

ANNUAL REPORT 2007



Longleaf Pine
Grass Stage

A Word From The Chairman & The President

We are especially pleased to provide the first-ever annual report of the United States Endowment for Forestry and Communities (the Endowment).

If we compare the growth of the Endowment to that of a mighty tree, we are just a seedling having recently germinated. Like that tree, if we are to mature, we must first put down a healthy root system. For the Endowment 2007 has been just that: a time of putting down a strong “root system” to support our long-term growth.

We are very encouraged by not only the potential the Endowment holds but also the reception that we’ve received locally (in our “hometown”) and nationally by sister foundations, as well as hundreds of individuals representing sustainable forestry and forest-reliant communities. The interest and excitement generated by the creation of the Endowment is a testimony to those who envisioned the benefits of a newly chartered organization to work at the nexus of forestry and rural communities across the U.S.

Through this report, you’ll learn more not only about our roots but also about our hopes and aspirations that we undergird with the stated desire to promote “systemic, transformative and sustainable change.” While the Endowment is instantly the largest U.S. foundation working in the forestry sector, we acknowledge that we can do very little without forging productive partnerships. Our lean staff model – three full-time employees – adds emphasis to our intent to work with and through others who share a common vision.

We’ve taken a thoughtful and deliberate approach to our work. As an organization chartered to work in perpetuity, we’ve resisted the urge to “leap before we look.” Thus, our board, staff and literally hundreds of others have engaged in a thorough process to define and refine a strategic direction to our work that is founded on “trying to do a few things well” as opposed to trying to “be all things to all people.”

We believe we’ve charted a sound course that over the years will yield an entity that will not only weather the storms that buffet, but will also leave a positive legacy for future generations of Americans. We’re energized by the opportunity and humbled by the responsibility.

As you peruse this document, we hope that you’ll get a good feel for who we are and what we’re about. That said, we know that as the old proverb states, “one of the greatest acts of faith is to plant a tree.” We acknowledge the truth of that statement as well as the reality in French Marshall Lyautey’s statement when he asked his gardener to plant a tree. The gardener objected that the tree was slow growing and would not reach maturity for 100 years. The Marshall replied, “In that case, there is no time to lose; plant it this afternoon!”



