The McKnight Foundation

STATEMENT OF INVESTMENT POLICY

I. Mission

The McKnight Foundation (the "Foundation"), a Minnesota-based family foundation, seeks to improve the quality of life for present and future generations. We use all our resources to attend, unite, and empower those we serve.

II. General

The Board of Directors (the "Board") of the Foundation is responsible for the development and periodic review of the Foundation's long-term financial objectives and the investment and spending policy for the Foundation's Endowment. The Board seeks to invest the Endowment to facilitate the Foundation's charitable work in perpetuity. It also seeks to more fully leverage its resource base on behalf of its mission while maintaining its long-term, prudent approach to asset management.

For purposes of this policy, the Endowment is divided into Corpus and Carve Out. The Carve Out is the 10% of the Endowment that the Board has identified for its Impact Investing Program. The Corpus is the remainder of the Endowment.

The Board has delegated responsibility for oversight of the Corpus to the Investment Committee (the "IC") and oversight of the Carve Out to the Mission Investment Committee (the "MIC" and together with the IC, the "Committees").

The Foundation has an Impact Investing Program that aims to prudently leverage the Foundation's investment assets in order to support its mission, enhance its credible influence, drive programmatic learning, and impact key philanthropic priorities. The Impact Investing Program is not tied to one philanthropic program or target objective. Rather, through the construction and execution of the program, the Foundation seeks to use its investment tools to support multiple goals.

III. Roles & Responsibilities

Unless otherwise stated, the standards and procedures in this policy apply to the IC for its oversight of the Corpus and to the MIC for its oversight of the Carve Out. The Vice President of Finance and Compliance is the primary Staff person supporting the IC and the Director of Impact Investing is the primary Staff person supporting the MIC.

The IC is responsible for formulating and implementing an overall investment strategy including asset allocation to meet the Foundation's long-term financial objectives and maintains the real value of the Endowment in perpetuity. In its asset allocation the IC factors in the MICs approach to managing the Carve Out.

Subject to this policy, the IC and MIC establish investment objectives and policy guidelines, and research, retain, and terminate investment managers, consultants, and custodians for the Corpus and Carve Out, respectively. The Committees are responsible for monitoring the implementation and performance of the Foundation's investment programs and individual managers.

The Committees consult with the Vice President of Finance and Compliance, the Director of Impact Investing and outside advisors, including the Foundation's investment managers, custodians, and investment consultants. The Committees may delegate certain duties and responsibilities to Staff or other Board-established committees, including implementing Committee actions; acting as the primary liaison to the Foundation's investment managers, custodians, and investment consultants; and managing the cash flows of the Foundation.

Investment managers are expected to provide a high degree of professional care, skill, prudence, and diligence in the management of assets under their direction. At the time of hire, each investment manager will agree in its investment management agreement with the Foundation to specific guidelines that address such issues as diversification of securities; industry, geography, type, and maturity of investments; liquidity; currency; the appropriate benchmark; and impact reporting (where appropriate).

The custodian is responsible for those custody services outlined in its custody account agreement with the Foundation. These duties may include safekeeping the assets, settling trades, receiving and crediting dividends and income, reclaiming foreign taxes withheld by foreign governments, providing notification of corporate actions, and providing proxy materials. In addition, the custodian may be responsible for various reports concerning holdings, unrealized gains and losses, and other accounting information as directed by the Committees and Staff.

The investment consultants work with the Committees and the Vice President of Finance and Compliance and Director of Impact Investing to determine an appropriate asset allocation to meet the Foundation's return objectives; monitor investment managers and make recommendations regarding the hiring, retention or termination of those managers; determine appropriate benchmarks for each investment strategy; and provide timely reports to the Committees.

IV. Investment Objectives

The primary long-term investment objective of the Corpus, and of the market-rate segments of the Carve Out, is to maintain the purchasing power of the assets. Historically, this has equated to a compound annual rate of return, including current income and capital appreciation, of 8% net of fees over five-year rolling periods. This objective is to be achieved in a manner consistent with prudent risk-taking and is reviewed and may be revised as the investment environment changes. The Foundation's current asset allocation and related benchmarks are found in Appendices A and B, respectively.

