Escheats Funds:
An Overlooked Source of Public Capital for Business Development in North Carolina

Michael A. Stegman and Aaron McKethan

September 12, 2005

Prepared with the support of:
The Rockefeller Foundation

CENTER FOR COMMUNITY CAPITALISM
THE FRANK HAWKINS KENAN INSTITUTE OF PRIVATE ENTERPRISE
THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

Michael A. Stegman is the MacRae Professor of Public Policy and Business at the University of North Carolina at Chapel Hill, Chairman of the Department of Public Policy, and Director of the Center for Community Capitalism in the Kenan Institute of Private Enterprise.

Aaron McKethan is a doctoral student in the Department of Public Policy and a Research Assistant in the Center for Community Capitalism.

Abstract

Improving capital access, especially access to equity, has become an increasingly important component of economic development policy because of the growing recognition that small business drives our entrepreneurial economy. Half of all U.S. non-farm private output and employment was generated by small firms, those with 500 or fewer employees, in 2003.

Rather than try to tap North Carolina's public employee pension fund as a source of equity capital for North Carolina companies with job-creating potential—which he didn't think would be either fiscally prudent or palatable among the constituency of retirees who had seen other states' public pension funds head down this path before, and sometimes with disastrous consequences—State Treasurer Richard Moore targeted the state's $600 million unclaimed and abandoned property, or escheat, fund as his capital source of preference. With a successful legislative campaign behind him that allows up to 20 percent of the Escheat Fund surplus to be invested in private equity, this case study of North Carolina's experience should be useful to other states whose pension funds remain out of reach as a source of economic development capital.

Introduction

The idea for this paper dates back to an October 2003 speech in New York City by the Honorable Richard Moore, Treasurer of North Carolina, before the Inner City Economic Forum, an ad hoc organization whose participants included, among others, corporate and banking leaders, consultants, pension fund managers, foundations, and a few academics. The forum was convened by noted Harvard Business School professor Michael Porter to discuss creative ways that promising inner city companies could gain access to capital markets, especially equity capital. Moore's brief remarks would follow presentations by a couple of California public pension fund managers, who spoke about the pitfalls and promises—and their early experiences, mostly positive—of alternative investment programs that feature sizable investments in inner city-oriented private equity funds and venture funds targeting minority- and women-owned companies. Economic development advocates had long viewed public pension funds—the largest 200 of which have a collective current valuation of more than $1.6 trillion dollars—as the holy grail in the access to capital. Thus, the participants welcomed these positive presentations and eagerly awaited Moore's remarks (Hebb and Clark, 2004). Moore has a progressive reputation in a southern state well known for its historically fiscal conservatism toward managing its pension funds; if he could make a compelling business case for placing a small share of retirement funds in an alternative investment program like those in California, New York, and other states, it would bode well for expanding capital access to small and minority-owned businesses not only in North Carolina but in other southern states as well.

But instead of joining the parade, Moore chose to march to a different tune, suggesting that conservative southern legislatures and retirement fund managers are not likely to join the fray, and that proponents of double bottom line investing using pension fund capital should, as he was doing in North Carolina, look for other pots of non-appropriated funds that lacked the fiduciary obligations associated with managing public pension funds. In North Carolina, said Moore, the biggest pool of untapped investment capital is the state's unclaimed and abandoned property, or escheat, fund, whose balance at the time of his address was nearly $550 million.

Following Treasurer Moore's remarks, a program officer from the Rockefeller Foundation asked him whether he would cooperate with a project documenting his efforts to tap North Carolina's Escheat Fund as a new source of equity for growth companies in underserved communities ignored by mainstream capital markets. His enthusiastic support led to the funding of this study.

Because state escheat programs are obscure and little-known in business development circles, this paper begins with a brief history and moves on to a detailed examination of North Carolina's program, including ongoing efforts to broaden the Treasurer's authority by allowing him to invest in funds that target promising companies that create jobs and economic opportunities for North Carolina workers but are too small to command the attention of conventional equity fund managers. Our North Carolina case study involves interviews with leading legislators, their staffs, and treasury department officials.