Dick Molpus, Chairman



Carlton Owen, President & CEO

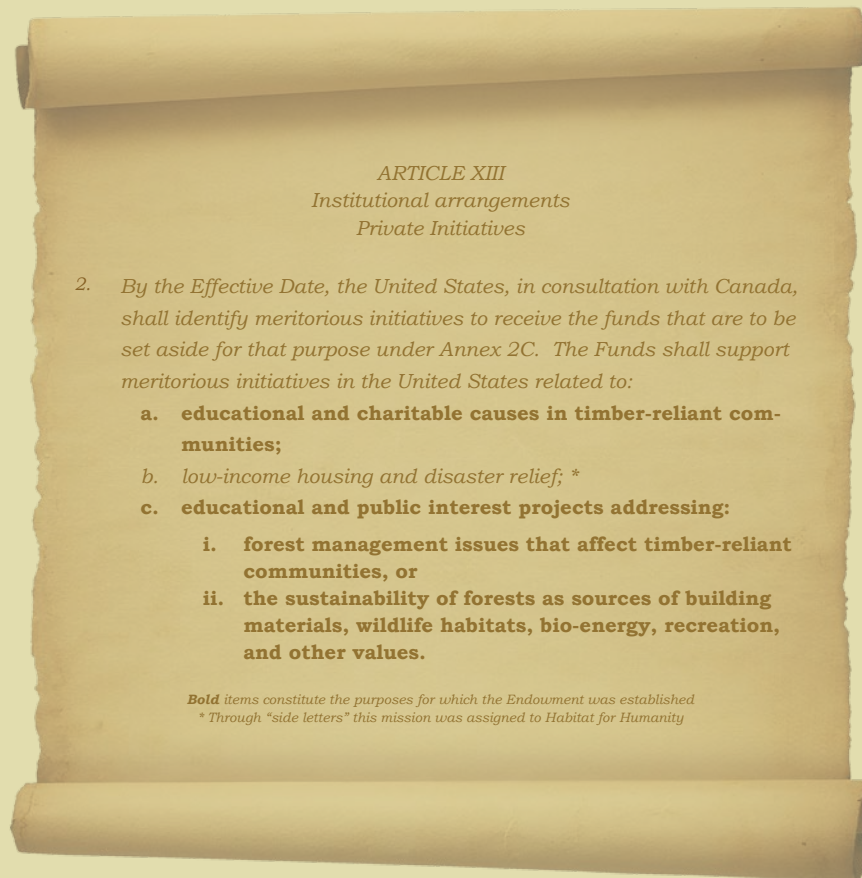


Longleaf Pine
Sapling

Background on the Endowment Establishment, Charter, Funding and Tax Status

The U.S. Endowment for Forestry & Communities, Inc. was chartered as a 501(c)3 not-for-profit corporation at the request of the governments of the United States and Canada in accordance with the terms of the Softwood Lumber Agreement (SLA) 2006 between the two countries.

Softwood Lumber Agreement 2006
(Excerpts)



The Endowment is one of three entities designated to share in a one-time infusion of funds to support "meritorious initiatives" in the U.S. It was endowed with \$200 million. The American Forest Foundation (\$150M) and Habitat for Humanity (\$100M) were the other institutions funded. To gain release of funds from the Canadian government, each organization had to undergo an audit to ensure compliance with all stipulations of the SLA and the associated side letters. KPMG conducted the review of the Endowment.

Carlton Owen
President & CEO
Greenville, SC

Diane Snyder
Vice President
Community Development
Enterprise, OR

Florence Colby
Executive Assistant
Greenville, SC

Staffing for Success

As a not-for-profit public charity, the U.S. Endowment operates with one of the leanest staff structures of its peer group. Our approach is founded on a commitment to a clear focus and dynamic partnerships, designed to achieve our objective of plowing the lion's share of our resources into "systemic, transformative and sustainable change." Our staffing model calls for only three full-time staff associates – the president who also serves a dual role as "program officer" in sustainable forestry; a vice president serving as the second program officer with emphasis on community development; and an executive assistant/office manager. Information technology, accounting, fund management and other support roles are outsourced. We depend upon our program partners for the breadth of resources needed to deliver services on the ground.



INTERNSHIPS EXTENDING THE REACH OF A LEAN STAFF

We have designed an on-going college internship program to provide real and substantial benefits to interns as well as to the Endowment. We've been especially blessed by valuable contributions in 2007:

Anne Rone
Furman University
March – June

Jerri Moro
Oregon State University
July – August

Sally Stephenson
Davidson College
July – August

Matthew Rutledge
Furman University
September – December

The Board of Directors Diversity and Experience

The Endowment is fortunate to be guided by a diverse and experienced Board of Directors. The SLA side letters call for a board to be comprised of "at least" seven members and a "liaison" appointed by the Canadian government. The Endowment has taken an inclusive approach that expanded total board membership to thirteen, with the Canadian liaison having full membership (by Amendment to the Bylaws adopted July 6, 2007). Members, with the exception of the President, serve staggered three-year terms.

Dick Molpus
Chairman
Jackson, MS

Peggy Clark
Chair, Audit Committee
Hot Springs, AR

David Dodson
Chapel Hill, NC

Mil Duncan
Vice Chair
Durham, NH

Mack Hogans
Bellevue, WA

Chuck Leavell
Dry Branch, GA

Duane McDougall
Treasurer
Lake Oswego, OR

Bruce Miles
College Station, TX

Carlton Owen
President & Secretary
Greenville, SC

Jim Rinehart
San Francisco, CA

Karl Stauber
Danville, VA

David Thorud
Seattle, WA

John Weaver
Montreal, Canada

Visit www.usendowment.org to read full bios.





