



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Richard McIndoe, Director of Strathclyde Pension Fund

Item 5

21st June 2023

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Direct Impact Portfolio (DIP)
Investment Proposal – Par Equity Northern Scale-Up Fund

Purpose of Report:

To set out a proposal for an investment of £25m within DIP.

Recommendations:

The Committee is asked to **APPROVE** an investment of £25m in Par Equity Northern Scale-Up Fund by DIP.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes ☐ No ☐ consulted: Yes ☐ No ☐

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1 Background

1.1 Portfolio Establishment

In December 2009, the Strathclyde Pension Fund Committee agreed to establish a New Opportunities Portfolio (NOP) with a broad remit to invest in assets for which there was an attractive investment case but to which the current structure did not provide access.

1.2 Review

The NOP strategy has been subject to 3-yearly reviews with the name changing to the Direct Investment Portfolio in 2015. The most recent review was concluded in November 2021. This made no change to the objectives, structure, overall size parameters, risk and return parameters, or governance structure, but did result in an increase in the individual investment size parameters and a further name change to the Direct Impact Portfolio (DIP).

1.3 Implementation Framework

DIP investment proposals are assessed on their own merits within an agreed implementation framework based on SPF's overall risk-return objectives and specific DIP parameters.

The framework agreed at the 2021 review is summarised below.

Direct Impact Portfolio	
Objectives	Primary objective identical to overall SPF investment objective. Secondary objective of adding value through investments with a positive local, economic or ESG (environmental, social, governance) impact.
Strategy & Structure	In line with SPF risk-return framework but focused on the UK and the Equity, Long Term Enhanced Yield and Short Term Enhanced Yield asset categories.
Risk and Return	Portfolio benchmark return of CPI +3% p.a. Individual risk and return objectives for each investment.
Capacity	Target allocation of 5% of total Fund (based on Net Asset Values). Range of 2.5% to 7.5% of total Fund.
Investment Size	Target: £30m to £100m Minimum: £20m Maximum: greater of £250m or 1% of Total Fund Value
Decision Making	3 stage process with review and satisfactory due diligence by officers, followed by a presentation to the Sounding Board before a proposal is taken to Committee for approval subject to completion of legal documentation.
Monitoring	Includes individual investment reports, participation in advisory boards, and a quarterly DIP monitoring report which is reviewed by the Fund's Investment Advisory Panel.
Co-investment	Existing co-investment programme should be extended in order to maximise its effectiveness, subject to development of a detailed proposal.

The following proposal has been assessed using this framework and has been reviewed by the SPF Committee Sounding Board.

2 New Investment Proposal

2.1 Key Terms

Name	Par Equity Northern Scale-Up Fund
Investment vehicle	UK Limited Partnership
Manager	Par Fund Management Ltd
Sector	Venture Capital
Investment objective	To invest in early stage, high growth technology companies in the north of the UK
Term	10 years (plus up to 2x1 year extensions)
Target size	£100m (Hard Cap £120m)
Proposed DIP investment	£25m
Target return	20% IRR (Net) / MOIC 3.0x

2.2 Investment Summary

The Par Equity Northern Scale-Up Fund (PE NSUF) has been created to invest venture capital (VC) funding into the most promising technology companies in the northern part of the UK (NUK). The fund aims to contribute towards bridging the financing gap that exists between early-stage seed, grant and/or business angel funding, and large-scale institutional investment capital in the NUK.

This financing gap is commonly referred to as Series A (or Scale-Up) financing and relates to investments in amounts between c.£3m-£15m, potentially spread across several funding rounds, to finance the commercialisation of new technology from the early revenue stage to full market acceptance and beyond.

The fund will focus on B2B (Business to Business) technology with strong intellectual property (IP) characteristics and scale-up potential.

An investment of £25m by DIP in the PE NSUF is proposed.

More information on the Manager is included in **Schedule 1**.

2.3 Investment Rationale

The VC industry is heavily weighted towards firms located in London and the South-East. While the majority of technology start-ups are created in the southern half of the UK (SUK), the ratio of VC funding actually invested to the number of scale-up opportunities is disproportionately skewed to the SUK, and in particular to the greater London region.

