

Legislative Analysis



MICHIGAN INNOVATION FUND

Phone: (517) 373-8080
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House Bill 5651 (H-1) as reported from committee
Sponsor: Rep. Greg VanWoerkom

Analysis available at
<http://www.legislature.mi.gov>

House Bill 5652 (H-1) as reported from committee
Sponsor: Rep. Jason Hoskins

House Bill 5653 (H-2) as reported from committee
Sponsor: Rep. Alabas A. Farhat

Committee: Economic Development and Small Business
Complete to 6-26-24

BRIEF SUMMARY: Together, House Bills 5651, 5652, and 5653 would establish the Michigan Innovation Fund, a program that would provide grants to certain venture capital funds and nonprofits to promote venture capital investment. House Bills 5652 and House Bill 5653 would amend the Michigan Early Stage Venture Investment Act and the Michigan Strategic Fund Act, respectively, to create the program and provide for its funding through the Michigan Early Stage Venture Investment Fund (known as the Venture Michigan Fund). House Bill 5651 is a companion bill that would make complementary changes to the Michigan Trust Fund Act.

FISCAL IMPACT: The bills would authorize realized investment returns in investment funds of the Michigan Early State Venture Investment program to be utilized earlier than they otherwise would have been under current law. See *Fiscal Information*, below, for further discussion.

THE APPARENT PROBLEM:

According to committee testimony, entrepreneurship in Michigan is hindered by a lack of access to early-stage capital for startups, and many believe that Michigan is far behind other states when it comes to support for early-stage businesses. Reportedly, very few funds exist that can take the risk on a new business to help it gain traction, so entrepreneurs feel pressured to move elsewhere to start their businesses for better access to capital. Legislation has been proposed to address this funding gap and encourage entrepreneurs to start and grow their businesses in Michigan.

THE CONTENT OF THE BILLS:

House Bill 5652 would amend the Michigan Early Stage Venture Investment Act to extend the Michigan Early Stage Venture Investment program and to require money from the program's investment funds to be deposited into the 21st Century Jobs Trust Fund, which would be used for the Michigan Innovation Fund program that would be established by House Bill 5653.

The Michigan Early Stage Venture Investment Act established the Michigan Early Stage Venture Investment Corporation (MESVIC) and authorized the MESVIC to create a Michigan Early Stage Venture Investment Fund (known as the Venture Michigan Fund, or VMF, which

comprises the Venture Michigan Fund I and the Venture Michigan Fund II) to invest in Michigan startups.

Because of changes made to the act in 2015, the Michigan Early Stage Venture Investment Corporation currently cannot enter into any new agreements with investors, and the Michigan Early Stage Venture Investment Fund is set to expire on January 1, 2030. Upon expiration, subject to any outstanding debts and obligations, \$140.0 million from the fund must be deposited in the general fund, and the remaining money must be deposited in the 21st Century Jobs Trust Fund. Upon the MESVIC's dissolution, the first \$140.0 million of its property must go to the general fund, with the remainder going to the 21st Century Jobs Trust Fund.

House Bill 5652 would instead require the MESVIC board of directors to determine the investment fund's expiration date, which would have to be after January 1, 2030. All money remaining in the fund upon expiration would be deposited into the 21st Century Jobs Trust Fund, and the \$140.0 million allocation to the general fund would no longer apply. Upon dissolution, all of the MESVIC's remaining property would be distributed into the 21st Century Jobs Fund.

If the MESVIC has one or more investment funds with realized earned returns on investments that exceed \$105.0 million as of June 30, 2024, the corporation's board would have to distribute \$105.0 million to the state treasurer for deposit in the 21st Century Jobs Trust Fund. For each following year, if the MESVIC has one or more funds with realized annual returns that exceed \$10.0 million as of June 30 of that year, at least 75% of those returns (as of June 30) would have to be distributed to the state treasurer to be deposited in the 21st Century Jobs Trust Fund.

The bill would also amend the act's requirements for a MESVIC's articles of incorporation to reflect these changes.

MCL 125.2237 et seq.

