

**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 Commerce and Tourism Committee

BILL: SB 976

INTRODUCER: Senator Bogdanoff

SUBJECT: Capital Formation for Infrastructure Projects

DATE: April 4, 2011

REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Pugh	Cooper	CM	<b>Pre-meeting</b>
2.			BC	
3.				
4.				
5.				
6.				

**I. Summary:**

In 2007 the Legislature created the Florida Opportunity Fund (FOF) as a \$29.5 million, state-supported foray into venture capital investments to assist young Florida companies representing certain industry sectors. The FOF’s mission has broadened since then, and as of June 30, 2010, the fund had invested just over \$3 million – matched on a \$2-to-\$1 basis by private investment partners – into six investment fund accounts. The fund’s private investment partners benefit only if the investment funds make money. Meanwhile, other states encourage private investors to participate in their venture-capital programs by awarding them contingent tax credits, claimable if their investments in individual companies fail to produce earnings to recoup the original principal investments.

SB 976 creates a new venture capital investment program, the Florida Infrastructure Fund Partnership (partnership). The partnership takes a different approach than the FOF and other states’ venture capital programs: it will award up to \$700 million in certificates for contingent state tax credits for an equal amount in private investments in strategic infrastructure projects. The credits are only redeemable to private investors to recoup all or a portion of their equity investments – if the projects do not achieve according to expectations. The earliest the credits can be claimed is 2023.

The FOF will serve as the general partner for the partnership. A new entity, the Florida Infrastructure Investment Trust (trust), is created to administer the certificates and contingent tax credits associated with the new investment program.

SB 976 creates ss. 288.9627 and 288.9628, F.S., and amends ss. 288.9621, 288.9622, and 288.9623, F.S.

## II. Present Situation:

### The Venture Capital Industry<sup>1</sup>

“Venture capital” is money provided by investment 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 supports entrepreneurial talent and appetite by providing funds to develop ideas and basic science into products and services. Venture capital funds build companies from the simplest form – perhaps just the entrepreneur and an idea expressed as a business plan – to freestanding, mature organizations. 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 three approaches:<sup>2</sup>

- Direct investment by state agencies to individual businesses through state-controlled institutions;
- Investment by state agencies or pension funds into privately managed funds or a portfolio of privately managed funds, to expand local venture capital; and
- Private investment spurred by state’s offering tax credits or other incentives for qualifying investments.

### Venture Capital in Florida

Florida ranked 15th in the United States in calendar year 2010 in terms of venture capital investment, with Florida companies receiving about \$190 million, down about 35 percent from the previous year.<sup>3</sup>

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<sup>1</sup> The primary source for information in this section is the National Venture Capital Association website, including the 2011 NVCA Annual Yearbook, available at <http://www.nvca.org/def.html>. Last visited March 30, 2011.

<sup>2</sup> Economic Development Finance. Karl F. Seidman. Published in 2005 by Sage Publications. On file with the Senate Commerce and Tourism Committee. Information on page 253.

<sup>3</sup> Information reported in Feb. 6, 2011, Orlando Sentinel article, on file with the Senate Commerce and Tourism Committee, and based on the national Moneytree survey by PriceWatera <http://www.floridaventureforum.org/newsletter.asp>.

An earlier study indicated that the revenue of venture-backed companies headquartered in Florida in 2008 was \$75.5 million – ranked 9<sup>th</sup> in the nation – and these companies’ employment totaled 242,074 – ranked 11<sup>th</sup> nationally.<sup>4</sup>

#### The Florida Opportunity Fund (FOF)

Created by the Legislature in 2007,<sup>5</sup> the FOF was intended to attract venture capital investment into targeted Florida industries by providing a state match. The FOF is organized as a private, not-for-profit corporation under ch. 617, F.S., with a 5-member board of directors selected by an EFI appointments committee. The FOF’s administrative staff is provided by EFI, and has a separate investment manager, Florida First Partners, comprised of Florida-based MILCOM Venture Partners<sup>6</sup> and the Credit Suisse Customized Fund Investment Group.<sup>7</sup>

The Legislature appropriated \$29.5 million for investments from the FOF in FY 2007-2008.

