HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1467 CS Capital Formation
SPONSOR(S): Grant and others
TIED BILLS: HB 1469 **IDEN./SIM. BILLS:** SB 2668

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR
1) Economic Development, Trade & Banking Committee	10 Y, 0 N, w/CS	Olmedillo	Carlson
2) Transportation & Economic Development Appropriations Committee	13 Y, 1 N, w/CS	McAuliffe	Gordon
3) Commerce Council			
4)			
5)			

SUMMARY ANALYSIS

This bill creates the Florida Capital Formation Act (Act), which is designed to increase the amount of venture capital investment in Florida by attracting early stage venture capital for emerging companies.

The bill requires Enterprise Florida, Inc. (EFI), to create a wholly owned subsidiary, non-profit, limited liability company known as the Florida Opportunity Fund (Opportunity Fund), which will solicit and invest private capital through an allocation manager. The Opportunity Fund will use $15,000,000 to guarantee private investments of capital in the Opportunity Fund which will be invested in venture capital funds that focus on opportunities in Florida.

The bill appropriates $300,000 in nonrecurring General Revenue to the Economic Development Trust Fund (EDTF) within the Office of Tourism, Trade and Economic Development (OTTED) to cover the startup costs of the Opportunity Fund and the costs of selecting an allocation manager.

The bill transfers $15,000,000 in nonrecurring General Revenue to the EDTF to be used by the Opportunity Fund to guarantee private investments and reasonable and necessary operating expenses.

This bill provides an effective date of July 1, 2006.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. HOUSE PRINCIPLES ANALYSIS:

Limited Government -- The bill creates the Florida Opportunity Fund, provides appropriations for startup activities and investment activities, and requires an annual report.

B. EFFECT OF PROPOSED CHANGES:

Present Situation:

Venture Capital Industry

Venture capital investing is commonly understood as the early-stage financing of new companies with high growth potential. Venture capital investments typically have several characteristics, including an investment in a startup or expansion-oriented company that has a higher level of risk than is typically associated with traditional bank lending activities; equity participation in the business by the venture capitalist; long-term investments with a 5 to10 year time horizon[1]; and an established mechanism for the payout of the venture capitalist at the end of that time period.[2]

Venture capital is money provided by professionals who invest alongside management in young, rapidly growing companies that have the potential to develop into significant economic contributors. Venture capital is an important source of equity for startup companies.[3]

Venture capitalists generally:

- finance new and rapidly growing companies;
- purchase equity securities;
- assist in the development of new products or services;
- add value to the company through active participation;
- take higher risks with the expectation of higher rewards; and
- have a long-term orientation.[4]

Venture capitalists actively work with the company's management by contributing their experience and business savvy gained from helping other companies with similar growth challenges. A venture capitalist may invest before there is a real product or company organized (so called "seed investing"), or may provide capital to a company in its first or second stages of development known as "early stage investing."   Venture capitalists mitigate the risk of venture investing by developing a portfolio of young companies in a single venture fund.

[1] While the initial public offering may be the most glamorous type of exit for the venture capitalists and owners of the company, most successful exits of venture investments occur through a merger or acquisition of the company by either the original founders or another company.
[2] OPPAGA Report on the Cypress Equity Fund, Report No. 98-33. For more information, see the National Venture Capital Association (NVCA) website at http://www.nvca.org/def.html. The NVCA is a trade association that represents the U.S. venture capital industry. It is a member-based organization, which consists of venture capital firms that manage pools of risk equity capital designated to be invested in high growth companies.
[3]Available at the National Venture Capital Association (NVCA) website, http://www.nvca.org/def.html, last visited March 2006.
[4] Id.

State Investments in Venture Capital

Over the past decade, a number of states have adopted programs targeting the formal venture capital industry.[5] Programs fall into five basic categories[6]:

- Direct Investment by state agencies to individual businesses. This type of program may be problematic, because it is difficult to find state agency staff with appropriate expertise.
- Investment by state agencies or pension funds into privately managed funds that have extensive geographical limitations (such as enterprise zone location requirements).
- Investment by state agencies or pension funds into a portfolio of privately managed funds. Investments are made in several private partnerships along with other investors. This model is effective at diversifying risk and helping focus a variety of experienced investors on legitimate capital needs of businesses.
- Private investment spurred by offering state tax credits for qualifying investments such as direct tax credits for investment in qualified businesses and direct tax credits for investment in qualified venture capital funds.
- Private investment spurred by offering contingent state tax credits used as a source of value for guaranty of investment. The tax credits are contingent because they are not claimed unless the venture capital investment fails to meet a guaranteed rate of return.

