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 Finance and Tax Committee

BILL: CS/SB 2310

INTRODUCER: Governmental Operations Committee and Senators Ring and Diaz de la Portilla

SUBJECT: Stimulating the Economy

DATE: March 28, 2008 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Pugh	Cooper	CM	**Fav/1 amendment**
2.	Wilson	Wilson	GO	**Fav/CS**
3.	ODonnell	Johansen	FT	**Favorable**
4.			GA	
5.				
6.				

Please see Section VIII. for Additional Information:

A. COMMITTEE SUBSTITUTE..... [x] Statement of Substantial Changes

B. AMENDMENTS........................ [ ] Technical amendments were recommended

[ ] Amendments were recommended

[ ] Significant amendments were recommended

I. Summary:

SB 2310 directs the State Board of Administration to invest a maximum 1.5 percent of the net asset value of the Florida Retirement System Trust Fund in technology and growth investments, as defined.

The bill also creates a $40 million prize ($20 million contributed by the state) to encourage the invention of a reusable space vehicle that could be used to replace the Space Shuttle.

The bill amends ss. 215.44 and 215.47, Florida Statutes, and creates an unspecified section of Florida law.

II. Present Situation:

Background on the State Board of Administration

The State Board of Administration (SBA) is created in Art. IV, s. 4 (e) of the State Constitution. Its members are the Governor, the Chief Financial Officer, and the Attorney General. The board derives its powers to oversee state funds from Art. XII, s. 9 of the State Constitution.

The SBA has responsibility for oversight of the Florida Retirement System (FRS) Pension Plan and the FRS Investment Plan, which represent approximately $140 billion, or 76 percent, of the $184 billion in assets managed by the SBA[1] as of June 30, 2007. The Pension Plan is a defined benefit plan and the Investment Plan is a defined contribution plan that employees choose in lieu of the Pension Plan. The SBA also manages 33 other investment portfolios, with combined assets of $44 billion, including the Florida Hurricane Catastrophe Fund (CAT Fund), the Florida Lottery Fund, the Florida Pre-Paid College Plan, and various debt-service accounts for state bond issues.

Investment decisions for the pension plan and several of the other funds are made by investment managers hired for those purposes by the SBA and their recommendations are reviewed by the SBA and its staff. By statute, the State of Florida has adopted federal fiduciary standards for management of the FRS and the other funds. The Employee Retirement Income Security Act of 1974 (ERISA) is regulated by the U.S. Department of the Treasury and is the Florida standard for management of public funds.[2] The SBA trustees and all fiduciaries who manage Florida funds are bound by law to follow the standards established in ERISA, even though government-sponsored plans are not required by federal law to adhere to its provisions. The SBA investment managers also are contractually bound to follow all federal and state laws in performance of their services to the state.

The Florida Retirement System (FRS) Pension Plan
The FRS Pension Plan is the leading pension fund in the nation, according to a February 2007 ranking by Standard & Poor's rating service; the ranking is based on the fact that Florida's fund has the highest funded ratio of any U.S. public pension fund, at 107.3 percent.[3] The national average is 81.8 percent. Florida's funded ratio means not only is the pension plan fully funded, but that it has more assets than liabilities. Plan assets are broadly diversified across and within 7 public- and private-market asset classes. Maintaining solid performance from the plan's investments is crucial because 71.7 percent of the source of retirement plan benefits comes from investment earnings, and only 28.3 percent from employer contributions (which are tax dollars).[4]

The Florida Retirement System (FRS) was created December 1, 1970, with consolidation of the Teachers' Retirement System, the State and County Officers and Employees' Retirement System, and the Highway Patrol Pension Fund. In 1972, the Judicial Retirement System was also consolidated with the FRS. The system was created to provide a program offering retirement, disability, and survivor benefits for participating public employees.

