

**MINUTES OF THE
SENATE SELECT COMMITTEE ON ECONOMIC GROWTH AND EMPLOYMENT**

**Seventy-sixth Session
April 6, 2011**

The Senate Select Committee on Economic Growth and Employment was called to order by Chair Ruben J. Kihuen at 1:28 p.m. on Wednesday, April 6, 2011, in Room 2134 of the Legislative Building, Carson City, Nevada. The meeting was videoconferenced to the Grant Sawyer State Office Building, Room 4412, 555 East Washington Avenue, Las Vegas, Nevada. [Exhibit A](#) is the Agenda. [Exhibit B](#) is the Attendance Roster. All exhibits are available and on file in the Research Library of the Legislative Counsel Bureau.

COMMITTEE MEMBERS PRESENT:

Senator Ruben J. Kihuen, Chair
Senator John J. Lee, Vice Chair
Senator Mark A. Manendo
Senator Don Gustavson
Senator Ben Kieckhefer
Senator Greg Brower

COMMITTEE MEMBERS ABSENT:

Senator Valerie Wiener (Excused)

STAFF MEMBERS PRESENT:

Kelly Gregory, Policy Analyst
Bryan Fernley-Gonzalez, Counsel
Leslie Sexton, Committee Secretary

OTHERS PRESENT:

Keith Rheault, Ph.D., Superintendent of Public Instruction, Department of Education
Kate Marshall, State Treasurer
Walt Borland, Executive-In-Residence, Nevada Institute for Renewable Energy Commercialization
Chuck Alvey, CEcD, President/CEO, Economic Development Authority of Western Nevada

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Chris Howard, CEO, NorthStar Business Source; Director, Entrepreneurial Initiatives, University of Nevada, Reno
Dusty Wunderlich, CEO, Optimum Strategy Group
Craig M. Stevens, Nevada State Education Association
Dave Archer, CEO, Nevada's Center for Entrepreneurship and Technology; Cofounder, Reno Angels
Ky Good, Managing Director, C4CUBE
Brian Krolicki, Lieutenant Governor
Michael E. Skaggs, Executive Director, Division of Economic Development
Chandler Marrs, Ph.D., President and CEO, Lucine Biotechnology
Mendy Elliot, State Small Business Credit Initiative
Patty Wade, President, Wade Development Company, Inc.; Wade Consulting Group, LLC
Randolph J. Townsend, Ex-Senator

CHAIR KIHUEN:

Today we are hearing Senate Bill (S.B.) 75.

SENATE BILL 75: Establishes a program to provide private equity funding to businesses engaged in certain industries in this State. (BDR 31-523)

KEITH RHEAULT, Ph.D. (Superintendent of Public Instruction, Department of Education):

We support S.B. 75. Anything that can be done to improve the fiscal funding coming to kindergarten through Grade 12 (K-12) education in these tight times is something we can support. The program the State Treasurer will explain will be using some of the Permanent School Fund (PSF), an account established to provide interest income to K-12 education. By statute the interest earned from that account must be placed in the Distributive School Account (DSA), the primary account used by the Department of Education to distribute the funds provided by the State to all the school districts and charter schools. The DSA is composed of a number of revenue streams from State general funds, real property taxes, annual slot taxes and the PSF. Over the past five years, the interest we have earned has dropped in half. At one time it was \$14 million. In fiscal year (FY) 2010, it dropped to \$9 million. In the *Executive Budget* for FY 2012, it is approximately \$6.6 million. With the drop in interest income, the program under S.B. 75 has merit. Once the DSA revenues have been determined, we apply The Nevada Plan, a series of formulas used to develop the per pupil payment to school districts. Adding funds from the PSF increases the

per pupil payment. We support the concepts in S.B. 75. The State Treasurer will explain the details of the program.

SENATOR KIECKHEFER:

If the interest generated by the PSF and added to the DSA is reduced, does the General Fund make up the difference?

Dr. RHEAULT:

Yes. That is currently happening.

SENATOR KIECKHEFER:

What is the principal amount in the PSF now?

DR. RHEAULT:

It is approximately \$310 million and has a current earning rate of approximately 2 percent.

SENATOR KIECKHEFER:

What is the source of that revenue?

DR. RHEAULT:

It was from several sources. The primary source was in the 1800s when the federal government allocated one township from each section to the states and they were able to use that land for various purposes. There are four or five other revenue streams that come in to the PSF, including unclaimed freight.

KATE MARSHALL (State Treasurer):

Senate Bill 75 seeks to increase funding for K-12 without increasing taxes or cutting costs by increasing the return on the investments of the PSF. Senate Bill 75 also enhances and augments the goals of Assembly Bill (A.B.) 449, building upon its structure to help ensure that the economic development it spawns bears its fruit in Nevada.

[ASSEMBLY BILL 449](#): Revises provisions relating to economic development.
(BDR 18-726)

I have submitted copies of my PowerPoint presentation ([Exhibit C](#)) and a document entitled, Proposed Regulation of the Office of The State Treasurer, Creation of the Nevada Capital Investment Corporation ([Exhibit D](#)). I have supplied you with a copy of "Envisioning Nevada's Future, Goals & Strategies

for Advancing Our Quality of Life” prepared for the Nevada Vision Stakeholder Group by Moody’s Analytics in September 2010 ([Exhibit E](#)). I have supplied you with a copy of an article by Russell Nichols entitled, “State Governments: The Latest Venture Capitalists” ([Exhibit F](#)).

The State Treasurer invests the State’s money and the money the State holds in trust. The latter is neither taxpayer money nor General Fund money. One example would be prepaid tuition. We invest and manage those funds. A third type of money that we invest and manage is the PSF. These funds are always managed through the hiring of an external professional fund manager. A request for proposal is always issued and professional fund managers reply. For example, today the Vanguard 529 College Saving Plan is managed by The Vanguard Group, Inc. The prepaid tuition fund manager is Bank of New York Mellon. These external fund managers make the investment decisions because they have the expertise. By statute, this is also a requirement for the PSF.

