

MAINE FUND OF FUNDS
REPORT OF THE LD1215 WORKING COMMITTEE
TO THE
JOINT STANDING COMMITTEE ON BUSINESS, RESEARCH AND ECONOMIC
DEVELOPMENT
SENATOR LYNN BROMLEY, CO-CHAIR
REPRESENTATIVE NANCY SMITH, CO-CHAIR
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MAINE FUND OF FUNDS CONCEPTUAL OVERVIEW

WHY FUND OF FUNDS:

1. Maine's Comprehensive R&D Evaluation and Innovation Index shows our level of venture capital investment continues to be below even peer EPSCoR states;
2. Maine continues to be a flyover State; 61% of 2007 VC went to companies in Silicon Valley/San Diego/LA and greater Boston;
3. Helps create a fertile private funding environment for commercialization of Maine's State funded R&D efforts without burdening the State's tax revenue.

BENEFITS: The many benefits include:

1. Stimulates the availability of funding for innovative companies;
2. Increases the venture capital (VC) culture and infrastructure in the state;
3. Increases the number of jobs in high-growth, knowledge businesses;
4. Exposes national VC firms to Maine innovation companies;
5. Creates a competitive investment market in the state;
6. Leverages investment funds through syndication;
7. Supports Maine-based commercialization of R&D efforts;
8. Program can be matched to State economy

HOW IT WORKS:

The mechanics:

1. State creates, or charges, entity with establishing Fund of Funds;
2. Fund borrows money at best rate available from lender(s) through a competitive process;
3. Fund invests in variety of VC's which specialize in growing companies in Maine's strong industry sectors;
4. Fund uses investor prerogative to encourage VC activity in the State;
5. VC returns to Fund repays debt to lender;
6. If "profit" after debt and cost of program covered, State retains;
7. If "shortfall" (i.e. returns don't cover debt and costs), then State makes lender whole (with limit of amount of obligation per year)

The Economics: *That returns from its investments in VC will cover the cost of borrowed funds and cost to manage program. The State derives the economic development benefits and any possible costs are deferred. The 10 year average return for VC is 17.9% annually.*

Venture Capital Returns through 9/30/07

Source: Thompson Financial/NVCA

Fund Type	1 Yr	3 Yr	5 Yr	10 Yr	20 Yr
Early/Seed VC	23.6%	6.8	3.1	34.5	20.8
Balanced VC	38.0	14.4	9.9	15.1	14.3
Later Stage VC	41.4	10.5	8.4	8.3	13.8
All Venture	32.3	10.4	6.7	17.9	16.4
NASDAQ	14.2	12.2	17.9	4.8	9.4
S&P 500	10.8	10.7	13.1	4.9	8.1

MAINE FUND OF FUNDS

A POWERFUL BUSINESS AND ECONOMIC
DEVELOPMENT TOOL FOR MAINE

CREATING INVESTMENTS IN MAINES ECONOMY

MAINE FUND OF FUNDS



\$17mm



Trinity
Ventures

20 yr VC

\$1bn

MAINE FUND OF FUNDS SERVING ENTREPRENEURS

"The Utah Fund of Funds has been very helpful introducing us to potential investors. One such introduction resulted in the venture capital firm, Flywheel Ventures, making a significant investment in our company." - David L Bailey, CEO, InteliSum Inc.; co-founder and former CEO, Iomega

"Capital is the life-blood of the biomedical industry. The Utah Fund of Funds will do more to attract capital to innovative life science companies in the state than any other single industry or government effort." - David Clark, President & CEO, Prolexys Pharmaceuticals

MAINE FUND OF FUNDS ESTABLISHING CAPITAL RELATIONSHIPS

"We were interested in working with the Utah Fund of Funds because it provided 5AM with an effective introduction to the State's impressive life science industry at the highest levels. While we have always been aware of Utah's strong resources in the biomedical field, we knew only a fraction of the important people in the state. Within the first year of our relationship, the Utah Fund of Funds has significantly increased our connections to the state's important scientists, entrepreneurs, venture capitalists, academic institutions and governmental officials. We have been very impressed with the State's 'team' effort to grow the life science industry and look forward to building a valuable long-term relationship with Utah."