Because Treasurer Moore's speech was about more than North Carolina, we tried to find out as much as we could about unclaimed property programs in other states, including the size of their escheat funds and their operating policies. In the course of our work we were fortunate to come across the trade organization, the National Association of Escheat Administrators (NAEA), whose executive director was not only gracious with his time but also shared with us the results of an unpublished 2003 survey of escheat fund programs. We use this survey and results of our own research to expand the potential usefulness of our North Carolina case, and to provoke a larger conversation among policymakers about tapping this source of capital to help grow their economies and create jobs and opportunities in underinvested parts of their respective states. We conclude this paper with a few recommendations.

Capital Access: Essential to an Entrepreneurial Economic Development Policy

As suggested above, improving capital access, especially access to equity, has become an increasingly important component of economic development policy because of the growing recognition that small business drives our entrepreneurial economy. According to the Small Business Administration, in 2003 half of all U.S. non-farm private output and employment was generated by firms with 500 or fewer employees. In North Carolina at the time, there were 650,900 small businesses, owned by women, minorities, and home-based individuals. (U.S. Small Business Administration, 2004). In a state in which most job losses have been concentrated in large firms—31 textile plants closed in North Carolina in 2001 alone, costing almost 12,000 jobs (The Rural Center, 2002)—while about two-thirds of all net new jobs were in smaller companies, it makes good policy sense to help small businesses access capital (U.S. Small Business Administration, 2004).[1]

The well-known economic power generated by venture-backed companies also gives more luster to small-business-driven state economic development strategies. After adjusting for size, "venture-backed companies generate more sales, pay more taxes, export more goods and services, and invest more in research and development than other companies" (Rhodes, 2003). According to Global Insights, Inc., a consulting firm based in Waltham, MA, which tracks these things, "companies that received venture funding at some point from 1980 to 2000 generated 11 percent of the gross domestic product in 2000" (Rhodes, 2003).

While lagging economic growth in North Carolina's rural communities has resulted in a bevy of targeted economic development programs, including one to improve capital access through the creation in 2001 of the $74 million-plus North Carolina Economic Opportunity Fund, a recent study suggests that significant parts of the state's more affluent urban counties are also hurting. According to Allen Serkin and Stephen Whitlow (2005, 3), "per capita incomes are lower, unemployment is higher and poverty is more acute in the 86 designated urban distressed census tracts than in rural distressed tracts."

North Carolina is home to several economic development entities, including venture funds such as the North Carolina Economic Opportunity Fund, an SBIC with more than $75 million in capital, and foundations, which are well positioned to provide the capital to assist struggling farmers in the state. The mission of the Golden LEAF Foundation, a nonprofit corporation created in 1999 to receive half of North Carolina's tobacco settlement monies, is to make grants and investments that will positively affect the economy of North Carolina; priority is given to projects that will promote economic development in tobacco-dependent and economically distressed counties. Some state legislators suggested that a portion of Escheat Fund monies could supplement Golden LEAF's capital base, as well as other proven entities whose track records show that they are positively impacting North Carolina's workforce and economy.

North Carolina's Escheat Law

Technically, escheat is the "reversion of property to a governmental entity in the absence of legal claimants or heirs."[2] The venerable rule of escheat "survives today," according to Richard L. Field (1996, 11), "not merely as a feudal relic, but because ownership abhors a vacuum. Someone must be deemed to have a legitimate claim to ownership of any property, real or personal."

In American jurisprudence, property rights are derived from state rather than federal law, which means that "each state defines what, when, where, and how property devolves to the state" (Testa, 2004). North Carolina's initial foray into escheat policies dates back more than two hundred years, when the North Carolina University Act of 1789 transferred escheated property to the University of North Carolina, America's first public institution of higher learning (NC Department of the Treasurer, 2002). In 1970, North Carolina voters approved a constitutional amendment that assigned unclaimed property to a new Escheat Fund that would be overseen by the Office of the State Treasurer (Sanders, n.d.).

