

MINUTES OF THE UTAH CAPITAL INVESTMENT BOARD MEETING

****APPROVED****

June 5, 2015 | 8:00 – 9:30am

Canyonlands Conference Room, Governor's Office of Economic Development
60 E South Temple, Third Floor, SLC, UT 84111

Board Members Present: Bob Majka, Val Hale, Richard Ellis, Samuel Straight

Guests Present: Bret Jepsen, Richard Pugmire, Susan Eisenman

Staff Present: Kathy Whitehead

Welcome and Related Business:

Bob Majka welcomed board and guests, and with confirmation of a quorum, moved to agenda item II, approval of the Q1 2015 Utah Capital Investment Board Meeting Minutes. Val Hale moved to accept the minutes as presented, and Richard Ellis seconded the motion. The board unanimously approved the minutes.

Item III. Current Status of Administrative Rules

Susan handed out a draft of the administrative rules and noted that attorneys for the Utah Capital Investment Corporation had also had a chance to review. She stressed to the board the importance of making rules sufficiently clear so that potential investors know what they're in for. The rules were structured in three separate schemes (Susan clarified that the law was changed during the last legislative session and GOED code was recodified and renumbered, noting UCIB is no longer 63M but 63N). For the Venture Capital Enhancement Act, the statute was changed to focus on new funds, and not provide tax credits as guarantee of the funds but as a measure of economic development.

The first issue that board needs to decide and put in rule is whether placement fee should be charged to the corporation for issuing tax credits. The fee would be used to defray the administrative cost of administering the tax credit program. Susan speculated that as the board moves into administering Fund 2, there may be more administrative costs as tax credits need to be issued.

Richard Ellis noted that the challenge we have is getting all the money upfront at closing (closings if there are many), but it's not an ongoing revenue source. It could be charged against as long as it was carried forward and the legislature didn't take it, it would be available to offset administrative costs.

Sam commented that we don't have money for outside lawyers to review draft rules. He asked whether this would count in the definition of administrative costs. There was general agreement that this would most likely fall in this category. Bob Majka noted that GOED has absorbed these

costs so far, but when the board moves forward with retaining SEC lawyers, the costs will be significant. Susan added that this would be a one-time review and would be required before the deal is closed.

Bob pointed out that UCIB has never had a budget so this fee would be to provide a limited budget. Val asked how much money we thought this would require. Susan noted that the fee cannot exceed .5% of private investment of the designated investor. After the board went through some scenarios of what this fee might be, Richard asked whether we have to fix this in rule.

Sam commented that rather than require a board vote every time a fee was assessed, it would be better to set it. Val wondered how many transactions we're expecting. Bret answered that over the next five years, there would be two such transactions: the refinance and the fund raise. The big costs associated would be hiring SEC attorneys to review the transactions and provide coverage for board.

Susan felt this would actually be a onetime cost and suggested that because the board can't hire its own counsel, the attorney generals' office would hire counsel for the board, up to a \$200,000 cost after a bidding process. It was felt that this would be more than adequate. Richard asked whether the AG's office or the law firm could float this cost for the board until the corporation could provide reimbursement.

Susan laid out two options: We can charge a management fee to pay for SEC attorney or UCIC could generously agree to pay for SEC attorney and then not charge the management fee in addition.

Bret felt that if it would move things forward for the corporation to pay for the SEC attorney rather than charge a management fee, and if this action was within statute, he was comfortable with the board recommending this course of action, with the caveat that Sam provides guidance on retaining the SEC attorney. The board agreed that this was best course of action, and would give board flexibility on adding management fees in the future if required.

The next issue Susan presented to the board was how to deal with the increment caps. She quoted the statute and then asked what if the increment is less or more than \$100 million, is it proportional? Richard felt the legislative intent was proportional. Bret clarified that Cooley would adhere to rules and then put in contract.

The next issue was designated purchasers – looking at other states, because these are refundable tax credits, other states have had state-based companies agreeing upfront that they would buy the tax credit to keep the tax refund in a state-based company. Utah doesn't have that. The statute allows for designated purchasers.

Sam asked whether there was any statutory definition of a designated purchaser. There is and Susan read the statutory definition, noting that if perhaps we were several years in the fund and it wasn't going as well, we might want to have these. Richard wondered which companies would be interested in this. He expressed doubt that anyone would want to commit to this type of obligation. Bob felt it didn't make sense at this point, though perhaps down the road it might. Richard asked whether the board was required to have designated purchasers, and Susan responded that we are only required to have rules about them.

Bret clarified that he felt Cooley's interest was in simply guaranteeing that if someone wanted to buy these tax credits, they could. After further board discussion over how this would work, Susan agreed to simplify the language of the rule to give board future flexibility, stipulating that if designated purchasers are identified, the board would be open to entertain this.

