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THE CAPCO PROGRAM AND 2004 LEGISLATION

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The Certified Capital Company (CAPCO) Program was created by the legislature in 2001 to provide venture capital for new business startups, for business expansion, and to create jobs. The Governor's Office of Economic Development and International Trade (OEDIT), which oversees the CAPCO Program, identified a number of concerns during 2002, the first year of implementation. These concerns were identified in a State Auditor Report that was released by the Legislative Audit Committee in October 2003. The report recommended the program be abolished and replaced with a less costly program that channels more money to early stage businesses. The report's findings resulted in 2004 legislation that was aimed at making the program more cost effective and accountable to taxpayers. This *Issue Brief* provides an overview of the program and summarizes the 2004 legislation.

CAPCO Program

How the program works. The CAPCO Program is an economic development tool used by the state to fund and encourage small business growth. To generate money, the state created two \$100 million pools of tax credits against the insurance premiums tax. The money that otherwise would have been paid by insurance companies in premiums taxes is used to make loans to CAPCOs, which in turn, either loan or invest in start-up or early-stage businesses. CAPCOs are for profit business entities such as corporations, partnerships, or trusts. Since the state taxes that insurance companies pay on premiums are credited to the state General Fund, the program is estimated to reduce General Fund revenues by \$200 million through FY 2014-15.

Allocation of first \$100 million pool. Various insurance companies provided the first \$100 million in 2002, which was then loaned to CAPCOs. The insurance companies recoup the money through two different means. First, they may claim up to \$10 million annually in state premium tax credits for the next ten years. Second, they can receive additional reimbursement from the CAPCOs to make up for the time loss value of the \$100 million provided up front.

The CAPCOs had \$100 million to loan or invest. In order to meet their financial obligation to insurance companies, CAPCOs invested \$44.3 million in government debt instruments. The interest and principal, upon maturity, is paid back to the insurance companies. At the end of 10 years, the OEDIT estimates that the annual rate of return for insurance companies will range from 7 to 11 percent on the \$100 million loaned to CAPCOs.

This left \$55.7 million for CAPCO operating expenses or investment in startup companies. CAPCOs reported that between the close of 2003 and mid-2004, the \$55.7 million was used or distributed as follows:

- \$19.2 million for operating expenses;
- \$26.0 million invested in 25 different businesses; and
- \$10.5 million remaining to invest in additional businesses or for operating expenses.

For the \$26.0 million invested in 25 businesses, reliable data are not available to determine the number of new jobs created by the CAPCO program.

2004 Legislation Impacting First Pool

The legislature enacted three measures in 2004 that impact the first \$100 million pool to make the CAPCO program more cost effective.

Limiting expenses. The initial program did not limit the amount of money CAPCOs could spend on legal and professional expenses. **SB 04-011** prohibits CAPCOs from using program money to pay for legal costs challenging the CAPCO program and expenses for lobbying or governmental relations.

Money for housing and mental health clinics. Prior to the passage of **HB 04-1190**, housing programs and community mental health clinics would have received money from the program if CAPCOs earned more than 10 percent — after discounting for cash flow differences — from moneys invested or loaned to Colorado businesses. When the 10 percent trigger was met, 30 cents of each dollar over the trigger would have gone to the Division of Housing for distribution annually: 50 percent to low- or moderate-income housing initiatives and 50 percent to community mental health clinics. **HB 04-1190** increases the likelihood these programs will receive money by requiring that when earnings are less than 10 percent, 15 cents of each dollar earned is distributed for housing and mental health clinics. If earnings are at least 10 percent, 20 cents of every dollar earned is distributed in the same manner.

Investment thresholds. The program required CAPCOs to invest 50 percent of the first \$100 million pool (\$50 million) in qualifying investments within five years from the allocation date, which was April 15, 2002. **SB 04-247** requires a CAPCO to invest 100 percent of the moneys received from the first \$100 million pool within ten years of the allocation date and imposes penalties if the investment threshold is not met. Since the CAPCOs have already set aside \$44.3 million to repay insurance companies and spent an additional \$19.2 million on expenses (\$63.5 million total), the OEDIT maintains that CAPCOs will need to re-invest or re-loan moneys that have already been paid back by Colorado businesses or obtain money from other sources to meet the 100 percent requirement. The measure also requires CAPCOs to invest more money in seed or early stage businesses. **SB 04-247** requires businesses that receive money to show that they have a reasonable

expectation to be headquartered in Colorado for at least three years. CAPCOs can be fined up to \$100,000 for program violations.

2004 Legislation Impacting Second Pool

The General Assembly enacted two measures that redirect the second \$100 million to two new \$50 million pools — one pool to a newly created venture capital authority and another to a major medical insurance provider.

Venture capital fund. **SB 04-106** redirects \$50 million to a newly created State of Colorado Venture Capital Authority. Recent estimates indicate that after expenses, about \$4 to \$4.6 million will be allocated to a venture capital fund which will be invested in small businesses each year over a ten-year period. The fund will be managed by a venture capitalist company selected by the authority through an RFP process. The authority is required to select the venture capitalist fund manager(s) by December 31, 2004. **SB 04-106** requires 100 percent, or \$50 million less expenses, to be invested within ten years in seed or start-up, early stage, or qualifying rural businesses as follows:

- 50 percent to statewide businesses;
- 25 percent to rural businesses; and
- 25 percent to businesses in enterprise zones not qualifying as rural businesses.

The legislation also requires the fund managers to report the number of jobs created from investments and requires a program audit by March 4, 2007.

Fund managers are required to repay money that is invested in businesses back to the state when the principal is repaid according to the terms of the contract. Repaid moneys will be held in a revolving Enterprise Fund which will be used to provide continued investment to early-stage businesses.

CoverColorado Program. **HB 04-1206** redirects the remaining \$50 million to CoverColorado. CoverColorado was established by the legislature to provide individual, major-medical health insurance to residents who have been denied health insurance coverage from private insurers because of pre-existing conditions. **HB 04-1206** makes \$5 million available to CoverColorado each year over a ten-year period.