

MINUTES OF THE

NEW MEXICO SMALL BUSINESS INVESTMENT CORP.

February 17, 2014

A meeting of the New Mexico Small Business Investment Corporation was called to order on this date at 9:00 a.m. in the conference room of WESST Enterprise Center, 609 Broadway Boulevard, N.E., Albuquerque, New Mexico.

A quorum was present:

Members Present

Mr. Alan Fowler, Vice Chair

Mr. Joseph H. Badal, Past Board Chair

Mr. Lupe Garcia

Mr. Steven E. Morgan, Secretary/Treasurer

Mr. Clarence L. Smith [designee of Hon. James Lewis, State Treasurer] [left at 11:15]

Members Excused

Ms. Roxanna Meyers, Chair

Ms. Launa Waller

Financial Adviser to Board

Mr. Russell Cummins

Board Legal Counsel:

Mr. Randy McDonald

Recording Secretary:

Ms. Judith Beatty

Guests Present:

Mr. Brad Steward, Pulakos CPAs

REVIEW AND ACCEPTANCE OF AGENDA

Mr. Badal moved to accept the agenda, as presented. Mr. Smith seconded the motion, which passed unanimously by voice vote.

JANUARY 2014 BOARD MINUTES

Mr. Badal moved approval of the January 24, 2014, minutes, as submitted. Mr. Morgan seconded the motion, which passed unanimously by voice vote.

JANUARY 2014 FINANCIAL REPORTS

Mr. Cummins reviewed highlights from the January financial statements.

-- The Loan Fund had an increase of \$418,631. This is the first month where the change was in effect that allows The Loan Fund to make capital calls monthly rather than quarterly.

-- Funds Available for Investment and Operations include The Loan Fund's increase from \$8.5 million to \$10 million and the \$1.5 million MFA line of credit, reducing the available funds to \$3 million. NM Growth Fund II will have no further capital calls other than for fund expenses, which increases available funds to \$3.5 million.

Mr. Badal suggested that Chair Meyers, Mr. Smith (if possible) and Mr. Cummins meet with Keith Gardner, the Governor's Chief of Staff, to update him on the progress in the NMSBIC's lending program.

Mr. Smith moved approval of the January financial reports, as presented. Mr. Badal seconded the motion, which passed unanimously by voice vote.

PULAKOS CPAS, AUDIT AND TAX PROPOSAL FOR YEAR ENDING JUNE 30, 2014: BRAD STEWARD, PRESIDENT, PULAKOS CPAS PC

Mr. Steward noted that Pulakos has performed audits for the NMSBIC for a total of seven years, and he has been engaged in those audits for six years.

Mr. Steward reviewed the proposal and planning for the 2014 audit with anticipated timeline. Pulakos is proposing a fee increase of \$450 for this year. He noted that Pulakos reduced its fees for the NMSBIC in 2010 and has not raised them since.

Mr. Cummins stated that he and Ms. Brescia are very pleased with the services provided by Pulakos, and recommend that the NMSBIC continue with them in 2014.

Mr. Steward commented that it has been a good working relationship. He said that, because of the nature of the NMSBIC's transactions, it has worked well for Pulakos to communicate with the NMSBIC almost constantly throughout the year.

Mr. Cummins remarked that this is a good example of a continuous audit – the monthly bank statements, board packages and any new agreements are sent over to Pulakos for review throughout the year.

Responding to Mr. Badal, Mr. Steward said all materials requested by Pulakos were readily provided, and there were no concerns whatsoever in terms of cooperation.

Mr. Badal asked if there is any requirement by the state that the NMSBIC rotate its auditors every seven years, and Mr. Steward responded that he did not believe so.

Mr. McDonald added that he relies on the statutory language that says the NMSBIC is “not a state agency for any purpose.”

Mr. Badal suggested that the NMSBIC include a statement in next year’s annual report that recognizes the State Auditor has a seven-year rotation requirement, that the NMSBIC is not considered to be a state agency, that having another formal audit would be cost prohibitive, etc.

Vice Chair Fowler stated that discussion on the issue of rotating audit partners will be on the agenda next year.

Mr. Badal moved for approval. Mr. Smith seconded the motion, which passed unanimously by voice vote.

EXECUTIVE DIRECTOR/INVESTMENT ADVISOR REPORT

- **Loan Reports**
- **Equity Partner Detail**
- **Take Away Report**

Accion

Mr. Cummins stated that, at last month’s board meeting, the Board asked that Mr. McDonald verify that a loan for the purpose of expanding operations outside of New Mexico is allowed by NMSBIC’s legislation. The loan was made to a New Mexico operation, but the operation was expanding into Arizona. Mr. McDonald’s response was that the loan can be made as long as the business has a majority of its full time employees in New Mexico and its office is located in New Mexico.

Mr. Cummins said Mr. McDonald had raised the point that if the borrower created a separate entity just for the Arizona operation, he did not believe the loan could be made to the separate entity because it would probably not meet the “majority of its full time employees” test. Mr. McDonald also said this highlighted another possibility that the company could move

its principal offices out of state or the majority of employees could shift to another state – the statute is silent on that, but his opinion was that no new loans could be made to the company after the shift.