While unclaimed property reverts to the state, upon evidencing proof of rightful ownership, individual claimants can regain ownership, regardless of how long the property has remained in state hands. North Carolina has no statute of limitations when it comes to recovering unclaimed property, but from years of experience and accumulated data the Treasurer's office has established expected reclaim and recovery rates, which help determine how liquid the fund needs to be to meet current and anticipated demands for claimants (North Carolina General Statutes, n.d.).

North Carolina, like other states, is statutorily required to publish in the county paper of the owner's last known address a one-time advertisement of the property owner's name and address. But the State goes well beyond this minimal requirement and employs public service announcements, broader use of the media, and public speaking engagements to get the word out to rightful owners. According to the National Association of Unclaimed Property Administrators (n.d.), states also work cooperatively "to collect and transfer property reciprocally; utilizing resources from other governmental agencies to help locate an owner (drivers license, social security administration, etc.); and the Internet."

Because escheat receipts are neither tax-generated nor subject to severe fiduciary obligations such as those associated with state pension funds, they are more flexible than most other state revenues. With a balance of $548 million in fiscal 2004 and growing, North Carolina's Escheat Fund thus represents a significant undervalued resource that could be put to effective use in promoting business development and wealth creation in underinvested regions of North Carolina.

Despite the inherent flexibility of the Escheat Fund, the state of North Carolina has imposed restrictions on both the spending and investment sides of escheated receipts. Under the state constitution, all earnings and interest generated from escheat investments must be used for educational purposes—specifically "to aid worthy and needy students who are residents of this State and are enrolled in public institutions of higher education in this State" (North Carolina Constitution). Historically, the General Assembly has appropriated the annual earnings from Escheat Fund investments to the State Education Assistance Authority (SEAA), which administers post-secondary education programs of student financial assistance (North Carolina General Statutes, 2001c). For the fiscal year ending June 2004, the appropriation was more than $36 million to SEAA, an increase of 150 percent over five years earlier.[3]

The Escheat Fund is invested in two primary portfolios: the Long- and Short-term Investment Funds (LTIF and STIF), both of which are pooled accounts holding surplus funds from various government operations, including the North Carolina state retirement system.[4] The LTIF holds fixed-income investments that are typically not needed to meet current obligations, generally defined as not being needed for between 12 months to 24 months. Because the STIF serves as a cash management account, it is invested in shorter-term instruments that can be readily liquidated to meet current needs. Although their maturity profiles may vary, both escheat pools are conservatively invested in such low-risk instruments as U.S. Treasuries, Fannie Mae and Ginnie Mae mortgage-backed securities, other asset-backed debt, corporate bonds, and so on (North Carolina General Statutes, 2001a).[5] The STIF has a greater concentration of certificates of deposit and other cash equivalents. In June 2004, the LTIF held $453 million in escheat receipts, which is an increase of 123 percent over the previous five years. In 2004, the state realized gross earnings from LTIF-invested escheat receipts of more than $37.5 million, an increase of 130 percent compared to five years earlier.

Escheat receipts invested in the STIF have also grown considerably in recent years, from $16.6 million in June 1999 to $44.3 million in June 2004, a five-year increase of 167 percent. During the same period, gross earnings more than doubled, from $451,388 in 1999 to $1.2 million in 2004.

Modernizing North Carolina's Escheat Fund Investment Program

As part of this project, we researched earlier efforts to modernize Escheat Fund investment policies, and in late 2004 and early 2005, we interviewed North Carolina Treasury Department officials, a bipartisan group of leading North Carolina legislators, and their staffs, and found broad conceptual agreement but no consensus on instituting investment guidelines.