- Andrew Schwab
Managing Director, 5AM Ventures (San Francisco)

MAINE FUND OF FUNDS UTAH FOF DISCUSSION

"It doesn't cost any money for the state of Utah and the return on investment is off the charts. You are putting zero money in and you're getting \$75 million back in tax revenue. That number will climb as you get more and more jobs," Neilson said.

Devin Thorpe, managing director of the Salt Lake City financial advisory company Thorpe Capital Group, said numerous venture capital firms want to take part in the fund but can't because there isn't enough money available. He supports expanding the tax credits.

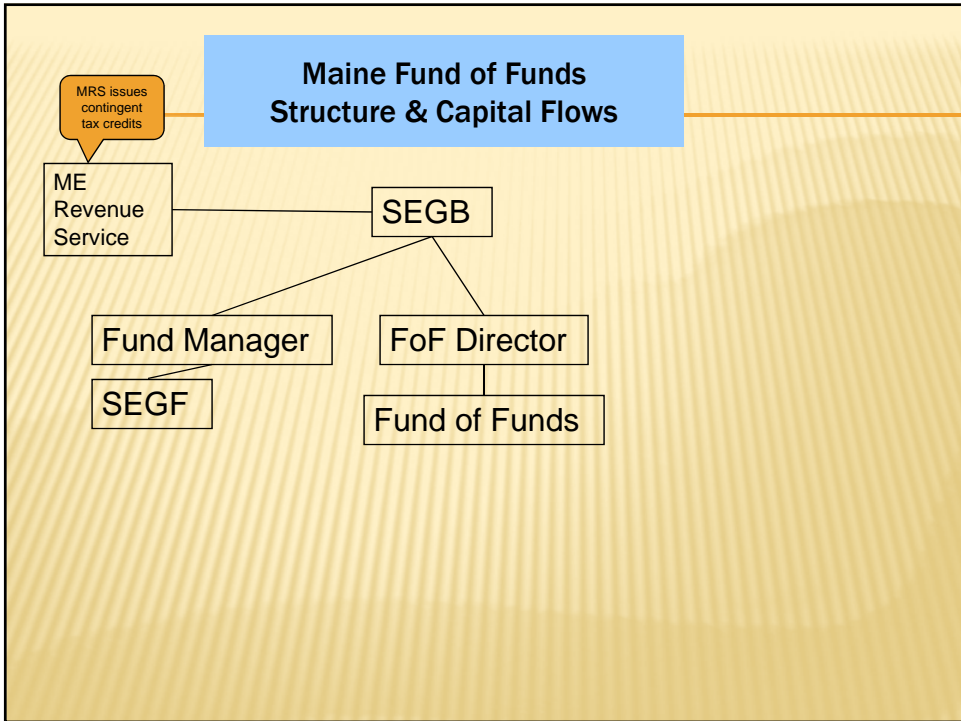
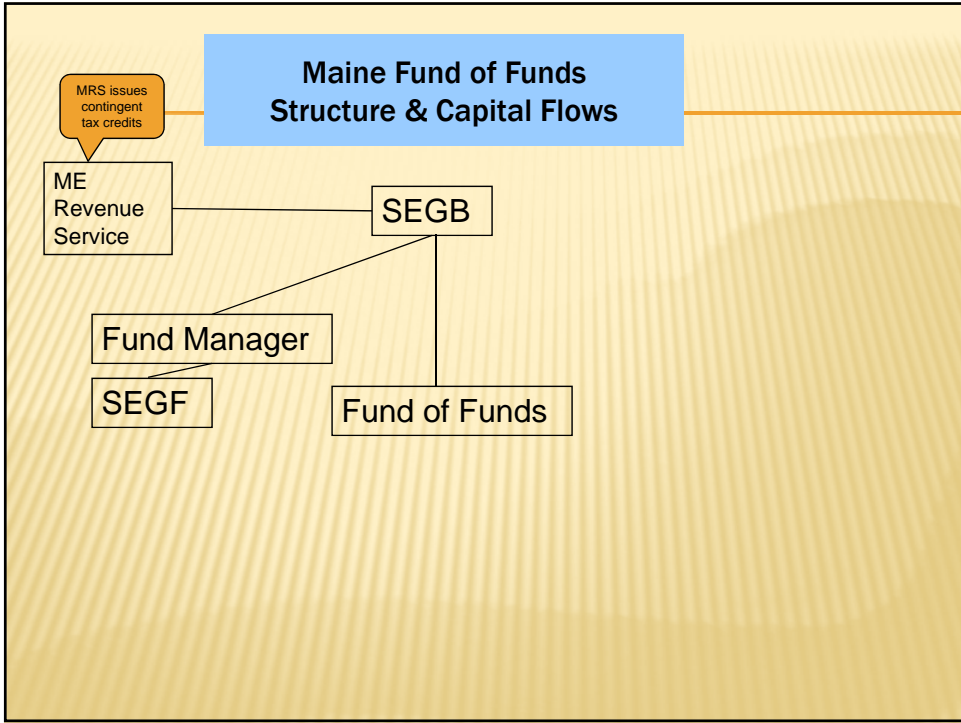
When the first \$100 million became available, the Fund of Funds received applications from 160 venture capital companies. The state invested in just 15 companies, said Thorpe, who is also president of Mountain West Capital Network, which encourages business development in Utah.

