



December 2011

Report No. 11-26

# Florida Growth Fund Investments Increase; Additional Data Needed to Estimate Economic Benefit

## *at a glance*

As of October 28, 2011, the Florida Growth Fund had invested \$176.5 million in 15 technology and growth companies and 11 private equity funds. Altogether, these investments have had a net internal rate of return of 23% since the fund's inception; the state would have to sell all or part of an investment that has increased in value to realize an actual return. Based on the fund's performance, the prospects for future investment opportunities, and an independent review of the fund manager, the SBA has authorized the investment of an additional \$250 million.

As of January 2011, eight of the technology and growth companies reported that they had created 451 jobs since the fund's inception. However, additional information is needed to conduct a comprehensive analysis of the investments' direct and indirect economic benefits. This data includes average employee wages, revenues, and capital investments. The fund manager will attempt to collect this data for use in future reports.

## Scope

State law directs OPPAGA to annually review the State Board of Administration's Florida Growth Fund, which invests in technology and high-growth businesses.<sup>1</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 fourth annual report addresses the board's progress in managing the fund.<sup>2</sup>

## Background

The State Board of Administration (SBA) is constitutionally authorized to oversee state funds, including investing state and local government assets.<sup>3</sup> The largest fund that the SBA manages is the Florida Retirement System Trust Fund, which had approximately \$114.5 billion in assets as of September 30, 2011. Although the board makes some of its investments directly, it generally utilizes external fund managers to research, invest, and manage monies in the retirement system portfolio.

<sup>1</sup> Section [215.474](#), F.S.

<sup>2</sup> *Economically Targeted Investment Program Under Development*, OPPAGA [Report No. 08-72](#), December 2008; *SBA Has Implemented the Florida Growth Fund; Economic Impact of Investments May Not Be Apparent for Several Years*, OPPAGA [Report No. 09-45](#), December 2009; and *The Florida Growth Fund Added Investments in 2010, but It Is Still Too Early to Assess Total Economic Impact*, OPPAGA [Report No. 10-60](#), December 2010.

<sup>3</sup> The board is composed of the Governor, Chief Financial Officer, and Attorney General.

State laws allows the SBA to make technology and growth investments using pension funds. The 2008 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. Growth and technology 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, meaning that they must maximize investment returns to the retirement system trust fund first, and maximize statewide economic benefits second.

In June 2009, the SBA implemented this legislation by establishing a limited liability company called the Florida Growth Fund, which was initially 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.<sup>4</sup> The SBA compensates Hamilton Lane from funds that it budgets for this purpose. As of June 30, 2011, the board had paid the firm \$3,961,539 since the growth fund’s inception. The company may also receive a percentage of the distributions from the fund if its investments produce returns.

Hamilton Lane 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 strategic plan prepared by Hamilton Lane and required by the contract, the portfolio is broadly diversified by industry, including business services, information technology, digital media, and life sciences. In addition to providing the SBA with quarterly and annual reports, Hamilton Lane must also annually update an investment plan that the SBA uses to assess the fund’s performance. The investment plan includes portfolio construction guidelines, investment restrictions, benchmark targets, and an overview of the target market.<sup>5</sup>

## Findings

### ***The Florida Growth Fund made nearly \$177 million in investments***

As of October 28, 2011, the Florida Growth Fund had invested \$176.5 million in 15 technology and growth companies and 11 private equity funds managed by 6 companies. (See Exhibit 1.) As of that date, the fund also had a net internal rate of return of 23.06%.<sup>6</sup> The Florida Growth Fund represents approximately 0.15% of the Florida Retirement System Trust Fund.

Investments are Florida-based; actual returns are in the future. The 15 technology and growth companies shown in Exhibit 1 are all Florida based and have a net internal rate of return of 23.75%. In addition, at least 50% of the funds invested in private equity funds are in Florida-based investments and have a net internal rate of return of 19.60%.<sup>7</sup> The fund’s overall net internal rate of

<sup>4</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>5</sup> 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.