Mr. Cummins stated that he followed up with Accion and reviewed this in detail with them, and they responded that this loan did meet the NMSBIC's requirements in the legislation.

Mr. Badal suggested that, as a best practices way of monitoring the portfolio, the NMSBIC send a questionnaire to the lending and equity partners once a year asking them if there are any loans or investments made to entities with an out-of-state footprint, and can they verify that the majority of the employees are in New Mexico.

Mr. Morgan said he liked this proactive approach given the focus the legislature has on economic development here and the interest in attracting businesses here.

Vice Chair Fowler commented that the questionnaire would also serve as a reminder to people when considering an investment or loan. He agreed with a point raised by Mr. McDonald that responses would have to be "to the best of your knowledge," so there is no implication that an audit might be necessary.

Mr. Cummins said he would create a compliance certificate for Board review.

Mr. Cummins also reported that the amendment increasing Accion's per-loan limit from \$200,000 to \$225,000, and The Loan Fund's per-loan limit from \$350,000 to \$500,000, are in the process of being finalized.

MFA

Mr. Cummins said he is still waiting on MFA's corporate resolution documenting their board's approval of the final loan terms.

Mr. Cummins reported that, in January 2014, MFA issued their audited financial statements as of 9/30/13 (their fiscal year), in which MFA reported a decrease in net assets of \$33.5 million for the year. He did an analysis of their financial statements, and pointed out that MFA had a \$40.9 million decrease in the fair value of their investments. MFA noted in their financial statements that the MFA's rating agencies do not include the fair value adjustment in their analysis of MFA's performance. After removing the impact of the fair value adjustment, MFA's adjusted change in net assets increased \$7.4 million in 2013. After conducting an analysis, as detailed in his report to the Board, Mr. Cummins' opinion is that the reported decline in net assets does not indicate a "material adverse effect" and that MFA is in sound financial condition.

New Mexico Mezzanine Partners

In response to the Board's request that he perform more due diligence related to raising the ceiling of the maximum investment in any one portfolio company from the current level of 20 percent to 25 percent, Mr. Cummins discussed this with Mike Doolittle. They agreed to hold off until Mr. Doolittle has a better indication that the other limited partners will agree to the change.

Mr. Cummins said the feedback Mr. Doolittle has received from his other advisors and partner on a proposed new fund is that Mr. Doolittle probably should devote his full attention to NMMP and that someone else in the organization should be involved in the new fund. When NMMP reached its end date, Mr. Doolittle would then transition over to the new fund.

NMMP Loans Added to Investment Detail Report

Mr. Cummins noted that the NMSBIC Investment Detail now includes the NMSBIC's 48 percent share of NMMP loans. The loans are identified by number for confidentiality purposes.

FNB Santa Fe Proposed Change in Collateral

Mr. Cummins reported that First National Bank of Santa Fe (FNB SF) has said they would be willing to pay a higher interest rate (10 basis points more) if NMSBIC would accept investment grade corporate bonds as security. FNB SF currently provides US Government Securities as collateral at 102 percent of the NMSBIC's deposit balances and has offered to provide investment grade corporate bonds as collateral at 120 percent of the NMSBIC's deposit balances.

Mr. Cummins said the NMSBIC has followed the state's guidelines on collateral in the past, although he believes it is not required to. In looking through the guidelines, he did not see where investment grade corporate securities are an acceptable type of collateral for state deposits. He added, though, that for whatever the deposit is, the state rules require that the bank provide 50 percent of the deposit amount as collateral. The type of collateral would be considered less safe, but FNB SF would be providing a higher amount at 120 percent.

Mr. Cummins said he wasn't proposing the NMSBIC do anything for the CDs rolling over in March, but thought this warranted board discussion. He noted that 10 basis points on \$6 million in CDs would amount to \$6,000 a year.

Mr. Badal said he thought the NMSBIC investment policy should be amended to allow it, assuming it could be done legally.

Mr. McDonald said he would review, and possibly ask the Attorney General's Office for clarification.

Mr. Cummins noted that the next Board meeting is in May with the next CD renewal in June.

Presentation to the State Investment Council

Mr. Cummins reported on the presentation that he, Roxanna Meyers and Anne Haines (Accion) made before the SIC at its January 28 meeting. He referred to a list of questions and comments from SIC members.

Mr. Cummins said the SIC was very pleased that the NMSBIC was focused on its lending program rather than equity program.

Mr. Badal said he continues to be concerned that the NMSBIC does not have a robust-enough loan program and is not covering as much of the state as the Board would like to see.

Mr. Smith made suggestions on people to invite to the annual "town hall" in Clovis this summer. He emphasized the importance of follow up in the weeks following the annual meeting.

Board members commented that the border region of New Mexico is underserved and should be part of the discussion going forward when the Board considers additional lending activity, either with the existing lending partners or with new ones.

Mr. Cummins said he would have discussions with The Loan Fund and Accion on possible ways of building up loan demand in these communities.