Among the SBA's statutory provisions is s. 215.47, F. S., which creates the "legal list" of authorized investments and their limits, in which the SBA is authorized to invest. Section 215.475, F.S., provides that the SBA must have an Investment Policy Statement[5] for the FRS, approved by the trustees, to govern the authorized investments and their objectives, as well as the evaluation criteria to be used to measure the performance of the investments. The SBA

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[1] State Board of Investment "Investment Report 2006-2007." Published November 30, 2007. Retrievable at http://www.sbafla.com/pdf/investment/annual/2007/AIR.pdf. Last visited March 13, 2008.
[2] Section 112.63(f), F.S.
[3] SBA Investment Report 2006-2007.
[4] Ibid.
[5] Retrievable at http://www.sbafla.com/pdf/funds/2007-06%20FRS%20TFIP%20Final.pdf. Last visited March 13, 2008.

does not have a plan for specifically investing in "economically targeted investments," or ETIs[6], but does consider investment opportunities that meet the investment goals and objectives as outlined in the policy statement.

According to SBA staff, if an ETI was presented for review, it could be selected based on the SBA authorizations under the statutory legal list, compliance with the fiduciary standards of care as provided in s. 215.47(9), F.S., and the guidelines of the Investment Policy Statement.[7]

The SBA analysis indicates that the pension plan has holdings in assets that meet a general definition of ETIs. For example, the SBA has $645 million in assets invested either directly or through joint ventures in Florida real estate holdings. These include apartments in three communities, four office properties, ten community shopping centers, four industrial properties, and three senior housing properties. Also, one focus of the SBA's private equity asset class of investments is venture capital. As of Sept. 30, 2007, the SBA's private equity portfolio had $157.3 million invested in 45 Florida companies located in 23 Florida cities.[8]

Economically targeted investments (ETIs)[9]

Section 404 of the federal Employment Retirement Income Security Act (ERISA) defines a fund manager's fiduciary duties and clearly states that pension funds must be managed "for the exclusive purpose of (1) providing benefits to participants and their beneficiaries; and (2) defraying reasonable expenses of administering the plan."[10] Within the last 20 years, the concept that investments, particularly in public-sector pension funds, could not only be fiduciarily sound but also perform a social good has come into vogue. In 1994, then-U.S. Labor Secretary Robert Reich issued guidance allowing pension fund managers to consider ETIs in their investment strategies.

Many general definitions of ETIs exist. The U.S. General Accounting Office (GAO) has defined ETIs in the following way:

> "ETIs are generally defined as investments selected for the economic benefits that they create for the public in addition to the investment return to plan participants. Investments in, for example, community development and infrastructure projects may create benefits such as construction of affordable housing, job creation or retention, or sales and tax revenue generation."[11]

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[6] The CS/SB 2310 changes the nomenclature from "economically targeted investments" to "growth and technology investments." However, the analysis uses the more common reference to "ETI" where appropriate.

[7] Analysis of SB 2310 by the State Board of Administration, dated March 4, 2008. On file with the Senate Commerce Committee.

[8] Information provided by SBA staff and on file with the Senate Commerce Committee.

[9] The Employee Retirement Income Security Act of 1974 (ERISA) is a federal law that sets minimum standards for most voluntarily established pension and health plans in private industry to provide protection for individuals in these plans. It is found in several sections of the U.S. Code and in the Internal Revenue Code. A basic site to retrieve information about ERISA is http://www.dol.gov/dol/topic/health-plans/erisa.htms. Last visited March 13, 2008.

[10] 29 U.S.C. sec. 1104(1)(a).

[11] GAO letter to Rep. Jim Sexton , chairman of the Joint Economic Committee of Congress, dated Feb. 27, 1998. Retrievable at http://archive.gao.gov/paprpdf1/159979.pdf. Last visited March 13, 2008.

