Investment Policy Statement

Last Updated: December 5, 2016

F.B. Heron Foundation

Preamble

The F.B. Heron Foundation ("Heron") exists solely to serve a public purpose — in our case, making investments that further the ability of people and communities to move out of poverty and thrive. This purpose guides not only our grant-making, but the use of all of our resources, including investment capital, so that we use them fully to contribute to the reduction of poverty, the widening of opportunity, and the improvement in material and social well-being for disadvantaged people and communities. The Heron investment policy thus reflects our intent to determine the social and financial return on all assets, and to select opportunities for deploying capital, whether as grants or as investments, so as to maximize both kinds of return.

In some respects, this investment policy document is similar to those of other foundations. It sets forth guidelines agreed to by our staff and board to be followed in our investing activities, and it describes the philosophy, risk appetite, performance objectives, metrics, benchmarks, and similar guidelines typically covered in other such statements. It notes the typical asset classes a foundation of our size invests in, such as debt, private equity, and public equity, and it sets financial performance expectations, to be measured against industry benchmarks.

However, unlike most other investment policies, this document makes extensive use of such concepts as "mission return," "social performance," and "mission" or "social" risk. In this respect, our approach entails a broader reckoning of risk and return than a traditional investment policy. For Heron, return is measured both in financial terms and by the degree to which any given use of capital leads to outcomes that are consistent with our philanthropic mission and public purpose. In this policy statement, "risk" refers to the probability of non-performance on both social and financial dimensions, and on the interaction between the two. Our view is that poor financial performance impairs an enterprise's ability to provide mission returns — in Heron's case, via reliable employment, income, and opportunity for people we serve. Similarly, poor performance on broad social dimensions translates into impaired enterprise value and higher risk over time, including impairment of Heron's expected return as an investor. Both are material to Heron's investment management and to our public purpose.

We intend, for the purpose of managing our investments, that these concepts of social risk, performance, and return acquire simpler and more reliable definitions and metrics over time — measuring the degree to which a given investment contributes to Heron priorities and quantifying the risk that a given investment may fail to reach its social targets or, worse, do unintended harm. The resulting measures will be applied to calculations of risk and return in the same way, and with comparable emphasis, as financial data. We acknowledge that, at the time this policy takes effect, metrics to measure social performance are at a stage of rapid and uneven development and will require further expansion and refinement. To improve the precision and usefulness of these measurements, we expect to invest in their continued development, and to benefit from both our own experience in implementing this policy and from the expertise of advisers and partners who help us carry it out. As the quality and availability of such data improves, Heron will be able to reliably measure the financial and social performance of its holdings against relevant benchmarks (including comparable groups of enterprises).

Heron's commitment to earning a social return on all of its assets does not replace our intent to invest our capital well and prudently for financial return, even though guidance for our investment policies emanates from our public purpose and mission, first and foremost. In our case, time horizon and investment choices, for example, primarily align with our anti-poverty mission. So while tax and fiduciary laws regulate our operations, they do not determine our investment policies. For example, with respect to time horizon, we define ourselves as neither a “spend down” nor a “perpetual” foundation but as fully focused on the best use of a dollar for mission, with ongoing decision-making regarding whether spending more or less capital is more or less likely to achieve the results we seek. Currently, we think success will require a long-term view and an emphasis on investments that, among other benefits, provide reliable, sound employment to the people we want to help. This may change over time, in which case our investment policy may change to reflect it.

In the same vein, we do not see our mission results as the province of our grant-making alone. Heron believes that all enterprises, regardless of tax status, have an impact on our mission and public purpose (positive, negative, or neutral). Consequently, we invest our capital (whether in the form of equity, debt, or grants) in enterprises across the spectrum of tax status, corporate structure, and size that will best achieve our objectives.

Like any prudent investor, Heron seeks to manage risk with an appropriate asset allocation. But at the heart of our approach to investment selection is an emphasis on enterprises above asset classes. We believe we have an obligation to invest in robust enterprises — whatever their tax status, size, or business — that can perform reliably for the people and communities that we are dedicated to serve. Our fiduciary duties of care, loyalty, and obedience to mission require that we look to invest capital in a way that supports both financial performance at the enterprise-level and reliable and high-quality social performance by the enterprises in our portfolio, whatever their legal form might be. We believe that investments in targeted enterprises with positive net contribution will perpetuate a cycle of favorable social performance, financial performance, and ultimately financial return to Heron as investor. Accordingly, our portfolio privileges a bottom-up approach focused on the particular financial and social characteristics of each enterprise or investment according to our broader strategy. We plan to apply this approach to investment vehicles as well as individual holdings as we optimize our portfolio over time.

