The Florida Senate

PROFESSIONAL STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

Prepared By: Transportation and Economic Development Committee

BILL: CS/CS/CS/CS/SB 2420

INTRODUCER: Transportation & Economic Development Committee, Finance and Tax Committee, Governmental Operations Committee, Commerce Committee and Senator Ring

SUBJECT: Venture Capital Investments

DATE: April 24, 2007 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Pugh	Cooper	CM	**Fav/CS**
2.	Rhea	Wilson	GO	**Fav/CS**
3.	Keating	Johansen	FT	**Fav/CS**
4.	Noble	Noble	TA	**Fav/CS**
5.				
6.				

I. Summary:

CS/CS/CS/CS/SB 2420 takes a comprehensive approach to promoting venture capital investment in Florida. It provides grants to state universities to finance early-stage, pre-marketing activities geared to commercializing university research products. It also creates a university-based institute to mentor emerging businesses and to match them up with potential private investors. Finally, it appropriates state monies for targeted investments in funds that assist Florida companies with a potential for high-tech, high-wage jobs.

Specifically, the CS creates:

- the State University Research Commercialization Assistance Grant Program (program) to finance the commercialization of products and services developed from the research and development conducted at Florida's public universities. The program is to be administered by the Florida Technology, Research, and Scholarship Board, an advisory group to the Board of Governors of the State University System (BOG) for the Centers of Excellence and world class scholars programs. The grant program will be financed with a $10 million appropriation of non-recurring general revenue in fiscal year 2007-2008.
- the Institute for Commercialization of Public Research (institute), operated by a public Florida university and located within a south Florida metropolitan area with extensive commercial air service, will mentor companies and showcase their products and services for private venture capital investors. From non-recurring general revenue, the institute

will be appropriated $900,000 and Enterprise Florida Inc. (EFI) will receive $100,000 to initiate the program's activities.
- the Florida Opportunity Fund (fund) will invest, in a fund of funds approach, in seed and early stage venture capital funds with a focus on Florida-based companies. The Legislature will appropriate $29.5 million for use as investments and $500,000 shall be appropriated to pay costs associated with initiating the fund's activities. The appropriations will be non-recurring general revenue.

This committee substitute creates ss. 288.9621, 288.9622, 288.9623, 288.9624, and 288.9625 of the Florida Statutes, and amends s. 1004.226, F.S.

II. Present Situation:

The Venture Capital Industry[1]
"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.

Venture capital investments typically have several characteristics, including an investment in a start-up 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; and an established mechanism for the payout to the venture capitalist at the end of that time period.

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.

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, known as "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 their risks by developing a portfolio of young companies into a single venture fund.

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

[1] The primary source for information in this section is the National Venture Capital Association website, available at http://www.nvca.org/def.html . Last visited March 11, 2007.

- 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. Programs include: 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 in Florida, total venture capital spending was more than $555 million for 114 deals in 2003 and 2004, and that 27 venture capital firms have headquarters in Florida.

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 fourth-most populous state, Florida ranked 13th in the U.S. in terms of venture capital investment in 2004. In 2004 Florida accounted for only $300 million, or 1.42 percent of the total venture capital funding in the U.S.

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
In 1995, the Enterprise Florida Capital Partnership, Inc., 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.

The Cypress Equity Fund is designed as a "fund of funds" to invest in national private venture capital funds that, in turn, would 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 began with a total of $35.5 million in commitments: $20.5 million from five private financial institutions, and $15 million from the Florida State Board of Administration. 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 a 1998 report on the Cypress Equity Fund, OPPAGA concluded that the fund has not contributed to achieving the goal of improving Florida businesses' access to venture capital because its investments were not targeted to in-state companies.[2]

As of Dec. 31, 2006, the Cypress Equity Fund portfolio is valued at $10.3 million. Since the program's inception, distributions and realized gains to investors have totaled $49.5 million, and the net compound internal rate of return is 22.5 percent.[3]

CAPCO

The 1998 Florida Legislature enacted the Certified Capital Company Act. 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, in turn, 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.

A 2005 review of the CAPCO program by the Governor's Office of Tourism, Trade and Economic Development (OTTED) indicated that $3 million was invested in 12 new investee companies, ranging from a business that specializes in transportation of construction materials, to child-care centers, to pool and spa installation.[4] Another $1.8 million was invested in existing companies. As of December 31, 2005, a total of $153.4 million has been made available to the 59 investee companies, which have created 1,028 jobs.

