

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Governmental Oversight and Accountability Committee

BILL: PCS/SB 1252 (865238)

INTRODUCER: Governmental Oversight and Accountability Committee

SUBJECT: Economic Development

DATE: April 1, 2010

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wilson	Wilson	GO	Pre-meeting
2.			WPSC	
3.			RC	
4.				
5.				
6.				

I. Summary:

The Proposed Committee Substitute authorizes the creation of \$350 million of capital investment for infrastructure projects in the State of Florida. The projects are defined to include major asset or business undertakings in water and wastewater; energy; road, rail, or port transportation; and communications that produce revenue streams to amortize the issuance of debt. It creates a new partnership structure to manage the undertaking, which is under the organizational configuration of the Florida Opportunity Fund, a subsidiary of Enterprise Florida, Inc (EFI).

This bill substantially amends the following sections of the Florida Statutes: ss. 288.9622 and 288.9623.

The bill creates the following sections of the Florida Statutes: ss. 288.9627 and 288.9628.

II. Present Situation:

Enterprise Florida, Inc. (EFI), is a state governmentally chartered not-for-profit corporation created by the 1992 Legislature to foster economic development. The Governor of the State of Florida is the nominal head of the board of directors. Other public and private members of the board are appointed designated by office or appointed by the Governor, President of the Senate, and Speaker of the House of Representatives. IEFI exists as a component of thirteen separate statutory parts of ch. 288, F.S., for commercial development and capital improvements. By law, it acts as the “principal economic development organization for the state” in the recruitment, encouragement, and expansion of existing and new businesses to all of Florida’s communities

and locations.¹ While influenced by its statutory authorization it acts autonomously from state government and its funds are not part of the state treasury.

EFI publishes an annual *Incentives Report*² which catalogues its mandates and performance. Among the areas in which the company has an advocacy or financial presence are:

- Transportation economic development;
- High impact performance incentive;
- Capital investment tax credit;
- Quick action closing fund;
- Innovation incentive program;
- Quick response training;
- Incumbent worker training;
- Semiconductor, space and defense technology;
- Rural incentives;
- Urban incentives;
- Enterprise zone incentives; and,
- Sales tax exemptions and refunds.

The company inherently operates in a collaborative manner and among its governmental peers are the Florida Black Business Investment Board, Inc.; the (Governor's) Office of Tourism, Trade, and Economic Development (OTTED); the Board of Administration (SBA); and eight institutions of higher education classified as research universities and centers of excellence.³ As the State of Florida's principal investment manager, the SBA has a separate focus on state initiatives through its private equity investments and in its recently authorized technology and growth investments.⁴

III. Effect of Proposed Changes:

Section 1. The PCS amends s. 288.9622, F.S., to add later stage venture capital and infrastructure funding to the statement of legislative intent on the authorized purposes of the Florida Opportunity Fund.

Section 2. The PCS amends s. 288.9623, F.S., to identify specific financial instruments and designated structures or participants in a newly created partnership undertaking.

Section 3. The PCS creates s. 288.9627, F.S., to facilitate the creation of the Florida Infrastructure Fund partnership by the Florida Opportunity Fund, itself a unit of EFI. The primary purpose is infrastructure investment in Florida in the areas of transportation, communications, utility and energy services. The Fund acts as the general partner and may receive a loan from the Florida Opportunity Fund in the amount of \$350,000 for initial organizational expenses. The partnership will raise other funds from investors and may allocate

¹ Section 288.9015, F.S.

² Section 288.095(3)(c), F.S.

³ Section 288.906, F.S.

⁴ Section 215.47, F.S.

to such investors up to \$350,000,000 in tax credit certificates from the Department of Revenue. The partnership will invest only in projects authorized by the board with designated investor capital at least twice that provided by the partnership. Investments are subject to seven policy parameters - written investment plan, likely attraction of capital, management, job creation potential, financial resources of investors, reasonable safeguards, and other success factors - and there is an annual financial and operating reporting requirement to the appointing authorities of EFI beginning in December 2010.

There is no pledge of the credit or taxing power of the State of Florida or any political subdivision. Investments that are prohibited under ss. 215.472 and 215.473, F.S., relating to Cuba, Iran and Sudan shall not be accepted by the partnership.

Section 4. The PCS creates s. 288.9628, F.S., which creates a Florida Infrastructure Investment Trust headed by the executive Director of OTTED, the vice chair of EFI, and the chief executive officer of EFI, or their designees. The Trust will issue contemporaneous contingent tax credit certificates with investment capital, not to exceed a maximum value of \$350,000,000. Trust members may not have an interest in any person to whom a tax credit is allocated. Certificates may not be redeemed sooner than twelve years from the time issued. The partnership must allocate the pro rata share of the tax credit available to the designated investor based upon the net capital invested and the market value of the partnership's assets. The designated investor may elect to have a certificate issued or to sell the credits and receive payment from the partnership. Credits that are sold may not exceed seven percent of designated investor's net capital investment and must be redeemed or offset on a tax liability within seven years.

