



**ICIC**  
Iowa Capital  
Investment Corporation

**2007 ANNUAL REPORT**  
**WITH UPDATES THROUGH 2008**  
**OF THE**  
**IOWA FUND OF FUNDS**  
**TO**  
**GOVERNOR CHET CULVER**

**January 21, 2009**

Copies to: Michael Tramontina, Iowa Department of Economic Development  
G. Richard Neumann, Iowa Capital Investment Board  
David Casey, Iowa Department of Revenue  
Legislative Leadership  
Secretary of the Senate  
Clerk of the House

## PURPOSE

Iowa Capital Investment Corporation's goal is to accomplish the purposes expressed in its enabling legislation in Iowa Code §§ 15E.61:

- *To mobilize private investment in a broad variety of venture capital partnerships in diversified industries and locales.*
- *To retain the private-sector culture of focusing on rate of return in the investing process.*
- *To secure the services of the best managers in the venture capital industry, regardless of location.*
- *To facilitate the organization of the Iowa fund of funds in which to seek such private investment and to create interest in such investments by offering state incentives for private persons to make investments in the Iowa fund of funds.*
- *To enhance the venture capital culture and infrastructure in the state of Iowa so as to increase venture capital investment within the state and to promote venture capital investing within Iowa.*
- *To accomplish these purposes in such a manner as to minimize any appropriations by the state of Iowa.*

## SUMMARY

The Iowa Fund of Funds program ("IFOF"), envisioned by the Legislature in 2002 and begun in 2005, continues to grow and have a positive effect on the Iowa economy. The first initiative of the Iowa Capital Investment Corporation, the IFOF is designed to expand access to professionally managed seed and venture capital for Iowa entrepreneurs. At December 31, 2007 the Fund of Funds had closed on commitments of capital to three venture funds – the first in early stage life sciences and medical services, the second in later stage manufacturing, distribution and services, and the third in consumer media and retail, health care and financial services. During 2008 commitments have closed on three additional funds ranging in focus from seed to later stage, and preliminary commitments have been made to two more funds as of the date of this report. The program has a pipeline of high quality experienced funds interested in working within Iowa and helping our local entrepreneurs.

These funds are actively seeking candidates for investment in new and growing companies across the state. As of this date, four companies have received capital from an IFOF-supported venture fund, receiving over \$26 million in total capital -- \$11 million directly from IFOF venture funds with the balance of \$15 million leveraged from other sources.

The Fund of Funds was formed by the Iowa Capital Investment Corporation ("ICIC"). In 2005 ICIC engaged Cimarron Capital Partners, L.L.C. ("Cimarron") as its fund manager. Cimarron brings extensive experience managing fund of funds programs and developing entrepreneurial ecosystems for states and regions.

In partnership with Iowa's banking industry, in 2006 ICIC launched a \$45 million fund supported by New Markets Tax Credits. This fund is now fully invested with projects in Dubuque, Sioux City, Des Moines, Fairfield, and Davenport. In 2008 this fund gained a second

commitment of \$50 million. ICIC supported the application with a commitment of \$5 million of contingent tax credits to encourage projects in rural communities.

These programs have been implemented without State appropriations or reductions of revenue. Contingent tax credits support the program, and are available to cover potential future losses. If investments perform well, the tax credits will not be used.

ICIC carefully coordinates its work to enhance the parallel efforts of the Iowa Department of Economic Development, the Iowa Capital Investment Board, the Regents universities, the local investing community, Iowa's technology and industry associations, and local entrepreneurs. Over time, ICIC will help build a thriving Iowa entrepreneurial ecosystem in which a self-sustaining Iowa Fund of Funds and its partner venture funds play an empowering role.

## **BACKGROUND**

*Creating a Venture Capital Network in Iowa.* The economic well-being of Iowa depends on the creation and growth of competitive, knowledge-intensive companies capable of success in high-growth domestic and international markets. These companies depend on Iowa's access to sophisticated risk capital and investment skills, employee talent, and a network of connections to entrepreneurial resources. These are all essential ingredients for a vigorous entrepreneurial Iowa. The Governor and Legislature have recognized that it is imperative these resources are made more broadly accessible to our local entrepreneurs. One important source of such money, talent and connections is found in the people making up America's 1000+ professional venture capital firms. Most of these firms have traditionally focused their efforts on the east and west coasts, leaving the rest of the country, including Iowa, with little access to the necessary resources of the national venture capital network. In recent years, leading states (including Iowa) have forged creative ways to connect themselves to this network, seeking to ensure that their most promising entrepreneurs have a chance to compete on a level playing field with their peers in the venture capital-rich areas of the country.

