Analysis

Oregon Business Development Department

Oregon Growth Board Report

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Request: Acknowledge receipt of a report on the investment policies and performance measures adopted by the Oregon Growth Board for the Oregon Growth Account and Oregon Growth Fund.

Recommendation: Acknowledge receipt of the report, with the understanding the Oregon Growth Board will submit annual reports to the Joint Committee on Ways and Means on the management of the Oregon Growth Account and the Oregon Growth Fund.

Analysis:

<u>Background</u>

The Oregon Growth Board (OGB) and its duties were established by HB 4040 in the 2012 session, and HB 2323 in the 2013 session. The Board was established on April 6, 2012. On January 1, 2014, management of the Oregon Growth Account (OGA) was transferred from the State Treasurer's Investment Division to the Board, and a new Oregon Growth Fund (OGF) was established and placed under the Board's authority. The Oregon Growth Board is charged with investing and managing the funds in both the OGA and OGF. The Joint Committee on Ways and Means adopted a budget note with the 2013 enabling legislation that directed the OGB to adopt investment policy statements for both the OGA and OGF, and to report, during the 2014 session, to the Legislature on these policies and on how the Board will measure investment performance and the performance targets it proposes.

The management responsibilities assigned to the Board are complex. As introduced, the 2012 legislation that established the Oregon Growth Board initially transferred the balance of Oregon Growth Account into the Oregon Growth Fund, and the management of the associated monies from the Oregon State Treasury to the Oregon Growth Board. The OGB was, therefore, to manage a single fund (the Oregon Growth Fund) for the purpose of supporting economic development, primarily by addressing capital gaps facing Oregon businesses.

This could not be done, however, because the Oregon Growth Account was established as a part of the Education Stability Fund. The Oregon Constitution [section 4(4)(d), Article XV] limits the use of earnings of the Education Stability Fund to financing public education in Oregon, and restricts withdrawals of the corpus of the Fund for only the same purpose. Furthermore, withdrawals from the Education Stability Fund are only permitted when specific economic conditions are met, or if the Governor declares an emergency, and in either of those cases require a three-fifths approval of each house of the Legislature.

Because these constitutional provisions prevented the Legislature from transferring monies from the Oregon Growth Account to the Oregon Growth Fund, the Legislature instead transferred the management of the Oregon Growth Account to the OGB, but retained the OGA within the Education

Stability Fund. The Oregon Growth Fund was established outside the Education Stability Fund as a separate fund, free of the constitutionally-limited use of providing financing for public education.

As a result, the Oregon Growth Board must continue to invest the Oregon Growth Account within the restrictions established by the state Constitution. The legislation did expand the allowable investments of OGA monies, by repealing the restriction that investments be solely for providing seed capital for emerging growth business, and by allowing the account to be used for making loans. Nonetheless, the Board must still invest OGA monies for the purpose of earning returns for the Education Stability Fund.

Funding Levels

The Oregon Growth Board will manage an estimated $149 million of total funds, including $147.1 million in the OGA, and $1.9 million in the OGF, in the current biennium. The table below provides additional details:

Oregon Growth Board

2013-15 Biennium Monies (in millions of dollars)

Oregon Growth Account (in Education Stability Fund, must be invested to earn returns for public education)	Total monies committed prior to transfer to the OGB	$109.6
	OGA uncommitted balance as of July 1, 2013	$18.7
	Additional deposits into the OGA in the 2013-15 biennium [1]	$18.9
	TOTAL	**$147.1**
	Note: Total uncommitted funds available for investment	$37.5

Oregon Growth Fund (not in Education Stability Fund, may be used to further economic development)	Total monies available as of July 1, 2013	$0.0
	Additional deposits into the OGF in the 2013-15 biennium [2]	$1.9
	TOTAL	**$1.9**
	Note: Total uncommitted funds available for disbursement	$1.9

Notes:

[1] OGA, by statute, currently receives 1.8% of Lottery revenues.

[2] OGF allocated $1.9 million of Lottery Funds in 2013-15 biennium budget.

Most of the OGA funds, a total of $109.6 million, have been committed to specific fund managers under contracts that were approved by the now-dissolved Oregon Growth Account Board, prior to the transfer of the account to the OGB. The Oregon Growth Account Board committed these monies to partnership investments. Under each partnership agreement, a general partner (fund manager) invests monies pooled from a number of limited partners (investors). The OGA serves as one of several limited partners in each such investment. When the partnership earns returns on an investment, these returns are distributed back to the limited partners (including the OGA), proportionate to the amounts each limited partner invested in the partnership. The Oregon Growth Board has authority, when the OGA receives these returns, either to designate them as declared earnings, or to retain them and use them to make additional investments. Under statute, 75% of any OGB declared earnings are distributed to fund need-based scholarships for post-secondary students in the Oregon Opportunity Grant program, and the remaining 25% are distributed to pay debt service costs on education lottery bonds.