<sup>6</sup> The internal rate of return is defined as the rate of return that would make the net present value of all future cash flows equal to zero. The net internal rate of return includes Hamilton Lane’s management fees and expenses, while the gross internal rate of return does not.

<sup>7</sup> In some cases, Hamilton Lane purchases a sidecar or side fund that contains all Florida-based investments while the main fund has a more regional focus.

return was an estimated 23.06% and represents the growth in the value of the entire fund since its inception. The net internal rate of return for each investment varied widely. For example, the range for technology and growth companies was -2.53% to 249.93%, while the range for private equity funds was -78.02% to 172.95%. However, the

investments do not currently pay dividends or capital gains. To realize an actual return, the state would have to sell all or part of an investment that has increased in value. According to SBA and Hamilton Lane managers, an overall industry guideline for holding the types of investments in the Florida Growth Fund is three to six years.

### Exhibit 1

#### As of October 28, 2011, the Florida Growth Fund Had Committed to Invest \$176.5 Million in 15 Companies and 11 Equity Funds

| Company Description  | Date Invested | Amount Invested        |
|--|---------------|------------------------|
| <b>Technology and Growth Companies</b>   |               |                        |
| Orlando-based telecommunications company   | 09/18/09      | \$4.5 million          |
| Tampa Bay-based digital media advertising services firm                                      | 12/30/09      | \$1.5 million          |
| Longwood-based waste management company  | 11/03/09      | \$7.1 million          |
| Coral Gables-based de novo aircraft parts and leasing business                               | 05/26/10      | \$10.0 Million         |
| Winter Park-based medical device company that makes lasers for cataract surgery              | 07/16/10      | \$8.0 million          |
| Boca Raton-based specialty commercial finance lender   | 08/16/10      | \$2.0 million          |
| Fort Myers-based enterprise software company that makes speech analytics solutions           | 09/28/10      | \$3.0 million          |
| Boca Raton-based medical products company focused on at-home sleep apnea diagnosis           | 12/22/10      | \$2.0 million          |
| Miramar-based company that makes compounds for treating of cancer and infectious diseases    | 01/18/11      | \$3.0 million          |
| Boca Raton-based aggregator of location data for wireless carriers                           | 01/20/11      | \$4.4 million          |
| Jacksonville-based global supplier and refiner of pine-based chemicals                       | 02/02/11      | \$5.0 million          |
| Jacksonville-based sales and marketing agency serving the consumer packaged goods industry   | 02/24/11      | \$14.5 million         |
| Tampa Bay-based technology services provider for the wireless telecommunications industry    | 02/24/11      | \$15.1 million         |
| Boca-Raton-based communications company  | 04/11/11      | \$5.0 million          |
| St. Petersburg-based technology company  | 06/17/11      | \$7.5 million          |
| <b>Total</b>   |               | <b>\$92.6 million</b>  |
| <b>Net Internal Rate of Return</b>   |               | <b>23.75%</b>          |
| <b>Private Equity Funds</b>  |               |                        |
| St. Petersburg-based fund that invests in Florida healthcare, communications, and technology | 10/01/09      | \$15.0 million         |
| West Palm Beach-based fund that invests across diversified Florida industries                | 05/17/10      | \$15.0 million         |
| Charlotte, NC-based mezzanine fund that invests in various Southeast businesses              | 07/02/10      | \$5.0 million          |
| Charlotte, NC-based mezzanine fund that invests in various Southeast businesses-sidecar      | 07/02/10      | \$2.5 million          |
| Winter Park-based fund that invests in early/seed stage defense/commercial companies         | 07/20/10      | \$7.5 million          |
| Miami-based growth-stage venture capital fund focusing on biotechnology and medical devices  | 01/21/11      | \$15.0 million         |
| Charlotte, NC-based mezzanine fund that invests in various Southeast businesses (secondary)  | 02/23/11      | \$1.4 million          |
| West Palm Beach-based fund that invests in distressed or turnaround situations               | 04/26/11      | \$5.0 million          |
| West Palm Beach-based fund that invests in distressed or turnaround situations (side fund)   | 04/26/11      | \$5.0 million          |
| Miami-based fund focusing on control and growth buyout equity investments                    | 06/30/11      | \$10.0 million         |
| Winter Park-based fund that invests in early/seed stage defense/commercial companies-sidecar | 08/24/11      | \$2.5 million          |
| <b>Total</b>   |               | <b>83.9 million</b>    |
| <b>Net Internal Rate of Return</b>   |               | <b>19.60%</b>          |
| <b>Grand Total</b>   |               | <b>\$176.5 million</b> |
| <b>Net Internal Rate of Return</b>   |               | <b>23.06%</b>          |

