

DATE: June 26, 2013
TO: Board of Commissioners
FROM: Patrick Quinton, Executive Director
SUBJECT: Report Number 13-26
Authorizing a Grant to the Portland Economic Investment Corporation for Investment in the Portland Seed Fund

BOARD ACTION REQUESTED

Adopt Resolution No. 7012

ACTION DESCRIPTION

This action will authorize an initial \$575,000 grant to the Portland Economic Investment Corporation (PEIC) to support capitalization of the Portland Seed Fund's second fund (PSF II); \$500,000 will serve as a capital grant for investment in local startups and \$75,000 will be allocated to cover administrative costs associated with the PEIC. This action will also authorize an increase in the grant to support capitalization of PSF II of up to \$250,000 in the event additional funds become available for such purposes.

BACKGROUND AND CONTEXT

The Portland Development Commission (PDC) provided \$700,000 in the form of an investment grant to the Portland Seed Fund's first fund (PSF I), as well as \$140,000 in administrative funds to support initial operational expenditures. Given the success of PSF I in stimulating the Portland economy and encouraging promising high tech startups to build and grow their businesses in and near Portland, the City of Portland (City) and PDC seek to capitalize PSF II to invest in additional early-stage businesses. PSF II is an early stage venture fund being formed by Angela Jackson and Jim Huston (the Principals) that will primarily invest in convertible debt and equity securities of privately held companies (the Portfolio Companies) in Greater Portland. The Principals will identify and invest in companies they believe to be capital-efficient growth companies that can demonstrate rapid progress towards their business objectives leading to accretive exits.

PSF II expects to make initial investments of \$25,000 and will reserve approximately 75 percent of the investable capital for follow-on investments. The PSF II investment strategy will be materially similar to that pursued by PSF I. Investments will generally be done with classes of seven to 10 companies; there will be four classes in PSF II, approximately nine months apart. The Principals, in combination with mentors, will provide intensive advice and consultation to the Portfolio Companies during a mentor period of approximately three months for each class, culminating in an Investor Demo Day. PSF II expects to raise a maximum of \$10,000,000 with a minimum offering of \$5,000,000.

Those Portfolio Companies which demonstrate the greatest progress in developing their business and which attract additional investment capital will be top candidates for follow-on investment. PSF II will invest in 30 to 35 companies over three years, with an additional five years for harvesting and managing the portfolio. This diversified portfolio approach offers individual investors the opportunity to build a large angel investment portfolio at a fraction of the dollars and time required if done on their own.

This action also authorizes a grant of up to \$75,000 to provide initial operational resources for PEIC to commence operation. The PEIC is a new 501(c)(4) organized for the stated purpose of promoting social welfare including the advancement of the economic development of Portland by encouraging and assisting industrial and commercial enterprises in locating and expanding in the Portland metropolitan area and attracting investment in catalytic redevelopment projects. The bylaws of PEIC call for an initial Board of Directors of three, with one each appointed by the boards of PDC, Greater Portland, Inc., and the Portland Business Alliance, each organizations dedicated to the advancement of economic development in Portland. It is believed that making the investment in PSF II through the vehicle of PEIC is an optimally prudent method of investing public resources.

Since PEIC is not controlled by PDC or any other governmental entity, it may take interests in the companies receiving funds from PSF II such that they may realize returns on investments if the company is ultimately successful. Under this organizational structure, PDC does not undertake any legal or financial risk or obligation related to the PSF or any of the entities it funds. On the other hand, unlike the structure utilized in the previous funding of PSF I, if any of the business recipients of PSF II funds becomes financially successful and generates profits or funds to be distributed to investors, these funds will be distributed to PEIC. By its articles and bylaws, the Board of PEIC must use these resources to advance economic development in Portland. While PDC does not have a controlling interest in PEIC, it will have a voice in discussions concerning how future investments by PEIC may best be made to promote the interests of the City.

The PDC has obtained assurances from both outside legal and accounting consultants that PEIC is a separate legal entity and that the legal prohibitions outlined above do not apply to PEIC.

Finally, should additional resources be identified in the fiscal year (FY) 2013-14 or FY 2014-15 budgets, this action authorizes an additional grant to PSF II in an amount not to exceed \$250,000.