In addition to taking the “enterprise view,” Heron will allocate and rebalance the concentration of asset classes, industry groups, and enterprise types to mitigate both social and financial risk, according to portfolio guidelines as articulated in the investment policy statement (IPS) and regularly reviewed and adjusted by the board. Here, we acknowledge that the practice of assessing “social risk” in this context is undeveloped when compared to the practice for financial risk, and that regular assessment and rebalancing of social risk is aspirational. Again, we anticipate that these practices will develop over time and we will be able to apply them to our portfolio as they develop.

This policy also departs from custom in its treatment of grants, which are considered part of Heron’s (off-balance-sheet) investment portfolio. Enterprise Capital Grants (ECGs), in particular, are tracked over time using methods similar to those used for tracking any enterprise or fund in our portfolio. Our financial role as a capital investor means that the lion’s share of grant dollars are placed as a form of equity investment, in which we take an active interest in the strength and performance of the grantee’s enterprise but concede all returns to the recipient. Because a key component of Heron grants is the provision of capital — designed to be spent to create capacity that will, among other things, help to increase the amount and reliability of their revenue and improve their performance — we view grants as investments that produce measurable performance in both financial and social terms (which can be positive, negative, or neutral) over a specified time period. We take this view even though the financial return does not accrue to Heron. This document therefore contains references to ECGs as a subset of equity holdings.
Similarly, we regard “program-related investments” (PRIs) as a subset of our debt and equity holdings. PRIs, as defined by the Internal Revenue Service (IRS), cannot have as their primary purpose the generation of income and tend to earn a below-market risk-adjusted financial return. Foundations make such investments because they

expect the mission benefits to be particularly high, even when financial return is not consonant with financial risk. In Heron's portfolio, PRIs represent one of a number of ways of balancing mission and financial return, and are therefore evaluated alongside other, similar financial instruments that also represent a combination of the two types of expected return.

Finally, we believe that the fiduciary responsibilities of all philanthropic institutions mean that we have both a duty of obedience to our specific mission and a duty of obedience to a larger public purpose. As a practical matter, we are obligated to examine our portfolio on an ongoing basis to identify holdings that may unintentionally do harm to our mission or to the broader shared interests of society.

We anticipate that if we are going to be able to achieve our mission and fulfill our public purpose, we will be compelled to engage as an investor and partner with all types of enterprise— for-profit corporations, governments, and nonprofits. This will enable us to comply with our fiduciary duties of care and obedience to mission. Our view is that mission performance is available from the entire range of enterprises, including, but not limited to, nonprofit organizations, and financial performance and return is available from all kinds of financial instruments and enterprise types, including, but not solely, for-profit companies.

From an ethical and pragmatic standpoint, the board extends Heron's fiduciary duties to the enterprises we finance and, ultimately, to their beneficiaries. And while Heron weighs both mission and financial performance as well as financial return in assessing the performance of investments in various legal forms of enterprises, we acknowledge that there will be differences in performance and return expectations from one to another.

Heron believes that our fiduciary duties of care require that our actions not detract from the long-term interest of those whom we intend to benefit by our philanthropy. Therefore, compliance with policies that account for mission risk, broadly construed (including environmental, social, civic, and similar systemic risks to the well-being of disadvantaged people and communities) is part of the board's fiduciary duty. Thus, while the specific problem Heron aspires to address — poverty — and our current strategy to do so are at the core of our investment policy, we also consider broader societal goals, which, if not taken into account, could ultimately undermine the marginal gains we would make by addressing the mission more narrowly.

Investment Principles

Heron's investment policy embodies eight guiding principles, summarized below:

1. **All investing is impact investing**. All enterprises, regardless of tax status, produce both social and financial results, on a spectrum from positive to negative, including neutral. Their financial and social performance is measureable and varies over time. The conscientious investor takes note of both. In addition to forecasting expected financial return, Heron aspires to evaluate social and financial performance using a "net contribution" framework in which the deployment of human, natural, and societal capital is measured for each investee. We strive to work with outside vendors of indicators, metrics, and scoring methodologies to determine the impact of each investment we make.

