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 Committee on Commerce and Tourism

BILL: SB 446

INTRODUCER: Senator Hukill

SUBJECT: Economic Development Incentive Application Process

DATE: March 1, 2013 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Siples	Hrdlicka	CM	**Pre-meeting**
2.			ATD	
3.			AP	
4.				
5.				
6.				

I. Summary:

SB 446 adds the requirement that as a condition to receiving incentives under the Quick Action Closing Fund and the Innovation Incentive Program, an applicant must obtain a surety bond, issued by an eligible or authorized bonding or insurance company, for the entire amount of the award. The Department of Economic Opportunity may grant a waiver of the surety bond requirement by certifying, in writing, to the Governor, President of the Senate and Speaker of the House of Representatives, an explanation stating its reasons for granting a waiver. If the surety bond requirement is waived, the applicant will then be required to secure the award through either an irrevocable letter of credit, cash or securities held in trust by a financial institution and subject to a control agreement, or a secured transaction in collateral under the control or possession of the applicant.

This bill substantially amends s. 288.061, F.S.

II. Present Situation:

Quick Action Closing Fund

The Quick Action Closing Fund (QACF) is a discretionary "deal closing" tool to be used by the Department of Economic Opportunity (DEO or department) in highly competitive negotiations where Florida's traditional incentives are not enough to win the deal.[1] Created by the Legislature in 1999, the QACF is intended to give Florida an opportunity to compete effectively for high-

[1] Enterprise Florida, Inc. (EFI), *2012 Annual Incentives Report*, *available at* http://www.floridajobs.org/about%20awi/open_government/2012_IncentivesReport.pdf (last visited February 25, 2013).

impact business facilities, critical private infrastructure in rural areas, and key businesses in economically distressed urban or rural communities, as well as the retention or creation of high-tech jobs that are directly associated with a more diverse aerospace economy in Florida.[2]

The department and Enterprise Florida, Inc. (EFI), have responsibilities to evaluate projects to determine eligibility for QACF funds.[3] Within 7 days of completion of its evaluation, the department must recommend to the Governor approval or disapproval of funds from the QACF for the project. The department must also provide any proposed performance conditions if it recommends approval of the project. Upon approval of the Governor, the department and the applicant shall enter into an agreement that sets forth the conditions for payment of the incentive funds.[4] The agreement must include, among other things, the total amount of funds awarded, performance conditions that must be met in order to obtain the award, demonstration of a baseline of current service and a measure of enhanced capability, the methodology for validating performance, and sanctions for failure to meet performance conditions. Funds awarded under this incentive are generally paid out after the business has made a substantial investment toward tangible personal property tied to the project.[5]

EFI is directed to validate the contractor's performance and make a report to the Governor and Legislature within 6 months after the completion of the contract.

Innovation Incentive Program

The Innovation Incentive Program (IIP) was created by the Legislature in 2006.[6] The purpose of the program is to provide financial resources so that the state can "respond expeditiously to extraordinary economic opportunities and to compete effectively for high-value research and development, innovation business, and alternative and renewal energy projects."[7]

To be eligible for consideration and qualify for a review for an IIP award, a prospective applicant must submit a written application to DEO prior to making a decision to locate new operations or expand an existing operation in this state. The application must include, among other things, existing business information, the location of the prospective project, a description of the type of business activity, product or research development to be undertaken, the total investment from all sources, the net new full-time equivalent jobs and the average wage of such jobs, the anticipated commencement date, and a detailed explanation of why the innovation incentive is needed to induce the applicant to expand or locate in Florida and whether an award would cause the applicant to do so.[8] The criteria used by the department to evaluate and recommend a project are detailed in s. 288.1089(5), F.S. In negotiating the amount of the award, the department must

[2] Section 288.1088, F.S.
[3] Section 288.1088(3), F.S.
[4] The Governor may approve projects requiring less than $2 million in funding without consulting the Legislature. For projects requiring funding between $2 million and $5 million, the Governor must provide a written description and evaluation of the project to the chair and vice chair of the Legislative Budget Commission at least 10 days prior to approving the project. For projects requiring more than $5 million in funding, the Legislative Budget Commission must approve the project prior to the release of funds. *See* s.. 288.1088 (3)(c), F.S.
[5] EFI, *2012 Annual Incentives Report*.
[6] Chapter 2006-55, L.O.F.
[7] Section 288.1089(1), F.S.
[8] For a comprehensive list of the criteria the department must consider, see s. 288.1089(3), F.S.

consider the amount of the incentive needed to induce the applicant to locate or expand in this state, as well as the statutorily prescribed criteria. The Governor must approve or deny the award based on the evaluation and recommendation received from the department. The Governor must consult with the President of the Senate and the Speaker of the House of Representatives prior to approving an award. The funds may not be released until the award has been reviewed and approved by the Legislative Budget Commission.

