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OPPAGA
OFFICE OF PROGRAM POLICY ANALYSIS & GOVERNMENT ACCOUNTABILITY

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The Florida Growth Fund Added Investments in 2010, but It Is Still Too Early to Assess Total Economic Impact

at a glance

As of November 2010, Florida Growth Fund managers had invested $73 million in seven Florida-based technology and growth companies and four private equity funds that invest in such companies. These investments represent 29% of the fund's total $250 million in assets. Although some of these companies report creating jobs, it is too early to assess the total economic benefits to the state provided by these investments.

Scope

Chapter 2008-31, *Laws of Florida*, directs OPPAGA to annually review the State Board of Administration's Florida Growth Fund, which invests in technology and high-growth industries targeted to benefit Florida's economy.[1] The annual review must include

- the dollar amount of fund assets invested in state technology and growth industries and the investments' percentage share of the system's trust fund net assets;
- a list of investments in state industries the board identified as technology and growth investments within each asset class; and
- an analysis of the direct and indirect economic benefits to the state resulting from the investments.

This third annual report addresses the board's progress toward implementing the fund.[2]

[1] Section 215.474, *F.S.*

[2] *Economically Targeted Investment Program Under Development*, OPPAGA Report No. 08-72, December 2008 and *SBA Has Implemented the Florida Growth Fund; Economic Impact of Investments May Not Be Apparent for Several Years*, Report No. 09-45, December 2009.

Background

The Florida State Board of Administration (SBA) is composed of the Governor, Chief Financial Officer, and Attorney General. Article XII, Section 9, of the Florida Constitution grants the board authority to oversee state funds, including pension funds. Specifically, the SBA oversees the Florida Retirement System's Pension Plan, which had approximately $109.3 billion in assets as of June 30, 2010. Although the board makes some of its investments directly, it generally hires and oversees external fund managers to research, invest, and manage monies in the Pension Plan portfolio.

The 2008 Legislature authorized the SBA to make technology and growth investments using pension funds. The Legislature authorized the SBA to invest up to 1.5% of net state retirement system trust fund assets in technology and high-growth businesses with a significant presence in Florida.[3] The Legislature determined that such investments would economically benefit the state. Investments may include space technology, aerospace and aviation engineering, computer technology, renewable energy, and medical and life sciences. No more than 10%, in the aggregate, of the fund may be invested in alternative investments such as equity funds, venture capital funds, or securities and investments that are not publicly traded and are not otherwise authorized by law. The investments must also be consistent with the board's fiduciary duties.

[3] Prior to passage of this legislation, the SBA invested pension funds in Florida-centered technology and high-growth industries as part of its overall investment portfolio. Although they potentially benefit the state, these investments are not economically targeted. As of June 30, 2010, these investments included $582.9 million, or 0.53%, of the state's pension funds.

In June 2009, the SBA implemented this legislation by launching the Florida Growth Fund, which the Legislature authorized to invest $250 million of capital in technology and growth businesses based in the state. The board selected Hamilton Lane to manage the fund. This Philadelphia-based investment company has a Florida office in Fort Lauderdale, as well as several other offices in the United States and overseas.

SBA compensates Hamilton Lane from funds that it budgets for this purpose. As of September 30, 2010, the board had paid the firm $2,715,385 since the growth fund's inception. The company may also receive a percentage of the distributions from the fund if its investments produce returns.

The growth fund manager is required to make prudent investments and regularly report to the SBA. The board's contract with Hamilton Lane requires the company to invest in technology and growth businesses domiciled in the state or whose principal addresses are in the state, or businesses that have a demonstrable and material operational presence in the state if they are not headquartered here. The contract also requires Hamilton Lane to invest in Florida-based investment management firms that directly invest in technology and growth businesses. According to the contract, the fund manager also must

- prepare a strategic plan for the fund's investments and promote the fund as a source of investment capital;
- provide the SBA with quarterly and annual reports on the fund's activities; and[4]
- create an investment plan to be updated annually that includes portfolio construction guidelines, investment restrictions, benchmark targets, and an overview of the target market.[5]

Hamilton Lane completed the strategic plan and the investment plan in July 2010. The strategic plan includes an overview of the private equity market and information about the fund's individual investments. The plan also identifies four high-growth sectors to target for investment: new media, healthcare and biotechnology, energy, and international. The investment plan includes the amount of funds committed, approved, and projected for each investment and investment allocations for each investment category. For example, the plan compares the actual allocation of the fund in early stage venture capital, 22%, to the target allocation of 15-25%.