Venture Capital in Florida

Enterprise Florida, Inc. (EFI) reports that total venture capital spending was more than $555 million for 114 deals in Florida in 2003 and 2004, and that 27 venture capital firms have headquarters in Florida.[7]

EFI also reports that:

> Since the late 1990's, venture capital investment in Florida has fallen sharply both in absolute dollar terms and as a share of the U.S. total. Despite being the 4th most populous state, Florida ranks 13th in the U.S. in terms of venture capital investment in 2004. In 2004 Florida accounted for only $300 million, or 1.42% of the total venture capital funding in the U.S. [8]

To date, Florida has promoted the investment of state funds in venture capital through two programs: the Cypress Equity Fund and the Certified Capital Company Act (CAPCO).

The Cypress Equity Fund [9]

In 1995, the Enterprise Florida Capital Partnership, Inc.,[10] created the Cypress Equity Fund as part of a strategy to help improve Florida businesses' access to venture capital. The Cypress Equity Fund's purpose is to facilitate initial venture capital investments by Florida private financial institutions and institutional investors, and provide a means to encourage national venture capital managers to consider investment opportunities in Florida. This program invests both public and private funds into privately managed venture capital funds.

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[5] EFI reports that 39 states have adopted programs to deliver or facilitate the formation of local seed and venture capital resources. Ibid, p. 3.
[6] Adapted from "Florida Early Stage Venture Capital Proposal: Business Case", EFI.
[7] http://www.eflorida.com/businessadvantages/1/venturecapital.asp?level1=29&level2=159
[8] Page 6, "Florida Early Stage Venture Capital Proposal, Fueling Florida's Next Bright Ideas", EFI.
[9] This summary was taken from the Office of Program Policy Analysis and Government Accountability (OPPAGA) Report on the Cypress Equity Fund, Report No. 98-33.
[10] In 1996, the Legislature replaced Enterprise Florida Capital Partnership, Inc., with the Capital Development Board.

The Cypress Equity Fund was designed as a "fund of funds" to invest in national private venture capital funds that, in turn, invest in companies with high growth potential. However, investments may be made

in venture capital funds located anywhere in the country and therefore are not required to target in-state companies.

The Cypress Equity Fund obtained $35.5 million in commitments from five private financial institutions ($20.5 million) and one public institutional investor, the Florida State Board of Administration (SBA) ($15 million). The Cypress Equity Fund Management Corporation, an entity established by the Capital Development Board, is responsible for overall management of the fund. The corporation, in turn, contracts with a private equity manager to invest fund assets with national venture capital firms.

In its report on the Cypress Equity Fund, the Office of Program Policy Analysis and Government Accountability concluded that the fund has not contributed to the achievement of its more important goal of improving Florida businesses' access to venture capital because its investments were not targeted to in-state companies.

EFI staff reported that the Cypress Equity Fund's net compound annual internal rate of return, since inception, is 22.9 percent. The Cypress Equity Fund is set to expire at the end of 2006.[11]

Certified Capital Companies [12]

The 1998 Florida Legislature enacted the Certified Capital Company Act.[13] This program encourages private investment in venture capital by providing direct tax credits for investment in qualified businesses. The stated purpose of this act is to stimulate a substantial increase in venture capital investments in Florida by providing an incentive for insurance companies to invest in state-certified capital companies (CAPCOs) which will invest in new or expanding businesses. Eligible insurance companies are granted insurance premium tax credits in amounts equal to investments in CAPCOs. The increase in investment capital is intended to contribute to employment growth, create high-paying jobs, and expand or diversify Florida's economy.

