A Word from the Chairman and the President

If you are a follower of the Endowment, you will find consistency between this report and earlier ones. That’s intentional. We will, as usual, use this year’s report to reflect on the past year, but, as our programs and approaches mature, our annual reports will be increasingly focused on our future plans.

Our Business Model

As we look at how our programmatic investments have developed and where we see them going, you won’t see radical change. Fundamentally, the Endowment is committed to “systemic, transformative, and sustainable change” for the good of the nation’s working forests and forest-reliant communities.

Our basic business model is founded on two beliefs: First, that real change comes from sticking with a course long enough to make a difference, and second, that we must invest all we do with calculated risk. In short, as a public charity we are part of the nation’s “innovation risk capital.” We are willing to do what others can’t or won’t.

These beliefs are rooted in what we call a “catalytic” business model. A catalyst is defined as “an agent that provokes or speeds significant change or action.” We go about “provoking or speeding” change through three basic and intertwined steps:

1. Work with partners to cast a vision for a better future;
2. Identify and connect the people and organizations who can help make the change; and,
3. Prime the pump to leverage the financial resources to do the work.

We Want and Need Your Feedback

This business model depends on discovery of bold ideas and opportunities. Our Board and staff are constantly sharing, listening, and enhancing community capacity, collaboration, and activating multiple value streams to advance systemic, transformative, and sustainable change for the health and vitality of the nation’s working forests and forest-reliant communities.

At the same time, change brings new talent and strategies. We are especially thankful for the addition of John Kulhavi of White Lake, Michigan; Kent Gilges of Canandaigua, New York; and Jon Voigtman, of Summit, New Jersey. John and Jon bring deep investment experience while Kent strengthens our understanding of conservation-based working forest management.

We approach our work and the year ahead with the same pledges that have guided our first six years – to do all within our power to advance our mission and to do so with integrity and transparency.

We Want You to Share Your Views

Mission

The Endowment works collaboratively with partners in the public and private sectors to advance systemic, transformative, and sustainable change for the health and vitality of the nation’s working forests and forest-reliant communities.

Vision

The Endowment supports a sustainable future – to meet broad societal objectives such as carbon-capture products, clean waters, wildlife habitats, and other ecological services, while ensuring healthy and vibrant forest-reliant communities.

History

The U.S. Endowment for Forestry and Natural Resources, Inc. (the Endowment) is a not-for-profit public charity. It was established September 21, 2006, at the request of the governments of the United States and Canada in accordance with the terms of the 2006 Softwood lumber Agreement between the two countries.

Theory of Change

The Endowment operates under a “theory of change” that focuses on work in three areas: retaining and enhancing healthy working forests; promoting and capturing multiple value streams; and enhancing collective capacity, collaboration, and leadership.

While many of our programmatic investments don’t lend themselves to simple characterization, all are clearly aligned and integrated within this theory.
Voting ‘Yes’ for Working Forests

The biggest winner in the 2012 elections? Funding for conservation! Voters passed 81% of local measures to raise funds for conservation through bonds or tax increases. An estimated $767 million was approved for parks, working lands such as forests, and to protect water quality. What does this mean for the Endowment’s future efforts to retain healthy, working forests?

First, it means that there is strong public support for natural resource conservation, and people will pay extra to protect resources in their communities. That bodes well for strategies such as payments for watershed services, whereby water users pay a little extra to protect and better manage the forests that clean their drinking water.

Another election lesson is that natural resource conservation is more successful when multiple interests benefit, such as recreation and water quality. The Endowment is creating new partnerships echoing this theme.

Forests That Protect and Rebuild Communities

The Endowment worked with the Department of Defense’s Readiness and Environmental Protection Initiative to permanently protect nearly 5,500 acres of working forest on the border of Georgia’s Fort Stewart. This removes the threat of development on this land, which would impact military training. Rayonier Inc., which sold the land to the Georgia Land Trust, retains timber harvesting rights, reducing the cost of the purchase and ensuring that forest reliant jobs are protected.

Similarly, the Endowment used water quality concerns in the Gulf of Mexico to stimulate reforestation in the Lower Mississippi River Valley. Reforestation of frequently flooded land reduces flood intensity and cuts down on nutrients and sediments from agricultural activities that, in turn, diminish water quality in the Gulf of Mexico. It also provides landowners with sustainable income. The Endowment ($250,000) and the Walton Family Foundation ($225,000) provided non-federal match to the Mississippi River Trust to trigger a planned investment of nearly $16 million by the Natural Resources Conservation Service. An estimated 16,000 acres will be replanted.

