Chairman’s Thoughts
Credits Retiring Members; Welcomes New Talent

Equally important as our investments in programmatic activity are investments in people—especially those who guide and those who implement our plans. In 2014 we reached a significant milestone—all inaugural Board members completed terms of service. As I end my first year as Chairman, it is my pleasure to recognize the last two of the original eleven members who charted a course of action for this small but effective organization. Peggie Clark—Arkansas’s first lady of charm and humor—ended her term with honor. From “inurn family,” Peggie served eight years and ensured that the success of America’s forest owners was always on the table. Her acumen, honesty in the family business, served us well as she chaired the Audit Committee. Her easy laughter, warm smile, and sly southern savvy will be missed.

Mack Hogans—the dirt forester from L.A. (that’s “Lower Alabama”) who rose to senior leadership in one of the best-known names in forestry (Weyerhaeuser)—also completed eight years. Mack combined command and control from rural roots with diplomatic skills that would be the envy of the United Nations. He showcased those talents as Chairman for four years, where all found him to be a listening, fair-minded, old-fashioned grandfather, a top athlete, and the wisdom of Solomon.

Returns on investment from our initial Board were stellar. Though it is bittersweet to see rich talent and now close friends retire from service, we are blessed to have well-qualified additions bring their own strengths.

Jim Hoolihan—former mayor of Grand Rapids, MN; long-serving board member and past president of the Blandin Foundation; and head of a family business that spans three-quarters of a century—joined in May.

We welcomed two more talents in November: John Cooper—formerly of NC and now associate professor of practice at Texas A&M University—brought personal perspective on minority landowner issues and deep understanding of rural development, poverty, and charitable engagement to change. Andrea Tuttle—former state forester of CA and renowned natural resources professional—shares an understanding of policy-making and global perspectives from years of international work.

The investments made in our Board are matched by those in six full-time staffers with whom it has been my honor to serve. Expected returns for the future look great!

President Shares Views
Recounts Hits, and One Miss, for 2014

While the stock market was on a tear, 2014 was a year of stability and enhanced performance for the Endowment staff. Not so on the programmatic side. For our most significant investment to date, we rode a rollercoaster.

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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
America’s forests are sustainably managed to meet broad societal objectives such as marketable 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 Communities, 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 restoring healthy working forests; promoting and capturing multiple value streams; and enhancing community capacity, collaboration, and leadership.

While many of our programmatic investments don’t lend themselves to simple characterization, all are closely aligned and integrate well under this theory.

Board of Directors

<table>
<thead>
<tr>
<th>Name</th>
<th>Office</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peggy Clark</td>
<td>Chair, Investment</td>
</tr>
<tr>
<td>John Weaver</td>
<td>President &amp; CEO</td>
</tr>
<tr>
<td>John Kuhavy</td>
<td>Vice President</td>
</tr>
<tr>
<td>John Cooper</td>
<td>President</td>
</tr>
<tr>
<td>Tamar Datei</td>
<td>Chair</td>
</tr>
<tr>
<td>Andrea Tuttle</td>
<td>President &amp; Secretary</td>
</tr>
<tr>
<td>James Farrell</td>
<td>Treasurer</td>
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<tr>
<td>Kent Giles</td>
<td>Treasurer</td>
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<tr>
<td>Mack Hoolihan</td>
<td>Treasurer</td>
</tr>
<tr>
<td>John Weaver</td>
<td>Treasurer</td>
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Previous Directors

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<tbody>
<tr>
<td>David Dodson</td>
<td>Chairman</td>
</tr>
<tr>
<td>Milt Duncan</td>
<td>President</td>
</tr>
<tr>
<td>Chuck Leavel</td>
<td>Chairman</td>
</tr>
<tr>
<td>Bruce Miles</td>
<td>President</td>
</tr>
<tr>
<td>Stephanie Rousseau</td>
<td>President</td>
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Staff

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Signe Cann</td>
<td>Chief Financial Officer</td>
</tr>
<tr>
<td>Florence Colby</td>
<td>Executive Assistant</td>
</tr>
<tr>
<td>Michael Goering</td>
<td>Director</td>
</tr>
</tbody>
</table>