COMMUNITY AND PUBLIC BENEFIT

In 2011 the Principals raised more than \$3,000,000 for PSF I from public (approximately 55 percent) and private (approximately 45 percent) investors. As of March 31, 2012, capital has been invested in 34 companies that fit the investment strategy: capital efficient businesses with high growth and scalability potential. In less than two years, \$21,000,000 of additional outside capital has been raised and more than 175 jobs have been created by Portfolio Companies. One Portfolio Company was acquired in September 2012 and another in 2013. The PSF I companies' customers and partners include IBM, Intel, REI, Marmot, Nike, Dockers, Twitter, and many more. Portland Seed Fund and its Portfolio Companies have been featured in *Fast Company*, *Wall Street Journal*, *Forbes, Inc.*, *Forrester Research*, and *PE Hub*.

Despite the PSF I successes and the presence of other local accelerators, the supply of early-stage capital for startups is still limited. Companies in the initial phases of their life-cycle face long odds in growing a successful business. Funding during the initial phases is an essential determinant of long-term success. Communities where seed and investment funding is available have an advantage over other communities in developing and scaling successful startups. Supporting a structured institutional funding source, such as the Portland Seed Fund, provides startups with access to early-stage capital and adds a degree of confidence to investors who may now be more willing to make local investments. Like PSF I, PSF II is expected to continue to grow the pool of viable startups that secure later-stage funding and, ultimately, commercial success.

Financial assistance to PSF II is consistent with the focus of the City's Economic Development Strategy on supporting traded sector firms, particularly entrepreneurs and early-stage businesses. PDC's financial support has the potential to benefit local residents by:

- Supporting job creation and retention;

- Attracting outside investment to the region;
- Increasing the local tax base; and
- Encouraging innovation and the development of new products and services.

PUBLIC PARTICIPATION AND FEEDBACK

No direct public participation was solicited in the development of this grant. However, PDC's initial grant to PSF I was presented in front of numerous public audiences beginning in February 2010 with then-Mayor Sam Adams' announcement of the concept in his State of the City address. The Portland Seed Fund has also been well-documented publicly through numerous media outlets, articles, and community events.

BUDGET AND FINANCIAL INFORMATION

There is \$500,000 budgeted in PDC's FY 2012-13 General Fund allocation for this grant. The remaining \$75,000 is budgeted in PDC's FY 2012-13 Business Management Fund. It is possible that PEIC may elect to hire PDC to assist it with distinct organizing task (e.g., set up accounting functions), in which case some of this amount may be returned to PDC in the form of fees for services. Should there be additional resources in the FY 2013-14 or FY 2014-15 General Fund budgets, the Board, through this action, is authorizing an additional grant to PSF not to exceed \$250,000.

RISK ASSESSMENT

The PDC's financial assistance to PEIC for PSF II is in the form of a grant and will not be repaid. While PSF II will make risky investments in startup businesses, potential losses to the PSF II do not pose a risk to PDC beyond the allocated grant amount. When successful investments occur, PEIC's portion of the economic returns will be returned for either reinvestment in the PSF II or in economic development activities that benefit Portland.

ALTERNATIVE ACTIONS

The Board could chose to not grant funds to PEIC.

ATTACHMENTS

- A. Portland Seed Fund II, LP Executive Summary

PORTLAND DEVELOPMENT COMMISSION

Portland, Oregon

REPORT NO. 13-26

ATTACHMENT A


**AUTHORIZING A GRANT TO THE PORTLAND ECONOMIC INVESTMENT
CORPORATION FOR INVESTMENT IN THE PORTLAND SEED FUND**

Attachment A includes this cover page and contains four pages:

- Portland Seed Fund II, LP Executive Summary

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Fund I:*

-  26 investments
-  \$843,000 invested by PSF
-  \$18 Million additional raised
-  125 jobs created
-  1 exit

*As of 12/31/12

Overview:

Portland Seed Fund II (the “Fund”) is an early stage venture fund being formed by Angela Jackson and Jim Huston (the “Principals”). The Fund will primarily invest in convertible debt and equity securities of privately held companies (the “Portfolio Companies”) primarily in Oregon and Washington. The Principals will identify and invest in companies they believe to be capital-efficient growth companies that can demonstrate rapid progress towards their business objectives leading to accretive exits.