The 2012 elections signal that successful efforts to retain healthy, working forests will require the Endowment continue connecting new partners, from national defense to coastal fishermen to water utilities, and a gaggle of outdoor recreationists from mountain bikers to birders.

Empowering Healthy Forests

Through 2012, the Endowment invested nearly $2.55 million to develop innovative ways to retain healthy, working forests. The USDA Forest Service, the Department of Defense, the U.S. Fish and Wildlife Service, the Geraldine R. Dodge Foundation, and the Gaylord and Dorothy Donnelley, Graham and Knobloch Family foundations have provided $2.75 million. The Endowment’s grantees have raised an additional $19.83 million. All together, nearly $25 million has been raised to keep working forests working and healthy.

“Retaining healthy, working forests near installations is an important part of military readiness. The presence of working forests and other working lands is an effective way to reduce the threat of encroachment on the Department of Defense testing and training mission, while also protecting jobs and the culture of the communities in which we operate.”

John Conger
Deputy Under Secretary of Defense for Installations and Environment

“Conservation ballot measures enjoy tremendous support from voters of all ages, parties, and ethnicities. With nearly $767 million in new programs approved in the 2012 elections, ballot measures are one key to helping retain healthy, working forests.”

Will Rogers
CEO, The Trust for Public Land
Asset Creation • Forest Investment Zones • Wood-to-Energy

Forest Initiatives Spawn Economic Development

Burning wood for energy is the most ancient of energy conversion technologies. Even so, innovation in the way we release energy from wood is rapidly evolving. Capitalizing on this innovation has brought together three of the Endowment’s seven initiatives—Wood-to-Energy, Forest Investment Zones, and Asset Creation—to stimulate new wood markets, create clean and renewable energy, and localize energy economies.

Through the Woody Biomass Joint Venture Fund with the USDA Forest Service, the Endowment is investing in technological innovation and conversion from expensive imported fuel oil to local, wood-based heating systems. Entrepreneurs and the Endowment envision profitable new businesses employing new wood-to-energy technologies. By providing early capital to these entrepreneurs, the Joint Venture is testing the commercialization potential of a few of the most promising technologies.

In the three Endowment-created Forest Investment Zones, regional collaborations connect forest-reliant rural communities to capital, federal and state policy, and markets needed to build locally-sourced wood energy economies for residential and commercial heating from petroleum to wood fuels.

Bold Ventures Build Community Wealth

A brave undertaking in rural Georgia demonstrates how the Endowment’s practices to envision, connect and prime the pump can drive big change in rural, forested communities.

About 75% of Jefferson County, GA, is covered in productive, working forests, yet statistics indicate that it is a poor place. Poverty rates and unemployment are high. Changing wood markets have diminished the local forestry business infrastructure and eliminated many jobs. The Endowment’s vision, however, is that in counties like Jefferson, wood can equal wealth.

The spirit of hope and determination is alive and well in Jefferson. Tom Jordan of the local development authority just landed the first two manufacturing businesses to locate in the county in more than a decade. Molly Howard worked her way from high school principal to superintendent and has dramatically increased graduation rates, and Pastor Dennis Thompson opened a new church and community center dedicated to serving those struggling to pull their families from poverty.

The Endowment’s newly created Asset Creation Initiative will work with local communities to help ensure that profits from wood-to-energy leverage broad-based economic opportunity in low-wealth rural communities.

In 2013, the USDA Forest Service and the Endowment will launch the Local Energy for America Fund (LEAF). LEAF will use foundation and government funds to leverage private sector capital to fill a critical gap in early-stage financing for conversion of commercial and institutional heating from petroleum to wood fuels.

The Jefferson story is rooted in a rural community with a vision and plan for change, a company with a new idea about generating renewable energy from domestic wood resources; a government agency partnering with the private sector to advance its mission; and a foundation seeking high leverage on its investment toward mission. At the core is North Star Jefferson, a wood-to-energy plant that will use waste wood from local mills to generate electrical power.

The Endowment holds an equity share in the plant, and will return 100% of its business profits for philanthropic purposes. The Endowment has challenged the community to recommend a use of the funds to solve an underlying cause of poverty. The new Jefferson Opportunity Enterprise (JOE) is now engaging clubs, civic organizations, community-based entities, students, business associations and churches in a year-long dialogue to move toward a recommendation.

