Fiscal Highlights

What's the Tax Liability Associated with the Utah Fund of Funds? - Thomas E. Young

What is the Fund of Funds?

The Fund of Funds is a private corporation created in 2003 with the purpose to boost venture capital investment in Utah-based companies. In a nutshell, the Fund of Funds borrows money from banks to invest in venture capital funds. If things go according to plan, the Fund of Funds makes a profit and pays back the bank loans plus interest.

What happens if things don't go according to plan?

This is when the state gets involved. The state has authorized the Utah Fund of Funds to issue $300 million in contingent tax credits. The tax credits act as collateral for the bank loans. Essentially, should the Fund of Funds be unable to pay back their loans because of poor investments or other cash-flow problems, the banks are allowed to "cash out" their tax credits in the amount of the default.

How much state tax liability is out there?

On the whole there is $300 million in potential tax credits that could be cashed out if the Fund of Funds were to issue all $300 million in tax credits. Of the total $300 million, as of now the Fund of Funds has only issued $130 million.

How much of the $130 million currently issued is "at risk" of being cashed out?

Based upon the current cash flow projections and asset valuations, the Fund of Funds may default on ***up to $15 million in loans beginning in FY 2017***.

Further Detail on Investments

Investments by the Utah Fund of Funds are not made directly into companies, but rather into venture and private equity funds. These funds then invest directly into companies. The Utah Fund of Funds can invest in funds focused on early stage start-up companies through later stage private equity companies. Because the Utah Fund of Funds is charged with boosting investment capital in Utah, the Fund of Funds seeks out asset managers that have a history of making investments in Utah-based companies or have indicated that they will invest in Utah-based companies.

In terms of who has lent the Fund of Funds money, the two banks are Zions Bank and Morgan Stanley. These two banks account for all of the $130 million used for investments and operations.

Financial Detail

The left chart below (titled "Fund to Fund Operational Costs") indicates what the operational and financing costs of the Fund of Funds have been. The Fund has two major expense categories: (1) Financing costs, which represents interest and fees related to the loans and (2) Operational Costs, which represents salaries, allocation manager, and economic development efforts. In 2012, the Fund of Funds spent $10.7 million on interest and fees and $1.2 million on operational costs. The $10.7 million in interest and fees in 2012 includes a one-time expense of $4.5 million to terminate a previous loan with Deutsche Bank. This termination saves the Fund about $3 million in annual interest expense.

The right chart below (titled "Fund of Funds Operational Revenues") indicates how much in distributions or return of/on investment the Fund has received back each year. In calendar year 2012, the Fund made $20.4 million in investment distributions.

The bottom chart (titled "Value of Investments and Aggregate Loan Balance") shows the loan balance and the value of existing investments over time. The blue line represents the aggregate loan balance of the business (i.e. what the Fund of Funds owes creditors). The orange line represents a general estimate of what the existing Fund of Funds investments are worth. The black line represents how much the Fund of Funds has committed to invest, but the funds have not been "called" (being "called" means that committed investments are finally transferred to the respective fund for actual investment, as opposed to just committing the funds).

The difference between the loan balance and the value of existing investments represents the $0 to $15 million "tax credits at risk."