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ADMINISTRATIVE AND RESEARCH OFFICE
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FINANCIAL ADMINISTRATION DIVISION
OFFICE OF FEDERAL AWARDS MANAGEMENT (OFAM)

EMPLOYEES' RETIREMENT SYSTEM
HAWAII' EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
OFFICE OF THE PUBLIC DEFENDER

December 28, 2020

The Honorable Ronald D. Kouchi
President and Members
of the Senate
Thirtieth State Legislature
State Capitol, Room 409
Honolulu, Hawaii 96813

The Honorable Scott K. Saiki
Speaker and Members of the
House of Representatives
Thirtieth State Legislature
State Capitol, Room 431
Honolulu, Hawaii 96813

Dear President Kouchi, Speaker Saiki and Members of the Legislature:

For your information and consideration, I am transmitting a copy of the Innovation Economy 2020 report, as required by Act 260, Session Laws of Hawaii 2007. In accordance with Section 93-16, Hawaii Revised Statutes, a copy of this report has been transmitted to the Legislative Reference Bureau and the report may be viewed electronically at <http://ers.ehawaii.gov/resources/reports-to-legislature>.

Sincerely,

CRAIG K. HIRAI
Director of Finance

Enclosure

c: Legislative Reference Bureau

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EMPLOYEES' RETIREMENT SYSTEM
OF THE STATE OF HAWAII

ACT 260, SESSION LAWS OF HAWAII 2007
RELATING TO THE INNOVATION ECONOMY

HAWAII VENTURE CAPITAL INVESTMENT
2020

Act 260, Session Laws of Hawaii 2007, expresses the State's desire to increase economic growth through the development of the State's human resources, and employing these highly skilled resources to leverage increases in innovation across the State's economy.

The Board of Trustees of the Employees' Retirement System (ERS) acknowledges the intent of Act 260. Accordingly, the ERS, through its investment policies and an appropriate-sized funding allocation, has demonstrated a commitment to supporting an innovation economy while at the same time pursuing its objectives of achieving attractive venture capital investment return for the benefit of its beneficiaries.

The ERS Board approved the creation of a Hawaii Targeted Investment Program (HiTIP) Policies and Procedures on March 10, 2008, which included the adoption of funding criteria, as required by Act 260. A \$25 million program funding allocation and a comprehensive HiTIP operating structure were approved on November 10, 2008 and December 8, 2008, respectively. A \$35 million program for HiTIP II was approved on September 12, 2016 and closed in the first quarter of 2017. A \$50 million program for HiTIP III was approved on November 12, 2019 and closed in December 2019. In May 2020, the allocation to HiTIP III was increased by \$25 million to a total of \$75 million. The purpose of the HiTIP is to invest venture capital in locally-based early-stage technology companies through a portfolio of local, regional, and national venture capital funds within an institutional investment program structure. Under a competitive search process, the ERS selected a discretionary investment manager to operate and manage the HiTIP, which is projected to have a program lifespan of up to 15 years per fund.

The ERS is required to annually report any Hawai'i venture capital investment. For calendar-year 2020, the ERS has supported Act 260 through the following investment measures:

- Since inception, HiTIP has committed \$81.25 million into twenty private equity funds and one Hawai'i-based co-investment. HiTIP I, at \$25.25 million of total capital, is fully committed to seven private equity funds and one co-investment. HiTIP II, a \$35.25 million pool, began investing in 2017 and has committed \$32.5 million to eleven private equity funds. HiTIP III, at \$75.25 million pool, began investing in late 2019 and has committed \$13.5 million to four private equity funds. Note, two underlying fund investments are split across HiTIP II & HiTIP III so the total number of unique private equity funds across all three HiTIP programs is twenty not twenty-two.
- HiTIP seeks to invest in the major industry sectors of the Hawaiian entrepreneurial ecosystem. The sector exposure of HiTIP I, as a percent of remaining value as of September 30 2020, is 57% Healthcare/Life Sciences, 12% Enterprise, 9% Tech – Cloud/SaaS/Software, 9% Consumer Products and Services, 5% Media/Entertainment/Communications, and 8% Other. For HiTIP II the sector exposure, as a percent of remaining value as of September 30 2020, is 50% Tech –

Cloud/SaaS/Software, 20% Healthcare/Biopharmaceuticals/Biotechnology, 12% Enterprise Products and Services, 5% Real Estate, 5% Consumer Products and Services, and 8% Other. For HiTIP III, the sector exposure, as a percent of remaining value as of September 30 2020, is 66% Tech – Cloud/SAAS/Software, 27% Enterprise Products and Services, 2% Real Estate, and 5% Other.