The PSF was established by the State Constitution. Land grants by the federal government made to the states allowed states to lease or sell the land. Penal fees are also added to the PSF. That money is not taxpayer money. Neither the Legislature nor the Executive Branch can diminish, change, modify, amend or manipulate the body of that money. It stays in that account and is not touched. Today the fund balance is approximately \$310 million. If the fund balance would drop to \$100 million tomorrow, the Legislature would have no obligation to restore the \$310 million. The PSF is held in trust for the school districts throughout the State for K-12 education and distributed through the DSA via specific formulae to those school districts.

Page 10 of [Exhibit C](#) shows the historical assets and returns of the PSF from 2005 to the present. For FY 2011, the yield is projected to be 2.53 percent. Even in better economic times in 2008, it only yielded 5.02 percent. It is invested in U.S. agency callable and noncallable bonds as shown on page 9. An instinctive reaction to that chart is that it is not very diversified. Because it is invested in only U.S. agency callable and noncallable bonds, it cannot overcome the risk of inflation. As inflation rises, it is worth less. When such a fund is not able to make a great deal of interest because it cannot keep up with inflation, over time, it is worth less.

Western states have permanent school funds established in state constitutions. These states also transfer interest earned on those PSFs to K-12 education. These states, like Nevada, are not allowed to touch the corpus of the fund.

Unlike Nevada, of the 12 states we surveyed, only 1 does not have a diversified portfolio to manage the money in such a way that it creates a return that benefits the state. A model portfolio is shown on page 12 of [Exhibit C](#).

SENATOR KIECKHEFER:

Senate Bill 75 indicates that statute allows the Treasurer to invest in U.S. stocks, commodities and real estate. Why is the PSF only invested in callable and noncallable bonds?

MS. MARSHALL:

In 2001, a bill was passed to allow the investment of public stock in the PSF. Potential constitutional issues required that the Treasurer seek a judicial determination to avoid such problems before investing in public stock. That request for judicial determination was not filed until March 28 in order to invest in public stock.

SENATOR BROWER:

It seems strange to me that this Legislature would pass legislation without first determining constitutionality when that legislation then requires a judicial determination on constitutionality at some later point. Can you clarify why we apparently did that?

MS. MARSHALL:

The former Treasurer is in the audience and he may better answer your question. At the time, it was argued, and I agree, that the PSF is a trust fund. It is not General Fund money. It is not tax money. We neither have the ability to diminish or change it nor do we have a liability if the value of the fund decreases. Therefore, it is a special fund that does not fall under the prohibitions of the Nevada Constitution, Article 8, section 9. The argument was successful and the bill became law. The language regarding a judicial determination was added to ensure that there would be no problems later.

SENATOR BROWER:

Have you received an answer from the court on your request for a judicial determination?

MS. MARSHALL:

No. There is a 30-day waiting period before the judge can hold a hearing.

SENATOR KIECKHEFER:

Would you have to file for a separate judicial determination to implement the provision of S.B. 75, or is that judicial determination exclusively for common stock?

MS. MARSHALL:

The judicial determination is for stock. The court does not distinguish between public and private stock. It should apply to this bill. If you would like me to seek affirmation of that, I can. On page 13 of [Exhibit C](#), you will see a chart describing what 12 other states are doing. Colorado is the only state that does not have a PSF invested in a diversified portfolio.

Page 14 of [Exhibit C](#) shows the results of those portfolios. The states with diversified portfolios in their PSFs show a return of from 7.5 percent to 14.3 percent, while Nevada's PSF shows a return of 3.1 percent. The Nevada Public Employees' Retirement System (PERS), also with a diversified portfolio, shows a return of 11 percent. The states with diversified portfolios are increasing funds available for K-12 education without increasing taxes or cutting costs elsewhere. This bill seeks to allow us to invest in private corporations. I share the optimism of this panel, the Governor's Office and every Constitutional Officer and elected official of this State that Nevada has legs; that we are bullish on this State and believe there is great opportunity in this State for growth, economic development, jobs and the things that this desert can spawn.

On page 15 of [Exhibit C](#), you will see one of the proposals contained in S.B. 75. To diversify the portfolio, we have a judicial petition. We seek to invest in public stock. We will also seek, through this bill, to invest in private stock. The greatest opportunity for return, focused on what kind of money the PSF can make, lies in a regionally targeted private equity program like iNVest in Nevada. We would invest in companies willing to come to Nevada and companies willing to expand here. This bill proposes to invest up to \$50 million of the PSF in a regionally targeted private equity program with an investment-return-oriented approach. The emphasis is on "up to." Today the invested funds will remain where they are. As there are opportunities to invest in private companies, we will. It is a process. If the bill passes today, I would not take \$50 million and put it in a vault, getting nothing until private corporations could be found in which to invest. The funds would slowly shift over as those opportunities present themselves. We would have to issue a request for proposal for an external fund manager with the expertise to make the decisions about specific investment targets in line with the goal of increased return.

Page 19 of [Exhibit C](#) is a graphic representation of the flow of funds for a private equity program. This is the structure likely to be put in place following passage of S.B. 75. I submitted proposed regulations detailing the Treasurer's Office method of handling investments of the PSF [Exhibit D](#). These proposed regulations mandate the commissioning of a seven-member board. This board will create transparency for the investment process. The board will hire an external fund manager who will make investment decisions. The board will not make investment decisions. The structure is like the Nevada PERS or the College Savings Fund.

Page 16 of [Exhibit C](#) shows the potential for the PSF investment earnings. For example, an annualized return of 7 percent would yield \$3.5 million on an investment of \$50 million. In comparison, Nevada PERS assumed rate of return for a private stock program is 13.25 percent. At that 7 percent return rate, we would see an annual increase over our current rate of return of \$2.25 million. This would be the benefit to K-12. It is appropriate to begin this program now so we can buy low. We have also supplied you with copies of Stakeholders' Presentation, Senate Bill 75, Proposal to Fund Private Equity Investments in Nevada Businesses ([Exhibit G](#)). The next series of speakers will refer to this exhibit.

