Legislative Analysis

Phone: (517) 373-8080
http://www.house.mi.gov/hfa

Analysis available at
http://www.legislature.mi.gov

VENTURE MICHIGAN FUND REVISIONS

House Bill 4195 (reported from committee as H-2)
Sponsor: Rep. Al Pscholka

House Bill 4196 (reported from committee as H-3)
Sponsor: Rep. Michael D. McCready

House Bill 4365 (reported from committee as H-1)
Sponsor: Rep. Brandt Iden

Committee: Commerce and Trade
Complete to 3-24-15

SUMMARY:

House Bill 4195 would amend the Michigan Early Stage Venture Investment Act of 2003 to prohibit the Michigan Early Stage Venture Investment Corporation from entering into new agreements with investors after the effective date of the bill. The corporation could, however, modify an existing agreement with an investor as long as no additional principal was borrowed from the investor and tax vouchers were not increased above the level that had been approved on the effective of the bill. The corporation could also modify an existing agreement with an investor that the corporation had received a loan or line of credit from and could expend money to modify the agreement as long as (1) expenditures were no more than $500,000 without the consent of the state budget director and (2) notification of the modification was reported to the State Budget Office and the chairpersons of the House and Senate Appropriations Committees within 30 days of finalization of the modification.

The bill would prohibit the corporation from creating a Michigan Early Stage Venture Investment Fund or make any new commitments to contribute capital to a venture capital company after the effective date of the bill. A fund could, however, modify an existing agreement with a venture capital company as long as no additional funds were committed to the company after the effective date of the bill.

The bill would prohibit the Department of Treasury from approving any new tax voucher certificates after the effective date of the bill and would reduce the total dollar amount of credit vouchers issued under the act from $600 million to $450 million.

The bill would require that corporation's annual report be made available on the internet and that copies be sent to the House and Senate Appropriations Committees. Additionally, new reporting items related to investments made and tax vouchers used under the corporation's activities would be added to the report's contents.

Finally, the bill would provide for remaining property after dissolution of the corporation to revert to the state's General Fund. (Current language allows distribution to a governmental unit or tax exempt organization.)

House Bill 4196 would amend the same act to move the expiration date for the fund from January 1, 2054, to January 1, 2030, and to remove certain existing language related to the distribution of money in the fund, thereby clarifying that any money in the fund (subject to outstanding debts and obligations) shall be distributed to the state's General Fund on that date.

House Bill 4365 would amend the Michigan Business Tax Act to reduce the total dollar amount of credit vouchers issued for the purposes provided in the Michigan Early Stage Venture Investment Act of 2003 from $600 million to $450 million.

The bills are tie-barred to one another, meaning none can take effect unless all are enacted.

BACKGROUND INFORMATION:

Public Act 296 of 2003, as later amended by Public Acts 233 of 2005 and 173 of 2007, created the Early Stage Venture Capital Investment Act. The stated purposes of the act are:

> *(a) To promote a healthy economic climate in this state by fostering job creation, retention, and expansion through the promotion of investment in certain businesses.*
> *(b) To allow the state to enter into agreements with Michigan early stage venture investment corporations to promote a healthy economic climate in this state.*

The act created the Early Stage Venture Investment Corporation, governed by a seven-member board that includes the State Treasurer, the Chief Executive Officer of the Michigan Economic Development Corporation (MEDC), and five appointed members. The act also authorized the board to hire a fund manager through a competitive bid process.

Tax vouchers were issued by the state to lending institutions to serve as collateral against the capital provided by the lending institutions to the Early Stage Venture Investment Corporation. Section 419 of the Michigan Business Tax (MBT) Act limited the value of the tax vouchers that could be issued to the amount sufficient for the Early Stage Venture Investment Corporation to raise $450 million of investment capital. The vouchers could be sold by the financial institutions in the event that loans were not repaid on schedule. Purchasers of these vouchers could then apply them against either an MBT liability or against required withholding payments under the Income Tax Act. Section 419 of the MBT Act also imposed a cap of $600 million on the total value of the tax vouchers that could be claimed, although House Bills 4195 and 4365 would reduce that amount to $450 million.