Board decided not to make a decision during the meeting about designated purchasers because they do not have any for now.

The rest of the rules discussion revolved around two major themes: 1) the board needs to provide potential investors with as much certainty as possible in support of refinancing Fund 1 and creating Fund 2; and 2) the board needs to make some tough decisions about measuring economic development increment. Cooley has expressed to Susan that investors want as close to a guarantee as possible that they will be made whole and they want that assurance as soon as possible in the deal, perhaps at closing.

Currently, the contingency of the tax credit is the economic development increment of the fund. Now that the tax credit is tied to economic development increments, the board must decide how it will calculate economic increment, how it will prove it, how often the board is going to determine it, and how the board is going to divide it among investors.

Bob asked where we would go to find the performance-based criteria. Samuel noted that this is the issue the legislature is interested in, and he questioned how the board would take this on. Susan suggested there are the BEBR and REMI economic models that could be presented to the legislature/public as proof of performance. Richard noted that the challenge comes from the inputs into the economic model. How do we verify inputs, that is, salaries, number of jobs created, etc., are valid?

Bret related that while the REMI model is a good source of directly measuring economic development, he felt the easier and better way might be to simply make introductions to entrepreneurs or fund managers through a letter from the local Utah manager of the fund endorsing UCIC's effectiveness in helping them secure funds. UCIC would bear the burden of

proof to UCIB verifying the data inputs in the letter since they are required to do this for auditing purposes anyway. UCIC would draw the conclusions and provide this document to UCIB, and UCIB would in turn provide a letter back to UCIC concurring that the performance has been proven.

UC2 Examples:

- Utah Capital II Fund Size = \$100 mm
- 3/15 Legislated Incentive-based Tax Credit structure:
- Higher of Invested vs Value capital = **\$25 mm** (est)
- Utah-based company introductions:
 - \$2 mm** Utah-based company introduction
 - \$25 mm intro for Utah-based VC firm, resulting in **\$5 mm** invested into Utah
 - \$50 mm intro for Utah-based PE firm, resulting in **\$20 mm** invested into Utah
- TBD BEBR or other 3rd party economic evaluation = **\$48 mm**

TOTAL Incentive Awarded by Year 5 (est) **\$100 mm**

Bret referred the board to the example on page two of Q1 2015 minutes, beginning at the fourth bullet. He suggested that the newswires and other public documents will confirm the financing introduction, and other proof can be provided via email and text from the fund managers. This evidence could be provided to UCIB as proof and UCIB (as controller of the tax credits) could in turn send a letter to the investor validating UCIC's effectiveness.

Susan suggested the legislature would want to see REMI or BEBR models as proof of economic development in addition to the letters.

Bob questioned that since only 15% of fund is Utah-based, what happens if we have arrangement with someone not in Utah? Don't these criteria become irrelevant? Brett responded that these are two separate things. The fund's investing could be 15-20%, but more importantly, the non-Utah institutional investors, that UCIC has lined up with local VC or PE firms, will put their money into a local Utah firm, which gets partially invested in Utah.

Bob voiced concern over the other 85% of "non-Utah" funds, since the tax credits are based on how these funds benefit Utah, and asked the question, "What happens to the 85%?" Richard responded that the hope would be the fund makes enough money that the tax credits never need to be called in.

Bret reminded the board that it wouldn't need to worry about that, since tax credits are not being requested on the 85%. UCIC is only bringing the board proof on the 15%, plus introductions, plus REMI and BEBR, etc.

Richard asked what the introductions are exactly? For instance, are we giving dollar for dollar credit for all types of investment, even if it's not directly related to the performance of the fund? Bret suggested that the best model for Utah might be where UCIC was just a broker, because then Utah's not at risk for anything. But in this industry you have to have a relationship with investors so they return your calls, etc. Bret has good rapport with those investors. And while the

investors are mainly interested in making money, it is important to remember that when Utah companies receive a large investment, the first thing they do is hire a lot of Utah employees.

Richard remarked that there are billions of dollars raised every year by these kinds of funds with no tax credit or guarantee. We're adding some incentive here, but now investors and attorneys want even more when really we don't have to give anything and people still raise money. That seems to be the challenge when it comes to giving tax credit. Susan suggested that it is the board that needs to find sweet spot where tax credits will enhance investments in Utah capital, but will still be a good value for the tax payer.

Bret explained how tax credits do and don't help in raising capital. The tax credits started in 2003. By 2006, capital was raised, but the terms were not ideal and equity raise was not in discussion. Bret noted that taking tax credits and incentivizing private sector to invest in a fund with a Utah angle is not an easy task, even now. Bret has to convince investors that with his track record, he can morph in-state and out-of-state managers to create a good fund. And if he's wrong, which he doesn't think he will be, there are tax credits to protect the Utah investments. It's that simple with an incentive based program.

