FISCAL NOTE

Requested by Legislative Council
01/23/2001

Bill/Resolution No.: HB 1454

Amendment to:

1A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	1999-2001 Biennium		2001-2003 Biennium		2003-2005 Biennium	
	General Fund	**Other Funds**	**General Fund**	**Other Funds**	**General Fund**	**Other Funds**
Revenues	$0	$0	$0	$0	$0	$0
Expenditures	$0	$0	$0	$600,000	$0	$600,000
Appropriations	$0	$0	$0	$5,700,000	$0	$4,700,000

1B. **County, city, and school district fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

1999-2001 Biennium			2001-2003 Biennium			2003-2005 Biennium		
Counties	**Cities**	**School Districts**	**Counties**	**Cities**	**School Districts**	**Counties**	**Cities**	**School Districts**
$0	$0	$0	$0	$0	$0	$0	$0	$0

2. **Narrative:** *Identify the aspects of the measure which cause fiscal impact and include any comments relevant to your analysis.*

The bill provides a state investment fund consisting of public and private sector funds to invest in primary sector equity (stock of new wealth creating enterprises) and to receive a return on those investments (ROI). According to the bill a total of $5,700,000 would be appropriated (from 4 public sources - see Appropriations section C below) if at least $5,000,000 in private investment is raised. As a result, initial fund value would total at least $10,700,000.

North Dakota Department of Economic Development & Finance, in cooperation with the North Dakota Securities Commissioner, will be responsible for establishing the State Investment Fund and contracting for private management and implementation of this investment fund.

The private fund manager would make only equity investments in new or expanding primary sector (new wealth creating) businesses or enterprises. Eighty percent of those investments (using a five year average) must be made in North Dakota businesses or enterprises.

The ROI for the fund is guaranteed to average a minimum of 6% annually for the first ten years of the investor's investment (exepting the tobacco settlement trust fund). If earning are not adequate the Bank of North Dakota will provide the funds to ensure the six percent average return.

Although the bill establishes an expected minimum rate of return, it does not provide an expectation for higher rates of return - which would also establish the kind(s) of financing and (ultimately) the type(s) of fund management required. What percentage of this fund will be targeted at early stage financing, expansion financing and later stage financing? Will the fund be prohibited from financing acquisitions and buyouts? (See attached file providing stages of financing definitions.) What financing gaps is this fund be positioned to address in the state?

There are some additional issues that may need to be addressed:

1. Will the fund be used for debt instruments in addition to equity? Equity will likely require significant subsidies (to guarantee 6% ROI) by the Bank of ND.

2. How will the fund be measured - by ROI only? Will other measures be used (i.e. number/type of jobs)?

3. How much control do the public funders need to have over the fund manager and over investments? (How will they be represented?)

4. Will anyone (outside the fund manager) approve investment decisions?

5. What reporting requirements do the fund managers have? Who do they report to?

6. Will fund managers receive incentives? Will they be allowed to own stock in the companies or enterprises they're investing in?

7. Can fund managers be utilized that are responsible for more than this fund?

FINANCING STAGE DEFINITIONS

EARLY STAGE FINANCING

Seed Financing: This stage is relative small amount of capital provided to an inventor or entrepreneur to prove a concept and to qualify for start-up capital. This may involve product development and market research as well as building a management team and developing a business plan, if the initial steps are successful.

Start-Up Financing: This stage provides financing to companies completing development and initial marketing. Companies may be in the process of organizing or they may already be in business for one year or less, but have not sold their products commercially. Usually such firms will have made market studies, assembled the key management, developed a business plan, and are ready to do business.

First-Stage Financing: This stage provides financing to companies that have expended their initial capital, often in developing and market testing a prototype, and require funds to initiate full-scale production and sales.

EXPANSION FINANCING

Second-Stage Financing: This stage is working capital for the initial expansion of a company that is producing and shipping, and has growing accounts receivables and inventories. Although the company has made progress, it may not yet be showing a profit.

Third-Stage Financing: This stage provides major expansion of a company whose sales volume is increasing and that is breaking even or profitable. These funds are used for further plan expansion, marketing, working capital, or development of an improved product.

LATER STAGE FINANCING

Bridge Financing: This stage is needed at times when a company plans to go public within six months to a year. Often bridge financing is structured so that it can be repaid from the proceeds of a public underwriting. It can also involve restructuring of major stockholder positions through secondary transactions. Restructuring is undertaken if there are early investors who want to reduce or liquidate their positions, or if management has changed and the stockholdings of the former management, their relatives and associates are being bought out to relieve a potential oversupply when public.

Open Market: This stage involves acquiring securities of companies whose common shares trade publicly.

ACQUISITION/BUYOUT

Acquisition Financing: This stage provides funds to finance the acquiring of another company. Venture Economics tracks these deals when calculating venture capital disbursements in situations where the funding is by a venture capital firm, but not when it is by a buyout firm.

Management/Leveraged Buyout: These funds enable an operating management group to acquire a product line or business, at any stage of development, from either a public or private company. Often these companies are closely held or family owned. Management/leveraged buyouts usually involve revitalizing an operation, with entrepreneurial management acquiring a significant equity interest.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*
   A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

The additional impact to state and local revenues (increasing new wealth and resulting increases in public sector tax revenues) is impossible to predict at this point in time.

   B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

Assuming that the proposed fund will target early stage and expansion financing, private fund management could easily be 5% (or perhaps higher) each year of the total fund value. For the 2001 - 2003 biennium, (for a fund equaling $10,700,000; $5.7 million public and $5 million private) we've estimated only $300,000 (less than 3%) annually ($600,000 for the biennium) for private sector fund management services.

Private fund managment (assisting early stage and expansion needs) would review a large number of proposals (i.e. applications, business plans and presentations) each biennium. Fund managers may also be contracting with external service providers in order to provide effective due diligence and research on potential projects. From those will be extracted the projects that will return as high a return (as possible) for the investors.

C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, of the effect on the biennial appropriation for each agency and fund affected and any amounts included in the executive budget. Indicate the relationship between the amounts shown for expenditures and appropriations.*

The public sector funds identified come from

(1) Board of University and School Lands, (1/10th of 1% is currently estimated at $700,000).

(2) the State Investment Board (retirement accounts), (1/10th of 1% is currently estimated at $3,500,000)

(3) Tobacco settlement trust fund ($500,000) and

(4) Bank of North Dakota ($1,000,0000 for 2001 - 2003 biennium). Later BND investments may be required to insure fund investors of average annual return of 6%.

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