House Bill 5653 would add a new section to the Michigan Strategic Fund Act to create the "Michigan Innovation Fund" program, which would be administered by the Michigan Strategic Fund (MSF) to provide grants to certain venture capital funds and nonprofits. The bill would also modify the current Venture Capital Investment Program.

Michigan Innovation Fund

The bill would authorize the MSF to create, operate, and spend or invest money for the Michigan Innovation Fund program for the stated public purpose of encouraging economic development and job creation in Michigan. The program would provide grant support for *qualified evergreen venture funds*, *qualified venture capital funds*, *qualified emerging evergreen funds*, and *qualified start-up support services* in Michigan, and grants would have to be awarded to all eligible applicants.

Qualified evergreen venture fund would mean a tax-exempt *qualified higher education institution* or Michigan nonprofit corporation that administers, manages, or operates one or more *evergreen funds*, if at least one of those funds provides early-stage venture capital funding to entities in Michigan, has been actively operating in Michigan for at least three years, has at least four years of experience in making early-

stage venture capital investments and in mentoring start-up companies, and has at least \$15.0 million in deployable capital or investments before January 1, 2024.

Qualified higher education institution would generally mean a state institution of higher education. It would also include a Michigan nonprofit corporation with the word “foundation” in its name that is incorporated under the Nonprofit Corporation Act for the purpose of supporting the objects and purposes of the University of Michigan, Michigan State University, or Wayne State University and for the purpose of assisting in that university’s educational purposes in an exclusively charitable manner,¹ in addition to a Michigan corporation incorporated under the Business Corporation Act for which a state institution of higher education is the only shareholder and whose name includes the words “biosciences” and “research.”²

Evergreen fund would mean either of the following:

- An investment plan or program of a Michigan nonprofit corporation that is exempt from taxation under section 501(c)(6) of the federal Internal Revenue Code.
- An investment fund organized for the purpose of investing in private debt or equity that has limited restrictions on or no provision for investor withdrawal and redemption rights, that operates on an open-end basis without a definitive closing date or fixed end date, and that allows capital to be raised on an ongoing basis and for the reinvestment of returns.

Qualified venture capital fund is defined under the act as a firm principally or primarily engaged in investing or acquiring early-stage businesses with growth potential that have not yet demonstrated consistent profitability or a proven business model, that is managed by two or more individuals with not less than five years of direct experience in venture capital, and that holds capital from investors other than the MSF.

Qualified emerging evergreen fund would mean either of the following:

- A public institution of higher education or a Michigan nonprofit that is exempt from taxation under section 501(c)(3) or 501(c)(6) of the Internal Revenue Code that administers, manages, or operates one or more evergreen funds, if at least one of those funds is organized to provide early-stage venture capital funding to entities within Michigan and has a principal office located in a county with a population of more than 600,000 and less than 700,000.³
- A Michigan nonprofit that administers, manages, or operates one or more evergreen funds, if that nonprofit is organized for the purpose of enhancing the vitality of the communities affected by Michigan’s Upper Peninsula by leveraging local resources with capital and expertise and fostering economic opportunity throughout the area.⁴

¹ This provision appears to reference the Michigan State University Research Foundation.

² This provision appears to reference the Biosciences Research and Commercialization Center at Western Michigan University.

³ This provision would apply to a public institution of higher education or a nonprofit based in Kent County.

⁴ This provision appears to reference InvestUP.

Qualified start-up support services would mean any of the following:

- Activity that supports the growth of the state’s venture capital talent pool and the development of the next generation of venture capital fund leadership in Michigan.
- Activity that supports the creation and growth of Michigan start-up companies or that supports the professional development and growth of their founders.
- Activity that supports the creation, development, and administration in Michigan of one or more designated Regional Technology and Innovation Hubs.⁵

Michigan Innovation Fund grants would be funded through money deposited into the 21st Century Jobs Trust Fund from the Michigan Early Stage Venture Investment Fund (as would be required by HB 5652). For the 2024-25 fiscal year, the MSF would use 80% of the money deposited into the 21st Century Jobs Trust Fund to provide grants to qualified evergreen venture funds for ***eligible activities***, 12% for grants to ***qualified nonprofits*** for qualified start-up support services, and up to 8% for grants to qualified emerging evergreen funds for eligible activities.