#### *Initial charge*

The FOF was established as a fund-of-funds program, meaning that it could only invest in investment funds, not directly in individual businesses; additionally, the investment funds had to match the state \$2 for every \$1 it invested. The emphasis was on “seed” and early-stage investments, because proponents of creating the FOF concluded that these types of companies were least likely to have access to venture funding and traditional financing. Targeted industries for the FOF investments included, but were not limited to, life sciences, information technology, advanced manufacturing processes, aviation and aerospace, and homeland security and defense.

To be eligible for state participation, an investment fund had to have an experienced and successful investment manager or team, and must focus on investment opportunities in Florida.

The FOF invested in its first fund in FY 08-09: \$594,000 in Element Partners II, according to FOF’s financial statements. As of June 30, 2010, the FOF had six investment fund partners and had invested just over \$3 million.

#### *Expansion of investment authority*

In 2009, the Florida Legislature amended s. 288.9624, F.S., to allow the FOF to make direct investments, including loans, in individual businesses and infrastructure projects; to form or operate other entities; and to accept funds from other public and private sources for use as investments.<sup>8</sup> These direct investments must be made in Florida infrastructure projects, or in businesses that are Florida-based or have significant business activities in Florida and operate in technology sectors that are strategic to Florida, including the original list of industry types. The FOF may not use its original appropriation of \$29.5 million to make direct investments or for any purposes not specified in the original legislation.

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<sup>4</sup> Venture Impact: The Economic Importance of Venture Capital-Backed Companies to the U.S. Economy. Prepared by Global Insight. Information on Page 14. Available at: [http://www.nvca.org/index.php?option=com\\_content&view=article&id=255&Itemid=103](http://www.nvca.org/index.php?option=com_content&view=article&id=255&Itemid=103). Last visited March 30, 2011.

<sup>5</sup> HB 83 (ch. 2007-189, L.O.F.)

<sup>6</sup> More information available at <http://www.milcomvp.com/>.

<sup>7</sup> More information available at <https://www.credit-suisse.com/us/en/>.

<sup>8</sup> HB 7031 (ch. 2009-251, L.O.F.)

In May 2010, the FOF launched a direct investment program with the Florida Energy and Climate Commission, a 9-member board housed administratively in the Governor's Office that is the lead entity for state energy and climate-change programs and policies. This new FOF fund is expected to increase the availability of investment capital in Florida for businesses engaged in developing or producing energy-efficient or renewable energy (EE/RE) products or services. The FOF has access to \$36 million initially in federal funds to make investments in qualifying businesses. Fund investments are restricted by statute to be used for facility and equipment improvement with EE/RE products; acquisition or demonstration of renewable energy products; and improvement of existing production, manufacturing, assembly, or distribution processes to reduce consumption or increase the efficient use of energy in such processes.

#### *Reporting Requirements*

The FOF is required by statute to submit an annual report by December 1 of each year to the Governor, the President of the Senate, and the Speaker of the House of Representatives that includes, at a minimum:

- An accounting of the amount of investments disbursed by the FOF fund;
- The progress of the FOF in accomplishing its responsibilities;
- A description of the benefits to the state resulting from the FOF, including the number of businesses and jobs created, the number of associated industries started, and the growth of related research projects; and
- Independently audited financial statements for the FOF that show receipts and expenditures during the preceding fiscal year for personnel, administration, and operating costs.

#### **Infrastructure Funding in Florida**

For nearly 6 decades, Florida has been one of the fastest-growing states in the nation, with population expanding from 3 million in 1950 to nearly 19 million in 2010.<sup>9</sup> Demand for energy, transportation, and communication systems expanded rapidly over the past several decades. Current projections suggest Florida may add an additional 5 million new residents by the year 2030.<sup>10</sup> Employment, tourism, gross state product, and income will expand as well, contributing to growth in demand for strategic infrastructure.