Falls Park on the Reedy River, Greenville, SC

Between Rock and a Special Place

The bulk of our first year was spent putting in place the necessary structural systems and procedures required to operate efficiently – part of that sound root system. Yet, we did have time for some fun. We had the privilege of joining with some of Upstate South Carolina's other business citizens in "giving back" to our new hometown. Through the generosity of our gifted board member Chuck Leavell of The Rolling Stones, we hosted a concert with all ticket sales benefiting land trusts in the Upstate. The event generated \$25,000 for our benefit partners and their work – Upstate Forever, Spartanburg Area Conservancy, Naturaland Trust, Conestee Foundation and Friends of the Reedy River.

Special Thanks to:

- Wal-Mart
- Brett Communications
- Link
- Community Journals
- The Conservation Fund
- Community Foundation of Greenville
- Piano Central
- Furman University's Student Environmental Action Group

Southern Hospitality At Its Best!

At various points in our startup, these hometown supporters stepped forward and made our mission possible. We are sincerely thankful.

- The Palmetto Bank
- Dixon Hughes PLLC
- Hayne Hipp Family Foundation
- Daniel-Mickel Foundation
- The Graham Foundation

KEY DATES FOR THE ENDOWMENT

September 21, 2006
(Delaware)
Formal Charter

November 28, 2006
First Board Meeting

November 30, 2006
(Form 1023/1024)
Submission to IRS

January 26, 2007
KPMG Audit Findings

January 31, 2007
(\$22.6 million)
Initial Transfer of Funds

February 7, 2007
("public charity"
170(b)(1)(a)(vi))
IRS Tax Status Ruling

April 11, 2007
(\$177.4 million)
Final Transfer of Funds

November 6, 2007
Adoption of Program
Focus

Longleaf
Pine Seeds

Charting a Strategic Focus

Nothing was more important in 2007 than gaining consensus on a strategic focus to achieve the Endowment's vision. To advance the broad mission set forth in the Softwood Lumber Agreement, the Board engaged in a three-step process – internal review and deliberation followed by a small, but highly diverse group of experts from across the forest- and forest-reliant community sectors who shared unfiltered thoughts about needs and priorities. In the final action that helped inform both of the earlier steps, we sought broad input from interested

parties through an online survey.

The Endowment's Board completed the nearly year-long process, resulting in the adoption of focal initiatives. This work is based on the Endowment's Theory of Change.

The Theory of Change

Our mission sets the context for promoting forest and community health in working forest landscapes. The basis of the Endowment's Theory of Change recognizes that forest-reliant communities differ from other communities in their existence within the richness of a forested environment. One cannot easily separate the fortunes of such communities from that of the forest. The Endowment envisions a future where healthy working forests provide multiple forest value streams that, when captured, lead to healthy forest-reliant communities. Healthy forest-reliant communities in turn

steward their forests in sustainable ways that maintain healthy working forests. Communities may desire assistance in any number of areas and ways, with intervention in any one potentially leading to a strengthening of the others.

Mission

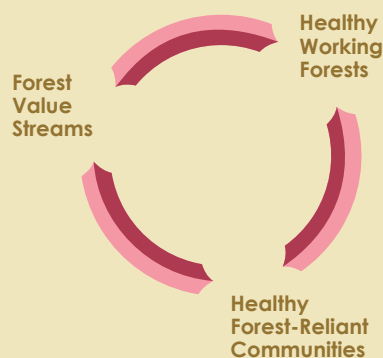
The Endowment works collaboratively with partners in the public and private sectors to advance systemic, transformative and sustainable change for the health and vitality of the nation's working forests and forest-reliant communities.

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.



