

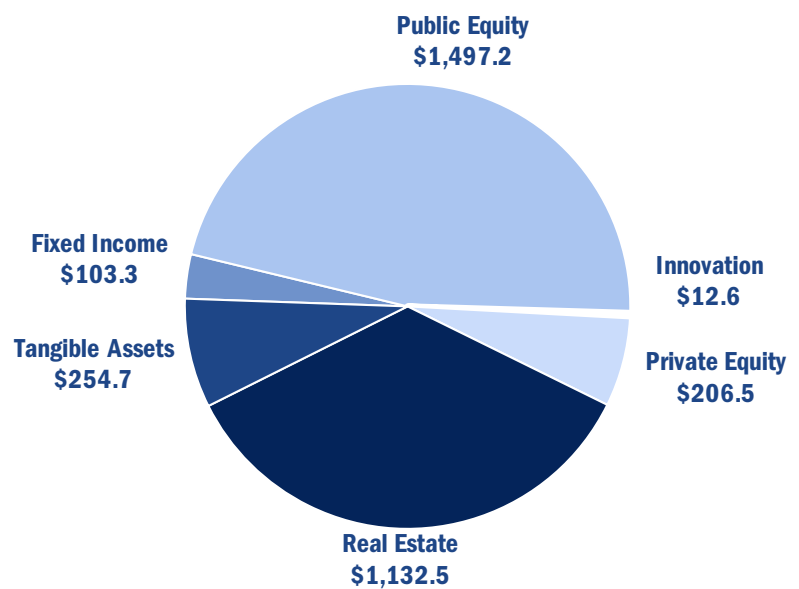


INVESTING IN WASHINGTON

While the Washington State Investment Board continually seeks the best investment opportunities no matter where they might be located worldwide, the state of Washington is home to many tremendous companies that offer the WSIB excellent investment opportunities. Many Washington investments can be found in all of the WSIB's investment portfolios.

The Economically Targeted Investment (ETI) Policy was adopted by the WSIB in March 2003 to confirm that the Investment Board will continue to seek quality investment opportunities in Washington state in accordance with established policies, statutory mandates and fiduciary duties.

The ETI policy directed WSIB staff to provide an annual progress report to the Board, beneficiaries, the Legislature and the Governor on Washington-based investment initiatives involving the WSIB, its private equity General Partners, and other groups and organizations working to improve economic opportunity and growth statewide.



Note: The private equity and real estate totals are WSIB's proportional share of the estimated fair market value of fund and property investments held by partnerships in which the WSIB participates.

Washington State Investment Board Economically Targeted Investments Policy



**2019 Annual Report
February 20, 2020**

Introduction and Summary

At the core of the Washington State Investment Board's (WSIB or the Board) risk management program is the fact that we build globally diversified investment portfolios. As of September 30, 2019, the Board managed \$141.8 billion in 37 funds investing on 6 continents, in 87 countries, within 46 currencies, and over 15,000 investment holdings. The Board conducts its investment activities in accordance with investment policies and procedures designed to maximize return at a prudent level of risk. Asset allocation explains over 90 percent of the variability of return. Accordingly, the WSIB invests in global asset classes including public equity, fixed income, real estate, tangible assets, and private equity to help control risk and ensure stronger overall performance.

This is the seventeenth annual report on the WSIB Economically Targeted Investments (ETI) policy. This year's annual poll of the WSIB's private equity general partners' (GPs) deal flow activity for the year ended September 30, 2019, shows continued interest and activity. Key findings include the following:

- 24 GPs looked at 325 Washington-based investment opportunities.
- 91 investment opportunities were still under consideration as of September 30, 2019.
- 21 investments were completed.
- Venture capital and private equity firms continue to look at investments in the region.

Washington is rich with investment opportunity and has earned the interest of, and access to, top quality GPs. The WSIB's GPs continue to actively seek quality Washington-based opportunities, and investments are being made in Washington-based companies.

The WSIB believes the state of Washington is an excellent place in which to invest a portion of the trust funds under management by the Board. As of June 30, 2019, \$3.2 billion in value was held in the WSIB investment portfolio in Washington-based investments through its public equity, fixed income, real estate, tangible assets, innovation portfolio, and private equity investment programs. Each investment was made consistent with the WSIB's statutory mandate. This \$3.2 billion investment in Washington represents approximately 3.0 percent of the state's Commingled Trust Fund (CTF), while the state's gross domestic product (GDP) is only 0.7 percent of the GDP for the investible universe within which the WSIB invests. Private equity commitments of \$18.4 billion have yet to be called, representing significant capital ready to be put to work as qualified investment opportunities arise. Further, the Washington-based investments made by the WSIB's GPs significantly leverage additional capital from other sources to be put to work in the state.

