GREATER**LONDON**AUTHORITY

REQUEST FOR MAYORAL DECISION – MD2556

Title: Recycling Returns from the London Co-Investment Fund

Executive Summary:

This MD seeks approval to allow SME Wholesale Finance Limited (SMEWFL) to reinvest the returns generated by the London Co-Investment Fund (LCIF) up until 2023, subject to certain conditions being met.

LCIF was set up by SME Wholesale Finance Limited in December 2014 to invest in equity investments in early stage start up and seed stage high growth SMEs using, in part, GLA funding approved under cover of MD1345. LCIF's investment period came to an end on 31 March 2019. The funding agreement between the GLA and SMEWFL contained a provision that a decision would be made on whether the returns from LCIF investments should be returned to the GLA or whether they might be reinvested in the current or any follow-on fund.

The funding arrangements approved under cover of MD1345 and reflected in the GLA's current funding agreement with SMEWFL provide that the GLA is entitled to returns on LCIF investments. This MD seeks the Mayor's approval to the GLA's consent to LCIF recycling such returns (generated before 8 May 2020) until 2023 to create and safeguard more jobs and provide a catalyst for business growth by investing in follow on funding for the businesses already invested in.

Decision:

That the Mayor approves the GLA's variation of its funding agreement with and the subsequent notification of SMEWFL that it consents to GLA Returns generated prior to 8 May 2020 to be reinvested in the London Co-Investment Fund (LCIF) back in to the existing portfolio companies as 'follow on' funding for a further period up to June 2023 and on the basis that:

1. such investments must be made on the commercial merits of each follow-on opportunity and in accordance with the current LCIF follow-on policy;
2. the selection of follow-on investment propositions would be across the entire portfolio of LCIF, i.e. across all sectors previously invested in; and
3. in the event that substantial exits are achieved during that period preference for such investment will be given to new businesses that are: (i) sub-sectors within the science, tech and digital sectors, where a continued market failure was evidenced; (ii) entities founded by women and BAME entrepreneurs; and/or (iii) entities based in outer London.

Mayor of London

I confirm that I do not have any disclosable pecuniary interests in the proposed decision and take the decision in compliance with the Code of Conduct for elected Members of the Authority.

The above request has my approval.

Signature: Sadiq	**Date:** 7/1/20

PART I - NON-CONFIDENTIAL FACTS AND ADVICE TO THE MAYOR

Decision required – supporting report

1. Introduction and background

1.1. The London Co-Investment Fund (LCIF) was established by SMEWFL in December 2014, following agreement by the previous London Local Enterprise Partnership (LEP), to allocate £25m of the Growing Places Fund into equity investments in early stage start up and seed stage high growth SMEs, as approved by the former Mayor under cover of MD1345. The intervention aimed to address the funding gap which had been identified as preventing science, digital and technology businesses from growing due to the lack of risk capital needed to accelerate growth and create jobs. This lack of funding meant companies could potentially start locating elsewhere particularly the USA and China where risk capital was prevalent.

1.2. LCIF is a part private/public led co-investment fund, based on the successful Scottish Co-Investment Fund model which has operated since 2003. It is the second largest co-investment fund focused on early stage venture capital in the UK.

1.3. The fund was established and is delivered by SMEWFL which trades as "Funding London" – itself established by the London Development Agency (LDA) in 2004 as an arms-length entity for the purpose of providing and administering venture capital and loan funds to London based SMEs, which found it difficult to access traditional sources of finance. A number of investment funds have been disbursed through Funding London since its inception, including the London Technology Fund (£15m), the Creative Capital Fund (£4.6m), the MMC London Fund (£14m), the London Co-investment Fund (£25m) and the £100m Greater London Investment Fund (GLIF).