The Foundation also wishes to be a catalyst in impact investing. To that end, the Committees will incorporate investment strategies relevant to the Foundation's mission into the Corpus and Carve Out where appropriate, and will, from time to time, seed innovative strategies. Where the Foundation takes additional risk or invests with charitable purpose, it seeks enhanced returns: direct social and environmental impacts and foundation learning. (The Impact Investing Program, its performance expectations and its detailed investment categories are described in Appendices A, B and C).

The Impact Investing Program includes baskets of public and private investments that are designated either as "aligned" with the Foundation's sustainability mission (and sometimes referred to as "Mission-Related Investments"/"MRI") or high impact for achieving the Foundation's more specific programmatic goals. High impact private investments (also known as "Mission Driven Investments"/"MDI") and high impact charitable investments (also known as "Program Related Investments"/"PRIs are not included in the comprehensive asset allocation structure described in this policy but are further explained in the appendices.

V. <u>Investment Management</u>

The Foundation's assets will be managed by professional investment managers and invested in professionally managed investment vehicles and business entities. Written guidelines specific to each manager of a separate account will be determined and implemented when the manager is retained. The Vice President of Finance and Compliance will evaluate adherence to the guidelines for the Corpus, and the Impact Investing Program Director will coordinate review of guidelines for the Carve Out. Exceptions to the written guidelines may be approved by the appropriate Committee.

When the Foundation invests in commingled (pooled) funds, the Foundation generally is required to accept the policy guidelines published by the fund managers. Where appropriate, the Foundation may attempt to influence a manager's approach to environmental, social, and governance (ESG) issues.

VI. <u>Restrictions on Investment Management</u>

No investment may be made that would place in jeopardy the Foundation's tax-exempt status or cause the Foundation to incur penalty taxes under the Internal Revenue Code generally, and in particular under provisions prohibiting self-dealing (Section 4941), excess business holdings (Section 4943), and jeopardizing investments (Section 4944).

VII. Standards for Prudent Investing

The Committees will ensure the Endowment is invested in an appropriately diversified portfolio and are responsible for setting overall, long-term investment guidelines, including asset allocation.

In investing and managing the Endowment, the Committees will comply with the duty of loyalty and act in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. Management and investment decisions about an individual asset will be made in the context of the Endowment *as a whole* and as part of an overall investment strategy with risk and return objectives reasonably suited to the Foundation's needs. In managing the Endowment, the Committees may incur costs that are appropriate and reasonable under the circumstances. The following factors, among others, will be considered in the management and investment of the Endowment:

- General economic conditions;
- The possible effect of inflation or deflation;
- The expected tax consequences, if any, of investment decisions or strategies;
- The role that each investment, or course of action, plays within the Foundation's investment portfolio, including expectations for asset class returns and volatility;
- The expected total return from income and the appreciation of investments;
- The overall measured risk of the portfolio and how investment decisions impact that risk measure;
- The need for diversification within the portfolio;
- Other resources of the Foundation;
- The long and short-term needs of the Foundation to make distributions and to preserve capital to carry out its exempt purposes;
- ESG considerations, risks or manager capacity; and
- An asset's special relationship or special value, if any, to the exempt purposes of the Foundation.

From time to time, the Committees may decide to evaluate the Endowment's exposure to issues of growing, long-term materiality, such as climate change. In addition, the Committees may consider social or environmental issues where business interests may work contrary to the charitable goals of the Foundation. For example, the IC has paid closer attention to the amount of coal company holdings in its portfolios.

VIII. Performance Measurement

The Committees will evaluate investment results at least semi-annually and will use the performance criteria described in Appendix B. The appropriate committee will also assess the ESG process and capacity of each of its managers periodically.

Specific "Watch List" criteria and procedures are outlined in Appendix B, which the Committees may amend from time to time as long as changes are consistent with this policy.

Taking quantitative and qualitative criteria into consideration, a decision to terminate a manager or continue to include them on the Watch List is at the discretion of the Committees.