Intern

<table>
<thead>
<tr>
<th>Name</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Coleman Allums</td>
<td>Furman University</td>
</tr>
</tbody>
</table>

1. Ended service, November 2014
2. Begun service, November 2014
3. Begun service, May 2014
In 2014, P3Nano—a public-private partnership initiated by the USDA Forest Service and the Endowment—awarded nine research grants worth more than $3 million to advance commercialization of cellulose nano-materials. The investment is expected to stimulate new industries, develop 21st-century green products, and provide high-wage jobs in rural America.

Uncommonly strong and lightweight, products made from cellulosic nano material could revolutionize the auto, aerospace, electronics, food packaging, and other industries. Projects will investigate using cellulose nanomaterial in cement, to reinforce plastics, creating fiberglass alternatives, reinventing fiberboard, developing advanced papers, and more.

International competition, recessionary pressures, and other factors have sapped the U.S. forest product sector’s once-robust R&D programs. According to the most recent data available, from before the 2008 recession, the forest industry devoted only half of 1 percent of total sales to R&D, versus an average of 3.4 percent for the U.S. non-high-tech manufacturing sector.

Public funding for R&D is also rapidly declining, even as many foreign competitors are ratcheting up investments. Without targeted investment and collaborative innovation to create high-value products and develop new markets, the forest products sector will weaken.

The P3Nano initiative, the Endowment’s effort to back new models for innovation, is leveraging public and private investments and spurring commitment to research and development for the next generation of forest products.
Drinking Water: Two-Thirds Originates From Forests

Investors look for companies that improve returns by lowering costs and improving efficiency. That’s also one of the Endowment’s strategies when assessing projects. For example, investing in management of forested watersheds to cut water treatment costs yields higher returns for consumers.

The Endowment is funding pilot projects in Arkansas, Georgia, North Carolina, Oregon, and South Carolina to demonstrate how watershed management can lower costs for water utilities and their customers.

Called Healthy Watersheds through Healthy Forests, this program promotes investments in sustainable management of forested watersheds, which are the source for two-thirds of the nation’s drinking water. Healthy, well-managed forests produce cleaner water that may be less expensive to treat. That gives water utilities and water consumers incentive to invest in healthy, well-managed forests in their watersheds.

Financial support from water utilities and their customers could help transform how landowners manage forested watersheds. If both forest owners and water users realize economic benefits, the change will be sustainable.

With the American Water Works Association, the Endowment is funding research to clarify the relationship between raw water quality and treatment costs—a critical point for winning support from water utilities and making forest management integral to the water service business. The Endowment is also hosting symposia and workshops to help forest landowners and water utilities find common ground and is securing funding from the Natural Resources Conservation Service for an analysis of water projects by the World Resources Institute.

“The rational investor buys shares in companies that are cutting costs and improving efficiency,” said Peter Stangel, Endowment SVP. “Forested watersheds are a similarly good investment: they cut water treatment costs for utilities, thus yielding high returns for consumers.”

“A couple of thoughts (but not directives): Focus the new funds and your energy on a relatively few activities in which [you] can make an important difference. Concentrate your resources on needs that would not be met without your efforts…. Expect to make some mistakes; nothing important will be accomplished if you make only “safe” decisions.”

-Warren Buffett

Excerpted from letters to his children as he endowed their foundations

Systemic, Transformative, and Sustainable Change
Consortium Seeks Enhanced Forest Health and Renewable Energy through Torrefaction

Commercially viable, advanced wood-to-energy products can be made from low-value trees and forest residues—material that often compromises forest health and heightens the risk of wildfires. To fill critical knowledge gaps, the Endowment, the USDA Forest Service’s Forest Products Laboratory, and Georgia Southern University’s Herty Advanced Materials Development Center have launched the Consortium for Advanced Wood-to-Energy Solutions (CAWES).