In 2004, the Treasurer put forth a legislative proposal that would allow up to 20 percent of the Escheat Fund principal to be allocated to investments that had the potential to produce "long-term economic benefits to the State of North Carolina from the creation or retention of jobs, wages, tax revenues and other economic growth."[6] Eligible investments would include, among others, economic development-related debt and equity instruments, including limited partnerships in venture capital funds; business loans guaranteed by the U.S. Small Business Administration that were made to North Carolina companies; and letters of credit or similar debt or credit enhancements of commercial bank loans made to North Carolina businesses.[7] Because this request applied to how escheat funds could be invested, not to how earnings could be used, Moore's proposal did not require a constitutional amendment.

Although the General Assembly took no action on the proposal during its 2004-2005 session, there seemed to be little organized opposition to it. Nevertheless, we found an undercurrent of concern and disillusionment stemming from earlier initiatives that had similar goals though different specifics.

.One source of concern had nothing to do with economic development. The Treasurer's proposal coincided with the desire of the University of North Carolina System to dig deeper into the corpus of the escheats fund to offset reduced appropriations to UNC. Resistance to he the Treasurer's proposal was based on a fear that diverting some of the corpus into alternative investments would reduce the size of the "pie," and thus make it harder to count on escheat funds in the future.

One source of concern dated back nearly fifteen years, when the General Assembly used escheat funds for economic development for the first time. In 1991, a $25 million loan was made to assist a regional nonprofit development entity, Global TransPark Authority (GTA), finance a land purchase to expand a runway for an airport-centered just-in-time global manufacturing and distribution facility in an economically distressed area of eastern North Carolina (North Carolina General Statutes, 2001b).

Since 1993, GTA has drawn down about $15 million of its line of credit but has only been able to repay 3 percent of the principal and accrued interest, despite repeated ultimatums from the General Assembly to extinguish the loan (Weisbecker, 2005). In June 2004 the General Assembly enacted legislation requiring GTA to pay down the loan by $2.5 million "as soon as feasible" and pay the remaining balance by July 1, 2005 (North Carolina General Statutes, 2001b). When both deadlines were missed, rather than foreclosing on the loan, the legislature once again extended GTA's deadline, first to August 2005, and then to October 1, 2007.

In addition to Global TransPark, there was a hangover from other disappointing economic development investment schemes that Treasurer Moore's escheat proposal had to overcome. First Flight Venture Center, a nonprofit corporation created to nurture new North Carolina-based technology companies, was spun out of the state Department of Commerce in 1992. Since then, First Flight has received approximately $19 million in state funding. Unfortunately, a 2001 state audit of First Flight uncovered significant management and financial problems, including excessive salaries and travel expenses, more than $500,000 in payments to a lobbyist, and questionable hiring practices by the agency's former chief financial officer. Although First Flight has not received additional state funds since the audit, some observers think that Global TransPark and First Flight, among others, may have "poisoned the well" for other types of economic development investing.

Finally, while North Carolina was not one of the several states that had invested pension funds in economically targeted investments (ETI) in the 1980s and early 1990s, it is possible that widespread stories of the disappointing results of some of these "first generation" investment programs played a role in the General Assembly's reluctance to broaden the Treasurer's Escheat Fund investment authority. Research suggests that the poorest performing ETI programs failed for one or more of the following reasons: pension fund manager(s) had limited experience investing in this new asset class; these investments were perceived as having been undertaken more for social purposes than for earning risk-adjusted market rates of return, which lessened their due diligence efforts;

or, minority-owned businesses suffer from an outdated perception of being inherently less well managed and less competitive than white-owned companies (Fairchild, no date).

Despite these myriad concerns, influential business and political leaders continued to look to escheat funds as a source of business development capital. For example, in February 2004, a report of a bipartisan committee appointed by Governor Mike Easley to recommend ways to strengthen North Carolina's burgeoning biotechnology industry recommended, among other things, investing $25 million to $50 million a year from state pension or escheat funds over the next five years in biotech startup companies. While the General Assembly provided partial funding for several of the committee's recommendations, it took no action on the pension/escheat fund proposal.