While as many as nine states have created CAPCOs, this type of program is increasingly viewed as the more "problematic" of the Venture Capital Funds (VCF) programs, in terms of:

> "...its high cost, poor design and target inefficiency. Unlike any other VCF program, the CAPCO program provides a 100% premium tax credit to insurance company investors. In effect, the government underwrites the entire investment risk."[5]

Other Models for Public Investment in Economic Development

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[2] "Review of The Enterprise Florida, Inc. Capital Development Board's Cypress Equity Fund," Report No. 98-33. Available at http://www.oppaga.state.fl.us/monitor/reports/pdf/9832rpt.pdf

[3] Letter from Abbott Capital to Enterprise Florida, Inc., dated Feb. 15, 2007. On file with the Commerce Committee.

[4] "Certified Capital Company Act" (CAPCO) Annual Report, January 1-December 30, 2005. Prepared by OTTED. Copy on file with the Commerce Committee.

[5] Daniel Sandler, Professor at the Faculty of Law, The University of Western Ontario, London; senior research fellow of the Taxation Law and Policy Research Institute, Melbourne; and associated with Minden Gross Grafstein & Greenstein LLP, Toronto. See Daniel Sandler, *Venture Capital and Tax Incentives: A Comparative Study of Canada and the United States* (Toronto: Canadian Tax Foundation, 2004) ("Sandler VC Study").

Florida statutes include a variety of state subsidies, tax credits, and tax exemptions targeted for economic development. Most are distributed or administered by OTTED or the Department of Revenue (DOR). However, in some cases the Legislature has established an alternative mechanism for specific purposes. Recent examples include the Innovation Incentive Program, Centers of Excellence, and Scripps Funding Corporation. Briefly:

- Ch. 2006-55, L.O.F., created the Innovation Incentive Program. The purpose of the program is to provide resources for significant economic development projects, including the location or expansion of research and development entities and innovation businesses in Florida. The law appropriated $200 million for the program for FY 2006-2007. These funds were placed in reserve by the Executive Office of the Governor. Unexpended funds for FY 2006-2007 are subject to annual appropriation.

  Section 288.1089, F.S., requires Enterprise Florida, Inc. (EFI), to evaluate applications for innovation incentive funds and to recommend eligible businesses to OTTED. Next, OTTED must certify the applicants as qualified businesses, and then recommend qualified businesses to the Governor for approval. The Governor is required to consult with the Legislature and receive approval prior to releasing innovation incentive funds to qualified businesses.

  Two recent recipients of funding under this program are the Burnham Institute (Burnham) for Medical Research and the Torrey Pines (Torrey Pines) Institute for Molecular Studies.[6] Burnham in August 2006 announced plans to open a research facility in Orlando, and has received $155 million in state innovation incentive funds.[7] Torrey Pines in September 2006 announced plans to expand its research operations to the city of Port St. Lucie, and has received $32 million in state innovation incentive funds.[8]

- Ch. 2006-58, L.O.F., created the Centers of Excellence Program, which is designed to foster and promote the research required to develop commercially-promising, advanced, and innovative science and technology and to transfer those discoveries to commercial sectors. The law established the Florida Technology, Research, and Scholarship Board within the Board of Governors of the State University System to recommend to the Board of Governors methods for implementing and administering the Centers of Excellence Program. The Board of Governors was authorized to select the Centers and disburse the $30 million appropriated for this purpose.

  In November 2006, the Board of Governors disbursed the entire amount to five universities to advance various research projects: Florida Atlantic University, Florida State University, the University of Central Florida, the University of Florida (which received two separate grants), and the University of South Florida.

[6] "Florida Has Implemented Promising Biotechnology Initiatives, But Faces Challenges," Report No. 06-71, by the Florida Office of Program Policy Analysis & Government Accountability. Published November 2006. Available at http://www.oppaga.state.fl.us/reports.
[7] Ibid.
[8] Ibid.

- During Special Session E in 2003, the Legislature provided for the creation of the Scripps Florida Funding Corporation (corporation), which is responsible for contracting with The Scripps Research Institute (TSRI) to establish a state-of-the-art biomedical research institute and campus in this state. The funding for the contract is provided by $310 million of the $543.5 million in federal economic stimulus funds provided to Florida under the Jobs and Growth Tax Reconciliation Act of 2003.