To date, the insurance industry has invested $150 million in three state certified CAPCOs. The insurance companies may claim insurance premium tax credits totaling $15 million each year for ten years.[14]

According to information in the most recent annual report on the CAPCO program,[15] there were 47 qualified businesses in which the CAPCOs had invested as of December 31, 2004. Examples of industries represented by the qualified businesses are electronic imaging, medical technology, boat manufacturing, credit card payment processing, vehicle fleet management systems, an internet portal for fishermen, and a cookie manufacturer. Most recent investments include businesses predominantly in the child daycare, landscaping and restaurant industries. The total number of full-time jobs in qualified businesses at the time of the initial investments in the 47 companies was 1,218. The total number of full-time jobs in all qualified businesses as of December 31, 2004, was 1,009.

Effects of Proposed Changes:

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[11] EFI staff, March 3, 2006.
[12] Unless otherwise noted, this summary was taken from Report No. 2005-030, Office of the Auditor General of the State of Florida. The CAPCO program is codified in s. 288.99, F.S.
[13] Codified as s. 288.99, F.S.
[14] Program Two was repealed by ch. 2005-91, L.O.F.
[15] Section 288.99(12), F.S., requires OTTED to report annually on the performance of the CAPCO program. The following Information was compiled from the latest annual report issued in 2004. "Certified Capital Company Act Annual Report on Performance", by the Executive Office of the Governor, Office of Tourism, Trade & Economic Development, June, 2005.

This bill creates s. 288.9621, F.S., the Florida Capital Formation Act (Act), which is designed to increase the amount of venture capital investment in Florida by pooling private investments, guaranteed by state dollars, for use by the Florida Opportunity Fund to make investments in venture capital funds that invest in Florida businesses.

The Florida Opportunity Fund

The directs EFI to organize the Opportunity Fund as a wholly owned, private, not-for-profit, limited liability company. The Opportunity Fund is granted all powers under ch. 608, F.S., which relates to limited liability companies. The Opportunity Fund must select an allocation manager for the raising and investment of capital by the Opportunity Fund who has demonstrated expertise in the successful management of investments in venture capital funds. In selecting a manager, the Opportunity Fund must also consider a candidate's expertise, quality of management, investment philosophy, prior investment fund results, and potential to meet the goals of this act.

Board of Directors

The Opportunity Fund will be governed by a five-member board of directors who have expertise in the area of the selection and supervision of early-stage investment managers or in the fiduciary management of investment funds or other appropriate expertise. The board of directors of the Opportunity Fund will be selected by a five member appointment committee[16] made up of members of EFI's board of directors. In selecting members, the appointment committee must consider a candidate's expertise in the management of investment funds, the selection or supervision of investment managers, or any other relevant expertise. Members of the Opportunity Fund's board of directors must serve terms in accordance with its organizational documents. Vacancies on the board will be filled by appointment by EFI. Members of the board of directors are subject to any restrictions on conflicts of interest specified in the Opportunity Fund's organizational documents, and may not have an interest in the fund manager or in any investments made by the Opportunity Fund. Members of the board will serve without compensation, but may be reimbursed for all reasonable expenses, as determined by the board.

Investments

The Opportunity Fund will seek out and guarantee private investments for use by the Opportunity Fund to invest in seed and early stage venture capital funds focusing on opportunities in Florida. Each private investor will receive a certificate containing the terms of the guarantee of the investment in the Opportunity Fund. While not precluded from investing in funds with a wider geographic spread of portfolio investment, the Opportunity Fund must require an investment fund to have a record of successful investment in Florida, be based in Florida, or have an office in Florida.

The Opportunity Fund must invest in private venture capital funds and may not invest in individual businesses. The Opportunity Fund must invest in venture capital funds with experienced managers or management teams with demonstrated expertise in the investment of venture capital funds. The Opportunity Fund may negotiate any and all terms and conditions for its investments, including claw back of management fees and other provisions that maximize investment in seed and early-stage Florida-based companies. Investments must be made in Florida-based companies in the following industries: life sciences, information technology, advanced manufacturing processes, aviation and aerospace, and homeland security and defense.

The Opportunity Fund may not invest in a venture capital fund unless that fund has raised capital from other sources in an amount equal to or greater than the investment of the Opportunity Fund such that the total invested in Florida-based companies receiving venture capital funds totals at least twice the investment of the Opportunity Fund.

[16] The appointment committee will be selected by the Vice Chair of EFI.