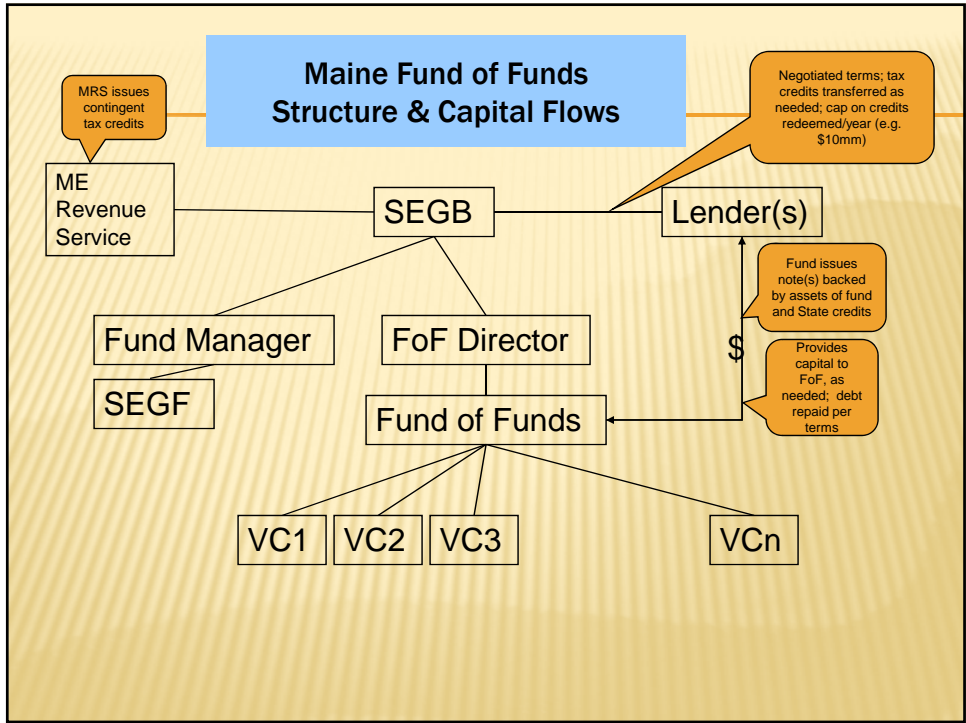
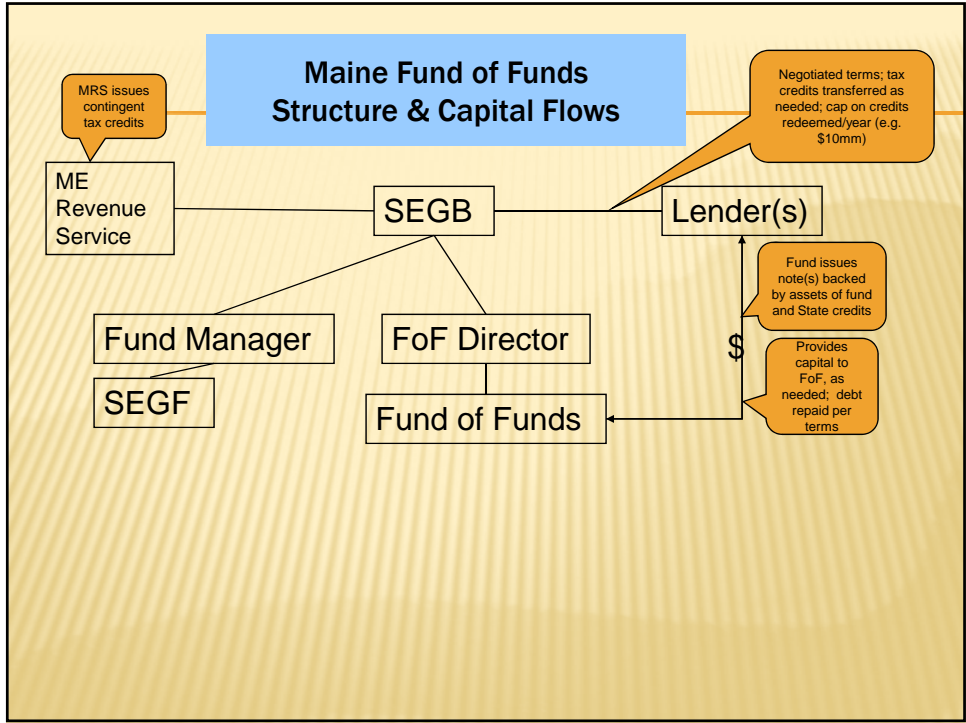
Source: Salt Lake Tribune, 8/21/07