Bold Ventures Build Community Wealth

The Endowment’s role is catalytic. By being willing to take calculated risks and by being a trusted partner with government, business and the community, it is leveraging its power and money as a philanthropic mission investor.

Investing in Job Creation

As an equity-owning partner, the Endowment will earn profits generated by a 20-year power purchase agreement with Georgia Power Company. By committing this financial return for philanthropic investment in Jefferson County, the Endowment will leverage, in direct financial benefit, up to ten times its initial $1.5 million equity investment in the North Star plant.

Moreover, as community leadership and a new scale of local nonprofit capacity are built as a result of the anti-poverty project, new philanthropic and economic development resources will be attracted both from within and outside the community.

This type of long-term, large-scale philanthropic investment is rare in low-wealth, rural places. Therefore, the Endowment will promote the Jefferson project as a replicable model for using forest assets to connect rural job creation, economic development, and philanthropic capacity toward solving critical social problems.

“We in Jefferson County want to utilize our natural resources to add value and stimulate economic development, while protecting our environment. North Star Jefferson will support traditional wood manufacturing, put area residents to work, protect the environment with proven technologies, and anchor a renewable energy sector in a rural county.”

Tom Jordan
Executive Director of the Development Authority of Jefferson County

“We are determined to prepare our young people for post-secondary education and good jobs, too often that means preparing them for life nowhere else. This investment in our community will make it more possible for our educated young people to have a future at home.”

Molly Howard
Superintendent of the Jefferson County School System

“Poverty in a place like ours sometimes seems intractable. But, we need to lead our people to higher aspirations. The Endowment-sponsored projects in Jefferson County allow us to say honestly to people that it is worth hoping and working for a brighter future.”

Dennis Thompson
Pastor, New Way Christian Church

“The Endowment has challenged the community to recommend a use of the funds to solve an underlying cause of poverty. It is leveraging its power and money as a catalytic, trusted partner with government, business and the community.”

Dennis Thompson
Pastor, New Way Christian Church
USDA Forest Service
The Forest Service is an essential partner on many of the Endowment’s initiatives and projects. The Forest Service helped launch the Woody Biomass Joint Venture, which focuses on taking promising technologies to commercial application. They are a core partner for the Forest Health Initiative, which applies modern technologies such as gene splicing to the pressing challenge presented by forest pests and diseases. The Forest Service helped create the Partnership for Southern Forestland Conservation, which seeks to maintain large blocks of working forest. Most recently, they supported the Asset Creation Initiative, which uses working forests to increase assets for minority landowners. It’s no understatement to say that the Endowment would not be where it is today without the U.S. Forest Service as a partner.

Natural Resources Conservation Service
A grant from the NRCS Conservation Innovation Grants program, matched by the Endowment, brought about a breakthrough in watershed conservation by the Conservation Trust for North Carolina: creation of watershed protection fees in Raleigh, N.C. This small fee, about 40 cents/household/month, creates a sustainable funding stream that is used to conserve the city’s watershed, saving expensive water treatment and storage costs. Most recently, NRCS supported the Endowment’s new Asset Creation Initiative, which focuses on using working forests to increase assets for minority landowners.

Department of Defense
The Ft. Stewart, Georgia, training and testing mission received a boost in 2012 when nearly 5,500 acres of working forest was permanently protected on the installation’s perimeter, just south of Savannah. Had this land been developed, it would have impeded the military’s ability to train and prepare our troops. Many installations are surrounded by working forest – retaining and keeping them healthy is the best and most cost-effective way to help the military maintain their readiness. Through aid to the Readiness and Environmental Protection Initiative (RIP), the Endowment is making working forests an important part of the military’s goal to protect their testing and training mission.

U.S. Fish and Wildlife Service
A commitment from the US Fish and Wildlife Service, matched by the Forest Service and the Endowment, supports an innovative approach to one of the greatest challenges facing natural resource conservation: shrinking budgets. In partnership with the Southeast Association of Fish and Wildlife Agencies and the Southern Group of State Foresters, the Endowment is leading an effort to seek enhanced cooperation between state forestry and wildlife agencies, particularly through their State Forest and Wildlife Action Plans.