2. **Heron, like all philanthropic institutions, is subject to the fiduciary duties of care, loyalty, and obedience to mission**. This obliges Heron to examine all of our investment holdings for both social and financial performance, and to make investment decisions that optimize both together to fully abide by our duty as a custodian of tax-privileged assets.

3. **All enterprises, regardless of tax status, fall within the scope of this policy**. Enterprises that receive Heron grants and PRIs receive the same duty of care with respect to those investments as do for-profit enterprises, even when Heron expects no financial return for itself or when risk of non-performance is relatively high.

4. **For Heron, investment risk encompasses beneficiary risk**. Risk assessment includes but goes beyond financial or mission risk to the foundation itself. While these are considered, our definition of risk also encompasses risks to beneficiaries, including the risk that companies cannot deliver results, reliable jobs, or both.

5. **Heron acts primarily as a capital investor in making both grants and investments**. In all sectors, we seek to invest in strong enterprises with reliable revenue. Investing with the overall needs of an enterprise in mind, with shared performance goals, promotes the resilience that enterprises and their leaders require to succeed. Most importantly, strong, reliable enterprises are better positioned to deliver results and employ and serve the people on whom we focus.

6. **Heron's investment decisions are fundamentals-driven**. We believe that enterprises that provide superior performance on both mission and financial dimensions are identified through thoughtful analysis of an enterprise's fundamentals — broad social contribution, market opportunity, management team, and business model, including revenue reliability — as compared against peers and understood within a larger industry, sector, and market context.

7. **Heron intends to operate as a strong and productive enterprise, like those in which it invests**. We strive to identify, build, and maintain the capacity to invest, co-invest, and leverage our funds well.

8. **Full achievement of our mission entails extending the reach of this policy beyond our walls**, and aligning ourselves with like-minded investors and enterprise leaders who can participate in transactions with us, help promote the kind of investing we envision, and leverage capital together. The changes we seek in the function of markets and civil society cannot be achieved by one investor acting alone, or even by many investors acting within individual funds, including philanthropy's largest. We will therefore develop, with others, data infrastructure, comparable performance analyses, certification protocols, investment vehicles, and similar practices that extend this style of investing beyond Heron and beyond philanthropy—bringing financial and non-financial impact together — with the goal that it becomes standard for the investment world and the economy as a whole.

Investment Policy

1. Purpose

The purpose of this Investment Policy Statement (IPS) is to establish guidelines for the prudent investment and administration of assets of the F.B. Heron Foundation ("Heron"). As a philanthropic institution, Heron is required to manage its assets for maximum public benefit and in compliance with its fiduciary duties of care and loyalty to the foundation and of obedience to its mission. Heron's mission — helping people and communities help themselves out of poverty — and its strategy to achieve that mission call for a broader set of investment parameters than is typical for most institutional investors. These parameters must support a holistic capital deployment methodology to serve both financial and mission-related objectives. This statement lays out the precepts, policies, and guidelines that Heron uses in balancing optimal financial performance, public responsibility, and fiduciary compliance.

The investment policy applies to all financial instruments, whether or not they are intended to produce financial returns to Heron, including grants, program-related investments (PRIs), debt instruments, and equities.

This policy statement outlines the investment guidelines that Heron deems to be appropriate and prudent in consideration of regulatory requirements and management of investments toward the fulfillment of our social and financial goals. Heron intends for this IPS to be used as a guideline rather than a rigid statement of policy from which there can be no deviation. Heron's board will review these policies annually and, from time to time, make changes as needed to reflect the changing nature of Heron's assets, mission, strategy, and economic conditions.

2. Fiduciary Duty

By moral and legal imperative, the board's fiduciary duty encompasses three central obligations:

- **Duty of care** to facilitate prudent stewardship of Heron's capital, and to extend that duty of care to beneficiaries by providing capital to enterprises that are aligned with our mission and contribute broadly to society;
- **Duty of loyalty** to ensure the impartial execution of all of Heron's dealings; and
- **Duty of obedience** to benefit the public and the mission of the foundation, as declared in the mission statement and encompassed by the corporate charter.

