



December 2016

Report No. 16-08

## Florida Growth Fund Investments Have Provided Over \$200 Million in Distributions to the FRS; Fund Managers Continue to Seek New Investment Opportunities

### *at a glance*

As of June 30, 2016, the Florida Growth Fund program had invested \$512.4 million in 37 technology and growth companies and 29 private equity funds. Investments were dispersed across 13 counties, with amounts ranging from \$6.8 million in Manatee County to \$156.3 million in Palm Beach County.

Since its inception, Florida Growth Fund I has experienced a net internal rate of return of 11.1% and has distributed \$201.5 million to the Florida Retirement System as of June 30, 2016.

Due to the success of Florida Growth Fund I, the State Board of Administration's managers authorized the initiation of Florida Growth Fund II, which made its first commitment in December 2014. To date, Florida Growth Fund II has made six fund commitments and five co-investments, totaling \$92.6 million in capital. Given initial fees, Florida Growth Fund II had generated a -1.4% net internal rate of return as of June 30, 2016. However, this fund is in the early stages of its investment timeline and fund managers expect positive returns as investments mature.

The program's investments also resulted in reported economic benefits to the state. Companies that received Florida Growth Fund investments reported creating 15,331 jobs as of June 30, 2016. The companies also reported paying an average annual salary of \$85,604 for those jobs created over the past year; however, salaries varied widely, from \$15,000 to \$767,000.<sup>1</sup> In addition, 12 companies and 7 private equity funds reported making \$51.8 million in capital expenditures between June 30, 2015 and June 30, 2016, bringing total capital expenditures to \$364.4 million since the fund's inception.

<sup>1</sup> Average salaries reported by Hamilton Lane are only for those new jobs created over the past year, and are not historical averages for all jobs created over the life of the program.

<sup>2</sup> Section [215.474, F.S.](#)

### Scope

State law directs OPPAGA to annually review the State Board of Administration's Florida Growth Fund, which invests in technology and high-growth industries.<sup>2</sup> The 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 ninth annual report addresses the board's progress in managing the Florida Growth Fund program and presents information on the economic impact of fund investments.<sup>3</sup>

### Background

The State Board of Administration (SBA) is constitutionally authorized to oversee state funds, including investing state and local government assets.<sup>4</sup> The largest fund that the SBA manages is the Florida Retirement System

<sup>3</sup> The prior annual reports can be found on OPPAGA's [website](#).

<sup>4</sup> The board is composed of the Governor, Chief Financial Officer, and Attorney General.

(FRS) Trust Fund, which had \$141.4 billion in assets as of June 30, 2016.

State law authorizes the SBA to invest up to 1.5% of net FRS Trust Fund assets in technology and high-growth businesses with a significant presence in Florida. Growth and technology investments may include space technology, aerospace and aviation engineering, computer technology, renewable energy, and medical and life sciences.<sup>5</sup> The board makes these investments through the Florida Growth Fund, a limited liability company established for this purpose.

The SBA contracts with Hamilton Lane to manage the fund.<sup>6</sup> As of June 30, 2016, the board had paid Hamilton Lane \$18 million in management fees to manage four separate tranches of capital since the fund's inception in 2009. The company may also receive a percentage of the distributions from the fund if its investments produce returns.

The board's contract with Hamilton Lane requires the company to invest in technology and growth businesses domiciled in Florida, with a principal address in the state, or that have an operational presence if they are not headquartered in the state.<sup>7</sup> The contract also requires the company to invest in Florida-based or Florida-focused investment management firms that directly invest in technology and growth businesses.<sup>8</sup> Hamilton Lane is required to provide quarterly and annual reports about its investments and to annually update an investment plan that the SBA uses to assess the fund's performance.<sup>9</sup>

Hamilton Lane managers reported that they always work with partners with expertise in specific industries and who serve as lead investors. Further, the fund never contributes more than 50% of any single investment, and some investments are made in stages as companies or equity funds meet specific milestones. For example, should a current portfolio of the Florida Growth Fund be awarded a large contract or look to open new locations, the Florida Growth Fund might support the company with additional capital.

