

OREGON GROWTH ACCOUNT BOARD

INTRODUCTION

Oregon Growth Account (OGA) was created, within the Education Stability Fund (ESF) (formerly known as the Education Endowment Fund), by Oregon Laws 1995, chapter 811 during the 1995 Legislative Session in conjunction with the establishment of the ESF. In accordance with the provisions of the Oregon Constitution creating the ESF, the ESF receives 18% of Lottery proceeds. Of the Lottery Proceeds placed in the ESF, five percent flow into the OGA in accordance with ORS 348.702, as revised. Effective July 1, 2013, ten percent is set to flow into the OGA pursuant to the ending of the amendment enacted by SB 496 (2009) that reduced OGA's allocated from the ESF from ten percent to five percent.

The OGA is viewed as a sub-account of the ESF for three distinct reasons. First, Oregon statutes require that the OGA fund be "accounted for separately." Second, the investment directives that apply to the OGA are different than those that apply to the ESF generally (and other trust accounts). The statutes governing the OGA require that the OGA earn returns for the ESF by making investments in or providing seed capital for emerging growth businesses in Oregon. Finally, investment responsibility for the ESF rests with the Oregon Investment Council, while a separate Board, which includes the State Treasurer, has investment responsibility for the OGA.

In accordance with ORS 348.707(4), the Treasurer determines the investment policies and procedures for the OGA, within and subject to the general purposes of the OGA set forth in ORS 348.702. Treasury employees act as staff to the OGA Board. In this capacity, staff may periodically submit new or updated investment policies and procedures to the OGA Board for review and comment. The investment policies and procedures reflect the following principles:

1. The purpose of the OGA is to earn returns for the ESF by making investments in or providing seed capital for emerging growth businesses. The OGA investment program is expected to have an economic development impact by the nature of the investments being made including, but not limited to, generating significant high skill, high wage employment and facilitating technology transfers related to academic research, discoveries or developments for the purpose of commercialization of a technology, product, process or innovation.
2. OGA funds will be invested only through external managers/partners (ORS 348.703).
3. The management companies shall invest in Oregon an amount that is at least equal to the amount of the principal transferred from the Oregon Growth Account to the management company for investment. Managers/partners will be given full discretion in making investments; i.e., after funds are allocated to the manager/partner, they are solely responsible for the investment of these funds within the partnership's investment guidelines, " . . . with the care, skill and diligence that a prudent investor acting in a similar capacity and familiar with such investments would use in managing and investing a similar account" (ORS 348.703(3)).

The OGA Board and Treasury staff will be involved with the selection, retention and monitoring of external managers and partners but will not entertain individual investment proposals from individual businesses or for particular projects, except to the extent necessary to facilitate the liquidation of assets held directly by the OGA Board as a result of the consolidation of the former Oregon Resource and Technology Development Account with the OGA or as a result of in-kind distributions of assets to the OGA Board by external managers or partners. Therefore, individual investment decisions will be left to the external managers and partners.

FUNCTION: Investment Management
ACTIVITY: Portfolio Standards & Procedures within the Oregon Growth Account

POLICY:

I. BACKGROUND

The Oregon Growth Account (OGA) is a sub-account of the Education Stability Fund (ESF). The OGA Board has established the Oregon Investment Program (the "Program") to participate in potential attractive long-term alternative investment opportunities in emerging growth businesses. Investment of moneys in the OGA will generally be implemented through participation in limited partnerships that make private equity or debt investments, including seed capital investments in emerging growth businesses, although other management and investment arrangements may be considered under appropriate circumstances. As defined in ORS 348.701:

- "Emerging growth business" means an individual or group of individuals or a new or small company, including but not limited to any new or small partnership, limited liability company, corporation, firm, association, or other entity, that has the capacity, upon obtaining appropriate capital, to generate significant high skill, high wage employment.
- "Management Company" includes an individual or group of individuals, firm, association, limited partnership, partnership, corporation, or other investment company.
- "Seed capital" means financing that is provided for the initial phases, including the first phase, of development, refinement and commercialization of a technology, product, process or innovation, including but not limited to facilitating technology transfers related to academic research, discoveries or developments for the purpose of commercialization of a technology, product, process or innovation.

