MINUTES OF THE UTAH CAPITAL INVESTMENT BOARD MEETING
****PENDING****
December 11, 2015 | 8:00-9:30
Governor's Office of Economic Development – Arches Conference Room
60 East South Temple, Third Floor, Salt Lake City, UT 84111

Board Members Present: Samuel Straight, Val Hale (phone), Pam McComas (phone), David Damschen, Derek Miller
Guests Present: Susan Eisenman, Bret Jepsen, Richard Pugmire, Scott Peterson
Staff: Kathy Whitehead, Heidi Voss

AGENDA

I. Welcome
II. Oaths of Office and Quorum
III. Review and Approval of Minutes
IV. Board Chair Selection Process
V. Administrative Rules Review and Approval
VI. Board Administrative Items
VII. UCIC Report
VIII. Other Business
IX. Motion to Adjourn

I. Welcome

Val Hale welcomed the board.

II. Oaths of Office and Quorum

New board members Pam McComas and Derek Miller were previously sworn in, and Sam Straight was also previously sworn in for a second term. Val then confirmed there was a quorum present before moving to review and approve minutes.

III. Review and Approval of Minutes

Sam moved that the July 1st board meeting minutes be approved. Val seconded and the board unanimously approved the minutes. Val then moved that the September 25th minutes be approved, and Sam seconded the motion. The minutes were also approved unanimously.

IV. Board Chair Selection Process

Val noted the recent turnover of board members, and recommended Sam consider the role as chair. Sam said that he would be willing to serve, and Val noted that Sam would not only bring his experience and legal expertise to the role of chair, but would provide the continuity necessary to move forward. Derek moved that Sam be made chair of the board. Pam seconded the motion and the board voted to unanimously accept Sam as the new board chair. Susan Eisenman offered to meet with Sam later to discuss the public meetings act and GRAMA. Sam was then asked to lead the rest of the meeting and moved to item V.

V. Administrative Rules Review and Approval

Sam turned the meeting over to Susan Eisenman for a review of the administrative rules. Susan reviewed the purpose of the administrative rules for the new members of the board, which is to clarify for consumers how to interpret statutes. There's a public process to draft, post, and approve these rules, and once approved they have the effect of law. Because the statutory scheme was changed this year, the board is required by the statute to post rules within 180 days of their effective date. Failure to post rules on time results in an invitation to appear in front of the administrative rules committee of the legislature. Susan noted that she has worked with the Cooley team of attorneys on this draft of the rules, which is very complex, but that she feels is fairly written and accurately outlines a process to administer tax credits. She also expressed that this upcoming year will likely be busier for the board than in the past because of two major events: one is deciding what to do about Fund 1 and the other is initiating Fund 2. These are good reasons to make sure rules are in place so potential investors in both funds know what to expect.

Bret Jepsen pointed out that the more loopholes that can be foreseen and closed ahead of time, the less money will be burned in attorney fees during negotiation. He expressed satisfaction in Cooley's draft of the rules in creating confidence for potential investors. Susan had read and felt she understood the rules and nothing stood out to her as something the board should be concerned about, but she did want to talk about how to define and credit economic development in increments. Summarizing again for new board members, she said that the statute was changed last year for the refinance of Fund 1, which will continue the old scheme from the statute before. Fund 2 will go forward with a new statutory scheme created this past year, which says that all funds going forward will be financed with equity, with no option for debt, and the tax credits are based on the economic development increment that the fund can demonstrate. At the time of closing the deal, investors will receive a certificate making them eligible to apply for tax credits at the end of the fund. Since there is a maximum amount of tax credits that can be redeemed in a year, investors will receive a balance certificate. If the credits applied for exceed the caps, investors could redeem their balance in remaining years.

<u>Redemption Reserve and Proof of Economic Increment</u>
Sam added that changes to the statute were largely influenced by a desire to demonstrate that this is really generating investment in Utah, especially when people are looking at this four and five years down the road. Susan agreed that this was the biggest change to the rules. There were some additions that required Cooley's further explanation and clarification, which will help investors understand how their investment will work with the fund. Another addition to the rules is what to do with the redemption reserve. If the end of the fund cycle arrives and tax credits are owed, first there is an option to engage designated purchasers to purchase tax credits for non-Utah entities. The designated purchaser would be someone with tax liability in Utah. Susan asked Bret to explain the redemption reserve.

Bret talked about how the legislation has stated from the beginning that there is a reserve fund, but in performance to date that fund has always run dry. As part of the new refinancing with equity, the goal is to capture approximately $10 million for the reserve fund. It will still give new equity players the opportunity to capture some gain. He wishes to honor the statute that has asked for a reserve account by capturing the money at closing. If there are ultimately losses in the portfolio, it will first go to the reserve account to be paid. After that it would go to tax credits. Susan agreed that tax credits are considered a last resort.