## Findings

### ***The Florida Growth Fund has committed to invest \$512.4 million in technology and growth companies and private equity funds***

As of June 30, 2016, the Florida Growth Fund program had committed to invest \$512.4 million in 37 technology and growth companies and 29 private equity funds. (See Exhibit 1.) As of June 30, 2016, Florida Growth Fund I had a gross internal rate of return of 13.9% and a net internal rate of return of 11.1% since its inception.<sup>10</sup> As of June 30, 2016, Florida Growth Fund II had a gross internal rate of return of 8.9% and a net internal rate of return of -1.4%. Florida Growth Fund II is in the initial stages of its investment period; funds of this nature typically have an initial negative rate of return before demonstrating positive returns. Florida Growth Funds I and II represent approximately 0.53% of the FRS Trust Fund.

<sup>5</sup> No more than 20%, 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 be consistent with the board's fiduciary duties.

<sup>6</sup> Hamilton Lane is a Philadelphia-based investment company that has a Florida office in Fort Lauderdale, as well as several other offices in the United States and overseas.

<sup>7</sup> SBA managers have directed Hamilton Lane to diversify fund investments to minimize risk. Consequently, the fund manager has invested in companies representing various industries such as aerospace, medical products, and telecommunications.

<sup>8</sup> Private equity fund investments and growth and technology investments are stratified among companies that invest in early-

stage, growth-stage, and later-stage as well as in debt investments in credit worthy companies.

<sup>9</sup> The contract also requires Hamilton Lane to provide the SBA with due diligence information, summary reports about each investment, executed closing documents, fund financial performance data, and any other information the board requests.

<sup>10</sup> The internal rate of return is defined as the rate of return that would make the present value of future cash flows from an investment plus the final market value of the investment equal the investment's current market price. The net internal rate of return is the return on investments after fees and expenses are assessed by Hamilton Lane, while the gross internal rate of return is the return before fees and expenses are assessed.

## Exhibit 1

As of June 30, 2015, the Florida Growth Fund Program Had Committed to Invest \$512.4 Million in 37 Companies and 29 Private Equity Funds

Technology and Growth Companies	Date Invested	Amount in Millions	Private Equity Funds	Date Invested	Amount in Millions
<b>Florida Growth Fund I</b>			<b>Florida Growth Fund I</b>		
Telecommunications	09/18/09	\$4.5	Health Care/Technology	10/01/09	\$15.0
Waste Management	11/03/09	7.1	Technology/Services	05/17/10	15.0
Advertising Services	12/30/09	1.5	Diversified	07/02/10	6.2
Aircraft Parts and Leasing	05/26/10	10.0	Diversified	07/02/10	1.4
Medical Devices	07/16/10	20.4	Defense/Commercial	07/20/10	7.5
Financial Services	08/16/10	2.4	Biotechnology	01/21/11	15.0
Software	09/28/10	5.8	Distressed/Growth	04/26/11	5.0
Medical Products	12/22/10	7.5	Distressed/Growth	04/26/11	5.0
Biotechnology	01/18/11	5.4	Diversified	04/26/11	11.3
Mobile Technology	01/20/11	8.9	Growth/Buyout	06/30/11	10.0
Chemicals	02/02/11	5.0	Defense/Commercial	08/24/11	2.5
Marketing	02/24/11	14.5	Early Stage	02/20/12	10.0
Telecommunications	02/24/11	15.1	Technology/Health Care	02/28/12	10.0
Communications	04/11/11	5.0	Technology/Health Care	03/23/12	7.5
Technology	06/17/11	10.4	Manufacturing/Distribution	09/25/12	7.5
Restaurants	02/13/12	6.8	Diversified Buyout	02/28/13	7.5
Food Services	04/09/12	4.8	Health Care	03/15/13	7.5
Security	05/24/12	10.0	Growth	04/12/13	5.0
Packaging	08/20/12	10.0	Life Sciences	07/16/13	7.5
Distribution	03/15/13	15.2	Health Care/Industrial/Aerospace	12/23/13	7.5
Restaurants	11/19/13	6.3	Diversified/Mezzanine	03/24/14	4.4
Health Care IT	12/26/13	5.1	Health Care/Technology	04/01/14	15.0
Clinics	03/26/14	5.0	Diversified/Mezzanine	04/03/14	5.0
E-learning	05/08/14	6.0	<b>Florida Growth Fund II</b>		
Health Care	05/16/14	2.0	Diversified Buyout	12/30/14	10.0
Mobile Technology	06/11/14	3.0	Aerospace	12/22/15	5.0
Health Care	06/26/14	3.8	Diversified/Mezzanine	12/30/15	4.6
Travel Technology	11/05/14	4.0	Technology/Health Care	12/31/15	7.5
Health Care	02/26/15	3.0	Technology/Services	04/28/16	10.0
Restaurants	06/15/15	5.7	Health Care	06/17/16	7.5
Health Care	05/10/16	7.4			
Telecommunications	05/16/16	9.7			
<b>Florida Growth Fund II</b>					
Industrials	07/06/15	5.5			
Building Materials	08/17/15	7.5			
Consumer Products	08/31/15	10.0			
Security	04/27/16	15.0			
Automotive Parts	07/20/16	10.0			
<b>Subtotal Technology and Growth</b>		<b>\$279.5</b>	<b>Subtotal Private Equity</b>		<b>\$232.9</b>
<b>Total</b>					
<b>\$512.4 million</b>					
<b>Gross Internal Rate of Return<sup>1</sup></b>					
Florida Growth Fund I: 13.9%					
Florida Growth Fund II: 8.9%					
<b>Net Internal Rate of Return<sup>1</sup></b>					
Florida Growth Fund I: 11.1%					
Florida Growth Fund II: -1.4%					