In order to meet future capacity over the next 20-25 years, it is estimated that Florida will need:

- \$47.0 billion for highway and rail infrastructure;<sup>11</sup>
- \$29.9 billion for water and wastewater facilities and infrastructure;<sup>12</sup>
- \$3.5 billion for aviation facilities and infrastructure;<sup>13</sup>
- \$2.8 billion for seaport facilities and infrastructure;<sup>14</sup> and

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<sup>9</sup> 2010 Census, Apportionment Population and Number of Representatives by State. United States Census Bureau. Interactive map at <http://2010.census.gov/2010census/data/>. Site last visited March 31, 2011.

<sup>10</sup> Florida Census Day Population: 1970-2030, Office of Economic and Demographic Research, August 2010. <http://edr.state.fl.us/Content/population-demographics/data/index.cfm>. Last visited March 31, 2011.

<sup>11</sup> Strategic Intermodal System Unfunded Needs Plan, Florida Department of Transportation, May 2006. <http://www.dot.state.fl.us/planning/systems/mspi/sisnplan.shtm>. Site last visited March 31, 2011.

<sup>12</sup> Clean Watersheds Needs Survey 2008 Report to Congress, United States Environmental Protection Agency. <http://water.epa.gov/scitech/datait/databases/cwns/2008reportdata.cfm>. Site last visited March 31, 2011.

<sup>13</sup> Strategic Intermodal System Unfunded Needs Plan, May 2006.

<sup>14</sup> Strategic Intermodal System Unfunded Needs Plan, May 2006.

- \$2.5 billion for storm water management.<sup>15</sup>

### **Contingent Tax Credit Programs**

Contingent tax credits help raise money for state-affiliated venture capital initiatives without immediately affecting state revenues. Contingent tax credit programs are statutory state guarantees established to incentivize venture capital investment into state target industries. Eight states – Arkansas, Iowa, Michigan, Ohio, Oklahoma, Oregon, South Carolina and Utah – have initiated programs authorizing the issuance of contingent tax credits to investors in state-sponsored fund of funds, providing investments in companies.<sup>16</sup> It does not appear that any state has created an infrastructure funding program backed by contingent state tax credits that is similar to the one proposed in SB 976.

### **III. Effect of Proposed Changes:**

SB 976 broadens the Capital Formation Act in Part X of ch. 288, F.S., to create the Florida Infrastructure Fund Partnership and the Florida Infrastructure Investment Trust as a means to attract as much as \$700 million in private capital to finance large-scale infrastructure improvements in this state. The bill makes available \$700 million in contingent tax credits, which are assigned to investors dollar-for-dollar of their principal equity investments. The tax credits may be used by investors only to recoup losses of such principal. The credits cannot be claimed prior to 12 years from the date of the investment, so the earliest, based on the bill's effective date, would be on or after July 1, 2023.

**Section 1:** Amends s. 288.9621, F.S., to modify the short title, Florida Capital Formation Act, in Part X of ch. 288, F.S.

**Section 2:** Amends s. 288.9621, F.S., to broaden legislative intent on the need for more seed capital and early-stage venture capital to include infrastructure projects.

**Section 3:** Amends s. 288.9623, F.S., to add several definitions relevant to the proposed Florida Infrastructure Fund Partnership. Key definitions are:

- Certificate means a contract between the trust and an investment partner to guarantee the partner's investment in the partnership under which the investment partner, under certain conditions, may redeem such certificate for a tax credit.
- Commitment agreement means a contract between the partnership and an investment partner under which the partner commits to providing a specified amount of investment capital in exchange for an ownership interest in the partnership.
- Infrastructure project means a capital project in the state for a facility or other infrastructure need in the state, a county, or a municipality with respect to any of the

<sup>15</sup> Clean Watersheds Needs Survey 2008 Report to Congress.