ORS 348.702(5) and ORS 348.703(3) govern investment activity. ORS 378.703(3) states: "A management company selected to manage the Oregon Growth Account shall manage the moneys in the account, subject to investment policies established by the State Treasurer and the investment directives or strategies of the Oregon Growth Account Board, with the care, skill and diligence that a prudent investor acting in a similar capacity and familiar with such investments would use in managing and investing a similar account. The management company shall invest in Oregon an amount that is at least equal to the amount of the principal transferred from the Oregon Growth Account to the management company for investment."

II. GENERAL POLICY

Private equity investments, i.e., investments in other than conventional public equity or debt investments, may provide an appropriate addition to the total ESF investment portfolio, and are compatible with the general objectives of the Fund, which include:

1. providing a means to provide benefits to the State's school systems and their beneficiaries;
2. investing to produce a return on investment which, based on levels of liquidity and investment risk, are prudent and reasonable;
3. attaining an adequate real return over the expected rate of inflation; and
4. complying with all applicable laws and regulations concerning the investment of trust fund assets.

Private equity investments possess a higher degree of risk with a higher return potential than traditional investments. Accordingly, total rates of return are expected to be greater than those that may be obtained from conventional public equity or debt investments. They have a low correlation relative to other investment classes and should therefore contribute to an overall reduction of risk and the enhancement of returns on a total ESF portfolio basis.

III. OBJECTIVES**A. PORTFOLIO INVESTMENT PERFORMANCE OBJECTIVE**

The performance objectives of OGA investments are challenging to benchmark given the requirement to invest in Oregon pursuant to ORS 348.703(3) as well as the early stage of investing, required by ORS 348.702(5). Public equity benchmarks, with a premium for illiquidity and risk, are a poor proxy since the OGA cannot invest in public market alternatives. Therefore, the OGA has established the following benchmarks:

1. After the investment period, individual partnerships are expected to deliver an internal rate of return (IRR) commensurate with their stated investment objective (but at least 12%) and a distribution multiple greater than 1.5 times invested capital.
2. Aggregate capital flowing to Oregon domiciled companies, within the OGA portfolio.

Staff will periodically evaluate performance benchmarks and premiums. In any case, results of such investments may not be meaningful for several years.

B. DIVERSIFICATION

Traditional measures of diversification may not be appropriate, given the investment constraints imposed on the OGA. Traditional measures of diversification include:

1. Stage -- Diversify investments throughout the various stages from seed and emerging growth businesses.
2. Industry Sectors -- Investments will be diversified across industries, subject to the investment opportunities and the discretion, within the parameters of the partnership agreements, of the general partners retained.
3. Size of Investments -- Investments will be diversified among a range of partnerships/investment vehicles of varying sizes, generally with a minimum commitment size of \$1 million but with an OGA ownership percentage usually at or below 25% of the total fund.
4. Geographical -- OGA investments by statute will be concentrated within the State of Oregon; this risk cannot be diversified away and may be significant. However, this risk may be mitigated by using managers with a focus beyond Oregon.
5. Time – the OGA Board will endeavor to invest in a consistent manner over time and shall not seek to “time the market.”

C. TOTAL PORTFOLIO DIVERSIFICATION

Correlation of the Program's investment return to other asset classes is not high, and the inclusion of alternative investments, therefore, provides an added measure of diversification to the Education Stability Fund.

PROCEDURES:**I. PROCEDURES AND STANDARDS****A. GENERAL PROCEDURES**

1. Treasury staff will screen available investment vehicles (generally, limited partnerships) and identify those that meet the Program's general strategy, selection criteria, and performance goals. Staff will coordinate the available investment proposals received by staff, the Treasurer, the Board, and its consultant. Such proposals may be rejected directly by staff if they do not meet the Program's investment strategy or criteria.
2. The Board's consultant will review the documents pertinent to an investment vehicle, including the offering memorandum, and identify possible issues. The consultant shall meet with the general partners, sponsors, or manager to discuss the investment, as necessary.
3. Treasury staff and the Board's consultant will identify promising investment vehicles and conduct full due diligence, for a possible recommendation to the Board. Upon completion of its due diligence, the consultant will provide a written report to the Board containing a summary of the proposed investment vehicle including: a description of the general partner's/manager's background, historical performance, and organization; the proposed investment strategy; the terms of the investment; the expected rate of return; the merits of the investment; issues and concerns surrounding the investment and how they might be resolved; and issues and provisions that should be subject to negotiation.
4. The Board will evaluate the investment vehicle and determine whether the investment should be funded, at a public meeting of the Board. Presentations and meetings between the Board and the general partners, sponsors or managers will be arranged as necessary to address issues or questions.
5. Legal counsel from the Oregon Department of Justice will be furnished partnership documents for those investment vehicles selected by staff and approved by the Board. Legal counsel will identify and resolve legal issues, working with outside counsel as needed, and discuss these with the staff as deemed necessary.