WALT BORLAND (Executive-In-Residence, Nevada Institute for Renewable Energy Commercialization):

I am also speaking as the former CEO of seven different venture capital-backed emerging growth companies that collectively raised approximately \$250 million in venture capital. As a result of that experience, I can talk to you at some length about the good, the bad and sometimes even the ugly of working with venture capital. On page 24 of [Exhibit G](#), you will find glossary definitions of fund of funds, J-curve, private equity and venture capital. I will use these terms throughout my testimony. Promoting the creation of new jobs is the key to the subject matter of S.B. 75. No doubt, increasing the return of the PSF has a direct advantage and benefit to K-12 education. I will talk about an even greater benefit. Investing in private equity is not unique to Nevada. The State Treasurer quoted the rate of return PERS is generating from making alternative investments. Nevada PERS has approximately \$24 billion invested on behalf of public employees, 10 percent of which has been allocated to alternative investment. From that 10 percent, PERS has commitments of approximately \$1.6 billion to venture capital firms with \$800 million already extended to those firms. The PERS managers are clearly investing successfully.

On pages 13 and 14 of [Exhibit G](#), you will see six funds that are spread across four different states. Their total investment is approximately \$800 million. All of these funds have had the objective of building a high-quality investment portfolio first and a corresponding promotion of job creation. One of the four states, Michigan, is in the process of raising another \$120 million fund in addition to the funds noted in the exhibit. Indiana raised a second fund. Ohio is in the process of raising a second fund of \$100 million. These states, having had successful experience with this type of investment opportunity in increasing the rate of return and job creation, have created multiple funds.

On page 15 of [Exhibit G](#), the vertical line on the chart shows when Indiana had initiated its program. The chart shows Indiana's success. The key is to stimulate the venture capital community. Private capital can augment public capital to drive considerably more activity. Public capital can attract private capital. We have that opportunity in Nevada with S.B. 75.

Page 16 of [Exhibit G](#) shows the same success in Michigan. Michigan did get hit harder by the recession in 2009 and 2010, which has reduced some of the impact of its success. In spite of that, Michigan has taken the lead in venture capital investing. In addition to private sector money, public sector investing can stimulate access to federal money, particularly from the U.S. Small Business Administration. There is a great leverage opportunity to raise additional capital and drive additional job growth.

Page 17 of [Exhibit G](#) lists four roadblocks to the present private equity market. Since Article 8, section 9 of the Nevada State Constitution presents another roadblock, the State Treasurer is being proactive by filing for the judicial determination. This constitutional roadblock is something we must address. We are in a catch-22. Nevada has virtually no venture capital in the State. Many people believe that is because investors do not perceive Nevada as a place with appropriate investment opportunities. Those opportunities do not exist because there is no venture capital. At some point we must break that, step out and create a venture capital industry in Nevada in order for Nevada to be successful. Senate Bill 75 is being proactive in doing that. It says to the world we are going to take the first step; we believe in Nevada; we are going to invest in Nevada; and we want others to do the same.

On page 18 of [Exhibit G](#), you see the traditional venture capital J-curve. Patience in investing is a virtue. The J-curve illustrates that one makes investments in the early years and experiences return in the later years.

I ask you to step back and look at Las Vegas. Ask yourself exactly how many more multibillion dollar casinos are going to be built in the next five years. Two weeks ago, the President and CEO of the Kauffman Foundation, Ewing Marion Kauffman, stated:

The truth has long been evident in federal data that show that most net new job creation in America comes from companies less than five years old. Entrepreneurship isn't a silver bullet, but economic recovery won't happen without it.

Senate Bill 75 is important because it increases the returns for the PSF and can facilitate the creation of a venture capital industry in the State, access leverage to private capital and additional public capital, and help make a difference in turning our economy around. Nevada Institute for Renewable Energy Commercialization enthusiastically endorses S.B. 75.

SENATOR KIECKHEFER:

What is the average rate of return on investment for a start-up company?

MR. BORLAND:

When you look at them individually, it is tougher to say because some do fail. Many of you have heard the formula that if you look at a traditional venture fund, you may come up to the plate and swing ten times. You may hit a couple of doubles, a few singles and strike out a few times, but you still hope for one grand slam. A fund manager invests in a variety of companies to balance a portfolio because not all investments will be equally successful. I can assure you that, having been part of seven different companies, not one of those companies failed. In every case, we hit a single or a double or a triple. In the course of doing that, we created from tens to hundreds of jobs in each situation. The experience of PERS is an interesting reference when considering a portfolio return of 13.25 percent across 175 different funds. The PERS would probably welcome the opportunity to invest in Nevada; however; no such funds exist in Nevada in which they can invest.

SENATOR KIECKHEFER:

For investment in private equity, what type of access is there for public review of the companies being invested in?

MR. BORLAND:

That depends on the nature of the agreement with the fund manager. Regarding PERS, in most cases, it is prohibited from discussing the returns in many of

those investments by the agreement with the general partners. That scrutiny is challenging at times to talk about individual deals. Nevada PERS can talk about portfolio returns on a general basis.

SENATOR LEE:

I understand certificate depreciation. I understand how inflation works. I understand the rule of 72. I understand what you are trying to do here. I understand that we are not making the interest. One thing that scares me is touting the concept of S.B. 75 as the greatest thing since buttered popcorn. I have concerns that we are taking money that is very valuable to the State. Yes, it should probably be invested in a better vehicle than it currently is in. I applaud the Treasurer and the former Treasurer for working on that. I asked the Treasurer some questions a few days ago, and I was not satisfied with the answers because I did not think they were deep enough.

You are talking about sophisticated investors managing money. Bear-Stearns, J.P. Morgan, Lehman Brothers, Merrill Lynch and Goldman Sachs have all been in financial trouble recently. For Nevada to loan \$50 million to companies and say we are going to give you a chance, there are no dividends and very little chance for appreciation. If we get that one home run, we will have done a good job. What are the risks for our money? I want to hear about something other than the opportunities for venture capitalists. What might the State lose in this bill? The PERS is doing a fine job. If you told me that we are going to structure the investments under this bill exactly like PERS, I could believe in that because I have seen their long track record. I am in favor of diversification.

Last week, I had the opportunity to question a man who is involved in your industry. I asked him what the stigma of Las Vegas does to companies considering a move to Nevada. He said it is bad; they do not want to move here unless they are involved in warehousing or some operation tied to California. I asked him what impact the weather has on decisions to relocate. He said it is not easy to bring people to our weather. I asked how many companies move their home offices anymore. He said they do not. Instead, they set up regional offices. I challenge you to tell me the downside of this bill. We need to consider the risk, not the 1 in 1,000 or the home run.