Eligible activity would mean an investment through an investment instrument (such as a convertible note, a simple agreement for future equity [SAFE], or an equity investment) in an early-stage start-up company located in Michigan that is engaged in one or more ***competitive edge technologies***, in addition to technical assistance related to such an investment and grants related to the investment or assistance.

Competitive edge technology is defined by the act as life sciences technology; advanced automotive, manufacturing, materials, information, and agricultural processing technology; homeland security and defense technology; alternative energy technology; or any other innovative technology as determined by the MSF board.

Qualified nonprofit would mean a nonprofit corporation that provides programming, technical assistance, or other support to promote the growth and development of the state’s start-up companies and their founders. It would include entities in Michigan that administer, manage, or operate funds that invest in start-up companies in Michigan.

In subsequent fiscal years, 45% would be expended for grants to qualified evergreen venture funds and qualified emerging evergreen funds for eligible activities, 30% would be deposited in the Jobs for Michigan Investment Fund for investment in or alongside qualified venture capital funds through the existing Venture Capital Investment Program, and the remaining 25% would be expended for grants to qualified nonprofits for qualified start-up support services.

The MSF would have to award grants to qualified evergreen venture funds and qualified emerging evergreen funds no later than 182 days after the money is deposited into the 21st Century Jobs Trust Fund. For all grants to those funds in a fiscal year, the total amount of grants provided to funds that invest in multiple industry sectors would have to be at least twice the total amount of grants provided to those that invest in only one sector.

⁵ A list of the first 31 Tech Hubs, designated in October 2023, can be found here: <https://www.eda.gov/funding/programs/regional-technology-and-innovation-hubs/2023>.

Grant agreements

House Bill 5653 would authorize the MSF to enter into grant agreements to ensure that a qualified evergreen venture fund or qualified emerging evergreen fund complies with the bill's requirements. A grant agreement would have to require an award to be committed within ten years after its receipt and could allow up to 10% of the award amount to be used for the recipient's administration of the award and technical assistance related to its investments (such as coaching, mentoring, and programming to support business founders).

Grant agreements would also have to require the recipient to repay 10% of investment returns to the MSF if any investment using grant proceeds results in a return of at least \$50 million within 10 years of the initial grant investment. This money would be deposited into the 21st Century Jobs Trust Fund to be used to award grants to qualified nonprofits for start-up support services.

An agreement could also require a recipient to provide an annual report on its activities.⁶ The report would generally have to summarize all administrative and operational costs incurred, including any professional fees and expenses, and provide a list of investments made with grant award proceeds during the immediately preceding calendar year that includes the following information:⁷

- The name and physical address of the recipient of each investment.
- The date and amount of each investment.
- A description of the type of investment and a description of the industry or economic sector in which the recipient operates.
- An indication of whether the investment is a new investment in the recipient or a follow-on investment.
- An indication of the number of jobs created, retained, or both as a result of the investment.

Venture Capital Investment Program

Currently under the Venture Capital Investment Program, the MSF board can authorize investments in or alongside a qualified venture capital fund that invests primarily in early-stage businesses. The program coordinates with the Michigan Early Stage Venture Investment Fund to ensure that a continuum of venture capital is available in Michigan, and 80% of the funds allocated through the program must focus on competitive edge technologies. To be eligible to receive investments through the Venture Capital Investment Program, a qualified venture capital fund generally must operate a business development office in Michigan that is staffed with at least one full-time employee who is actively seeking opportunities for venture capital investments in Michigan businesses, unless the qualified venture capital fund requests an investment opportunity that is targeted to a specific transaction involving a competitive edge technology that will not occur without the MSF's investment.

