



NewForests

Sustainability Report FY2013

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Message from the Managing Director

The financial year 1 July 2012 – 30 June 2013 (FY13) was a period of continuing growth for New Forests. We completed investing our Australia New Zealand Forest Fund (ANZFF) and welcomed the initial close of its successor, the Australia New Zealand Forest Fund 2 (ANZFF2). We also completed the final close of our Tropical Asia Forest Fund (TAFF) and expanded our Forest Carbon Partners (FCP) fund in the United States into a second phase. We achieved new acquisitions milestones for our company, including purchasing an operating sawmilling business, Timberlink Australia, through an ANZFF investment and closing our first TAFF investment in a timber plantation project in Malaysia. By late June 2013, New Forests had assets under management and committed capital of over AU\$1.9 billion.

New Forests' business strategy is to implement three distinct investment strategies managed by dedicated investment teams in Sydney, San Francisco, and Singapore. The business relies on a set of shared services related to financial management, client relations and client reporting, business administration, risk management and compliance, research, communications, and sustainability. New Forests was established with the idea that sustainable forest management would be central to all of our investment programs and with the goal of demonstrating leadership and innovation around issues such as markets for ecosystem services, independent third-party certification of our forest management, proactive management of social and environmental issues, and engagement with NGOs, community groups, governments, and intergovernmental organisations on sustainability issues.

Forestry investment has become a significant international asset class. The growth of the asset class to more than US\$90 billion invested by institutional investors has been supported by the transition from extensive harvest of natural forests and publicly-owned forests to management of highly productive plantations. We believe that our business is unique in encompassing both production and conservation investments. New Forests has implemented a comprehensive program to manage our business in a sustainable way and achieve sustainable outcomes through our investment programs. This includes the tools discussed in this report, such as our Social and Environmental Management System, a commitment to third-party certification standards, internal auditing and review for continual improvement, and direct oversight by our Board of Directors for social and environmental policies and impacts. Our annual sustainability report seeks to provide our employees, clients, and other stakeholders with open information on how we address sustainability in our business.

Forest management is a complex business with myriad issues that need to be understood and managed. This means that successfully delivering the outcomes we expect from our business—including excellent investment returns, improved environmental outcomes, and positive relations with stakeholders—requires a collective effort. New Forests has a talented group of employees with a wide variety of experience, specialisations, and interests. I believe that this diversity and our systems for decision making and accountability are the basis for successful implementation of our sustainability policies and commitments.

I invite you to read our third annual sustainability report and to provide us feedback and comments.

Sincerely,



David Brand
Founder and Chief Executive Officer, New Forests Pty Ltd

Introduction

New Forests was established in 2005 as an asset management business specialising in forestry and environmental markets. Today the company is a leading forestry investment management organisation headquartered in Sydney with three regional investment strategies led by funds management teams in Sydney, Singapore, and San Francisco.

In this third annual sustainability report, New Forests presents our progress and performance in the areas of responsible investment and sustainability. This report includes an overview of New Forests, an introduction to responsible investment in our asset classes, a review of our sustainability program performance and targets, and a discussion of our material social and environmental impacts. In keeping with emerging best practice in sustainability reporting, we present this information in the broader context of our business and the environmental, social, and economic contexts in which we operate.¹ The reporting parameters include the activities related to the New Forests group of companies for our fiscal year 2013 (FY13), the period 1 July 2012 to 30 June 2013.²

New Forests

Population growth, the changing climate, and the realities of the Earth's limited capacity to supply natural resources will continue to create opportunities and risk for the global business environment, and timberland investment is no exception. Timberland investment has some uniquely positive characteristics when we look at some of the world's challenges. Timber is a renewable resource, capable of being harvested and regrown in perpetuity. Wood products are also recyclable and decompose into simple non-toxic materials. Wood use is also evolving to become a core element of a 'bio-based,' green economy that will increasingly use sustainable biomass for electricity production, liquid fuels, new biomaterials, and bio-chemicals. Forests sequester and store carbon, provide the basis for much of the diversity of life on earth, conserve soils, regulate freshwater, and provide a spiritual and cultural basis for much of human society. These are not only important underpinnings of a sustainable future society, but add real value and create new investment opportunities in the forestry asset class. New Forests believes that investment managers who understand these markets, and the drivers behind them, will be best positioned to deliver value to clients and shareholders.

New Forests' timberland investment strategies respond to these market opportunities. Our investments support the allocation of capital into long-term, sustainable forestry management and commercial management of ecosystem services. Our investments target real assets that deliver timber products or provision environmental services, both of which are essential in today's world. Commitment to responsible investment is central to New Forests' business strategy and corporate culture. The principles guiding our responsible investment approach include identifying environmental, social, and corporate governance (ESG) opportunities and risks, utilising third-party certification, being transparent in dealing with stakeholders, and seeking continual improvement in our business. This framework is embedded within New Forests' overall governance and management systems. New Forests instituted a corporate sustainability program in 2010, and at that time the company also became a signatory to the UN Principles for Responsible Investment.³ Within this program, the company sets key corporate sustainability targets and works to ensure that a consistent, high standard of ESG performance is achieved throughout our business.

