MEMORANDUM

TO: Members of the Authority

FROM: Timothy Sullivan
Chief Executive Officer

DATE: April 13, 2022

SUBJECT: Special Adopted New Rules and Concurrent Proposed New Rules New Jersey Innovation Evergreen Fund Evergreen Program (**N.J.A.C. 19:31-25**)

Request:

The Members are asked to approve:

1) The attached special adopted new rules and concurrent proposed new rules for the New Jersey Innovation Evergreen Program and to authorize staff to (a) submit the special adopted new rules and concurrent proposed new rules for promulgation in the New Jersey Register and (b) submit the proposed program rules as final adopted rules for promulgation in the New Jersey Register if no formal comments are received; subject to final review and approval by the Office of the Attorney General and the Office of Administrative Law; and

2) The creation of the New Jersey Innovation Evergreen Program, a tax credit and investment program authorized by the New Jersey Economic Recovery Act of 2020 (Sections 20 through 34 of P.L. 2020, c. 156 and amended by P.L. 2021, c. 160), to foster collaborative engagement among established corporations that will purchase tax credits and commit strategic value to the New Jersey innovation economy, venture capital firms that will invest the funds raised, and the innovative, early-stage businesses that will receive the funds in the form of investment; and

3) Delegation to the Authority's Chief Executive Officer to establish a date/s for the corporate business tax auction (no more than annually) and to approve follow-on investment (with certain exceptions) as explained in this memorandum.

New Jersey Economic Recovery Act:

On January 7, 2021, Governor Phil Murphy signed the New Jersey Economic Recovery Act of 2020 (ERA) into law. The ERA presents a strong recovery and reform package that addresses the ongoing economic impacts of the COVID-19 pandemic and positions New Jersey to build a stronger and fairer economy that invests in innovation, in our communities, and in our small businesses the right way, with the protections and oversight taxpayers deserve. Tax incentives and other investment tools are critical to economic development, and when used correctly they can drive transformative change that uplifts communities and creates new opportunities for everyone.

The ERA includes 15+ economic development programs, including:

- Tax credits to incentivize job creation and capital investment;
- Investment tools to support and strengthen New Jersey's innovation economy;
- Tax credits to strengthen New Jersey's communities including revitalization of brownfields and preservation of historic properties;
- Financial resources for small businesses, including those impacted by the COVID-19 pandemic;
- Support for new supermarkets and healthy food retailers in food desert communities;
- Additional tax credits for film and digital media.

The program being presented for the Members' approval in this memorandum is the New Jersey Innovation Evergreen Program (the Evergreen Program or Program) – one of the 15+ programs under the ERA. The Evergreen Program is an incentive and venture investment program designed to support job creation and the innovation ecosystem, with a focus on targeted industries.

This memorandum provides a summary about the Evergreen Program including program limits and general details about the program, eligibility criteria, specific program requirements, application process and the application review process. The specific details – and what will be promulgated and will govern the program – are included in the attached rules proposed for Board approval.

Program Purpose and General Description

Innovation can occur anywhere, but it may have the greatest chance of success when born and fostered with the collaboration of interested partners. Entrepreneurship is a primary contributor to job creation and sustainable economic growth. New businesses can create disruptive products and services that launch new markets and spur employment in high-wage industries. While innovation is frequently associated with early-stage enterprises, few such businesses have the depth of resources of more established corporations necessary to turn their innovative ideas into realized solutions. Proximity and access to funding are key value drivers for the development of an entrepreneurial ecosystem. Venture capital can serve a critical function to help commercialize, test and scale research and ideas to truly transform the economy and, to attract and retain budding entrepreneurs. The Evergreen Program directly addresses our state's competitive position in venture capital funding nationally and aims to create the conditions necessary for our entrepreneurs to succeed.

The Evergreen Program forms a platform that partners with the private sector to raise and invest capital in qualified New Jersey-based companies. The Evergreen Program will secure funding and strategic support from the sale of state corporate tax credits in a competitive auction, then partner with private venture capital firms to co-invest the funds in eligible early-stage businesses in New Jersey. This application of known economic development tools form a novel mechanism intended to create alignment among the resources of New Jersey's established corporate citizens with professional venture capital investment firms and early-stage businesses in New Jersey. To accomplish the purposes of the Evergreen Program, the statute creates an Evergreen Fund to be held by the Authority. The Evergreen Fund shall receive the payment by tax credit purchasers; distributions from payments or repayments made to the Authority from Evergreen Program qualified investments; and money received pursuant to payments, repayments, or redemptions required due to a default or failure to comply by tax credit purchasers, qualified venture firms, or qualified businesses. In addition to funding qualified investments, the Evergreen Program statute authorizes payment of the Authority's administrative costs for the Evergreen Program and requires that 75 basis points (0.75%) be used for EDA programmatic support that create an innovation ecosystem that supports and promotes high-growth businesses in the State. The overview provided here highlights the three primary components of the program: Tax Credit Sale Auction; Venture Firm Qualification; and, Investment Qualification. Additional program details are included in the sections below, and full program details are contained in the draft rules (**Appendix A**) and the statute.