Not discouraged by past legislative inaction, Richard Moore once again submitted his escheat fund proposal to the General Assembly near the start of the 2005-2006 session. The measure was introduced in March 2005; after separate majority votes in the House and Senate, it was ratified on July 26, 2005, and signed into law by the governor a few days later, on August 8. While several legislators wanted the state to more actively promote job creation through venture-type investments in promising companies in parts of the state hit by mass layoffs from closed textile and apparel plants, and others cited the decline of the tobacco industry and the need to help tobacco farmers transition to other crops or other industries altogether, we are not sure that any economy-related changes in North Carolina were at the heart of the legislative turnaround.

Rather, we came away from our interviews with a sense that the combination of the rapid and continuing growth of the Escheat Fund and the spiraling costs of higher education ultimately put the proposal over the top. Education advocates in the General

Assembly saw higher tuition costs at the state's public colleges and universities, especially at the flagship campus in Chapel Hill, as a major threat to upward mobility for the sons and daughters of factory workers and others who see a college education as a ticket to the middle class. This winning legislative strategy is reflected in the approved measure's title: *An Act to Establish a Modern Investment Program for the Prudent and Appropriate Management of the Escheat Fund, for the Benefit of "Needy and Worthy" Students as Provided for in the State Constitution* (NC General Assembly, 2005b).

This time, the majority coalition supported Richard Moore's argument that a more modern investment strategy that included the option of allocating up to 20 percent of the Escheat Fund surplus in non-fixed income securities (such as real estate, private equity, or public equity) can help grow both North Carolina businesses *and* investment earnings—ultimately leaving him with "more money available for tuition assistance" (Rice, 2004).

Passage of the measure was no doubt also aided by a positive assessment of the fiscal impact by the General Assembly's Fiscal Research Division. The Legislative Fiscal Note accompanying Senate Bill 341 (NC General Assembly, 2005a) estimated that shifting up to 20 percent of the excess Escheat Fund balance "should increase the average annual investment income over the long run, when compared to the annual return under the current portfolio." "In theory," continues the Note, "the increase in annual income should be around 10%...although the rise in yield [will also cause] a modest rise in the volatility of the annual return" (p.1).

The National Implications of the North Carolina Case

When we began this project, we had no idea that the balance in North Carolina's Escheat Fund was approaching $600 million, and growing. A quick Internet search of other states' unclaimed property programs indicated that escheat funds are alive and well in these places also, and led us to believe that North Carolina's successful initiative to use a portion of escheat resources for business development might be applicable and replicable elsewhere. This section summarizes the results of our scan of the escheat fund environment and interviews with the manager of the national trade organization of escheat fund administrators.

Since the inception of its escheat program in 1969, Minnesota has collected $326 million in unclaimed property, returning 44 percent to rightful owners, and had $184 million on hand as of the end of fiscal 2004 (Minnesota Department of Commerce, 2004). At the same time, California's escheat fund balance was $599 million (California State Controller's Office, 2005); Indiana's was $285 million (IndianaUnclaimed.com, 2005), and Maryland's was more than $200 million (Comptroller of Maryland, 2003). South Dakota took in $5 million in receipts in fiscal 2005, which was significantly greater than the previous four year average of $3.8 million (South Dakota Office of the State Treasurer, 2005). Oregon takes in about $16 million a year in new, unclaimed property receipts, while returning about $4 million to owners (Oregon Department of State Lands, 2004). Finally, if there was any question of the potential of unclaimed property receipts to contribute to important state priorities, Texas put an end to such doubt when it announced in October 2003 that its unclaimed property fund balance had topped $1 billion, while taking in an additional $71 million in gross receipts in 2003 (Texas Comptroller of Public Accounts, 2003).

Further explorations on the Web turned up other sources of significant unclaimed property funds that do not necessarily find their way into a state's escheat fund balance. We realized that when it comes to abandoned property, even nickels and dimes add up, especially when the unclaimed property is bottles—as in soft drinks. According to *www.containerrecycling.org*, ten states collect some or all unclaimed bottle deposits. California, Massachusetts, and Michigan collect 100 percent of unclaimed bottle deposits, and Michigan collects 75 percent. "In 2000, abandoned deposits amounted to $84.7 million in New York, $28.5 million in Massachusetts, and $23.5 million in Michigan" (Container Recycling Institute, n.d.). Because fewer people are redeeming bottles than in the past, unclaimed deposits are rising, having gone in Massachusetts from $20 million in 1997 to $31 million in 2001.