MR. BORLAND:

It is important to talk about the downside. The Treasurer, this Committee and the Legislature have a fiduciary responsibility to make good decisions. My response to your questions is threefold. You gave several examples of very large

publicly held companies. We already make investments in publicly held companies. Just because a company is large and public does not mean it is immune from failure. The State is already taking a certain degree of portfolio risk by investing in anything that ostensibly is not federally guaranteed. Some may even question that guarantee under certain circumstances. We need to be cognizant of the fact there is risk in public and private funds.

If we were the first state to make these kinds of investments, it would be difficult to clarify the desired risk profile. Approximately 30 other states and many other countries are successfully making these kinds of investments. They all have the same concern about the risk to the principal. Regarding the four states referenced earlier, when you add the additional fund already closed in Michigan and the two funds Ohio is trying to close, you are looking at a \$1 billion commitment over an extended period of time on behalf of those states. They are not making such investments because they have incurred losses. Their legislatures would not approve further investments if that were the case. Looking at private equity, the key to the Treasurer's proposal in S.B. 75 is professional management. Nevada PERS uses such a professional manager to be successful. Nevada PERS does not pick venture capital funds; a gatekeeper does that. It is invested in approximately 50 different general partners across approximately 175 different funds in order to mitigate the risk of losing principal.

Step 1 is to have a professional manager. The regulations proposed by the Treasurer stress the importance of oversight and professional management. Step 2 is to mitigate any portfolio risk by spreading the risk across multiple opportunities. If we were to make a single \$50 million investment, we may as well put that sum on the roulette wheel and hope we win. Senate Bill 75 would allow the Treasurer to take up to \$50 million and put it in the hands of a professional fund manager who will spread it across multiple funds. Each one of those funds would raise accompanying private capital or Small Business Administration capital. Each one of those funds spreads the investment across multiple companies. I can only speculate how many funds and how many companies would be involved. I would not say that there would be no risk at all. After having been successful in this kind of investing in Nevada for almost 30 years, I can say we do have the expertise to mitigate risk so that you can be comfortable in supporting S.B. 75.

SENATOR LEE:

I appreciate that answer. I do not care what other states do. They do not care what I do. I care about this money, and I want to do the best I can with it for the State of Nevada.

MR. BORLAND:

We are both Nevadans trying to do the right thing for Nevada. I believe everyone in this room shares your concern.

CHUCK ALVEY, CECD (President/CEO, Economic Development Authority of Western Nevada):

I am here in support of S.B. 75. My testimony begins on page 20 of [Exhibit G](#). We already know that Nevada has the highest unemployment rate in the Country and that Nevada has a lack of high-quality jobs. The private equity market investments will create high-quality, good-paying jobs in Nevada. One company for example, Advanced Materials and Manufacturing Technologies, LLC, has several contracts in Nevada in spite of the fact that it is a new company. The owners have a good track record. They need capital investment now to extend those contracts. They could grow from 4 to 20 employees. Trans World Health Services, Inc., is a company that started years ago and built a system that was in Britain. It sold that company and returned to Nevada. The company is trying to start another company to produce computer software for health care clinics across the Country. The model indicates if it could attract approximately \$1.5 million in investment, it could employ 20 people by the end of this year and 60 people within five years. The company is getting offers of investment from the San Francisco Bay Area on condition that it moves to that area. The company does not want to move out of Nevada.

It has been repeatedly said that Nevada is overly dependent upon the gaming and tourism industries. Private equity market investments will assist in bringing economic diversification to Nevada by providing new and expanding industries to the State. Our target industries are the Stage 2 entrepreneurs with 10 to 100 employees and \$50 million to \$500 million in revenues. They can use the kind of leverage this kind of fund can make available.

Alere Medical, Inc., another new company to Nevada and a strong operating company, started with three employees. The company does remote medical monitoring. The executives of that company left the company and moved to the San Francisco Bay Area to start a new company called Sanare, LLC, a diabetics

consolidation service company. The company's owners will be opening in Nevada next week with 40 to 50 employees. They considered Tennessee, Florida and Ohio. They chose Nevada because of their previous positive experience in Nevada with Chris Howard and the fund with which he helped them. I just learned today that they have raised \$100 million in venture capital from the San Francisco Bay Area. The investors are not requiring the company to move to California because the company can demonstrate it did successful work in Nevada. The program under S.B. 75 can seed this kind of success for future growth.

The private equity markets will attract new business to Nevada by providing funding that will allow those businesses to flourish in our State. In Toledo, Ohio, a local venture capital fund was created with \$22 million, half of which came from the state enterprise fund. It has started 76 new technology companies in the first three years. One-third of those companies came from the university. Another third came from private individuals who had ideas and started businesses from home. The remaining third came from outside Ohio. They came from places where they could not get noticed: Boston, Silicon Valley or San Diego. The condition for funding was that the company had to stay in Ohio or buy back the fund's equity.

Private equity market investments will create high-quality, good-paying jobs that attract college graduates. The Website <<http://www.youreconomy.org>> pointed out that between 2006 and 2008, when the Great Recession was slamming Nevada, companies not headquartered in Nevada saw a job loss of 6.2 percent. Companies based in Nevada at that time saw a job loss of 0.2 percent.

We ran an impact model for the State Treasurer. Page 21 of [Exhibit G](#) gives the assumptions of that model, and page 22 of [Exhibit G](#) shows the results of that model. One of the expected results is the creation of 640 new direct jobs. They will be technology or knowledge-based jobs that relate well to the knowledge fund under A.B. 449.

We need the tools provided in S.B. 75 in order to attract the kind of companies the Nevada Vision Stakeholders want to attract to Nevada.

CHRIS HOWARD (CEO, NorthStar Business Source; Director, Entrepreneurial Initiatives, University of Nevada, Reno):

I support S.B. 75. I have been involved in venture capital and private equity in Nevada. In 1999, my partners and I started Nevada Ventures, the only registered venture capital fund in the State at that time. We brought several companies to Nevada on condition that they locate here. One of those companies was Alere Medical, Inc. At that time, the company had four people. When we sold the company seven years later for \$170 million, all of the funding came from outside Nevada. We could not find the capital in Nevada. Nine months later, the company was sold for \$250 million. We have proven there are opportunities in Nevada. That was an example of venture capital.