I. Tax Credit Sale Auction

The State of New Jersey is authorized to sell corporate tax credits, annually, via competitive auction to eligible corporations through the first six years of the seven years of the Evergreen program with a maximum of $300 million in aggregate. Corporations may purchase the credits for a minimum of 75 percent of face value, along with a strategic commitment to support the State's innovation economy and requirement to be available to serve on the New Jersey Innovation Evergreen Advisory Board. The proceeds of the sale will form the capital of the Evergreen Fund. The Evergreen Fund provides the funding for the Evergreen Program investment, the administrative costs of the Evergreen Program, and funding for other programs administered by the Authority that create an innovation ecosystem promoting high-growth businesses in the State.

II. Venture Firm Qualification

Qualified Venture Firms may access the funds in the Evergreen Fund to make investments into qualifying New Jersey businesses. All investments must be matched by the Qualified Venture Firm, as discussed in section III below. In order to invest the Evergreen Fund monies, the Evergreen Program establishes an application process through which a venture firm will, first, apply for certification as a qualified venture firm. Approval will enable the firm to apply for funding from the Evergreen Fund to make qualified investments in qualifying early-stage New Jersey businesses.

III. Investment Qualification

Venture firms may submit applications for qualifying investments funded by the Evergreen Fund after receiving EDA Board approval as a qualified venture firm or in conjunction with an application for certification as a qualified venture firm. Such qualified investments in New Jersey-based businesses must receive an investment from the qualified venture firm fund that matches or exceeds the qualified investment. Individual special purpose vehicles (generally anticipated to be limited liability companies, or LLC's) will be established to consummate the qualified investments for the Evergreen Fund. As the Evergreen Fund's investments mature and experience exit events (e.g. a sale or initial public offering), the proceeds flow back to the special purpose vehicle for payment to the qualified venture firm of its carried interest and a transfer of the remainder to the Evergreen Fund, providing a stream of capital to support the purposes of the Evergreen Fund.

It is anticipated additional follow-on capital investment will be needed to support growing early-stage businesses as noted in the delegation request. The Authority shall have the right, but not the obligation, to make a follow-on investment from the Evergreen Fund into the qualified business. The follow-on investment will be made on a pro rata basis with the qualifying venture firm's investment at the same ratio which the Evergreen Fund matched the initial qualifying investment.

A qualified venture firm shall report on its qualified investment activity and related special purpose vehicle(s) in its annual report. During the qualified business compliance period, all qualified businesses must maintain a place of business in New Jersey and must maintain one of the following: its principal business operations in New Jersey, at least 50 percent of its full-time employees filling a position in New Jersey, or at least 50 percent of wages paid to employees filling a full-time position in New Jersey.

The areas described above are outlined in greater detail in this memorandum and in detail within the full program regulations.

Key Definitions

Certain technical definitions from the Evergreen regulations are highlighted here:

Incentive area means an area in this State: designated pursuant to the "State Planning Act," P.L.1985, c.398 (C.52:18A-196 et seq.), as Planning Area 1 (Metropolitan); or that has been designated as a qualified opportunity zone pursuant to 26 U.S.C. s.1400Z-1.

Opportunity zone means a federal population census tract in this State that was eligible to be designated as a qualified opportunity zone pursuant to 26 U.S.C. s.1400Z-1 as may be amended.

Principal business operations mean at least 50 percent of the business's full-time employees reside in the State, or at least 50 percent of the business's payroll for full-time employees is paid to individuals living in the State. For purposes of this definition, payroll shall mean wages. Note that "full-time employees" in the rules, including this definition, excludes any employee who is primarily engaged in final point-of-sale retail.

Qualified business compliance period means the period starting with the qualified investment in a qualified business and ending on the sale or other disposition of all shares of stock of the qualified business from the Evergreen special purpose vehicle, including any distribution of the shares to the Authority. If the distribution of the shares of stock from the Evergreen special purpose vehicle to the Authority occurs in less than five years after the qualified investment, the qualified business compliance period shall be five years or such other shorter qualified business compliance period determined by the Authority, which may be based on factors including, but not limited to, the number of the qualified business full-time employees filling a position in New Jersey.

Qualified venture firm active fund means the entity managed by the qualified venture firm or an affiliate of the qualified venture firm from which the qualified venture firm invests in a qualified business alongside the qualified investment.

Reserves means capital in the fund which has been reserved for follow-on investments and qualified venture firm management fees and direct expenses; the 75 basis points for programs that support the State's innovation ecosystem; and administrative, legal, and auditing expenses of the Authority in administering the program. The Authority may also reserve such amounts as it considers necessary to achieve the opportunity zone eligible census tract goal and any goals that may be developed pursuant to the disparity study.

Targeted industries is defined the same as in Emerge: any industry identified from time to time by the Authority that shall initially include advanced transportation and logistics, advanced manufacturing, aviation, autonomous vehicle and zero-emission vehicle research or development, clean energy, life sciences, hemp processing, information and high technology, finance and insurance, professional services, film and digital media, non-final point of sale retail food and beverage businesses, including food innovation, and other innovative industries that disrupt current technologies or business models. A qualified business shall be considered to be in a targeted industry if the business is engaged primarily in a targeted industry. The Authority may consider whether a qualified business is engaged primarily in another innovative industry that disrupts current technologies or business models, by assessing factors including, but not limited to, whether businesses in the industry are offering products or services that significantly improve current market offerings on the basis of price or other performance levels, whether the new industry creates opportunities for new businesses to enter and redefine the supply chain or value chain of an industry, or whether the industry utilizes new technology or business processes that allow New Jersey-based businesses to collect a share of revenues that were traditionally only available to companies in other geographies.