These duties, taken together, underlie Heron's investment policy and are applicable across all investees. Thus, portfolio performance on broad social dimensions is no less important to fulfilling our fiduciary duty than portfolio performance on financial dimensions.

3. Objective

Heron will manage its investments in order to optimize both social and financial performance. It is our hypothesis that social and financial performance at the enterprise level will ultimately be correlated to the financial return that an enterprise is capable of generating for its capital providers, and therefore its ability to contribute to Heron's operating strength. Subject to data availability, Heron will measure and report on the financial and social performance of its holdings with relevant benchmarks and performance of comparable groups of enterprises, according to industry group, enterprise size, and asset class.

“Social performance” encompasses not only beneficial changes within the organization receiving the investment but also broader changes that are influenced by that organization’s activities. To this end, we strive to employ a consistent measurement framework across all enterprises and asset classes that informs whether a given entity is making a net contribution to the world.

“Financial performance” is the measure of how well a firm can deploy assets from its primary mode of business to generate revenue and cash flow. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregate. Financial performance at the enterprise level is a key consideration regardless of the return the foundation expects from an investment. Heron intends to maintain an enterprise-level view of its investments even when the foundation makes investments through intermediaries.

4. Time Horizon

Heron is a capital investor with a long-term time horizon. We seek to match our focus on the long term with companies that operate with the same timeframe in mind. We seek to calibrate the holding period of our investments to an enterprise’s needs for successful execution of both mission and financial goals.

5. Portfolio Construction

Heron will favor a “bottom-up” or “enterprise-level” method of portfolio construction, while monitoring market and asset-class exposures described below. Secondarily, we will make investments and examine the portfolio’s profile in accordance with the section on “Risk Management.”

We aim to continually optimize the social performance of the entire portfolio, a process that requires evaluating how each asset contributes to or detracts from our broader goals. Heron seeks to invest in companies, government entities, nonprofit enterprises, and market segments that impart a net contribution to society. Heron aims to exclude and/or divest from entities that undermine its mission of expanding self-sufficiency and economic opportunity among low-income people and communities.

We seek to build the portfolio in three ways:

- **At the enterprise level**: We will look to make capital investments in enterprises that provide exposure to opportunities for superior mission and financial returns. The portfolio will include a broad array of enterprises — large and small, for-profit and non-profit, public and private — to achieve Heron’s strategic objectives.

- **At the market level**: As we optimize the portfolio to accomplish our mission, we will periodically review certain sectors and industries that may offer better mission-return potential than others. Over time, we may tilt the portfolio toward those sectors and industries and take into consideration cyclical and valuation trends as we do so.

- **At the asset-class level**: We will allocate capital according to the asset class limits described in Appendix B. Beyond these limits, the portfolio will privilege a bottom-up approach focused on the particular financial and social characteristics of each enterprise or investment according to our broader strategy.

Enterprise Capital Grant (ECG) investments will be focused on nonprofits that require capital to achieve more reliable revenue, whether it be earned or contributed (or both), and where growth will enhance mission performance. Heron monitors financial performance of all investments, including ECGs, regardless of whether it expects to share the return with the investee.

6. Performance Objectives & Benchmarks

- Heron will regularly evaluate the financial and social performance of its individual investments. Risk assessments are conducted to evaluate financial health while the evolving "net contribution" framework will eventually enable tracking of financial and social metrics over time.

- Heron will seek to achieve a financial return that meets that of appropriate benchmarks and that generally tracks our expectations for asset-class composition of the portfolio. See Appendix C for the most relevant benchmarks currently available as well as those in development.

- Heron will, to the extent possible, look to leverage outside capital and participate in shared investment vehicles as a way to increase impact through influence.

7. Risk Management

Social and financial performance are tracked in tandem on a regular basis. At inception, each investment is assigned an impact and financial risk rating, which are reviewed and revised at least annually. These ratings integrate expected mission and financial performance.

Heron uses an integrated risk-management process to identify, measure, and communicate risk and to manage that risk on an ongoing basis. The risk-management processes covered by this policy refer to investment risk, including operating and legal risk that may arise from the investing function. It is not meant to (nor can it) eliminate risk, but simply provides a framework for monitoring and managing it. External managers and data providers serve as vital partners in this pursuit.