The WSIB has made a strong commitment to facilitate access to and awareness of quality in-state investment opportunities. Further, it has devoted resources to implement that policy and to track in-state investment activity. The WSIB continues to interact with regional partners and various economic development networks to assist Washington companies to achieve exposure to appropriate potential sources of capital.

Overview of Policy

The WSIB's private equity portfolio originated in 1981 and is invested in limited partnerships. Each partnership, which is managed by a GP, acquires or creates ongoing businesses or operating companies at the discretion of the GP. Ultimately, the companies are sold in the public market or to strategic or financial buyers, and only then can the true return on investment be accurately measured. To meet return and plan objectives, the WSIB's private equity portfolio has diversified investments in a broad cross section of sub-sectors, industries, and geographic regions, including Washington and other Northwest states.

In March 2003, the Board adopted an ETI policy to communicate the roles and responsibilities of the WSIB relative to such initiatives. ETIs are defined in this instance as investments having the primary objective of investment return to pension trust fund assets with the possible collateral effect of assisting the regional economy and the economic well-being of the state of Washington, its localities, and its residents.

In the ETI policy, the Board reiterated its “fiduciary duty to invest and to manage the entrusted funds in a manner consistent with statutes, regulations, Board policies, and the highest standard of professional conduct for the exclusive benefit of fund beneficiaries.” The Board has established written policies and procedures for all its investments “designed exclusively to maximize return at a prudent level of risk.” The Board will continue to seek quality investment opportunities within the state in accordance with its established policies, statutory mandates, and fiduciary duty.

The Board requests its private equity GPs report annually on Washington-based investments evaluated during the prior year. Private equity investments include securities that are generally not listed on a public exchange and are not easily accessible to most individuals. These investments range from initial capital in start-up enterprises to leveraged buyouts of mature corporations. Private equity investments are typically long-term commitments that may last up to 12 years or more. Although less liquid, and perhaps riskier than publicly traded investments, private equity investments can offer higher returns than traditional public equity and are an attractive asset when employed as part of a larger, balanced portfolio.

The Board established a staff role to facilitate the exchange of information between its private equity GPs and appropriate parties with knowledge of quality in-state investment opportunities and, in accordance with the ETI policy, provide this annual report of relative activities to the Board, beneficiaries, Legislature, and Governor.

Investment Environment

Although the WSIB portfolio comprises asset classes other than private equity, much of the following report focuses on private equity, including venture capital. This is due to the fact that the policy reporting is focused only on private equity, and much of the in-state investment activity of interest has been focused on the venture capital arena.

One way to view the investment environment is to start with a view from the top down and describe the climate at the national level, along with industry specific and investment stage indicators. Since the economic downturn in 2008 and 2009, venture capital investing in the U.S. has generally been strong and growing overall. However, the upward trend has been interrupted periodically by political or economic concerns. The periods of weakness have typically lasted only a quarter or two, and then been followed by recovery in the venture capital investment pace. The pace of investment during the last 6 years has been strong.

According to the *MoneyTree Report* by PricewaterhouseCoopers (PwC) and CB Insights (*MoneyTree Report*), U.S. venture capitalists invested \$26.0 billion in 1,304 deals in the third quarter of 2019. The dollar amount was a 15 percent decrease compared to the second quarter, while the number of deals completed declined 16 percent. Venture capital investing continues at a strong level and there have now been 24 consecutive quarters in which over \$10 billion was invested in a quarterly period. During the third quarter there were 55 transactions that had a value in excess of \$100 million and they represented 49 percent of total dollars invested in the quarter. This represents the continuation of the trend of firms remaining private for longer periods and leading to larger private market funding requirements.

Venture capital investments during the first 9 months of 2019 were \$82.8 billion in 4,284 deals. This was an increase of 6 percent on a dollar basis and a decrease of 12 percent for the number of deals completed compared with the same period in 2018, when \$77.9 billion was invested in

4,856 deals. The average deal size for this period was \$19.3 million compared to the prior year period amount of \$16.0 million, reflecting the impact of large transactions.