Longleaf Pine Cone



Focal Initiatives

Retaining And Restoring Healthy Working Forests

Advance retention, restoration and health of working forests in support of forest-reliant communities.

Promoting And Capturing Multiple Value Streams

Leverage markets, infrastructure and practices to add value and strengthen social and economic conditions in forest-reliant communities.

Enhancing Community Capacity, Collaboration And Leadership

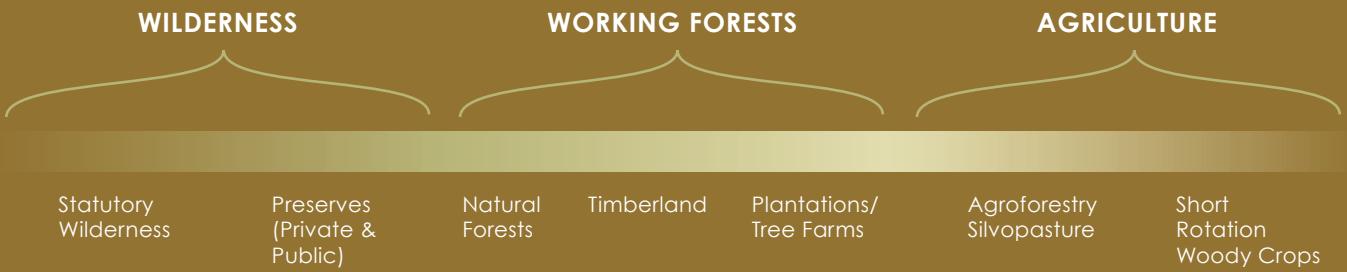
Strengthen capacity of forest-reliant communities through awareness, technical assistance, training, services, targeted investments and shared learnings.

Concentrating Our Work

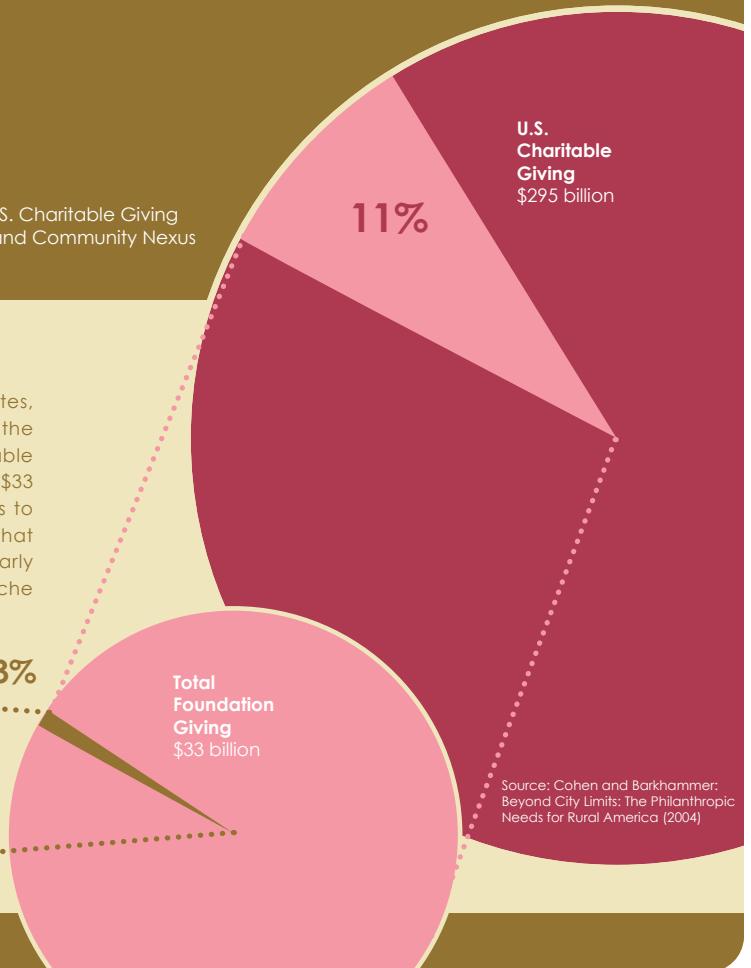
Healthy Working Forests

While the Endowment is interested in the health and vitality of all types of forests, our focus is on *healthy working forests*. The Endowment defines a healthy working forest as one that maintains the function, diversity, and resiliency