In 2005, the board contracted with GCM Grosvenor Private Markets to be the fund manager for Venture Michigan Fund I (VMF I). In 2006, $200 million in tax vouchers were collateralized with Deutsche Bank and Credit Suisse to provide investment capital. From March 2007 to July 2010, 11 fund managers were hired to invest a total of $95 million in

Michigan startup businesses, with reported actual investments of $79 million to date (see Figure 1).

FIGURE 1
Venture Michigan Fund I - Fund Managers

Arboretums Ventures II
Arboretums Ventures III
Arsenal Venture Partners II
Chrysalis Ventures III
Early Stage Partners II
Fletcher Spaght Ventures II
North Coast Technology Investors III
Nth Power Fund IV
RPM Ventures II
TGap Venture Capital Fund II
Venture Investors Early Stage Fund IV

Source: Venture Michigan Fund financial statements (for year ending December 2013)

In 2010, the board again contracted with GCM Grosvenor Private Markets to be the fund manager for Venture Michigan Fund II (VMF II). In 2010, $250 million in tax vouchers were collateralized with Stanton (an affiliate of Credit Suisse) to provide investment capital. From March 2011 to December 2013, nine fund managers were hired and have begun to invest a total of $120 million in Michigan startup businesses (see Figure 2).

FIGURE 2
Venture Michigan Fund II - Fund Managers

Arboretums Ventures II
Cultivian Sandbox Food & Agriculture Fund II
Draper Triangle Ventures III
Flagship Venture Fund IV
Mercury Fund Ventures III
MK Capital II
Plymouth Venture Partners II
Plymouth Venture Partners III
Venture Investors Early Stage Fund IV

Source: Venture Michigan Fund financial statements (for year ending December 2013)

As of a recent reporting, VMF I and VMF II have resulted in total investments of approximately $150 million in 41 Michigan startup companies. Representatives of GCM Grosvenor Private Markets indicate investments were delayed in some cases due to the financial crisis of 2007 and 2008.

Repayment of Loan for Venture Michigan Fund I
VMF I was structured so that the loan would be paid back with both proceeds from the investments and tax vouchers. The first payment for loans to Deutsche Bank is due starting in FY 2014-15. The MBT Act restricted the amount of vouchers sold to taxpayer(s) in any one year to no more than 25% of the total vouchers issued ($50 million). The proceeds from the sale of vouchers will be used to pay interest and principal due. The repayment schedule is anticipated to be as follows:

- FY 2014-15: $50 million
- FY 2015-16: $50 million
- FY 2016-17: $40 million

Deutsche Bank is expected to sell the vouchers to a Michigan taxpayer (or taxpayers) per the above schedule. The amounts listed will be realized as reductions to state revenue (approximately 77% will be a GF/GP reduction; the remaining 23% will be a School Aid Fund reduction).

Repayment of Loan for Venture Michigan Fund II
At this time the magnitude of tax vouchers that will be sold to pay for the debt obligation for VMF II is unknown. A potential total liability of $250 million exists for VMF II. Tax vouchers would be redeemed beginning roughly five years from now.

Expiration of Fund
Section 31 of the act provides for the fund holding the VMF investments to expire on January 1, 2054.

FISCAL IMPACT:

House Bills 4195 and 4365 would limit the amount of any future state liability through tax vouchers authorized by the Michigan Early Stage Investment Corporation. As indicated above, vouchers totaling $140.0 million are expected to be redeemed over the next three years under Venture Michigan Fund I. The amount of additional vouchers that will be claimed, and the impact the bill would have on that amount, cannot be projected precisely. The fiscal impacts depend in part on the amount of tax vouchers actually sold absent the bills' provisions. If less than $450 million in total are eventually sold, then reducing the cap from $600 million to $450 million would have no impact. However, if more than $450 million would have been sold, then the savings to the state would be anything above the $450 million threshold.

The impact of House Bill 4196 would depend on the performance of fund investments between 2030 and 2054. House Bill 4195 would ensure that all remaining funds in 2030 would revert to the state's General Fund.

Fiscal Analysts: Kyle I. Jen
Jim Stansell
Mary Ann Cleary

■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.