Duke Energy
Duke Energy helped jump-start the Forest Health Initiative pilot project to use genetic engineering techniques to develop a fungus- and rot-resistant American chestnut in a fraction of the time required for traditional tree breeding techniques. Why is Duke interested? Not only is their service area in the heart of the chestnut’s original range, but they bring the entrepreneurial spirit of a private corporation to the table. Duke also supports the “braided” approach used by the Endowment in this project, which brings together scientists, conservation organizations, and federal agencies to work toward a mutually-agreeable solution to forest health challenges.

Private Foundations
The Endowment is blessed with generous and timely support from a number of private foundations. The Gaylord and Dorothy Donnelley Foundation, Knobloch Family Foundation, Geraldine R. Dodge Foundation, and Graham Foundation support the National Conservation Easement Database. The Knobloch, Weyerhaeuser, Gates, and Lora L. and Martin N. Kelley Family Foundations, the Sand County Foundation Bradley Fund for the Environment, and the American Forest Foundation helped launch the Endowment’s Healthy Watersheds through Healthy Forests Initiative. The Energy Foundation supported the Northern and Dry Forest Investment Zone policy work on conversion from fossil fuels to community-scale, thermal woody biomass. Most recently, the Endowment matched a Walton Family Foundation award for an ambitious reforestation project in the Lower Mississippi River Valley.
Partnerships Lead to Huge Potential Gains in Forest Health

The Endowment’s Forest Health Initiative (FHI) tests the potential of modern biotechnology as a tool against the tsunami of pests and diseases ravaging America’s forests. The goal of the pilot project was to genetically engineer a disease resistant American chestnut in three years, not the decades required by traditional nursery techniques.

In 2012, the Endowment convened the first-ever Canada/U.S. Forest Health Summit. The event, sponsored by the Canadian Forest Service and USDA Forest Service, led to a vision for enhanced cross-border collaboration and coordination to address forest health threats.

Three years in, the coalition that conducted a “braided approach” to the work – science, regulatory, and socio-environmental – agree they have significantly advanced development of a disease resistant American chestnut. The greatest gains, however, have come in the process used to conduct the work.

FHI set aside the premise that the best approach would be a piecemeal competitive process. Instead, the steering committee – comprised of leaders (Duke Energy, the USDA Forest Service, and the Endowment), environmental interests (The Environmental Defense Fund; and The Nature Conservancy, and an independent scientists – pulled together top scientists and institutions to collaborate. Clemson University, Penn State University, SUNY- College of Environmental Science and Forestry; and the University of Georgia joined with the USDA Forest Service lab in Mississippi to tackle the work.

Similarly, all three federal biotechnology regulatory agencies are engaged: EPA, FDA and USDA Animal and Plant Health Inspection Service. Dozens of business, conservation and environmental interests were assembled to ensure rigorous social and environmental input.

The next step for FHI is demonstration plantings to test the environmental input.

Using forests as a Tool to Keep Drinking Water Costs Low

Changing the oil in your car is an inexpensive way to avoid costly engine damage repairs. Protecting the health of forests is a cost-effective way to avoid quality water declines that result in expensive treatment and storage costs.

The USDA Forest Service estimates that forested watersheds provide drinking water to nearly two out of three Americans. The smart, economical way to keep drinking water clean and affordable is to keep the forests in the watershed healthy.

The Endowment and the Natural Resources Conservation Service (NRCS) are pioneering ways to keep drinking water costs low. Our grantee, The Conservation Trust for North Carolina, worked with Raleigh’s mayor and city council to create a watershed protection fee. The fee costs the average homeowner 40 cents per month and generates about $1.8 million annually for land conservation to protect drinking water quality. Paying a little now for watershed conservation will save Raleigh residents money in the future.

A Vision for Watershed Protection

To find ways to make investments like these norm, the Endowment convened water experts who prioritized ways to “mainstream” water consumer investments in forested watersheds. In 2012, the Endowment implemented those priorities.

With the American Water Works Association and the Water Research Foundation, we are advancing the “Source Water Protection Vision and Roadmap” – the industry’s watershed protection plan. The goal is to partner with the water utility industry nationwide to find efficient ways to protect forested watersheds at the community level.

Expanding Non-Traditional Markets
Promoting the Benefits of Wood-based Products

What do the following projects have in common?

- Market development on post frame buildings by the National Frame Building Association
- Building standards research by the American Wood Council
- Market development targeting multi-family and light commercial markets by WoodWorks

They are all 2012 grants by the Softwood Lumber Board (SLB), and each is funded through the first-ever “Research and Promotion Program” – or check-off – for a forest product.

