# HB 681

# Department of Legislative Services

Maryland General Assembly
2013 Session

## FISCAL AND POLICY NOTE

House Bill 681 (Delegate Fisher, *et al.*)
Ways and Means

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**Invest Maryland Program - Alteration of Program Requirements**

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This bill repeals the provisions in the Invest Maryland Program that specify the allocation and use of designated capital to invest in qualified Maryland businesses. The bill also repeals the Maryland Venture Fund Authority (MVFA) in the Department of Business and Economic Development (DBED). Instead, DBED is required to allocate designated capital in equal yearly amounts to the economic development unit of each county and Baltimore City. The annual reporting requirement for DBED on the program is altered to reflect the change in designated capital allocations under the bill.

The bill takes effect June 1, 2013.

## Fiscal Summary

**State Effect:** General fund expenditures increase by $10.1 million in FY 2014 for the State to fund prior commitments made to venture firms under the program. General fund expenditures increase by $6.7 million in each of FY 2015 and 2016, and by $5.0 million in each of FY 2017 and 2018 to continually fund prior commitments made to venture firms. Out-year general fund expenditures between FY 2019 and 2023 total an additional $22.4 million for the same purpose. Net DBED special fund revenues and expenditures are unaffected; however, the allocation of special funds is changed, as discussed below. This estimate assumes staffing levels at DBED are unaffected by the bill.

| ($ in millions) | FY 2014 | FY 2015 | FY 2016 | FY 2017 | FY 2018 |
|---|---|---|---|---|---|
| Revenues | $0 | $0 | $0 | $0 | $0 |
| GF Expenditure | 10.1 | 6.7 | 6.7 | 5.0 | 5.0 |
| Net Effect | ($10.1) | ($6.7) | ($6.7) | ($5.0) | ($5.0) |

*Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect*

**Local Effect:** Local government revenues increase from distributions of designated capital under the bill in FY 2014 and 2015. Local government expenditures increase correspondingly as local economic development units allocate the funds to qualified businesses. Local governments experience operational impacts to administer the funds distributed under the program.

**Small Business Effect:** Meaningful for businesses that receive investments through the State and local programs supported by Invest Maryland Program funding, and for any that receive funding under the bill.

## Analysis

**Current Law:** DBED, in consultation with MVFA, provides funds to private venture firms for the purpose of making investments to support the operations of qualified businesses, subject to restrictions on the use of the funds (designated as qualified and nonqualified distributions).

Venture firms can use funds for specified organizational, professional, and management costs and expenses of the venture firm. These qualified distributions do not include (1) amounts paid to an insurance company or affiliate that contributes funds to the program or (2) lobbying expenses. Before a venture firm can make a nonqualified distribution (use the money for any purpose), it must first remit to the Comptroller the amount of designated capital it received. Any venture firm investment proceeds that exceed the original amount of designated capital and are not otherwise retained by the venture firm are then divided 80% to the general fund and 20% to the venture firm. The Comptroller is required to transfer within 30 days to the general fund any monies received under the program.

DBED is prohibited from acquiring an ownership interest in an enterprise that exceeds 25% when making an Enterprise Fund equity investment. An insurance company or affiliate is prohibited from managing a venture firm, beneficially owning more than 15% of the ownership interest of a venture firm, or controlling venture firm investments.

Beginning on January 1, 2013, DBED must report annually on the implementation of the program to the Governor and the Senate Budget and Taxation and House Ways and Means committees.

**Background:** Chapter 409 of 2011 (HB 173) established the Invest Maryland Program, a State-supported venture capital program, and increased funding for the Enterprise Fund and Maryland Small Business Development Financing Authority (MSBDFA) within DBED. Funding is provided through tax credits against the insurance premium tax for insurance companies that make qualified contributions to the program. MVFA solicits cash (designated capital) from insurance companies through a competitive process overseen by an independent third party.