Heron balances a portfolio view (i.e., "top down") risk assessment — asset allocation, concentration risk, diversification, industry and geographic exposures, manager and enterprise limits, and liquidity — with an assessment of idiosyncratic enterprise risks (i.e., "bottom-up").

Standard policies related to specific areas of risk are as follows:

- **Concentration**: We will concentrate exposure where we see potential for outsized mission and financial performance, subject to policy limits. See Appendix B for portfolio limits.

- **Liquidity Preference**: Heron's liquidity preference stems from its obligation to fund investment commitments and a desire to fund effective, efficient operations. In order to meet cash obligations over a three-year period, the portfolio should contain assets with daily/weekly liquidity characteristics in accordance with the limits in Appendix B.

8. Responsibilities

The board's responsibilities include, but are not limited to, the following:

- Developing and adopting policies (including this IPS) to achieve Heron's strategic objectives;
- Reviewing policy recommendations made by staff;
- Periodically reviewing and amending policy as appropriate;
- Delegating approval authority to the president and/or the investment committee;
- Reviewing periodic summary reports of the foundation's investment portfolio and overall compliance with the IPS; and
- Periodically reviewing Heron's Registered Investment Advisor relationships and soliciting requests for proposals as appropriate.

The investment committee's responsibilities include the following:

- Convening monthly, or as needed, to review and approve/decline investment recommendations;
- Periodically evaluating investment objectives and portfolio limits; and
- Regularly reviewing investment performance.

The duties of the staff include, but are not limited to, the following:

- Implementing and adhering to the IPS;
- Rating investments upon booking;
- Setting expectations for performance in terms of risk and return;
- Engaging with Heron's Investment Advisors or other pertinent parties to seek advice and counsel regarding manager selection, investment strategy, and results;
- Rebalancing the portfolio to account for market fluctuations and/or cash needs up to 5 percent of assets, in consultation with Heron's lead director for investments, a board position;
- Regular monitoring of liquidity requirements of the investment portfolio and operations;
- Tracking performance of the portfolio and reporting internally and to the board on the portfolio's social and financial goals;
- Assessing the tax implications of investment activities;
- Maintaining investment-related files and records, custody relationships, and accounting procedures; and
- Periodically reviewing the policy and making recommendations to the board regarding new policy development, revisions, or amendments.

The independent investment advisor's responsibilities include:

- Advising and commenting on investment guidelines, asset allocations, and investment managers;
- Assisting in the selection of new investment managers and monitoring important developments with current managers;
- Providing monthly performance evaluation reports; and
- Maintaining regular communication with staff.

9. Transparency

Heron views its investing function and portfolio not only as a social and financial tool focused on its own portfolio holdings, but as a way to influence a larger group of enterprises and investors. We seek to leverage our work through collaborative investing, co-investment, syndication, and knowledge-sharing. To that end, when legally permitted, Heron shares information on investment opportunities, portfolio performance, and market conditions with like-minded investors and via the website.

10. Payout Management

Heron is a private foundation and operates under that regulatory framework. It applies grants, PRIs, and charitable operating expenses toward its IRS-mandated payout obligation. Management manages payout based on the quality of available investments and the vicissitudes of the markets. We believe fiduciary duty to mission requires full deployment of Heron's resources, which includes, but also goes beyond, compliance with IRS regulations, such as payout requirements.

Appendix A: Style Profile

The list below outlines the range of factors that Heron may use in determining a suitable investment opportunity.

Enterprise Evaluation

- **Stage**: Heron focuses on enterprises with established, growing revenues and clear, untapped market opportunities. It will also invest in some early-stage enterprises and, on an exception-basis only, start-ups.
- **Contributor/Extractor**: Heron seeks to avoid companies it deems to be “net extractors” of society’s capital and invests in those that we judge to be “net contributors” to the world.
- **Socioeconomic Mix**: Heron invests in enterprises that show evidence that they value all stakeholders, including but not limited to employees, customers, and clients across the income spectrum.
- **Management Team**: Heron looks for seasoned management teams with a deep bench, a track record of success, and ethical decision-making.
- **Revenue Reliability**: Heron looks for enterprises that have reliable, recurring revenue that results in more stable jobs for employees and reduces performance risk for clients and customers.