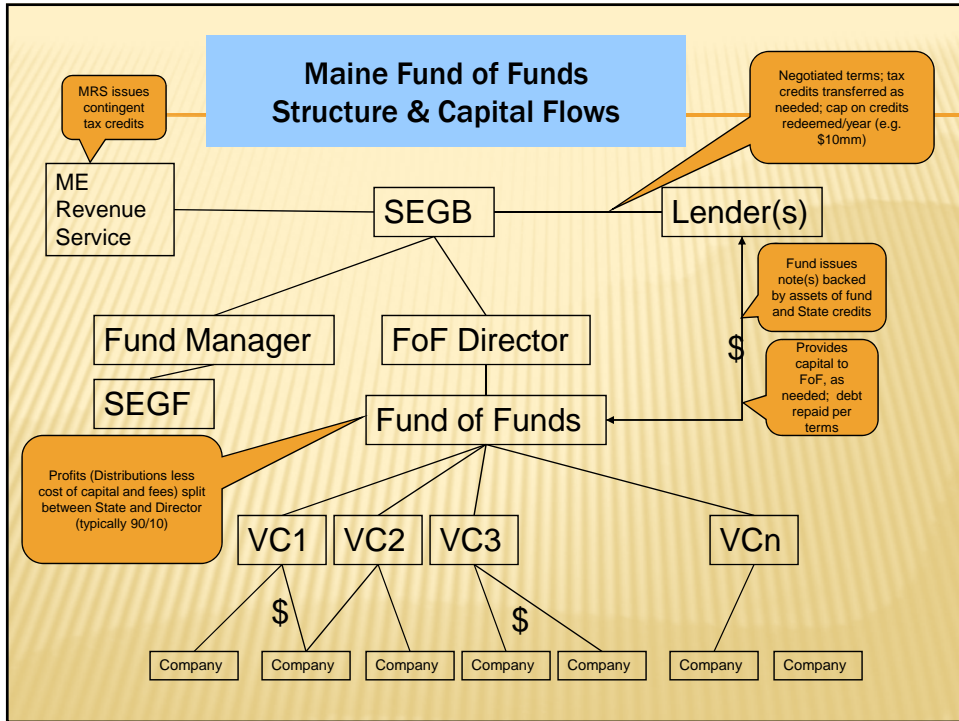
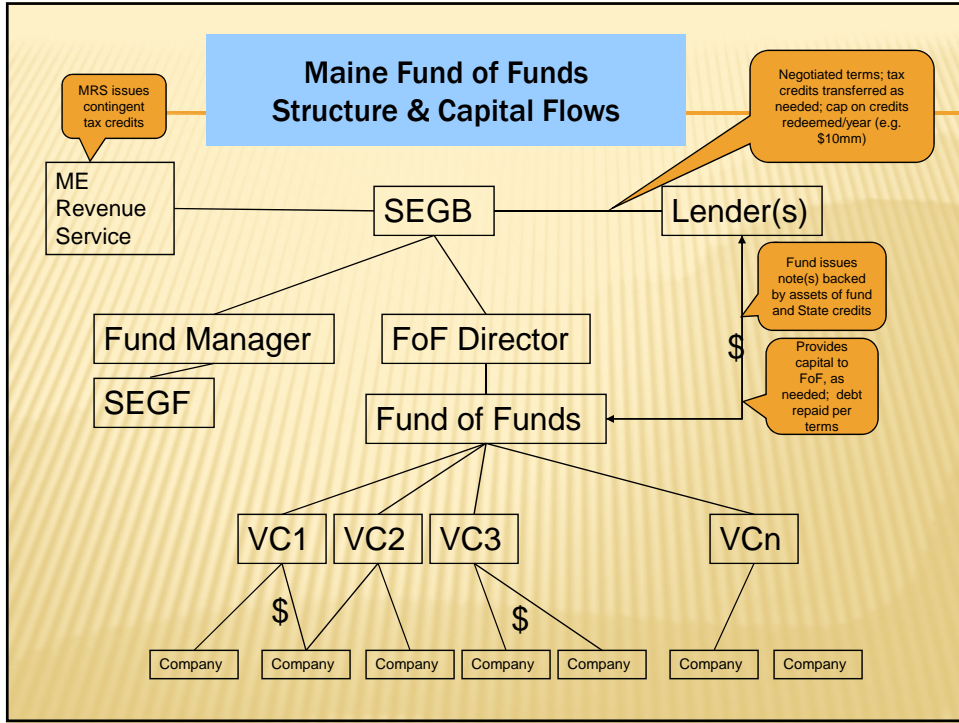