Eligibility Criteria Highlights

Each of the three primary components of the Evergreen Program – tax credit auction, venture firm qualification, and investment qualification – requires a unique set of eligibility criteria due the disparate nature of each component. The following highlights key eligibility requirements for the three components of the Evergreen Program in accordance with the statute, with additional clarification as provided in the program rules. Full eligibility details are contained in the draft proposed rules, N.J.A.C. 19:31-25, based on the Economic Recovery Act statute in Sections 20 to 34 of P.L. 2020, c.156, amended by P.L. 2021 c.160.

Tax Credit Purchaser Requirements

To be awarded a tax credit under the program, a potential purchaser must meet various criteria contained in the rules, **Appendix A,** and explained in the auction overview, **Appendix B**, including but not limited to:

- The amount of tax credits to purchase shall not be less than $500,000;
- The percentage amount of the face value of the tax credits the bidder proposes paying shall not be less than 75 percent of the face value of credits;
- Each component of the strategic commitment, including the cost to the proposed purchaser of each such component, must be described in detail. The strategic commitment may include, but is not limited to mentorship hours, internship offerings, sales and distribution pipeline access;
- Commit to serve on the New Jersey Innovation Evergreen Advisory Board for one-year from the time of approval;
- Provide a refundable deposit for 10% of the tax credit purchase offer, not to exceed $500,000, at the time of application (which will be applied to the final purchase amount paid);
- Purchasers must agree to publicize their involvement with the Evergreen Fund.

The Authority shall evaluate and score each completed bid application once the application period has closed and all applications have been received. If the amount of tax credits requested for purchase exceeds the total amount available for purchase, the Authority may pro rate the amount of tax credits allocated to each tax credit purchaser based on the formula as noted (**Appendix B)**. Successful tax credit purchasers will not receive less than $500,000 of Program tax credits. If the proration were to result in any potential tax credit purchaser receiving less than $500,000, the Authority shall award tax credits only to the highest scored potential tax credit purchasers that would result in a proration with at least $500,000 of tax credits to each potential tax credit purchaser.

The auction will be run as a competitive process. Prior to opening the bid application window, the Authority will establish and publicly disclose the timeline, will publish the weighted criteria, and will disclose whether the Authority may seek best and final offers. After the application window closes, NJEDA staff will review the applications for completeness and will score and rank the completed bids. If best and final offers are permitted, the Authority may seek to do so, for example, if the aggregate amount of tax credits requested exceed the amount of tax credits available. If more tax credits are available than the aggregate amount requested in bid applications, applicants, starting with those ranked highest, may elect to increase their purchase amount. Detailed information about the Auction Timeline can be found in **Appendix B**.

Tax credit purchasers shall be required to complete their strategic commitment with expenditures of at least 80% of the value of each commitment component in order to remain in compliance. In the tax credit purchaser contract, the tax credit purchaser will be provided an opportunity to cure by completing the commitment component over the next year. Failure to do so, absent extenuating circumstances or the Authority’s written consent, will require the tax credit purchaser to pay the difference between the cost of the strategic commitment component as set forth in the bid application and the actual cost of the amount of the strategic commitment delivered by the tax credit purchaser. Until such amount is paid to the Authority, the tax credit purchaser will not be able to participate in future competitive auctions. The amount paid by the tax credit purchaser will be deposited into the Evergreen Fund. Additionally, any tax credit purchaser selected to be a member of the New Jersey Evergreen Innovation Advisory Board that does not participate in a majority of that Board's meeting and activities will not be eligible to purchase tax credits in the next twelve months.

No Undue Financial Advantage

As required by the statute, the Evergreen Program requires that no undue financial advantage inures to a tax credit purchaser as a result of a qualified or follow-on investments from the Evergreen Fund. To ensure this, during the twelve-month period after the approval of the award of tax credits to a tax credit purchaser, the Authority shall not approve a qualified or follow-on investment to a qualified venture firm that is (1) managed by; (2) beneficially owned, through rights, options, convertible interests, or otherwise, more than 15 percent of the voting securities or other voting ownership interests by; or (3) whose direction of investments are controlled by, a tax credit purchaser. Through the various Evergreen Program applications, Staff will inquire about the above three situations at the time of applications for both tax credit purchases and for qualified and follow-on investments. Additionally, the Evergreen Program statute requires the Chief Executive Officer of the Authority to certify that these steps are taken to prevent undue financial advantage.

Qualified Venture Firm Certification Requirements

Venture firms must be certified as qualified venture firms under the Program to apply for Evergreen Fund investment capital to support early-stage investments in New Jersey. Applicant firms can apply for certification either before identifying a potential qualified investment, or in conjunction with an application for a qualified investment. Venture firm applications for Program certification will be reviewed by staff on a rolling basis and will be presented to the Board of the Authority for approval.

Venture firm applicants that meet all program minimum requirements (detailed in N.J.A.C. 19:31-25.7 of the proposed rules) and that have submitted all required documentation will be scored based on the Program's weighted criteria for venture firms. The minimum requirements must be met both at the time of application for initial certification and at the time of application for investment.

1) Number of Investors Employed by the Firm: Qualified venture firms must employ at least two full-time investors with the authority to direct investment capital with at least five years of money management experience (each) at the time of application. Relevant money management experience shall include, but is not limited to, operational and investment oversight, in the venture capital or private equity sectors, including but not limited to, investment firms, investment banks, asset management or similar investment management institutions, family office funds, or significant angel investment experience. To be significant, angel investment experience shall consist of $100,000 of aggregate investments and two investments per year. The experience shall be met as of the date the determination for certification is made.

