PHED Committee #2
October 21, 2013

MEMORANDUM

October 18, 2013

TO: Planning, Housing, and Economic Development Committee

FROM: Jacob Sesker, Senior Legislative Analyst JS

SUBJECT: Business Innovation Network—Update

Introduction

DED Director Steve Silverman will present an implementation strategy for enhancing the Montgomery County Business Innovation Network (BIN). He will be joined by Mike Knapp (Orion Ventures, LLC), who has been working with DED on this effort.

This briefing provides the Committee with an opportunity to engage DED in a discussion regarding its efforts to re-position the incubators to achieve greater economic development impact. This is a briefing only—no action is required at this time.

DED has been working closely with the State of Maryland and the National Institute of Standards and Technology to develop a partnership that will leverage the National Cyber Security Center of Excellence, a federally funded research and development center, in order to both attract private sector cyber security employers and also create an incubator for start-up companies working on civil cyber security. The evolution of that partnership will affect the entire incubator transition plan. DED will provide additional updates in writing or as part of the January DED Update.

This packet contains the following attachment:

- BIN New Model Strategy Development & Implementation Slides: © 1

Background: The BIN Facilities

The Business Innovation Network currently consists of 5 facilities: William Hanna (Shady Grove), Rockville, Germantown, Wheaton, and Silver Spring. The total cost—including lease costs, debt service operating expenses, and personnel costs—is approximately $4.5 million, of which approximately $2.5 million is recovered in rent/licensing fees and other income. The remaining $2.0 million is covered by the County through the annual operating budget. Those figures include approximately $400,000 in personnel costs for the 5 facilities.

William Hanna (Shady Grove)
- Debt service costs: $439,000
- Operating expense plus personnel costs: $1,040,000
- Total costs: $1,479,000

Rockville
- Debt service costs: $400,000
- Operating expense plus personnel costs: $544,000
- Total costs: $944,000

Germantown
- Lease costs: $640,000
- Operating expense plus personnel costs: $528,000
- Total costs: $1,168,000

Wheaton
- Lease costs: $330,000
- Operating expense plus personnel costs: $216,000
- Total costs: $546,000

Silver Spring
- Debt service costs: $0 (facility is owned outright)
- Operating expense plus personnel costs: $306,000
- Total costs: $306,000

Of the two leased facilities, the lease obligation in Germantown extends into 2026, whereas the Wheaton lease expires in 2016.

DED's Program Review

DED seeks to ensure that the Business Innovation Network is achieving maximum economic impact. The current BIN program, which was among the first and remains among the largest in the nation, was designed to meet real estate needs of many small start-ups and, while there have been successes, the current best practice is to provide more targeted and intensive assistance to incubator program participants. As such, the incubators must provide more extensive wrap-around services and programming that is targeted for specific industries/industry clusters, and must also effectively leverage a wide range of public and private sector assets.

DED established the following policy objectives for the Business Innovation Network (BIN) transition: (1) grow technology companies; (2) develop economic clusters in target industries; (3) increase Montgomery County jobs that align with Montgomery County demographics; (4) leverage key regional research and business assets; (5) increase investment in local start-up companies; and (6) support a pipeline of new companies that can graduate from BIN within a reasonable, specified timeframe.

In order to achieve those objectives, DED will need to: (1) identify specific industries upon which to build a program; (2) assess and identify different incubator/accelerator models; (3) conduct fiscal analysis of proposed alternatives; (4) identify and formulate partnerships with appropriate private and public/academic organizations; and (5) restructure the existing program and assets to meet commercialization goals.

Industries selected

The industries selected reflect the County's strengths and opportunities: life sciences, data analytics (such as cyber, health IT, education technology, and bioinformatics), and green technology. In addition, an accelerator program for companies in industries in which products can move quickly from concept to market is under consideration.

Once again, industry selection is critical in order to provide targeted programming and intensive support, to cultivate and develop partnerships with private and public/academic partners, and to brand and market the programs and the facilities.

New model

While the new model may or may not result in reduced debt service/lease costs, it will certainly require additional funding for operating expenses (and possibly personnel). This will require both a shift in focus and an increased capability to cultivate, develop and manage partnerships. The program will not succeed without partners who can assist in the selection of BIN tenants, help develop programming, provide entrepreneurial support, provide mentoring, and (last but not least) invest capital.

