

PDC

PORTLAND DEVELOPMENT COMMISSION

DATE: January 26, 2011

TO: Board of Commissioners

FROM: Bruce A. Warner, Executive Director

SUBJECT: Report Number 11-04
Approval of Grant to Portland Investment Intermediary (L.P. in Portland Seed Fund)

EXECUTIVE SUMMARY

BOARD ACTION REQUESTED

Adopt Resolution No. 6844

ACTION SUMMARY

This action will authorize a \$500,000 grant to Portland Investment Intermediary for capital to invest in the Portland Seed Fund.

The City of Portland and the Portland Development Commission (PDC) seek to create the Portland Seed Fund (Fund) to invest in early stage businesses. The Fund will make investments of between \$25,000 and \$100,000 to start-ups at the earliest stage of development. The Fund will fill the most critical gap in funding for growing companies, increasing the job creation prospects for start-up firms and the pipeline of viable companies for later stage investors.

The Fund will be structured as a for-profit entity and be managed by an independent fund management entity (Manager). Because of legal limitations, a separate not-for-profit intermediary named Portland Investment Intermediary (Intermediary) has been established to receive the City's funds and commit that capital, as a limited partner, to the Fund. PDC has already approved a grant of \$40,000 to the Intermediary to provide to the Manager to fund the establishment and initial operations of the Fund (Operating Grant). The Intermediary will negotiate a separate agreement with the Manager regarding the deliverables for receipt of the Operating Grant. At the initial closing of the Fund, PDC's \$500,000 grant will fund the Intermediary's investment as a limited partner in the Fund (Capital Grant).

The Fund expects to raise a minimum of \$2M, inclusive of PDC's grant, prior to its first close. The Manager has received commitments from the Oregon Growth Account (OGA) for \$500,000, contingent on a \$2M close, and the City of Hillsboro for \$250,000. The remaining \$750,000 is expected to come primarily from individual investors, but with potential investments from other local governments and foundations. The first close of the Fund, involving capital commitments of at least \$1M, is expected to occur by March 31, 2011.

PUBLIC BENEFIT

Despite the prevalence of small business activity in the Portland region, the supply of capital for early-stage companies has been limited due to a lack of an institutional mechanism for providing seed capital and a migration by investors, including angels, toward later stage companies. This lack of predictable seed capital has created an insurmountable hurdle for most entrepreneurs looking to move ideas to proven concepts with market potential. While most seed stage companies face long odds in growing a successful business, the lack of seed funds ultimately diminishes the prospects that Portland will be home to frequent entrepreneurial success and significant job and wealth creation. By improving the conditions for survival in the concept stage, the Fund is expected to grow the pool of viable start-ups that win later stage funding and, ultimately, commercial success.

This action will support the following PDC goals:

- Strong Economic Growth and Competitiveness
- Sustainability and Social Equity
- Healthy Neighborhoods
- A Vibrant Central City
- Effective Stewardship over our Resources and Operations, and Employee Investment

PUBLIC PARTICIPATION AND FEEDBACK

The Fund has been presented in front of numerous public audiences beginning in February 2010 with the Mayor's announcement of the concept in his State of the City address. The Intermediary Board was selected based on recommendations from the entrepreneurial and investment communities.

COMPLIANCE WITH ADOPTED PLANS AND POLICIES

One of the themes of the City's Economic Development Strategy is the importance of innovation and entrepreneurship in driving job creation and economic growth in the local economy.

The Fund seeks to support this strategy by improving the conditions for entrepreneurs and start-ups in the nascent stages of their development, in the hopes that these young companies will impact:

- Job creation
- Investment capital leveraged and venture capital attracted to the region
- Investment returns and successful exits
- Experienced entrepreneurs attracted to and retained in the region

FINANCIAL IMPACT

The Operating and Capital Grants will be funded by PDC's General Fund Allocation in Fiscal Years 2009-10 and 2010-11. PDC has no obligation to provide additional grants to the

Intermediary but may consider additional grants to the Intermediary based on the success of the Fund in achieving job creation and firm growth outcomes.

RISK ASSESSMENT

PDC's investment in the Fund is in the form of a grant and will not be repaid. While the Fund will make risky investments in start-up businesses, losses to the Fund do not pose risk to PDC beyond the initial grants.

WORK LOAD IMPACT

Because of the structure that has been established to manage the Fund, this investment will have minimal impact on staff resources at PDC.

ALTERNATIVE ACTIONS

Because of legal limitations, an equity fund managed by PDC was not possible. PDC could, however, choose to operate a debt capital fund with similar objectives. Feedback from the entrepreneurial community indicated that early stage companies want the option of receiving equity investments. In addition, PDC does not possess the internal expertise to manage a risk capital fund and will benefit from professional management of the investment. Lastly, by providing capital to a private fund, PDC will leverage its investment with capital from other public and private parties.

CONCURRENCE

PDC's Financial Investment Committee has approved both grants. The action is consistent with the Economic Development Strategy's focus on supporting entrepreneurship in Portland. In addition, the Finance ReThink process identified venture capital for early stage businesses as an unmet financing need.