Source: State Board of Administration and Hamilton Lane.

Hamilton Lane has taken several steps to minimize investment risk. As noted in our 2010 report, State Board of Administration managers reported that they have directed Hamilton Lane to diversify investments in the fund to minimize risk. Consequently, Hamilton Lane has invested in companies representing various industries such as aircraft parts, medical products, telecommunications, and waste management. Similarly, private equity fund investments are stratified among companies that invest in early-stage, growth-stage, and mezzanine-level companies and funds.

Further, Hamilton Lane managers report that they always work with co-investors or partners with expertise in specific industries and who also serve as lead investors. In addition, the Florida Growth Fund never contributes more than 50% of any single investment. Moreover, some investments are made in stages as companies or equity funds meet specific milestones. For example, Federal Food and Drug Administration approval of a company’s medical product could be a milestone that triggers additional investment.

In many cases, companies give the Florida Growth Fund non-voting positions on their boards of directors. These positions are filled by a Hamilton Lane representative who has access to all company information provided to voting board members.

Based on several factors, the SBA has authorized additional Florida Growth Fund investments. The SBA initially authorized Hamilton Lane to invest \$250 million of Florida Retirement System Trust Fund assets in growth and technology businesses. To assess the success of these investments, the SBA hired a consulting firm to review Hamilton Lane’s management of the Florida Growth Fund. The firm based its assessment on the fund manager’s

- staff and organization;
- investment philosophy and process;
- operational due diligence and resources;
- fees and structure; and
- performance.

In a June 2011 memorandum to the SBA, the firm reported that Hamilton Lane scored above average in all categories.

Based on the fund’s performance, the prospects for future investment opportunities, and the positive independent review of Hamilton Lane’s management of the fund, on September 1, 2011, the SBA authorized Hamilton Lane to invest an additional \$250 million. SBA and Hamilton Lane managers do not anticipate adopting a new strategy for this second round of investments.

***Companies receiving Growth Fund investments have used them to create jobs and expand business activities***

Hamilton Lane managers report that 8 of the 15 technology and growth companies receiving Florida Growth Fund investments created 451 jobs between the fund’s inception and January 2011. (See Exhibit 2.) The number of jobs created ranged from 1 (Miramar pharmaceutical company) to 318 (Longwood-based waste management company).

**Exhibit 2  
Florida Growth Fund Companies Have Created 451 Jobs Since the Fund’s Inception**

| Industry                   | Location     | Date Invested | Jobs Created |
|----------------------------|--------------|---------------|--------------|
| Telecommunications         | Orlando      | 09/21/09      | 16           |
| Digital Media Advertising  | Tampa Bay    | 12/30/09      | 83           |
| Aircraft Parts and Leasing | Coral Gables | 02/08/10      | 11           |
| Medical Devices            | Winter Park  | 07/15/10      | 14           |
| Commercial Lender          | Boca Raton   | 08/16/10      | 3            |
| Enterprise Software        | Fort Myers   | 09/28/10      | 5            |
| Waste Management           | Longwood     | 11/03/10      | 318          |
| Pharmaceuticals            | Miramar      | 01/18/11      | 1            |
| <b>Total</b>               |              |               | <b>451</b>   |

Source: Hamilton Lane.