Restructuring and Fiscal Impact

The restructured BIN would create a focus on data analytics in both the William Hanna and Rockville incubators. The current life science focus of the Germantown incubator would be strengthened. The Silver Spring accelerator would operate as an accelerator program (which would include intensive programming, mentoring, business development counseling, and access to capital/seed funding). A green technology incubator would be programmed but would not operate out of County space (for example, the incubator could be a partnership with Bethesda Green). The Wheaton facility would close at the end of the current lease term. Obviously, some Wheaton tenants will graduate from the incubator program over the remaining period of the lease, while others will be transitioned into private commercial space.

DED has identified lease savings and other real estate savings, and envisions that those savings will be repurposed to improve programming. Even with those real estate savings, the cost of the BIN will increase due to increased programmatic costs.

Staff Analysis

Staff is supportive of DED's initiative overall, but additional issues will need to be addressed as the transition takes shape over the coming months. DED has presented a well-considered plan to transform Montgomery County's incubator network. Staff concurs with DED's selected industries. However, the transformation to BIN 2.0 will be challenging. The most significant challenges are:

1. ***The fiscal impact will depend on what level of vacancy is required in order to facilitate transition.*** Vacancy allows flexibility during a period of transition—as current BIN tenants graduate, it may be advantageous to not re-tenant that space. The fiscal analysis of the transition addresses costs only, assuming level operating costs, and does not include changes to income or operating expenses associated with increased vacancy rates. DED has confirmed that there is a

contingency reserve built into the assumed costs—whether or not those contingency reserves are adequate is difficult to estimate at this time.

2. ***The timeline is aggressive and DED has limited staff capacity for new projects.*** The transformation of the BIN will require a tremendous amount of work, and if that work is to be done more or less within the existing resources and DED's current personnel complement, it will place pressure on a relatively small number of individual staff members who are already fully programmed. The fiscal analysis assumes funding for $180,000 of consultant services to assist with the transition—the viability of the transition depends heavily upon whether this funding is approved in the budget.
3. ***Negotiating and closing on complex partnership agreements is a special skill requiring a broad set of business, legal, and policy skills.*** Staff believes that building these partnerships will require additional operating money to fund consultant efforts or additional personnel (preferably high-level experienced professionals willing to work on a 2-3 year term contract). Obviously, additional consultants or staff will increase the fiscal impact of the transition. However, Staff believes that it would be best to internalize this work as much as possible (rather than pulling those skills from other departments) in order to build internal capacity to develop and manage partnerships as the program stabilizes and evolves.
4. ***The schedule envisions transitioning Silver Spring into an accelerator at the same time as the transitions of the Germantown, Shady Grove, and Rockville facilities.*** Staff foresees two potential problems with starting an accelerator program in Silver Spring at the same time that the other facilities are in transition. First, DED may find that the learning curve for implementing an accelerator program is steeper than anticipated. Second, given the increased program costs and the fact that the Silver Spring facility is owned outright, it is possible that the facility would need to be sold at some later point in order to fund operations of the other incubators. If DED is able to aggressively develop and close partnership agreements related to the Silver Spring accelerator, this timeline may be achievable. If closing those partnership agreements proves elusive, it may become necessary to re-evaluate the future plans for the Silver Spring facility.
5. ***The presentation does not identify any additional costs associated with the transition of any remaining Wheaton tenants into private space.*** Staff agrees that the current Wheaton incubator lease payments represent the only near-term opportunity to reduce the BIN's real estate footprint, though ultimately some of those savings may be offset by a need to provide rent subsidies. The current Wheaton Business Incubator staff, and the one DGS employee who currently works with small businesses in Wheaton out of the Regional Services Center, are capable of coordinating efforts and providing a baseline level of service to current Wheaton tenants and Wheaton small businesses generally, during the transition. The slides do not address establishing a more robust neighborhood-focused support system for small businesses in Wheaton specifically or generally in neighborhoods undergoing rapid change—ultimately, it may become necessary to add to the County's capacity to address the small business needs in a limited set of transitioning neighborhoods.