<sup>1</sup> Internal rate of return figures are as of June 30, 2016.

Source: State Board of Administration and Hamilton Lane.

Most fund investments are in Florida-based companies; six industries account for over 67% of investments. Seventy-seven percent of total Florida Growth Fund I commitments are in Florida-based companies, and Florida Growth Fund II has invested 91% of its capital in Florida-based companies. According to SBA and Hamilton Lane managers, all of the technology and growth companies have a significant Florida presence that ranges from being headquartered in the state to having a substantial portion of their employees and core divisions or business functions (e.g., engineering, sales, and production) in the state. As of June 30, 2016, investments in these companies resulted in a gross internal rate of return of 14.4% for Florida Growth Fund I and 10.8% for Florida Growth Fund II.

SBA managers also reported that approximately 39% of Florida Growth Fund I and 16% of Florida Growth Fund II private equity fund commitments have been invested in businesses with a significant footprint in Florida. As Florida Growth Fund II matures and underlying fund commitments deploy more capital, exposure to Florida-based companies will increase. As of June 30, 2016, these investments have resulted in a gross internal rate of return of 12.3% for Florida Growth Fund I and -1.5% for Florida Growth Fund II. However, most of the Florida Growth Fund II investments are new funds and are in the early stages of their investment timelines.

Florida Growth Fund direct investments include a wide range of industries, from restaurants to medical device manufacturers to telecommunications companies. However, 67.5% of the investments fall into six industry areas.<sup>11</sup>

- Professional, Scientific, and Technical Services—17.5%
- Information and Electronic Sales—16.6%

- Wood Product and Metal Manufacturing—11.1%
- Administrative and Support Services—10.4%
- Accommodations and Food Services—6.4%
- Health Care and Social Assistance—5.5%

Three of these industries are among Florida’s growth leaders. Specifically, over a six-year period (2009 to 2015), the state’s growth outpaced national growth in accommodations and food services (1.5%), health care and social assistance (1.4%), and professional, scientific, and technical services (0.6%).

Five counties account for a significant portion of fund investments. Florida Growth Fund direct and private equity investments are dispersed across 13 counties. Investment amounts range from \$6.8 million in Manatee County to \$156.3 million in Palm Beach County. Direct and private equity investments in five counties—Broward, Hillsborough, Miami-Dade, Orange, and Palm Beach—account for 76.3% of the funds that have been invested since the program’s inception. (See Exhibit 2.)

