05/15/2024

McKNIGHT FOUNDATION

Investment Policy Statement

(Last Amended May 2024)

MᶜKNIGHT FOUNDATION

I. MISSION

The McKnight Foundation ("McKnight" or "Foundation") was founded in 1953 and independently endowed by William and Maude McKnight. A Minnesota-based family foundation, it strives to advance a more just, creative, and abundant future where people and planet thrive. Programs contribute to building vibrant and equitable communities, taking bold and urgent action on the climate crisis, and supporting Minnesota artists and culture bearers, global resilient food systems, and neuroscience.

II. PURPOSE

This Investment Policy Statement ("IPS") is intended to:

A. Outline the objective for invested Foundation assets ("Endowment");

B. Outline the investment-related roles and responsibilities of the Board of Directors ("Board"), Investment Committee ("IC" or "Committee"), the Investment Office ("Office" or "Staff"), and third-party providers who assist with the management of the Endowment ("Consultants" or "Advisors");

C. Identify other McKnight governance groups that may have a role in decisions that affect investments such as the Finance & Audit Committee of the Board ("FAC") or the voting members of Family Membership Group ("FMG")

D. Establish investment policies, which incorporate prudent risk parameters, appropriate asset guidelines and realistic return goals in order to be effective, yet remain adequately flexible as to be practical;

E. Provide a framework for regular constructive communication between the Board, Committee, Investment Office, and Advisors;

F. Support the Foundation's spending policy; and

G. Define standards for monitoring assets and measuring the success of investments.

The Committee will review the IPS annually, amending it as necessary to ensure continued relevance. The Board approves all changes to the IPS. This policy was last reviewed and updated as shown in the document.

III. INVESTMENT OBJECTIVE & RISK TOLERANCE

The primary investment objective of the Foundation is to achieve a ***long-term rate of return in excess of the actual rate of inflation plus spending*** to preserve purchasing power of Foundation assets and support the perpetual nature of the Foundation's mission. This financial return target is 5% plus expected long-term inflation. McKnight relies on asset class assumptions over a 20-year horizon and a consensus inflation rate expectation to estimate the viability of this return goal.[1] McKnight uses a total return strategy to achieve this objective.

Risk is an important consideration in the investment of assets. McKnight seeks to minimize the volatility and variability of grantee payments, and generally avoid permanent loss of capital. Consistent with its total return strategy and moderate risk tolerance, the Foundation has a long-term investment horizon and can withstand some short- and medium-term volatility. Accordingly, the IC will monitor total portfolio liquidity and risk as measured by standard deviation. The Foundation may take advantage of less-liquid investments, such as private investments, hedge funds, and other alternative assets, which typically offer higher return and/or lower total portfolio volatility through diversification.

IV. REGULATORY CONSIDERATIONS

The Foundation is managed consistent with the standard of prudence under the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and all other applicable legal and regulatory considerations. This includes meeting the IRS requirement that private foundations distribute 5% of their fair market value annually for charitable purposes.

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[1] 20-year market assumptions from Mercer.

V. ROLES & RESPONSIBILITIES

The table below summarizes the primary roles and responsibilities for investment decision-making and oversight:

Responsibilities & Decision-Making				
	Board	**Investment Committee**	**Investment Team**	**Consultants**
IC Member Selection	Select	Consult		
Investment Policy Statement	Approve	Recommend	Prepare	Consult
Asset Allocation		Approve	Recommend	Prepare
Mission Alignment Strategy	Approve	Recommend	Prepare & Propose	Consult
Manager Selection		Approve	Analyze & Recommend	Prepare
Manager Termination		Approve	Analyze & Recommend	Prepare
Investment Policies (Includes Rebalancing Policy)		Approve	Prepare & Recommend	Consult
Periodic Rebalancing		Chair Review	Prepare & Execute	Consult
Quarterly Reporting & Data Analytics		Review	Analyze	Prepare
Manager Monitoring		Review	Prepare	Prepare
Selecting Consultants		Select	Recommend	
Mission & Impact Management Framework		Approve	Recommend	Consult
Measure & Report Impact & Learning		Review	Consult	Prepare
Governance	Approve	Consult	Consult	

A. Board of Directors

Approve and set strategic direction for the organization, including the Endowment. Approve fundamental architecture for investment function.

B. Investment Committee

Determine investment strategy. Provide oversight for management of the Endowment. Recommend changes to architecture of McKnight's investment function.

C. Investment Office/Staff

Anchor investment function. Implement policies and decisions of IC to enable the Endowment to meet McKnight's short, medium, and long-term financial goals. Work closely with consultants to incorporate expertise. Ensure cohesive integration of people, strategy, information, ideas, and risk management across the investment process.