1.4. LCIF was designed to meet the growth capital needs of SMEs as they emerged from London's leading public and privately funded accelerators, incubators and support programmes. It is funded from two sources – a £25m grant from the London LEP's Growing Places Fund, and £1.6m from Funding London itself. Of this £26.6m sum, just over £3m (11%) is allocated to support the running costs of LCIF over the initial 10-year lifespan, with £22.9m available for investment.

1.5. One of the explicit aims of setting up SMEWFL was that it would enable the repayments from venture capital and loan fund investments to be held in a permanent, legally recognised vehicle for the purposes of reinvesting the proceeds for similar initiatives in the future. Both the MMC London Fund and the London Co-Investment Fund have been partly funded by returns from the earlier funds. As stated in the original approval document MD1345, LCIF was designed in a way to enable repayment of the GLA's £25m back to the organisation.

1.6. In June 2017, under cover of MD2086, the Mayor approved the acquisition of SMEWFL by the GLA becoming its sole company member and guarantor. As such, SMEWFL became a wholly owned subsidiary company of the GLA.

1.7. The LCIF is one of the most active investment funds of its kind in Europe, having closed 189 investments in 150 companies since its inception. The fund is seen as an important participant in the early stage technology ecosystem, by its investees, co-investment partners and other stakeholders. The LCIF brand is strong and is widely recognised as being associated with the Mayor of London and as part of London's strategy to support SMEs in the science and technology sectors.

1.8. The LCIF is currently exceeding the initial expectations set out in the 2014 business plan:

- on investments, LCIF has now deployed its full quota of funds into 150 companies via 189 investments;
- its co-investment multiple is well ahead of the initial 2.9:1 target, with its current multiple across the fund standing at 7:1, which has resulted in over £160m leveraged from the private sector – well over double that envisaged at inception; and

- on jobs created, the target of 2,653 is set over the life of the fund, currently the amount of FTE jobs created stands at 2,080. It is expected that an additional 2,980 FTE jobs will be created by the end of the Fund's life which will far surpass its initial target.

1.9. An interim evaluation of LCIF was carried out in February 2019. It found that as of 30 September 2018, LCIF companies had produced c£65m of revenues. This equates to average revenues of £528k per business, a significant achievement considering that almost all investees were at pre-revenue stages when first receiving investment from the LCIF.

1.10. The LCIF's investment period came to an end on 31 March 2019. The agreement between the GLA and SMEWFL in respect of LCIF, provides for a decision to be made before the end of the investment period on whether the returns from LCIF investments should be paid to the GLA or whether they might be reinvested in the current or any follow-on fund. This decision would have been made prior to the end of the investment period however due to delays in the LEAP proposal papers and subsequent meetings this initial deadline was missed. The GLA has worked with SMEWFL throughout to keep them updated on the progress of the decision. There are currently no plans in place at the GLA for providing further investment capital to allow for continuance of the fund. There is no other initiative available to take the place of LCIF and this is already having a negative impact on the early stage eco-system as LCIF injected, on average, £5.4m per annum.

1.11. A proposal paper was taken to the London Economic Action Partnership (LEAP) Board on 12 June 2019 which outlined three options for the future of the fund. It should be noted that whichever option was selected, following the May 2020 Mayoral elections an incoming Mayor would have the option to change this in line with the LCIF funding agreement should they want the funding paid back to the GLA from that point onwards. All options given were based on 2023 as this is the date that Funding London's operational costs are secured until in the original grant agreement:

- Option 1 – use the returns from exit of investments to fund other LEAP objectives, with a review point in 2023 to consider the future approach to any outstanding returns.
- Option 2 – recycle the returns from the exits until 2023 to deliver further jobs created / safeguarded and providing a catalyst for business growth by investing in new businesses with a refined sectoral focus.
- Option 3 (selected) - recycle the returns from exits until 2023 to deliver further jobs created/ safeguarded and provide a catalyst for business growth by investing in follow on funding for businesses already invested in.