Because $109.6 million in the OGA is already committed to existing partnerships, these funds are not available to the Board for new investments. The Oregon Growth Board, however, will receive forecasted $37.5 million of uncommitted funds this biennium that will be available for new investments. The Legislature has, by statute, directed that 10% of total Lottery Funds required to be deposited into the Education Stability Fund, be deposited into the Oregon Growth Account. This represents 1.8% of the state's total Lottery Funds revenues. The March 2014 revenue forecast projects that $18.9 million will be deposited into the OGA in the 2013-15 biennium under this provision. Furthermore, an estimated $18.7 million of earlier-biennium Oregon Growth Account deposits remained uncommitted as of the start of the biennium, and were thus inherited by the OGB and are now also available for investment purposes.

Additionally, the Legislature deposited $1.9 million of Lottery Funds into the Oregon Growth Fund for the 2013-15 biennium. This deposit was provided on a one-time basis. If the Governor includes a recommendation for an additional deposit next biennium, this request must be included in a policy option package.

Investment Policies – Oregon Growth Account

The Oregon Growth Board will now manage the $109.6 million of partnership contacts inherited from the Oregon Growth Account Board. The Board's investment policies allow it to invest the uncommitted OGA funds in the same manner, i.e., by entering into partnerships as a limited partner and utilizing the services of either a management company or another state agency as the general partner. The Board retained a policy adopted earlier by the Oregon Growth Account Board to require general partnerships or state agencies to invest at least the amount contributed by the OGA in the state of Oregon. (As an example, if the OGA provides $5 million to a partnership, and the other partners combined provide an additional $20 million, then all of the partners must agree to a restriction that at least $5 million of the total $25 million available to the partnership must be invested in Oregon.)

The Board's investment policies for the OGA do not preclude it from adopting other investment models for OGA funds, however, no such alternatives were specified. The Board has, however, adopted a number of investment guidelines that include:

1. Preference for early- and growth-stage focused funds to address capital gaps in Oregon.
2. Preference for Oregon-based managers or managers with historic presence in Oregon.
3. Preference for investments in the $1,000,000 to $5,000,000 range.
4. Preference to contribute no more than 25% of a fund's total capital.
5. Preference e for managers targeting key industries, including high tech, clean tech, advanced manufacturing, outdoor/active wear, and forest products.
6. Preference for managers targeting Oregon traded sector companies.

7. Encouragement for managers to invest in businesses in rural Oregon, and to invest in businesses of underserved populations, including minority- and women-owned businesses.

The proposed asset allocations suggest a preference that future OGA investments will focus less on venture capital (seed, early state, and late state capital), and more on growth capital investments, than the previous investments by the OGA Board. The Board categorizes the 77% of the legacy OGA investments as venture capital investments and 21% as growth capital investments (with the remaining 2% split between Oregon Accelerators and Special Situations). OGA proposes investing uncommitted OGA funds in a 70% venture capital/28% growth capital ratio, a modest change from prior practices.

Investment Policies – Oregon Growth Fund

The OGB is authorized to use monies in the Oregon Growth Fund to make investments, loans, or grants (grants are not permitted from the Oregon Growth Account). The Board is to use these funds for the purpose of furthering economic development. The Board's options for the uses of OGF monies are substantially broader than the options available for OGA monies, primarily because there is no requirement that these funds be invested to provide financing for public education.

The Board's investment policies for the Oregon Growth Fund are generally identical to those listed above for the OGA, with the addition of granting authority. The allocation of OGF monies is designated to be concentrated entirely in the category of "Special Situations." The Board defines Special Situations as residual category that includes any investments that are not for Oregon Accelerators, venture or angel capital investments, or growth capital investments. Examples provided of potential special situations uses include micro-lending, groups where investment return is possible but not clear (such as venture capital beauty shows with a prize), and grants that "fertilize the soil," but for which direct returns are not measurable (such as start-up conferences).

Performance Measures

The Oregon Growth Account Board established a target for the Oregon Growth Account, for partnership investments to deliver an internal rate of return of at least 12% and for the investments to provide a distribution multiple greater than 1.5 times invested capital. The Oregon Growth Board has not retained these targets for the Oregon Growth Account, and has not approved targets for the Oregon Growth Fund. Instead, the Board will measure each investment's performance individually, and establish separate performance targets for each investment. These targets will include one or more of the following: number of businesses assisted, types and amounts of resources leveraged, returns on investment, and the impact on jobs and wages in this state.

Legislative Fiscal Office Recommendation

The Legislative Fiscal Office (LFO) recommends the Committee acknowledge receipt of the report. LFO notes that the Oregon Growth Board has a statutory requirement to submit an annual report to the legislative committees related to business and economic development. LFO recommends that the Joint Committee on Ways and Means adopt an understanding that these reports will also be presented annually to the Committee.

LFO recommends that the Committee especially monitor the following items as these reports are presented:

1. The performance metrics the Board adopts for each individual OGA and OGF investment, and the performance of each investment against these targets;
2. The ability of the Board to improve the earnings rate of the Oregon Growth Account over the earnings rates achieved by the OGA's prior management;
3. The ability of the OGA to promote economic development in Oregon, while conforming to its constitutional requirement to provide earnings to finance public education;
4. Whether or how the Board's OGA investment policies limit the supply of potential partnerships under the operating partnership investment model; and
5. The outcomes of the Board's policy of allocating 100% of Oregon Growth Fund assets to Special Situations.