The internet sector received the highest level of funding in the third quarter of 2019, at \$10.0 billion and 41 percent of deals completed. Next highest was the healthcare sector at \$4.9 billion and 14 percent of deals completed, followed by mobile & telecommunications at \$2.9 billion and 12 percent of deals completed. Deal activity was highest in the quarter for early stage deals at 369 transactions, which represented 28.3 percent of the total. Seed stage deals represented 25.2 percent of total transactions and expansion stage were 21.9 percent. Later stage deals represented 9.6 percent of deal flow, but due to transaction size were 41 percent of the total dollar amount invested.

As usual, California was the state that received the highest level of funding at \$14.7 billion from 524 transactions. This represented 57 percent of the dollar amount invested and 40 percent of the number of deals completed in the third quarter of 2019. Washington was in fifth place for the number of deals completed at 55, and fourth place for dollar amount invested at \$670 million in the period.

According to PwC/CB Insights MoneyTree data, for the 12-month period ended June 30, 2019, the number of deals done in the U.S., Northwest, and Washington decreased, as compared to the period ended June 30, 2018. Regarding dollars invested, the amounts were substantially higher for the U.S., while declining modestly for the Northwest and Washington, as compared to the period ended June 30, 2018. In the most current 12-month period, venture capital investments in the U.S. totaled \$123.4 billion in 5,633 deals, up 39 percent with respect to amount invested and down 11 percent for the number of deals. Of that U.S. total, \$2,548 million (down 13 percent) was invested in 249 deals (down 10 percent) in the Northwest region (defined as Washington, Oregon, Idaho, Montana, and Wyoming). Washington captured 184 of the Northwest deals (down 5 percent) and \$2,153 million of the newly invested dollars (down 2 percent). Venture backed transactions in Washington have exceeded \$1.0 billion in each of the last six 12-month periods ended June 30. Based on the PwC/CB Insights MoneyTree data, capital being invested into Washington-based companies appears to be continuing at an active level. During this same time frame, WSIB GPs called \$4.5 billion (WSIB's portion) of capital, a portion of which was invested in Washington-based companies.

For the first three quarters of 2019, 162 U.S. venture capital funds raised \$29.6 billion, according to the PitchBook-National Venture Capital Association Venture Monitor (*PitchBook Report*). This amount compares to \$56.8 billion in 290 funds for all of 2018. While the pace of fundraising is not as strong as in 2018, it remains at a very healthy level, as 2019 will be the sixth year in which over \$30 billion will be raised by venture funds. The *PitchBook Report* also indicated that funds continue to increase in size with nearly half of all funds sized \$100 million or above, up from roughly 30 percent in 2014. Funds sized at \$500 million or larger have amounted to 9.3 percent of all funds raised so far in 2019, up from 5.2 percent in 2017. As of September 30, 2019, there have been 15 funds that closed with a fund size above \$500 million which raised a total of \$14.4 billion. Limited partners appear to have a continuing strong interest in venture capital investments.

Firms with offices in the Northwest which reported raising funds during 2019 included Maveron (Fund VII for \$180 million), Providence Ventures (Fund II for \$150 million), West River Group (\$150 million), Voyager Capital (Fund V for \$100 million), Founders' Co-op (Fund IV for \$25 million), Madrona Venture Labs (Fund III for \$11 million), Madrona Acceleration Fund (\$100 million), Portland Seed Fund (Fund III for \$14 million) and Cascade Seed Fund (Fund VI for \$5 million).

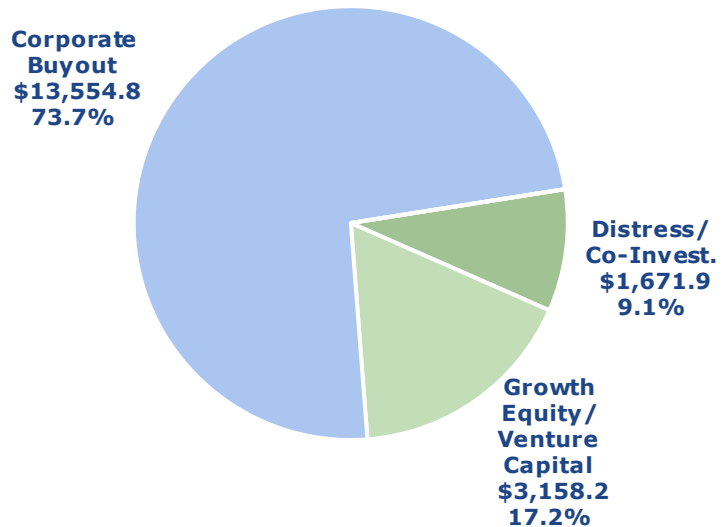
An October 2019 report in the *Puget Sound Business Journal* presented details on the largest venture capital and private equity firms in the Puget Sound region and investment activity in 2018. The 17 firms listed reported a total of \$18.8 billion of funds under management. Not all firms

provided detail on deals done in Washington during 2018, but for those that did report, the total invested was \$324.9 million in 127 Washington-based deals. This compares to \$14.8 billion of assets under management and \$257.3 million invested in 117 Washington-based deals from the list presented last year for 2017.