1.12. The board agreed option 3 was preferential, and suggested the following decisions be sought from the Mayor:

a) that the recycling of returns from LCIF to fund further early stage companies and provide follow on funding for businesses already invested in be endorsed;

b) that the targeting of investments at sub-sectors within the science, tech and digital sectors, where a continued market failure was evidenced, be endorsed;

c) that the targeting of investments at companies founded by women and BAME entrepreneurs be endorsed;

d) that efforts be made to ensure companies based in outer London were targeted for new investments;

e) that the specific sub-sectoral scope be agreed in consultation with LEAP Members; and

f) that the proposal for reinvestments to continue until June 2023, with a view to potentially making LCIF an evergreen fund in the future, forming part of the London Growth Hub's offer to early stage companies, be endorsed.

1.13. Following the LEAP Board meeting, a follow up meeting took place on 11 September 2019 to clarify the detail of the decision that was made at the LEAP board meeting. At this meeting it was agreed that:

a) funds available from exits should be primarily re-invested in follow-on funding rounds in the existing LCIF portfolio, as new funding rounds were unlikely to be viable based on current forecasts for returns;

b) the investments should be made on the commercial merits of each follow-on opportunity and in accordance with the current LCIF follow-on policy;

c) the selection of follow-on investment propositions would be across the entire portfolio of LCIF, i.e. across all sectors previously invested in;

d) if substantial exits were achieved during the period to June 2023, the decision to continue re-investing should be revisited in discussion with the GLA and LEAP Members. Whilst this would be identified through ongoing dialogue with the GLA, a formal review of the approach would be triggered once £10 million of cumulative funds had been made available for re-investment across the LCIF portfolio at any time before June 2023. This figure was considered to be adequate in size in order to attract the other co-investment partners and therefore trigger a new funding round.

e) any new investments made would be in line with Mayoral priorities, LCIF would look specifically to support businesses from underrepresented groups from London who are less likely to access conventional VC funding and therefore any investments in new businesses would need to be targeted at:

i. Sub-sectors within the science, tech and digital sectors, where a continued market failure was evidenced;
ii. Companies founded by women and BAME entrepreneurs; and/or
iii. Companies based in outer London.

1.14. The Greater London Investment Fund (GLIF), which launched on 30 May 2019, is complementary to LCIF. It targets companies beyond seed stage and will invest in all of London's priority sectors as listed in the Economic Development Strategy. GLIF's overarching strategy is to provide finance for innovative SMEs to allow them to scale-up and achieve their growth ambitions. Businesses that are seeking to scale-up can play a key role in supporting economic growth and job creation. GLIF differs from LCIF in that it is made up of different types of funding; it offers both equity and loans and is delivered as a fund of funds through its investment managers – MMC ventures and the FSE Group. The amount of funding available is higher than LCIF with the equity arm being able to invest up to £2million for Series A funding. There is also a much larger focus on the circular economy with £14 million set a side specifically for businesses which operate as circular systems.

1.15. The need for the funding is still high. The interim evaluation has highlighted the persistence of market failure in the venture capital sector. The most significant change consultees had observed in the funding landscape in London was an increase in the overall supply of investment capital, but a substantial proportion of which has been invested in a very small number of businesses. Data from the Small Business Equity Tracker 2018 supports this finding, showing that SMEs in London received £4.0bn of funding in 2017, up from £1.7bn in 2016 and up from £100m when the LCIF was launched in 2014. Despite this overall increase in the supply of capital, there was shared consensus among consultees that a funding gap remained for businesses in the earlier stage Science, Technology and Digital Sectors, particularly at the Pre-Series A stage (e.g. seed). The key drivers behind the lack of Pre-Series A funding emerging from consultation were:

- the risk profile and lack of track record of early-stage businesses limited the amount of capital investors were willing to invest;
- a significant increase in the number of tech start-ups in London increased competition for available capital;
- despite the number of active angels willing to invest, there are difficulties finding an investor willing to lead a funding round; and
- linked to the above, there are reported difficulties in co-ordinating investors to form a syndicate.