D. Advisor/Consultant

Provide independent, expert investment advice, and thought partnership, with specific deliverables. Deliver support where economies of scale, and human and technical resource add substantial value.

VI. SPENDING

The spending rate will be at a level sufficient to meet grant obligations, appropriate to the Foundation's current financial situation, and to comply with IRS rules so that the Foundation is achieving a minimum annualized distribution of 5% over a multi-year period. The Foundation's spending rate is affirmed by the Board annually and is shaped by the Investment Committee, Finance & Audit Committee, and Staff. (See Appendix A for current absolute return target). A projected annual spend of more than 5.3% of projected endowed assets requires approval by voting members of the Family Membership Group (FMG). From 2024 – 2028 the Board and FMG members have authorized spending an additional dollar amount annually in order to meet specific strategic priorities of the Foundation.

VII. INVESTMENT POLICY

In order to achieve its financial return target, the Foundation is willing to incur investment risk. McKnight also seeks to contribute to effective, resilient markets where capital markets are solving social and environmental problems rather than exacerbating them. McKnight seeks to unlock portfolio opportunities and investment advantages through diversity and the transformation to a clean energy economy. In 2022 the Board resolved that:

> *The McKnight Foundation seeks to integrate its investment activity with the Foundation's mission and values. McKnight has committed to achieving* ***net zero greenhouse gas emissions*** *across the Endowment by 2050 at the latest. It seeks* ***to embed both equity and climate sustainability in our investment strategy****, always within the context of prudent investment decision-making.*

McKnight takes a prudent approach to risk, relying on the long-term benefits of a widely diversified portfolio. The Committee adopts strategic targets and acceptable ranges for each asset class to improve the probability of achieving the financial return target. McKnight seeks to earn an **overall attractive risk-adjusted rate of return**.

Where possible, McKnight prioritizes its mission with the following types of investments:

- <u>Mission-Aligned</u> includes managers with deep ESG capacity or where McKnight has established investment prohibitions aligned with our mission.
- <u>High Impact</u> includes managers and funds where social and environmental impacts are well articulated and measured or where McKnight's mission priorities are fundamental to the investment strategy.
- <u>Program-Related Investments</u> are charitable investments. Tied to the Foundation's mission and interests, these may be defined by concessionary terms and/or risk beyond McKnight's typical appetite.

Currently, there are no set upper or lower limits on the amount in impact investments. The Foundation expects robust returns across all three types of investments. In evaluating impact investments, the Committee, Investment Staff and Advisor will seek, and balance, three types of returns:

1. Financial
2. Social & Environmental Impacts
3. Learning to the Foundation, its program teams, or the field

McKnight takes a rigorous conventional approach to identifying and underwriting risk in impact in all it investments. The Foundation's efforts to capitalize on emerging sectors in the economy, and find solutions to intractable challenges may result, at times, in the Foundation incurring additional risk.

Such risk should be adequately compensated according to our comprehensive return expectations.

The Foundation has a comprehensive Diversity, Equity & Inclusion strategy for our entire organization. Called the "Fairness & Arbitrage Framework," it aids McKnight in identifying opportunities and seizing advantages in the market, and it promotes fairness across the investment industry. Our approach includes communicating expectations with our managers, opening fund manager searches more broadly and investing in diverse emerging managers. Annually, the Foundation will collect and analyze data on women and BIPOC employees and inclusionary practices at our fund managers.

VIII. ASSET ALLOCATION

McKnight understands that strategic asset allocation across broadly defined asset classes with varying degrees of risk, return, and correlation is a material factor in meeting long-term investment goals. The Investment Committee establishes a specific target for each asset class, with an allowable range. When setting the target allocations, the Investment Committee should consider the intended role of each asset class and the benefit it provides to the McKnight portfolio. McKnight may invest in any asset class unless prohibited in this document.

The Investment Committee will determine and approve the asset allocation annually with guidance from the Investment Office and Advisor. Revisions will occur as needed to ensure they are appropriate to the investment objective and risk tolerance. (See Appendix A for the current Asset Allocation.)

IX. RISK MANAGEMENT

The Committee will monitor different types of investment risk, including volatility, liquidity, concentration, and leverage.

- Volatility is managed through diversification by asset class, strategy, and return drivers.