According to a report prepared by Renaissance Capital, during 2019 there were 159 U.S. initial public offerings (IPOs), which raised \$46.3 billion. This was a decrease of 17.2 percent in the number of IPOs and 1.2 percent in proceeds generated. Activity level was reported to have been led by healthcare with 70 IPOs reported, followed by technology. There was one IPO completed by a Washington-based company in 2019: Adaptive Biotechnologies. This is down from 2018 when four IPOs were completed by Washington-based companies.

A review of the \$18.4 billion WSIB private equity overhang by strategy at June 30, 2019, points out that 73.7 percent of the unfunded commitments are in the area of corporate buyouts. The Growth Equity/Venture segment was 17.2 percent of the unfunded commitments and Distressed/Co-Investment was 9.1 percent. Overall the unfunded commitments increased \$2.9 billion, from \$15.5 billion last year, reflecting an active pace of new partnership commitments during the period. The unfunded commitment amount provides substantial capital for new private equity investments, including possible Washington-based investments.

Portfolio Allocation by Strategy Based on Unfunded Commitments at June 30, 2019 (\$ Millions)



Discussions regarding Washington-based investments often focus on the dollars WSIB has invested in Washington-based transactions through its GPs. While this is an important amount, it may also be useful to expand the perspective to consider the total amounts invested by WSIB GPs in Washington-based transactions. For example, as of June 30, 2019, the WSIB had invested approximately \$594 million as a limited partner through the Private Equity program in Washington-based transactions. However, the total amount invested by WSIB GPs in Washington-based transactions was \$10.2 billion. This amount reflects capital from other limited partners and the GPs, which has been invested in the same transactions. The total amount invested is 17x the amount from only the WSIB. The true impact of the WSIB’s investment on the Washington economy is substantially enhanced by recognizing the total amount invested by WSIB GPs, not simply the WSIB portion.

The Puget Sound has also given rise to the growth and development of numerous businesses and professional organizations in the past decade that provide entrepreneurs and small companies with guidance and mentoring, networking, and showcase events to potential investors.

It does appear that investment capital is available to support the growth of technology companies in Washington State and the U.S. Interesting investment opportunities continue to attract dollars, whether from local players or more remote sources.

Investments in Washington

The WSIB seeks the best investment opportunities no matter where they might be headquartered. The state of Washington is home to many successful companies, and Washington-based investments can be found in many WSIB investment portfolios. The following table reflects a summary of Washington-based investments in the WSIB CTF portfolio at each fiscal year ended June 30 for the years 2014 through 2019.

Washington Investments in the WSIB CTF Portfolio						
Investment Class	Value - Fiscal Year Ended June 30 (\$millions)					
	2014	2015	2016	2017	2018	2019
Public Equity	\$474.6	\$557.8	\$652.3	\$1,027.5	\$1,169.3	\$1,497.2
Fixed Income	68.6	66.3	66.3	104.9	100.6	103.3
Real Estate	789.5	847.9	906.0	1,043.1	985.9	1,132.5
Tangible Assets	24.5	23.6	23.2	80.8	112.0	254.7
Innovation	0.0	0.0	0.0	0.0	0.0	12.6
Private Equity	234.1	269.3	211.1	190.8	290.8	206.5
Total	\$1,591.3	\$1,764.9	\$1,858.9	\$2,447.1	\$2,658.6	\$3,206.8