Recent independent research undertaken in 2020/21 by PwC and the Scale-Up Institute found that the greater London area accounted for c.20% of the identified scale-up opportunities yet attracted 64% of the VC funding invested in the period. The equivalent figures for the NUK were 30%/9% respectively which highlights the disparity. The balance represents the SUK region (ex-London).

This relative scarcity of scale-up funding and its adverse effect on the development of young, innovative technology companies in Scotland/NUK was one of the key findings of the Scottish Technology Ecosystem Review (STER) commissioned in 2020 by the Scottish Government and written by Mark Logan, ex-COO of Skyscanner. Andrew Noble (PE Partner) co-authored the subsequent STER Investment Implementation Addendum with Logan in March 2021, which has influenced the development of the PE NSUF.

Research by the British Business Bank in 2021 reaffirmed the catch-22 situation that VC firms tend not to undertake many deals where the investor and investee are more than 2 hours travel time apart and that 80%+ of VC firms are based in London. These firms are unlikely to establish regional offices in the absence of sizeable technology ecosystems and/or pipelines of new opportunities. The NSUF is seeking to contribute towards addressing this anomaly.

Through its long-standing presence and profile in the NUK business angel / EIS (Enterprise Investment Scheme) investment markets and its recent award-winning achievements, PE already sees a strong deal flow of scale-up opportunities. Indeed many of PE's own earlier stage, but maturing, angel / EIS portfolio investments would be suitable for the NSUF. Any potential conflict of interest in this specific scenario would be addressed by strong governance controls and by such investments being led (and valued) by other third-party investors.

The Manager envisages the fund investing into IP-rich technology opportunities in the following sub-sectors:

- Enterprise Software;
- Healthcare & Medical Devices;
- Energy & Resources;
- Food Security;
- Industrials and Space;
- Digital, Media & Entertainment.

The NSUF's first close is anticipated in July and is anticipated to be in the amount of c.£30m. This will comprise £15m from Scottish National Investment Bank (SNIB) (plus an additional £5m in subsequent closes); £7m from British Business Investments (BBI); £4m from the Par Investor Network (PIN), £1.25m from two family offices and up to £4m from other PIN / HNWI investors. PE will also be committing £1.5m.

It is proposed that the DIP investment would be committed as part of the second close, which is targeted for later in Q3 2023. There are multiple other potential investors in advanced due diligence for the second/subsequent closes.

2.4 Risks

The main risks of the proposed investment are considered to be as follows:

- Origination Risk;
- Investment Risk;
- Key Personnel Risk.

A summary of risks and key mitigants is contained in **Schedule 2**.

2.5 Projected Return

The fund is targeting an investment return of 20% IRR (Net). This is considered appropriate for a VC fund investing in early-stage technology companies, which is considered to be at the higher risk end of the investment spectrum.

2.6 Exit

The fund will have a basic term of 10 years comprising a 5-year Investment Period (IP), followed by a holding period of 5 years with up to 2x1 year extensions. Repayment of capital and investment returns are expected from asset realisations after typical holding periods of 3-5 years.

2.7 Fees

The management fee is typical of the managers in DIP's equity/VC portfolio. The fee will be calculated on investor commitments during the IP and thereafter on the invested capital, which is in line with market practice.

Carried interest provisions also apply. These are structured such that Par require to perform strongly before they benefit under them, however 20% of any carried interest earned will be donated to the Par Foundation (see Schedule 3 for more details).

The management fee and carried interest provisions are in line with DIP's experience of the VC market.

2.8 ESG and Impact

Par Equity take a proactive approach to ESG and Impact and while the fund is not an "impact" fund as such, the Manager is a certified carbon neutral organisation, has recently become B Corp Certified and is a founder member, signatory and/or supporter of a variety of organisations which aim to improve the ESG credentials of both VC managers and investee companies alike in becoming more sustainable, diverse, and better corporate citizens.

A summary of the fund's ESG and Impact factors are contained in **Schedule 3**.