Since OPPAGA’s 2015 report, Polk County received its first direct investment of \$10.0 million in an automotive parts company. In addition, several counties that received investments in previous years received additional investments over the past year (e.g., Alachua, Hillsborough, Lee, and Palm Beach counties). During that period, Palm Beach County investments nearly doubled, from \$78.8 million in 2015 to \$156.3 million as of June 30, 2016.

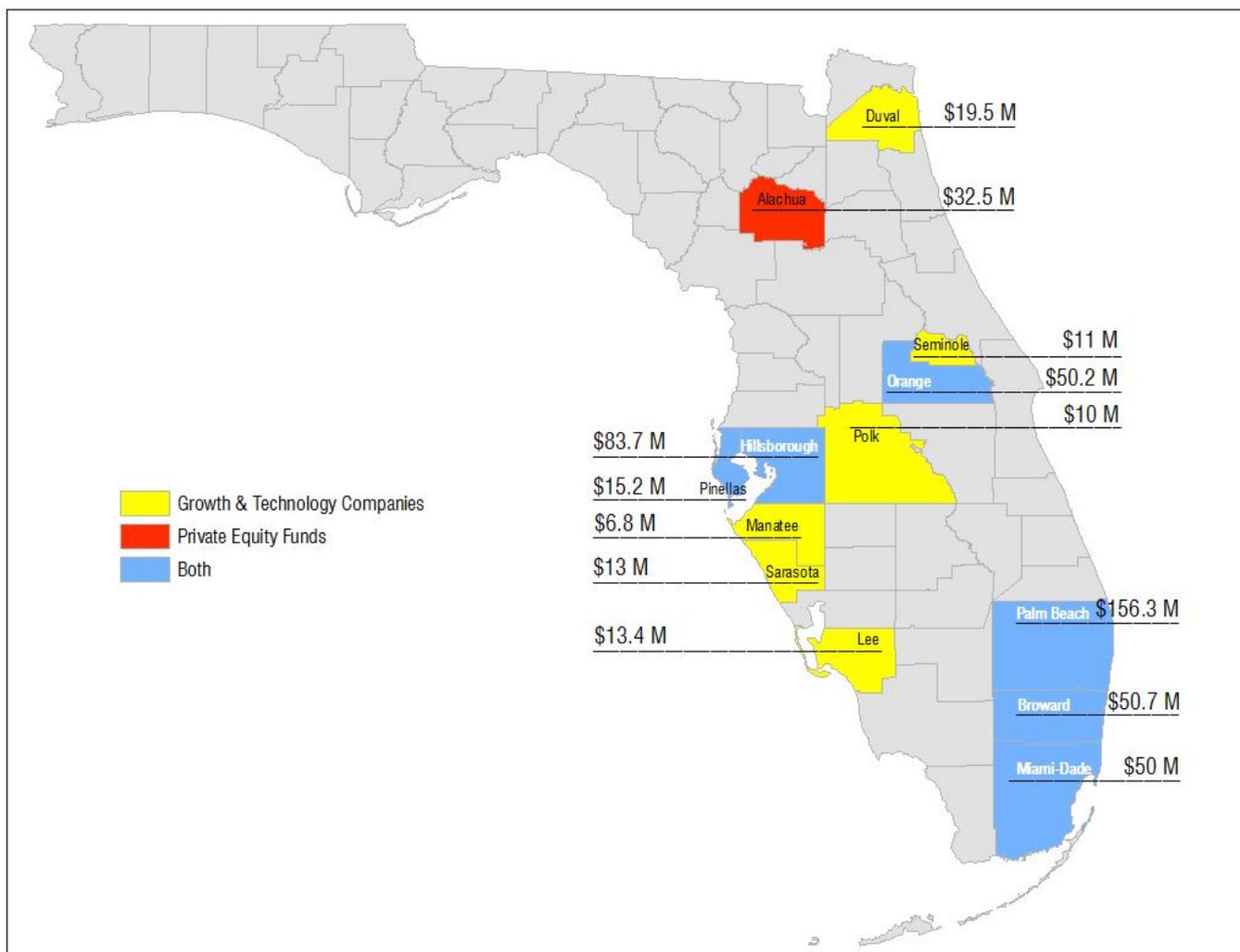
While the private equity funds have offices in specific counties, they may invest in other counties, states, and countries. Thus, the economic impact of the private equity fund commitments likely differs from that of the direct investments in technology and growth companies domiciled in Florida counties.