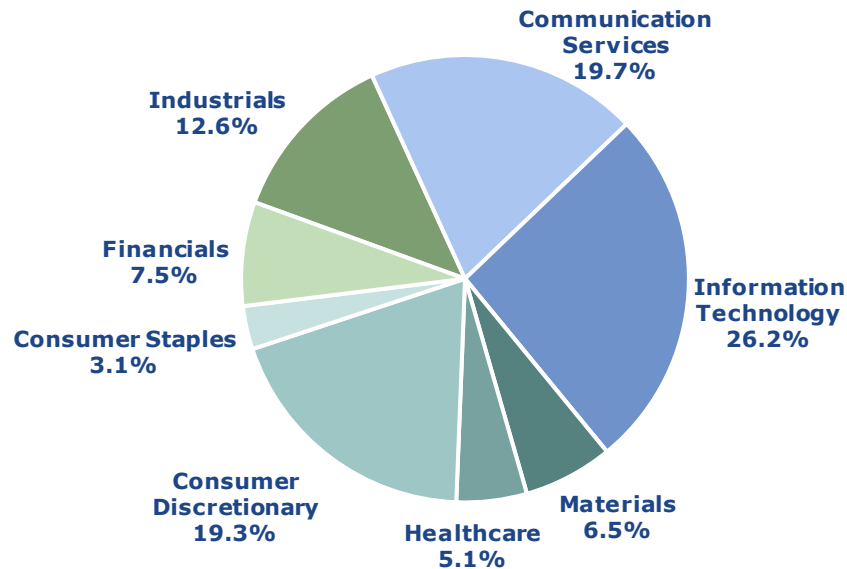
Note: Values include Boeing.

The WSIB CTF portfolio contains numerous public equity and fixed income investments in Washington-based companies. In the year-over-year comparison, the June 30, 2019, total value was up \$548.2 million or 20.6 percent. The value of public equities increased 28.0 percent; this was due to the strong stock price performance of many large Washington-based companies that are heavily represented in the passive indices, somewhat offset by reductions in holdings by several active managers. The value for fixed income increased 2.7 percent and reflects the market value of holdings. The 14.9 percent increase in investment value for real estate reflects a combination of acquisitions and dispositions, as well as increases and decreases in values at the property level. It also reflects, in some cases, changes due to financing and refinancing activities. The tangible assets investment value increased \$142.7 million, or 127.4 percent, due primarily to recent agricultural investments in Washington state. The Innovation Portfolio now holds an investment in a Washington-based company that was valued at \$12.6 million.

The 29.0 percent decrease in value year-over-year for private equity was due to \$184.8 million of proceeds from realizations, compared to \$48.4 million new in-state investments combined with substantial appreciation in the fair market value for various companies in the past fiscal year. This past year was very strong for realizations. As of June 30, 2019, the WSIB had \$206.5 million of invested value in Washington-based companies in its private equity portfolio, representing approximately 1.4 percent of the total domestic private equity portfolio value. The fair market value is the value remaining of more than \$594.3 million invested by the WSIB since 1992 through its GPs. The current Washington-based investments have been made by 37 different funds managed by 22 individual GPs, 3 of which were regionally-based.

The following chart depicts the breakout of Washington-based investments in the private equity portfolio by industry. The largest concentration is in the Information Technology sector at 26.2 percent, followed by the Communications Services sector at 19.7 percent, and the Consumer Discretionary sector at 19.3 percent. The Information Technology sector has been the largest sector for a number of years, although at a lower level in the current period due to realizations during the past year.

Private Equity Holdings in Washington-Based Companies by Industry at June 30, 2019



At June 30, 2019, the WSIB’s private equity portfolio, invested with 96 GPs in 271 partnership funds, was valued at \$24.2 billion. An additional \$18.4 billion had yet to be called by the GPs. The unfunded commitment represents a significant amount of capital to be invested in the future by current WSIB GPs, many of whom actively review and evaluate investments in Washington State.

Highlights of 2019 ETI Activity

WSIB staff has sustained program efforts to provide exposure and understanding of the Board’s policy in the state and establish contact with the local and regional organizations and networks in order to accomplish successful implementation of the ETI policy.

Regional Funds

Since 2000, the WSIB has invested in funds managed by six regional firms. Endeavour Capital is still actively investing funds to which the WSIB has made commitments. Endeavour SEAM, Evergreen Pacific Partners, Frazier Healthcare Ventures, OVP Venture Partners, and Polaris Venture Partners (Seattle office closed during 2011), are no longer in active investment periods. During 2019, staff continued to conduct meetings with regional funds. The meetings with over 100 firms and interested parties in the past 17 years have focused on developing strong relationships with fund managers and initiating a long, deep due diligence process on the funds and their portfolio companies.

Staff has performed due diligence on regional funds raising capital, although most of the fund sizes are smaller or the funds younger than those the WSIB usually invests in directly.