1.16. There is no additional funding allocated to this proposal. Operational costs are secured through to September 2023 through the existing programme (c.£82k a quarter).

2. Objectives and expected outcomes

2.1. By adopting the decisions listed above, LCIF will continue to drive job creation and deliver economic growth in London. It will continue to be an example of a successful public/private venture which has gained approbation within the sector.

2.2. LCIF will continue to build on the good work already accomplished with regard to the diversity and inclusivity of the fund future plans include working with partners and other industry participants to focus on increasing diversity within the venture capital sector.

3. Equality comments

3.1. The Mayor's Economic Development Strategy recognises the importance of the Science, Digital, and Tech sectors and the need for continued support to ensure the growth potential of these economic priorities is exploited fully. Since the launch of the LCIF, it has also been recognised that groups such as women, disabled people and people from Black, Asian and Minority Ethnic (BAME) communities face acute barriers in accessing finance, an issue the Mayor is keen to address. Any future interventions would therefore seek to improve awareness of the access to finance initiatives among these underrepresented groups to encourage increased take-up.

3.2. The latest portfolio analysis in September 2018 stated that 22% of LCIF Founders were female and 20% were from a BAME background. The team at LCIF recognises the importance of furthering the inclusivity agenda in line with the Mayor's strategy and agree that the fund and its partners should continue to demonstrate improving levels of engagement with women, BAME and disabled founders.

3.3. The programme will link with the Mayor's Economic Fairness agenda. The Funding London team in conjunction with the Economic Fairness team will be running short workshops to early stage companies applying for LCIF on the Good Work Standard to raise awareness of the steps required to become a fair and inclusive employer.

3.4. The programme will also link with the Mayor's London Growth Hub to support investment readiness across London's diverse entrepreneurs and enterprises.

4. Other considerations

4.1. There is a risk that sufficient returns are not received to be able to invest money back into the portfolio companies. In order to mitigate this risk, the GLA will continue to work closely with Funding London to ensure appropriate support is being given to companies as well as ensuring regular conversations are being had with co-investors and regular performance updates are being received.

4.2. LCIF equity funding targets seed stage, high growth SMEs in London's strategic sectors of digital, science and tech – thereby addressing the second and third priorities in the Mayor's Economic Development Strategy which seek to address the funding issues still faced by early stage SMEs with high growth prospects.

4.3. It is recognised that the GLA elections take place in May 2020 and an incumbent Mayor may not fetter unreasonably the discretion of any successor administration. Whilst however, the proposals in respect of which decisions are sought involve the entry into arrangements that extend beyond the present Mayoral term, the proposed reinvestment concerns only the reinvestment of GLA LCIF returns generated before 8 May 2020. A successor administration could still therefore, exercise its rights under the LCIF funding agreement including the requirement that further post 8 May 2020 GLA LCIF returns be paid to the GLA. As a result, we are content that the making of the decisions sought do not have the effect of fettering unreasonably the exercise of any successor administration in this regard.

5. Financial comments

5.1 This decision seeks approval to alter the original repayment terms with SMEWFL which included the repayment of the initial £25m GLA grant investment into LCIF. It was anticipated that by 2020 the Authority would start to see these repayments materialise, however this decision is seeking permission to recycle these funds, alongside other returns, back into LCIF instead.

5.2 At present the initial GLA investment has a fair value of £31.7m (as provided by SMEWFL) which will form part of the recycle of the returns up until 2023.

5.3 As SMEWFL is a subsidiary company of the GLA, there is a certain degree of financial risk associated with this decision. As highlighted above in point 4.1 in the event where the returns made prove to be insufficient for the 'follow on' funding, LCIF may look to the Authority to make up for any shortfalls. Furthermore, the GLA will be liable for all investments proposed as written off.