Mission Fit

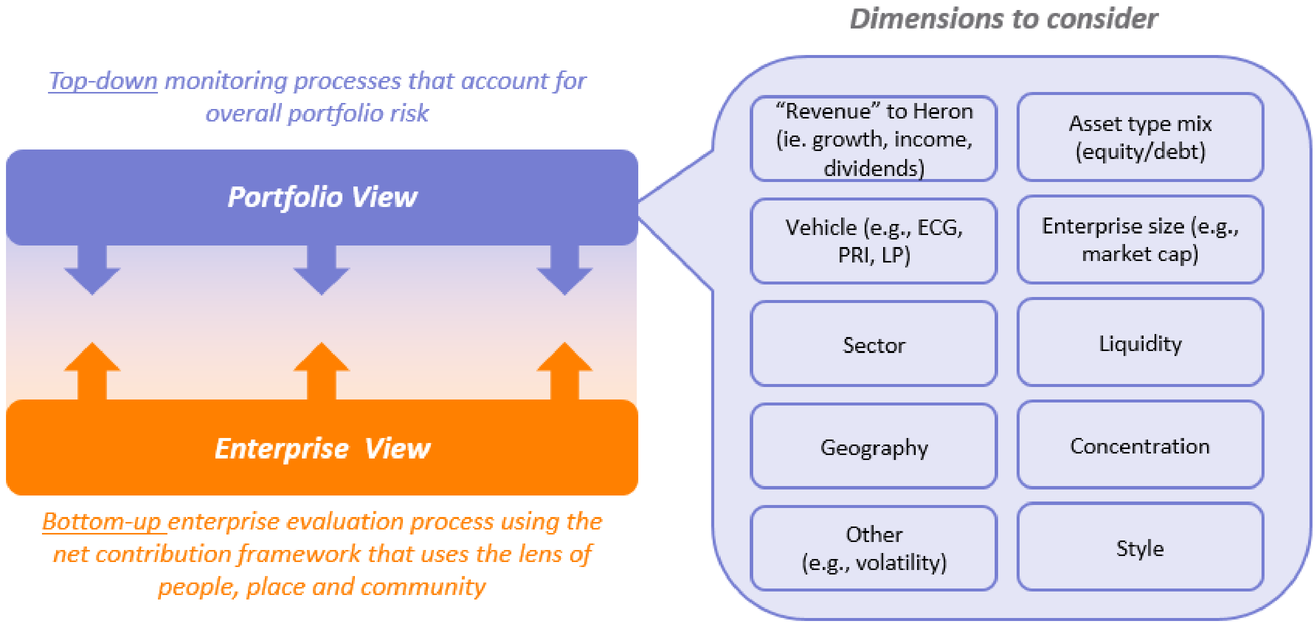
- **Jobs and Employment Quality**: Heron considers a range of employment-related outcomes to be positive indicators for investment, such as maintaining substantial existing employment or job growth that provides higher-than-average levels of pay, benefits, training, and promotion.
- **Socioeconomic Mix (Employment Base):** Heron looks for job-growth at the entry level.
- **Improvements in Markets and Public Policy**: Heron looks for indirect impact such as multiplier effects or innovation to stimulate broad change in market practices and public policies that compound its direct investment-level impact.

