Legislative Fiscal Bureau
Fiscal Note

HF 2078 - Iowa Capital Formation Act, Venture Capital (LSB 5216 HV)
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Fiscal Note Version - New

Description

House File 2078 creates a mechanism for a newly-created corporation to raise money to be invested in venture capital investment funds and provides State tax credits to be used to guarantee that the investors of the money receive all of the principal and an unspecified rate of return at the end of the investment period. The guarantee is in the form of contingent tax credits. If the full principal and promised rate of return are not available at the end of the investment period, State tax credits would be issued to the investor to make up any shortfall. The tax credits could be transferred in cases where the original investor did not have sufficient Iowa tax liability to fully utilize the credits.

Three entities are created to accomplish the intent of the Bill:

1. Iowa Capital Investment Board - A Board composed of five voting and two non-voting members. The voting members are appointed by the Governor and confirmed by the Senate. The Majority Leader of the Senate and the Speaker of the House each appoint one non-voting member. The duty of the Board is to establish criteria and procedures for allocation, issuance, and redemption of the contingent tax credits. The Board is also responsible for projecting the amount of contingent tax credits that may be redeemed in future years. The Board is limited to $100.0 million in contingent tax credits, although tax credits not used can be reissued with new investments. The use of tax credits is further restricted to no more than $20.0 million initially redeemable in any one year. No tax credits can be redeemable within the first five years of the program.
2. Iowa Capital Investment Corporation - The Corporation is created as a private, non-profit corporation separate from the State. The purpose of the Corporation is to organize the investment of money in, and to select an investment manager for, the newly-created Iowa "Fund of Funds." The Corporation's five-member Board of Directors shall be selected by an appointment committee selected by the Iowa Economic Development Board.
3. Iowa Fund of Funds - The Iowa Fund of Funds is created as a private for profit company authorized to make investments in new or existing private seed and venture capital entities. The Fund of Funds shall principally make investments in high quality venture capital funds managed by investment managers who have made a commitment to consider investments in businesses located in Iowa and have committed to maintenance of a physical presence in Iowa. The Fund of Funds shall also establish and administer a loan guarantee or other credit program for rural Iowa equal to no more than 5.0% of its assets. The Fund of Funds is liquidated 50 years after establishment, and remaining assets transferred to its owners.

Assumptions

1. The Board will package the $100.0 million in tax credits into investment packages of smaller sizes ($10.0 million, for example). Each investment package will be accounted for separately (profits from one will not offset losses from another).
2. The rate of return promised to investors will be 6.3%, compounded annually.

3. The Iowa Capital Investment Board and the Iowa Capital Investment Corporation will each charge the 0.5% fee allowed under the Bill.
4. The investment manager hired by the Corporation will be paid an annual fee of 1.25% of the investment amount plus 20.0% of all capital gains resulting from the investment.
5. The Board will allow only "closed end" investment structures, and will require all investments to be fully closed prior to calculation of any tax credits due to the investor.

Fiscal Impact

The contingent tax credits used to guarantee the principal and rate of return of the original private capital investment do pose a potential risk to the State General Fund. The credits are limited under the Bill to no more than $20.0 million per year and cannot be redeemed for at least five years. The total amount of credits that could be utilized is $100.0 million over the life of the Program. The money subject to the contingent tax credits will be invested in various venture capital funds. Venture capital funds make or lose money in all economic conditions. It is not possible to predict whether the venture capital funds selected by the investment manager will make or lose money.

To ensure that no tax credits are issued, each investment package must return not only the original investment amount, but also sufficient capital gains to cover the promised return on investment and the fees charged by the Board, the Corporation, and the investment manager. Each investment package would have to return capital gains to the Fund of Funds of 8.36% or higher compounded annually, for no tax credits to be used.

For example, $10.0 million is invested in the Fund of Funds at 6.3% for ten years. Corporation and Board fees reduce the amount to $9.9 million which is then invested in various venture capital funds. After ten years, this investment package is closed and the value is now $22.1 million, which equates to an 8.36% annual rate of return. The investment manager retains $3.7 million for annual management fees and rate of return incentive. The investors receive their original $10.0 million plus $8.4 million in capital gains. In this example, no tax credits are issued and no excess capital gains are available for future investment.

The Iowa Capital Investment Board and the Iowa Capital Investment Corporation will not have any fiscal impact on State finances since all expenses will be paid from administrative fees charged against the invested funds. The issuance, redemption, and tracking of the contingent tax credits will have an administrative cost to the Department of Revenue and Finance. This cost should be less than $100,000 over ten years.

Sources

Iowa Department of Revenue and Finance
Legislative Fiscal Bureau

/s/ Dennis C Prouty

February 7, 2002

The fiscal note and correctional impact statement for this bill was prepared pursuant to Joint Rule 17 and pursuant to Section 2.56, Code of Iowa. Data used in developing this fiscal note and correctional impact statement are available from the Legislative Fiscal Bureau to members of the Legislature upon request.