  OTTED was the initial recipient of the $310 million appropriation. OTTED disbursed the funds to the corporation pursuant to a funding agreement. The purpose of the corporation was to receive a lump-sum payment of $310 million guaranteeing that a funding source will be available for period disbursements to TSRI's Florida operation over a seven-year period. Undisbursed funds held by the funding corporation have been invested by the State Board of Administration. The law stipulated that undisbursed funds revert back to the General Revenue Fund only if the contract between the funding corporation and TSRI is terminated. To date, scheduled annual disbursements have been made to TSRI, pursuant to their contract with the corporation.

These three programs have the potential to improve state universities' role in technology transfer, a process through which an entity that develops a new technology, but does not have the wherewithal or desire to bring it to market, transfers that raw technology to another entity that has the ability to commercialize it. A 2001 report by the Senate Commerce and Economic Opportunities Committee noted that university-to-industry technology transfers can be a key factor in building a high-skill, high-wage state economy. However, the report concluded that, by 2002, Florida universities, in general, did not appear to be performing as many technology transfers as their peer universities.

The report identified the importance of university-to-business transfers, reviewed the statutory and regulatory framework for technology-transfer activities, and identified the impediments to successful university-to-industry collaboration. One of the missing "inputs required to fuel the technology-transfer process" are commercialization resources, including pre-venture "seed" funding, sound business guidance, and administrative support.

III. Effect of Proposed Changes:

CS/CS/CS/CS/SB 2420 creates a broad spectrum of state venture-capital investments, and funds them with $41 million of non-recurring general revenue in FY 2007-208.

Section 1 amends s. 1004.226, F.S., to create the **State University Research Commercialization Assistance Grant Program**. The program is designed to provide financing for the commercialization of products and services developed from the research and development conducted at Florida public universities. A university may apply for funds to be used for a variety of pre-marketing activities, including, but not limited to, securing patents, establishing start-up companies, developing license agreements, attracting private investment, and supporting other activities that are necessary to establish commercially viable ventures for the marketing and sale of products resulting from university research.

The grant program will be administered by the Florida Technology, Research, and Scholarship Board, which was created by chapter 2006-58, L.O.F. This 11-member board, which is advisory to the Board of Governors of the University System (BOG) for the Centers of Excellence and world class scholars programs, will make the grant awards and agreements for this program, with administrative support from the BOG. The Florida Technology, Research, and Scholarship Board is representative of business leaders, industrial researchers, academic researchers, scientists and leaders in the emerging and advanced technology sector.

The CS encourages the board to work with EFI and other entities with experience in early business development. It also prohibits the board from taking an interest in, or benefiting from, any project receiving a state grant under this program, and creates penalties for board members who violate this provision.

Grants under the State University Research Commercialization Assistance Grant Program may be provided under the following categories:

- Phase One grants, which may not exceed $50,000 per project, may be used to assist with early market research, independent evaluation, consultation, and other initial activities that may be required to develop an initial business model for a university research product having the potential for commercialization.
- Phase Two grants, which may not exceed $100,000 per project, may be used to match private investment in a university research commercialization proposal. Phase Two grants must be used to develop a complete business plan for the commercialization of a university research product. For a Phase Two grant proposal, the university must document the availability of $1 in private support for each $1 in state funding requested.
- Phase Three grants, which may not exceed $250,000 per project, may be used to match private investment relating to the implementation of a completed business plan for a university research product. For a Phase Three grant proposal, the university must document the availability of $1 in private support for each $1 in state funding requested.

Subject to the availability of funds, the board must periodically solicit specific proposals from universities for grants. When evaluating the projects submitted for funding the board must consider the following criteria:

- The potential return to the university which may be reasonably assumed based on the business case presented in support of the proposed project;
- The potential for the creation of high-wage jobs resulting from the success of the proposed project;
- The potential of the proposed project to address a pressing needs of the residents of the state;
- The potential of the proposed project to enhance the economic competitiveness of the state and the university;
- The technical, financial, organizational, and marketing feasibility of the project and its business plan; and
- The potential of the proposed project to create other related business enterprises.