Although still tied up in legal research, litigation, and legislative debate, potential new sources of significant unclaimed property are the dormant balances on bank cards whose owners cannot be located, and stored value card balances on such things as phone and gift cards and the like (Field, 1996).

In addition to the above review, we were fortunate to gain access to the results of an unpublished survey of unclaimed property programs conducted in 2003 by the National Association of Escheat Administrators (NAEA), which enabled us to take a more systematic look at where reporting states were investing their unclaimed property receipts. Because we are in North Carolina, we pay special attention to the investment programs of the eight southeastern states that participated in the NAEA survey. As suggested above, there is significant variation across state escheat policies and practices.

According to NAEA, in 2003 half of all states reporting data for the survey deposited escheat funds in their respective general fund, while 13 states deposited escheat funds in trust funds dedicated to a range of social programs.[8] (See Table 1) For the eight southern states of most interest to us, we supplemented the survey data with telephone interviews of escheat program administrators in Alabama, Florida, Georgia, Louisiana, Mississippi, South Carolina, Tennessee, and Virginia, in addition to North Carolina. As in North Carolina, the Treasurer is responsible for overseeing escheat property programs in most of the surveyed states, although in Florida and Georgia, the state's Chief Financial Officer and Commissioner of Revenue, respectively, handle the responsibility.

Five of these nine southeastern states transfer surplus escheat funds to their respective general fund, and the funds are accounted for as part of the budgetary process. In the remaining four states, including North Carolina, constitutional or legislative provisions direct the uses to which escheat fund surpluses are put. Similar to North Carolina, Florida and Virginia use their surpluses to support education, but in their cases, it is K12 schools rather than colleges and universities. Breaking with the education juggernaut, Tennessee dedicates surplus escheat fund receipts to health care, with a special focus on supplementing resources in underserved areas of the state.

At first blush, one might consider those states for which there are no provisions for targeting surplus funds better situated to use escheat funds for double bottom line investing, since there are no established claimants for these resources. However, we also think that North Carolina's success might encourage states that target surplus funds to priority areas like health and education to reexamine their respective escheat fund investment strategies, in the expectation that by adopting more modern investment strategies, they may be able to increase yields, and thus total allocations to their priority programs. The key point is that this would not require any change to established allocation practices.

Profiles of State Unclaimed Property in Selected Southeastern States

State	Authority Over Unclaimed Funds	Holder of Unclaimed Property	Targeted Uses for Unclaimed Property
Alabama	State Treasurer	Escheat Reserve Fund and General Fund[1]	None
Florida	Chief Financial Officer	Unclaimed Property Trust Fund and Principal State School Trust Fund[2]	Education
Georgia	Commissioner of Revenue	General Fund[3]	None
Louisiana	State Treasurer	General Fund[4]	None
Mississippi	State Treasurer	Special Agency Fund and General Fund[5]	None
North Carolina	State Treasurer	Escheat Fund and State Educational Assistance Authority[6]	Education
South Carolina	State Treasurer	Treasurer's Segregated Account and General Fund[7]	None
Tennessee	State Treasurer	General Fund and Health Access Incentive Fund[8]	Health
Virginia	State Treasurer	General Fund and Literary Fund[9]	Education

Source: telephone survey by the Center for Community Capitalism, 2004.

[1] Alabama: On a quarterly basis, the State Treasurer transfers the balance of the Escheat Reserve Fund to the state's General Fund minus approximately $30 million to be used to pay claims and administrative costs.

[2] Florida: The Unclaimed Property Trust Fund retains $15 million to pay claims and administration. The balance is regularly transferred to the "Principal School Fund" managed by the Florida Department of Education to benefit the state's school system.