¹ This report contains Standard Disclosures from the Global Reporting Initiative (GRI) Sustainability Reporting Guidelines, and the report is guided by the GRI-G4. However, this report is not in full accordance with the GRI-G4 and is not externally assured.

² All information in this report relates to FY13 unless explicitly noted.

³ See <http://www.unpri.org/> for more information.

Forests Provide an Array of Ecosystem Services



Our Business

New Forests is a funds management company, headquartered in Sydney, with specialised investment teams based in Sydney, Singapore, and San Francisco. This gives us local insight and capabilities via dedicated investment teams, while maintaining consistent corporate services across the business in the areas of fund administration, governance, research, sustainability, communications, and investment analytics. New Forests' international presence now includes a group of seven wholly-owned subsidiary businesses and 42 employees in Australia, New Zealand, Southeast Asia, and the United States.⁴ New Forests is registered with the Australian Securities and Investments Commission and holds an Australian Financial Services Licence.⁵

New Forests offers investment management services to qualified investors in the timberland and environmental markets asset classes and currently manages more than AU\$2 billion⁶ in assets and committed capital on behalf of institutional investors. In FY13, New Forests experienced growth across all three of our regional investment strategies. As of the end of our most recent financial year at June 30, 2013, the aggregate of assets under management and committed capital was AU\$1.95 billion, representing more than 50% growth in capital and assets under management from FY12. As a private company, we do not publicly report on detailed corporate financials; however, we voluntarily provide figures for our assets and capital under management. New Forests continually works to invest committed capital via the funds we manage, add value to the assets that we manage, and develop new investment products for institutional and other qualified investors.

On the following pages, we provide an overview of each of our regional investment programs (Australia New Zealand, Southeast Asia, and United States) as well as maps indicating the location and type of our assets under management in each region.

⁴ As of January 31, 2014.

⁵ New Forests Advisory Pty Limited (ACN 114 545 274, AFSL 301556).

⁶ Note that all references are to Australian Dollars unless otherwise stated. As of January 31, 2014.

Sustainable Forestry Investment in Australia and New Zealand

Timberland investment in Australia and New Zealand offers investors exposure to mature timber markets, well-established forestry management systems, and increasing Asian demand for wood products. New Forests has successfully transacted more than AU\$1 billion in Australia and New Zealand forestry in recent years, playing a leading role in the transition of the industry toward institutional ownership.

Fund Products

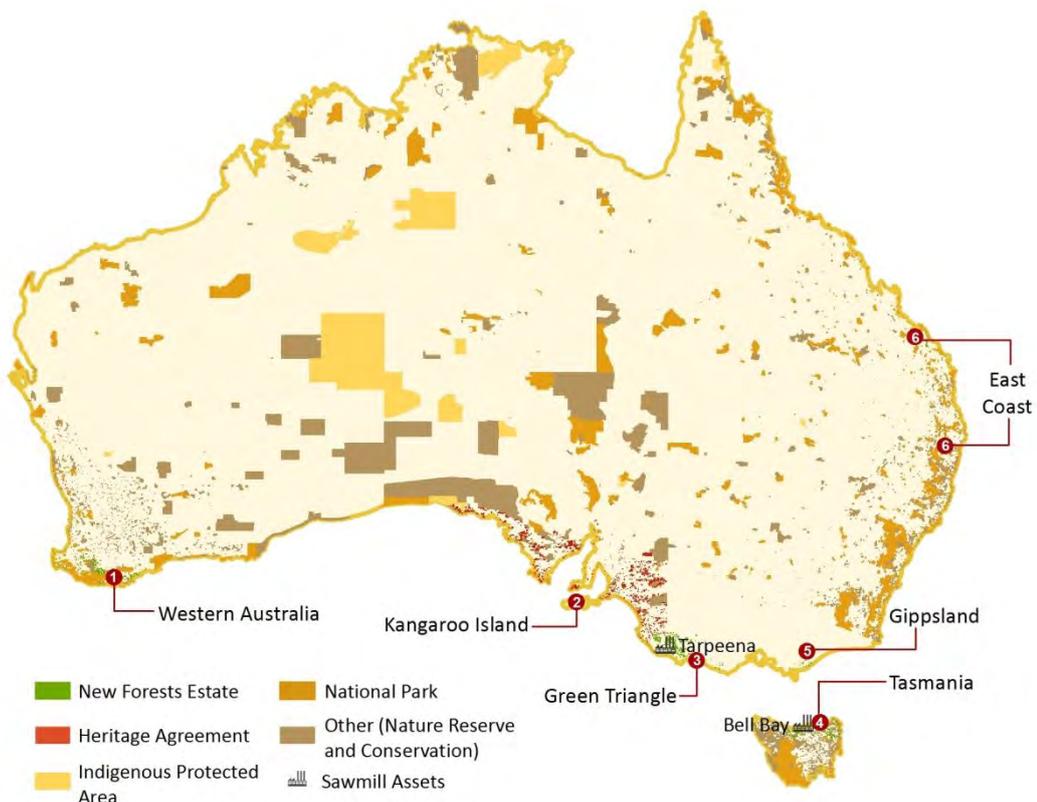
- Australia New Zealand Forest Fund (ANZFF)
- Australia New Zealand Forest Fund 2 (ANZFF2)

