.

The fund would help address market failure as banks are generally unwilling to lend at the small end of the market. This has been borne out by the substantial over-subscription of the current fund.

Investment in the fund is, however, not straightforward. There are strategic and financial risks. The scale of the investment would commit virtually all the funds available or potentially available to the LEP, leaving little scope to invest in projects in other equally deserving key sectors, for a significant period of time. Opportunities in these sectors are not currently identified and may not materialise. Nevertheless, once committed to the Life Sciences Fund, unless other sources of funding become available to the LEP, we have significantly reduced financial capacity to support them.

Assumptions have also been made that the investment needed can be funded from a combination of expected returns from the original Life Sciences Fund and new capital funds, e.g. the Shared Prosperity Fund, and if these fail to materialise when, or in the quantum, needed, the gaps can be bridged by using Growing Places Funding. This is discussed more fully in the Financial Case.

7. Economic Case

The options analysis is appropriate for the business case and considers whether the fund could be delivered at a different size and the implications of each.

The business case describes the benefits expected from this investment. We do not have alternative projects identified which can be used to make comparisons. It is therefore a judgement call on whether this would be the best use of the LEP's limited resources, or whether better outcomes could be achieved investing in another sector, unlocking development sites, or to allocate to further funding to programmes such as Accelerate.

However, the fund is expected to be generate the following outputs. There are based on the outputs achieved by the current fund. The level of outputs could be adjusted based on the investment criteria set, if a new fund was developed.

Output	
Jobs created	997
GVA	£65m
Co Finance	£40m
Private match (investment level)	£85m
Businesses supported	81
Increase in EZ income*	£704k pa

*based on number of businesses occupying space at AP that have received support through the existing fund.

There is a sound basis for the outputs estimated and the have been reviewed independently by an economist that felt they may be on the conservative side.

Based on the outputs above the BCR 3:1 showing excellent value for money. The project is also very likely to have supply chain benefits which have not been calculated as well as the reputational benefits of further enhancing the life science sector in the region.

8. Commercial Case

Investment funds are not unusual and there are many potential fund managers capable of operating the envisaged Life Sciences Fund. The experience of the first Life Sciences fund including aspects of the deal structure, performance management of the fund managers etc will improve the specification and contracting. The procurement of the project will be managed by GMCA's procurement team and will follow the government's Find a Tender processes (which replaces OJEU). It would be beneficial if the investing partners agreed to be represented and advised collectively by one set of legal advisors, thereby avoiding multiple negotiations with procurement and legal advisers if each acted independently.

The legal structure is expected to be similar, if not identical, in form to that of the current fund; each investing party (the LEP, Bruntwood and GMCA) becoming partners in a limited liability partnership. This means the LEP's share of the partnership would be included as an asset on the LEP's balance sheet.

9. Financial Case

Bruntwood and GMCA have confirmed that their funding is secured, but on the understanding that the minimum "workable" size of the fund is £25M and therefore subject to the LEP contributing £10M to a new fund. There is the potential to increase the size of the fund through funding from the British Business Bank, but this is far from secure. Cheshire East has confirmed that it is not able to commit to a new fund.

Proposed funding:

Funder	Amount (£m)	Status
GMCA	£10	Committed
Bruntwood	£5	Committed
CWLEP	£10m	uncommitted
Sub total	**£25m**	
British Business Bank	£20m	uncommitted
Total	**£50m**	

In order to meet the £10M requirement, assumptions have been made that the investment can be funded from a combination (£5M) of expected returns from the original Life Sciences Fund and (£5M) of new capital funds, e.g. the Shared Prosperity Fund, and if these fail to materialise when, or in the quantum, needed, the gaps can be bridged by using Growing Places Funding. These assumptions need to be examined closely.

The LEP's investment in the new fund is not expected to be needed until after GMAC and Bruntwood have invested, namely towards the end of the investment period of the new fund and therefore from, say, 2024-25. This is equal to year 9 of the original Life Sciences Fund, and slightly earlier than the planned realisation phase of the fund. While it is possible that the asset value of the LEP's share in the original fund will exceed £5M (i.e. half the value invested), it is also possible that realisations and withdrawal of the funds may not provide sufficient cash flow to meet the investment requirements to the new fund.

While new capital funds for local investment such as a Shared Prosperity Fund are expected from Government, there are no guarantees that LEPs will be the recipients or the channel through which such funds will be allocated, or that such funds could be used to repay temporary funding. Indeed, if the commitment has already been made to the fund, there is little incentive to Government to replace it with a subsequent allocation.

Given the inherent risks in the availability of funds from the proposed sources, mitigation will need to be provided by "earmarking" GPF funds for deployment into the Life Sciences fund from 2024-25 onwards. Given the committed value to the new fund, the earmarked amount, would be the entire balance of GPF (see Appendix 11.2). Any use of GPF to bridge or fund the

Life Sciences commitment should initially be considered a loan to the LEP, not a grant, repayable when or if grants are received or from the realisation proceeds of the second fund.