A 1995 GAO report on ETIs noted that in a survey of the 139 largest public pension plans, 50 of the 119 respondents indicated "that they had invested a total of $19.8 billion (or 2.4 percent of all respondents' assets) in ETIs to promote housing, real estate, or small business development. Of this amount, about $3.2 billion was invested in ETIs to promote business development."[12]

A 2002 survey indicated that 31 states included ETIs as part of their investment strategies. The California Public Employees Retirement System (CALPERS) is the nation's largest public pension fund with $253 billion in assets, as of December 31, 2007.[13] CALPERS' investment in ETI-type private equity was as high as 17 percent in 2002, and the investments range from real estate to environmental projects to emerging California businesses. Another state, Washington, has invested more than $1.4 billion of its $85.4 billion state investment fund in Washington-based real-estate ventures or companies seeking private equity.[14]

The next generation of space craft for human flight

The Space Shuttle is being phased out due to age of the fleet in September 2010, and only 11 more shuttle launches are planned. The shuttle program's replacement – Ares I rockets launching Orion crew capsules comprising the Constellation program – are still being developed, and their first flight may not occur until 2015. NASA has awarded grants to two companies, under its Commercial Orbital Transportation Services (COTS) program: SpaceX for its reusable Dragon crew and cargo capsule launched by a Falcon missile, and, more recently, to Orbital Science Corporation. Space X had hoped to launch in 2013, and the company late last year signed an agreement to test launch in Florida, but recently announced possible delays in its schedule.

Meanwhile, Space Florida, the state's space development organization, has signed an agreement with Bigelow Aerospace to support the development of an orbital space transportation vehicle suitable for crew and cargo to launch from Florida.[15] Other states also are participating or are planning to participate, in public-private partnerships to further the development of commercial spacecraft that may fill the 5-year gap between 2010 and 2015, when the Constellation program begins launching.

Government is not alone in promoting the development of commercial space vessels. The X Prize Foundation [16] was established in 1995 by a group of young engineers and entrepreneurs to spur competition in the development of a new spacecraft. The competition was for development of the first privately built aircraft that could safely carry a pilot and the equivalent weight of two passengers to the edge of space, then repeat the feat within 2 weeks.

Inspiration for the competition was the $25,000 prize offered in 1919 by hotelier Raymond Orteig to the first person who flew nonstop between New York and Paris. In 1927, Charles

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[12] "Public Pension Plans: Evaluation of Economically Targeted Investment Programs." GAO/PEMD-95-13. Retrievable at http://archive.gao.gov/t2pbat1/154006.pdf. Last visited March 13, 2008.
[13] Fact sheet retrievable at http://www.calpers.ca.gov/eip-docs/about/facts/investme.pdf.
[14] http://www.sib.wa.gov/financial/pdfs/eti/2007.pdf. Last visited March 13, 2008.
[15] More information available on Space Florida's website at http://69.89.14.74/business.php.
[16] More information available at http://www.xprize.org/about.

Lindbergh won the prize; he was one of nine people or teams who spent a combined $400,000 in pursuit of the $25,000 prize.[17]

Similarly, the $10 million X Prize (later renamed the Ansari Prize after contributors) attracted 26 teams of competitors, who spent an estimated $100 million in their efforts. The winner in October 2004 was Mojave Aerospace Ventures' SpaceShipOne, whose owners spent more than $20 million to win the $10 million prize.

III. Effect of Proposed Changes:

Section 1 expresses legislative intent about the economic benefits of technology and growth investments

Section 2 amends s. 215.44, F.S., to add technology and growth as a class of investments to be included in the SBA's annual report, and requires the SBA to conduct an analysis of the direct and indirect economic impacts to the state from these investments.

Also, the phrase "technology and growth investments" is defined to mean a type of alternative investment in business sectors that include, but are not limited to, aerospace and aviation engineering, computer technology, renewable energy, and medical and the life sciences, and which are likely to stimulate the state's economy.

Section 3 amends s. 215.47, F.S., to direct the SBA to invest no more than 1.5 percent of the net asset value of any fund, as measured on December 30 of the previous year, in such investments, as long as such investments are consistent with, and do not compromise or conflict with, the SBA's fiduciary obligations. Based on the pension fund's March 26, 2008, asset value of $130.2 billion, the amount of investment in GTIs could total $1.95 billion.