<sup>11</sup> Businesses’ industry areas were determined using North American Industry Classification System (NAICS) codes. The following codes were used: Professional, Scientific, and Technical

Services (541); Information and Electronic Sales (51 and 443); Wood Products and Metal Manufacturing (32 and 323); Administrative and Support Services (561); Accommodations and Food Services (72); and Health Care and Social Assistance (62).

**Exhibit 2**

**Florida Growth Fund Commitments Totaling \$512.4 Million Are Distributed Across 13 Counties**



Source: OPPAGA analysis of data provided by the State Board of Administration and Hamilton Lane.

***Florida Growth Fund investments have expanded to include credit opportunities and a new tranche of capital***

Since 2009, the SBA has authorized Hamilton Lane to invest a total of \$750 million across four tranches of capital.<sup>12</sup> The first tranche of \$250 million was used to establish the fund in 2009, and a second tranche of \$250 million was provided in 2011. In 2013, to address Florida small businesses’ need for debt capital, SBA managers initiated negotiations with Hamilton Lane to devote approximately \$100 million of uninvested capital from the second tranche to a third tranche used to invest in credit

opportunities. In 2014 the Florida Growth Fund program initiated investing in a fourth \$250 million tranche, Florida Growth Fund II.

Fund managers continue to invest using Florida Growth Fund II capital and the credit tranche. According to SBA and Hamilton Lane managers, the Florida Growth Fund program has continued to see strong investment opportunities in the state of Florida. The investment strategy for Florida Growth Fund II is similar to the strategy of Florida Growth Fund I, which is to make investments in growth and technology companies in the state, as well as private equity funds that invest in Florida.

<sup>12</sup> A tranche is a portion of a larger security.

The credit tranche complements the other Florida Growth Fund tranches by creating an ongoing cash flow stream through monthly or quarterly interest payments. Fund managers seek to invest \$3 million to \$15 million per transaction, with transactions varied by industry and loan type.

As of June 30, 2016, Florida Growth Fund II had made six fund commitments and five co-investments, totaling \$92.6 million in capital, while the credit tranche had made seven investments representing \$39.6 million of invested capital.

The Florida Growth Fund has started to demonstrate significant positive returns to the FRS Trust Fund. SBA managers reported that the fund distributed \$201.5 million to the FRS Trust Fund as a result of its investment activity from inception to June 30, 2016. This liquidity has been the result of full company exits, partial recapitalizations, ongoing dividends, and interest payments from underlying portfolio companies.

As of June 30, 2016, a total of 11 investments had been exited, resulting in more than \$130 million of the \$201.5 million total distributions to the FRS Trust Fund. (See Exhibit 3.) For example, since

OPPAGA's 2015 report, the fund exited an investment in a Jacksonville-based chemical company. The investment resulted in \$21.2 million of distributions to the FRS Trust Fund, a return of over four times the invested capital of \$5 million. At the time the investment was exited, the company reported adding 10 jobs in Florida with an average annual salary of \$77,000 for those jobs created in the year prior to exit. Similarly, during the same period, the fund sold its position in an early stage biotechnology company in South Florida. This sale resulted in \$13.4 million of distributions, a return of almost 2.5 times the initial \$5.4 million investment. The company reported creating seven jobs over the duration of the investment with an average annual salary of \$71,000 for those jobs created in the year prior to exit.

Overall, exited investments had created 2,163 jobs at the time of exit and made more than \$145 million of capital expenditures in Florida. The salaries of jobs created by exited investments ranged from \$33,050 to \$80,584 per year, with an average salary of \$65,436 per year for jobs created in the year prior to exit. This exceeds the state average annual income of \$44,429 per year.