In the venture capital world, many companies seeking funding from experienced venture capitalists do not meet minimum investment standards and are not funded. The same will be true of companies in Iowa, and perhaps to a larger extent because the venture capital environment in Iowa is immature. For that reason, success of the Fund of Funds program cannot be measured solely by the number of Iowa companies that receive funding from professional venture capitalists. A measure of success should also consider the positive effect on those companies that do not receive funding. Aspiring entrepreneurs will be provided the opportunity to gain an understanding of the standards required by high quality, professional venture firms; to address deficiencies, and to meet those standards. Companies that achieve these national standards of quality will be more likely to find the capital they need to grow and prosper. The ultimate success of Fund of Funds investments will help build overall economic momentum, and catalyze cultural change and a more robust entrepreneurial ecosystem in Iowa in the years and decades to come.

*Strategic Goals.* A key strategic goal of Iowa policy leaders is to create a dynamic entrepreneurial ecosystem in Iowa, to cause a change in our culture that will both encourage more entrepreneurs and help them succeed. ICIC and the Iowa Fund of Funds will play our part to help achieve this goal. This is a goal that will take decades of hard work to achieve.

*Iowa Fund of Funds.* Through legislative action in 2002, the Iowa Legislature created the Iowa Fund of Funds Program. The program is designed to help level the national venture capital playing field and bring venture funds, expertise, and networked resources to assist Iowa entrepreneurs. The Legislature also directed that resources to be allocated to support loan guarantees and other related credit enhancements for rural and small business borrowers within the state. Codified in Iowa Code §§ 15E.61 et. seq. (“Capital Investment Act” or “Act”), the Legislation pledges up to \$100 million of transferable Iowa tax credits to be used to support the capitalization of the Fund of Funds and its investments in venture capital funds. The tax credits, which are applicable against State income, franchise, and premium taxes, are contingent and have value to the holder only to the extent of future losses in the program, if any.

*ICIB and ICIC.* In order to facilitate the goals set forth in the Act, the Legislature authorized the formation of the Iowa Capital Investment Board (“ICIB”) and the Iowa Capital Investment Corporation (“ICIC”). ICIB is a state agency that authorizes the commitment of tax credits, while ICIC directs the program. The members of the ICIB Board of Directors are Rick Neumann (Chair), Gene Blanshan (Vice-Chair), Suzanna de Baca, Carol Garrett, Daniel S. Rogers, Senator Pat Ward, Representative Roger Thomas, and Senator Roger Stewart.

ICIC is a private, 501(c)(3), not-for-profit corporation organized under Iowa Code Chapter 504A on May 7, 2002. The members of the ICIC Board of Directors are Dennis Murdock (President), John Rigler (Vice President), Bruce Tamisiea (Treasurer), Tim Urban, and Julie Bintner. Ms. Bintner resigned in January 2008 and was succeeded by Cyril Mandelbaum in December 2008. Serving as general counsel is the firm of Davis, Brown, Koehn, Shors & Roberts, P.C. ICIC is audited annually by a private auditing firm selected and supervised by the State Auditor. Deloitte & Touche has served as auditor from inception through 2007. Upon its termination, ICIC is scheduled to turn its assets and accumulated profits over to the State.

*Formation.* In 2005, technical amendments to the original legislation removed impediments to securing low-cost investment capital. With this resolved, the Iowa Fund of Funds, Fund A, LLLP (the “Fund of Funds”), an Iowa private, for-profit limited partnership, was capitalized on June 28, 2005. ICIC is the General Partner of the Fund of Funds. In accordance with the statute, the investments of the Iowa Fund of Funds have focused on partnership interests in private venture capital funds rather than direct investments in individual enterprises.

*Management.* The statute requires ICIC to employ a professional fund allocation manager. In 2005 Cimarron Capital Partners LLC (“Cimarron”) was engaged in this capacity. Cimarron, a national leader in regional private equity, has operations in Des Moines, Little Rock, Phoenix, Chicago, and Oklahoma City.