F:\Sesker\project files\Economic Development\Incubators\102113 PHED BIN final.docm

Business Innovation Network: New Model Strategy Development and Implementation

An Update Report
October 21, 2013

OrionVentures

Charge for Next Phase of BIN Program

- Identify specific industries upon which to build a program
- Assess and identify different incubator / accelerator models
- Conduct fiscal analysis of proposed alternatives
- Identify and formulate partnerships with appropriate private and public / academic organizations
- Restructure existing program and assets to meet commercialization goals

Industry Sectors Selected After Evaluation by DED

- Orion presented industry sectors that met key objective criteria including available talent, sustainable wages, critical mass of companies and partnership opportunities.
- Industries selected
  - Life Sciences
  - Data Analytics (including Cyber, Health IT, EdTech, and Bioinformatics)
  - Green Tech
  - Accelerator

BIN Program and Policy Objectives as Presented to Council and DED

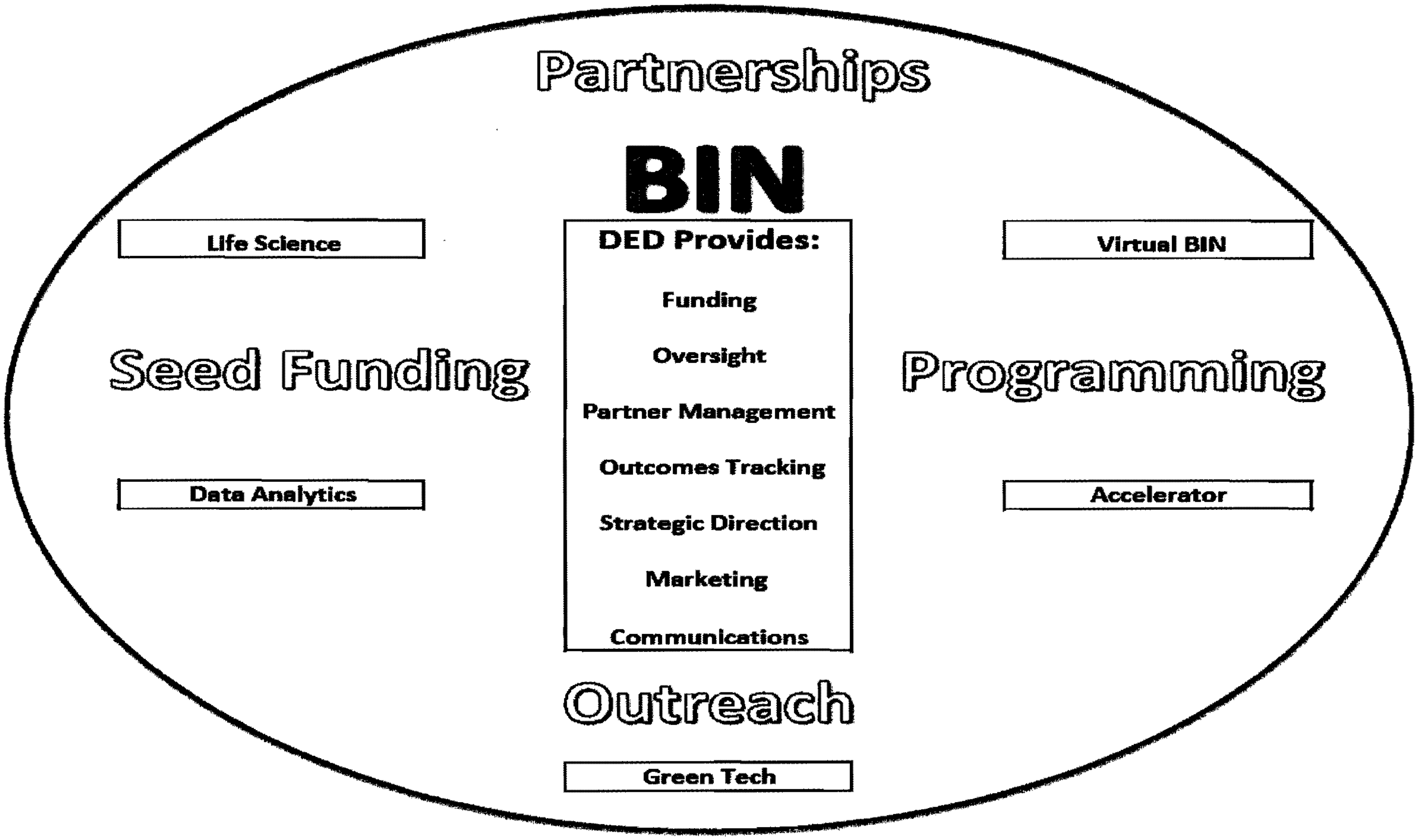
❖ **Agreed Upon Policy Objectives:**

- Grow technology companies
- Develop economic clusters in target industries
- Increase Montgomery County jobs that align with County demographics
- Leverage key regional research and business assets
- Increase investment in local start-up companies
- Support a pipeline of new companies that can graduate from BIN within specified timeframe

New Model for the BIN

- Shift from spending $4+ million to support real estate and minimal funding for programming to focusing primarily on programming and company support.
- New model will identify partners with industry sector expertise and leverage that expertise to provide entrepreneurial support, market analysis, programmatic support, mentoring and investment.
- County will move from real estate management to partnership management, support, and communications.
- Strategic approach to create fewer, more successful companies.

