F I S C A L   I M P A C T   R E P O R T

		ORIGINAL DATE	02/18/13		
SPONSOR	Trujillo, CA	**LAST UPDATED**	02/25/13	**HB**	401/aHBIC
SHORT TITLE	State Investment In Tech Transfer Companies			**SB**	
				ANALYST	Walker-Moran

REVENUE (dollars in thousands)

Estimated Revenue					**Recurring or Nonrecurring**	**Fund Affected**
FY13	**FY14**	**FY15**	**FY16**	**FY17**		
	NFI	NFI	NFI	NFI	Recurring	

(Parenthesis ( ) Indicate Revenue Decreases)

Relates to SB 223, HB 240, HB 405, SB 357, and SB 9

SOURCES OF INFORMATION
LFC Files

Responses Received From
State Investment Council (SIC)
State Treasurers' Office (STO)
Attorney General's Office (AGO)
Economic Development Department (EDD)
State Land Office (SLO)

SUMMARY

Synopsis of HBIC Amendment

The House Business and Industry Committee amendment to House Bill 401 adds research develop by "a state institution of higher education or" to the authorized investments made by the New Mexico Private Equity Funds and Business Investments, to expand authorized investments through the Severance Tax Permanent Fund (STPF).

Synopsis of Original Bill

House Bill 401 (HB 401) amends section 7-27-5.15 NMSA 1978, New Mexico Private Equity Funds and Business Investments, to expand authorized investments through the Severance Tax Permanent Fund (STPF): 1) in a New Mexico business that is established to perform technology transfer, research and development, research commercialization, manufacturing, training, marketing or public relations in any field of science or technology, including but not limited to energy, security, defense, aerospace, automotives, electronics, telecommunications, computer and information science, environmental science, biomedical science, life science, physical science, materials science or nanoscience, using research developed in whole or in part by (HBIC amended language is inserted here) a prime contractor designated as a national laboratory by an act of congress that is operating a facility in the state, or an affiliated entity; and 2) has an agreement to operate the business on state lands.

Current law authorizes the State Investment Council (SIC) to invest in: (1) Cooperative investment agreements with parties that have demonstrated abilities and relationships in making investments in new, emerging, or expanding businesses; and (2) New Mexico aerospace businesses that have received an award of at least $100 million from the U.S. government (a separate bill, SB 223, proposes to remove this particular authorization).

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends (June 14, 2013).

FISCAL IMPLICATIONS

According to the SIC, there is no fiscal impact. There is a contingent impact of indeterminate size depending on variables not considered under HB 401 which would be related to the suggested STPF investment scope expansion prescribed under the bill.

According to the State Land Office (SLO), this bill incentivizes businesses to locate and invest on state trust lands, which results in increased revenue from leasing that would benefit one or more of the 21 state land trust beneficiaries. In addition to increasing revenue for trust beneficiaries, which also reduces the burden on taxpayers and the General Fund, encouraging sound investments on state trust land could also reduce the investment risk of the State should the venture not be successful.

SIGNIFICANT ISSUES

According to the State Treasurer's Office (STO), it may be that the revised qualifications for the bill are only met by two companies to the exclusion of other potential investments made to New Mexico private equity funds or other business investments.

According to the SIC: While obviously well intentioned in seeking to spur economic development and job growth by increasing the productive use of public lands and investment in technology and other companies located on state trust lands, there is a question whether this bill can be effective in encouraging these honorable efforts.

HB 401 is proposed under NMSA 7-27-5.15, which allows for differential rate (below market rate) investments, also known as Economically Targeted Investments (ETIs) to be made from the Severance Tax Permanent Fund. Historically, ETIs in which the SIC has invested have had a spotty track record, and have led to documented underperformance by the STPF over time.

The SIC, which had its powers and membership reconstituted by the legislature in 2010, has in recent years focused strongly on making best-in-class investments intended to optimize performance and returns to the permanent funds. Economic development benefits – if there are any – have been secondary to an investment's ROI characteristics, and are only considered a factor for comparison if an investment's fundamentals meet appropriate market standards.

In no small part, this is due to the current statutory guidelines regarding investment of the STPF, which allow for considerable Council discretion in investing in differential rate vehicles in New Mexico. In reviewing the historical track-record, the Council has voiced concerns that many previous investments falling into this category have arguably not provided optimal return of STPF dollars.

For example:

- From 1993-2004, the NM Private Equity Program was focused on job and industry creation rather than return on investment. Annualized investment returns for that period were -18 percent, and notably occurred during some of the historically prime years for venture capital investing. Since 2004, when the strategic focus shifted to producing investment returns, performance has turned positive, while still achieving secondary economic development benefits.
- From 2001-2008, the SIC invested in 25 NM film and television projects, offering zero-interest loans in lieu of profit sharing. While all principal was returned, and certainly the projects brought jobs and spent money in the state, only two films produced profit, and opportunity cost to the STPF was more than $30M (compared to investments conservatively made in US Treasury Bills).
- In 2007, the SIC by statute was required to allocate 1 percent of the STPF to the NM Small Business Investment Corporation (SBIC). Of the $47M invested by SBIC, today approximately $14M of value has been lost through equity investments made by the SBIC in NM businesses and venture funds. Additionally, at least $5M is undeployed and sitting idle, while another $5M is committed, but locked into low/no-real return certificates of deposit pending draw-down at a future date.