2.9 Investment Size and Cash Requirements

SPF Fund value at 31 st March 2023	£27,718m
DIP allocation (target 5% of main fund) NAV	£ 1,386m
Current DIP NAV	£ 1,394m
NAV Range (Lower) 2.5%	£ 693m
NAV Range (Upper) 7.5%	£ 2,079m

2.10 Investment Strategy

The proposed investment falls within the Venture Capital sector and therefore the Fund's Equity allocation. Equity is a key area of investment focus for DIP.

Allocations following this investment, based on Fund values at 31st March 2023 and total DIP commitments to Equity, would be as follows:

Equity, £ in DIP	£303m
Equity, % in DIP	15%
Equity, % of Total Fund	1%
Equity, % Total Fund (target 52.5%)	56.3%

3 Policy and Resource Implications

Resource Implications:

Financial: Investment of £25m to be drawn as required. Fee structure is considered to be in line with the market.

Legal: The investment will be subject to satisfactory completion of due diligence, including review and execution of appropriate legal documentation.

Personnel: None

Procurement: None

Council Strategic Plan: SPF supports the mission: ***to enable staff to deliver essential services in a sustainable, innovative and efficient way for our communities***. The LGPS is one of the key benefits which enables the Council to recruit and retain staff.

Equality and Socio-Economic Impacts:

Does the proposal support the Council's Equality Outcomes 2021-25? Please specify. Equalities issues are addressed in the Fund's responsible investment policy.

What are the potential equality impacts as a result of this report? None

Please highlight if the policy/proposal will help address socio-economic disadvantage. None

Climate Impacts:

Does the proposal support any Climate Plan actions? Please specify: Yes – Par Equity is a certified carbon neutral organisation and has recently become accredited as a B Corp Certified organisation, which means that they have been

independently verified as meeting a high standard of social and environmental performance. This is consistent with Strathclyde Pension Fund's Climate Change strategy, which is being developed in line with Item 34 of the Council's Climate Action Plan.

Par are also active supporters or signatories of various initiatives which seek to promote the environmental (and social) credentials of both the VC industry and the companies in which it invests.

What are the potential climate impacts as a result of this proposal?

No specific contribution from this proposal, although there are anticipated to be a number of investments in the sustainability space and which will result in the reduction or displacement of carbon emissions.

Will the proposal contribute to Glasgow's net zero carbon target?

No specific contribution from this proposal.

Privacy and Data Protection Impacts:

To be fully provided for in the legal documentation for the proposed investment.

Are there any potential data protection impacts as a result of this report
Y/N

N

If Yes, please confirm that a Data Protection Impact Assessment (DPIA) has been carried out

4 Recommendations

The Committee is asked to **APPROVE** an investment of £25m in Par Equity Northern Scale-Up Fund by DIP.

Schedule 1	Investment Manager: Par Fund Management Limited
Schedule 2	Investment Specific Risks
Schedule 3	ESG and Impact

Investment Manager: Par Fund Management Limited

Founded in Edinburgh in 2008, Par Equity (PE or Par) is an experienced and successful VC manager which focuses on business to business (B2B) and/or deep technology opportunities mainly in the North of the UK (NUK).

Par has developed an innovative and successful model for investing VC funding as well as technical and commercial expertise into early stage, high growth technology opportunities, and currently has Assets Under Management (AUM) of £173m.

To date PE has operated on a business angel / EIS investment funding structure with over 200 private individuals/investors in its UK and US networks, many of whom are technology specialists in their own fields and well placed to both originate new opportunities and/or contribute to the appraisal process of others. As an earlier stage investor, the PE angel network typically invests between £0.5m to £3.5m per opportunity.

PE has a highly experienced management team with extensive digital technology investment experience in both the UK and US. The fund manager is led by Managing Partner Paul Munn and Partners Andrew Castell, Paul Atkinson, Andrew Noble and Robert Higginson who between them have extensive accountancy, commercial, entrepreneurial and investment experience.

Par has to date undertaken 73 investments, of which 45 remain invested and 28 have been realised. The realised investments alone (all exits, regardless of outcome) have generated an IRR of 24% and MOIC of 3.2x (based on a combined total cost £43m / total realisations £137m) which puts Par in the top quartile of VC investors in Europe.