Section 4 creates the "Reusable Space Vehicle Industry Prize Program" within OTTED. The program's purpose is to spur competition and entrepreneurial investment in designing a reusable space vehicle.

The prize is $40 million, half of it in state dollars and the rest a private match, to the company or individuals providing the most significant advancement toward designing and building a reusable space vehicle. The competition runs from January 1, 2009, to January 1, 2014.

Florida's Lieutenant Governor shall serve as chair of the program and appoint a committee for the purpose of developing an application form, rules and guidelines related to submitting entries, judging the entries, administering the program and awarding the prize.

The application form and other relevant information must be posted on OTTED's website on or before January 1, 2009.

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[17] http://www.charleslindbergh.com/plane/orteig.asp. Last visited March 14, 2008.

The structure and operation of the prize program shall, to the extent practicable, mirror the Ansari Prize program as awarded by the X Prize Foundation in 2004. OTTED shall adopt rules as necessary to administer the program, which shall terminate January 2, 2014.

Section 5 provides an effective date of July 1, 2008 for the provisions of SB 2310.

IV. Fiscal Impact Statement:

A. Tax/Fee Issues:

The state is expected to contribute $20 million, from an unspecified source, to fund half of the "Reusable Space Vehicle Industry Prize Program."

B. Private Sector Impact:

Florida companies, especially those in aerospace, high-tech, biomedical and similar fields, may benefit from investments by the SBA.

The additional investment allocation to the specified business sectors may be up to $1.95 billion, based upon market values of the trust fund on March 26, 2008.

C. Government Sector Impact:

There should be no pressure to increase required FRS fund contributions brought on by investments targeting GTIs that generate collateral economic benefits, assuming that the prevailing rate of return for GTI investments is consistent with the rate of return achieved by FRS fund investments generally.

The state is expected to contribute $20 million, from an unspecified source, to fund half of the "Reusable Space Vehicle Industry Prize Program." to be awarded in state fiscal year 2013-14.

V. Technical Deficiencies:

None.

VI. Related Issues:

The phrase "technology and growth investments" will be subject to interpretation as the term is inclusive of other, related business sectors. Because the Florida Retirement System is paying out more in benefits than it receives in terms of employer payroll contributions, the expansion to sectors that have long asset maturity cycles must be reconciled with its ability to pay promised benefits. In the near term this will not be difficult. In the longer term, absent extended appreciation of its equity asset base, this will challenge the matching of income with payouts. There are four principal factors affecting this situation: the 2007 reallocation of the portfolio base that has caused the SBA to move out of traditional equities; the need for stable income-producing assets to fund known liabilities of a progressively retiring workforce; the liquidity of the entire invested base when long-term interest rates reset at levels higher than those in place today; and the higher payroll contributions needed from employers to return the system to long-term normal cost. As concentration limits are adjusted to fund new, less liquid investments that produce no current capital gains or income, this will affect the other factors requiring greater yield to re-balance the invested assets.

It is inherent in the nature of these technology and growth commitments that the investment and maturity cycle will be measured in years as some of the ventures are new or developing technologies for which a commercial market is still formative. Health-related investments have similarly long maturities since the products are usually subject to federal regulation and peer review. The capital invested, therefore, will have to be patient.

There is no specific source of the prize funds but the context implies that it will not come from the FRS. The reasons for this are threefold: first, assets in this trust fund are not appropriated in the customary sense of the term; second, the bill determines that prize monies are "state funds," which trust fund assets are not since the FRS is a multi-employer plan; and, third, the expected payment date is several fiscal years removed from the present one.

VII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Governmental Operations on March 27, 2008:
Raises from one to one and one-half percent the amount of the net assets of the trust fund that may be allocated to technology and growth investments; permits the SBA to offer investment manager opportunities to Florida-based firms; and changes the nomenclature from "economically targeted investments" to "growth and technology investments."

B. Amendments:

None.