The Fund expects to make initial investments of \$25,000 and will reserve ~75% of the investable capital for follow-on investments. The Fund investment strategy will be materially similar to that pursued by Portland Seed Fund I (“PSF I”), a predecessor fund formed by the Principals in 2010. Investments will generally be done with Classes of 7-10 companies; there will be four Classes in the Fund, approximately nine months apart. The Principals, in combination with mentors, will provide intensive advice and consultation to the Portfolio Companies during a mentor period of approximately three months for each Class, culminating in an Investor Demo Day.

Those Portfolio Companies who demonstrate the greatest progress in developing their business and who attract additional investment capital will be top candidates for follow on investment from the Fund. The Fund will invest in 30-35 companies over three years, with an additional five years for harvesting and managing the portfolio. This diversified portfolio approach offers individual investors the opportunity to build a large angel investment portfolio at a fraction of the dollars and time if doing it on your own.

Fund Size and Capital Commitment:

The Fund expects to raise a maximum of \$10,000,000 with a minimum offering of \$5,000,000; minimum commitment levels are \$60,000 for individuals and \$250,000 for institutional investors. Capital will be called from investors in multiple tranches over several years with no single capital call to exceed 33% of committed capital.

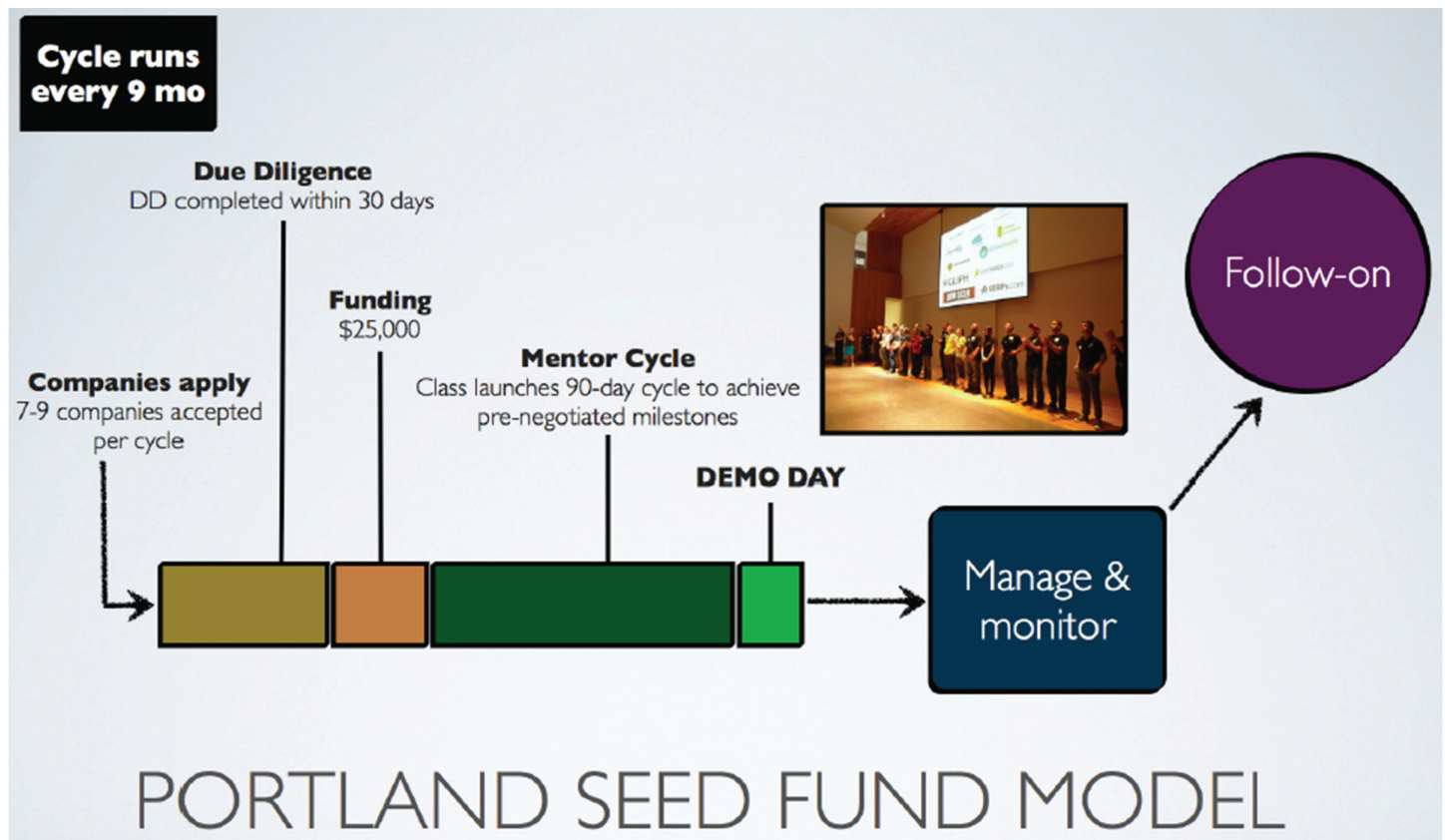
Investment Strategy:

