

Establishment of For-Profit Associated Entity – University of North Carolina at Chapel Hill

ISSUE OVERVIEW

In September 2006, the University of North Carolina Board of Governors approved a request from the Kenan-Flagler School of Business of The University of North Carolina at Chapel Hill to establish three associated entities: (1) KFBSF Private Equity Fund I, L.P.; (2) KFBSF Real Estate Fund I, L.P. as for-profit investment funds; and (3) KFBSF, Inc., a North Carolina not-for-profit corporation of which the Kenan-Flagler Business School Foundation, Inc. (Business Foundation) is the sole member and serves as General Partner for the funds. The Board approved similar requests to establish Private Equity Fund II, L.P. (in 2010), Real Estate Fund II, L.P. (in 2011), Real Estate Fund III, L.P. (in 2014), Private Equity Fund III, L.P. (in 2015), and Real Estate Fund IV (in 2017) without tax-exempt status. These student investment funds are all part of an educational program of the Business School and each fund ranges from \$2.5 million to \$6 million in size.

The Limited Partner investors are by invitation only, generally have a relationship with the school, and must meet certain eligibility requirements. In addition to the General Partner, profits are distributed to the Limited Partners. There were 29 Limited Partners in Private Equity Fund I, 38 Limited Partners in Private Equity Fund II, 24 Limited Partners in Private Equity Fund III, and 30 Limited Partners in Private Equity Fund IV. Any funds to the General Partner in excess of expenses are transferred to the Business Foundation.

The General Partner is organized and operated to support the Business School and its educational programs. It is managed under the direction of its board of directors, which consists of seven directors, four of whom are employees of the university and three of whom are elected by the board of directors of the Business Foundation. The General Partner is also an "Associated Entity" under Board rules and has adopted conflict of interest, document retention, and whistleblower policies in accordance with the rules and on behalf of these investment funds.

KFBSF Private Equity Fund IV, L.P. is almost fully invested, and Kenan-Flagler and UNC-Chapel Hill now request authority to establish a tenth student investment fund — KFBSF Private Equity Fund V, L.P. If future students are to participate in this educational program, additional funds will need to be raised and an additional investment fund established. Section 600.2.5[R] (specifically section C.2.) of the UNC Policy Manual, *Regulation on Required Elements of University-Associated Entity Relationship*, requires that associated entities have nonprofit corporate and tax-exempt status unless the Board approves otherwise.

The primary objective of these limited partnership funds is to give selected students hands-on experience in operating private investment funds. To our knowledge, the KFBSF Private Equity Fund was the first student-managed private equity fund in the U.S. These students work with faculty and friends of Kenan-Flagler to identify and evaluate investment opportunities and to make investment recommendations to the General Partner. Students participate, without pay, as part of an investment management course for academic credit. After an investment is made by the partnerships, the students monitor the investment. Through the identification, evaluation and monitoring process, students gain insights into the operation and management of private investment funds and their portfolio companies as well as establish personal and professional relationships with investment managers. A secondary objective is to provide investment returns to the partners who are the investors.

It is recommended that the Board of Governors approve the establishment of KFBSF Private Equity Fund V, L.P. as a UNC-Chapel Hill associated entity and an educational program at the Kenan-Flagler School of Business without obtaining nonprofit tax-exempt status.