Hamilton Lane's quarterly reports to the SBA include updates on the fund's status, market conditions, and financial statements. SBA managers use this information to monitor the fund's performance and ensure that investments are consistent with the contract and the fund's goals. To further ensure accountability over fund management, SBA meets quarterly with Hamilton Lane representatives to discuss fund performance and investment strategy.

Findings

As of November 2010, the Florida Growth Fund had made 11 investments totaling $73 million. Although some companies that received these investments report job creation, it is too early to assess the total economic benefits to the state provided by these investments. The state may not realize such benefits for several years.

Hamilton Lane has invested $73 million in seven technology and growth companies and four private equity funds

As of November 2010, Hamilton Lane had committed to investing $73 million (29% of the Florida Growth Fund's total assets) in 11 companies. Seven of these companies represent co-investments, meaning that they invested in partnership with private equity sponsors. The remaining four companies are private equity funds that are partnerships invested in technology and growth companies. Ten of the 11 investments are located in Florida, while 1 has a significant presence in the state. See Exhibit 1.

At the time of our 2009 report, Hamilton Lane had invested $26.5 million in the Longwood-based waste management company, the Orlando-based telecommunications company, and the St. Petersburg-based private equity fund. The eight remaining investments (five companies and three private equity funds) were made since then.

[4] The contract requires Hamilton Lane to provide the SBA with an annual report within 150 days of the end of each fiscal year. The fiscal year begins on January 1 and ends on December 31. Given the fund's low activity in 2009, the parties agreed that no annual report was necessary in 2010. The next annual report is due in 2011.

[5] The contract also requires Hamilton Lane to provide the SBA with all due diligence information, summary reports about each investment, all executed closing documents, the financial performance of the fund, and any other information the board requests.

Exhibit 1
The Florida Growth Fund Has Invested $73 Million in 11 Companies Located Throughout the State

Company Description	Amount Invested	Investment Date
Technology and Growth Companies		
A Coral Gables-based aircraft parts and leasing business focused on mid-technology airframes and engines	$10 million	February 8, 2010
A Longwood-based waste management company that provides non-hazardous solid waste services	7 million	November 3, 2009
A Winter Park-based medical device company developing a laser system for the treatment of cataracts and presbyopia	5 million	July 15, 2010
An Orlando-based telecommunications company that provides customers with interactive voice services	4.5 million	September 21, 2009
A Fort Myers-based enterprise software company providing advanced speech analytics solutions that extract business intelligence from recorded conversations with customers	3 million	September 28, 2010
A Boca Raton-based specialty commercial finance lender providing working capital lines of credit to U.S. small and medium-sized companies	2 million	August 16, 2010
A Tampa Bay-based digital media advertising services firm	1.5 million	December 30, 2009
Private Equity Funds		
A St. Petersburg-based private equity fund that invests in Florida healthcare, communications, and technology companies	$15 million	October 1, 2009
A West Palm Beach-based private equity fund that invests in Florida across diversified industries, with targeted companies typically maintaining a proprietary technology or service offering	10 million	May 17, 2010
A Charlotte, NC-based Small Business Investment Company and mezzanine private equity fund that invests in businesses in the southeast across a diversified set of industries[1, 2]	7.5 million	July 2, 2010
A Winter Park-based private equity fund that invests in seed and early stage companies within the government/defense and commercial sector industry space	7.5 million	July 20, 2010
TOTAL	**$73.0 million**	

[1] The Small Business Investment Company Program, administered by the U. S. Small Business Administration, provides financing to eligible small businesses through qualified investment management firms.