The Endowment served as the primary advocate, convener and initial funder of work that led to a global check-off for softwood lumber products used in the United States. The outcome? More than $20 million is available in 2012-13 to grow markets for softwood lumber via the SLB.

Check-offs to Revitalize Paper, Hardwood Markets

The Endowment’s vision is for America’s forests to be sustainably managed to meet broad societal objectives and to provide family-supporting jobs. For guidance as to how to implement this ambitious vision, we studied the nation’s agricultural producers. Growers of products from peanuts to pecans have voted to “assess their own production on a per unit basis” to generate funding for research and promotion programs.

It worked! These self-imposed check-off programs have revitalized agricultural markets from cotton to cattle.

The Endowment’s strategy was to bring check-offs to the forest products industry for the first time. Our 24-month campaign to convince leaders from the worldwide softwood lumber sector to capitalize on the power of a cooperative approach to grow markets has been wildly successful.

With the Endowment’s leadership, members of two other sectors – paper and paper-based packaging, and hardwood lumber and hardwood plywood – will cast their ballots in 2013 for what could become the second and third forest products check-offs.

There are more opportunities for this strategy, such as softwood plywood and woody biomass for dedicated energy production. The most challenged segment of the forest products value chain – timber harvesting – could also benefit. The Endowment is committed to working with any segment of the forestry community to help them create self-sustaining programs to grow markets.

Enormous Payoffs in Market Growth, Job Creation

Through 2012, the Endowment has invested about $1 million in collaborative efforts with the softwood lumber, paper and paper-based packaging, and hardwood lumber and hardwood plywood sectors. These three industries have also invested a similar amount. The objective is to study, promote, and move to vote on new check-offs.

The payoff is enormous. More than $50 million annually in check-off revenues could be generated. The real gains, however, will come through increased markets for forest owners who will reap financial rewards while enhancing forest health. Tens-of-thousands of families will also benefit from the retention or addition of family-supporting jobs in rural America.

“Commodity check-offs are proven tools to help grow markets and to engage consumers in a better understanding of the benefits of particular agricultural products.”

Sonia Jimenez
Director, Promotion and Economics Division, USDA’s Agriculture Marketing Service

“The U.S. Endowment for Forestry and Communities deserves credit for its vision, commitment of financial resources, and persistence toward helping to establish check-offs for softwood lumber and other forest products sectors. Check-offs create the opportunity and potential to help grow one of the world’s greenest businesses.”

Steve Lovett
Executive Director of the Softwood Lumber Board
The Endowment-sponsored review of Georgia’s Forest Action Plan and State Wildlife Action Plan sought ways to leverage resources and address common priorities benefitting the Georgia Forestry Commission and the Georgia Wildlife Resources Division. The facilitated meetings of our respective program managers and directors fostered a greater understanding of agency-specific priorities and led to enhanced cooperation on prescribed burning, invasive species, and longleaf pine restoration. We are currently working on a project to optimize each agency’s objectives with restoring longleaf pine ecosystems.

Robert Farris
Director, Georgia Forestry Commission

“Investing in watershed conservation is the best way for our citizens to save money on their water bills in the long run. The Endowment’s financial support helped Raleigh pioneer a system that is working well for all involved.”

Charles Meeker
former Mayor of Raleigh, NC

Statements of Financial Activity (For the 12 Months ended December 31)

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<tr>
<th>Program Income and Expenses</th>
<th>2012*</th>
<th>2011</th>
<th>2010</th>
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<tr>
<td>Program Income (public and private support)</td>
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<td>Program Expenses</td>
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<td>(grants, workshops, program-related investments, and related expenses)</td>
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<th>Administrative Expenses</th>
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<td>Personnel, general and administrative expenses</td>
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<th>Investment Income and Expenses</th>
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<td>Interest and Dividend Income</td>
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<td>Realized and Unrealized Gains (Losses)</td>
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<td>Investment Fees</td>
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<td>Total Increase (Decrease) in Net Assets</td>
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<td>Net Assets at Beginning of Period</td>
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<td>Net Assets at End of Period</td>
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From 2007 - 2012, a $20,361,000 Endowment investment leveraged $128,363,000 from partners for a total of $148,724,000 for projects.

- Grantee Match: $111,778,000
- Internal Match: $16,585,000
- Endowment: $20,361,000

* 2012 information is preliminary pending completion of year-end closing and audit procedures.

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