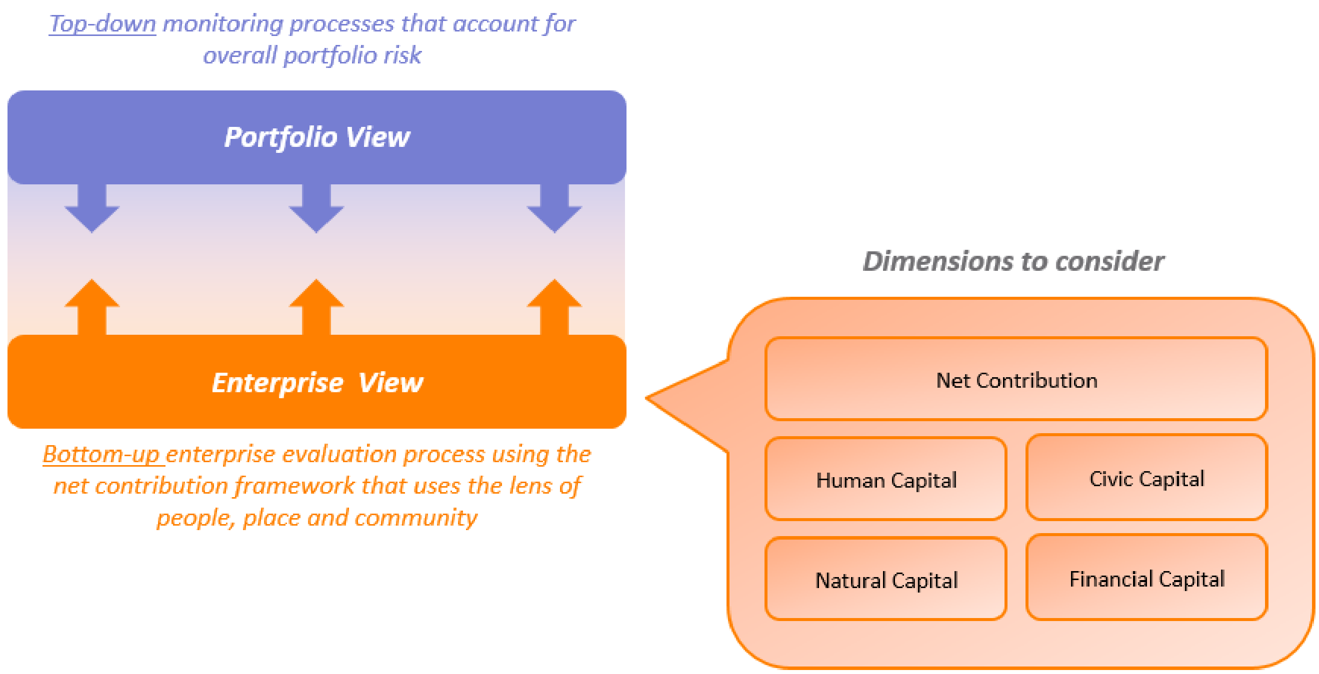
Other Investment Considerations

- **Impact Stickiness:** Heron evaluates investment opportunities with an eye toward how long its thinks the value and impact created will remain after it exits. It may take advantage of opportunities to “hard wire” the mission impact through structuring or governance in the face of superior expected mission returns.
- **Risk Alignment**: Heron looks for investments where the mission and financial risk are aligned to reduce the probability of divergent outcomes.
- **Reputation:** Heron believes that some individuals are worth backing based on the strength of their reputation, ideas, or vision; conversely, some should be avoided.
- **Active/Passive Management**: Heron believes that active management rarely delivers superior financial returns in efficient markets over time. However, it reserves the time and budget to assess and monitor active investments where it sees potential for superior mission returns and enterprise enhancements.

