WILENTZ
—ATTORNEYS AT LAW—

New Jersey's Innovation Evergreen Fund – Harnessing Venture Capital Firms to Serve as Catalysts for Development of High Growth Businesses In Targeted Industries Located In Planning Area 1 and NJOZs

By Anne Babineau and Robert Beckelman

05.07.2021

The New Jersey Innovation Evergreen Act (the "Act") provides for the creation of an Innovation Evergreen Fund ("IEF") from which the New Jersey Economic Development Authority ("EDA") can allocate funding to venture firms to make investments of capital in high growth, targeted industry businesses with less than 250 employees.[1] To the extent that EDA is to receive dividends and returns from businesses in which the venture firms invest, the fund is designed to become self-sustaining, and could even produce revenue for the General Fund of the State.[2]

Purchasers of Tax Credits will generate the money for the IEF

EDA is authorized to auction up to $60 million in tax credits annually during the first 6 years after launch of the Program. [3] Bidders at the auction must offer to buy a minimum of $1 million in credits, be willing to pay at least 85 percent of the dollar amount of tax credits, and commit to provide mentorship, networking, and collaboration opportunities to qualified businesses that receive funding under the program.[4] The purchasers can apply the credits against liability for Corporate Business Tax.[5] However, recognizing that the purchaser may not have Corporate Business Tax liability itself, the Act also authorizes the investor to apply to EDA for a certificate which can be used to sell or assign the credits for not less than 85% of the credit amount to one other party.[6] To maintain the integrity of the program, EDA is required to "ensure that no undue financial advantage shall inure to a purchaser that also is: managing a qualified venture firm; beneficially owning, through rights, options, convertible interests, or otherwise, more than 15 percent of the voting securities or other voting ownership interests of a qualified venture firm; or controlling the direction of investments for a qualified venture firm."[7] Prior to an auction, EDA will establish and disclose to bidders the weighted criteria it will utilize, which EDA is required to base on "the price offered to purchase the tax credits and the quality of the mentorship and networking opportunities and other support of the State's innovation ecosystem offered by a purchaser in its bid."[8]

What goes into EDA's decision-making with regard to determining whether a venture firm should be qualified under the Program?

In order to even be considered, the firm must 1) meet the definition of a "venture firm," which among other things means that it "invests cash in a business during the early or expansion stages of a business in exchange for an equity stake in the business,"[9] 2) have an equity capitalization, net assets, or written commitments of no less than $10,000,000 in the form of cash or cash equivalents on the date the determination for certification is made, and 3) have no fewer than two of the principals or persons employed to direct the qualified investment of capital with at least five years of money management experience in the venture capital or private equity sectors.[10] The Act provides that the EDA's criteria shall include, but not be limited to:

- management structure (including the willingness of management to work with EDA to support targeted industries[11] and the innovation ecosystem in the State[12], and to locate in the State; knowledge,

experience, and capabilities of the applicant in subject areas relevant to high-growth businesses;[13] and whether the State's investment would exceed 15 percent of the total invested in the applicant);[14]
- investment strategy (including record of investing in high-growth businesses, investments identified in New Jersey or surrounding areas, and performance of the general partner or fund manager);[15]
- location of the applicant's venture firm and the proposed structure of the applicant venture firm's investments in qualified businesses, with preference given to applicant venture firms that are located in, and to those who agree to dedicate a greater portion of qualified investments into qualified businesses located within an incentive area, namely Planning Area 1 or in an area that *was eligible to be designated* as a federal qualified Opportunity Zone (a "NJOZ").[16]

The Act also limits the EDA's decision making with regard to venture funds as follows: "no more than two qualified investments shall be made with each qualified venture firm in a calendar year;"[17] and "[t]he fund shall not invest in a qualified venture firm if EDA determines that an undue financial advantage would inure to a [tax credit] purchaser or if the investment would be inconsistent with the investment policies and goals of the State."[18] In its process of selecting venture firms, the EDA is required to follow practices designed to ensure transparency.[19]

What businesses can be funded by the venture firm and how are the amounts of investment in the business limited?

A venture firm can invest capital in one or more qualified businesses[20] from IEF money allocated to it by EDA at the times, in the amounts, and subject to the terms and conditions that the qualified venture firm determines to be necessary and appropriate.[21] Its investment must be a "direct investment of money" in a New Jersey business with less than 250 employees at the time of the investment and that is engaged in a targeted industry.[22] In order to be a qualified investment, the venture fund must use the IEF fund investment "for the purchase of shares of stock, with an option to make an additional investment in an option or warrant or a follow-on investment, in the discretion of the EDA."[23] Notably all of the venture funds investment using IEF funds is to be "matched by an investment by a qualified venture firm."[24]

Although the venture firm will determine in the first instance, the amounts and the terms and conditions that the qualified venture firm determines to be necessary and appropriate, EDA will determine the amount of funding that is "necessary and appropriate to effectuate the purposes" of the Act.[25] Among other things, the EDA may limit the amount of allocated fund money that a qualified venture firm invests in a qualified business based upon the size of investments that the qualified business has received, the source of the investments, and the industry in which the qualified business is engaged.[26] EDA is required to have a goal for 25 percent of the fund money that is allocated to qualified venture firms to be reserved for investment in businesses located in areas eligible to be designated as an Opportunity Zone,[27] and based on the finding of a "disparity study" to be conducted, EDA "may institute a set-aside plan to ensure that fund money allocated to qualified venture firms is reserved for investment in women- and minority-owned business enterprises in this State."[28]

Each qualified investment in a business shall not exceed $5,000,000 in initial investment but the amount can be increased to $6,250,000 in the case of a business: (a) which utilizes intellectual property that is core to its business model and was developed at a New Jersey-based college or university; (b) is considered a university spin-off business as determined by the authority; or (c) is certified by the State as a 'minority business' or a 'women's business.'"[29] The $5,000,000 limitation that pertains to initial investment in a qualified business does not limit the amount of follow-on investments that could later be authorized.[30] The EDA will require the venture firm to make investments in the business that equal or exceed the amount of capital received by the venture firm from the fund under the program.[31]

Conclusion: New Jersey's IEF is another EDA program, not unlike the Community Anchor Investment Program, which follows an 'investment model." It is also designed to provide a catalyst for venture capital to invest in high growth businesses in State Planning Area 1 and NJOZs and helping to attract targeted industries, but also providing dividends and return to the State.