- Liquidity will be monitored across the Endowment for short, medium, and long-term needs, with particular attention to private investments and the level of unfunded commitments.
- Concentration risk can include:
    - Geographic and/or sector exposure;
    - Over-reliance on one investment management firm, defined as managing more than 25% of the total Endowment in aggregate.
    - Over-representation in one investment strategy, defined as when McKnight's investment is larger than 15% of a strategy's assets under management (AUM). This may occur when a strategy is shrinking or when McKnight has seeded a vehicle or invested early in a strategy and/or fund manager that has promise.
    - The Committee reviews any departures from concentration risk guidelines at least annually to either affirm their acceptability or to recommend action.
- Leverage will be monitored at the strategy or fund level.

X. REBALANCING

From time to time, the portfolio will deviate from policy target weights. Deviations can be caused by market movements, cash flows, and variations in asset class performance. In addition, McKnight will have cause to rebalance to generate liquidity for capital calls, paying grants and/or meeting other operational expenses. Liquidity needs will be met in keeping with policy ranges. The Committee will remain aware of any asset classes that exceed their range. Depending on market conditions, the Committee may opt to exceed an asset class range; for examples to avoid selling illiquid assets or to keep investing in an overweight asset class to maintain vintage-year diversification.

Each quarter the Investment Office will develop and implement a plan to rebalance the portfolio to meet Endowment and organizational needs. The Consultant's input will be invited. Finally, the plan is shared, in advance of any trades, with the Chair and Vice Chair for questions or reflections. Committee leadership may always consult the full committee, if deemed necessary.

XI. INVESTMENT MANAGER SELECTION

The Committee defines the strategy for each asset class and may choose to define the scope for an individual investment manager search.

New Managers: The Investment Office, working with Consultants, sources and recommends new investment managers or strategies to the Investment Committee for approval.

Follow-on Funds: The Investment Office is responsible for making the decision to recommit or decline commitment on follow-on private funds. It relies upon both Consultant and in-house diligence unless there is a material change to call to IC consideration.

Managers to Monitor: A Watch List of liquid investments is generated quarterly and provided to the Committee (Appendix B) for review. The Investment Committee, Staff, or Consultant may choose to initiate a fuller Investment Manager review based on the Watch List. The Investment Committee also receives a quarterly list of illiquid strategies that the Staff is monitoring due to performance.

Termination: At any time, the Investment Office with the Consultant may recommend terminating a liquid manager. The Committee will approve the recommendation or flag for discussion. The IC will vote on any recommendations to sell private positions on the secondary market.

XII. BENCHMARKING & PERFORMANCE MONITORING

Long-term portfolio performance is benchmarked against the Financial Return Target of 5% plus US long-term inflation. Returns for the total portfolio will be evaluated against an index comprised of policy-weighted asset class indices (Appendix A).

The performance of individual managers will be measured against suitable market-driven benchmarks. These benchmarks will be included in the regular performance reporting at quarterly Investment Committee meetings. Annual reviews of each asset class will include other performance tools as helpful, such as the Public Market Equivalent (PME) for private investments. Impact or mission-aligned investments are evaluated against traditional benchmarks, and may also be evaluated against separate criteria, including non-financial performance objectives (Appendix C.)

XIII. PROXY VOTING

Proxy voting is an important responsibility for an institutional asset owner. McKnight expects ballots to be voted by fund managers in a manner consistent with maximizing long-term shareholder value, which requires companies to manage social and environmental risks and opportunities proactively. Staff ensures separately managed accounts are voted in line with McKnight's investment approach.

XIV. CONFLICT OF INTEREST

All persons responsible for investment decisions or who are involved in the management of or providing advice on, the management of Foundation assets shall disclose any potential conflicts via the Board of Directors' Conflict of Interest policy. Any such conflicts will be managed by a Governance Committee protocol that identifies situations for recusal, the degree to which a conflicted individual may participate in a related discussion and reporting requirements. This provision does not preclude the payment of ordinary fees and expenses to McKnight's third-party providers in the course of their services on behalf of McKnight.

APPENDIX A: ASSET ALLOCATION, BENCHMARKING, & SPENDING RATE

The performance of the McKnight Endowment will be evaluated against a composite Policy Benchmark that reflects target asset allocation. Currently its ***long-term annualized rate of return target is 7.2%.***

McKnight Asset Allocation and Policy Benchmark			
	Target (%)	**Range (%)**	**Benchmark**
Growth			
Domestic Equity	17.0	10 to 24	MSCI ACWI IMI (MSCI All Country World Investable Market Index)
International Equity	13.0	8 to 18	MSCI ACWI IMI
Developed	*8.0*	*5 to 11*	MSCI ACWI IMI
Emerging Markets	*5.0*	*3 to 7*	MSCI ACWI IMI
Global Equity	14.0	9 to 19	MSCI ACWI IMI
Private Equity	20.0	10 to 30	MSCI ACWI IMI (1-quarter lag)
Private Debt	5.0	2 to 8	70% Morningstar LSTA US Leveraged Loan 100 30% Bloomberg US Corporate High Yield (1 quarter lag)
Total Growth	**69.0**		