Other Potential Implications:

As discussed, below, there are substantial matters affecting the status of public meetings and records, the regulatory status of the certificates to be issued by the Department of Revenue, and the aggregate funding commitments of the partnership.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

Current law provides that the following information held by the Florida Opportunity Fund or the Institute for the Commercialization of Public Research is confidential and exempt from public records requirements:

- Specified materials relating to methods of manufacture or production, potential trade secrets, or patentable material;
- Information identifying investors or potential investors;
- Information that is confidential and exempt under the laws of another state, the federal government, or another nation;

- Proprietary confidential business information regarding alternative investments for 10 years after the termination of the alternative investment.⁵

Current law also provides a public meetings exemption for any portion of a meeting of the board of directors of the Florida Opportunity Fund or the board of directors of the Institute for the Commercialization of Public Research at which information that is confidential and exempt under the public records exemption is discussed.⁶

Section 24(c), art. I, *State Constitution*, requires new exemptions from public records or public meetings requirements, or expansions of existing requirements, to be created by the Legislature in bills separate from any substantive legislation. The bill's requirement that the Florida Opportunity Fund facilitate the creation of and engage in the management of the Florida Infrastructure Fund Partnership constitutes the creation of a new governmental entity exemption that must be in a separate bill if the expanded confidentiality and exemptions are to attach.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

The bill acts as a means for securing up to \$350 million in private investment capital to be used for venture capital and infrastructure funding. Investors will have this capital locked up for a minimum period of twelve years. The investment is partially secured by the issuance of tax credits payable by the Department of Revenue against any taxes owed by the investor. As a practical matter, these credits operate in much the same fashion as a warrant which entitles the holder to a redemption at a conversion price at a certain time. Warrants are inherently securities, that is, documents that evidence ownership of equity or debt, and may be subject to registration or regulatory compliance under state or federal laws. Caution should be exercised in the use of the term "credits" as these imply dollar-for-dollar equivalency; such credits would have only a fractional value at redemption since they would represent a loss of value from the \$350 million of original investment.

A related tax policy matter presents itself. A more common form of economic organization in Florida has been the professional association and limited partnership, entities that do not pay corporate taxes in the conventional sense. Tax credits received by a designated investor may be used against any taxes owed the state under s. 72.011(1)(a), F.S., including those for which there may have been limited tax liability. For reference purposes those taxes are:

⁵ Section 288.9626(2)(a), F.S.

⁶ Section 288.9626(3)(a), F.S.

Section/Chapter Statute Citation	Tax
125.0104	Tourist development tax
125.0108	Tourist impact tax
198	Estate taxes
199	Intangible personal property taxes
201	Excise tax on documents
202	Communications services tax
203	Gross receipts tax
206	Motor fuel taxes
207	Commercial motor vehicle tax
210	Tax on tobacco products
211	Tax on severance and production of minerals
212	Tax on sales, use and other transactions
213	State revenue laws; general provisions
220	Income tax code
221	Tax on particular income tax payers
379.362(3)	Saltwater products licenses (oysters)
376	Pollutant discharge prevention and removal
403.717	Waste tire and lead-acid battery
403.718	Waste tire fees
403.7185	Lead-acid battery fees
538.09	Registration of second-hand dealers
538.25	Registration of secondary metals recyclers
550	Pari-mutuel wagering
561	Beverage law; administration
562	Beverage law; enforcement
563	Beer
564	Wine
565	Liquor
624	Insurance code
681.117	Motor vehicle sale warranty fees

Several of the above taxes have their proceeds pledged for the issuance of debt. Among these are tourist development taxes and excise taxes on documents. Other taxes, saltwater products, gross receipts, and tobacco, have their proceeds distributed to specific trust funds. Interruption of these revenue streams will have an impact on the funding of the expenditure program to which the revenue source is associated. For example, proceeds of the gross receipts tax are used for the issuance of bonds for public education capital outlay (PECO). Excise taxes on documents also secure the issuance of debt for the purchase of environmentally endangered lands.

The bill uses the term bonds to described the investment vehicle. Bonds come in two forms, revenue and general obligation. The former implies a stream of predictable, *secured* income usually from charges or admissions, the latter based on the overall credit worthiness of the issuer. There are also bond-like securities known as certificates of participation (COP) which confer *unsecured* income rights to the holder as a function of a regular stream of payments. At maturity a COP may pass ownership of the asset to the

public entity. It is unclear from the text of the bill which form will be employed although it is clear that they will be revenue generating instruments. Presumably, they will be customized to the projects at the discretion of the board.

In December 2009, the Division of Bond Finance in the SBA issued its annual report on state debt affordability.⁷ Its concluding statement was:

“There is no debt capacity available over the next three years because the projected benchmark debt ratio exceeds the 7% policy cap. An estimated \$4.8 billion in debt capacity becomes available in 2014 due to a substantial reduction in debt service caused by the retirement of Preservation 2000 bonds.”

It is unlikely that any agency of the State of Florida will be able to participate in this arrangement prior to 2014.