<sup>16</sup> Various reports are available about one or all of these states' programs. As a sample, see "Building a Regional Venture Capital Industry with Contingent Tax Credits," at [http://www.cdfa.net/cdfa/cdfaweb.nsf/fbaad5956b2928b086256efa005c5f78/d726ee6624cfb02c86257577007238da/\\$FILE/nasvftaxcredits.pdf](http://www.cdfa.net/cdfa/cdfaweb.nsf/fbaad5956b2928b086256efa005c5f78/d726ee6624cfb02c86257577007238da/$FILE/nasvftaxcredits.pdf); "Government Based Private Equity Programs," at [http://www.cdfa.net/cdfa/cdfaweb.nsf/fbaad5956b2928b086256efa005c5f78/93e41838bbf61b5b8825781f005a8545/\\$FILE/Neilson.CDFA%20Presentation\\_Jan%202011.pdf](http://www.cdfa.net/cdfa/cdfaweb.nsf/fbaad5956b2928b086256efa005c5f78/93e41838bbf61b5b8825781f005a8545/$FILE/Neilson.CDFA%20Presentation_Jan%202011.pdf); Utah's Fund of Funds program, at <http://www.utahfundoffunds.com/>; and Invest Iowa, at <http://www.investiowa.com/icic/web.nsf/pages/fundoffunds.html>. Last visited March 24, 2011.

following: water or wastewater system, communication system, power system, transportation system, renewable energy system, ancillary or support system for any of these types of projects, or other strategic infrastructure of the state, the county, or the municipality.

- Investment partner or partner means a person, other than the partnership, the fund, or the trust, who purchases an ownership interest in the partnership or a transferee of such interests.
- Tax credit means a credit issued against the taxes specified in s. 288.9628(7)(c), F.S.

**Section 4:** Creates s. 288.9627, F.S., the Florida Infrastructure Fund Partnership. This section details how the partnership is created, its purposes, and how it operates.

#### *Governance*

The partnership is organized and operated under ch. 620, F.S., as a private, for-profit, limited partnership or limited liability partnership. The partnership is not an instrumentality of the state.

The FOF is identified as the general partner for the partnership, and is authorized to loan up to \$750,000 to the partnership for use in paying initial organizational expenses and to solicit investment partners. The FOF also is responsible for managing the partnership's business affairs, including, but not limited to:

- Hiring one or more investment managers to assist with the management of the partnership;<sup>17</sup>
- Soliciting and negotiating the terms, contracting, and receipt of the investment capital;
- Receiving investment returns, paying investment partners and approving investments; and
- Engaging in other activities necessary to operate the partnership.

#### *Infrastructure Investments*

The partnership is authorized to make direct investments in Florida-based infrastructure projects that foster economic development and meet an important infrastructure need of the state. Eligible infrastructure projects include: water or wastewater systems, communication system, power system, transportation system, renewable energy system, ancillary or support system for any of these types of projects, or other strategic infrastructure located within the state.

Capital for these investments must be raised by the partnership through "commitment agreements" with investment partners approved by the FOF's board. The bill provides for the issuance of certificates by Florida Infrastructure Investment Trust (*described in Section 4 below*) for future contingent tax credits that guarantee the return of investment capital from the partnership to its investment partners.

These contingent tax credits will guarantee the principal investment to the partners, but not potential earnings.

SB 976 requires that the total principal investment payable to the partnership and the total amount of contingent tax credits to be issued by the Department of Revenue (DOR) may not

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<sup>17</sup> The Fund may only solicit investment managers that have maintained an office in Florida for at least 2 years.

exceed \$700 million. However, if the partnership fails to obtain investment commitments totaling at least \$100 million by December 1, 2012, then the partnership must cancel all agreements and return investment amounts back to the investment partners.

