



PHILIP ANGELIDES
Treasurer
State of California

October 26, 2005

Zach W. Hall, Ph.D.
President
California Institute for Regenerative Medicine
P.O. Box 99740
Emeryville, CA 94662-9740

Dear Dr. Hall:

I am writing this letter to urge the California Institute for Regenerative Medicine, as it puts together its strategic research plan, to ensure that the State of California and its taxpayers share the financial benefits resulting from the research funded by the Institute.

As I said last December in convening the first meeting of the Independent Citizen's Oversight Committee (ICOC), California's "taxpayers expect to share fairly in the financial returns from their investment" in stem cell research. During the campaign for Proposition 71, the California Stem Cell Research and Cures Act, proponents offered California voters the hope of finding life-saving cures, reducing health costs, and creating jobs for California's future. In addition, the campaign also noted that the measure created a possibility for the State to share in licensing and royalty revenues that might flow from new technologies and therapies created through the Institute's grants.

I believed last year, and I continue to believe today, that the Institute should make it a top priority to secure royalties for the State as it pursues its goals of advancing medical science and creating useful new therapies, as the text of the Act provides:

"The ICOC shall establish standards that require that all grants and loan awards be subject to intellectual property agreements that balance the opportunity of the State of California to benefit from the patents, royalties, and licenses that result from basic research, therapy development and clinical trials with the need to assure that essential medical research is not unreasonably hindered by the intellectual property agreements."

The financing provisions of Proposition 71 do not stand in the way of seeking such agreements. The measure stated that the Institute "may utilize state issued tax-exempt and taxable bonds to fund its operations, medical and scientific research, including therapy development through clinical trials, and facilities." The availability of both taxable and tax-exempt financing gives the Institute the flexibility to design a research strategy to meet its objectives at the lowest cost to the taxpayers and in ways that comply with any federal restrictions on the use of tax-exempt bonds.

October 26, 2005

Dr. Hall

Page two

Some Californians have argued that it would be prohibitively expensive for the Institute to pursue royalty agreements because doing so would prevent the State from using tax-exempt bonds under federal law. This conclusion is unwarranted in two respects.

First, the use of state bond financing to fund stem cell research is a new frontier in federal tax law. As the Institute develops its research and grant strategy, my office, in conjunction with the State's bond counsel, is willing to work with the Institute to seek advice from the U. S. Treasury Department and Internal Revenue Service to determine which portions of the research program can be financed with tax-exempt bonds and under what royalty conditions.


Second, contrary to a misconception, tax-exempt financing may not always offer the lowest-cost choice for the Institute. In cases where federal law may preclude the use of tax-exempt bonds for grants that include royalty agreements, issuing taxable bonds would be a better financial option for the State and its taxpayers than forgoing royalties if the anticipated royalties exceed the extra interest costs. In other words, the Institute does not face a single either-or choice, but rather a set of decisions about how to best benefit taxpayers and advance medical research.

My staff estimates that the interest rate difference between issuing taxable and tax-exempt 30-year general obligation bonds is currently about 0.75 percentage points. Even in the worst-case scenario – where, to obtain royalties, the State must sell only taxable bonds to fund the Institute's entire research grant program – my staff estimates that the added interest cost to the State over the 30-year term of the bonds would be \$423 million. By contrast, the economic study released by the Proposition 71 campaign last year estimated that the Institute could reasonably expect to receive as much as \$1.1 billion in licensing fees and royalties over the next three decades. If that is the case, even the maximum use of taxable bonds would result in \$677 million more in net revenues to the State and its taxpayers than if the Institute uses only tax-exempt financing and forgoes any royalties.

It is more likely that the Institute will want to pursue a strategy that involves a mix of taxable and tax-exempt financing, as the State will do with the recent housing bond approved by the voters. As the Institute moves forward to develop its strategic research plan and intellectual property policies, the Treasurer's Office will continue to be available to advise you on the Institute's funding options and help find the most cost-effective way to finance the next generation of medical discoveries for Californians and the world.

Please feel free to contact me or my staff if you have any questions.

Sincerely,



Phil Angelides
State Treasurer

cc: Honorable Members, Independent Citizen's Oversight Committee (ICOC)