This does not preclude the issuance of debt through the Florida Development Finance Corporation (FDFC) either by the corporation directly or through other governmental entities on whose behalf it customarily acts.⁸ FDFC issues debt on behalf of qualified borrowers which is secured by letters of credit, credit enhancements, or mortgages that protect its security interests. As of June 30, 2009, the FDFC had \$151 million in outstanding debt. It is co-located with EFI in its Orlando headquarters. EFI provides certain administrative services to FDFC for which it received \$30,000 in 2009. FDFC is supported by fees it charges for the issuance of private activity bonds that support a public purpose and it is managed by the staff of EFI.

B. Private Sector Impact:

The investment capital will be secured from private sources. Investors receive, in exchange for the investment, a deductible expense and a partial recovery in the event of loss at the end of the lock-up period. It is possible that the investments will occur in tranches over several time periods and the proceeds themselves may act as multipliers for the issuance of debt. Each issuance will be accompanied by placement fees, which, in the aggregate, are customarily expressed as a percentage of the overall amount.

There are several different levels of fees associated with this arrangement, as follows:

- Initial expenses : \$350,000;
- Aggregate tax credits: \$350,000,000;
- Certificate issuance expenses: up to 25 basis points of aggregate investment capital;
- Bond issuance fees and related underwriting and rating expenses: from 50 to 150 basis points;

⁷ State of Florida, Division of Bond Finance, *2009 Debt Affordability Report*, Tallahassee, FL: December 2009, p. 26.

⁸ Chapter 288, Florida Statutes, Part IX, Capital Development.

- Credit enhancement to investment grade: variable based upon deal structure and revenue streams.

There are a number of other fees, fixed and variable, associated with the issuance of debt and these typically include: bond and tax counsel; escrow agent; title insurance, printing and advertising; environmental and appraisal.

C. Government Sector Impact:

Depending upon the industry sectors to which the funds are allocated, the proceeds of the invested capital could substantially advance any capital projects that comprise a long-range capital investment plan. The definition of infrastructure project in the bill contemplates that the ultimate beneficiaries will be public agencies but they may also be contract vendors acting as instrumentalities on behalf of the public entities. In P3 projects, that is, Public Private Partnerships, a common form of financial transaction in transportation projects, public agencies engage private capital sponsors for the financing and operation of revenue-producing assets.⁹ There are 40 references to such partnerships in the Florida Statutes.

On April 2, 2010 the Revenue Estimating Conference¹⁰ conducted a preliminary estimate on the PCS and concluded that it exposed the State of Florida to contingent tax credits in the amount of \$350,000,000 beginning in 2023.

VI. Technical Deficiencies:

None.

VII. Related Issues:

As noted, above, it may be more appropriate to refer to the “credits” as “certificates” as they have a fractional value only to the extent that there is a loss of principal.

In discussions with the Division of Bond Finance the associated leverage of this capital ranges from a factor of ten to twenty. This means that the multiplier effect could result in a \$3.5 billion to \$7.0 billion in total leveraged capital.

Because this potentially large pool of investable capital is committed for a long duration it will likely attract well-capitalized investors only; as such this fund assumes the attributes of a hedge fund as it additionally is structured as a partnership, the legal form such entities take.

Hedge funds are thinly regulated capital pools and typically are managed through a 2/20 relationship. The general partners take up to two percent of assets as a management fee and up to twenty percent of realized profits. The twenty percent is taxed at long-term capital gain tax rates rather than ordinary income which substantially reduces the federal tax liability to the partners. This proposal is structured so that some of the fee structures provided to the partnership are not

⁹ Section 334.30, F.S.

¹⁰ Section 216.136(3), F.S.

apparent in the bill, although they are usual and customary among hedge fund industry participants. Partnership interests are not registered securities relative to the requirements of the Securities Act of 1933 and their placement is restricted to accredited, high net worth investors. Typically, such partnerships are not registered under the Investment Company Act of 1940. Given the leverage involved in typical hedge fund operations the amount realized from recurring fees grows as scale and the corpus of capital increases.

Hedge funds are permitted to enter into related party transactions in which members of the partnership may trade for their own accounts or the accounts of unnamed others while discharging their nominal duties. FDFC also permits such transactions and discloses their existence in its annual report.¹¹

The bill is structured in such a manner that the operation of the Fund, the newly created Partnership, and the trust certificate issuance process are vertically integrated into an organization nominally headed by the Governor or persons directly employed by the Executive Office of the Governor. The appropriateness of concentrating such decision-making authority in an office actually or functionally responsible for the issuance of large future financial credits should be discussed. This discussion becomes even more important if a subsequent legislature contemplates creating a public records and meetings exemption to shield parts of the investment process and designated investors from public scrutiny.

VIII. Additional Information:

- A. **Committee Substitute – Statement of Substantial Changes:**
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

- B. **Amendments:**

None.

This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.

¹¹ Florida Development Finance Corporation, *Annual Report for the Year Ended June 30, 2009*, Orlando, FL, p.16.