House Bill 5653 would specify that the businesses receiving investments must be located in Michigan and would eliminate the competitive edge technology exception. The bill would also remove the provisions requiring the Venture Capital Investment Program to coordinate with

⁶ The MSF would be responsible for prescribing a standard form for the report and publishing it on its website.

⁷ A recipient would not be required to report information that is exempt from disclosure under the Freedom of Information Act (FOIA).

the Michigan Early Stage Venture Investment Fund and designating 80% of the funds for investments in competitive edge technologies.

Additional provisions

The MSF board could authorize money in the Jobs for Michigan Investment Fund from the Michigan Innovation Fund not invested as authorized under the act to be managed by the state treasurer as part of the common cash of the state, if the money is separately accounted for.

The bill would amend other provisions of the act to require money deposited into the 21st Century Jobs Trust Fund to be expended as described above for the Michigan Innovation Fund program, allow the Jobs for Michigan Investment Fund to consist of money deposited under the Michigan Innovation Fund, and remove references to MSF funding for tourism promotion.

MCL 125.2088b et seq. and proposed MCL 125.2088u

House Bill 5651 would amend the Michigan Trust Fund Act to provide for the deposit of money from the Michigan Early Stage Venture Investment Fund (as would be required by HBs 5652 and 5623) into the 21st Century Jobs Trust Fund. Money deposited in the fund from these sources could only be transferred and disbursed for the purpose of the Michigan Innovation Fund program.

MCL 12.257 and 12.258

All three bills are tie-barred together, meaning that none of them can take effect unless all three bills are enacted.

HOUSE COMMITTEE ACTION:

The H-2 substitute reported from the House Economic Development and Small Business committee for HB 5653 allowed qualified emerging evergreen funds in the Grand Rapids area and Upper Peninsula to be eligible for grant funding, reduced the amount of a grant award that could be used for administrative expenses from 20% to 10%, and required 10% of the money from large long-term investment returns to be kept by the MSF for future grants.

FISCAL INFORMATION:

The bills would authorize realized investment returns in investment funds of the Michigan Early State Venture Investment program to be utilized earlier than they otherwise would have been under current law. Current law would not release the funds until January 1, 2030, with \$140.0 million deposited in the general fund and the remainder deposited in the 21st Century Jobs Trust Fund. Available funds would be deposited in the 21st Century Jobs Trust Fund for a newly created Michigan Innovation Fund program that would support evergreen venture funds, venture capital funds, emerging evergreen funds, and qualified support services.

For FY 2023-24, \$105.0 million would be available for deposit into 21st Century Jobs Trust Fund as long as realized earned returns in at least one investment fund exceeded \$105.0 million. It is currently estimated that there are approximately \$125.0 million in realized earned returns, which is sufficient investment returns to allow for this deposit.

In subsequent years, at least 75% of returns of an investment fund could be deposited in the 21st Century Jobs Trust Fund if at least one investment fund has realized earned returns that exceed \$10.0 million. For FY 2024-25 and beyond, it cannot be determined with any certainty how much would be available for deposit in the 21st Century Jobs Trust Fund.

Under the Michigan Innovation Fund program, the 21st Century Jobs Trust Fund may also receive returns from grant proceeds that were used as an investment if the return is \$50.0 million or more within 10 years of the initial investment of the grant proceeds.

Funds deposited in the 21st Century Jobs Trust Fund are subject to appropriation by the legislature for the purposes prescribed in the Michigan Innovation Fund program (described in detail above).

[NOTE: The FY 2024-25 recommended legislative changes to return \$60.0 million of the investment returns early and to be deposited in a Michigan Innovation Fund to support a new Michigan Innovation Fund program that would support young startups in Michigan]

ARGUMENTS:

For:

Supporters argue that the bills would address the lack of a thriving start-up culture in Michigan by providing funding to established organizations that have expertise in venture capital investing. They believe that taking action to develop the state’s venture capital sector would catalyze broader economic development, since those investments would attract additional investment from around the country.

Neutral:

No arguments opposing the bills were presented during committee testimony, but concerns were raised about provisions that would allow only nonprofit fund investors to have access to the first round of funding through the program, since for-profit funds would be excluded despite sharing the goal of supporting Michigan’s startup businesses.