IX. Foreign Currency Exposure

The appropriate Committee may authorize relevant global and international managers to use currency futures and forwards in order to reduce the volatility of the Foundation's U.S. dollar returns from investments in non-dollar securities. Tactical asset allocation managers may use foreign currencies as a separate investment strategy, consistent with their guidelines. Without the explicit authorization of the appropriate Committee, no manager may use currency futures or forwards if their effect is to leverage the Foundation's assets, circumvent applicable investment guidelines, or introduce unacceptable risk into the portfolio.

X. Use of Derivatives

The appropriate Committee may authorize relevant managers to use options, futures, or other derivatives consistent with their guidelines in order to reduce risk in the portfolio, or to implement a market strategy more rapidly or at lower cost. Without explicit authorization of the appropriate Committee, no manager may use derivatives (including, without limitation, swaps, structured notes, and collateralized mortgage derivatives) if their effect is to leverage the Fund's assets, circumvent applicable investment guidelines, or introduce unacceptable risk into the portfolio.

XI. Use of Fund of Funds Managers

The Foundation may invest in hedge funds or other private investments through "fund of funds" vehicles. Fund of funds investments may provide the Foundation with additional due diligence, diversification, and risk reduction. Fund of funds investment managers typically disclose to investors the private investment funds in which they invest, but may disclose little to no information about underlying investments. The Foundation recognizes that the nature of fund of funds manager reporting may limit the ability of the Committees to examine the policies, procedures, and investments of the underlying investments in connection with due diligence concerning these investments.

XII. Investment of Cash Balances

The Foundation has engaged an overlay account manager to invest any short-term cash balances. Cash balances in individual, non-pooled manager portfolios will be securitized to the relevant manager benchmark, and cash held in the Endowment's cash account will be securitized to the Barclays Capital Intermediate Government/Credit Index.

XIII. Securities Lending

The Foundation, at the direction of the appropriate Committee, may enter into securities lending agreements with custodian banks for separately managed accounts. The required cash collateral pool must meet quality guidelines of a Tier 1 money market fund. The custodians must provide a review, not less than quarterly, of the amount of securities on loan (in dollar and percentage of portfolio terms), income generated from such loans, and the net income accrued to the Foundation by account and as a whole. It is recognized that pooled accounts may engage in securities lending at the discretion of their managers.

XIV. Proxy Voting

The appropriate Committee will engage a third-party vendor to vote proxies of the Foundation's common stocks in separately managed accounts. These proxies will be voted in a manner consistent with maximizing sustainable, long-term returns. The Foundation understands that ESG risks and opportunities may be material for individual businesses and are relevant for building a healthy, thriving economy that offers broad, lasting benefits to the companies in our portfolios.

The Foundation recognizes it has limited ability to mandate Foundation-specific criteria to investments in pooled accounts and that if its custodian has chosen to lend its securities, the Foundation temporarily loses its ability to vote these shares. In specific instances, the Foundation may attempt to recall shares in order to exercise proxy voting rights.

XV. Asset Allocation

The IC will review the statement of *Asset Allocation for the Endowment's Corpus and Carve Out* (Appendix A) annually, consult with the MIC regarding the Carve Out, and vote on any proposed revisions. The IC will notify the Board of changes. Any revisions must be consistent with the overarching investment principles outlined in this policy.

The Committees may periodically delegate authority and responsibility for the transition of monies to the Vice President of Finance and Compliance.

XVI. <u>Amendments and Review</u>

The Committees will review this policy annually to ensure it continues to satisfy the Foundation's needs; the Committees' market expectations; and applicable legal, regulatory, and fiduciary standards. The Committees will submit suggested revisions to the Board for approval.

APPENDIX A
ASSET ALLOCATION FOR THE ENDOWMENT'S CORPUS AND CARVE OUT

Any revisions to the appendices must be approved by the appropriate Committee.

The Endowment will be invested in a broadly diversified portfolio that may include: following categories:

- Publicly-traded equity managers that invest in either a specific market sector or geographic market. Managers may employ an active or passive strategy.
- 3M stock that reflects the Foundation's origins and is a distinct allocation within domestic equity.
- Absolute return strategy managers seek to lower portfolio volatility and lessen downside risk. Some strategies seek to outperform a benchmark, while others are focused on achieving a stated absolute level of performance. Hedge funds, asset allocation and other strategies can be found within the absolute return category.
- Private investment managers that provide diversification and high returns over a long, illiquid holding period. Manager strategies may include targeted investments in distressed securities, management buyouts, natural resource partnerships, real estate, venture capital, and others.
- Fixed income managers or cash investments that limit volatility and provide liquidity for the Foundation's spending needs.
- Overlay manager that invests idle cash in potentially higher returning instruments.