- Since inception, HiTIP funds have looked at 1,384 investment opportunities with 766 Hawai'i-based companies. Of these companies, 207 are currently being tracked for a potential future investment.
- HiTIP I funds have invested into five companies operating in or that were started in Hawai'i. Total direct investment by HiTIP I funds into Hawaiian companies is \$35.8 million, 143% of ERS's HiTIP I commitment. Including capital from co-investors, \$255 million has been invested into Hawaiian companies, 1,020% of ERS's HiTIP I commitment. HiTIP II funds, which in aggregate are still early in their investment periods, have invested into four companies operating in or that were started in Hawai'i. Total direct investment by HiTIP II funds into Hawaiian companies is \$0.2 million, 0.5% of ERS' HiTIP II commitment. Including capital from co-investors, \$2.5 million, 7.0% of ERS' HiTIP II commitment. HiTIP III is still early in its investment phase and multiple Hawai'i based companies are in discussions with HiTIP funds for potential investment.
- As of September 2020, the HiTIP I portfolio has distributed 74% of invested capital. A major source of liquidity in the portfolio has come from twelve Initial Public Offerings (IPOs). Polaris Venture Partners VI portfolio companies Alector (ALEC) and Covetrus (CVET) went public in February 2019. Polaris Venture Partners VI portfolio company Scholar Rock (SRRK) went public in 2018. MPM BioVentures V portfolio company Rhythm Pharmaceuticals (RYTM) completed its initial public offering in 2017. Epic Venture Partners IV portfolio company Everspin Technologies (MRAM) and Polaris Venture Partners VI portfolio company Editas Medicine (EDIT) went public in 2016. Another Epic portfolio company, Instructure (INST) and Pantentes Talgo (TGO) from Vantera Transformative Energy and Materials Fund went public in 2015. Conatus Pharmaceuticals (CNAT) and Aratana Therapeutics (PETX) from MPM BioVentures V and Receptos (RCPT) from Polaris Venture Partners VI went public in 2013. Verastem (VSTM) from MPM BioVentures V went public in 2012. As of September 30, 2020, the gross Internal Rate of Return (IRR) of the HiTIP I fund is 8.77% with a Distributed to Paid-In Ratio (DPI) of 0.74x and a Total Value to Paid-In Ratio (TVPI) of 1.51x.
- As HiTIP II is still heavily in the investment stage for its funds as of September 2020, only 2% of invested capital has been distributed. During the course of the year, fund managers have made an aggregate of 48 investments. As of September 30, 2020 the gross Internal Rate of Return (IRR) of the HiTIP II fund is 4.50% with a Distributed to Paid-In Ratio (DPI) of .02x and a Total Value to Paid-in Ratio (TVPI) of 1.06x.
- HiTIP III is too early for meaningful performance data.
- Despite the unusual and limited year for traveling, there were over 1,240 hours spent by HITIP fund managers to mentor and assist local companies (nearly an 80% increase from the prior year). This represented an accumulation of 71 days and 17 trips over the course of a full year ending June 30, 2020. In these sessions, approximately 40% of the reported activity related to instances of one on one mentorship for local companies. Additionally,

nearly a third of the reported activity related to diligence, which in some scenarios led to investments for local start-ups.

- Hawaiian HiTIP fund companies have spent \$4.29 million in Hawai'i, and produced a gross output of \$4.61 million in goods and services in the state. These companies employed 138 people in total, 22 of which were based in Hawai'i. The companies have also paid \$4.39 million in wages and salaries to full-time employees and \$790 thousand to part-time employees in Hawai'i. The expectation is for these results to continue to accelerate with the most recent addition of HiTIP III and the continued investment activity from the prior programs.