MAINE FUND OF FUNDS RISKS AND REWARDS

<u>Risk</u>	<u>Reward</u>
\$10mm per year of redeemed tax credits, for eight years. \$80mm maximum.	Exposure for Maine companies to top rated venture capital funds.
Additional costs of financing and program expenses if no returns.	Potential for funding for Maine companies
	Preponderance of "profits" to State (returns over cost of capital and fees)
	Additional jobs with funded companies; tax revenues and multiplier effects
	National reputation for leadership in this area.







MAINE FUND OF FUNDS INVESTMENT CRITERIA

Returns

- First priority is to cover the cost of capital and fees; returns
- Second priority is establishing a larger venture community in Maine - out of state funds dedicated to Maine, new in-state funds, supporting existing funds in Maine

Balanced Portfolio of funds

- Early Stage, Late Stage, Buyout; Tech/IT, Life Sciences, Composites, Resources, etc; Regional, Local, & National Funds

Strong Commitment to Maine

- Experience and Fit with Maine Entrepreneurs
- Previous experience investing in Maine or willing to spend significant time in Maine

MAINE FUND OF FUNDS EXAMPLE OF CAPITAL FLOWS TIMING

- Yrs 1-6:
 - MEFoF establishes funding arrangement with lender(s) (e.g. Maine bank syndicate, large bank (Deutsche, Merrill Lynch), MainePERS);
 - MEFoF make commitments to invest in a portfolio of specific venture capital funds (VC) designed to maximize interest in Maine opportunities and minimize chance of credits being utilized;
 - MEFoF will draw on debt and invest in VC funds as funds are called for by VC;
 - Fund Director /Maine creates climate for VC interest;
 - Fees paid annually: Director (~ 1%); Program expenses; perhaps lender fees; perhaps interest on debt.