2) Minimum Assets Under Management: Qualified venture firms must demonstrate at least $10,000,000 in assets under management at the time of application, which will be measured as the sum of a firm's net assets of the funds managed by the qualified venture firm, equity capitalization

of the funds managed by the qualified venture firm, and written commitments of cash or cash equivalents committed by investors.

3) Diversity, Equity & Inclusion: The evaluation methodology places a material emphasis on venture firms' diversity, equity, and inclusion policies and track record against such policies. Diversity, equity, and inclusion are foundational elements of building a stronger and fairer State economy. Applicant responses to diversity equity and inclusion policy categories will be evaluated by the Authority's Diversity, Equity, and Inclusion team using a checklist to test conformity with industry best practices which will be identified on the Authority's website. The checklist, which will be posted on the Program website, may include such criteria as policies on investments in underrepresented founders, diversity metrics of portfolio company Board of Directors, diversity metrics of the venture firm, and recruitment and retention of diverse staff. Consideration will also be given to timeliness of policies, for example, policies in place prior to the events of 2020 and the increased focus on diversity, equity, and inclusion that followed. Firms that do not initially meet the requirements of the diversity, equity and inclusion policy weighted criteria may develop robust policies that adhere to industry best practices and reapply.

Please refer to **Appendix C** for the specific proposed evaluation criteria, weights, minimum acceptable score, and further clarification on each of the different proposed aspects the Authority will consider in its scoring evaluation of qualified venture firm applicants.

Qualified Investment Requirements

Applications for investment will be completed jointly by qualified venture firms and businesses seeking capital. Staff will review investment applications on a first-come, first-served basis and will screen both qualified venture firms and businesses for eligibility. The NJEDA staff underwriting process will be limited to ensuring qualified businesses meet all requirements of the Program. The Program does not establish a review for the merits of the proposed investment. Rather, the Program will rely on qualified venture firms that will share aligned interests with the NJEDA through incentive-based carried interest compensation to identify strong investment opportunities. Venture firms will evaluate the quality of investment opportunities through their normal course of business. Eligible qualified investment applications, along with approval requests for associated fees and expenses, will be submitted to the Board of the Authority for approval following staff review.

Please refer to **Appendix D** for the specific proposed eligibility criteria and further clarification on each of the different proposed aspects the Authority will consider in its scoring evaluation of qualified investment applicants.

Qualified Venture Firm Requirements at Time of Initial Investment

Qualified venture firms must both demonstrate they continue to meet the initial certification requirements through the time of initial investment approval. Firms will not be requalified based on the Program's weighted scoring criteria at this time.

1) Limit on Size and Number of Investments: Qualified venture firms may only complete two qualified investments per calendar year. Applications for investments shall not be less than $100,000 per qualified investment must be limited to $5,000,000 per investment. If the business is a NJ university spin-off, utilizes intellectual property developed at a NJ university that is core to its business model, or is certified by the State as a "minority business" or a "women's business" pursuant to P.L. 1986, c. 195 (N.J.S.A. 52:27H-21.17 et seq.)., the businesses will qualify for a qualified investment of up to $6,250,000. In cases where multiple qualified venture firms apply for investments into the same business, applications will be approved on a first-come, first-served rolling basis until the initial investment dollar limit for any given business is reached. Multiple firms can invest into the same qualified business up to a $5,000,000 aggregate initial investment limit, or $6,250,000 limit for select types of companies, if the investments occur in the same fundraising round.

   To mitigate concentration risk, qualified venture firms may only receive aggregate Program capital across investments up to 15 percent of the firm's total assets under management, to be tested at the time of initial and follow-on investment application. At the time of application for follow-on investments, the Program will also limit aggregate investments into any qualified businesses based on a percent of the Program's uninvested and invested capital. The proposed regulations permit the Program to set a business concentration cap of up to 15 percent. Staff is recommending that the Board approve setting this cap initially at 10 percent to limit concentration risk to ensure a broad disbursement of investment funds at the outset of the program while market learnings are accumulated. This metric will be evaluated annually and staff will seek Board approval to revise it up or down as program intelligence is accumulated.

   If the Program is unable to fulfill a firm's entire request for investment due to investment size and concentration risk policies or an availability of funds, a qualified venture firm may amend the amount requested through its investment application.

2) Initial Investments by a Firm: Any initial investment by the Program must represent the qualified venture firm's first investment into the business. This is intended to prevent venture firms from using Program capital to prop-up failing investments.

3) Timing of Investment Application: Qualified venture firms must have at least begun negotiations over a draft term sheet with a business before applying for NJIEF funding. In all cases, an executed stock purchase agreement, which finalizes the terms of the investment between the venture firm and the business, must be submitted by qualified venture firms in order to close on an investment from the Fund. Ideally, Program investments will be made contemporaneously with investments by venture firms' funds, however, the NJIEF Program may accept applications for investment in a qualified business up to 90 days after a qualified venture firm investment. The investments must be part of the same fundraising round and on equal terms. This look-back period is required to ensure Program approval processes move efficiently enough to participate in fast-moving, competitive venture capital investments.

Please refer to **Appendix C** for specific criteria and additional clarification for the qualified venture firm evaluation, and to **Appendix D** for a detailed description of the Program's initial and follow-on investment approval process.