“Our initial work will center on determining the commercial viability of torrefaction—the ‘roasting’ of wood in a low-oxygen environment—to create an energy-dense product that can more easily be shipped, stored, and used to produce renewable energy,” said Alexander Koukoulas, President and CEO of Herty.

The Endowment and the USDA Forest Service, via its State & Private Forestry division, jump-started the consortium with a $4 million investment.

Bold Plan to Demonstrate Positive Power of Enterprise Falters

With a change in plans by a major partner, a four-year impact investment effort may fail, the Endowment has conceded. In late 2010 the Endowment created a public-private partnership to develop a community-scale wood-to-energy project. It would provide a market for low-value and waste wood, support a local sawmill, shore up a sagging tax base, and create 25 direct and 50 indirect jobs in recession-stricken Jefferson County, Georgia. It would also generate a guaranteed 20-year stream of income for the community to invest.

The Endowment put up $3 million (half to own 40 percent of the entity and thus 40 percent of the returns; half as a start-up loan) to leverage a total $80 million investment. North Star Jefferson had much going for it, including the 20-year power purchase agreement with a Fortune 500 company, a proven technology, and an experienced project developer.

A for-profit subsidiary, Community Wealth through Forestry (CWF), was created to hold the Endowment’s North Star Jefferson interests on behalf of the community. Net revenues from the 40 percent ownership was expected to approach $500,000 per year.

Endowment President Carlton Owen called North Star Jefferson “the quintessential triple-bottom-line project. And the social benefit was truly stellar. Most such schemes involve short-term philanthropy for only a few kids. This was a long-term, universal program tied to a stable, for-profit business.”

The Endowment asked residents to agree on one reinvestment strategy that if pursued consistently would lift their deeply challenged, majority minority community. A nonprofit community activist helped a representative, 15-member “listening committee” discuss ideas with their neighbors and study approaches that had worked elsewhere.

CWF then developed the chosen strategy: Children’s Savings Accounts (CSAs) for each of the 3,400 K–12 students in the county. In a tiered approach, families below the poverty level would receive $2 for every $1 invested for each child, up to a total of $120 per year per child. Families earning up to twice the poverty level would get a dollar-for-dollar match. No one would be left out: higher-income families would get 50 cents for each dollar—an instant 50 percent return.

Studies from around the globe show it isn’t the amount of money that goes into a CSA that makes the difference; rather, it’s the conversations about the future and the goals parents set for their children. Most CSAs involve short-term philanthropy for only a small segment of a population. Nowhere did the Endowment find a long-term, universal program tied to a for-profit business.

CWF was forced to take legal action to remove its first partner, however, and another party was selected. The power purchase agreement was extended to 30 years, raising the community’s potential return to as much as $1 million a year. Then in 2014 the second partner sought to withdraw from its commitments, dimming prospects for the effort.

A complete autopsy of the experience will be publicly available before year-end 2015.
**What’s News**

**2012**

- January: Hardwood producers seek help to grow markets; Endowment cofunds check-off development
- April: Asset Creation Initiative takes forest pathway to economic progress for disadvantaged populations
- May: Resources for the Future creates Chair in Forest Economics and Policy with Endowment support
- September: Endowment manages military’s Readiness and Environmental Protection Integration challenge program

**2013**

- March: Second Forest Health Summit, in Ottawa, advances cross-border forest health collaboration
- May: State of Forestry and Forest Industry meeting identifies challenges and opportunities for growth
- May: Innovation Agenda for future forest products begins as Forest Investment Zone projects wrap up
- July: National Conservation Database adds 100,000th easement, helps land trusts coordinate efforts

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**Advance Forest Health**

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**Actions Follow Cross-Border Summits Convened by Endowment**

In late November the Endowment released the first report (2013/2014 Year End Report) of results of cross-border collaboration to address forest health issues affecting the second-largest forest expanse in the world—the combined forest estate of Canada and the U.S.

“While cooperation among our two countries and especially forest scientists and forest managers in both has a long-history,” said Endowment President Carlton Owen, “the enhanced collaboration and the positive results showcased in this report point to the importance and benefits to the forests and people of both nations when that cooperation is more strategic. As we’ve seen with Ebola, it is vitally important that people focus on cooperation and rapid sharing of information to effect positive results. The forests of North America are benefiting from just such collaboration.”