In exchange for the cash received from the insurance companies, DBED provides insurance companies with tax credits that can be used to offset insurance premium taxes over a five-year period. DBED can award a maximum of $100.0 million in tax credits, which can be claimed beginning in tax year 2014. The cash or designated capital received from insurance companies is to be deposited into the Enterprise Fund within DBED in three annual installments, with the first installment made in 2012. Of the auction proceeds, 24.75% will be retained by the Enterprise Fund, 67.0% will be distributed to eligible private venture firms, and 8.25% will be distributed to MSBDFA.

*Program Implementation*

Fiscal 2014 marks the second of three years in which DBED is using funds acquired from the auction of tax credits to make venture capital investments under the program. The auction was held in March 2012 and netted $84 million. As a result, the State will forego $100 million in general fund revenues over five years beginning in fiscal 2014 and has paid a premium of $16 million to do so. DBED disbursed its first award in September 2012 and currently reports a pipeline of over $5 million in potential deals with early stage companies; approximately $4.7 million has been committed to date. The Governor's proposed fiscal 2014 budget includes $28.0 million for Invest Maryland, reflecting the second year of funding for the program. Of the total funding, $6.9 million will stay in the Enterprise Fund for DBED investments, and $2.3 million is allocated to MSBDFA. The remaining $18.8 million will be allocated to private venture firms.

DBED has contracted with a consultant to identify qualifying private venture firms. The consultant was responsible for receiving and reviewing applications, conducting due diligence, developing an investment strategy consistent with statutory requirements, and presenting a recommended list of venture firms for final approval. In December 2012, MVFA approved its first private venture partner. The venture firm will receive $12 million to invest in early stage companies. To the extent that the early stage companies post positive returns, the venture firm will return the principal to the State as well as 80% of the profits. Subsequently, two other firms have been approved; the total commitment to date is $25 million. MVFA expects to approve between six and eight venture firms in total.

**State Fiscal Effect:** MVFA will have contractually obligated the entirety of available program funds for private venture firms ($56.0 million) by the effective date of the bill. As such, general funds are needed to avoid a future default on the obligations caused by the transfer of funds to local economic development units under the bill. Therefore, general fund expenditures increase by $10.1 million in fiscal 2014, $6.7 million in each of fiscal 2015 and 2016, and $5.0 million in each of fiscal 2017 and 2018 for the State to fund prior commitments made to venture firms under the program. Out-year general fund expenditures between fiscal 2019 and 2023 total an additional $22.4 million for the same purpose. This reflects the estimated designated capital outlays to venture firms provided by DBED – actual general fund expenditures may differ in any single year but will total $56.0 million over 10 years.

This estimate assumes that fiscal 2013 allocations to MVFA and MSBDFA are spent or encumbered before June 1, 2013, and thus are not affected by the bill.

To the extent that funds in the Governor's proposed fiscal 2014 budget for the program are affected under the bill, funding for MSBDFA ($2.3 million), the Maryland Venture Fund ($6.9 million), and private venture firms ($18.8 million) through the Enterprise Fund is instead transferred to local economic development units. The reallocation of special funds for DBED is likewise altered in fiscal 2015 from the transfer to local economic development units. This estimate assumes staffing levels at DBED are unaffected by the bill.

**Local Fiscal Effect:** Local government revenues increase from distributions of designated capital under the bill in fiscal 2014 and 2015. Local government expenditures increase correspondingly as local economic development units allocate the funds to qualified businesses. Local economic development organizations experience operational impacts to administer the funds distributed under the program.

**Small Business Effect:** Small businesses that receive support through the Maryland Venture Fund or MSBDFA are negatively impacted from the transfer of funding from the program to local economic development units. Small businesses in localities benefit to the extent that local economic development units disburse the funds under the program to small businesses, a possibility – but not a requirement – under the bill.

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## Additional Information

**Prior Introductions:** None.

**Cross File:** None.

**Information Source(s):** Department of Business and Economic Development, Baltimore City, Prince George's and Montgomery counties; Department of Legislative Services

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