[3] Georgia: The Commissioner of Revenue does not retain funds for paying claims. Rather, the Department of Revenue regularly makes requisition requests to the Legislature to provide appropriate funds from the General Fund to pay claims.

[4] Louisiana: The State Treasurer maintains a small escrow account valued at approximately $500,000. This account is used to pay all ongoing unclaimed property claims. When incoming unclaimed property funds cause the escrow account to exceed $500,000, the Treasurer regularly transfers excess funds into the General Fund.

[5] Mississippi: The State Treasurer receives all unclaimed property held by the state. These funds are held in a "Special Agency Fund" along with other short-term miscellaneous funds held and invested by the state. The Treasurer's Investment Division invests this Fund in multiple short-term and low-return instruments, primarily certificates of deposit. All interest generated from these investments is transferred to the state's General Fund. The Unclaimed Property Division in the Office of State Treasurer regularly requisitions an amount from the Special Agency Fund appropriate to pay claims.

[6] North Carolina:

[7] South Carolina: On a quarterly basis, the State Treasurer projects what will be needed to pay claims and to administer the unclaimed property program. All excess monies in the Treasurer's Segregated Account are transferred to the state's General Fund.

[8] Tennessee: The State Treasurer transfers unclaimed property funds, minus estimated claims and administrative costs, to the General Fund. Each year, the legislature may divert some of unclaimed property funds to the Health Access Incentive Fund, which is a set-aside fund from the General Fund. The Commissioner of Health uses these funds to provide financial incentives for health care practitioners to provide services to underserved areas of the state. Incentives offered to physicians include relief from up to 50 percent of student loans in exchange for a two-and-a-half-year commitment to practice medicine in health shortage areas in the state, physician practice start-up grants. Beginning in 1987, when the Health Access Incentive Fund was established, all unclaimed property in Tennessee was regularly transferred to the Fund. The Fund built up a balance of approximately $30 million by 1995. As the state faced budget shortfalls in the mid-1990s, the legislature changed the statute that had authorized the transfer of unclaimed property to the Health Access Incentive Fund. Since 1995, the legislature authorizes on an annual basis an amount of unclaimed property funds that can be diverted to the Health Access Incentive Fund, with the remainder going to the state's General Fund.

[9] Virginia: The State Treasurer transfers unclaimed property funds, minus estimated claims and administrative costs, to the General Fund. However, unlike several other states that transfer unclaimed property funds to the General Fund, Virginia's unclaimed property in the General Fund, along with interest generated from its investment in the General Fund, is transferred to the Literacy Fund each year. Created in the Virginia Constitution in 1810, this is a special fund controlled by the Department of Education to enhance K12 education by extending low-interest loans to school districts, counties, and municipalities throughout Virginia for a variety of purposes, such as equipment for computer labs and helping K12 students pass Virginia's standards of learning (SOL) tests.

Conclusions

This project is about helping states identify alternative sources of public capital for potential investment in double bottom line private equity funds with risk-adjusted rates of return while creating jobs and wealth-building opportunities to underserved populations and communities. Research suggests that such returns are achievable and that the latest generation of targeted equity funds available for investment is a far cry from an earlier generation of economically targeted investments that sacrificed financial performance and professional management for social and political gain (Daniels and

Nixon, 2003). However, a state's decision to do double bottom line investing is not costless; it comes at the price of additional time, effort, and the new expertise necessary to achieve social impact without sacrificing financial performance (Gabrieli, 2004).

Rather than target state employee pension funds, for reasons discussed in this paper, Treasurer Moore identified the Escheat Fund as his capital source of preference. With the completion of a successful legislative campaign allowing the state Treasurer, as the Escheat Fund's sole trustee, to adopt more modern investment strategies, including investing in private equity funds, North Carolina's experience can help other states with similar ambitions.

We touched above on one of the two key insights we gained from conducting this case study. The first is that policymakers are reluctant to expand use of the Escheat Fund to promote economic development through projects such as the ill-fated loan to Global TransPark. At the same time, there was broad support for investing in growth companies located in undercapitalized areas, or in areas that are poorly served by the larger capital markets. Among influential North Carolina legislators, at least, economic development does not always connote disciplined investing and competent stewardship, which is why the Escheat Fund legislation doesn't speak to that.