*Investment Allocation and Strategic Objectives of the Fund of Funds.* Working with its fund manager, ICIC has developed a formal policy to guide the allocation of venture fund

investments and achieve the strategic objectives of the Fund of Funds. The Iowa Fund of Funds is investing in a diverse set of private venture capital funds so as to connect Iowa's most promising entrepreneurs with the full resources of the national venture capital network.

Each fund management team agrees to establish an appropriate presence within the state and work aggressively with entrepreneurs, angel investors, other venture funds, university tech transfer and development staff, economic developers, and corporate business development groups to identify promising Iowa opportunities.

To minimize the use of Iowa contingent tax credits, the Iowa Fund of Funds invests only in carefully selected and diversified private equity and venture capital funds with capable management teams and a demonstrated history of earning market rates of return. In the aggregate, the portfolio is being constructed to be broadly diversified across industries, time and geography, and across stage of investment within the following general guidelines:

Early Stage (includes seed and start-up) 20% - 35%  
Traditional Venture Capital 30% - 45%  
Later Stage (includes expansion & mezzanine) 20% - 30%  
Special Situations (turnarounds, restructuring, etc.) 5% - 10%

To meet the needs of the Iowa economy, fund commitments are focused in several strategically important industries:

Life Sciences (including agricultural technology, animal sciences and cleantech)  
Information Technologies  
Financial Services  
Advanced Manufacturing

## **SUMMARY OF ACTIVITIES IN 2007 and 2008**

Since 2002, ICIC has worked to create the Fund of Funds and build it into the active investing program it is today. With the Legislature's timely assistance in 2005 and continued support, ICIC made significant progress in 2007 and 2008.

### Commitments to Venture Funds

The Iowa Fund of Funds has selected eight venture capital funds for investment. As of December 31, 2008, six investment commitments have closed and two commitments are pending. The closed commitments were to:

- **Prolog Ventures Fund II**, a \$5 million commitment to this \$66 million early stage life sciences fund focused on deals in the central Midwest. Based in St. Louis, the managers of Prolog Ventures engaged a local representative in Iowa and formed an investment advisory board consisting of key members of the life sciences and entrepreneurial communities from Iowa State and the University of Iowa.

- **Bayview Capital Partners Fund II**, a \$2.7 million commitment to this \$125 million fund focused on late-stage manufacturing, services, and distribution companies in the Midwest. Based in Minneapolis, the fund is a licensed Small Business Investment Company. The managers of Bayview Capital Partners are engaged in extensive marketing, development, and educational efforts within Iowa in partnership with Iowa banks, attorneys, and CPAs.
- **Village Ventures Fund II**, a \$5 million commitment to this \$104 million fund launched in February of 2007. Village Ventures, based in Boston, is a seed and early stage venture capital firm. They focus their efforts on consumer media and retail, health care and financial services in emerging US technology centers which possess world class innovation but generally lack local sources of institutional early stage capital. The managers of Village Ventures have engaged a local representative in Iowa and have a vigorous program to identify prospective companies.
- **LFE Growth Fund II**, a \$5 million commitment to a \$30 million fund that invests growth and expansion capital in smaller middle-market growth-stage companies in the business services, consumer and health sectors. Based in Minneapolis with an office Ankeny, LFE has a special emphasis on businesses that are owned or led by female entrepreneurs or that serve markets of interest to women.
- **OCA Ventures II**, a \$5 million commitment to a \$50 million seed and early stage venture fund. Based in Chicago, OCA focuses on core technologies, financial services, for-profit education and technology-enabled services.
- **Petra Growth Fund II**, a \$5.5 million commitment to a \$150 million private equity fund focused on debt and equity investments in high growth small businesses. The managers of Petra are engaged in extensive marketing, development, and educational efforts within Iowa, and have engaged the Des Moines firm LWB Financial to extend their marketing reach.

The two pending commitments include:

- \$7.5 million to a \$125 million fund that will focus on early-stage firms offering technology-enabled or business information services with an emphasis on information technologies, life science (medical devices, healthcare IT, and animal/plant sciences), and wireless technologies.
- \$7 million to a \$100 million fund that will focus on expansion and late-stage financings in small companies.