We bought another company, a private equity company, with two people, some intellectual property and small revenue. It was located in Nevada. We purchased that company and its holding company, NorthStar Investors, Inc. After the seven years we held it on an undiscounted return basis, our rate of return was 3,580 percent when we sold it. Part of the condition of the sale was that it remain in Nevada. We created jobs that stayed in Nevada and made money for the State.

We have six other companies, located in Nevada, in which we are invested. If we could get participation from other investors, venture capital funds or private equity groups within Nevada, everybody wins. If the State is one of those investors, the State would have the same opportunity as we have. The cautionary tale relates to what you do after you invest the money. Our model is to invest, then have intense management oversight. In a broad-based investment policy, this may not be possible or necessary in every case. Speaking to Senator Lee's concern about risk, depending on the type of investment, you can structure the oversight differently. Where the investments are broadly based, you can have sufficient oversight from other larger groups. Where you are dealing with companies located here, you have the opportunity to have oversight.

Trans World Health Services, Inc., asked us if we would be interested in investing in their company. Since we are fully invested at this time, we could not do that now. I made contacts with my network of investment bankers around the Country. There was no one in Nevada with whom I could share this opportunity. We need to have some facility here to have credibility. It may have to be the State. Eventually, we will attract the private purveyors of capital. We will have shown a nexus here in which we have confidence. The opportunities

are available. They have to be vetted. You have to be careful in what you do. Risk is real. It must be managed. That is the key.

Approximately one year ago, at the University of Nevada, Reno, I ran a graduate fellowship grant for the U.S. Department of Energy. We studied the intellectual property that lives at the University. There are opportunities there in which the State can invest to enable that intellectual property to move to commercialization. That would be another benefit to the State.

The Treasurer's proposal with S.B. 75 is not theoretical. It is already happening privately. It is opportunity for anyone who wants to step up and be involved. I do not expect that we would have any connection with the process in S.B. 75. I am not here speaking on behalf of the University. I am only here to say that the theory works, and it works here in Nevada. A structure can be constructed that would benefit the State.

DUSTY WUNDERLICH (CEO, Optimum Strategy Group):

Our company is an investment banking asset management firm in Lake Tahoe, Nevada. The members of our management team are native Nevadans. I have had the opportunity in my career to raise capital for some of the largest private equity groups and institutional investors in the world. Recently, my colleagues and I started focusing on the opportunities in Nevada. We like to assess risk and answer every no before we move to the yes.

I have submitted a printed copy of my presentation ([Exhibit H](#)). We have been studying the market for approximately one year. We analyze risk extensively, from a global macro view to a local micro view. We decided to look at a State fund perspective and how to affect private equity and venture capital. Josh Lerner, Professor from Harvard Business School, studied all of the different innovative funds implemented worldwide and found that they are all state funds. He made specific observations about successful, state-based, private equity funds. One out of ten of these funds is successful. In spite of that, there is still a huge opportunity under S.B. 75 if the investment is structured in a specific way.

Page 4 of [Exhibit H](#) lists critical factors to state fund success. One of the first things we talk about is not copying other markets. We have been vocal about this. We are the next-to-largest pool of venture capital in the Country. Trying to be like Silicon Valley is going to lead to failure for Nevada. We are adamant that the fund not go in that direction. Nevada has unique competitive advantages.

We see a high amount of deal flow for those competitive advantages. New York is learning this the hard way. The valuations on venture capital have gone up 30 percent since New York implemented its venture capital program. Most of that is because Silicon Valley money is going into it. Nevada must be unique in the way we structure this.

The fund structure must mirror the private markets. Before S.B. 75 was proposed, we were studying ways to structure a fund to put into this market. We thought in traditional terms. One such term is "2 and 20" that refers to the management fee and the carried interests. Two percent on the assets managed is the management fee to keep the fund going, assess due diligence, etc. The 20 percent is on the back end for carried interest. That is where the money is made for private equity managers. If we take that out and do not have incentives aligned with building better companies and selling those companies, there is a risk of driving out all private capital and producing lackluster investment returns. We propose that this follow private market returns. Most private equity firms put up 1 percent of the assets under management as part of their contribution, putting money alongside the other investors. These are key as we start to develop this program. We want to attract capital. If we take a narrow niche without these parameters and put it into the Nevada market, we will drive out the private capital and not have the opportunity to bring other capital into this and other private equity firms. At the end, the investment returns will not be what we want. That is something we want to avoid at all costs. That is why we have looked at this from a risk analysis point of view versus being purely optimistic.

Page 5 of [Exhibit H](#) outlines the fund strategy we believe could be the most lucrative. The left column lists the areas at which we are looking for investment opportunities. On the right are different areas of the capital markets we can utilize for this strategy. Venture capital early-stage companies are great, but they are very risky. Small-to-midmarket private equity is an important part of the strategy, but use only a part of the strategy. We want to promote the work that Ky Good and C4CUBE are doing at the business incubator. We want entrepreneurs to learn what it is like to start a company. We want to foster that growth. We do not want to pour money into it before it is mature. We look into mature companies that want to relocate. One example is American AVK Co. in Minden. The company relocated from Silicon Valley, California. It produces fire hydrants and water piping materials for municipalities and contractors. The company has provided over 100 well-paid manufacturing jobs and is continuing to grow. This is the type of company we want to bring to Nevada that will have

immediate impact. We want to assist companies who are already in Nevada by putting capital into these companies for expansion and growth.

Distribution and manufacturing are two areas where we are seeing a lot of interest from companies. We are located one day via trucking from the best consumer market, with 50 million people, in the world. Many companies want access to that market. This makes infrastructure important. Infrastructure tends to be a little less risky than pure private equity, so it diversifies the overall approach.

The strategy must be opportunistic, taking those entrepreneurs in our region and investing into those companies. We still want to support that as a part of the strategy, not the entire strategy.