of all components and can either produce or has the potential to produce a range of wood-based products, while also serving a broad range of societal needs including recreation, water, wildlife and other ecological services.



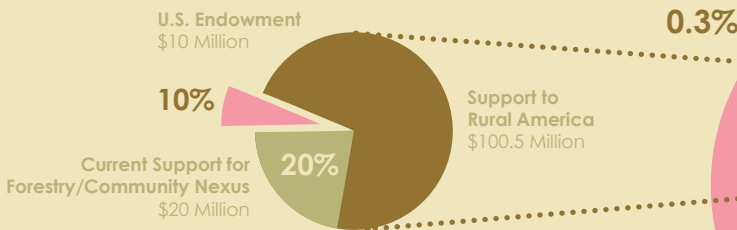
Breakdown of Total U.S. Charitable Giving Awarded to Forestry and Community Nexus



Source: Cohen and Barkhamer: Beyond City Limits: The Philanthropic Needs for Rural America (2004)

PUTTING THE ENDOWMENT IN CONTEXT

By comparison to the giant sequoias of the foundation world – Gates, Ford, Kellogg – the U.S. Endowment is truly a seedling. Yet, in its niche, the Endowment is the largest foundation in the U.S. While overall charitable giving in the U.S. approaches \$300 billion, with just over 11 percent (\$33 billion) coming from foundations, only an estimated \$100 million goes to rural America. Of foundation funds, about 20 percent fuels initiatives that might be considered the Endowment's "peer work." Thus, in the early years of the Endowment's existence, it will grow funding within its niche by 50 percent – *not insignificant by any measure.*



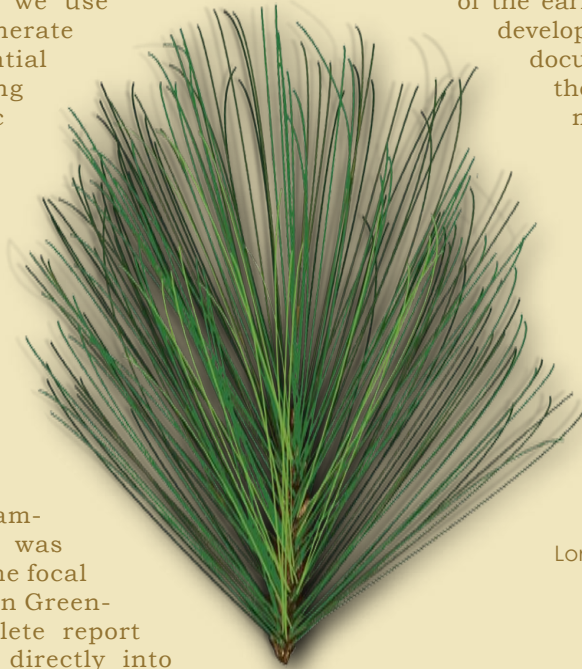
Working with Potential Grantees

Process

To make progress against our focal initiatives and to maintain our lean staff model, the Endowment operates using an online grant application/management system. We target our work via a two-step request-for-proposals process. For the bulk of our work, we use “open call” requests to generate “pre-proposals” from potential partners interested in working with us to achieve a specific objective. The pre-proposal process substantially reduces work required by applicants and allows the Endowment Board and staff to seek full proposals from a much shorter list of “final” candidate proposals.