Once the approval process has been completed, the department and the award recipient will enter into an agreement that specifies the amount of the award, the performance conditions and measures, and a schedule of payments and sanctions for failure to comply with performance conditions, including clawbacks. New contracts must also include, among other things, provisions related to job creation, reinvestment of royalty revenues, reporting requirements, and a process for amending the agreement.[9]

Program Operations

For contracts executed under the QACF or the IIP, the department includes clawback provisions and sanctions for non-performance.[10] Sanctions for noncompliance generally include a requirement that the company repays all or a portion of the incentive award, plus interest. The contracts may also include the right to impose a lien on the assets of the business.

Since its inception through June 2012, 120 projects have been approved to receive QACF grants.[11] As of the end of the 2010-2011 fiscal year, the state has executed 98 contracts. Of those, 10 businesses have received one or more incentive payments after meeting a portion of their contract requirements but are now ineligible for future payments and for two of the completed QACF contracts, companies were required to repay funds when projects did not meet expectations. For the IIP, there are nine approved projects and there are no projects for which contractors have become ineligible for payments or had to repay expended funds.

Surety Bonds and Letters of Credit

A surety bond represents an agreement to ensure performance between three parties: the principal, the obligee, and the surety.[12] The principal is the entity whose debt or default is in the subject of the bond. The obligee is the entity to which the principal owes a duty of performance. With a performance bond, there is a guarantee that the contractor or principal will perform the contract and if the principal defaults or fails to complete the contract, the surety must pay damages up to the limit of the bond or has to complete the contract.[13] A surety bond usually costs about 0.5 percent to 2 percent of the contract amount.[14] In determining whether to issue a surety bond, a surety company will typically review the contractor's capacity to perform the

[9] Section 288.1089(8), F.S.
[10] Department of Economic Opportunity, *Senate Bill 446 Bill Analysis*, (Jan. 25, 2013) (on file with the Senate Commerce and Tourism Committee).
[11] DEO, *2012 Annual Incentives Report.*
[12] 72 C.J.S. *Principal and Surety* s. 12 (2013).
[13] 7 FLA. JUR. 2D BONDS s. 17 (2013).
[14] Surety Information Office, *Surety Bonds or Bank Letters of Credit*, *available at* http://suretyinfo.org/?wpfb_dl=69 (last visited February 25, 2013).

requirements of the project and the company's financial situation, including a review of financial statements, credit score, and credit references.[15]

An irrevocable letter of credit is an instrument that acts as a guarantee for payment in the event of default in the performance of the contract. The cost of a letter of credit is usually 1 percent of the contract amount covered by the letter of credit.[16]

Florida has also required surety bonds in the construction or repair of public buildings or works. Pursuant to s. 255.05, F.S., a performance bond is required to be posted when an entity contracts with the state or a local government for the construction or repair of a public building or work. For state agencies with any contract for more than $100,000, a performance bond or some other security in the amount of the contract must be posted prior to commencing work.[17] The threshold amount for local governments is $200,000. The statute also provides that other forms of securitization, such as an irrevocable letter of credit, cash, or a certified check may be tendered in lieu of a surety bond.

III. Effect of Proposed Changes:

Section 1 amends s. 288.061, F.S., by requiring that incentive agreements that award funds through the Quick Action Closing Fund or the Innovation Incentive Program must be guaranteed or secured. The applicant may accomplish this by posting either a surety bond or an alternate securitization.

Surety Bond

As a condition of receiving funds under ss. 288.1088 or 288.1089, F.S., an applicant must obtain a surety bond, issued by an eligible or authorized bonding or insurance company. Funds may not be paid to the applicant until the department certifies compliance with this requirement. The contract may provide that up to half of the premium payment may be paid from the award but may not exceed 3 percent of the award. The applicant must notify the department at least 10 days before each premium payment is due. Further, the contract or agreement must provide that the bond remain in effect until all performance conditions are satisfied. If an applicant receives a notice of cancellation or nonrenewal of the bond,[18] the department must be immediately notified. The cancellation or nonrenewal of a surety bond will be a violation of the contract or agreement between the applicant and the department. As such, the department will be released from any obligation to make future scheduled payments unless the applicant is able to obtain a new surety

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[15] The Associated General Contractors of America and National Association of Surety Bond Producers, *The Basic Bond Book, Second Edition, available at* http://nasbp-news.org/basicbondbook/pdf/2011-NASBP-Basic-Bond-Book.pdf (last visited February 25, 2013).