The right side of page 5, [Exhibit H](#), identifies different areas in which we want to invest in order to use the capital structure to minimize risk. Noncontrolling private equity investments tend to be very good—sometimes. Private equity managers can get in, take control and drive down companies. It is more about finding the companies, supporting their growth and expanding through strategic equity investments.

The returns on mezzanine debt are excellent right now, in the midteens. Using debt investments is a good way to take a solid position in the capital structure and still see good returns without as much risk as the equity investment. In cases where the companies do not want to give an equity investment, we need to do something to attract them there.

United States corporations are sitting on \$1 trillion in cash. They are buying up companies left and right. Mergers and acquisitions are excellent ways to bring value and other big corporations into Nevada when they buy companies or merge with companies in the State.

We have worked closely with the federal Immigrant Investor Program in Nevada. This is an innovative financial instrument, providing low-cost capital tied to job creation. Every \$500,000 invested must create ten jobs.

We want to attract other private equity firms globally along with other venture capital firms that come alongside us. This fund will not always get every deal done, so it is important that we attract other capital into the State in partnership with us.

From our perspective of being involved in alternative assets and private equity on a global basis, we are big proponents of S.B. 75. We support this bill with an air of caution, urging proper risk analysis and using the right strategy.

SENATOR LEE:

Are you making mezzanine loans, and is that what you want to do with the money the Treasurer wants to invest from the PSF?

MR. WUNDERLICH:

It can be a way to make investments. For example, if we had a good manufacturing company that wants to move to Nevada and build a new plant, we see the opportunity for it to come here. If we can structure the right debt to get that plant built, we can create the jobs that we need in this State. In that case, using mezzanine debt with good returns is a good risk.

SENATOR LEE:

Is your goal to take those types of companies from private to public?

MR. WUNDERLICH:

That could be an exit strategy. The initial public offering market is not lucrative right now. I lean more to the merger or acquisition for an exit.

SENATOR LEE:

For the record:

So basically, the companies that you're interested in investing are companies that you think could make a lot of profit for...I don't know if you guys get a 12b-1 load, I don't know how you guys, you know, break points. I don't know how you guys get paid. But this isn't really for companies that are coming here and just need a chance to get a few bucks to get on the ground and pay the loan back. I mean, let's put that on the record. This is all about taking those companies, the 1 in a 1,000, the home run, whatever you want to call it. That's basically, and I know it, I'm just asking you to explain that.

MR. WUNDERLICH:

I would say that it varies away from the 1 in a 1,000. This is more of traditional private equity investing versus early-stage venture capital, which has been proposed quite a bit. That is where one takes start-ups without revenues, when one is trying to foster a new technology or a new concept to the markets. It is

a very risky strategy. The 10-year venture capital returns are negative, but the 15-year returns are 38 percent. Private equity-style investment tends to be more consistent. They have been in the teens for the last 20 years.

SENATOR LEE:

I appreciate your presentation. I am just working the issue in my mind.

CRAIG M. STEVENS (Nevada State Education Association):

We support S.B. 75. It is difficult to grow this PSF. The land trust is static. Nevada gave away its ability to grow this fund by giving away its land. This bill provides an opportunity to grow this fund beyond the minimal performance it has shown over the last few decades. With some risk to this relatively stagnant pool of money, the State has an opportunity to increase funding to education. We ask that you help education invest in Nevada so Nevada can return the favor.

DAVE ARCHER (CEO, Nevada's Center for Entrepreneurship and Technology; Cofounder, Reno Angels):

I have submitted a copy of my presentation ([Exhibit I](#)). I will be talking about the needs side of this equation, the people who need these investments rather than the investors themselves. Nevada's Center for Entrepreneurship and Technology (NCET) was founded in 1999 to help Nevadans start and grow their businesses through educational programs and by connecting them to the resources they need to succeed. We are tax-exempt under the IRS code section 501(c)(3) and receive no State funding. We create programs based on gap analysis, attempting to avoid duplication of what anyone else is doing. Page 2 of [Exhibit I](#) lists some of the programs we have created.

When I joined NCET five years ago, there was very little venture capital funding in Nevada. There were only two angel groups. Yet many early-stage and midstage companies needed that level of funding.

The differences between venture capital funding and angel funding are noted on page 4 of [Exhibit I](#). Angel investing can be considered an investment club: individuals who come together with each committing to invest from \$25,000 to \$50,000 per year for an aggregate of up to \$2 million per company. In contrast, venture capital invests more than \$2 million, tends to take money pooled from investors and uses a professional fund manager to manage their aggregate investments.

The Reno Angels were founded in June 2008. We now have 12 individuals who invest \$25,000 each year. To date, we have invested approximately \$1 million in six companies which are listed on page 5 of [Exhibit I](#). The companies are involved in early breast cancer detection, medical health records, and race and sports book. The funds invested represent the savings of our members, so we are sensitive to risk. We diversify.

In the three years the Reno Angels have been operating, we have had 75 companies apply to us for funding. The requests have totaled approximately \$36 million. The investments of our 12 members have totaled \$900,000, leaving a three-year shortfall of \$35.1 million. That much need has gone unfunded. The other two angel groups in Nevada, the Sierra Angels and the Vegas Valley Angels, are in a similar position. Page 7 of [Exhibit I](#) lists companies we were unable to fund due to lack of money, time or expertise. There is a need for investment capital in Nevada, and [S.B. 75](#) is a great way to have that happen.

KY GOOD (Managing Director, C4CUBE):

I have submitted a copy of my presentation ([Exhibit J](#)). Page 2 of [Exhibit J](#) explains who we are and what we do. C4CUBE is a business incubator. Every day, we discuss minimizing risk for the investor, and we try to explain it from the entrepreneurs' point of view. I applaud the Treasurer's efforts to promote [S.B. 75](#) and to seek the professional management of the funds to be invested.

The point of the information on page 3 of [Exhibit J](#) is that building a sustainable job-growth cycle requires leveraging access to capital, identifying talented management and mentoring. Money alone is not the answer. It is a critical piece that must be managed.