Response:

Supporters of the legislation respond that the high-risk nature of early-stage investments make nonprofit firms the best option to take on that risk, since they can absorb lower returns than a for-profit investor while being able to continue investing. They add that due to Michigan’s lack of early-stage capital, many smaller for-profit firms are currently unable to provide the funding that companies need to scale their businesses.

POSITIONS:

Representatives of the following entities testified in support of the bills (5-14-24):

- Ann Arbor Spark
- Automation Workz
- Clara Technologies
- Invest Detroit
- Michigan Black Business Alliance
- Michigan Venture Capital Association

The following entities indicated support for the bills:

- Alerje, Inc. (5-14-24)
- aLlight Sciences (5-14-24)
- Arcascope (5-14-24)
- Ashling Partners (5-14-24)
- Auricle, Inc. (5-14-24)
- Bioscience Navigators (5-14-24)
- BlueConduit (5-14-24)
- Brightwater Tools (5-14-24)
- Center Electric (5-14-24)
- City of Detroit (5-14-24)
- Cogrounded (5-14-24)
- CubeWorks (5-14-24)
- Decimal Code (5-14-24)
- Detroit Regional Chamber (5-14-24)
- Eberg Capital (5-14-24)
- Economic Development Leaders for Michigan (6-4-24)
- Ecovia Renewables (5-14-24)
- 86 Repairs (5-14-24)
- Farmish (5-14-24)
- Fifth Eye (5-14-24)
- First Ignite (5-14-24)
- Fusion Coolant Systems (5-14-24)
- GreenMark Biomedical (5-14-24)
- Grounded RVs (5-14-24)
- HealthBar (5-14-24)
- Housing North (6-4-24)
- Iaso Therapeutics (5-14-24)
- iReprogram (5-14-24)
- Kall Morris (5-14-24)
- M3D (5-14-24)
- Michigan Central (5-14-24)
- Michigan Regional Council of Carpenters and Millwrights (6-4-24)
- Middle Third (5-14-24)
- MediCool Technologies (5-14-24)
- MemryX (5-14-24)
- Mercury Fund (5-14-24)
- Michigan State University Research Foundation (5-14-24)
- Michigan Translational Research & Commercialization (5-14-24)
- Motion Grazer AI (5-14-24)
- Motivation, Inc. (5-14-24)
- Mountain Pass Solutions (5-14-24)
- Movellus (5-14-24)
- New Enterprise Forum (5-14-24)
- NewHaptics (5-14-24)
- NX Fuels (5-14-24)

- On It Solutions (5-14-24)
- 100k Ideas (5-14-24)
- Opnr (5-14-24)
- Pearl Edison (5-14-24)
- PhotosynQ (5-14-24)
- PlayBooked (5-14-24)
- Poás Bioenergy (5-14-24)
- Quantitative Collectors Group (5-14-24)
- Red Cedar Ventures (5-14-24)
- Refraction AI (5-14-24)
- Ripple Science (5-14-24)
- Spartan Innovations (5-14-24)
- Student Achievement Systems (5-14-24)
- Tandem (5-14-24)
- Taza Aya (5-14-24)
- Tech Stars (5-14-24)
- TechTown Detroit (5-14-24)
- The Patient Company (5-14-24)
- TheraB Medical Products (5-14-24)
- Ulendo Technologies (5-14-24)
- University of Michigan (5-14-24)
- Upkara (5-14-24)
- Venture Catalysts (5-14-24)
- Viewpoint (5-14-24)
- Washtenaw County Commission (6-4-24)
- Western Michigan University (5-14-24)
- Western Michigan University Biosciences Research and Commercialization Center (5-14-24)
- Workit Health (5-14-24)

A representative of Union Heritage testified with a neutral position on the bills. (5-14-24)

The Mackinac Center for Public Policy indicated opposition to the bills. (5-14-24)

Legislative Analyst: Holly Kuhn
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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations and does not constitute an official statement of legislative intent.