



Memorandum

TO: COMMUNITY AND
ECONOMIC DEVELOPMENT
COMMITTEE

FROM: Paul Krutko

SUBJECT: CATALYST PROGRAM

DATE: January 11, 2008

On November 14, 2006, City Council authorized the City Manager to negotiate and execute an Investment Management Agreement with Pacific Community Management, Inc., Pacific Community Ventures' wholly owned subsidiary, to provide investment management services for the City's Economic Development Catalyst Program (EDCP). Pacific Community Ventures, a community development venture capital firm, was selected to manage the EDCP through an RFP process conducted earlier in 2006. The City executed the Investment Management Agreement with Pacific Community Management (PCM) in January 2007.

The City will provide up to \$3 million over the next four years to leverage substantial venture capital investment in private San Jose small businesses. PCM will match every City dollar invested through the EDCP with a minimum of \$5.70 from PCM and other co-investors. In addition to increasing the direct impact of City funds, the EDCP is anticipated to make equity investments that will enhance job creation, expand the local tax base, and facilitate the integration of other programs and services targeted to the small business community.

Although the City did not require a specific focus on hiring and training low- and moderate-income individuals, PCM's mission supports the identification of small businesses that will provide training, benefits, and profit-sharing opportunities for these employees. Over the 10-year term of the Agreement, PCM will recommend, perform due diligence, and facilitate investments in high potential small businesses with: (1) positive cash flow, (2) annual revenues of at least \$3 million, (3) a strong management team in place, and (4) a clear path toward growth and increased profitability. It is anticipated that the EDCP will be fully funded over the first 4 years of the Agreement with PCM.

First EDCP Investment - BenteK

For the inaugural EDCP investment, PCM has provided the City with an Investment Notice regarding a \$350,000 preferred stock investment in BenteK, a low-volume, high-complexity manufacturer whose services include engineering, design, and supply chain management. The leverage ratio for this investment is 6.7:1. Among the City's co-investors are JP Morgan's Bay Area Equity Fund, Fundamental Capital, and Medford Investments. The BenteK investment is a second-round infusion of capital to support the company in meeting its sales requirements for its second-best quarter ever.

OED staff, with the assistance of the City Attorney's Office and external counsel, reviewed the Investment Notice, the Securities Purchase Agreement, and the Investors' Rights Agreement, and subsequently provided a recommendation to the City Manager to move forward with a preferred stock investment in BenteK. The first EDCP investment closed at the end of April 2007.

In terms of the social rate of return, the average hourly employee earns over \$12 per hour. Bentek's full medical plan pays between 50% and 100% of employee health benefits. Additionally, Bentek provides a 401(k) investment plan with a company match as part of its benefits package.

Bentek recently expanded their operations into additional leased space contiguous to their existing facility. With a new CEO (a former Board member) and VP of Sales, Bentek finished 2007 with a healthy backlog and strong anticipated growth in revenues and profitability. Higher production levels will require corresponding growth in employment of approximately 10% per year. OED's work2future division is positioned to provide assistance with any employment or training needs.

Second EDCP Investment – Kimomex Markets

In July, the City made a preferred stock investment of \$502,000 in Kimomex Markets, a growing company seeking additional working capital. The Hispanic food market is an integral component of family life and culture. Hispanic shoppers visit their grocery stores nearly twice as often as non-Hispanics, assisting to make the Hispanic market the fastest growing niche in the US retail grocery business.

Approximately 90% of Kimomex's employees are low to moderate income. Hourly employees earn, on average, approximately \$10.40 per hour. Nearly 80% of full-time employees have medical benefits through Kimomex, and an estimated 50% of employee spouses also receive these benefits. Currently, Kimomex employs over 100 employees, with another 100 to be hired upon the opening of a new store.

Kimomex's Mercados Suvianda store on the east side of San Jose is doing exceptionally well; however, construction delays on tenant improvements to the former Albertson's store next to City Hall have negatively affected projected revenues. With the underlying issues now resolved, Kimomex is moving forward with plans to open their second facility in April 2008.



PAUL KRUTKO
Chief Development Officer

Office of Economic Development

ECONOMIC DEVELOPMENT CATALYST PROGRAM

Presentation to
Community & Economic Development
Committee

January 28, 2008



Economic Development Catalyst Program

- **PILOT PROGRAM**

- **PROGRAM OBJECTIVES**

- Support high growth companies
- Leverage City capital contribution
- Generate financial return
- Connect dots with other City programs

- **CITY'S CAPITAL CONTRIBUTION**

- Funded from DESF
- Up to \$3 million

Economic Development Catalyst Program

- **RFP PROCESS**

- Extensive outreach
- Market based approach
- City Council approved:
 - RFP issuance
 - Investment agreement with Pacific Community Management (PCM)

- **INVESTMENT STRATEGY**

- PCM identifies, structures, nurtures and develops exit strategy
- Receives 3% advisory fee
- Minimum operating revenue of \$3 million
- City equity investments between \$250K to \$500K
- Leverage 5.7:1
- Exit over 4 to 5 year period, typically via acquisition or buy-out

Economic Development Catalyst Program

- **PACIFIC COMMUNITY MANAGEMENT**

- Wholly-owned affiliate of Pacific Community Ventures (PCV)
- PCV has developed and managed three similar funds
- Key investors include Wells Fargo, CALPERs
- Intensive Business Advisory Assistance
- Double bottom line focus (financial and social rate of return)
 - Full-time jobs with benefits
 - Wealth sharing
 - Transferable training
 - Individual Development Accounts

Economic Development Catalyst Program

- **CURRENT DEAL FLOW**

- **Bentek**

- High-complexity, low-volume contract manufacturing services
 - Key customers – semiconductor manufacturers, government, aerospace, etc.
 - \$350K of preferred stock
 - Leveraging of 6.7:1
 - Wealth-sharing program for non-management employees

- **Kimomex**

- Hispanic-themed grocery stores
 - Specialty goods and services, including pharmacy and hot deli
 - \$502K of preferred stock
 - Leveraging of 11.8:1
 - Wealth-sharing program for non-management employees

- **ANTICIPATED INVESTMENT PIPELINE**

- 7 to 12 transactions
 - Over 4 to 5 year timeframe
 - Potential future capitalization opportunities

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