**Exhibit 3**

**Exited Investments Have Distributed \$130.7 Million to the FRS Trust Fund, a 20.3% Gross Internal Rate of Return from \$72.7 Million of Invested Capital**

Industry	Distributions	Gross Internal Rate of Return <sup>1</sup>	Jobs Created	Average Salary <sup>2</sup>	Capital Expenditures
Technology	\$13.6 million	29.5%	80	\$75,000	\$0.5 million
Waste Management	17.5 million	20.1%	790	56,857	138.0 million
Advertising Services	7.3 million	68.1%	50	50,000	-
Medical Devices	0.3 million	-	17	80,584	-
Financial Services	0.2 million	(25.6%)	(44)	-	0.3 million
Biotechnology	13.4 million	27.8%	7	71,000	0.1 million
Chemicals	21.2 million	74.2%	10	77,000	3.5 million
Marketing	49.4 million	40.5%	1,310	33,050	-
Communications	0.0 million	-	(50)	-	-
Travel Technology	4.3 million	16.7%	0	-	-
Health Care	3.4 million	17.1%	(7)	80,000	3.0 million
<b>Total</b>	<b>\$130.7 million</b>	<b>20.3%</b>	<b>2,163</b>	<b>\$65,436</b>	<b>\$145.4 million</b>

<sup>1</sup> Gross Internal Rate of Return reflects the rate of return before any fees are assessed by the fund managers.

<sup>2</sup> These are the average salaries reported to Hamilton Lane for those jobs created in the year prior to the investment being exited.

Source: State Board of Administration and Hamilton Lane

The liquidity in the fund was also complemented by the recapitalizations of existing portfolio companies. Given the strong growth of the companies in which the Florida Growth Fund

program has invested, lenders have felt comfortable making additional loans to these companies. From June 30, 2015 to June 30, 2016, two

such recapitalizations have resulted in \$14.9 million of distributions to the Florida Growth Fund.

The credit tranche also continues to have consistent liquidity from ongoing quarterly interest payments as well as full repayments of loans. For example, the program made a \$3 million loan to a home health care business, resulting in a 1.1 times return of capital.

However, while the Florida Growth Fund program has had several positive outcomes from its investments, there are also some investments that have underperformed. For example, a South Florida communications company in which the program invested \$5 million has lost all of its value given a decrease in sales and a continued use of cash on hand. The company had 50 employees at the time of initial investment, but now has no full-time employees.

### ***Companies receiving Florida Growth Fund investments continue to create jobs and make capital expenditures***

According to Hamilton Lane managers, companies in which the Florida Growth Fund has invested reported creating a total of 15,331 jobs as of June 30, 2016, a net increase of 786 since June 30, 2015. (See Exhibit 4.) This included 4,240 jobs created by technology and growth companies and 11,091 jobs created through investments made by underlying private equity funds commitments.<sup>13</sup> At the same time, five investments resulted in no job growth or loss. Data provided by the fund manager also indicate that companies and funds paid an average annual salary of approximately \$85,604 per new job created over the past year.<sup>14</sup> This exceeds the state's annual mean income of \$44,429. However, incomes vary greatly, ranging from \$15,000 to \$767,000 per year.

Florida Growth Fund direct and equity investments have also resulted in increased capital expenditures. Specifically, 12 growth and technology companies and 7 private equity funds reported making an estimated \$51.8 million in capital expenditures between June 30, 2015, and

June 30, 2016, bringing total capital expenditures to \$364.4 million since the fund's inception.