GPF could therefore be used to fund other projects in the short term so long as it was repaid by 2023-24, but commitments beyond that should be avoided until the proposed funding becomes clearer and more secure.

10. Management Case

The management approach is appropriate for a fund of this size and nature. It is proposed that the management processes in place for the current fund are broadly replicated for this fund. The current structure is that a fund management company is appointed. They then report to their own Investment Committee to have investments approved.

The fund managers separately report to an Investment Advisory Panel which is chaired by an independent person, with representatives from each of the partners. The onus is on the IAP to have sufficient skills to manage the performance of the fund manager.

The project timetable for establishment of a new fund has been updated from the Business case and while challenging is achievable, if the LEP is able to confirm its commitment.

Milestone	Start date	Finish Date
LEP Board Approval		January 2021
Performance and Investment ratification		February 2021
Contributions of partners agreed		January 2021
Draft Invitation to tender	December	January 2021
Draft LPA and FMA	December	January 2021
Establish New LLP		February 2021
Tender Period	February	March 2021
Appoint new fund manager		April 2021
Launch new fund		May 2021
Investment Period	May 2021	May 2026

A risk register has been included and is appropriate for this stage of the project and draws on the lessons learnt from the first fund.

11. Appendices

11.1. Final Business Case (attached)

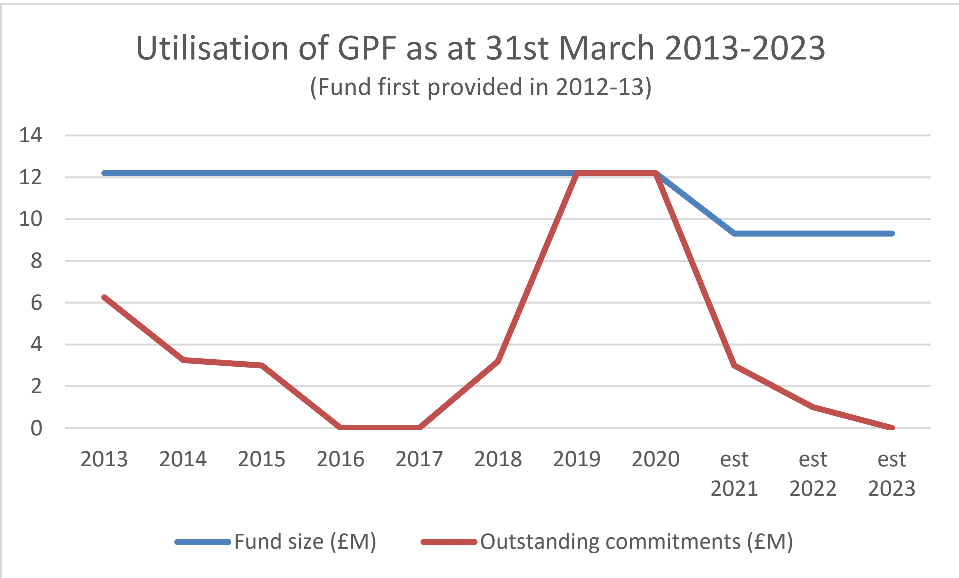
11.2. Background of Growing Places Funding (GPF)

GPF was first awarded to the LEP in 2012. Over the years, there have been a total 19 applications to the fund (including EZ) requesting a total of £31m, and the amount lent, due to the revolving nature of the fund has reached £19m. In the first two years four loans were made totalling £6.26m which were used to facilitate three new housing developments and the infrastructure works at Omega. A further investment was then made in Cheshire Green Employment Park in 2017. However, there have been times where the LEP held a significant balance for a number of years and come under pressure from BEIS to utilise the funding. All recent loans have been into Enterprise Zone (EZ) investments which are due to be repaid by drawing on the EZ loan facility.

In 2020-21, GPF has been used or committed as grant, permanently reducing the fund, to support business case development and the Business Restructuring grants programme.

The current balance of GPF is £0. Repayment of the EZ loans is expected to be complete in 2021-22 and the Cheshire Green Loan is due to be fully repaid by September 2022. It may be repaid earlier as interest continues to be strong in the site (The loan is repaid out of the proceeds of the sale of plots).

The graph illustrates the utilisation of GPF over the years.



The table summarises the current position on GPF.

	£m
Original Fund	12.1
Less: Grants Awarded / Committed	
Business Case Development	(1.2)
Business Restructuring Grants	(1.6)
Available Fund	9.3
Outstanding loans	
Cheshire Green (repaid by 2022-23)	(2.8)
Enterprise zone (repaid by 2021-22)	(6.5)
Current Balance	-
Balance at 31 March 2023	9.3