The Committees may, from time to time, identify investments providing exposure to compellingly undervalued or mission-aligned asset classes or opportunities that may not fall within one of the above categories.

Asset Allocation for Entire Endowment*

Segment	Normal	Minimum	Maximum
US All Cap Equity	12	5	25
Non-US Developed Equities	7	0	15
Emerging Markets Equities	5	0	10
Global Equity	14	5	25
3M Stock	5	4	6
Private Equity	20	15	25
Absolute Return	25	10	30
Fixed Income/Cash	12	10	15
Total	100%		

**The asset allocation does not include high impact direct investments (MDI) or investments with charitable purpose (PRIs), as described in Section IV of the investment policy statement.*

In addition, the Foundation's exposure to various asset classes will be calculated by reviewing the portfolios of all managers in order to understand exposures and compare to other foundations or groups.

<u>Asset Allocation for Carve Out</u>

Segment	Amount	Types
Public Markets	$75 million	Stocks, bonds, long-short
Private Markets	$75 million	Funds, direct equity positions
Charitable Intent (PRI)	$50 million	Loans, guarantees, equity

The public markets basket will include some high impact private investments that have commercial expectation, but are not included in the Endowment's overall asset allocation. The charitable intent basket is also not included in the Endowment's overall asset allocation.

<u>Rebalancing</u>

The Vice President for Finance and Compliance monitors growth and changes within the portfolio and will propose a rebalancing plan to the appropriate Committee when needed.

APPENDIX B:
PERFORMANCE MEASUREMENT

Performance Review Process:

The financial performance of each investment in the Endowment shall be evaluated according to this policy. Performance will be based upon evaluations by a third-party independent consulting firm and/or by staff. In addition to investment return, the IC will periodically review the ESG ratings of all managers in collaboration with the MIC.

Fund, manager, and direct investment financial performance will be reviewed periodically and evaluated over the long-term. Financial performance refers to measuring returns, risk, and risk-adjusted returns.

Impact, as opposed to financial performance, will be monitored separately by the MIC for Impact Investing Program investments. Learning returns from the Impact Investing Program will be monitored and leveraged by the Director of Impact Investing with Foundation Staff and peers as appropriate.

The Committees will periodically review the qualitative developments of each investment manager. This evaluation should include, but is not limited to, changes in ownership, personnel turnover, adherence to investment style and philosophy, and any other qualities or attributes that the Committees deem appropriate.

Performance Criteria:

The performance criteria below apply to Corpus.

The total Corpus will be compared to: (a) a broadly accepted benchmark that reflects the current asset allocations, (b) a "balanced" benchmark of 70% ACWI and 30% Barclays Int. Gov/Credit Index, and (c) a peer group of similar institutions.

The Foundation expects the following long-term performance of each public market investment manager:

- Outperform the relevant benchmark over a market cycle, typically three to five years; and
- Rank above the median of the relevant peer group over a market cycle.

In order to ensure that fund managers are on track to achieve their long-term goals, he Foundation will maintain a "Watch List" for liquid investment managers whose funds have:

1. Underperformed the relevant benchmark over the most recent rolling 12 months <u>and</u> ranked below the median of the relevant peer group over the most recent 12 months;

2. Qualitative developments the appropriate Committee believes require ongoing monitoring; <u>or</u>

3. Been designated by either Committee as requiring additional monitoring.

Alternative mangers (excluding private equity) will be measured against the most appropriate benchmark and are expected to outperform over the most recent 12 month rolling period.

Any manager that is on the Watch List will be reviewed at each meeting of the relevant Committee to determine whether further action is warranted. A fund manager can be removed from the Watch List for one of the following reasons:

1. The investment performance meets its investment benchmarks.

2. The Committee understands why the manager is not meeting a stated benchmark and believes it is in the Foundation's interest to retain the manager notwithstanding the failure to meet a benchmark.