Example Results of Enhanced Canadian-U.S. Collaboration:
- **Markets:** Environmental product declarations for particleboard and medium-density fiberboard will help make wood products a preferred material for green building.
- **Fire:** A coordinated approach to sharing wildland firefighting resources portends more effective suppression.
- **Pests:** Enhanced collaboration facilitates response to spruce budworm outbreaks in eastern North America.
- **Inventory:** First-generation continuous map of above-ground forest biomass and above-ground carbon in North America aids planning.
- **International:** Coordination of information for the 2015 Global Forest Resource Assessment report will improve accuracy.
**Invigorate Forest-Rich Communities**

“**The four most dangerous words in investing are: this time it’s different.**”

— Sir John Templeton

**Management of Forests Rewards African Americans; Promotes Land Retention**

The Endowment’s pilot program, launched in 2013 to help African American landowners resolve land tenure problems and adopt forest management practices, has posted results for its first full year of operation.

In 2014 the program engaged 357 forest-owning African American families, with 128 targeted for full forestry and land tenure services. Of those receiving full services:

- 105 now have or are developing forest management plans;
- 62 are receiving land tenure services, such as wills, estate plans, or resolution of heirs’ property;
- 92 have implemented forestry practices, such as thinning; and
- 60 have completed or planned timber sales.

The program aims to build family wealth and improve forest health and productivity through four basic mechanisms: secure land tenure, forest management plans, forest practices, and access to markets. Only 20 percent of family-owned forestland is managed under written plans, and for African American forestland owners in the Southeast, the percentage may be even smaller, according to USDA Forest Service reports. In 2013 only two of the 133 African American owners who initially signed up to participate in a Low Country (South Carolina) sustainable forestry program of the Center for Heirs’ Property Preservation had forest management plans. Whether the next generation will retain and manage the family woodlot or sell it for conversion to other uses may depend on the owner’s ability to realize a return on its productivity,” said Alan McGregor, the Endowment’s Vice President.

Critical to the program is collaboration with USDA and state agencies, particularly the Natural Resources Conservation Service (NRCS), the USDA Forest Service, the Farm Services Administration, and state forestry commissions. A clear measure of success: 75 African American landowners have received or are under consideration for cost-share funding for forestry plans and practices from the NRCS Environmental Quality Incentives Program (EQIP).
Zone Work Concludes; Forest Communities Benefit

A five-year project with three ambitious goals—advancing forest health, growing markets, and invigorating forest-rich communities—has closed out, reporting gains at a regional scale.

In 2009 the Endowment, working as funder, bridge-builder, and risk-taker, challenged three regional nonprofits to collaboratively and holistically address the economic impact of changing forestry markets on communities in forest-reliant regions. Despite the recession’s drain on philanthropic and government resources, grantees leveraged more than $8 million to match the Endowment’s $6 million investment, generating tangible results and identifying opportunities for future investment.

The Forest Investment Zone Initiative focused on three regions—Northern Forest (Maine, New Hampshire, New York, Vermont), Central Appalachia (Kentucky, Ohio, Tennessee, Virginia, West Virginia), and Dry Forest (eastern California, Oregon)—each with a distinct forest ecosystem and social-political-economic context, including soft demand for forest products, mill closures, weak civic capacity, and often poor forest management.

In each zone the Endowment partnered with a strong nonprofit intermediary: the Northern Forest Center led the initiative in the Northern Forest Zone, the Mountain Association for Community Economic Development directed the Central Appalachia Zone, and Sustainable Northwest steered the Dry Forest Zone. Grantees received $2 million each and assembled local partners to supplement their expertise and coverage.

Strategies that gained traction and hold potential include the following:

Opening Public Lands via Community Collaboratives

In the Dry Forest Zone, diverse local stakeholders—bridge industry, community, and environmental divides—sought agreement on plans for public lands management. After 15 years of legal impasse, federal forests in the Northwest are again producing timber for local mills, and planning and activities have resumed on more than 4 million acres of National Forests.