About the Authors

Anne Babineau and Robert Beckelman are shareholders in the Redevelopment and Real Estate practice groups at Wilentz, Goldman & Spitzer, P.A.

Footnotes

[1] N.J.S.A. 34:1B-290; 291(b); 362(b)(1)(c).

"Targeted industry" means any industry identified from time to time by the authority which 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-retail food and beverage businesses including food innovation, and other innovative industries that disrupt current technologies or business models.

EDA is also authorized to use a small amount of the fund (.75 of the fund) for programs administered by the EDA that create an "innovation ecosystem" that supports and promotes "high-growth businesses" in the State.

"Innovation ecosystem" means funding, programs, and events that support the establishment and expansion of high-growth companies in targeted sectors. Examples of such funding, programs, and events include: mentoring programs for start-ups, meet-up or networking events, funding for locating a business in a collaborative workspace, programs that provide business services, and entrepreneurial education to companies.

[2] N.J.S.A. 34:1B-299(c); N.J.S.A. 34:1B-291(c).

[3] N.J.S.A.34:1B-362(b)(1)(c). NJEDA has noted that the Act provides fiscal protections for the State because, recognizing the self-sustaining design of the Act, in any given year, the NJEDA may not auction off tax credits if more than $15 million is available to the NJEDA from moneys received from any prior auction of tax credits pursuant to the program. N.J.S.A. 34:1B-290.

[4] N.J.S.A. 34:1B-292.

[5] N.J.S.A. 54:10A-5; N.J.S.A. 34:1B-294(a).

[6] N.J.S.A. 34:1B-295(b)(c)(d). The party who purchased the credits at auction is required to pay 10% of the consideration it receives to the State's General Fund. N.J.S.A. 34:1B-295(d).

[7] N.J.S.A. 34:1B-293(c).

[8] N.J.S.A. 34:1B-292(c).

[9] Venture firms are defined as "a partnership, corporation, trust, or LLC that invests cash in a business during the early or expansion stages of a business in exchange for an equity stake in the business. It may include a venture capital fund, a family office fund, or a corporate investor fund, provided that a professional manager administers the venture firm." N.J.S.A. 34:1B-297(b). The venture firm is required to create a special purpose vehicle for the qualified investment of the fund. N.J.S.A. 34:1B-298(b)(4).

[10] N.J.S.A. 34:1B-297(b). EDA is required to review each qualified venture firm annually for these criteria, and failure to continue to meet these requirements can result in disqualification. N.J.S.A. 34:1B-297(d).

[11] See footnote 1.

[12] See footnote 1 for definition of "innovation ecosystem."

[13] "High-growth business" means a business that is growing significantly faster than the average growth rate of the economy or is a start-up company that is investing in developing a product or new business model that will allow it to grow significantly faster than the average growth rate of the economy within the next three to five years." N.J.S.A. 34:1B-289.

[14] N.J.S.A. 34:1B-296(b)(1).

[15] N.J.S.A. 34:1B-296(b)(2).

[16] N.J.S.A. 34:1B-296(b)(3).

[17] N.J.S.A. 34:1B-298(a)(1).

[18] N.J.S.A. 34:1B-298(a)(3).

[19] EDA is required to "provide written notification to each venture firm that the authority refuses to certify as a qualified venture firm, communicating in detail the grounds for the authority's refusal." N.J.S.A. 34:1B-297(d). An annual audit of the qualified venture firm's books and accounts is also required. N.J.S.A. 34:1B-298(b)(2); an annual report must be furnished to the EDA (N.J.S.A. 34:1B-299(a) and (b); and a report must be provided to EDA on n the amount of the stock sold or disposed of and the consideration received for the sale or disposition. N.J.S.A. 34:1B-299(c) and (d).

[20] A "qualified business" is defined as one that " is registered to do business in New Jersey; has its principal business operations located in the State and intends to maintain its principal business operations in the State; and is engaged in a targeted industry. N.J.S.A. 34:1B-289. "Principal business operations" is defined " to means at least 50 percent of the business's employees, who are not primarily engaged in retail sales, reside in the State, or at least 50 percent of the business's payroll for employees not primarily engaged in retail sales is paid to individuals living in this State." N.J.S.A. 34:1B-289.

[21] N.J.S.A. 34:1B-298(c).

[22] N.J.S.A. 34:1B-289.

[23] Id.

[24] Id.

[25] N.J.S.A. 34:1B-298(a). In its agreement with the venture firm, the EDA may limit the amount of allocated fund money that a qualified venture firm invests in a qualified business based upon the size of investments the qualified business has received, the source of the investments, and the industry in which the qualified business is engaged. N.J.S.A. 34:1B-298(c).

[26] N.J.S.A. 34: 1B-298 (c).

[27] N.J.S.A. 34:1B-298(a)(4).

[28] N.J.S.A. 34:1B-298(a)(5).

[29] N.J.S.A. 34:1B-298a(2).

[30] N.J.S.A. 34:1B-298(a)(2).

[31] N.J.S.A. 34: 1B-298(b)(1).