3. In cases of changes within the firm, the characteristics of the portfolio are acceptable.

Watch List managers will be specifically monitored each quarter and one of the following actions taken:

1. Termination

2. Extension of Watch List status

3. Removal from Watch List status

Although there is no specific limitation on the time a manager may remain on the Watch List, the Foundation will seek to obtain sufficient information to decide whether to terminate the manager or remove the manager from Watch List status as soon as is practical after sufficient information is obtained.

The performance criteria below apply to Carve Out.

Segment	Financial Performance	Impact
Public Markets	Market Rate (Benchmarks & peer groups)	Aligned
Private Markets	6% target return	Aligned or High Impact
PRI	Charitable (Below market interest, or very high risk)	High impact

The MIC may add funds, managers, and investments under its jurisdiction to an Impact Watch List that will be reviewed quarterly at the MIC meeting.

The MIC will use the same general approach as the public markets Watch List. However, the MIC is expected to employ additional discretion as some investments may be higher risk; lack clear peer groups; utilize a blended benchmark; or concern the repayment of interest or principal on a loan. The Foundation also recognizes that alongside financial return, the impact investments are intended to produce social and/or environmental impact, and learning returns. This will require additional evaluation and balancing in order to arrive at a final conclusion about performance. Additional evaluation criteria are described in Appendix C.

The Foundation Staff and consultant will monitor the performance of the impact investments and provide quarterly reports to the MIC.

APPENDIX C:
IMPACT INVESTING PROGRAM

I. Asset Allocation:

See Appendix A for information on the asset allocation of the Carve Out.

II. Impact Investing Returns:

Financial Returns: See Appendix B for the targeted financial return of each basket in the Carve Out. In collaboration with Staff, the investment consultant will provide a quarterly financial report on public and private investments in the Carve Out. Public equity funds will reflect data from the most recent quarter, whereas private investment information will typically lag by a quarter. Program Related Investment (PRIs) performance will be tracked by staff and reported to the MIC annually.

Impact Returns: The Impact Investing Program will conduct an annual, comprehensive assessment of the social and environmental impacts from McKnight's Impact Investing Program portfolio in collaboration with the impact investment consultant. This will include public, private, and charitable investments Measurement will include:

- Quantitative measures of key program-related impact (e.g. affordable housing units; energy savings; clean energy generated)
- Qualitative measures of program-related impact (e.g. policy influence; creation of new models; contribution to public education or support)
- Engagement and learning highlights as appropriate.

Learning Returns: Capturing learning returns is an ongoing process between impact investing and grant making staff and the Board. Staff will seek informal opportunities to share knowledge with colleagues, as well as opportunities for diverse market participants to interact with grantees. In addition, Staff will use a formal process to collect and catalog program learning – ideally at the beginning of diligence of an investment idea and again at close.

III. Investing Guidelines & Parameters:

Public Markets: Substantial portions of financial assets are invested in public equity and fixed income securities. The actions of large corporations have important impact, both positive and negative, on issues and communities within the Foundation's grant making scope. The Foundation seeks to make investments in managers to drive greater alignment between its investments and charitable purpose, change corporate practices, enhance its credible influence, and generate relationships and insights material to its program work. The Foundation seeks to align the public markets basket in the Carve Out with the Foundation's charitable mission of social and environmental sustainability.

Private Markets: These markets provide an opportunity to invest in fund managers or directly into businesses that are building new products, services and models for a more socially and environmentally sustainable future. Private market investments may provide an opportunity for measuring impact more accurately and are likely to yield enhanced collaboration and learning return to priority grant making areas.

It is expected that the basket of private investments will be broadly diversified in terms of risk and return expectations. At investment, the MIC will identify whether a private opportunity is expected to return in accordance with market expectations for private equity (referencing customary 70/30 blend of PE and real asset benchmarks) or whether it is a higher impact investment that will have an absolute return expectation (see Appendix B

The following considerations will be used in deploying the Private Market allocation:

- The Foundation seeks to commit the capital in the Carve Out within four years of program launch.
- There is no fixed term for the investments. Expectations for terms are similar to the overall asset class (8-10 years with 1-2 year extensions).
- The Foundation seeks to build a well-diversified basket of investments.
- The Foundation may consider co-investment alongside private managers.
- There is no target asset mix. We seek the best ideas across private equity, venture capital and real estate opportunities. Higher impact investments could include direct equity, structured loans, government or commercial paper or smaller specialty private equity funds.
- Direct investments in start-up and Series A should be approached with caution. Investments with substantial risk from unproven technology or that are highly capital intensive and fixed, should be approached with caution.
- There is no targeted program impact allocation, but there is likely concentration within Midwest Climate & Energy, Mississippi River, and Region & Communities programs. We are open to the consultants "best ideas" in other topical areas of grant making.
- The international exposure should be limited to 15% (committed capital) but there are no other geographic restrictions.
- The Foundation will evaluate both the strength of the impact commitment and willingness to measure social and environmental impacts by fund or business leaders.

Program Related Investments (PRI): The Foundation's PRI program predates the formation of the Impact Investing Program and is a long-standing, widespread US foundation tool. PRI's are considered "charitable" capital and are best suited for areas where traditional capital cannot achieve the proper balance of risk and return. PRIs are often used to address market failures, bridge market gaps, and test new business models. PRIs should have strong social and environmental impacts that align with the Foundation's programs. PRIs may be completed with either nonprofit or for-profit entities subject to IRS guidelines.

The following considerations will be used in deploying the PRI allocation:

- Minimum size of $1 million.
- Most often deployed as loans or guarantees, but the MIC may decide to make equity PRIs or utilize other strategies.
- No restrictions on Foundation grant making program areas.
- Domestic deployment only.
- Expected return on invested capital is below normal risk-adjusted market rates of return.
- Loss of principal is not expected, but higher risk PRIs with greater potential for loss of capital may be explored.

GLOSSARY:

Carve Out –10% of the Endowment designated by the Board for the Impact Investing Program.

Corpus – The investable assets of the Foundation not specifically allocated to the Carve Out.

Endowment – The investable assets of the Foundation.

ESG – Environmental, Social & Governance.

Fiduciary Responsibility - A legal duty to act on behalf of another party's interests. In this case, Fiduciary Responsibility has been delegated by the Board to the investment committees.

Impact Investments – Those investments that align with and/enhance the Foundation's mission. All of the Carve Out are impact investments and may be either market rate or concessionary in their return targets. Investments in the Corpus may also be categorized as impact investments.

Impact Investing Program – The Foundation's investment program that aims to leverage some of the Foundation's investment assets prudently to support its mission, enhance its credible influence, drive programmatic learning, and impact key philanthropic priorities.

Investment Committee (IC) – Board-created committee with delegated authority to manage the Corpus. The IC sets the overall allocation for the public and private segments of the Endowment, but not higher risk direct investments (formerly known as MDI) or charitable investments (known as Program Related Investments).

Investment Consultant – Any outside advisor that makes investment recommendations, conducts analysis and research, provides reporting, or in any other manner assists the investment committees in fulfilling their delegated duties.

Mission Driven Investment (MDI) – High impact investments, including direct investments that contribute to achieving the Foundation's programmatic goals. MDI was previously used by the Foundation to describe investments with slightly concessionary return that were tightly aligned with priority program goals for social and environmental change.

Mission Investing Committee (MIC) – Board-created committee with delegated authority to manage the Carve Out. The MIC establishes the architecture and performance expectations for the Carve Out. It has a direct decision-making role on specific investment opportunities.

Mission Related Investment (MRI) – A broadly used term that can be synonymous with the term "impact investing." In the Foundation's Impact Investing Program, MRIs are investments that have mission alignment and market rate expectations for financial return.

Program Related Investment (PRI) – An IRS-defined category for private foundations that defines arrangements that take the form of investment, but are undertaken primarily to further charitable purposes and do not have the production of income or appreciation of value as a significant purpose. Foundations may or may not count PRIs toward their 5% distribution requirement.

Risk-Adjusted Returns – A metric that considers the magnitude of risk involved in producing that return and includes such measures as alpha, beta, r-squared, standard deviation, and the Sharpe ratio.

Staff – The President, Vice President of Finance and Compliance, Director, Impact Investing, and other Foundation employees with responsibility in managing the Foundation's investments.