	Target (%)	Range (%)	Benchmark
Risk Reduction			
Fixed Income/Cash	17.0	11 to 23	Bloomberg US Universal
Absolute Return	10.0	7 to 13	50% MSCI ACWI IMI 50% T-Bills5
Total Risk Reduction	**27.0**		
Inflation Protection			
Private Real Assets	4.0	2 to 6	25% FTSE EPRA/NAREIT Developed Index (net) 75% S&P 500 Global Infrastructure (net)
Total Inflation Protection	**4.0**		
Total	**100.0**		

APPENDIX B: WATCHLIST

Philosophy

McKnight takes a long-term view of performance and evaluates a manager against a relevant market index or blend of market indices, peer performance as well as execution against its own strategy. McKnight can tolerate benchmark agnostic or other managers who tend to have high tracking error.

Purpose

The Watchlist is intended to highlight potential material issues and allow McKnight to take preemptive action. The Investment Committee and Staff do not need to take action when an Investment Manager deviates from its benchmark or peer universe but should remain mindful of performance drivers and affirm that its conviction holds.

Criteria

A marketable Manager will appear on the Watchlist when it has:

1. Ranked in the bottom quartile of the relevant peer universe over the most recent 12 months;
2. Underperformed the relevant benchmark and ranked below the median of the relevant peer universe over the most recent 36 months;
3. Qualitative developments requiring ongoing monitoring; or
4. Been designated by the Committee or Investment Office as requiring additional monitoring.

Process

The Watchlist will be reviewed at quarterly Committee meetings. The Investment Office and Advisor will make a recommendation to: Remove from the list if the originating issue is resolved, Continue Monitoring, or Terminate. Managers should not remain on the Watchlist for longer than 18 months without explicit Committee affirmation, which should take place at the annual review for the relevant asset class, and annually thereafter.

APPENDIX C: GOVERNANCE & MEASUREMENT: NET ZERO & DEI

In 2021, the McKnight Board of Directors committed to become a net zero endowment by 2050 at the latest. The Foundation will assess the greenhouse gas emissions from each investment fund annually using actual and estimated data that measures changes in the Endowment over time. The Investment Committee recommends targets for the pace of reduction and other strategic decisions to the Board. One of McKnight's goals is to signal to both the market, and to its fund managers, the seriousness with which investors must approach the energy transition.

In 2021 McKnight also began to measure factors related to diversity, equity, and inclusion at each of its fund managers and across peer foundations. Manager self-reporting allows McKnight to gain a comprehensive view of the endowment and measure changes over time. Reporting will include both diversity data as well as a comprehensive inclusion score, all of which can be measured against investment industry peers. One of McKnight's goals is to signal to both the market, and to its fund managers, the seriousness with which investors must approach the investment advantages of diverse talent, broader pipelines for deals and managers, and improved access to capital.

APPENDIX D: PROGRAM-RELATED INVESTMENTS

The Board has allocated $100 million to program-related investments (PRIs), "charitable" investments that are defined by, and subject to, IRS guidance. With either for-profit or non-profit counterparties, charitability is tied to the Foundation's mission and interests and may be defined by concessionary terms and/or risk beyond the usual appetite of McKnight as an institutional investor. PRIs may be used to address market failures, bridge market gaps, and test new business models. They should have strong social and environmental impacts aligned with the Foundation's mission and its institutional priorities.

Our goal is to avoid loss of capital on a portfolio basis. PRIs are not included in measuring the financial performance of the Foundation's market-rate Endowment.

PRIs are monitored by staff on a regular basis. An annual PRI review will be presented to the Investment Committee. PRIs that are determined to be at risk of default or otherwise non-performing shall be reported to the Committee at its next quarterly meeting.

APPENDIX E: VMB & MINNOW BRANCH FUNDS

The Endowment includes two branch funds that were endowed with the purpose of supporting direct charitable grantmaking by the Family Membership Group. While these separate funds are a part of McKnight's endowed assets, they may be invested differently or according to the overall Endowment strategy. VMB & Minnow branch funds are currently indexed to US public equity and fixed income. Grantmaking withdrawals serve to rebalance the funds, otherwise Investment Staff will facilitate a rebalance. The IC will review fund performance annually.