Page 4 of [Exhibit J](#) identifies the reasons that job growth occurs. According to the Ewing Marion Kauffman Foundation, 87 percent of companies that have money, mentoring and support have a successful exit from the incubation process. All of the elements listed on page 4 are in Nevada today. We need to strengthen our capital position and leverage and understand that mentoring and structuring for the discipline is required to bring that success to the 87 percent level.

Page 5 of [Exhibit J](#) highlights three companies we have presented in our monthly investment meetings at our business opportunity forums. Maslow6 and 3G Studios received money in October 2010. Maslow6 is relocating part of its

business to Nevada. We only fund companies that will bring all or part of their company to Nevada so we can have control over how the funds are used, thus managing the risk. I am CEO of Eye-Com Corporation that has strong company discipline. We have hired 22 engineers. We manage our money. The element of bringing money, mentoring and support is critical in any process of capitalization.

BRIAN KROLICKI (Lieutenant Governor):

I embrace the effort being proposed in S.B. 75. This room is filled with people, like me, who are hungry for investment capital in Nevada to make attractive investment returns, create jobs, incubate new industries and diversify our economic development. We do have a fiduciary responsibility, but we must not lose sight of the economic development of precious and limited resources. The PSF is a profound and substantive asset. We have been trying to utilize it, rather than to have it just sit there. That has been difficult. During my tenure as State Treasurer, we used these monies to guarantee local school bonds, which made the schools' credit less expensive. How can we use this asset to bring value beyond supplementing the DSA under the Nevada Plan?

In 2010, I studied ways to use the funds of the PSF. One of my concerns, shared by the current Treasurer and others in this room, is the constitutionality of S.B. 75. Article 8, section 9 of the Nevada Constitution is real. I do not want to tamp down enthusiasm on this bill, and I know courts change and attorneys have different opinions. In 2001, I did not file for a judicial determination based on legal advice that I would not get the decision I was looking for. I appreciate what the Treasurer has done to file for a judicial determination now. This money should be deemed eligible to invest in some form of public-private partnership and other types of investments in private equity placement.

I support Assembly Bill 449 as a primary vehicle for economic development. My issues and concerns about the bill should be addressed, and we are doing that. I have submitted a letter to Chair Kihuen asking to withdraw S.B. 395.

SENATE BILL 395: Establishes a technology commercialization plan for Nevada.
(BDR 18-906)

We do not need to create too many vehicles, boards, investment committees and funds. We need to focus in an appropriately channeled way. Should this Committee choose to proceed with S.B. 75, I urge that the governance of the provisions of S.B. 75 be part of A.B. 449. Under A.B. 449, a board of economic

development will have investment vehicles and decision-making policies. Intelligent private-sector people will be on the Catalyst Fund, the Knowledge Fund and a possible research and development fund. I pose this in a friendly and constructive way. Perhaps the governance of how monies are deployed, if judicial determination is received, can be channeled through the infrastructure of A.B. 449.

I do support the creation of the corporation for public benefit mandated in section 5 of S.B. 75. This is important from a liability issue, from a safe-harbor issue and from potentially leveraging certain constitutionally eligible funds. An aspect to managing these monies would help ensure that constitutional constraints are followed. I support the underlying intent of S.B. 75. We need to be careful. The risks are real. More insight into the associated fiduciary aspects would be helpful. When I was Treasurer, the average duration for the PSF portfolio was approximately 1,200 to 1,400 days. We know this is not liquid money. We need to make sure that the horizon matches the fiduciary responsibility.

In the letter I sent to Chair Kihuen, I mentioned a possible solution that is immediately available to us. From a fiduciary standpoint, it makes sense. That solution is PERS. With a portfolio worth approximately \$24 billion, PERS has the ability to carve out a portion of that to invest in Nevada opportunities with similar credit profiles as the ones outside of the State in which they already invest. I urge the PERS board to work with the board suggested in A.B. 449 to coordinate these activities to make this capital available. Under A.B. 449, unclaimed property can also be a source of investment funds.

SENATOR LEE:

Recently, I spoke with a water district retiree, Dick Wimmer. I asked him how his retirement savings had been invested. He said that his pension fund had been managed by the Public Employees' Retirement System Board but not mixed with PERS funds. I have been told it is not possible to have the Board manage PSF money. Is that correct? I am not in favor of loaning out the \$50 million.

LIEUTENANT GOVERNOR KROLICKI:

There are some walls between PERS and all of us. It is a separate fund. There are constitutional protections. Blending purposes or having a joint venture is problematic. The Public Employees' Retirement System uses some fine firms to manage its alternative investments. These people would be available separately.

The PERS is an actuarial program for 20 to 50 years. This bill is about job creation, safe return and preservation of capital over a shorter period of time. The purposes of a PERS fiduciary are different than what we are looking at. The management of the funds under S.B. 75 should be separate from PERS management.

SENATOR LEE:

I do not care about the bill. I care about making the money do the things the Treasurer has proposed. When you consolidate money, you get break points. Many positive things happen when one puts a lot of money together. Is there a way to consolidate this volume of money in a safe and secure place that would allow the Treasurer to use more money for education?

LIEUTENANT GOVERNOR KROLICKI:

The Public Employees' Retirement System of Nevada is interested in getting a safe return on the dollars invested. The purposes under S.B. 75 are different. A good return is desired. There is also a strategic aspect involved. The PERS is "funds to funds." Nevada PERS invests in fund managers who invest in these kinds of things. It is much broader. We do not have those kinds of resources. We would be looking at getting into specific investment opportunities. That is the Catalyst Fund. The Catalyst Fund will not put \$10 million into one corporate private-sector opportunity, it would put \$250,000. The monies could be blended, used for infrastructure, improvement of real property and funding eminent scholar programs, as proposed in A.B. 449.

SENATOR LEE:

That is not the answer I wanted. I do not want to invest that \$50 million. I want that money to be protected and safe for the future generation of children. You continue to refer to the bill. When you were Treasurer, was it possible that you could have gotten a better return on this money by utilizing something tying into PERS, using its people or following its investment strategies?

LIEUTENANT GOVERNOR KROLICKI:

The investment strategy at the time was to get the chart that was shown, the broad portfolio, not private equity or private placement or venture capital. It was to get an exposure similar to a traditional investment for a retirement portfolio: 50 percent in equity exposure over a longer term. These are longer-term monies. These would be paying dividends. They are stable. They are ongoing concerns. The risk profile is much different. That is how we envisioned it. It would produce better results over a longer period of time. The PSF has grown from

approximately \$100 million to \$310 million since I was Treasurer. This is a precious resource that should not sit there making only 2 percent interest.