Par won the Best EIS Investment Manager award in both 2021 and 2022 (from the EIS Association) out of c.80 UK EIS managers. From the UK Business Angel Association (UKBAA), Par won the Best Angel Group in the UK award in 2021 (out of 70 applicants), the first time a VC firm has won both these awards in the same year. Also from the UKBAA, Par won the Best Exit (2021); Best Scale-Up Team of the Year (2021); and Most Active Investor in the Regions (2022) awards.

Par also won the Best Exit (2021) and Most Impactful Regional Investment (2022) awards from the Growth Investor Awards, and at the European Private Equity Awards were finalists for 2 awards (2022), namely Best VC House of the Year and Best Exit of the Year.

A proposed investment by DIP of up to £20m was approved by the SPF Committee in 2018 to the Par Equity Healthtech Fund, subject to Par securing a certain level of additional commitments from other investors. In the event however they were unable to secure sufficient support and the Committee's investment approval subsequently lapsed. In hindsight the main reason for this was that the healthtech sector in isolation was considered to be too narrow in scope and is the reason that it is now one of six sectors targeted by the NSUF

Investment Specific Risks**Origination Risk**

Par Equity are long established with a relatively high profile in the VC investment market and currently receive a high volume of inbound opportunities for their angel and EIS investment vehicles (1,000+ opportunities p.a. of which they would typically invest in only 6-8). Of this pipeline c.100 approaches would be suitable for the proposed NSUF, which is in addition to the potential suitability of Par's existing portfolio of investee companies. While only a modest number of these opportunities will meet the fund's full investment criteria and be of sufficient quality, it demonstrates the profile and reach of Par's existing business and network. This and the largely unmet need for scale-up capital in the NUK leads to the view that the origination risk is relatively low.

Investment Risk

The proposed investment is into a VC fund, which operates in a relatively high-risk segment of the investment market with no guarantee of success. A VC fund would typically anticipate experiencing a number of outright investment losses, a larger number of moderately successful investments and hopefully one or two "stellar" investments, which combine to generate the relatively high/blended targeted return. The principal comfort in this regard is PE's successful track record in its previous investments.

Key Personnel Risk

The risk of over-reliance on key personnel is pertinent to any manager. Par however has enjoyed a stable senior team over the years since its establishment in 2008 with the addition of multiple additional personnel in both the investment and administrative teams particularly over the past 5/6 years. The volume of opportunities currently received and processed on an annual basis reflects the profile of the Par business and its investment teams within the market. Par's resource is therefore considered to be sufficient to successfully manage the proposed NSUF.

ESG and Impact

Par Equity are committed to being responsible investors and this is manifested by their commitment to multiple organisations which seek to promote the impact of both their own industry as well as the companies in which they invest. By their nature the latter are typically fledgling organisations often lacking the knowledge and resources to develop their ESG/Impact policies and credentials.

Alongside the British Venture Capital Association (BVCA), Par are on the steering committee of ESG_VC which is supported by more than 125 VC firms in the UK, Europe and the US. The initiative is a response by the VC industry to the social, environmental and economic challenges that are increasingly impacting early-stage businesses. It aims to standardise ESG reporting across early-stage VC investing, making it fit for purpose, easy to benchmark and ultimately raising standards across the industry.

The Manager is also a signatory of the Investing in Women Code and an active supporter of The Future VC Programme, which aims to improve the inclusiveness of the VC industry. Par are also signatories to Tech She Can, the Tech Talent Charter and Moving Forward. These programs aim to improve diversity in the tech and VC ecosystems and create fair and equal working conditions for employees in the technology sector.

In 2021, PE helped to launch (and continue to support) Mint Ventures, a female-only angel investment group in Scotland, which aims to encourage more female investors into Scotland's tech ecosystem.

Very recently PE were formally accredited as being B Corp Certified. This is a designation that a company is meeting a high standard of verified social and environmental performance, accountability and transparency on factors ranging from employee benefits, charitable giving and supply chain practices etc. The status requires a commitment to continuous ongoing improvement and is formally reassessed on a 3-yearly basis.

The Par Foundation will be established on the fund's launch. This charitable body will receive 20% of any carried interest earned by the Manager to be used towards ecosystem building initiatives e.g. improving computer science participation in schools, P2P networks and/or furthering gender participation in technology companies.