2007 Grants

The only significant programmatic investment in 2007 was nearly \$60,000 invested in the focal initiatives workshop hosted in Greenville in November. A complete report from that project that fed directly into the Board’s final decision-making process is available at www.usendowment.org.



Longleaf Pine Needles

Looking Forward To 2008

The Board has approved a first-half 2008 programmatic fund of \$5 million. Second half 2008 funding levels will be reviewed at the May 2008 Board meeting. A final decision will be heavily influenced by fund and market performance. Much of the early 2008 work will consist of developing “state of the issue” documents to better refine/define the best places for programmatic implementation within the three focal initiatives.

Our Key Commitments

- Sustained Results
- Sound Stewardship
- Adding Value
- Collaboration and Partnering
- Impact
- Highest Ethical Standards
- On-going Learning

To further explore our commitments, stewardship principles, governance, effectiveness strategy and ethics policy, please visit www.usendowment.org.

Legal Counsel

To ensure full compliance with all relevant laws and regulations, the Endowment’s Board of Directors has opted to have legal counsel at all meetings of the Board. At its first meeting in November 2006, the Board voted unanimously to retain Watkins Ludlam Winter and Stennis, P.A. of Jackson, MS. Partner David Grishman provides primary services. *(The Endowment is especially grateful that during the Endowment’s formative stages, Watkins Ludlam provided more than \$18,000 in pro bono services).*

Financial Management

The Endowment's full Board of Directors serves as the Investment Committee. To facilitate its work, the Board asked an ad hoc Investment Committee of Mack Hogans, Duane McDougall and Carlton Owen to review proposals from various fund management firms. The Board voted unanimously to engage Commonfund as the sole manager of the Endowment's corpus and to use The Palmetto Bank for day-to-day operational services.

Approach To Corpus

The Endowment transferred its \$200 million corpus to Commonfund effective May 1, 2007. A detailed investment policy provides guidance on types of investments and allocations against a plain-language goal of generating 8.875% annually.

While the Board will revisit this policy from time to time, we plan an annual "re-set" of the corpus to meet intergenerational equity (*the buying power of a dollar over time*). As an example of how this will work, the corpus that was \$200 million on May 1, 2007, was "re-set" on January 1, 2008, to \$203,330,000 (2.5% inflation over 8 months).

A Word From Our Fund Manager

We believe that the current market environment, one characterized by slowing economic growth and continued challenges in the credit markets that have led to a re-pricing of risk, will be challenging for investors over the short-term. Given this outlook, diversification will be paramount and security / strategy selection is likely to drive investment returns. A thoughtfully diversified portfolio that includes allocations to strategies that offer downside protection and capital preservation characteristics (such as hedged equity and absolute return strategies) as well as long-term illiquid investment programs (such as private capital and distressed debt) that can take advantage of time-frame arbitrage as well as pricing dislocations that may exist in more inefficient areas of the market should be able to outperform more traditionally oriented portfolios.

Commonfund Strategic Solutions
December 31, 2007

Commitment To Openness And Transparency

In addition to maintaining an up-to-date website that serves to inform interested parties of our actions, we also post our full IRS Form 990 on our website as well as quarterly "plain language" financial statements and commentary.

DESIRED RATE/USE OF LONG-TERMS RETURNS

CATEGORY	RATE (%)
Inflation	2.5
Real Growth	1.0
Program	5.0
Admin/Overhead	0.375
TOTAL	8.875

U.S. ENDOWMENT FOR FORESTRY & COMMUNITIES, INC. PORTFOLIO ASSET ALLOCATION

Asset Class	Benchmark Allocation (%)	12/31/2007 Allocation (%)
Total Portfolio	100.0%	100.0%
Equity Strategies	69.0%	68.8%
Domestic Equity	25.0%	32.0%
International Equity	15.0%	14.9%
Hedged Equity	15.0%	15.6%
Private Capital	8.0%	0.1%
Commodities	6.0%	6.3%
Natural Resources	3.0%	0.0%
Fixed Strategies	31.0%	31.2%
Traditional Bonds	15.0%	21.5%
Absolute Return	5.0%	7.1%
Distressed Debt	3.0%	0.0%
Private Real Estate	8.0%	0.0%
Cash	0.0%	2.6%