Susan asked Bret to explain some of the rules drawn up by Cooley regarding economic development increment.

Bret said that when legislation passed last May, they knew this would be a new mandate for the UCIC, to actually prove value, and they have a couple of great opportunities to do that. He gave the example of some Utah-based funds that their firm believed were institutional grade and could raise real institutional money. After many calls and a share of ideas, they were ultimately able to close on a total of $75 million worth of capital commitments. The commitments are usually drawn over a 3-5 year period. They have worked with financial auditors and modeled their information, and the expectation is that approximately $35 million of that will flow back into Utah. Of course, UCIC will report back to the board on an annual basis and disclose what the actual numbers are. Then there could be a discussion about the official certification as far as tax credits go.

In the past year there was also a company that attended one of the events sponsored by UCIC. The goal during these events is to try to mobilize capital. Utah based companies are not likely to actually close on investments or get attention from non-Utah based venture capital firms. It just so happened that a match was made and they closed on $2 million as a result of the event. Both parties were grateful for the introduction. Bret reiterated that the purpose of why they are here is to try to capture some value for the state of Utah. They know that this leads to jobs and economic growth. As they have met, they have felt the need to get out, hustle, and prove their worth. He asked that the board make sure that the rules be consistent with their goals and timelines.

Bret noted that $35 million is an unusually strong year for his company and he doesn't see that as the norm going forward. Susan asked the board, particularly Val Hale and Derek Miller, if there may be any political discomfort with the claim that there would be economic development increment before a deal is even inked. She believes the goal of the new scheme is to be fair and accurate in attributing economic development.

Val Hale felt that the most critical thing is to be accurate and not appear to be inflating the value of what the board is doing. David Damschen asked for clarification that the board is talking about the effective date of the most recent legislation. Susan pointed out that the rules could have been in place months ago. David felt that it's understandable to take time to get rules in place. Derek Miller agreed with both David and Val, and said that everyone could agree that these rules are an improvement to the vague outline given before. He cautioned that it would be good to make sure it's clear to everyone in the political environment that the money being brought here is real economic development impact, not dollars going into state coffers. That is a potential area of confusion.

David said that if there is discomfort with how economic benefit is calculated, the rules can be revisited and amended as needed.

Economic Increment Cap and Increment to Tax Credit Ratio

Something that was discussed during a prior UCIC meeting is whether to implement a cap on how much economic increment can be certified in one year. In order to get the best chance of return from the state, investors have to look at Bret and put pressure on him to do his job well. Susan asked the board to consider whether incentives get misaligned if Bret's team does so well that all of the economic increment gets banked sooner than expected. Statutorily they are obligated to promote the Utah Fund of Funds regardless of tax credits, but will they have the same motivation to do so when they have met the $100 million tax credit cap. Should there be a yearly cap? Derek pointed out that if the board is worried about motivation after a $100 million cap, then an even lower yearly cap would only exacerbate the problem.

Bret expounded on some of the discussion at the UCIC meeting, saying the member who brought it up wondered if the bar was too low for capturing economic development. He pointed out that this board would likely argue that it is not. He also said that responsibilities at the firm and to investors would certainly keep him and his team motivated regardless of caps. Their goal is to create an atmosphere to help companies or funds when they come. He agreed with Derek that any unnatural gates to that free market operation would be a hindrance. He assured the board that everything he does is with Utah's economic growth in mind

Susan reminded the board that although there is a great deal of trust with Bret and his performance, the rules are meant to survive when all of the current board and UCIC members are no longer involved. Derek asked if the 1:1 ratio between economic development increment and tax credit is set in statute or in the rules. Susan clarified that it is being set by rule. Derek felt that it was valuable to have some room to change the ratio down the road if it needs to be changed. Susan cautioned that any such change would have to have no retroactive effect, so as not to bait and switch investors.

The board agreed that no one was interested in setting an economic increment cap, but that in the future a change to the ratio to tax credits could be considered.

Economic Modeling

Susan told the board that she, David Damschen, Richard Ellis, and Bret Jepsen met offline to discuss whether the economic model should be discounted. Richard felt that the model was "soft." The Cooley team was not happy about the idea because the decision of how much to discount an economic model seems like a very arbitrary decision. Susan asked that the board consider what is best for the fund and not necessarily what Cooley has advised because Cooley is a representative of the UCIC, not the board, and their goal is the most certainty for investors. The board is primarily interested with being a good steward of tax credits. That being said, she said she felt in her discussions with Cooley that they were on the same page as far as protecting the tax credits. She wanted to be sure the board knew they had room to think differently from Cooley, and that they are ultimately in charge of the tax credits.