Annual GP Deal Flow

The WSIB conducted its seventeenth annual survey of the WSIB private equity GPs by sending letters to 39 GPs requesting information about their deal flow review in Washington for the year ended September 30, 2019, including the number of transactions done, number passed, and any still in process. The poll was sent to GPs that manage funds that have not completed their investment periods and that do invest within the U.S. The results continue to show strong, consistent, and active Washington deal interest. The following table highlights the results.

Annual Report for the Year:						
	2014	2015	2016	2017	2018	2019
Number of GPs involved	36 of 47	35 of 51	31 of 51	25 of 35	26 of 39	24 of 39
Transactions reviewed	1,029	747	879	413	346	325
Transactions not pursued	693	264	233	213	229	213
Number of GPs involved	22	22	19	11	13	13
Transactions in pipeline	310	447	616	187	98	91
Number of GPs involved	13	12	12	4	9	11
Transactions Completed	26	36	30	13	19	21

These responses suggest that Washington-based companies continue to earn the interest of top-quality GPs. It should be noted that the private equity program transitioned to a lesser number of active venture capital focused funds in the WSIB portfolio. As such, they are no longer included in the GP survey. Primarily due to the lower number of active venture capital funds, the number of GPs contacted, total transactions reviewed, and transactions still in the pipeline has declined compared to the 2014 to 2016 periods. However, the data continues to suggest that WSIB GPs consistently review and do deals in Washington in the normal course of their business, aside from the advent of reporting that activity. Washington is rich with investment opportunity and does not appear to have a problem attracting venture capital and private equity firms to come to the region to check out companies, review deals, and fund their choice of opportunities. The data is also an important reminder that not all deals get done.

Regional Networks

Staff represented the WSIB at regional meetings and events. Each of these presented an opportunity to participate in and, hopefully, contribute to the regional investment environment, broaden the WSIB regional contact base, and enhance the WSIB image. Staff will continue to build and strengthen these relationships over the long term to the benefit of all parties.

Looking Forward

The flexibility of the WSIB policy allows staff to respond to needs effectively as they arise. Personal contacts remain an important means to maintain valuable relationships with networks and interested parties in the state. Staff interaction with GPs will encourage sustained access and interest in Washington deal flow. The WSIB will continue to work with the Washington individuals and networks in place to:

- Assist Washington-based companies to achieve exposure to appropriate potential sources of capital through the WSIB’s relationship with both local and national GPs and other funding sources.
- Expand ways the WSIB contributes and adds value to the regional environment.
- Enhance relationship building with regional GPs and other investment organizations.
- Continue to develop WSIB GPs’ awareness of, and accessibility to, potential Washington-based opportunities.
- Maintain monitoring of targeted investment policies and programs in other states.

Staff will build on the policy implementation efforts to date to generate long-term results and continue to reflect the WSIB as a strong, interested ally and resource for the Washington investment environment.

Appendix

Dollars Invested and Number of Deals July 1, 2018, through June 30, 2019 (\$ Millions)

Washington

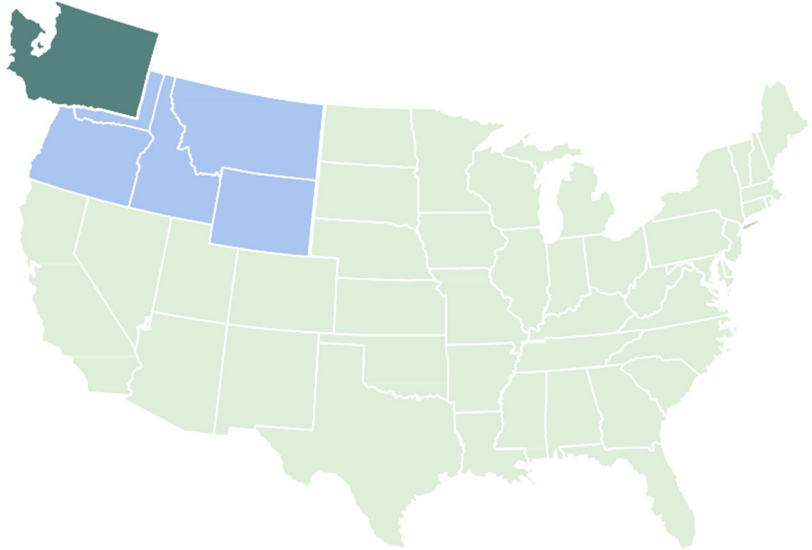
Number of Deals: 184
Amount: \$2,153

Northwest

Number of Deals: 249
Amount: \$2,548

U.S.

Number of Deals: 5,633
Amount: \$123,365



Source: PwC/CB Insights MoneyTree Report