The 2007 Financial Report

INCOME

Pre-investment Interest	\$793,991
Realized Endowment Earnings	250,000
Short-term Bank Interest	12,170
Donations (foundations, businesses)	41,425
In-kind (office space, services)	15,000
Misc.	6,000
TOTAL	\$1,118,586

EXPENSES

Salaries and Benefits	\$439,427
Office and General Expenses	97,730
Board and Staff Travel	70,858
Program Investments	59,301
Misc.	1,366
Total	\$668,682

STATE OF ENDOWMENT

May 1, 2007

\$200,000,000

December 31, 2007

\$213,580,208



Longleaf Pine
Seeds in Cone

Audited financial information will be posted
at www.usendowment.org when available.





Mature Longleaf Pine

Tree of the Year

Longleaf Pine

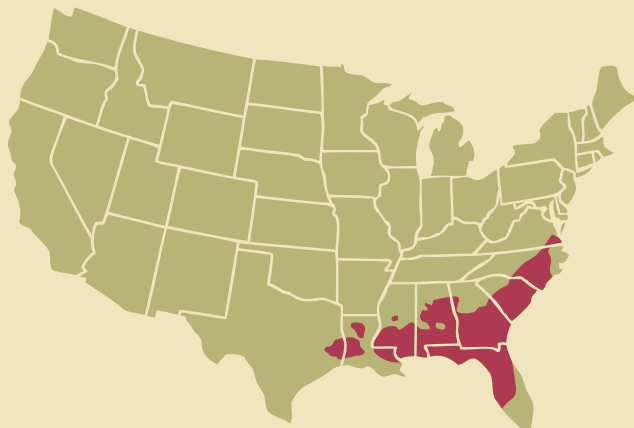
Pinus palustris

Standing Tall in the Southeast

The longleaf pine tree, once the most important of southern conifers, spanned more than 60 million acres. Today, perhaps only 3-4 million acres remain. Unique with its seedling staying in the “grass stage” for two to many years along with the open park-like habitats, longleaf forests defy the eye and are among the most diverse forested habitats in North America. Among its endemic residents are the indigo snake and gopher tortoise. The straight-grained wood is favored for building, the long needles (up to 18 inches) are prized as mulch and the tree is a veritable factory of chemical products from varnishes to pharmaceuticals. Once favored for ship masts, longleaf forests are making a comeback thanks to concerted conservation efforts of natural resources agencies, conservation groups and visionary landowners.



Mid-growth Longleaf Pine



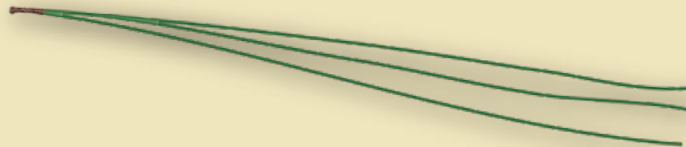
■ = Longleaf Pine Country

Source: www.cnr.vt.edu/dendro



“Many organizations care about forests, and many others serve the needs of people. Perhaps the greatest distinguishing feature of the U.S. Endowment is that we seek not just to conserve forests but also to serve the needs of the people who live within them and depend upon them for quality of life in all its dimensions – economic, social and environmental.”

Carlton Owen
President & CEO



This report was printed on Finch Fine, Bright White, Ultra Smooth 100 lb. text and 130 lb. double-thick cover. The wood fiber used to make this paper is independently certified by two of the world's premier forest certification standards as coming from responsibly managed forests. Certification ensures that the U.S. Endowment's publications meet strict environmental and socio-economic principles consistent with our mission. www.finchpaper.com