He further stated that right now there are many funds in Utah but many will not make our due diligence threshold, but there are also more than when the program started that are institutional grade. Those are ones that have a third party validation. The market has matured, but it's still a tough sell. Bret believes he can sell the incentive based idea, but he has to have some clear rules for targets that Utah Capital can achieve. UCIC needs to know that if it makes an introduction to a Utah entrepreneur that it's going to get dollar for dollar regardless of whether they're in the fund or not. Investors need that certainty on day one that the rules are in place and enforceable throughout life of the fund.

Susan suggested that we need to provide objective evidence to satisfy auditors. Bob concurred that obtaining letters from the firms that are backed up with historical numbers should suffice, along with REMI or BEBR models. Susan suggested that Cooley and Brett give her a proposal and she'll work to determine if that is sufficient evidence.

Sam turned the discussion to the calculation portion, asking Bret what concrete evidence was typically required by the investor. Susan pointed the board to the statute, noting there are two things to look at. The statute details five things as being economic development planning; and then clarifies in the calculation part that there is a demonstrated positive impact on economic development which shall be measured by 1) a method to calculate and 2) the corporation engaging an independent third party. So it really depends on the method. Susan suggested if the board looks at this in terms of outlining both the method and the proof of method, then the rule can be defined. Referring to the chart on page 4 of these minutes, Susan suggested that Bret

simply clarifies the method and proof of method for each of the calculations under bullet four. The board would then turn that into a rule to stipulate method and validation. The letter is the proof of the method. The method is the dollar for dollar calculation.

Richard reminded the board to consider that the methods will influence behavior. Firms will opt for the dollar-for-dollar approach. And Bret agreed that the board doesn't want to incentivize UCIC to put more money to work in Utah if it's riskier.

Bret and Susan discussed coming up with a form letter that the local company could provide to UCIC stating something like, "This is to certify that based on the introduction of UCIC, X number of dollars was invested in my company." This would satisfy the burden of proof both for the auditors and for Cooley.

Bob noted the board needs to be mindful of the 15/85 split concentration inside and outside Utah, and push back on the legislature to make sure they understand UCIB is acting to ensure all the tax credits remain safe.

Noting the time, and amount of items to be discussed, the board decided to defer some agenda items to the regularly scheduled end of second quarter meeting. Bret pointed out that he has a term sheet that expires in 30 days, which requires a board decision. After some discussion, board agreed to meet on July 1st from Noon – 2:00 pm. Richard and Bob will call in. The question was asked whether there are changes to the rules that have to take place in order to do the refinancing? Bret answered that he didn't think so. Susan referred to Section 406 and suggested it would be okay to refinance the debt without changing the rule. Bret then added that anything vague can be covered in the closing documents. When the board asked if Bret could extend the 30-day term sheet by one or two days, he felt that was possible.

Noting the time constraint, Bret asked if we could move directly to agenda item VIII, discussing the equity refinancing. Susan had outlined some issues that the board needs to review and determine whether Cooley's suggestions under the legislative code and in the spirit of the existing rules make it as clear to investors as possible. Susan asked whether the board was okay with her planned approach to work with Cooley on this. Richard remarked that investor certainty seems to be the area of greatest concern.

The board then turned attention to the three year check-in tax credits. Bret drew a timeline on the board to illustrate the context of the refinancing and the cost of the capital. He noted the original financing of \$100M at 6.8% plus a preferred return – pretty expensive. In 2012 there was refinancing with a couple of local investors that dropped the cost of capital to 4%. Obviously, we've been crushed with interest along the way, which eats into gains. So, for the first time, in 2014 the value of the portfolio was essentially flat debt to equity. By Q1 2015, the markets

strengthened. Up to this point, there have been limited options in terms of refinancing. UCIC now has a term sheet to retire a part of the debt, and is looking at how to determine the split. Is it a 65/35 equity to debt? Term sheet allows whole transaction to be refinanced. If performance continues to be strong, we feel it important to retain an upside, which is where the 65/35 split comes in. The prospective buyer essentially wants a “lemon law rule” to limit risk on investment. They want to make sure that there is an assessment of the portfolio by year three, and that portfolio can’t drop below 90% of purchase price (which is close to a 20% discount to where assets trade currently). Essentially the portfolio would have to drop 30% within three years to trigger this assessment. This is highly unlikely and therefore a reasonable cushion, particularly given that the current scenario is that anytime we miss a payment it immediately triggers the default provision.

Bob remarked that he felt this approach was reasonable and conservative. Asked why 65/35 was best for Utah. Bret explained that in an equity scenario, we give up all the upside. But given the strong performance, UCIC would like to see a portion of this flow back to Utah. One thing learned from the legislative audit is that there is a request to explain decisions and rationalization. Bret felt there would be danger that if we went equity only, the auditors might come back and ask why we sold Utah short.