B. SELECTION CRITERIA

1. The OGA will generally invest with individuals or organizations with prior investment management experience. Primary emphasis will be on the quality and experience of the individuals who manage the investments.
2. Additional criteria to be considered shall include:

- a) A well-developed investment focus that meets the Program's objectives, and a favorable assessment of the proposed investment's strategy and market conditions;
- b) Relevant investment experience of partners/managers and key staff, individually and as a team, as well as their stability;
- c) Organizational depth and significant time commitment to the investment vehicle;
- d) Well-structured decision-making and transaction execution processes, including:
 - deal flow and initial analysis of portfolio investments,
 - pricing, selection and negotiation of portfolio investments,
 - financial structuring of portfolio investments,
 - management or oversight of portfolio companies,
 - development of exit strategies;
- e) Consideration of relevant issues, such as conflicts of interest and alignment of interests, among others;
- f) Experience in, and a demonstrated record of, successful prior investments;
- g) Appropriate proposed terms and structure for the investment;
- h) Meaningful capital commitments by the partners/managers;
- i) An active presence in the State of Oregon, on a regular and recurring basis, to evaluate potential investment opportunities.

C. STANDARDS

1. Types of Allowable Investments -- Any appropriate investment vehicle that has the potential for returns superior to traditional investment opportunities and that is not otherwise prohibited by the OGA investment policies or by law.
2. Prudent Investor Standard -- The selection of Program investment vehicles will be guided by the care, skill and diligence that a prudent investor acting in a similar capacity and familiar with such investments would use in managing and investing a similar account.
3. Negotiated Terms -- Terms, such as preferred returns, lower fee structures, and profit splits should be negotiated where prudent. All agreements are subject to the negotiation of satisfactory terms by Treasury staff, in concert with the Department of Justice.

II. STRATEGY**A. ALLOCATION**

The allocation to the Program will be 100% of OGA's total asset value, and approximately 10% of the total Education Stability Fund. The OGA will be selective, and invest such assets as are allocated to this Program prudently, and as opportunities become available. Diversification within the OGA is a consideration, but is extremely limited given the legislative mandate. Rather, the OGA will invest in private equity funds opportunistically, as opposed to strategically.

B. METHOD OF PARTICIPATION

The Program will consider large well-established investment vehicles as well as new and smaller investment vehicles, subject to prior demonstrated investment success. To the extent possible, partnerships shall be structured to create an alignment of interest between the limited and general partners.

C. INVESTMENT FUNDING

Partners/managers retained by the OGA shall make capital calls during the investment period in accordance with the partnership agreement. Such requests must be in compliance with Treasury internal control procedures, which require, but are not limited to: authorized signatures, original letterhead, pre-established bank accounts, and sufficient notice. E-mail notification is preferred, once the pre-established bank account information has been set up.

D. INVESTMENT LIQUIDATIONS

Partners/managers shall return capital to the OGA through cash distributions, whenever possible. Partners/managers shall liquidate any marketable securities before making distributions to the OGA. In instances where liquidation is not in the best interest of the OGA, partners/managers may distribute securities with sufficient advance notice to Treasury staff. Treasury staff shall then retain a third party manager to liquidate such securities as deemed appropriate by the third party manager, generally, within a six-month period.