Annual Report

The bill requires the Opportunity Fund to provide an annual report on its activities to the Governor, the President of the Senate, and the Speaker of the House of Representatives. The report shall include the following:

- a copy of the independent audit of the Opportunity Fund;
- a valuation of the assets of the Opportunity Fund;
- a review of the progress of the manager in implementing the Opportunity Fund's investment plan;
- the rate of return;
- the benefits to the state resulting from this program;
- a list of venture capital funds that the Opportunity Fund has invested in; and
- the number of businesses created and their associated industry.

Investment of Funds by State Board of Administration

The bill requires OTTED to account for funds transferred under the Act separately within the Economic Development Trust Fund. OTTED must make all funds available for investment by the State Board of Administration (SBA) or its investment manager. The SBA or its investment manager must invest and reinvest the monies in accordance with s. 215.47, F.S.,[17] and any trust agreement between the SBA and OTTED. SBA may deduct fees and expenses as provided in a trust agreement. Upon the request of OTTED, SBA may release funds to the Opportunity Fund to fund certificate obligations and operational expenses. SBA must also invest and reinvest any funds returned to them by the Opportunity Fund in accordance with s. 215.47, F.S., and any trust agreement.

Appropriations

The bill provides a $300,000 nonrecurring appropriation from the General Revenue Fund for fiscal year 2006-2007 to the EDTF in OTTED to be used for start-up activities necessary to implement this act, including costs associated with the creation of the Opportunity Fund and the selection of a fund manager.

The bill provides a $15,000,000 nonrecurring appropriation from the General Revenue Fund to the EDTF within OTTED for subsequent investment in the Opportunity Fund for use in meeting certificate obligations or for reasonable and necessary operating expenses. Any balance remaining at the end of any fiscal year will be available for carrying out the purposes of this act until July 1, 2020. On that date, $15,000,000 or the balance of unobligated funds remaining, whichever is less, must be returned to the General Revenue Fund and any proceeds in excess of that amount may be retained for continuous reinvestment by the Opportunity Fund. If at any time the Opportunity Fund dissolves, all of its assets, and any funds remaining for the purpose of this act, must revert to the General Revenue Fund.

C. SECTION DIRECTORY:

Section 1. Creates Part X of chapter 288, consisting of s. 288.9621, F.S., relating to the Capital Formation Act.

Section 2. Provides an appropriation of $300,000 for startup costs, and $15,000,000 to the EDTF for use by the Florida Opportunity Fund to guarantee private investments in the Opportunity Fund and to cover reasonable and necessary operating expenses.

[17] Section 215.47, F.S., provides that monies invested in trust funds may be invested in certain ways, for example - in bonds, savings accounts, CDs, etc.

Section 4. Provides an effective date of July 1, 2006.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   The bill provides a $300,000 nonrecurring appropriation from the General Revenue Fund for fiscal year 2006-2007 to the EDTF in OTTED to be used for start-up activities necessary to implement this act, including costs associated with the creation of the Opportunity Fund and the selection of a fund manager.

   The bill provides a $15,000,000 nonrecurring appropriation from the General Revenue Fund to the EDTF within OTTED for subsequent investment in the Opportunity Fund for use in meeting certificate obligations or for reasonable and necessary operating expenses.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill should have a net positive impact on the amount of venture capital investment in Florida businesses.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   The bill does not require a municipality or county to spend funds or to take any action requiring the expenditure of funds, does not reduce the county's authority to raise revenue, and does not reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

   None.

B. RULE-MAKING AUTHORITY:

None.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES

On March 30, 2006, the Economic Development, Trade and Banking Committee adopted two amendments that remove the public records exemption and clarifies that the intent of the bill is to invest in Florida entities.

On April 17, 2006, the Transportation and Economic Development Appropriations Committee adopted a strike-all amendment to the bill. The amendment:

- Requires EFI to create the Florida Opportunity Fund which will seek out and invest private capital in venture capital funds focusing on opportunities in Florida;
- Provides provisions relating to the Opportunity Fund's board of directors and its powers and duties;
- Requires SBA to invest monies received by the Opportunity Fund;
- Requires an annual report;
- Provides a $300,000 appropriation for startup costs of the Opportunity Fund; and
- Provides for a $15,000,000 appropriation to use by the Opportunity Fund to guarantee private investments and for reasonable and necessary operating expenses.