Although it is difficult to attribute all of the job growth to Florida Growth Fund investment activities, five of the six company managers we were able to contact reported that the investments were crucial in allowing their companies to hire more employees. One manager said the additional workers enabled the company to serve more customers, while another reported that the company’s additional workers prepared a major product for the manufacturing process. Moreover, a company that did not use the growth fund investment to create new jobs reported using it to pay the salaries of current employees and to fund clinical trials and drug manufacturing.

***Additional performance information is needed to calculate the Growth Fund’s economic benefit to the state***

Florida law requires OPPAGA to analyze the direct and indirect economic benefits to the state resulting from Florida Growth Fund investments. The statutes authorize us to conduct these analyses in consultation with the Legislature’s Office of Economic and Demographic Research (EDR). To date, the data necessary to complete this analysis has been unavailable, primarily because the fund’s investments were made too recently to result in measureable economic benefits.

OPPAGA’s future annual reports will attempt to measure these direct and indirect economic benefits using an input-output model such as the statewide model or REMI.<sup>8</sup> The model results will be reported in the aggregate, as a measure of the growth fund’s economic impact, not on an investment-by-investment basis. According to EDR officials, the model requires the collection of various data from the companies and equity funds

in which the Florida Growth Fund is invested. This data includes

- jobs created;
- average employee wages and high and low wage ranges;
- employee position titles;
- revenues for all activities and those related to the Florida Growth Fund; and
- capital investments.

However, according to SBA managers and Hamilton Lane representatives, the Florida Growth Fund does not require companies in which it invests to report such information. This is because the fund’s goal is to maximize risk-adjusted returns for the Florida Retirement System, not to collect economic development data. Further, SBA officials reported that the companies consider this data proprietary confidential business information, the disclosure of which they believe would harm their business operations.<sup>9</sup>

Nevertheless, Hamilton Lane representatives reported that the fund manager would continue to request that companies provide some of the data necessary for a more comprehensive economic analysis, specifically employee wages, position types, and job growth trends. In future annual reports, OPPAGA, with the assistance of the Office of Economic and Demographic Research, will use this information to provide estimates of direct and indirect economic benefits to the state.

## Agency Response —————

In accordance with the provisions of s. 11.51(5), *Florida Statutes*, a draft of our report was submitted to the State Board of Administration for review and response. The written response has been reproduced in Appendix A.

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<sup>8</sup> Regional Economic Models, Inc., (REMI) is a private group that develops regional forecasting and policy-analysis models. The REMI model incorporates aspects of four major modeling approaches: Input-Output, General Equilibrium, Econometric, and Economic Geography. Each of these methodologies has distinct advantages as well as limitations when used alone. The REMI integrated modeling approach builds on the strengths of each of these approaches.

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<sup>9</sup> Section [215.4401\(3\)\(b\)](#), *F. S.*, provides that proprietary confidential business information held by the SBA regarding alternative investments, such as those held by the Florida Growth Fund, are exempt from the constitutional provision that allows the public to inspect or copy public records. This exemption is in effect for 10 years after the termination of an investment.

**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

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EXECUTIVE DIRECTOR & CIO

December 21, 2011

Mr. R Philip Twogood  
Coordinator  
OPPAGA  
Claude Pepper Building, Room 312  
111 West Madison Street  
Tallahassee, FL 32399

Dear Mr. Twogood:

We reviewed OPPAGA's preliminary and tentative report entitled, *Florida Growth Fund Investments Increase; Additional Data Needed to Estimate Economic Benefit*. 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,

A handwritten signature in blue ink that reads "Ashbel C. Williams".

Ashbel C. Williams  
Executive Director & CIO

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



# *The Florida Legislature*

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

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OPPAGA provides performance and accountability information about Florida government in several ways.

- Reports deliver program evaluation and policy analysis to assist the Legislature in overseeing government operations, developing policy choices, and making Florida government better, faster, and cheaper.
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Project supervised by Kara Collins-Gomez (850/487-4257)  
Project conducted by Darwin Gamble, Larry Novey, and Alex Regalado  
R. Philip Twogood, Coordinator