[2] Mezzanine financing is often used as a way for a company to borrow an amount of money beyond what a traditional lending institution such as a bank would loan in an effort to acquire another company. The mezzanine loan fills the gap between what a bank will loan and the cost of acquiring the company. The resulting debt is subordinate to debt owed the bank, but superior to equity financing, which typically requires exchanging a company's stock in return for capital.

Source: State Board of Administration.

Current investments are too recent to result in measurable economic benefits to the state

It is too early to assess the total economic benefits of current Florida Growth Fund investments because the state may not realize such benefits for several years. Moreover, the SBA does not expect to earn competitive rates of return on these investments for at least 8 to 10 years because such investments typically involve relatively young or start-up companies. Such companies often have high failure rates and have difficulty attracting early-stage capital. To address this risk, SBA managers reported that they have directed Hamilton Lane to diversify investments in the fund. For example, Hamilton Lane has attempted to minimize risk by stratifying investments among early and later stages of venture capital, and diversifying investments by geography and industry.

SBA managers report that the growth fund's investments to date have encouraged business expansion and created at least 176 new jobs in Florida's growth and technology sector.[6] The Longwood-based waste management company reported creating 86 jobs, the Tampa Bay digital media firm reported creating 83 jobs, and the Winter Park medical device company hired 7 employees.[7]

To assess the progress of these investments as the Florida Growth Fund matures, OPPAGA's future annual reports will measure the direct and indirect economic impact of fund investments using an input-output model; we will conduct this analysis in consultation with the Office of Economic and Demographic Research. The input-output model assesses the direct and indirect economic effects of specific investments. *Direct impacts* are those created by the initial investment, such as employee salaries and expenditures of the companies in which the funds were invested. These activities lead to *indirect impacts* such as the employee salaries and expenditures of other companies in related industries that do business with the companies in which funds were invested. We also will report on whether these investments are projected to provide competitive rates of return to the Florida Retirement System Pension Plan before collateral economic benefits are considered.

Agency Response

In accordance with the provisions of s. 11.51(5), *Florida Statutes*, a draft of our report was provided to the executive director of the SBA for review and response. The executive director's response is provided on page 4.

[6] Future reports will examine job creation among companies in which the fund is directly invested as well as the companies in which private equity funds are invested.

[7] To date, the other companies have not reported creating new jobs.

STATE BOARD OF ADMINISTRATION
OF FLORIDA

1801 HERMITAGE BOULEVARD
TALLAHASSEE, FLORIDA 32308
(850) 488-4406

POST OFFICE BOX 13300
32317-3300

December 7, 2010

Mr. Gary R. VanLandingham
Director
OPPAGA
Claude Pepper Building, Room 312
111 West Madison Street
Tallahassee, FL 32399

Dear Mr. VanLandingham:

We reviewed OPPAGA's preliminary and tentative report entitled, *The Florida Growth Fund Added Investments in 2010, but it is Still too Early to Assess Total Economic Impact*. We have no objection or questions in regard to the information presented in the report.

We welcome OPPAGA's efforts and, as always, we appreciate your diligence and professionalism.

Sincerely,

Ashbel C. Williams
Executive Director & CIO

cc: Ms. Flerida Rivera-Alsing, Chief of Internal Audit, State Board of Administration
Ms. Kim Mills, Director of Auditing, Chief Inspector General's Office

OPPAGA supports the Florida Legislature by providing data, evaluative research, and objective analyses that assist legislative budget and policy deliberations. This project was conducted in accordance with applicable evaluation standards. Copies of this report in print or alternate accessible format may be obtained by telephone (850/488-0021), by FAX (850/487-9213), in person, or by mail (OPPAGA Report Production, Claude Pepper Building, Room 312, 111 W. Madison St., Tallahassee, FL 32399-1475). Cover photo by Mark Foley.

OPPAGA website: www.oppaga.state.fl.us

Project supervised by Kara Collins-Gomez, Staff Director (850/487-4257)
Project conducted by Darwin Gamble (850/487-9247)
Gary R. VanLandingham, Ph.D., OPPAGA Director