Mr. Cummins discussed the role of Finance New Mexico in providing information about the NMSBIC'S lending partners.

Mr. Cummins noted that New Horizons, in Hobbs, is interested in promoting economic development and diversifying the economy and is also considering a loan facility.

[Break.]

NMSBIC BOARD CONTINUING EDUCATION

--- SMALL BUSINESS INVESTMENT ACT, NMSA 58-29-1 ET. SEQ.

Board members reviewed relevant sections from the Small Business Investment Act.

SHORT-TERM INVESTMENTS, ONE YEAR CD INVESTMENT FOR \$1.5 MILLION
-- CASH FLOW FORECAST
-- COMPETITIVE CD INTEREST RATES AND BANK LOAN-TO-DEPOSIT RATIO

Mr. Cummins reviewed an updated cash flow forecast for the coming 12 months. He proposed that the NMSBIC continue to increase its CD ladder from \$1 million rungs per quarter to \$1.5 million rungs per quarter. Projected cash balances at December 30, 2014 would be \$1.97 million.

Mr. Cummins recommended that the \$1 million CD maturing on March 8 it be renewed and increased to \$1.5 million, and invested for one year at First National Bank of Santa Fe.

Mr. Badal so moved. Mr. Garcia seconded the motion, which passed unanimously by voice vote.

In response to a request made by Mr. Badal at the last meeting, Mr. Cummins said he had prepared a list of loan-to-deposit ratios at various banks in New Mexico.

LEGISLATIVE UPDATE, HOUSE BILL 36 AND SENATE BILL 99

Mr. Cummins presented a recap of proposed changes to 7-27-5, the NMSBIC's funding legislation. While he and Mr. McDonald saw nothing in the bill that would impact the NMSBIC, there are changes that could require the State Investment Officer to request additional information from the NMSBIC for him to perform his duties under the funding legislation.

Mr. Cummins said there is reference in the proposed legislation to having 1/4 percent of the Severance Tax Permanent Fund allocated to investments approved by the Technology Research Collaborative ("TRC"). Participating institutions in the TRC include the national laboratories, major research institutes and all of the post-secondary educational institutions in the state.

[Mr. Smith left the proceedings.]

FLYWHEEL VENTURES, PROPOSED CHANGES TO NEW MEXICO GAP FUND I, L.P.
-- TREVOR LOY, GENERAL PARTNER, AND CHRIS TRAYLOR VENTURE PARTNER

Mr. Loy and Mr. Traylor made a slide presentation to the Board.

Mr. Traylor reviewed the nine companies in Flywheel Gap Fund I.

Mr. Loy said there are four companies in the portfolio where The Gap Fund thinks there is an opportunity to put more effort, resources, and potentially more capital, and help the companies become profitable as opposed to modestly breaking even.

Mr. Loy stated that The Gap Fund's existing cash balance is \$495,301. At the moment, there is no more allocation for management fees and three more years of fund management expenses at \$8,000 per year, leaving \$471,301 available to invest in these four companies.

Mr. Loy stated that their original assumption in 2007 was that they would get companies up and running and fund them once or twice. A combination of events in the following year caused New Mexico's venture capital industry to fall apart.

Mr. Loy stated that, while the companies need more capital to continue to grow, they also need more help through Flywheel's experience and expertise. He proposed to take a portion of the remaining capital and increase the expense budget from \$24,000 over three years to \$48,000 over three years, as well as take \$50,000 a year for the next three years and direct it toward management fees. This would pay for Mr. Traylor's time.

Responding to Mr. Garcia, Mr. Cummins said no cash would be transferred to Flywheel. Currently, The Gap Fund has \$495,000, of which about 90 percent is the NMSBIC's share on their balance sheet. If there were no changes in the market value of any of these companies, in three years the NMSBIC would get back about 90 percent paid back. The proposal would allow The Gap Fund to use about \$178,000 of that cash for management fees and expenses that would, The Gap Fund believes, help improve returns of the companies and therefore boost the return to the NMSBIC.

Mr. Cummins stated that, based on his conversations with Messrs. Loy and Traylor, if no change were made to the management fee, the chances are fairly good that the \$471,000 would not be deployed. If the additional \$178,000 is allocated, there is a good chance that some or all of the remaining \$297,000 would be deployed.

[Mr. Loy and Mr. Traylor left the room.]

Mr. Badal said he could see the value The Gap Fund could potentially add to these portfolio companies with this proposal, but did not think the Board should make a three-year commitment.

Mr. Badal moved to approve \$50,000 for the next 12 months and up to an additional \$8,000 in administrative expenses, for a total of an additional \$58,000; and that there be semi-annual progress reports to assist the Board in making a decision a year from now on how to proceed.

Mr. Garcia seconded the motion, which passed unanimously by voice vote.

Mr. Badal and Mr. Cummins agreed to visit with Flywheel along with one or two other Board members, if available.

CHAIRMAN'S COMMENTS

None.

ADJOURNMENT

Its business completed, the NMSBIC Board adjourned the meeting at 12:15 p.m.



Alan Fowler, Vice Chairman and Vice President

5/23/14

Date