#### Expanding Our Funds' In-State Iowa Presence and Capital Leverage

*In-State Development Efforts.* The managers of all of the selected venture funds have agreed to participate in a wide variety of Iowa venture activities, including the annual Venture Capital and Entrepreneur Conference in Des Moines sponsored by the Iowa Department of

Economic Development. Each fund has committed to conduct aggressive deal prospecting in the state. Their presence in Iowa gives Iowa entrepreneurs an avenue to directly interface with potential funders and help build business plans and financial strategies that will meet the market test. The presence of venture capital firms in Iowa expands the likelihood that Iowa entrepreneurs will obtain the capital they need to grow and prosper.

### Investing in Iowa Companies

As of this date, Iowa companies have received over \$26 million of equity and debt financing as a result of the work of IFOF portfolio funds -- \$11 million directly from the IFOF venture funds, and the balance of \$15 million leveraged from other sources.

- Bayview II invested in Accu-Mold, Inc. of Ankeny, a precision maker of small, high technology molded plastic parts with exciting prospects in medical devices and advanced manufacturing markets.
- LFE Growth Fund II invested in Global ID Group, of Fairfield, a leading provider of testing and certification for food and agricultural products.
- Prolog Venture Fund II invested in Asoyia, of Iowa City, a developer of soybean oil with zero trans fats.
- Bayview II invested in Applewhite Dental Partners, of Dubuque, a dental practice management company with facilities in Cedar Rapids, Ft. Dodge and Manchester.

With these investments, the Iowa Fund of Funds has attracted to the Iowa economy more than twice the \$11.8 million invested in portfolio funds through 2008. This illustrates the economic multiplier potential of the Fund of Funds program.

- *Capital Leverage.* Part of this leverage represents the ability of the Fund of Funds to make large capital resources available to Iowa enterprises through carefully selected, smaller capital commitments to venture funds. The six portfolio funds have raised over \$500 million in commitments, and have met the test of the private market -- they compete worldwide for capital and are able to raise the major share of their capital from private sources in a competitive market.
- *Co-Investment Networks.* The managers of IFOF portfolio venture funds also bring extensive networks of venture and private equity co-investors able to multiply their own direct investments. On average, every dollar invested by an IFOF portfolio fund is expected to attract two to three matching dollars from co-investors.
- *Investing Culture and Expertise.* Finally, the managers of IFOF portfolio venture funds bring investing expertise into the state. Iowa has historically lagged other states in the breadth and vigor of its entrepreneurial economy in high-knowledge, high-growth, and high-capital-intensive industries. By importing expertise and culture, we transmit the “intellectual DNA” of entrepreneurship and venture investing into our Iowa ecosystem and help jump-start a more dynamic economy better able to compete in global technology markets.

### Developing Additional Funding Sources to Lower Capital Costs

The Fund of Funds is capitalized by private investments with the support of contingent tax credit certificates issued by the Iowa Capital Investment Board. Iowa Designated Investor, Inc., a single purpose entity, is to date the only investor in the Fund of Funds. Funding was first provided in 2005, supported by a \$10 million line of credit from West Bank in West Des Moines. Funding was expanded in February 2008, supported at that time by a \$30 million line of credit from West Bank and the Bank of Oklahoma. ICIC expects to secure additional funding on an as-needed basis,

The tax credits have value only to the extent the overall program experiences a loss and their redemption is contingent on certain State-approved criteria. The credits are limited to \$100 million in the aggregate and \$20 million in any fiscal year.

A team of Iowa corporations stand ready to purchase these tax credits, should the need arise. These commitments, obtained with the help of the Iowa Association of Business and Industry, have been essential to enabling ICIC to raise capital at low cost. The members of this team include Iowa Network Services, First National Bank of Muscatine, Dubuque Bank & Trust, Quad City Bank & Trust, Ames National Corporation, and others.

During 2007 and 2008, we:

- *Continued our financing relationships* with West Bank and Wells Fargo to support the Fund of Funds.
- *Developed additional funding options* to add investment capacity and flexibility to the Iowa Fund of Funds at reduced cost.
- *Developed mechanisms to monetize tax credit certificates* if needed and improve the value of the certificates and further reduce costs.

### Demonstrating Good Financial Stewardship

During 2007, we undertook our second financial audit with the active assistance and supervision of the Auditor of State, Mr. David Vaudt, and his staff. This audit was conducted by Deloitte and Touche. The audit report and financial statements are available from ICIC and the Office of the Auditor of State.