The second and more important insight is that, despite North Carolina's slow economic recovery from the recent recession, and mass layoffs from manufacturing plant closings, stimulating job creation through targeted business investment proved not to be a strong enough engine to drive legislative change. What drove the engine was runaway inflation in the state's colleges and universities, and the need for more scholarships and need-based financial aid for lower-income students. Policymakers recognized that unless the General Assembly was willing to allocate more and more of the Escheat Fund corpus to financial aid, it had better figure out a way to increase portfolio earnings from the Fund, which historically have been limited to very low-risk fixed income securities. What closed the deal was an estimation by the General Assembly's fiscal research unit that a modernized investment program allowing as much as 20 percent of the Escheat Fund balance for alternative investments, including private equity, had the potential to increase overall average returns by about 50 basis points.

Our review of other state escheat fund programs suggests that North Carolina's experience has broad potential for replication. States that deposit escheat funds directly into their respective General Funds can get bigger bang for their bucks by adopting a blended strategy that incorporates a portion of escheat funds into the annual state budget, and a portion into a double bottom line investment program that promotes business development while generating earnings that can be targeted to other priority needs. However, the experiences discussed in this article are most directly applicable to the several states that, like North Carolina, dedicate escheat fund earnings to areas like K12 education or health care for the poor, where rapidly rising costs and needs require additional resources, some of which may be derived from higher yields from the pursuit of more modern escheat fund investment strategies.

Notes

[1] From 2000-2001 in North Carolina, 204,590 new establishments were created, with about 160,000 employees: 55,460 in firms with 1-19 employees, and around 50,000 in firms with between 20-499 employees. During this same period, job losses were mostly in firms with 500 or more workers (169,540); losses in firms with 1-19 employees totaled 59,250, and in companies with between 20-499 employees the losses were about 100,000.

[2]This definition comes from the Florida Department of Financial Services. (2005). *Statewide financial statements (SWFS) year end reporting requirement #13.* Retrieved September 10, 2005 from http://www.fldfs.com/aadir/statewide_financial_reporting/rules/rule13.pdf.

[3] The Treasurer does withhold from investment income an amount equal to projected expenses of the Escheat Fund. Thus, total transfers to SEAA equal total Escheat Fund investment income minus a small amount for Escheat Fund administration. In 2004, the value of administrative expenses was $2.4 million.

[4] All investment performance data provided by Pam Wortham, Deputy Treasurer of the North Carolina Department of Treasury.

[5] Eligible LTIF investments are specified in G.S. 147-69.1. The largest LTIF participant is the State Teachers' and Retirees' Pension Fund, which accounts for nearly 80 percent of the total value of the LTIF. The Local Government Pension Fund is the second largest participant, accounting for another 10 percent. The Escheat Fund, the third largest participant, accounts for less than 10 percent of the LTIF.

[6] "Changes needed to allow Escheat Fund investments that provide additional benefit of supporting the economic development and growth of North Carolina, including North Carolina-based businesses." A document containing legislative changes to North Carolina General Statute 147-69.2 (b) (11). Provided to authors by Andrew Silton, Office of NC Treasurer (November 2004).

[7] Ibid.

[8] 2003 State Program Statistics: Administration and Operations. Survey Results by the National Association of Unclaimed Property Administrators.

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The Kenan Institute's Center for Community Capitalism engages in multi-disciplinary research and outreach activities that explore ways to apply private sector approaches to revitalization of America's distressed communities. The Center's work focuses on techniques that are both effective in building wealth and assets in disadvantaged communities and are sustainable from a business perspective.

Center for Community Capitalism
Kenan Institute of Private Enterprise
The University of North Carolina at Chapel Hill
Campus Box 3440
Chapel Hill, NC 27599-3440
www.kenaninstitute.unc.edu/CCC/