E. EARNINGS DECLARATIONS

All investment returns on moneys in the Oregon Growth Account, including but not limited to returns from investments in limited partnerships and interest income on moneys placed in the Oregon Short-Term Fund or in another interest bearing account, shall remain in the Oregon Growth Account until such time as the Treasurer, in accordance with this policy, declares them as Oregon Growth Account earnings available for transfer from the Account and crediting to the Oregon Commercialized Research Fund (or other account as determined by the State Legislature). The Treasurer will, from time to time, review the Oregon Growth Account's investment returns and determine whether a portion of those returns can be

declared as earnings without impairing the Account's long-term goal of maximizing the overall rate of return on lottery moneys deposited into the Account consistent with the Account's investment focus. In making this determination, the Treasurer will consider:

- (1) the current and anticipated future expenses of the Oregon Growth Account Board and the Treasurer in carrying out the operations of the Oregon Growth Account and the related duties of the Board and the Treasurer;
- (2) the existence and need for reserves in the Account to cover current investment commitments;
- (3) the potential need to make additional investments in current investment vehicles to maximize the overall return from those investment vehicles;
- (4) the existence (or anticipated future development) and relative attractiveness of new investment opportunities and the availability of other moneys in the Account for such investment opportunities; and
- (5) such other factors as the Treasurer may consider appropriate under the current circumstances.

F. PROMOTION OF THE OREGON GROWTH ACCOUNT

Treasury staff have the discretion to fund sponsorship opportunities, within the venture capital and entrepreneur communities in Oregon (e.g., Oregon Entrepreneurs Network Venture Northwest Conference), for amounts up to \$2,000 per event, and up to \$5,000 annually. All such fundings shall be reported to the board at a subsequent public meeting.

III. IMPLEMENTATION

A. STAFF REQUIREMENTS

Appropriate staff will be assigned as the workload necessitates.

B. LEGAL COUNSEL

Relevant legal advice will be obtained from the Oregon Department of Justice. However, due to the complex nature of the Program's investments, expert outside legal counsel may be used when deemed necessary by staff and the Department of Justice. The Department of Justice retains the sole authority to hire outside counsel, at their discretion.

C. CONTRACT EXECUTION

1. General Partners/Managers will be informed of the Board's approved commitment, immediately following the Board meeting.
2. Legal counsel will receive written verification of the committed amount in conjunction with the partnership documentation, and shall review and approve all agreements for legal sufficiency prior to execution.

3. The Chief Investment Officer or Deputy Chief Investment Officer is authorized to execute contracts on behalf of the OGA Board, for investments authorized by the Board.

IV. CONSULTING CONTRACTS

- A. Consulting contracts shall expire on a date not to exceed four years from the effective date of the contract.
- B. Consulting contracts shall include a “no-cause” termination clause with a maximum 90 day notice period.
- C. It is the policy of the OGA Board to continuously review all contractors.
- D. Consulting contracts may be renewed or extended beyond the original expiration date, limited to a final expiration date that is no more than four years beyond the original expiration.
- E. Upon the final expiration of the original contract, or whenever directed by the Board, staff shall undertake and complete a RFP process which shall include the following:
 1. Identification of those potential candidates who may reasonably be believed to perform those services under examination;
 2. Publication of a RFP which shall include, but not be limited to:
 - a. description of services requested;
 - b. description of the potential or preliminary standards required by the OGA Board of the candidates; and
 - c. request for pricing or fee schedule information.

V. MONITORING

A. REPORTS

1. Reports prepared by the consultant will be furnished to the Board, quarterly, on Program activity and performance, and annually in an expanded format. The annual report shall capture, in addition to investment performance and total capital invested in Oregon companies, economic development metrics provided by the general partners, that may include: portfolio company employees in Oregon, and payroll, income, property and other state taxes paid.
2. Partners/managers shall provide quarterly reports to the consultant and Treasury staff on investment activity and performance. In addition, audited financial statements

- shall be provided on an annual basis, unless otherwise agreed upon with Treasury staff.
3. In accordance with ORS 348.703(6), the State Treasurer shall annually submit a report to the Governor and to the Legislative Assembly on the investment of moneys in the Oregon Growth Account. The report shall include a summary of the amount of money invested by industrial sector or business classification, by region of this state, by size of investment and by type of investment.

B. ADHERENCE TO STRATEGY

The actual strategy employed by partners/managers will be judged relative to stated objectives and strategies. The staff and consultant will interact with the partners/managers periodically as necessary. Given the illiquid nature of these investments, however, it is not anticipated that these investments can be exited once a commitment is made.

VI. REVIEW AND MODIFICATION OF INVESTMENT POLICY STATEMENT

The Board may review this Policy statement and procedures from time to time to determine if modifications are necessary or desirable, and make recommendations to the Treasurer and the Oregon Growth Account Board.