### Developing Iowa Business Development and Venture Industry Relationships

During 2007 and 2008, our fund manager was active in expanding our relationships and resources both within Iowa's entrepreneurial community and into the national venture capital community:

- *Co-sponsored* the October, 2007 Entrepreneur and Venture Capital Conference in Des Moines.



- *Marketed IFOF* at the BIO Conference, the World's Best Technologies Showcase, and numerous venture forums across the country.
- *Contributed to [www.IowaEntrepreneur.com](http://www.IowaEntrepreneur.com)*, an educational site for Iowa entrepreneurs and investors.
- *Participated* as a member in a number of Iowa business and trade associations and actively represented the interests of Iowa's angel and private equity investors and entrepreneurs.
- *Developed* contacts within the angel capital, private equity and investment community in the State. Encouraged and facilitated communications among angel investors and venture investors to increase local capacity to invest in attractive deals.
- *Enhanced our relationships with all three Regent universities*, Pappajohn Centers, and small business accelerators to spread knowledge of private equity capital and investing throughout the state.

#### Committing \$45 Million in Iowa from the Federal New Market Tax Credit Program

The New Market Tax Credit Program (NMTC) permits taxpayers to claim a credit against Federal income taxes for qualified equity investments made to acquire stock or a capital interest in designated community development entities (CDEs). CDEs must use substantially all of the proceeds from such investments to make investments in low-income communities, identified by census tract. Allowable investments range from real estate to venture capital. The tax credit provided to the investor will total 39% and can be claimed over a seven-year credit period.

ICIC organized the Iowa Development Corporation, an Iowa non-profit corporation for the purposes of securing NMTC for the State of Iowa. Iowa Development Corporation in turn formed Iowa Community Development, L.C., an Iowa limited liability company that has been designated by the US Department of the Treasury as an approved CDE to conduct investment activities in Iowa. ICIC, with the support and assistance of the Iowa Department of Economic Development and the Iowa Bankers Association, and with Iowa Business Growth Company acting as the fund manager for the CDE, then applied for NMTC on behalf of the CDE.

Iowa Community Development received an allocation of \$45 million of these NMTC credits in June 2006. By 2008 these resource had been committed to projects across the state. In 2007 a second request was initiated, and in October 2008 a second allocation was received of \$50 million. ICIC supported the application with a commitment of \$5 million of contingent tax credits to help the program accomplish projects in rural parts of the state. The program is now seeking additional appropriate investments in targeted census tracts in Iowa.

Iowa Community Development has committed and closed on its first \$45 million allocation of new market tax credits to the following Iowa projects:

- \$9,000,000 to River Point West, Des Moines, Iowa, a mixed-use development planned to include 500 housing units, 200,000 sq. ft. of retail space and 500,000 sq. ft. of commercial space;
- \$7,000,000 to Village Place, Des Moines, Iowa, a mixed-use development which has sparked additional development in Des Moines' historic East Village;
- \$9,500,000 to the Adler Theater, Davenport, Iowa, the renovation of an historic theater in a highly distressed census tract;
- \$10,000,000 to Northwest Airlines Call Center, Sioux City, Iowa, a project intended to create over 200 jobs and stimulate development in a distressed census tract;
- \$5,750,000 to Cambridge Investments Headquarters, Fairfield, Iowa, a project involving the construction of a green headquarters building for Cambridge Investment Group, a leading independent broker/dealer with over 250 employees in Iowa.
- \$3,750,000 to the Julien Hotel, Dubuque, Iowa, for the renovation of a 135,000 square foot historic hotel in a highly distressed census tract.

In addition to the above, Iowa Community Development has recently committed \$10 million to support a project in Dubuque that would bring a new IBM facility to that City, along with approximately 1300 jobs.

#### Providing Advice to the Legislature and Executive Branch

ICIC is available to serve as a resource of expertise to provide information to legislative committees and the Executive Branch on the advantages and disadvantages of a variety of investment programs in early to late stage capital. We stand ready to assist the Legislature and Governor in developing sound economic development programs for Iowa.

We appreciate the help of our Legislature and Governor, whose continuing support of our program and patient understanding of our goals and timelines are so important to our success.

Respectfully submitted,

Dennis Murdock  
President