Making Certification Feasible for Small Owners and Producers

The Center for Forest Certification at the University of Kentucky could be an enduring legacy of the Central Appalachia Zone. It gives family-forest owners and producers access to group certification at an affordable price, dismantling the barrier to new markets for green products. The center has certified 67,800 acres and helped 93 wood products companies and 59 loggers secure certification.

Generating Community-Scale Biomass Heat

In the Northern Forest Zone, the Model Neighborhood Project enabled 40 home-owners in Berlin, New Hampshire, to switch from oil to state-of-the-art wood pellet heating systems, generating $400,000 in local economic benefits, saving families $100,000 on their fuel bills, and avoiding 681 tons of carbon emissions. This project is now being replicated in Vermont and Maine and in the Adirondacks.

Catalyzing Innovation in Wood Products Manufacturing

The Northern Forest Zone’s Regional Wood Products Consortium persuaded 28 wood products companies to adopt the tools of lean manufacturing, mass customization, and online marketing. One example: once near bankruptcy and with just three employees, Timeless Frames of Watertown, Vermont, now produces digitally customized picture frames, employs 300 people, and uses 2 million board feet of northern hardwoods annually.

Creating Community-Owned Forests

In Maine, New Hampshire, and Vermont, 13 community-owned forests covering more than 11,000 acres now generate income from timber sales for the sponsoring municipality while providing recreation, preserving ecologically sensitive land, and furthering public understanding of the forest as a critical asset. The Northern Forest Zone’s partners help localities identify properties to purchase and finance, engage the broader community, and help plan for continued forest management and long-term stewardship.

To learn more about the Forest Investment Zone Initiative results, visit www.usendowment.org.

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

<table>
<thead>
<tr>
<th>Program Investment</th>
<th>2014*</th>
<th>2013</th>
<th>2012</th>
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<tbody>
<tr>
<td>Partner Investment (public and private support)</td>
<td>$2,738,000</td>
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<td>Program Expenditures</td>
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<tr>
<td>Grants and Contracts</td>
<td>5,146,000</td>
<td>6,335,000</td>
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<td>Impact Investments ($8,650,000 cumulative)</td>
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<tr>
<td>Total</td>
<td>$7,896,000</td>
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<td>$11,658,000</td>
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| Net Assets at End of Period | $219,235,000 | $204,475,000 | $189,072,000 |
| Income, realized and unrealized gains | $17,804,000 | $19,458,000 | $16,967,000 |
| Total Increase in Net Assets | 14,760,000 | 15,403,000 | 11,269,000 |
| Net Assets at Beginning of Period | $204,475,000 | $189,072,000 | $177,803,000 |
| Net Assets at End of Period | $219,235,000 | $204,475,000 | $189,072,000 |

| Operation Expense | $616,000 | $629,000 | $611,000 |
| Personnel, General and Administrative | | | |
| Investment Activity | | | |
| Income, realized and unrealized gains | $17,804,000 | $19,458,000 | $16,967,000 |
| Total Increase in Net Assets | 14,760,000 | 15,403,000 | 11,269,000 |
| Net Assets at Beginning of Period | $204,475,000 | $189,072,000 | $177,803,000 |
| Net Assets at End of Period | $219,235,000 | $204,475,000 | $189,072,000 |
| Leverage | | | |
| Endowment investments of $30,659,000 leveraged | | | |
| $105,971,000 in partner and external investments for a total of $136,630,000. | | | |
| $30,659,000 | $136,630,000 |

* 2014 information is preliminary pending completion of year-end closing and audit procedures
** Cumulative impact investments from 2010-2012

*This report was printed on Husky Offset 70 lb. text and Finch Fine, Bright White, Ultra Smooth 100 lb. cover. The wood fiber used to make these papers is independently certified by one of the world’s premier forest certification standards as coming from responsibly managed forests. Certification ensures that the Endowment’s publications meet strict environmental and socio-economic principles consistent with our mission.