

MEMORANDUM



DATE: January 21, 2015
TO: House Appropriations Committee
FROM: Mary Ann Cleary, Director
Kyle I. Jen, Deputy Director
Jim Stansell, Senior Economist
RE: Venture Michigan Fund

This memorandum provides background information on the Venture Michigan Fund program, which is anticipated to create a total state revenue loss of \$140.0 million over the next three years.

Background

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.

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 and have invested a total of \$95 million in Michigan startup businesses (see Figure 1).

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).

At this time, VMF I and VMF II have resulted in total investments of \$150.1 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

Based on preliminary information, several options exist for repayment:

- Deutsche Bank sells the vouchers to a Michigan taxpayer (or taxpayers) per the above schedule. The amounts listed would be realized as reductions to state revenue (approximately 77% would be a GF/GP reduction; the remaining 23% would be a School Aid Fund reduction). This is the presumed default option if no legislative action is taken.
- The State of Michigan purchases the vouchers directly. This potentially reduces the amount of vouchers that need to be sold, as a discounted purchase price is anticipated if the vouchers are sold on the open market. This action presumably requires the Legislature to make GF/GP appropriations.
- State of Michigan pays off the total four-year debt in FY 2014-15 at an estimated cost of \$120 million, saving the state \$24 million. This action presumably requires the Legislature to make a GF/GP appropriation and would require a larger amount of funds to be identified up front within current budget constraints.

Repayment of Loan for Venture Michigan Fund II

At this time it is unknown when and if tax vouchers will be sold to pay for the debt obligation for VMF II. A potential total liability of \$250 million exists for VMF II.

Long-Term Outlook

Section 31 of the act provides for the fund holding the VMF investments to expire on January 1, 2054. The section references remaining funds being distributed to the state general fund. The phrasing in the relevant sentence is, however, difficult to interpret. Reportedly, the bylaws of the Michigan Early Stage Investment Corporation provide for remaining funds to be distributed to the MEDC or its successor.

The amount of any remaining funds will depend on how fund investments perform over the next four decades.

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

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)