Overview of New BIN Network



Implementation Scenario

Year 1

Communications – Lay out new program vision, goals and objectives both internally and externally.

Life Sciences – Enter into industry partnership; identify appropriate space for partnership; transition companies from current location to alternate sites; develop financing model and company development framework w/ partner.

Data Analytics– Initial focus on cybersecurity; Formalize relationship with NCCoE; Identify space for NCCoE and incubator; Enter into industry partnership; Begin recruitment of incubator companies.

Implementation Scenario

<u>**Year 1**</u> (cont.)

Green Tech - Develop MOU w/ Green [illegible]
Develop and implement marketing plan.

Accelerator -Identify accelerator partner and focus for first cohort; Establish timeline for first accelerator class; Implement first accelerator class; Identify partner and focus for second accelerator class; Develop funding model.

Real Estate - Develop incubator real estate partner relationship; Establish framework to bring new and existing companies into commercial real estate.

Current Finances

Financial Overview of BIN Facilities (Estimate to $000s Based on BIN FY14 Budget as of 6/18/13)							
Facility	Debt Service or Lease	Operating Expense	Personnel Costs	Total Costs	Rent & Other Income	Budget Gap	County Funding OE & PC
William Hanna	$ 439,000	$ 961,000	$ 79,000	$1,479,000	$1,081,000	$ 398,000	$ 429,000
Rockville	$ 400,000	$ 465,000	$ 79,000	$ 944,000	$ 434,000	$ 510,000	$ 479,000
Germantown	$ 640,000	$ 443,000	$ 85,000	$1,168,000	$ 563,000	$ 605,000	$ 650,000
Wheaton	$ 330,000	$ 140,000	$ 76,000	$ 546,000	$ 123,000	$ 423,000	$ 431,000
Silver Spring	$ -	$ 230,000	$ 76,000	$ 306,000	$ 270,000	$ 36,000	$ 76,000
TOTAL:	$1,809,000	$2,239,000	$ 395,000	$4,443,000	$2,471,000	$1,972,000	$2,065,000

Source: MCDED

Current Finances

Facility	Total Costs without PC	County Funding OE	Net
William Hanna	$ 1,400,000	$ 350,000	31,000
Rockville	$ 865,000	$ 400,000	-31,000
Germantown	$ 1,083,000	$ 565,000	45,000
Wheaton	$ 470,000	$ 355,000	8,000
Silver Spring	$ 230,000	$ -	40,000
TOTAL:	$ 4,048,000	$1,670,000	93,000

New Finance Proposal

YEAR 1

Facility	FY2014 real estate costs	Recommended real estate costs	FY2014 Personnel costs	Recommended programming and personnel costs
William Hanna	$ 1,400,000	$ 700,000 [1]	$ 79,000	$ 750,000
Rockville	$ 865,000	$ 865,000	$ 79,000	
Germantown	$ 1,083,000	$ 1,083,000	$ 85,000	$ 750,000
Wheaton	$ 470,000	$ 0	$ 76,000	$ 0
Silver Spring	$ 230,000	$ 230,000	$ 76,000	$ 250,000
Green Technology	$	$	$	$ 250,000
TOTAL:	$ 4,048,000	$ 2,878,00	$ 395,000	$ 2,000,000

New Finance Proposal

YEAR 2 (Transition from real estate focus to [illegible]

Focus Area	FY 2016 Recommended Real Estate Costs	FY 2016 Recommended programming and personnel costs
Data Analytics	$ 1,650,000	$ 1,000,000
Life Sciences	$ 1,137,000	$ 750,000
Accelerator	$ 262,000	$ 375,000
Green Technology	-	$ 300,000
TOTAL:	$ 3,049,000	$ 2,425,000

This table reflects the following:

- Recommend increasing investment in Data Analytics,
- Flat investment in Life Sciences (assumes a multi-year contract with private partner)
- A $ 50,000 increase for green technology,
- 3 accelerator programs in Year 3.

Real estate costs for FY2016 are estimated at a 5% increase over FY2014 expenses.
A percentage of the real estate costs will be offset by rental income.
Using current ratios, rental income equal approximately $1.8M.