Qualified Business Requirements

To receive an investment from the NJIEF, a business must meet several eligibility requirements at the time of application for investment, some of which are highlighted below.

1) New-Jersey Based: The business has its "principal business operation," as defined above, in the State. Additionally, businesses must maintain a place of business in New Jersey.
2) Targeted Industry: The business must be engaged in a targeted industry, as defined above.
3) Limit on Size: The business must employ fewer than 250 full-time employees.
4) High-growth Business: Qualified businesses must meet one of the Program's high-growth tests. The statute requires that the determination of "high growth" be based on the company growing "faster than the average growth rate of the economy." The proposed rules provide that the Authority will determine and publish the specific metrics on the Authority's website and lists three possible categories in which to measure the business's growth: revenue, customers, and valuation. At the outset, staff is proposing that the Board approve using only those three categories and use a 25% threshold to determine "high growth." Thus, to qualify, businesses must demonstrate annual revenue or customer growth of at least 25%, or valuation growth of 25% since their prior fundraising round. The statute also permits applicants that are too early in their life cycle to record one year of sales or customers or that have not previously raised third-party equity capital to meet the requirements for a high-growth business on a projected basis. To substantiate the projections, the proposed rules require the investing qualified venture firm to submit its base case projections. To qualify, the analysis prepared by the qualified venture firm must project 25% revenue, customer, or valuation growth in any one-year period over the subsequent 3-5 years.

Follow-on Investment Requirements

The Program authorizes follow-on investments alongside the qualified venture firm into the qualified businesses after the initial qualified investment. The screening process for follow-on investments requires EDA staff to verify that firms and businesses continue to meet Program requirements. Qualified venture firms will not be recertified at that time. Because follow-on investments may present an opportunity for the State to increase its exposure to a valuable investment, the proposed rules permit the Authority to decide whether to approve or decline a follow-on investment if the qualified venture firm is decertified or the qualified venture firm or qualified business are not in compliance with Program requirements, subject to approval by the Board of the Authority. Examples of scenarios the Authority may deem an investment is in the best interest of the State are cases of atypical financial promise, such as 'unicorn' investments that are rapidly appreciating in value, or while significant economic development is still anticipated in New Jersey, despite a shortfall in technical compliance.

The maximum follow-on investment from the Fund into a qualified business shall not exceed the lesser of: i. $5,000,000 (or up to $6,250,000 if so approved) on an aggregate basis of follow-on investments in a twelve-month period; ii. a business concentration cap based on a percentage of invested plus uninvested capital of the fund; and iii. 15 percent of the total invested with the qualified venture firm by all of its investors, including investments in any Evergreen special purpose vehicles (total assets under management). The proposed regulations permit the Program to set a business concentration cap of up to 15 percent. Staff is recommending that the Board approve setting this cap initially at 10 percent to limit concentration risk to ensure a broad disbursement of investment funds at the outset of the program while market learnings are accumulated. This metric will be evaluated annually and staff will seek Board approval to revise it up or down as program intelligence is accumulated.

Appendix D notes specific proposed criteria at the time of initial and follow-on investment and further clarification on evaluation of the Program's requirements at the time of investment.

<u>Post-Approval Process</u>

<u>Tax Credit Auction</u>

Upon selection as a tax credit purchaser, corporations will execute a tax credit purchase agreement outlining their obligations under the Program. Failure by the purchaser to pay the amount agreed on time may make the the purchaser ineligible from NJIEF auction participation in the next twelve months. In such event, the Authority may offer the tax credits for purchase to other purchasers based on score ranking, without re-auction, on the same or better terms as in the other purchaser's tax credit purchase offer.

There will be annual reporting of strategic commitments and annual monitoring advisory board participation post-auction. An annual EDA staff review will evaluate corporate tax credit purchasers' compliance in meeting their approved strategic commitments. A failure to meet at least 80% of a strategic commitment component will result in the requirement for the company to pay to the Authority an amount equal to the difference between the value of the missed strategic commitment, as identified at the time of application, and the amount actually spent. The tax credit purchase contract will be grant a one-year cure period to tax credit purchasers to return to compliance before payment is due.

At time of application, each auction applicant must designate a relevant individual in their organization who will participate on the Evergreen Advisory Board. Ideally, this individual will have a professional background and role in innovation, startups, or research and development, and serve in a senior position within the organization. The statute requires the CEO to establish a process to appoint the members of the Evergreen Advisory Board from the tax credit purchaser representatives. Upon execution of the purchase agreement by the tax credit purchaser the appointed Advisory Board member (or in case of unavoidable conflict, a different representative) will serve for a year-long period and shall be required to engage in the majority of Evergreen Advisory Board meetings and events. Staff anticipates that this will include quarterly meetings and ecosystem-building events in the State. NJEDA-convened quarterly meetings will enable Evergreen Advisory Board members to present learnings from their strategic commitment, share feedback for the next auction, and offer guidance on programmatic initiatives to support the innovation economy. Examples of other Evergreen Advisory Board commitments such as networking and ecosystem-building events include NJ Founders and Funders and pitch competitions. Evergreen Advisory Board member requirements will be clearly outlined in the tax credit purchase agreements. If the tax credit purchaser does not comply with the Evergreen Advisory Board requirements, the company will not be eligible to participate in an auction in the following year.