#### *Investment decision-making*

The partnership must evaluate infrastructure projects interested in receiving investments based on the following factors:

- The written business plan for the project, including all expected revenue sources;
- The likelihood of the project attracting operating capital through grants or from investors or other lenders;
- The management team for the proposed project;
- The project's job creation potential in Florida;
- The financial resources of the entity proposing the project;
- The presence of reasonable safeguards to ensure the project provides a continuing benefit for residents of the state; and
- Other factors deemed by the partnership to be relevant to the likelihood of the success of the project.

Additionally, the partnership may only invest in infrastructure projects, which:

- Fulfill an infrastructure need in the state;
- Raise twice as much equity or debt capital from other sources as is invested by the partnership; and
- Have appropriate legal controls in place to ensure that no infrastructure project will be fraudulently closed.

The partnership may not invest more than 20 percent of its total funds available for investment in any single infrastructure project. The partnership is prohibited from investing in any infrastructure project authorized under the Florida Rail Enterprise Act, related to high-speed rail projects;<sup>18</sup> with any financial institution or company identified in s. 215.472, F.S., that engages in commerce with Cuba; or with any “scrutinized company,” as that term is defined in s. 215.473, F.S., relating to companies that engage in commerce with Iran and Sudan.

#### *Provisions related to the Credit of the State*

SB 976 prohibits the partnership and the FOF from pledging the credit or taxing power of the state or any political subdivision of the state, nor are their obligations also debt to the state or other political subdivisions. Finally, the partnership and the FOF must pay their debts only from their own resources.

#### *Reporting Requirements*

The partnership must submit an annual report December 1 of each year to the Governor, the President of the Senate, and the Speaker of the House of Representatives. The annual report, at a minimum, must include:

- An accounting of the amount of investment capital raised and disbursed by the partnership.

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<sup>18</sup> Sections 341.8201 – 341.842, F.S.

- The progress of the partnership’s activities, including the progress of infrastructure projects that have been provided direct investment under the program.
- A description of the costs and benefits to the state resulting from the partnership’s investments, including:
  - A list of infrastructure projects;
  - The costs and benefits of each project to the state;
  - The number of businesses and associated industries affected;
  - The number, types, and average annual wage of jobs created or retained; and
  - The impact of the program on the state’s economy.
- Independently audited financial statements, including statements that show receipts and expenditures during the preceding fiscal year for the partnership’s operating costs.

**Section 5:** Creates s. 288.9628, F.S., the Florida Infrastructure Investment Trust (trust), a state beneficiary public trust, to be governed by an independent board of trustees (board).

#### *Governance*

The board is comprised of the Chief Financial Officer; the Executive Director of the Office of Trade, Tourism, and Economic Development; and the Vice Chair of Enterprise Florida, Inc., or their respective designees. The bill allows an administrative officer to act on behalf of the Trust under the direction of the board. The board members and the administrative officer are prohibited from receiving compensation from, and having a financial interest in, any investment partner. They serve without compensation, but are entitled to reimbursement of their expenses.<sup>19</sup>

#### *Powers and duties of the trust*

SB 976 authorizes the trust to:

- Engage consultants and retain professional services;
- Issue tax certificates to the investment partners, redeemable for contingent tax credits;
- Sell the contingent tax credits;
- Expend funds and invest funds; and
- Enter into contracts, and bond or insure against loss.

As mentioned above, the trust may issue certificates, redeemable against the contingent state tax credits, to partners that make equity investments in the partnership. A certificate issued to a partner guarantees the availability of tax credits equal to the principal investment specified in the partner’s commitment agreement with the partnership. Certificates issued by the trust may not exceed a total aggregate of \$700 million of tax credits. Further, a certificate issued by the trust must have a specific calendar year maturity date designated by the trust of no earlier than 12 years after the date of issuance. A partner’s certificate and related tax credits can be transferred to a new owner in whole or in part.

SB 976 specifies that the provisions of ch. 517, F.S., dealing with regulation of securities, do not apply to the certificates and contingent tax credits transferred or sold under this program.