**MAINE FUND OF FUNDS
EXAMPLE OF CAPITAL FLOWS TIMING (CONT)**

- Yrs 7-15 (and beyond):
 - MEFoF begins to get distributions from VC;
 - MEFoF begins repaying principal and interest on the debt;
 - Fees paid annually: Director (~ 1%); Program expenses; perhaps lender fees;
 - Additional distributions from VC = profit to FOF are typically split between State and Director (e.g. 90%/10%)
 - If VC distributions insufficient to cover debt service, lender redeems tax certificates (max \$10mm/yr).

**MAINE FUND OF FUNDS
EXAMPLE OF RETURNS DISTRIBUTION**

	Example #1	Example #2	Example #3
Annual ROI	15%	9%	3%
Cost of capital	7%	7%	7%
Director fees	1%	1%	1%
other costs	1%	1%	1%
"Profit"	6%	0%	-6%
Split of profit:			
State:	90%		
Director:	10%		

MAINE FUND OF FUNDS

LENDER ISSUES - LENDERS LOOK FOR:

1. Constitutional issues (e.g. MI - “vouchers” were constitutional, “credits” were not)
2. Full backing of State
3. “Refundable”
4. “Transferable”
5. Credits backed \$1 for \$1 (i.e. \$80 mm of credits can be redeemed for \$80mm cash)
6. Credits that cover both P&I (e.g. MI - DB lent \$200mm against \$200mm of authorized credits; OH - lent 85% of tax credit authorization).

Commitment fees, closing fees, interest reserves, etc are all negotiable. The more fungible the credits, the stronger the State negotiating position on the facility.

MAINE FUND OF FUNDS

LESSONS LEARNED

KEY LEGISLATION SUCCESS INGREDIENTS

- Director should not be the one negotiating the financing arrangement.
- Restrictions on VC should be minimal
 - Utah only requires that VC's spend time in Utah evaluating deals.
 - Good VC funds don't accept LP's with restrictive provisions (data point; 60% of vc firms raising money in '07 courted Utah FOF as a potential LP; in states with FOF's with obligations tied to the investment, roughly 25% of vc's courted)
- Tax credits should be “redeemable”, \$1 for \$1, and used for both principal & interest.
- The borrowing arrangements must also not be overly constrained, so the manager has negotiating room.

**MAINE FUND OF FUNDS
UTAH FUND OF FUNDS RESULTS TO DATE (JULY '07)**

- 135 VC funds have applied;
- \$69/\$100mm committed to 15 VC funds;
- Those funds have raised \$3.0 billion;
- \$50mm from these 15 funds have been invested in 23 Utah companies;
- Other VC invested an additional \$293mm in these 23 companies;
- These Utah companies have added 974 jobs, at average salary of \$62k, 2X state average;
- Utah Revenue Service estimates \$75mm in tax revenue from these jobs over 10 yrs.

MAINE FUND OF FUNDS SUMMARY OF DRAFT LEGISLATION

1. Small Enterprise Growth Board (“SEGB”) charged with creating FOF and hiring managing director (“Director”);
2. SEGB charged with negotiating borrowing arrangement for the Fund through a competitive bid process;
3. The Fund may be capitalized by one or more of a syndicate of local banks, MainePERS, or larger banks;
4. SEGB charged with overseeing Director, who will make commitments to invest in selected venture capital funds (no more than \$20mm per VC fund);
5. SEGB and the Director may charge fees for their services;
6. Director may share in “profit” of the Fund;
7. State Issues \$80 million of tax credit certificates, which may not be redeemed after 12/31/2030, and may be redeemed only \$10mm per year. These certificates will only be redeemed if the Fund defaults on its obligations to repay debt when due, and then only for the shortfall. SEGB / Internal Revenue shall maintain a public registry of certificate holders
8. The certificates are “refundable” certificates, which means the State needs to pay cash if the redeemer has no state tax liability in Maine.