After initial purchase, the tax credit purchaser has the option to resell the tax credit for no less than 85 percent of the transferred credit amount. If this option is chosen, the tax credit purchaser is obligated to pay ten percent of the sale to the General Fund of the State. The initial bidder will remain obligated to fulfill the strategic commitment detailed in the executed purchase agreement. There are no additional resales.

More information about these post-approval monitoring processes can be found in **Appendix B**.

Qualified Venture Firm

Following Board approval of the certification as a qualified venture firm, venture firms will be notified and will receive a qualified venture firm agreement to execute detailing guidelines and expectations for program participants, including, but not limited to:

- Make qualified investments in qualified businesses as the managing member of uniquely created Evergreen special purpose vehicles that align with the matching private investment fund (or qualified venture firm active fund);
- Cause an audit of the qualified venture firm's books and accounts of the Evergreen special purpose vehicle holding qualified investments following the completion of a NJIEF qualified investment;
- Agree that the qualified venture firm will publicize its participation in the "New Jersey Innovation Evergreen Fund".

Once the qualified venture firm is approved for a qualified investment, the qualified venture firms will need to establish a special purpose vehicle to invest NJIEF capital. The terms of the Evergreen special purpose vehicle governing agreements will be standard across the Program. Each Evergreen special purpose vehicle agreement will incorporate select terms, such as management fees and carried interest rates, from the governing documents of the qualified venture firm's active fund that will co-invest alongside the Evergreen special purpose vehicle. Other terms that will be matched are the right to participate in non-equity investments such as options or warrants. Decisions to invest in non-equity follow-on opportunities will be made by the Authority at that time, subject to availability of capital in the Evergreen Fund and the approval of the Board of Authority.

The NJIEF will pay the firm's management fee, direct expenses (only those necessary to comply with the Program), and carried interest rate up to a limit established by the Authority based on peer industry norms, to be updated from time to time. Initially the Program will limit management fees and carried interest rates to 2.5 percent and 30 percent, respectively, which represents a standard ceiling for premium venture capital rates (per Preqin industry data). Upon establishing the Evergreen special purpose vehicle, qualified venture firms will issue capital calls to fund the approved investments, expenses and the firm's management fees.

Annual Certification Test

Qualified venture firms will be evaluated for continued certification annually upon receipt of firms' required reporting documents. Completed annual reports must be submitted by qualified venture firms each year following certification. If the qualified venture firm is managing qualified investments through Evergreen special purpose vehicles, the annual report must also contain information about the qualified businesses, including employment information. Reports are due within 120 days of qualified venture firms' tax year end. Absent prior approval by the Authority, if a qualified venture firm fails to comply with its annual reporting requirements, the NJEDA may withhold management fees, direct expenses, and carried interest incentive payments until the firm is back in compliance with reporting requirements. Firms that fail to report for two consecutive years will be decertified and deemed no longer eligible for new NJIEF initial investments. The Authority may also remove the qualified venture firm from the Evergreen special purpose vehicle or require termination of the Evergreen special purpose vehicle.

The annual report includes, but is not limited to:

- All qualified investments made during the preceding calendar year;
- Financials, audited by a certified public accountant, who is licensed in accordance with the "Accountancy Act of 1997," P.L. 1997, c. 259 (N.J.S.A. 45:2B-42 et seq.), or licensed in accordance with the laws of another state, of the qualified venture firm active fund and the Evergreen special purpose vehicle;
- The number of full-time employees of each qualified business, along with payroll and other employee information, as of the end of the preceding year (or at time of investment termination);
- Any other information the Authority requires to ascertain the impact of the program on the economy of the State.

The annual report must be certified by an independent certified public accountant. The statute requires firms to continue to maintain at least two professional investors with at least five years of money management experience and at least $10,000,000 in net assets, equity capitalization, or committed capital. If the annual report does not demonstrate such ongoing compliance, the qualified venture firm will be decertified. Additionally, firms must demonstrate continued compliance with its firm's diversity, equity, and inclusion policies, or (as applicable) with best efforts to invest in incentive areas, will be rescored and decertified if their score falls below the Program's minimum acceptable score. A decertified venture firm shall no longer be eligible to qualify for new qualified investments, until recertified, but it will retain the management of the existing qualified investments for which the qualified venture firm was initially approved. A firm can be re-certified if they re-apply and are again certified.

Certain failures by a venture firm to comply with the Evergreen Program requirements, such as material misrepresentation in any submission to the Authority, failing to submit two consecutive annual reports, or other defaults that the Authority concludes merits ending the relationship with the venture firm, the Authority may replace the venture firm or force a termination of the special purpose vehicle, either of which may result in the forfeiture any management fees or carried interest associated with prior investments.

More information about qualified venture firms' annual reporting requirements, including a full list of requirements can be found in **Appendix E**.

Qualified Business

Following Board approval of a qualified investment, the NJEDA will execute a contract with qualified businesses, either directly or indirectly through the special purpose vehicle established for the purposes of the investment. The agreement will outline the business's requirements to maintain a place of business in New Jersey and to either: a) maintain its "principal business operations" (as defined above) in the State, or b) maintain at least 50 percent of full-time employees "filling a position in New Jersey" or pay 50 percent of wages to full-time employees "filling a position in New Jersey." For this program, "filling a position in New Jersey" requires the employee to spend 80% of the employee's time in New Jersey.