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<sup>19</sup> The trust and the FOF may seek reimbursements for expenses by charging a fee for the issuance of certificates to investment partners. The fee may be no more than .25 percent of the aggregate investment capital committed to the partnership.



*Notification and Election of Tax Credits*

If, on the maturity date of a certificate, a partner's principal investment has suffered a "net capital loss," the partnership must provide written notification of this circumstance to the partner. "Net capital loss" is defined to mean an amount equal to the difference between the total investment capital made by the investment partner to the partnership and the amount of the aggregate actual distributions received by the investment partner. The notification must include:

- An estimate of the fair-market value of the partnership's assets;
- The total capital investment of all partners;
- The total amount of distributions received by the partners; and
- The amount of the tax credit for which the partner is entitled to be issued.

Upon receipt of notice from the partnership, each partner can elect to:

- Have the tax credits issued in its name;
- Authorize the trust to sell the tax credits on its behalf, with the proceeds of the sale paid to the partner; or
- Maintain its investment in the partnership.

An affected partner has 30 days, after receiving notification, to provide written notification to the partnership and the trust which option it has chosen. Failing to provide a timely notice will result in the investment partner being deemed to have elected to maintain investment in the partnership.

*Issuance and Sale of Tax Credits*

In the event that a partner becomes eligible and elects to claim tax credits under the program, the bill provides that the trust will, on behalf of the partner, apply to DOR for the issuance of tax credits. The tax credits certified by DOR may not exceed the partner's net capital loss. The partner must agree in writing to transfer its interest in the partnership to the fund before receiving tax credits.

Alternatively, the trust may sell tax credits on behalf of a partner, in an amount no more than the lesser of the maximum amount of tax credits available under the terms of the certificate issued to the partner or the amount necessary to repay a partner's net capital loss. Before receiving the proceeds from the trust's sale of tax credits, the partner must agree in writing to transfer its interest in the partnership to the fund.

Within 30 days following receipt of a partner's election or the trust's sale of the tax credits, the trust must notify the partnership and then apply to DOR for issuance of the contingent tax credits in the name of the partner or purchaser. The application must include the following information: the partnership's certification of the amount of credits to be issued, identification of the applicable taxpayer, and the tax against which the credits can be applied. Within 30 days of the receipt of an application, DOR must issue tax credits to the partner or purchaser in the amount designated by the trust in the application. If the trust is unable to sell the partner's tax credits within 90 days, the bill provides the partner with the option to modify its election choice.

As specified earlier, the amount of tax credits that may be claimed or applied against state taxes may not exceed \$150 million in a state fiscal year. The tax credits issued by DOR can be used to

offset state sales, corporate, or premium insurance tax liability, or as refund of taxes paid; such credits must be applied or taken as a refund within 7 years after the credits are issued.

The bill provides that ch. 517, F.S., dealing with regulation of securities, does not apply to the certificates and credits transferred or sold pursuant to the provisions of the bill.

Section 6: Specifies an effective date of July 1, 2011.

#### **IV. Constitutional Issues:**

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

#### **V. Fiscal Impact Statement:**

A. Tax/Fee Issues:

At its March 10, 2011 meeting, the Revenue Estimating Conference (REC) determined by consensus that SB 976 will have a recurring negative, but indeterminate, impact on both state and local government revenues, as annualized in the next four fiscal years.

The REC noted in its written estimate report that, "It is not possible to determine what net operating capital losses could be 12 years out, therefore the Cap (\$150 million annually) is assumed to be the maximum recurring amount." Further, the REC noted that, "This bill exposes the state to contingent future tax credits ranging from \$0 to \$700 million, beginning in 2023 at the earliest."

B. Private Sector Impact:

Indeterminate, but likely positive for both businesses and residents of the areas where the infrastructure projects are constructed.

C. Government Sector Impact:

Indeterminate. DOR may incur some costs associated with administratively handling the issuance and transference, where applicable, of the contingent tax credits.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**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.

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

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