Bret wanted to ensure that all board members have full knowledge about the transaction and is comfortable with it before the vote is taken. He asked Susan whether he could meet with board members individually. Susan clarified that those meetings can take place individually, but no decisions can be made until the quorum is present in a public meeting.

Bob then turned the discussion to agenda item IX. New Board Members. Derek Miller’s name was put before the board to replace Taylor Randall. Val will discuss this nomination with the Governor and Derek during the trade mission to make sure there are no concerns before submitting this name formally for consideration. Bob also presented the board with the resume of Pam McComas as a candidate to replace him when his term expires in November. Bret suggested that she has a strong global markets background as well, which would serve the board well. With no members voicing opposition, Ms. McComas’s name will also be put forward to the Governor for consideration.

Following this discussion, Sam left the meeting, dissolving the quorum and adjourning the meeting.

The remaining board members remained to discuss some items not requiring a quorum. Bret clarified some action items: 1) Susan will send Bret draft three of the document on Monday incorporating Cooley’s comments. 2) Bret will meet with board members individually to update members on transaction.

Susan clarified that she and Sam will pursue the deal with the SEC attorney, and will need the term sheet. Since the SEC attorney will be an agent of the attorney general's office, he or she will be subject to the confidentiality agreement and the document will be designated a protected record under GRAMA. Susan and Sam will draft a request for proposal to present to the board.

Bret asked if there were any other questions he could answer. Richard asked whether Bret expected more capital calls on Fund 1. Bret responded that yes, he does, and contractually up to 10% can still be called. Richard commented that they have \$2M this year so far, and there is \$8M unfunded left. Richard's follow-up question was whether this would have any potential impact on the refinancing. Bret said that part of the transaction would be to put some unfunded aside which will be called to meet the capital calls.

Bob asked about prepays, and Bret responded that yes, there is a prepayment penalty, though they're working to waive this.

Discussion turned to agenda item V. – UCIC Update. Richard Pugmire gave the following report:

Quarter 1 has come in strong. We've gotten 23 of the 28 funds so far. There is a \$6 million gain so far and we don't expect the other five funds to affect this significantly up or down. We're \$117 million NAV now and a \$20 million difference between debt, which is fantastic performance. We've received over \$2 million distribution in the past few weeks, though we're not on pace to what we would like to see for distribution, but that could easily change. Bret commented here that UCIC has exposure to Fitbit, which is expected to perform well.

It is important to mention that taxpayer risk has always been in the forefront for UCIC. In 2008 the board made a strategic shift to diversify the portfolio more toward high quality managers, more buyout growth equity, only high quality VC. This strategy has played out very well – these funds have performed at 25% net IRR compared to 10% of prior commitments. Richard ran the model to show that with the debt position of the previous 6.8% and the slow distribution pace on the '06 to '08 vintage year funds, it looks like there would have been an event two years ago. That is the risk we're trying to alleviate by going to the equity model.

Bret commented that this was an important point he wanted to drive home in a public setting. The three year assessment looks to total value (which is distributions plus NAV) as opposed to distribution. Richard Pugmire suggested that the other thing to remember about the assessment is that even though it's an annual assessment, at the final distribution there is a 100% true-up. So this is similar to the debt principal, but it pushes

it further down the road if there's a problem with the 10%. And it aligns with the distribution pattern.

Richard Ellis asked whether the fund investment period was extended. Bret clarified whether he meant UCIC's? or the underlying? Richard Pugmire said that commitments were made in UCIC's from 2006 – 2010. The three underlying funds are still in their investment periods; one will wrap up this year, and the other two are uncertain but will not move the needle. Bret followed onto Richard's comment about the recession, stating this is when UCIC felt strongly they needed to put capital to work. The most recent commitment was made in 2010 (the inception date), there is a typical investment period of 3-5 years, pointing out that we're near the end of the investment periods. Richard stated there was no way to be exact on these dates, because some funds don't have an end of period in their documents.

Richard Ellis asked if they release funds – the capital commitments?. Richard Pugmire answered yes, that there have been some funds that will, and they will send an official letter. However, if the cushion is small they won't release it due to follow-on investments. In this market, some funds following a value-oriented strategy may not find anything, and might decide not to invest the capital and return 20% of commitment.

Bret suggested that some high quality funds are inherently easier to work with because of the stability – they know they are going to get raises, so they are willing to waive fees, and make it easier to get extensions. Richard Ellis asked if there are any funds that are just dogs? Bret suggested that this possibility has already been built into the model, and reflected in the NAV. Most (25 out of 28) are above cost. He further clarified that the model was taken out ten years to show expected return on a fund by fund basis.

With this, the public portion of the meeting adjourned at 10:15 a.m.

Next Meeting: July 1st from Noon – 2:00 pm at GOED Offices, 60 E South Temple.