Each proposed project must be evaluated on its individual merits. The board will execute contracts with state universities' whose projects have been accepted for grants. The contracts must, at a minimum:

- Specify procedures and schedules governing the disbursement of the grant funds;
- Require each university to submit a business plan;
- Require each university to submit data on the performance of the project that received grant funding;
- Require the university to negotiate repayment to the state General Revenue Fund of the grant funds once the project becomes financially sustainable; and
- Require the university to spend 95 percent of grant proceeds for the uses in the grant application, and not reduce grant proceeds by deducting facilities charges.

As part of its existing annual report, the board must include the number and value of university research commercialization grants awarded and repaid.

Section 2 creates the **Institute for Commercialization of Public Research, Inc.**, in section 288.9625, F.S., The institute will be a not-for-profit corporation registered, incorporated, and operated in accordance with ch. 617, F.S., and provides for many of the same requirements for this institute that are required of the Institute for Human and Machine Cognition, Inc.

The CS provides that the institute be operated by a Florida public university and that the institute be located in southern Florida in a major metropolitan area with extensive commercial air service. The actual site will be selected by the EFI Board of Directors after review of proposals submitted by interested public Florida universities.

The institute's purpose is to assist in the commercialization of products developed by the research and development activities of publicly supported universities and colleges, research institutes, and other publicly supported organizations within the state. The institute must support existing commercialization efforts at Florida universities. It may not supplant, replace, or direct existing technology transfer operations or other commercialization programs, including incubators and accelerators.

To be eligible for assistance, the company or organization attempting to commercialize its product must be accepted by the institute before receiving the institute's assistance. The institute shall receive recommendations from any publicly supported organization for any company that is commercializing the research, technology, or patents from a qualifying publicly supported organization. The institute reviews the business plans and technology information of each such recommended company, before making its decision whether to accept it.

For each company that is accepted, the institute shall provide mentoring, develop marketing information, and use its resources to attract capital investment into the company. The institute's other duties are to:

- Maintain a centralized location to showcase companies and their technologies and products;

- Develop an efficient process to inventory and publicize companies and products that have been accepted by the institute for commercialization;
- Routinely communicate with private investors and venture capital organizations regarding the investment opportunities in its showcased companies;
- Facilitate meetings between prospective investors and eligible organizations in the institute;
- Hire full-time staff who understand relevant technologies needed to market companies to the angel investors and venture capital investment community;
- Operate within an allocated annual budget of $1 million or less; and
- Develop cooperative relationships with publicly supported organizations all of which work together to provide resources or special knowledge that is likely to be helpful to institute companies.

The institute is prohibited from developing or accruing any ownership, royalty, or other such rights over, or interest in, companies or products in the institute and shall maintain the secrecy of proprietary information. It also may not charge for services rendered to state universities and affiliated organizations, community colleges, or state agencies.

The institute's board must submit a report each December 1 to the Governor, the President of the Senate, the Speaker of the House of Representatives, EFI, and the president of the university under whose aegis the institute is placed. The report shall include, at a minimum:

- Any assistance and activities provided to assist publicly supported universities, colleges, research institutes, and other publicly supported organizations in the state, by institute;
- A description of the benefits to this state resulting from the institute, including the number of businesses created, associated industries started, the number of jobs created, and the growth of related projects; and
- Independently audited financial statements, including statements that show receipts and expenditures during the preceding fiscal year for personnel, administration, and operational costs of the institute.

<u>Section 3</u> creates the **Florida Capital Formation Act** in ss. 288.9621, 288.9622, 288.9623, and 288.9624. The intent of the act is to mobilize venture equity capital for investment in emerging companies, which have the potential for jobs, high growth-potential technologies, products, or services that will further diversify Florida's economy.

The CS creates the Florida Opportunity Fund as a private, not-for-profit corporation organized and operated under ch. 617, F.S., with EFI as its sole shareholder or member. The fund is expressly found not to be a public corporation or instrumentality of the state. The fund must manage its business affairs and conduct business consistently with its organizational documents and the purposes set forth in the section. The corporation is not authorized to amend, modify, or repeal a bylaw or article of incorporation without the express written consent of EFI.

EFI's vice-chair is directed to select an appointment committee of five members of EFI's board of directors. The appointment committee must select the five initial board members for the fund. Members must include persons who have expertise in the area of the selection and supervision of early stage investment managers or in the fiduciary management of investment funds, and have other areas of expertise as considered appropriate by the appointment committee.