Derek said that he was familiar with the models that were being considered. If it is a legitimate model, it ought to be trusted. Susan and Bret agreed that the model is put together by experts and that tinkering with the model might be problematic. Sam also agreed and felt the same way about the rules written by Cooley. They are receiving the best professional advice they can get and there are not many reasons to make unnecessary changes. David said that if there is discomfort with "softness" in the model once it is in place, perhaps the source of the softness could be identified and the model altered.

Scott Peterson, chair of the UCIC, added some additional insight, having worked with Ernst & Young for 32 years and spent 2 years at the Financial Accounting Standards Board (FASB). He noted this issue of discounting models arose in his work there as well. They asked questions about why they should discount, and how much is appropriate. The conclusion was that economic models developed should be trusted as they are, and not discounted. He pointed out that the real issue with even well trusted models, like Black-Scholes, is "garbage in, garbage out." The issue is what you put into the model. He expressed what a challenge it has been at UCIC to decide how to attribute economic increment. When giving casual advice to friends and colleagues, does that accrue benefit to UCIC and the UCIB? How credit goes into the model is a complicated thing and, as Richard Ellis pointed out, there is a lot of "softness" in the inputs. Scott felt that it was more important to evaluate the front end and what's going into the model rather than discounting the number that comes out.

<u>Specificity of Cooley Rules</u>

Derek asked if the action of the board today would be a motion to post the rules. Susan clarified that the rules still needed to be formatted, but yes. Derek asked if the rules would approve the use of the $100 million tax credits. Susan said that the board already has authority to issue the tax credits, and the rules will implement how the issuing process works. When Bret is close to closing, the SEC attorney, previously approved, will be engaged to review the deal. Scott added that it would not even then be approval of tax credits, but potential access to tax credits. Susan agreed that all five contingencies to get the tax credits must be met.

David asked about the degree of specificity of the Cooley rules, which he and Richard Ellis felt were too much for what was appropriate for the rules. They felt the move from statute to rule should be slight, not a big jump. Susan said that there have been changes to make the rules more generalized and less specific to the upcoming deal. She felt that the rules are still very complex, but that the specificity wouldn't be a problem, because what's in there is necessary. She gave the example that if an investor ends up exercising on tax credits and redeeming them, they forfeit future benefit from the fund. Bret asked how an investor would exercise tax credit if the fund is still active. Richard Pugmire helped explain that the fund lives could be as long as 20 years and that a 10 year assessment down the road is usually done. At that point you know the direction the fund is going. Fund 1 has been uncertain because of the debt finance dragging performance.

<u>Authority to Reject UCIC Report</u>

Bret pointed out that negotiations with potential investors over the next few months will reveal more things they will want certainty on. Those things can be brought back to future meetings and addressed. Susan noted that the burden of proof of economic development increment lies with UCIC. The biggest concern has been double counting, so she has added that the board could have authority to adjust the UCIC report given by the corporation. She pointed out that a similar problem exists here as with the economic modeling. How much should they second guess what Bret provides the board? Under what circumstances should changes be made? The Utah Legislature needs assurance that the board is working with good, transparent data to back up their economic increment is being claimed for tax credits. The rules say adjustments or discounts can be made in the case of double counting. Does the board want more authority than that? Cooley suggested a 45-day negotiation period to go back and forth.

Sam felt the rules should leave room for a high degree of flexibility. In the past Bret has brought the report to the board and the board has asked whatever questions they need to. Together everything has been worked out. He felt that this is a good way to look at reports. Bret felt that he and his team have worked to earn the trust of the UCIB and Susan reiterated that the rules will still be in place in future funds with different people involved.

Susan noted that time was running low and Sam summarized a few points. One was that the purpose of the rules is more certainty for investors, which will increase likelihood of participation. Bret added that all parties involved would be protected. The second point is that the rules would make it less likely that tax credits would ever actually be given and that all of the steps and contingencies are now clearly outlined. Third is that the boards have to rely on the advice of outside counsel, including Susan and Cooley. Sam doesn't see the rules as one-sided or in favor of anybody and that it's an effort to make a clear scheme people can follow.

Susan noted that the draft rules have already been submitted to the Tax Commission, and the board is likely to see some additional changes that will be done as comments to the rules, and the board can then address those at a later date. With that, Derek moved that a vote be taken to approve the rules to be posted with the changes discussed in the meeting today. Sam seconded the motion and the board approved unanimously. Several members expressed appreciation for all of Susan's hard work with the rules.

Sam then moved to agenda item VI.

VI. Board Administrative Items

Conflict of Interest

Susan discussed activities that qualify as conflicts that must be disclosed on the Conflict of Interest form. Board members were also reminded not to accept gifts over $50 from someone who is affected by board policy. She asked all board members required to disclose to make sure the form is submitted to the Attorney General's office. Anyone with questions was invited to refer to Susan. Sam then moved to Item IX.

IX. Motion to Adjourn

Sam moved to end the quorum and David seconded, allowing some board members to leave the meeting for other commitments. This adjourned the public portion of the meeting.