In the event of a failure to comply with this requirement during two consecutive years, the Authority ***may*** exercise its right to require the qualified business to redeem the shares of stock purchased with the qualified investment for an amount equal to the greater of the sum of the qualified investment and follow-on investments or the fair market value of the shares of stock at the time of the redemption demand. If, for example, such failure results from a decline of NJ employment or employee residency relative to total qualified business employment, the qualified business will have one year to come into compliance prior to the Authority having the redemption right described in this section. If the qualified venture firm or any other investor offers to purchase such qualified investment for the same amount as set forth above, the Authority may accept such purchase instead of redemption. Any decision forgo this redemption right will be approved by the Board of the Authority. These requirements will remain in place for the duration of the qualified business compliance period, as defined herein.

To monitor the qualified businesses's adherence to the ongoing Program requirements, the qualified venture firm annual report must include independent Certified Public Accountant-certified employee and wage logs for full-time employees as of December 31st, lease agreements demonstrating a place of business in New Jersey, and any other information the Authority may require for Program compliance.

Evergreen Fund Reserve Policy

Once initial investments into qualified businesses are approved by the Board of the Authority, Staff will reserve capital in the Evergreen Fund for potential follow-on investments into those businesses. Qualified venture firms will provide NJEDA staff with information about the amount reserved by the firm relative to the size of the firm's initial investment. Updated reserve estimates will be provided annually by qualified venture firms, which will inform staff allocation decisions about changes to Program reserves.

As stated in the rules, staff will reserve amounts for follow-on investments in lock-step proportion with the venture firm up to a limit of $5,000,000 for typical investments, or up to $6,250,000 for qualifying businesses, within a 12-month period, subject to all applicable caps on follow-on investments (as described previously).

In addition to reserving capital for follow-on investments, the Program will reserve funds to pay qualified venture firm management fees and direct administrative expenses necessary to comply with the Program (such as costs for establishing the Evergreen special purpose vehicles and compiling the annual reports). As described above, the NJIEF will pay firms their standard management fee and carried interest rate up to the limit established by the Authority based on peer industry norms. Reserves for management fees will be guided by a management fee schedule provided by the venture firm at the time of initial investment, to be updated annually.

Additional direct administrative expenses paid by the NJIEF to qualified venture firms will be limited to a budgeted cap applied to all NJIEF investments, established by the Authority based on industry standard costs of establishing and winding down a special purpose vehicle, auditing a special purpose vehicle, and other direct miscellaneous administrative and accounting costs. If a qualified venture firm's direct expenses exceed the budgeted limit, of $15,000 per special purpose vehicle for formation and wind down costs, and $12,500 per special purpose vehicle per year for the life of the special purpose vehicle for ongoing administrative costs such as an annual audit, the firm must cover any excess costs.

The Evergreen Program statutes establishes a goal to reserve 25 percent of the Evergreen Fund money that's allocated to qualified venture firms for investment in businesses located in opportunity zone eligible census tracts in the State. One way Staff proposes to further this goal is by awarding points in the Program weighted scoring criteria to venture firms that either have offices located in incentive areas (which include qualified opportunity zones and Metropolitan areas as designated through the State Planning Act) or that agree to establish a policy to dedicate a greater portion of Program funding to investments into businesses located in incentive areas. Staff anticipates that such firms will likely invest in businesses located in opportunity zone eligible census tracts. Moreover, of the 75 basis points of Evergreen Fund capital statutorily dedicated for the administration of programming to support the innovation ecosystem, Staff intends to include a notable emphasis on opportunity zone eligible census tracts, including such activities as investor and founder networking events, targeted marketing, and targeted support for startups in opportunity zone eligible census tracts. Authority staff will track all Program investments into qualified businesses located in opportunity zones and will make amendments to its approach if the 25 percent goal does not appear to be achievable based on the experience of the Program.

Additionally, the Evergreen Program statute requires that EDA undertake a study to identify potential disparity in the magnitude of venture capital funding to women- and minority-owned businesses in the State, and, depending on the outcome of such study, the Authority may institute a set-aside plan to ensure allocation of funding from the Fund for investment in women-owned and minority-owned businesses. This study, conducted by Rutgers University (initiated in 2021), is nearly complete. If supported by the study, Staff will return to the Board to recommend any changes, such as a reservation or set aside policy.

As permitted by the statute, Staff will also reserve up to 100 basis points of the Evergreen Fund capital of for any other expenses the Authority must incur in administering the Program, such as outside legal counsel or an external fund administration service to help track the portfolio. Utilizing the Evergreen Fund for the Authority's own administrative expenses means that the Program does not need to charge application fees to cover these costs, other than the standard fee for third-party costs.

Finally, the statute requires a reserve of 75 basis points for programs that support the growth of innovation in New Jersey. This reserve will be used for additional programs to support the innovation economy.

These funds will be reserved following the successful completion of a tax credit auction and upon the deposit of investment returns into the fund.

Request for Delegation

Delegation to the Authority's Chief Executive Officer is requested of the Board of the Authority for the following items:

i) To establish a date/s for the corporate business tax auction (no more than annually). Any change to the tax credit auction scoring criteria and the approval of tax credit purchasers will be brought to the Board. Please refer to **Appendix B** for a complete description of the auction process, including a summary timeline of activities.

ii) To approve follow-on investments unless (1) the qualified venture firm is decertified or (2) the qualified venture firm or qualified business is not in compliance with the requirements of this program (including any agreements). The NJIEF statute authorizes follow-on investments from the Evergreen Fund into qualified businesses that previously received a program qualified initial investment approved by the Board of the Authority. The maximum size of follow-on investments will be capped as described in the **Qualified Investment Requirements** section of the memorandum, and a full description of the follow-on investment approval process is described in **Appendix D**. Typically, follow-on investments follow a formulaic review process. Delegated authority will allow Authority staff to expeditiously screen and approve applications for follow-on investments to mitigate the risk of forgoing the Authority's pro-rata investment rights. Additionally, the Evergreen Fund's ability to reserve capital for and execute follow-on investments may be an important tool in incenting qualified venture firms and qualified businesses to apply for NJIEF qualified investments.