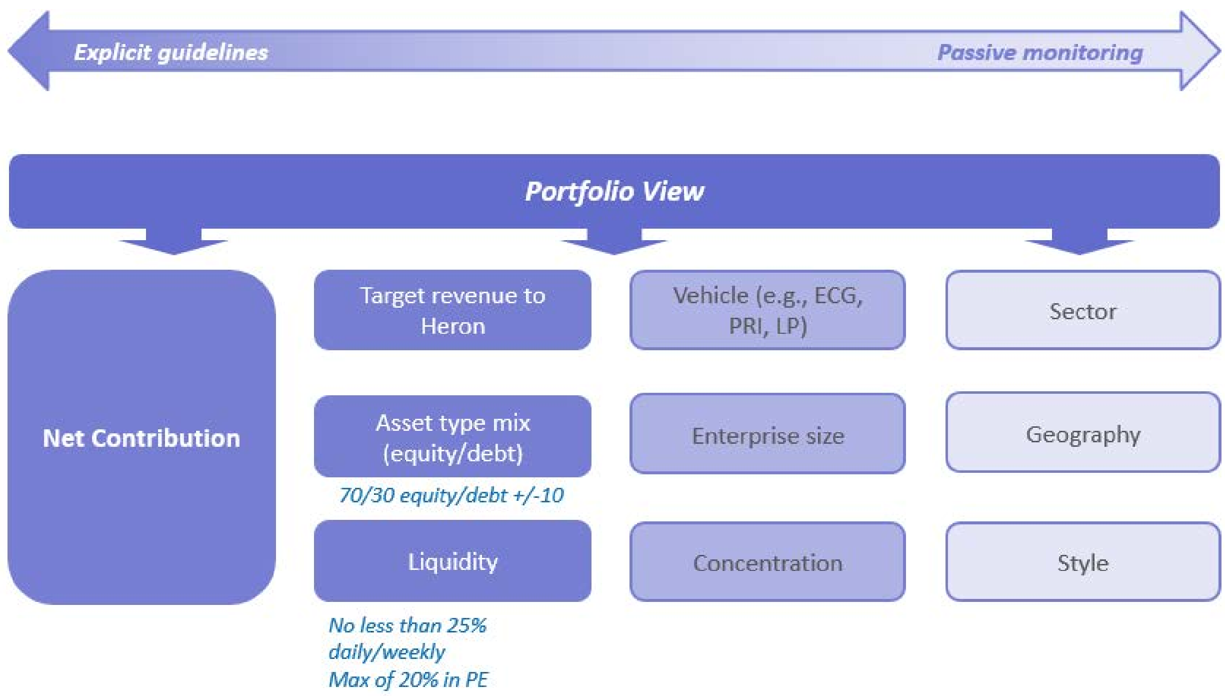
Appendix B: Portfolio Construction & Management

What Does Heron Want to "Manage To"?





What Does Heron Want to “Manage To” in the Portfolio Construction Process?



Appendix C: Example Financial Benchmarks

Asset Class	Current Benchmark	Recommended Primary Benchmark(s)	Secondary ESG/MRI Benchmark(s)
US Equity	Wilshire 5000	Russell 3000 Index	MSCI USA IMI ESG
Non-US Developed Equity	MSCI EAFE	MSCI EAFE Index	MSCI EAFE ESG
Emerging Markets Equity	MSCI EM	MSCI EM Index	MSCI EM ESG
Fixed Income	Barclays Aggregate	Blend of Barclays MBS, Taxable Municipal and Non-Investment Grade Municipal Bonds (weighted to mandate/mission guidelines	Barclays Aggregate Bond Index: MSCI US Aggregate Sustainability Index
Private Equity	Russell 3000 + 3%	Russell 3000 + 3%; Peer Medians; Public Market Equivalents	CA Impact Investing Benchmark
Private Debt	N/A	CS Leveraged Loans; S&P LSTA; BAML High Yield	CA Impact Investing Benchmark (under development)

Environmental, Social, and Governance (ESG) Index Descriptions:

- **MSCI USA IMI ESG**: Has exposure to large-, mid- and small-cap companies. The index is designed for investors seeking a benchmark comprised of companies with strong sustainability profiles and relatively low tracking error to the underlying equity market. Constituent selection is based on data from MSCI ESG Research.

- **MSCI EAFE ESG**: A capitalization-weighted index that provides exposure to companies with high ESG performance relative to sector peers. The index consists of large- and mid-cap companies across developed markets, excluding the United States and Canada. The index is designed for investors seeking a benchmark comprised of companies with strong sustainability profiles and relatively low tracking error to the underlying equity market. Constituent selection is based on data from MSCI ESG Research.

- **MSCI EM ESG**: A capitalization-weighted index that provides exposure to companies with high ESG performance relative to sector peers. The index consists of large- and mid-cap companies across 21 emerging markets countries. The index is designed for investors seeking a benchmark comprised of companies with strong sustainability profiles and relatively low tracking error to the underlying equity market. Constituent selection is based on data from MSCI ESG Research.

- **Barclays MSCI US Aggregate Sustainability Index**: Fixed-rate, investment-grade corporate bond benchmark that includes issuers with MSCI ESG ratings of BBB or higher. This benchmark is designed to positively screen "best-in-class" issuers that are more effective at managing the ESG risks most relevant to their industry peer group.

- **Cambridge Associates Impact Investing Benchmarks**: Benchmark reflects a broad array of institutional growth equity, venture capital, and mezzanine funds. Private debt methodology is still being considered.