BACKGROUND

Fund Overview

The Fund will invest capital in amounts ranging from \$25,000 - \$100,000 in roughly 20 companies per year. The Fund will rely on the following metrics to measure its impact:

- Job creation
- Investment capital leveraged and venture capital attracted to the region
- Investment returns and successful exits
- Experienced entrepreneurs attracted to and retained in the region

The Manager has the discretion to establish the appropriate legal structure for the Fund, and it is anticipated that the Fund will be structured using a standard for-profit partnership structure in which the Manager serves as the general partner and investors serve as limited partners. The

Fund will likely have operating characteristics similar to other venture funds, including a fixed life, carried interest, management fees, investment committee, and board of advisors.

While the Manager is on pace to raise \$2 million, PDC's requirement is that the Manager will match the Capital Grant at least 1:1, with a goal of raising an additional \$1.5 million prior to the final close of the Fund.

Structure and Role of the Intermediary

Because of legal limitations, the Intermediary has been established to receive both the Operating and Capital Grants and serve as a limited partner in the Fund. The Intermediary is a 501(c)(3) not-for-profit corporation with a five person board of directors. The current directors are:

Holly Files (President) – KC Distance Learning
Brent Bullock (Secretary) – Perkins Coie
Diane Fraiman – Voyager Capital
Kanth Gopalpur - Monsoon
Michael Powell – Powell's Bookstore

The Intermediary does not have staff or an operating budget at this time. The board is responsible for all decisions and actions taken by the Intermediary but will not have a role in the management of the Fund. Directors serve for a fixed term on the board.

Responsibilities of the Intermediary

- **Select Manager** - The Intermediary is responsible for selecting the Manager and, in August 2010, selected Bridge City Ventures (BCV) to manage the Fund after an open RFI process.
- **Contract with Manager** - Upon execution of the grant agreement with PDC, the Intermediary will negotiate an agreement with BCV that governs the use of the Operating Grant and outlines the expectation and objectives for the Fund. The Intermediary will invest the Capital Grant according to the same terms and conditions as other limited partners in the Fund.
- **Provide Strategic Direction** - The Intermediary will serve as an informal advisor to the Manager so that the structure and operations of the Fund can achieve the Fund's dual mission of generating returns for investors and improving the access to capital for early stage companies.
- **Serve as Fiduciary for Investment on the Fund** - The Intermediary will have the ongoing responsibility of monitoring its investment in the Fund and of managing any returns to the Intermediary. The Intermediary will reinvest any returns back into the Fund or investment funds with a similar mission.
- **Report on Investment Outcomes** - The Intermediary will make annual reports to the PDC Commission on the performance and economic impact of the Intermediary's investment in the Fund, as well as future investments if applicable.

Structure and Role of the Fund Manager

BCV has been selected as Manager and will perform the duties traditionally associated with the general partner in a venture capital fund: source deals, make investment decisions, manage investments, and generate returns. In addition, BCV will design and establish the Fund as well as raise capital to leverage the Capital Grant.

The BCV investment team is comprised of Angela Jackson and Jim Huston. Jackson and Huston have collectively founded three companies, worked over 40 years in entrepreneurial ventures and technology corporations, and spent 30 years investing in seed and venture backed companies. Ms. Jackson is an active angel investor and management advisor with more than 30 investments. She currently serves as the part-time Director of the Portland State University Business Accelerator. In the past, she has coached and advised entrepreneurs and seed/early stage companies through her firm, AB Jackson Group LLC, where she is Managing Partner. Since 2005, Mr. Huston has served as a Managing Director of Blueprint Ventures, a technology growth capital firm with approximately \$200 million under management. Prior to Blueprint Ventures, Mr. Huston was Director of Strategic IP for Intel Capital and led Intel's IP Acquisition Fund acquiring patents and other IP for growing new businesses at Intel.

Responsibilities of the Fund Manager

- **Establish the Fund** – BCV will perform all tasks required to establish the Fund. In establishing the Fund, BCV will determine the following key attributes to the Fund:
 - i. Overall fund structure;
 - ii. Revenue and expense model for self-sustaining operations;
 - iii. Management and governance of the Fund;
 - iv. Mechanism for generating consistent deal flow;
 - v. Processes for reviewing and approving investments, including the establishment and composition on an investment committee;
 - vi. Processes for managing and exiting investments; and
 - vii. Life of the Fund and mechanism for unwinding investments.
- **Raise Capital** - While PDC and the City will provide assistance in raising the profile of the Fund and identifying potential sources of capital, BCV is leading and staffing the capital raising effort. The Manager's capital raising role will include responsibility for developing documentation legally required for all capital raising efforts, including but not limited to term sheet, private placement memoranda and subscription agreements.
- **Report on Fund Performance** - BCV will make annual reports to the PDC Board of Commissioners and Portland City Council in addition to a range of stakeholders regarding fund performance and economic impact of the companies receiving fund investments.