Additionally, Staff may exercise operational authority to execute standard portfolio management obligations of Program investments that may arise during the normal course of business, including any shareholder votes, decisions to extend the life of an Evergreen special purpose vehicle, or other industry standard activities. Such operational authority does not include any action that creates a new obligation or liability of the Authority (other than continuing existing obligations, such as continuing to pay management fees if the life of an Evergreen special purpose vehicle is extended); such actions will be brought to the Board.

Rulemaking Process

The ERA authorizes the Authority to promulgate special adoption rules for the Evergreen Program, which will be effective immediately upon filing with the Office of Administrative Law and continue for 180 days. In addition, Staff proposes pursuing concurrently the proposal of long-term rules, which will include a 60-day public comment process pursuant to the Administrative Procedures Act rulemaking procedures.

Compliance with Executive Order 63

In accordance with the Executive Order 63 directive to ensure outreach efforts are made to the public and affected stakeholders for agency rulemaking, the Authority issued a news release advising the public that the draft Evergreen Program rules, including auction guidelines and venture firm and deal qualification processes, were available for review and of the opportunity to provide informal input.

The Authority staff convened two virtual roundtables which provided an overview of the Evergreen Program and the opportunity for the public feedback, on:

- Thursday, January 6th, 2022 at 9:30 a.m.
- Thursday, January 6th, 2022 at 2:00 p.m.

Additionally, the public were able to submit written feedback through the NJEDA's Economic Recovery Act transparency website (www.njeda.com/economicrecoveryact) or through the newly established email account (njief@njeda.com) from January 6th through January 14th, 2022.

Fees

There are no external fees associated with any element of the Evergreen program (auction, venture firm qualification, investment qualification) except for the standards costs of due diligence, , including, but not limited to, debarment/disqualification reviews or other analyses by a third party retained by the Authority. Although not an application fee, at the time of auction, a 10% deposit up to $500,000 must be paid by bidders at the time of application. This deposit will serve as a qualifier to ensure corporate bidders maintain sufficient capital to participate in the auction and the seriousness of their bid. If awarded, the deposit will be attributed to the final award payment. If there is another reason (documentation, etc.) that a bid is denied, this amount will be refunded to the auction participant.

Reports on Implementation of Program

Staff will establish a framework of key performance indicators (KPIs) to quantifiably measure how well the Evergreen Fund will meet the NJEDA's operational and strategic goals over time. Along with the goals and outcome of the Program, the Authority will also request demographic information related to the businesses availed of funding from the Evergreen Program, including demographic information with respect to the company's leadership. This is part of the Authority's ongoing efforts to measure to what extent its programs and services are serving New Jersey's diverse residents, communities, and businesses. Other metrics are anticipated to focus on the Program's outreach efforts and volume of applicants, process and operational effectiveness, and economic development outcomes. The KPIs will provide valuable insight for staff and the Board to assess the effectiveness of the Evergreen Fund. These KPIs are still under development.

As required by the statute, Staff will prepare a report on the implementation of the Program to be submitted to the Governor and the State Legislature every two years. Each report shall include the following information: 1) the names and locations of qualified businesses receiving capital, 2) the amount of each qualified investment, 3) a CPA-certified report on the consolidated performance of the fund, 4) the cumulative amount of capital committed by tax credit purchasers, 5) the rate and amount of fees charged by each qualified venture firm, 6) the classification of each qualified business according to the industrial sector and size of the business, 7) the State's return on investment, 8) the total number of jobs created in the State by the qualified business after the qualified investment, 9) the average wages paid for the jobs, and, 10) any other metrics the Authority determines are relevant based upon national best practices.

Recommendation

The Members are requested to approve: (1) The attached special adopted new rules and concurrent proposed new rules for the new Evergreen Program and to authorize staff to (a) submit the special adopted new rules and concurrent proposed program rules for promulgation in the New Jersey Register and (b) submit the proposed program rules as final adopted rules for promulgation in the New Jersey Register if no formal comments are received; subject to final review and approval by the Office of the Attorney General and the Office of Administrative Law; and; (2) the creation of the Evergreen Program, a tax incentive program authorized by the New Jersey Economic Recovery Act of 2020 (Sections 20 through 34 of P.L. 2020, c. 156), to encourage economic development, targeting the Governor's priority sectors through job creation and investment into the innovation economy; and; (3) Delegation to the Authority's Chief Executive Officer, to establish a date/s for the corporate business tax auction (no more than annually) and to approve follow-on investment (with certain exceptions) as explained in this memorandum.

Tim Sullivan, CEO

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Attachments:
Appendix A – Proposed New Rules – Evergreen Program
Appendix B – Auction Application and Review Process
Appendix C – Qualified Venture Firm Requirements and Weighted Criteria Evaluation
Appendix D – Qualified Investment Evaluation
Appendix E – Qualified Venture Firm & Business Annual Reporting Requirements