### **Exhibit 4 Florida Growth Fund Companies Reported Creating 15,331 Jobs Since the Fund's Inception**

Industry	Date Invested	Jobs Created
<b>Technology and Growth Companies</b>		
Aircraft Parts and Leasing	05/26/10	32
Software	09/28/10	38
Medical Products	12/22/10	40
Mobile Technology	01/20/11	(1)
Telecommunications	02/24/11	70
Technology	06/17/11	33
Restaurants	02/13/12	751
Food Services	04/09/12	155
Security	05/24/12	81
Packaging	08/20/12	120
Distribution	03/15/13	248
Restaurants	11/19/13	166
Health Care IT	12/26/13	25
Clinics	03/26/14	2
E-learning	05/08/14	20
Health Care	05/16/14	72
Mobile Technology	06/11/14	(39)
Health Care	06/26/14	6
Restaurants	06/15/15	155
Engineering Services	07/06/15	75
Building Materials	08/17/15	0
Consumer Products	08/31/15	28
Security	04/27/16	0
Health Care	05/10/16	0
Telecommunications	05/16/16	(1)
Automotive Parts	07/20/16	1
Exited Companies <sup>1</sup>		2,163
<b>Subtotal</b>		<b>4,240</b>
<b>Private Equity Funds</b>		
Health Care/Technology <sup>1</sup>	10/01/09	894
Technology/Services <sup>1</sup>	05/17/10	436
Diversified <sup>1</sup>	07/02/10	8,919
Defense/Commercial	07/20/10	155
Distressed/Growth <sup>1</sup>	04/26/11	(95)
Growth/Buyout	06/30/11	0
Early Stage <sup>1</sup>	02/20/12	16
Technology/Health Care <sup>1</sup>	02/28/12	54
Technology/Health Care <sup>1</sup>	03/23/12	220
Manufacturing/Distribution <sup>1</sup>	09/25/12	70
Health Care	03/15/13	61
Growth	04/12/13	314
Life Sciences	07/16/13	1
Health Care/Industrial/Aerospace	12/23/13	38
Aerospace	01/08/16	8
<b>Subtotal</b>		<b>11,091</b>
<b>Total</b>		<b>15,331</b>

<sup>1</sup> Data includes information for companies that were previously reported; these companies have since been exited.

Source: State Board of Administration and Hamilton Lane.

<sup>13</sup> The type of job created through co-investments and private equity fund investments varied widely, from warehouse workers to registered nurses to vice presidents of marketing.

<sup>14</sup> This reflects the average salary reported to Hamilton Lane for those jobs created over the past year.

## **Agency Response** ———

In accordance with the provisions of s. 11.51(2), *Florida Statutes*, a draft of our report was submitted to the Executive Director of the State Board of Administration. The departments' written responses have been reproduced in Appendix A.

## Appendix A

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STATE BOARD OF ADMINISTRATION  
OF FLORIDA

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

POST OFFICE BOX 13300  
32317-3300

RICK SCOTT  
GOVERNOR  
CHAIRMAN

JEFF ATWATER  
CHIEF FINANCIAL OFFICER

PAM BOND  
ATTORNEY GENERAL

A. H. WILLIAMS  
EXECUTIVE DIRECTOR & CIO

November 29, 2016

Mr. R. Philip Twogood  
Coordinator  
Office of Program Policy Analysis & Government Accountability (OPPAGA)  
Claude Pepper Building, Room 312  
111 West Madison Street  
Tallahassee, FL 32399

Dear Mr. Twogood:

We reviewed the preliminary findings and recommendations included in OPPAGA's draft report titled, *Florida Growth Fund Investments Have Provided Over \$200 Million in Distributions to the FRS; Fund Managers Continue to Seek New Investment Opportunities*. We have no objection or questions in regard to the information presented in the report.

As always, we appreciate OPPAGA's diligence and professionalism.

Sincerely,

A handwritten signature in blue ink, appearing to read "Ashbel C. Williams".

Ashbel C. Williams  
Executive Director & Chief Investment Officer

cc: Ms. Melinda Miguel, Chief Inspector General, Executive Office of the Governor  
Ms. Kim Stimer, Chief Audit Executive, State Board of Administration

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# *The Florida Legislature*

## *Office of Program Policy Analysis and Government Accountability*



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Project supervised by Kara Collins-Gomez (850/717-0503)  
Project conducted by Larry Novey, Justin Painter, and Taylor Filaroski  
R. Philip Twogood, Coordinator