After selection of the initial board members, vacancies on the board must be filled by vote of the board of EFI. Fund board members are subject to any restrictions on conflicts of interest specified in the organizational documents and may not have an interest in any venture capital investment selected by the fund under ss. 288.9621-288.9624, F.S. Further, members serve without compensation though they may be reimbursed for all reasonable, necessary, and actual expenses as determined and approved by the board, pursuant to s. 112.061, F.S.

Upon organization, the board is required to conduct a national solicitation for investment plan proposals from qualified venture capital investment managers for the raising and investing of capital by the Florida Opportunity Fund. Any proposed investment plan must address the applicant’s level of experience, quality of management, investment philosophy and process, provability of success in fundraising, prior investment fund results, and plan for achieving the purposes of the act. The board is authorized to select only those venture capital investment managers who have demonstrated expertise in management of and investment in companies.

The CS permits the fund to invest only in seed and early stage venture capital funds that have experienced managers or management teams with demonstrated experience, expertise, and a successful history in the investment of venture capital funds. Such investments must focus on investment opportunities in Florida, in companies that include, but are not limited to, enterprises in life sciences, information technology, advanced manufacturing processes, aviation and aerospace technologies, and homeland security and defense.

Further, the fund is authorized to invest only in funds that have raised capital from other sources so that the amount invested in an entity in this state is at least twice the amount invested by the fund.

The fund is not authorized to make direct investments in individual businesses.

By December 1 of each year, the board is required to issue a report to the Governor, the Senate President, and the Speaker of the House of Representatives concerning the fund’s activities. The report must include:

- An accounting of the amount of investments disbursed by the fund;
- A description of the benefits to Florida resulting from the fund, including the number of businesses and jobs created; and
- Independently audited financial statements.

Section 4 appropriates the nonrecurring sum of $30 million from general revenue to EFI for the Florida Opportunity Fund for FY 2007-2008. Of those funds, $29.5 million will be used for investments and $500,000 to initiate the fund’s activities.

Section 5 appropriates the nonrecurring sum of $10 million in general revenue to the BOG for the University Research Commercialization Assistance Grant Program to fund the grants created in this CS. The funds will be disbursed by the BOG pursuant to grant agreements and contracts by the Florida Technology, Research, and Scholarship Board.

Section 6 appropriates the nonrecurring sum of $100,000 to Enterprise Florida, Inc., and the nonrecurring sum of $900,000 from the General Revenue Fund to the Institute for the Commercialization of Public Research to finance activities necessary to implement their responsibilities in FY 2007-2008.

Section 7 directs the Office of Program Policy Analysis and Government Accountability (OPPAGA) to conduct an interim review and evaluation of the Capital Formation Act, prior to the 2012 legislative session. OPPAGA is specifically directed to revaluate the state's total investment under the program, private-sector investment, the rate of return, creation of new businesses and jobs, any debt incurred, and the industries impacted. It also must recommend outcome measures to further evaluate the program. The report is due to the Governor, the President of the Senate, and the Speaker of the House of Representative no later than January 1, 2012.

Section 8 provides an effective date of July 1, 2007.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

If the intent of the CS is to stimulate greater economic activity in Florida is realized, then the private sector will benefit from the creation of high-wage jobs and a diverse economy.

The board members of the Institute for the Commercialization of Public Research and the Florida Opportunity Fund are prohibited from receiving compensation; however, they are authorized to receive compensation for travel and per diem expenses as provided in s. 112.061, F.S

The Institute for the Commercialization of Public Research, a not-for-profit corporation, is appropriated a nonrecurring sum of $900,000 from the General Revenue Fund for the purpose of initiating activities necessary to implement its responsibilities under this act for fiscal year 2007-2008.

C. Government Sector Impact:

A total of $41 million nonrecurring general revenue is appropriated under this CS. Of that amount, $40.1 million is appropriated to government entities:

- $30 million to EFI for the Florida Opportunity Fund, of which $29.5 million is for investments and $500,000 to pay the fund's costs to initiate its duties.
- $10 million to the BOG for the university research grants; and
- $100,000 to EFI to help with the startup activities for the institute.

VI. Technical Deficiencies:

None.

VII. Related Issues:

The CS requires that the institute be located in the southern part of the state in a large metropolitan area with extensive commercial air services. Geographical specificity regarding where "south" Florida ends and "central" Florida begins is not made expressly in the bill.

VIII. Summary of Amendments:

None.