6. Legal comments

6.1. The foregoing sections of this report indicate that:

6.1.1 the decisions requested of the Mayor concern the exercise of the GLA's general powers, falling within the statutory powers of the GLA to do such things as may be considered to further, and or be facilitative of or conducive or incidental to the furthering of, the promotion of economic development and wealth creation in Greater London; and

6.1.2 in formulating the proposals in respect of which a decision is sought officers have complied with the GLA's related statutory duties to:

(a) pay due regard to the principle that there should be equality for all people;

(b) consider how the proposals will promote the improvement of health of persons, health inequalities between persons and to contribute towards the achievement of sustainable development in the United Kingdom; and

(c) consult with appropriate bodies.

6.2. In taking the decisions requested, the Mayor must have due regard to the Public Sector Equality Duty - namely the need to eliminate discrimination, harassment victimisation and any other conduct prohibited by the Equality Act 2010, and to advance equality of opportunity and foster good relations between persons who share a relevant protected characteristic (race, disability, sex, age, sexual orientation, religion or belief, pregnancy and maternity and gender reassignment) and persons who do not (section 149 of the Equality Act 2010). To this end, the Mayor should have particular regard to section 3 (above) of this report.

6.3 Should the Mayor be minded to make the decisions sought officers must ensure that:

6.3.1 the GLA's LCIF funding agreement with SMEWFL is varied to reflect that the GLA's decision on reinvestment of GLA LCIF returns and notification to SMEWFL of the same before any commitment is made to this by the GLA; and

6.3.2 they continue to adhere to the principle that such reinvestment applies solely to GLA LCIF returns generated prior to 8 May 2020 in order (as set out at section 4.3 above) to avoid fettering unreasonably the discretion of any post 2020 GLA election administration and that the GLA enters into and executes agreements with SMEWFL in this regard before any commitment to consent to reinvestment is made.

6. Planned delivery approach and next steps

Activity	Timeline
Reinvestment decision (signed DOV)	10/01/20

Appendices and supporting papers:
None.

Public access to information
Information in this form (Part 1) is subject to the Freedom of Information Act 2000 (FoIA) and will be made available on the GLA website within one working day of approval.
If immediate publication risks compromising the implementation of the decision (for example, to complete a procurement process), it can be deferred until a specific date. Deferral periods should be kept to the shortest length strictly necessary. **Note**: This form (Part 1) will either be published within one working day after it has been approved or on the defer date.

Part 1 – Deferral
Is the publication of Part 1 of this approval to be deferred? YES
If YES, for what reason: Disclosure of the information contained in this MD form before entry into and execution of the documentation required to formalise the GLA's consent for reinvestment of GLA LCIF returns would prejudice the GLA's commercial interests.
Until what date: (a date is required if deferring) 16/01/20

Part 2 – Sensitive information
Only the facts or advice that would be exempt from disclosure under FoIA should be included in the separate Part 2 form, together with the legal rationale for non-publication.
Is there a part 2 form – NO

ORIGINATING OFFICER DECLARATION:	Drafting officer to confirm the following (✓)
Drafting officer: Richard Cumbers has drafted this report in accordance with GLA procedures and confirms the following:	✓
Sponsoring Director: Debbie Jackson has reviewed the request and is satisfied it is correct and consistent with the Mayor's plans and priorities.	✓
Mayoral Adviser: Rajesh Agrawal has been consulted about the proposal and agrees the recommendations.	✓
Advice: The Finance and Legal teams have commented on this proposal.	✓
Corporate Investment Board This decision was agreed by the Corporate Investment Board on 6 January 2020.	

EXECUTIVE DIRECTOR, RESOURCES:
I confirm that financial and legal implications have been appropriately considered in the preparation of this report.

Signature M. D. Ella **Date** 6.1.20

CHIEF OF STAFF:
I am satisfied that this is an appropriate request to be submitted to the Mayor

Signature D. Bellamy **Date** 6/1/2020.