[16] Surety Information Office, *Surety Bonds or Bank Letters of Credit.*

[17] For contracts between $100,000 and $200,000, the Secretary of Management Services may delegate to state agencies the authority to exempt an entity from the performance bond requirement. For contracts in excess of $250 million, if a bond for the contract amount is not available at a reasonable cost, the state or the local government may set the bond at the largest amount reasonably available, but not less than $250 million.

[18] An issuer of the surety must provide at least 45 days advance written notice if it plans to not renew the surety bond or for any other reason other than nonrenewal or cancellation. If the issuer cancels the surety bond for nonpayment, the issuer must provide 10 days written notice. If the cancellation or termination occurs within the first 90 days, the issuer must provide at least 20 days written notice. *See* s. 626.9201, F.S.

bond or secure the award by the option described below within 90 days before the effective date of the cancellation of the bond.

Alternate Securitization

The department may grant a waiver of the surety bond requirement if the applicant is unable to acquire a surety bond or can demonstrate that obtaining a bond is unreasonable in cost. If the department grants a waiver, it must certify in writing to the Governor, President of the Senate, and Speaker of the House of Representatives the following information:

- An explanation stating the reasons why the applicant is unable to obtain a bond, to the extent such information is not confidential;
- A description of the economic benefits expected to be generated by the incentive award that indicates that the project warrants waiver of the requirements; and
- An evaluation of the quality and the value of the applicant which supports the selection of alternative securitization, including:
  - A financial analysis of the company, including an evaluation of the company's short-term liquidity ratio measured by its assets to liability, the company's profitability ratio, and company's long-term solvency measured by its debt-to-equity ratio;
  - The historical market performance of the company;
  - A review of any independent evaluations of the company;
  - A review of the latest audit of the company's financial statement and the related auditor's management letter; and
  - A review of any other types of audits that were related to the internal and management controls of the company.

If the department grants a waiver, the incentives contract or the agreement must contain a provision requiring the applicant to secure the award through:

- An irrevocable letter of credit issued by a financial institution[19] with a physical office in Florida and whose deposits are federally insured;
- Cash or securities held in trust by a financial institution and subject to a control agreement; or
- A secured transaction in collateral under the control of the applicant for the value of the award amount. The department has authority to negotiate the terms and conditions of the security agreement.

Similar to the surety bond requirement, the contract or agreement must provide that the release of any funds is contingent upon the receipt of documentation by the department evidencing compliance with these provisions. Additionally, the selected security arrangement must remain in effect until all performance conditions specified in the contract or agreement have been satisfied. Any breach will result in violation of the contract or agreement and releases the department from its obligation to make any future scheduled payments.

[19] A "financial institution" is defined as a state or federal savings or thrift association, bank, savings bank, trust company, international bank agency, international banking corporation, international branch, international representative office, international administrative office, international trust company representative office, credit union, or an agreement corporation operating pursuant to s. 25 of the Federal Reserve Act, 12 U.S.C. ss. 601 et seq. or Edge Act corporation organized pursuant to s. 25(a) of the Federal Reserve Act, 12 U.S.C. ss. 611 et seq. *See* s. 655.005, F.S.

In the event of a default under either securitization provisions, the department may, in addition to any other remedies under the law, sue to enforce its interest.

This section grants rulemaking authority to the department to adopt rules to implement this section.

Section 2 provides that this act shall take effect July 1, 2013.

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:

None.

B. Private Sector Impact:

SB 446 may impose costs on prospective applicants due to the requirement to secure or guarantee the award amount. The costs imposed may be in the form of premiums or other professional fees related to creating the secured transaction.

C. Government Sector Impact:

SB 446 may impose some indeterminate recurring cost to DEO to setup and maintain a tracking system for the financial instruments. There may also be administrative costs incurred by DEO to comply with the necessary rule-making authorized by the bill.[20]

VI. Technical Deficiencies:

Under section (3)(a), the bill indicates that the bond must be issued by an "eligible or authorized bonding company"; however, it fails to define which bonding companies are eligible or authorized.

[20] Department of Economic Opportunity, *Senate Bill 446 Bill Analysis,* (Jan. 25, 2013) (on file with the Senate Commerce and Tourism Committee).

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.

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