MICHAEL E. SKAGGS (Executive Director, Division of Economic Development):
Senate Bill S.B. 75 compliments A.B. 449. The latter has a Knowledge Fund that puts funds into the University of Nevada, Reno, University of Nevada, Las Vegas, or the Desert Research Institute to hire talent, the bright people who have the intellectual property that can be commercialized and become companies that create jobs. The recently proposed amendment to that bill addresses the federal leveraging opportunity. It would identify a portion of the Knowledge Fund available to be used as matching funds when the Universities, nonprofit organizations or companies apply for federal grants. Senate Bill 75 is the third piece. It addresses a means to get money to the companies that will help them grow after we have discovered a viable technology that has market value. This money can go to seed funds and venture capital, neither of which we have. A part of the State strategy should be to grow a brain-based economy. We should take the ideas of the citizens of the State and turn them into companies based in Nevada.

CHANDLER MARRS, PhD. (President and CEO, Lucine Biotechnology, Inc.):
You have my written testimony ([Exhibit K](#)).

MENDY ELLIOT (State Small Business Credit Initiative):
The State Small Business Credit Initiative has \$13.8 million that I have been asked to align with A.B. 449 and work with the Commission on Economic Development to invest. We have two years in which to identify a solution for the State, starting with venture capital, micro-enterprise lending, small business lending and working with the financial institutions in Nevada. We are listening to what testifiers have to say about the importance of jobs, putting Nevadans back to work and assisting small businesses. We want to make sure that Nevada has the capacity and capability to move forward. We have a responsibility to leverage these dollars 10 to 1, based on the U.S. Treasury requirements. We work with the U.S. Small Business Administration, the Nevada Small Business Development Center and anyone in the State who has any opportunity to partner with us. Our directive from the Governor's Office is to align whatever projects and programs we develop under the grant application to the federal government—which is due June 27—with the directives developed by the Seventy-sixth Session of the Legislature.

PATTY WADE (President, Wade Development Company, Inc.; Wade Consulting Group, LLC):

I support S.B. 75. I started a new company approximately ten months ago. We represent 33 companies that want to come to Nevada. Two of these companies are renewable energy companies that were able to take advantage of a funding mechanism called the Revolving Loan at 3 percent through the U.S. Department of Energy. As funded by the American Recovery and Reinvestment Act of 2009, this will result in 600 new skilled jobs coming to Nevada paying in the mid-\$30,000s. Renewable energy companies represent approximately 30 percent of the companies that are looking to move to Nevada. The 33 companies we represent have the potential to bring 2,000 new jobs to Nevada. We would like to find another funding mechanism that is not limited to renewable energy companies. Senate Bill 75 seems to be a source for that. The jobs created by new business will have secondary and tertiary effects.

RANDOLPH J. TOWNSEND (Ex-Senator):

I have no pecuniary interest in S.B. 75. I believe in this bill and the things it can do for Nevada. Section 4, line 36 of the bill refers to "private equity funding" as "an investment in or a purchase of securities in operating businesses that are not publicly traded on a stock exchange." This definition does not include venture capital. An equity investment means that you will own something if you choose to do so. The chance of investing \$50 million on Wall Street is zero. You may be lucky to see a return of 5 percent to 10 percent in the first year because you want to be conservative, rational and measured. We know there will be a benefit to education. What kind of State do we want? Do we continue to give tax breaks to bring companies to Nevada that are only looking for a freeway? Do we invest in companies that bring intellectual capital and high-paying jobs with health care filled by people committed to our communities who do not use our social services because they make enough money to not need them? Or do we continue those tax breaks to companies that do not yield the returns we expect? You have a choice to make, and S.B. 75 is one of the tools you can use. It has the potential to build a broader economic base for the State consisting of the long-lasting, positive kinds of jobs we want.

An example of this kind of business in southern Nevada is called Switch Communications Group, LLC (Switch). It is a joint venture developed by a prominent family, Peter M. Thomas and the Thomas & Mack Development Group, LLC. Switch is a data storage center. Almost every large company in the world that has intellectual property houses and protects that property at Switch

in Las Vegas. The television feed from the Vancouver Olympics was sent to Switch in Las Vegas before dissemination to all NBC outlets. The company's clients include Disney Pictures, Sony Corporation and Microsoft. Other companies are considering storing their intellectual capital there. Smart people want to be around other smart people. They want access to smart universities that can produce more intellectual capital to their databases. If I can be helpful in your consideration of S.B. 75, I will be glad to do so.

CHAIR KIHUEN:

Seeing no one else who wishes to speak, the hearing on S.B. 75 is now closed. Seeing no one who wishes to make public comment, the meeting is adjourned at 3:28 p.m.

RESPECTFULLY SUBMITTED:

Leslie Sexton,
Committee Secretary

APPROVED BY:

Senator Ruben J. Kihuen, Chair

DATE: _____

<u>EXHIBITS</u>			
Bill	Exhibit	Witness / Agency	Description
	A		Agenda
	B		Attendance Roster
S.B. 75	C	State Treasurer Kate Marshall	PowerPoint Presentation
S.B. 75	D	State Treasurer Kate Marshall	Proposed Regulation Of The Office of The State Treasurer, Creation of the Nevada Capital Investment Corporation
S.B. 75	E	State Treasurer Kate Marshall	Envisioning Nevada's Future, Goals & Strategies for Advancing Our Quality of Life"
S.B. 75	F	State Treasurer Kate Marshall	State Governments: The Latest Venture Capitalists
S.B. 75	G	State Treasurer Kate Marshall	Stakeholders' Presentation, Senate Bill 75, Proposal to Fund Private Equity Investments in Nevada Businesses
S.B. 75	H	Dusty Wunderlich	SB75 Presentation
S.B. 75	I	Dave Archer	Presentation
S.B. 75	J	Ky Good	Nevada State Bill 75 Creating Jobs
S.B. 75	K	Chandler Marrs	Testimony