The Fund will primarily invest in software companies, specifically mobile, ecommerce, consumer internet, internet infrastructure, and business productivity applications. A small percentage of the Portfolio Companies will be cleantech, active consumer apparel, or low capital-intensive medical devices (where FDA is minimal). The primary filters the Principals will use when selecting companies will include capital efficiency, growth potential, flexibility of business model, product viability, market opportunity, and strength of team.

Investment Strategy cont.:

The Fund will typically be the first institutional money into a company. Standard initial investment by the Fund will be \$25,000 in the form of a convertible note with a cap and special conversion provisions at Principals' option. Grouping multiple companies into Classes will offer efficiency benefits to the Principals, allow mentor access to the companies to be more efficient, and allow the early stage entrepreneurs to learn from each other. The mentoring will be done by a combination of the Principals, successful entrepreneurs from the community (including PSF I alumni founders), venture capitalists who have an interest in the region, service providers, and functional experts. The majority of the mentoring will occur in the Portland Metro area, although the Firm typically takes each class to Seattle and Silicon Valley to connect with mentors and investors in those regions. The hands-on mentoring with the companies functions as "experiential" due diligence to Principals, who learn during the 90-day cycle which companies are prime for follow-on investment.

This investment strategy is based on the ability of the Principals to quickly identify those companies who are most likely to grow into larger businesses, and provides a time-efficient mechanism for the Principals to manage the Fund, deal flow, and the portfolio. Below is a model of a "typical" investment cycle.



Approximately 70-75% the investment capital of the Fund will be reserved for follow-on investments in promising Portfolio Companies. This differs from many other accelerator programs and angel investors who do not reserve for follow-on investments, and are less able to stay meaningfully engaged with companies as they mature.

Results from Portland Seed Fund I (PSF I):

In 2011 the Principals raised just over \$3M for PSF I from public (~55%) and private (~45%) individual investors. As of Dec. 31, 2012 capital has been invested in 26 companies that fit the investment strategy: capital efficient businesses with high growth and scalability potential. Through Dec. 31, 2012 PSF I has directly invested ~\$843,000, including ~\$175,000 in follow on investment. In just 18 months, 15 of the 26 companies have raised an additional \$18.1 million from other investors, including tier-one VCs - or \$21.5 for each PSF I dollar invested. One company was acquired in Sept. 2012 and another in 2013. The PSF I companies' customers and partners include IBM, Intel, REI, Marmot, Nike, Dockers, Twitter, and many more. Portland Seed Fund and its Portfolio Companies have been featured in Fast Company, Wall Street Journal, Forbes, Inc, Forrester Research, PE Hub.

The Portland Seed Fund Team:

The team of Angela Jackson and Jim Huston bring a strong complementary skill set and demonstrated track record of success to the Fund. Jim has been a venture capitalist since the mid 90s, beginning with Intel Capital through 2004 and with Blueprint Ventures (~ \$200M under management) from 2004 - 2010 with a stellar investment track record. Angela Jackson grew up in the family of a serial entrepreneur, and has a decade plus career as both an active angel investor and advisor to hundreds of early stage companies. Combined, Angela and Jim have invested in more than 70 companies either as individual angel investors or through organized angel groups or through venture funds they managed. Together Jim and Angela bring a full company life cycle perspective and skill set to the Fund.

Further Information:

A Private Placement Memo (PPM) is available to interested accredited investors. This Summary does not constitute an offer to sell or a solicitation of an offer to buy securities as any such offer would be made to a specific person named on a PPM. No information in this Summary should be relied upon by anyone to the extent any information contained herein is inconsistent with, or adds additional information to such PPM.