It is worth noting that the STPF currently has 69 percent of its funds earmarked for possible ETI investment by statute. Only 1 percent - that for SBIC – is actually mandated by statue, while all others are allowed or have an implied mandate.

If passed, HB 401 would not automatically require deployment of capital, though like all legislation, can be construed as a legislative directive, which has also been signed and endorsed by the Governor. It is difficult to say if the Council would find such an imperative persuasive enough to actively pursue the investments outlined by HB 401.

According to the Economic Development Department (EDD), although the aerospace industry sector has a long history of successes in New Mexico and continues to grow here, a great deal of research and development is taking places in other sectors, such as energy, water, biosciences, information technologies and digital media. Allowing the SIC to make investment in these sectors broadens the potential to commercialize new technologies and create new jobs and investment beyond the aerospace sector.

PERFORMANCE IMPLICATIONS

HB 401 simply provides additional guidelines for the SIC to consider when making quality investments in NM tech transfer companies. It does not tell them they shall make these investments, and instruction is merely implied. It is for this reason, and the other variables the Council may or may not consider when making such an investment, e.g. Is it at market rate? Is the company institutional quality? Are there associated economic development benefits or other revenues produced due to the investment locating on state trust land? These and other questions could have significant impact on the ultimate quality of an investment and its overall effect on the permanent funds.

The LFC tax policy of accountability is met with the bill's requirement to report annually to the legislature, the legislative finance committee, the revenue stabilization and tax policy committee and any other appropriate interim committee. The report shall provide the amount invested in each New Mexico private equity fund, as well as information about the objectives of the funds, the companies in which each fund is invested and how each investment enhances the economic development objectives of the state.

According to the EDD, Successfully commercializing technology developed in the State can contribute to the growth of New Mexico's economy, generate new investment and revenue and create high-wage, career-oriented jobs that may act as an incentive to keep graduates of NM universities in the State.

There are many examples of companies that have commercialized technologies developed within the national laboratories with great success. EMCORE is but one example. Others do not succeed and this can often be attributed to the lack of seed capital needed in the early stages of developing products and services that may be years away from generating revenue. In the 1980s Stolar Research received a $35,000 seed capital grant from the State of New Mexico to develop mining safety and homeland security products that has resulted in the continuous growth of the company. In December 2012 the company announced an expansion that will create 50 new jobs at an average salary of $60,000. The company currently has a facility in Raton which will remain in operation. A new facility is now under construction in Rio Rancho, the location of the new jobs, representing a substantial investment. The program that provided the seed capital for Stolar was discontinued in the late 1980s.

ADMINISTRATIVE IMPLICATIONS

Per the SIC: The Council itself currently makes no 'direct' investments as contemplated by HB 401, but invests instead in NM-based venture funds run by professional managers whose best interests are to make only top quality investments available to this strategy. There is an alignment of interests between the passive investor, the SIC, and the Venture Fund managers due to profit sharing, or carried interest. Bad investments will not produce profit, so there is no legitimate incentive for a professional to make one. Under NMSA 7-27-5.15, while below-market rate investments are allowed under the NM Private Equity Program, they have been rejected in practice for several years.

Along those lines, it is unclear what HB 401 would actually do, other than possibly broaden the scope of allowable companies for potential investment under statute. While most of the types of businesses named in HB 401 are already allowable for co-investment if of appropriate institutional quality, there is some broadening of the original scope and intent under NMSA 7-27-5.15, which is to facilitate technology transfer. For example, it is unlikely whether marketing or public relations companies (as mentioned in HB 401) would meet the current investment criteria allowable under the law.

At this time, the Council is allowed to invest up to 9 percent of the Severance Tax Permanent Fund, or currently more than $360M in NM Private Equity. As of January 2013, the Council identified 5 percent of the STPF, as an appropriate long-term target for this allocation, to be reviewed on at least an annual basis.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB 9 seeks to change membership in the SIC.

There are some other bills seeking to adjust the guidelines or amounts of investments the Council can consider under NMSA 7-27-5.15:

SB 223 seeks to remove the Private Equity Investment Advisory Committee as a statutory entity and to remove investments in aerospace businesses.

HB 240 seeks to create a $100M non-profit small business development fund using STPF dollars.

HB 405 seeks to allow investment from the STPF in bonds funding public/private projects.

SB 357 seeks to increase the amount allocated from the STPF to SBIC from 1 percent to 1.5 percent.

TECHNICAL ISSUES

According to the STO, consideration should be given to the SIC's due diligence process for Private Equity investments by following the Prudent Investor Rules following guidelines that requires a fiduciary to invest trust assets as if they were his own. The managing investor should consider the needs of the trust's beneficiaries, the provision of regular income, and the preservation of trust assets and should avoid investments that are excessively risky.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

According to the EDD, many research and technology developed in NM leaves here to receive investment or other incentives offered by other states. The availability of new investment funding should reduce the loss of some of these early stage companies. The bill also requires a company to operate on state-owned land to be eligible for funding, providing a stop-gap or incentive to grow and maintain the business in New Mexico.

EWM/svb