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Ohio Taxpayers on the Hook as Venture Fund Can't Pay Bondholders.

- Waiting for startups to produce cash, it couldn't meet debts
- Venture-capital fund's returns have lagged benchmark

The venture-capital fund created by Ohio to cultivate local startups is going on public assistance.

Still waiting for its young companies to morph into the next Snap Inc. or Facebook Inc., the Ohio Capital Fund, which was financed through the sale of municipal bonds, didn't generate enough money from its investments to pay $9.8 million on February 15, when the first principal payments on its debt started coming due, according to a securities filing. To avoid a default, it had to draw on $7.5 million from the state, the only time the fund has turned to that taxpayer lifeline in its 11-year history.

Ohio is among at least a dozen states, including New York, North Carolina and Pennsylvania, that have established funds to foster nascent tech companies. The Ohio fund, founded in 2005, was created by the state legislature to transform an economy upended by the decades-long loss of manufacturing jobs.

To encourage investors to buy the fund's bonds, Ohio agreed to extend as much as $20 million of tax credits per year over the thirty-year life of the program — insuring it can cover the debt even while waiting for investments to pay off. This allowed securities issued for the program to carry a AA-rating, just two levels below Ohio's general-obligation debt.

"Anyone you talk to would prefer a scenario where you don't use tax credits," said Mark Williams, chairman of the Ohio Venture Capital Authority, which oversees the fund. "I think when this was built and designed it was understood that was very possible."

The Ohio fund, managed by an affiliate of Cincinnati-based Fort Washington Investment Advisors, has only delivered an annualized return of 7.2 percent, compared with 8.9 percent for the median venture capital fund, according to the Ohio Venture Capital Authority. When factoring in debt costs, expenses and the $15 million in management fees paid to Fort Washington-affiliate Buckeye Venture Partners since 2005, though, that swings to a 6.5 percent yearly loss.

"Due to the geographic constraints and the limited universe of funds in which OCF could invest, we feel that the underlying fund performance is in line with expectations," said Stephen Baker, Fort Washington's head of private equity. The legislation creating the fund didn't set a performance objective.

The regional effort marked a push to jumpstart the economy by breaking the near monopoly that America's coasts have on the venture-capital industry. Just 22 percent of such investments went to companies outside San Francisco, New York, Boston and Los Angeles in 2015, according to the Center for Regional Economic Competitiveness and Brentwood, Tennessee-based Cromwell Schmisseur LLC, which designs state venture programs. The consulting firm didn't work with Ohio.

“Because of the extreme geographic concentration of venture capital, it is much harder for good deals to get financing where they’re at,” said Eric Cromwell, founding member of Cromwell Schmisseur. “When well-designed, programs like this encourage private investment in high-growth potential businesses between the coasts.”

Greatest Hits

The fund has committed capital to 30 venture funds, which are required to put at least half of the money in state-based startups. Those funds have invested $284 million in 88 Ohio companies, helping to spur the creation of about 1,100 jobs, according to a Nov. 16, 2016 program summary.

It has scored some hits. Among them is CardioInsight, a Cleveland-based medical device company that’s developed a new approach to improve the mapping of electrical disorders of the heart and was purchased by Medtronic Plc for $93 million in June 2015. Simbionix, another Cleveland company that creates virtual reality surgical simulation and training, was sold in 2014 for $120 million.

The Ohio fund has received $82 million from its investments so far. Its holdings were valued at $96.6 million as of June 30.

Until February, it only had to pay semi-annual interest on almost $160 million of debt. Then principal payments kicked in, increasing debt-service costs from about $7 million to $19.5 million a year. The fund is scheduled to make $195 million in debt payments between Feb. 2018 and August 2027, according to the state.

Its next payment is due Aug. 15 and it’s possible the state may need to cut another check if distributions from the underlying funds don’t materialize, Williams said.

Ohio Governor John Kasich opposes issuing more debt for the fund and wants the cash it earns to pay off debt first, instead of being reinvested, said Lyn Tolan, a spokeswoman for the Ohio Development Services Agency, which advises the fund.

Ohio moved into venture capital to nudge the economy more than to make a profit, given that steadier returns can be found elsewhere. Returns after fees for the median venture capital fund that began making investments between 2005 and 2014, ranged from 0.77 percent in 2014 to 19.4 percent in 2010, according to data compiled by Cambridge Associates.

“Overall, returns are disappointing and fall short of expectations,” said Diane Mulcahy, an adjunct lecturer at Babson College’s division of entrepreneurship and a Senior Fellow at the Ewing Marion Kauffman Foundation, where she manages the foundation’s private equity, venture capital and real assets investments. “If the state’s true intent was to create jobs, is borrowing to invest in a venture capital fund the best way?”

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