



Oregon Investment Act (HB 4040): A Critique

The Treasurer, Governor, Rep. Read and others have introduced the Oregon Investment Act (HB 4040) in the 2012 Legislative Session. This bill will do several things:

What the Oregon Investment Act does: The OIA will transfer the Oregon Growth Account to a new Oregon Growth Fund within the State Treasury overseen by a new Oregon Growth Board but managed by Business Oregon. It will also allow for other funds, public and private, to be added to the menu of funds managed by the Oregon Growth Board.

The current OGA was created in 1995 to provide capital for business start-ups in Oregon via limited partnerships with private venture capital funds. The OGA is made up of funds from the Education Stability Fund (drawn from Lottery Funds). The OGA currently has about \$100 million invested via limited partnerships.

Where will the funds come from? The newly created Oregon Growth Fund is intended to absorb other pre-existing economic development funds in the State at the recommendation of its board and the agreement of the Legislature. The OIA is intended to consolidate these funds and manage them in a coordinated fashion, using them to leverage more lending from community banks and more investment from private capital funds, federal grants, etc. The OGF Board will make recommendations to the 2013 Legislature regarding further consolidations of funds.

The State currently has dozens of disparate economic development funds including the OGA, Oregon Investment Fund (the PERF set aside managed by Credit Suisse), the State Energy Loan Program, a variety of funds managed by the Business Development Department (aka Business Oregon), and others, totaling several hundred million dollars. These funds have been appropriated by the Legislature over the years to promote economic development. They are scattered amongst different agencies, are not coordinated, and in some cases not very well run. Most importantly they are not used synergistically with the lending that community banks are doing. In fact, in many instances the community banks don't even know of the existence of these funds, and even if they know of them, don't know how to access them.

What will the Oregon Growth Fund do? The Oregon Growth Fund will be authorized to undertake various economic activities, including venture capital investments as well as "to make, purchase, guarantee or hold grants and loans including ... participation interests in loans..." (Section 5(3)).

While the bill mentions loan guarantees and loan participations in this one section, it leans heavily toward venture capital investments (and grants) rather than participations with community banks and credit unions. The currently existing OGA and the OIF are both



oriented toward venture capital and it appears that this bill is in part an attempt to readjust some of those rigid sideboards.

Venture capital leans toward start-ups with higher risk and higher potential profits, and often results in turn-over sales of start-ups to out of state firms, while conventional lending by community banks is oriented more toward existing businesses, more often small businesses, with longer term, patient capital with a less risky profile which tends to keep profits and jobs in the state. There is a general consensus that outside of the Portland metro area, community banks need participation loans from larger institutions and the Wall Street banks are not available. This should be a central role for the Oregon Growth Fund, but there is little in the bill language to make that seem likely.

In addition, where the bill mentions "grants," one has to ask, why should the state make outright grants to businesses? Why not take equity for our investments as would any private parties? Without an equity stake, the State simply reduces risk for private investors who retain all potential upside but with reduced downside.

Who will oversee the Fund? The OGF will be staffed by Business Oregon, and governed by a seven person board consisting of the Treasurer and six gubernatorial appointees, of whom at least one will be from each congressional district; one with experience in banking; one with experience in investment or loan portfolio management; two with experience in small business. The board members cannot all be from the same party. There will also be two non-voting legislators on the board.

Because this bill largely creates a shell for something yet to be created, it is hard to make judgments. Everything will depend on who sits on the Board and what kind of recommendations they make.

This board configuration represents an improvement over earlier versions; however, one banker is not enough. If this is not going to be another instance of sloppy and confused economic development policies, which the OIA is supposed to correct, it should be governed by people with experience in banking and other financial institutions, not politicians or political donors. We recommend that at least two community bankers serve on the Board.

The list of board members does not mention farmers. The reason given is that if one were to name farmers, there would be pressure to name other "interest groups," e.g. building trades, credit unions, etc. and soon you would have an unwieldy board. This may be true, but small farmers are one group that most needs access to credit, and if they are not represented, they will likely be ignored yet again.



What will be the cost to the State? The OGF is mandated to attract private investment capital into the Oregon Growth Account ("similar to the State's College Savings accounts") through "income and corporate excise tax subtractions or other tax expenditures." (Section 5(9)(b))

This goes beyond the partnerships with private equity and venture capital firms directed through the current OGA and OIF and instead it seeks to attract private capital directly into the OGF. This will cost the State money when direct lending and investment should make the State money. It is not clear what is gained through this mechanism. Private capital investments, as well as private lending, could be attracted through well managed partnerships without tax expenditures.

Further, the College Savings Account, 529 model, which is referenced in the bill is in fact like both a traditional and Roth IRA rolled together -- no tax going in and no tax on the gain coming out. If the Legislature agrees that the OGF needs access to more capital, it should budget the amount needed, and expect equity or repayment, not create a tax break that will have an unknown impact on the General Fund, not be amenable to changes during downturns, and provide a flow of income to Business Oregon outside the budget process.

Additionally, Section 5(4) seems to exclude individuals as tax-advantaged investors, including only businesses or entities. This needs to be clarified.

Who will manage the money? The OGF will not manage or invest its funds directly; rather it will contract with "one or more management companies" to invest its funds (Section 6).

This seems unlikely to promote loan participations with community banks, but rather to encourage venture capital investments. Additionally it will be an additional cost with no clear benefit. If the point is to consolidate and coordinate the State's far flung economic development funds, parceling them back out among private managers seems counter-productive. Further, Business Oregon, the Department of Energy, and other state departments currently have a number of loan programs that they do not shop out. We see no need to assume that privatizing these functions will serve the public good.

Some critical definitions need clarification:

Under Section 20, Section 23, and Section 25 an "emerging growth business" is defined as one that will provide... "significant high-skill, high-wage employment." However what that term means is not defined and must be. Currently Oregon has only low-wage and high-wage jobs, according the term "high-wage" to any job above about \$33,000. This is not an adequate standard or definition.

Section 25 (1)(b), an older provision, says "there exists an estimated gap of between \$100 and \$200 million between available venture capital resources and the need of Oregon businesses



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for such resources.” Is this still true? We have just had a banner year with more than \$238 million in venture capital investing in Oregon. This legislation has no controls over the flow of public revenue to private venture capital undertakings.

This is most decidedly not a state bank. The State's \$10 billion plus in the Short Term Fund will still go to Wall Street banks, with resultant investment and profits leaving the State. The OGF will not be run by bankers and will not have as a principal purpose the stability of our local banking sector. Nor will the OGF be able to leverage funds as a bank could.

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