FY2013 Highlights

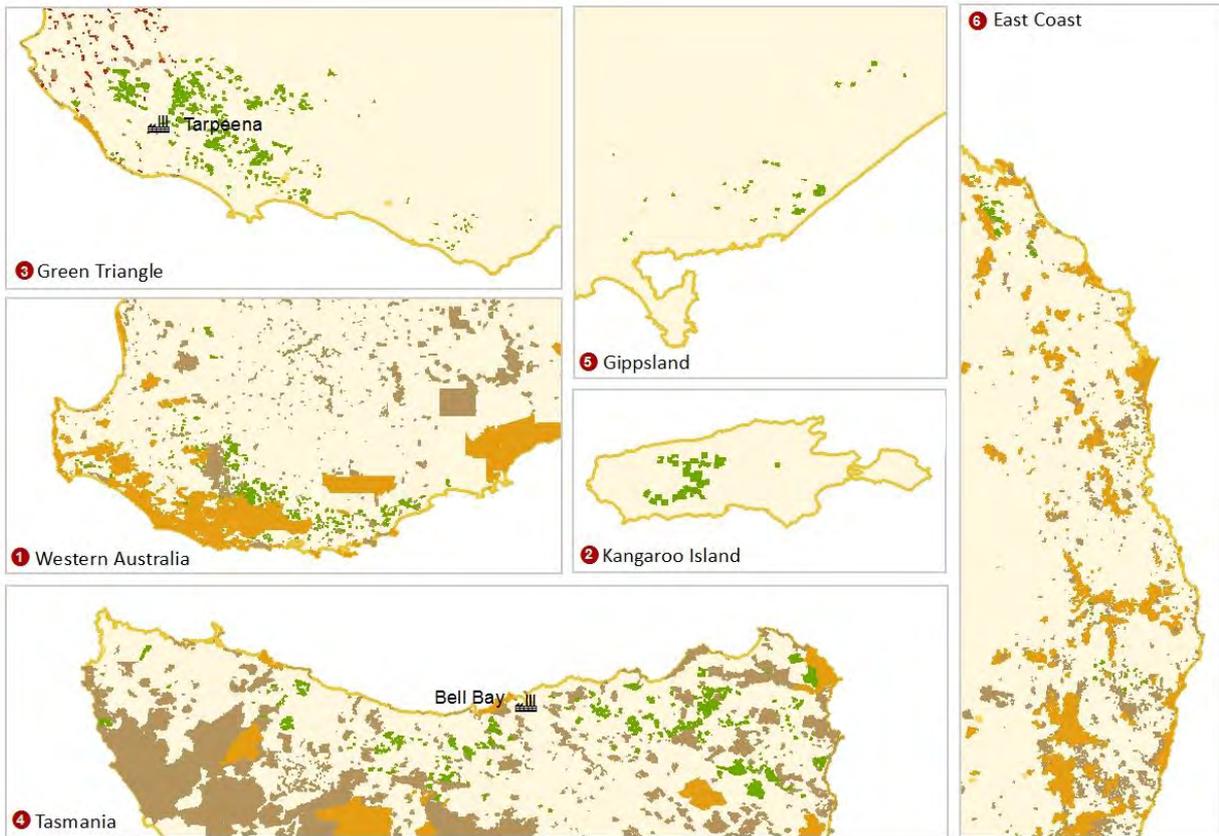
- New Forests successfully completed investing ANZFF's committed capital in less than three years from fund close. The ANZFF portfolio includes two high-quality softwood estates comprising over 90,000 hectares in Victoria, South Australia, and Tasmania and a hardwood timberland estate of more than 270,000 hectares across various regions of Australia. In January 2013, ANZFF established Timberlink Australia Pty Ltd to acquire an operating sawmilling business with softwood sawmills in Tasmania and South Australia as well a national sales and distribution network headquartered in Victoria. The acquisition marked New Forests' entry into investment management for forestry processing assets.
- In June 2013, New Forests announced the initial close of ANZFF2 at AU\$570 million, marking the launch of the company's second round fund dedicated to Australia and New Zealand.

A Landscape of Production and Conservation

New Forests' Australian estate includes over 370,000 hectares of land and trees in all six Australian states, offering significant scale for a landscape of production and conservation values. This map shows how our estate relates to neighbouring protected areas. Through on-the-ground social and environmental management efforts, we seek to collaborate with stakeholders to support regional conservation priorities and achieve outcomes at scale, in addition to undertaking direct works on the properties we manage. In FY13, no assets were managed in New Zealand.



*Datasets sourced from the Australian Government Department of Environment Collaborative Australian Protected Area Database (CAPAD) and internal New Forests data



Aerial View of a Plantation Forest Mosaic Landscape in the Green Triangle Region of Australia



Sustainable forestry in emerging markets of Southeast Asia

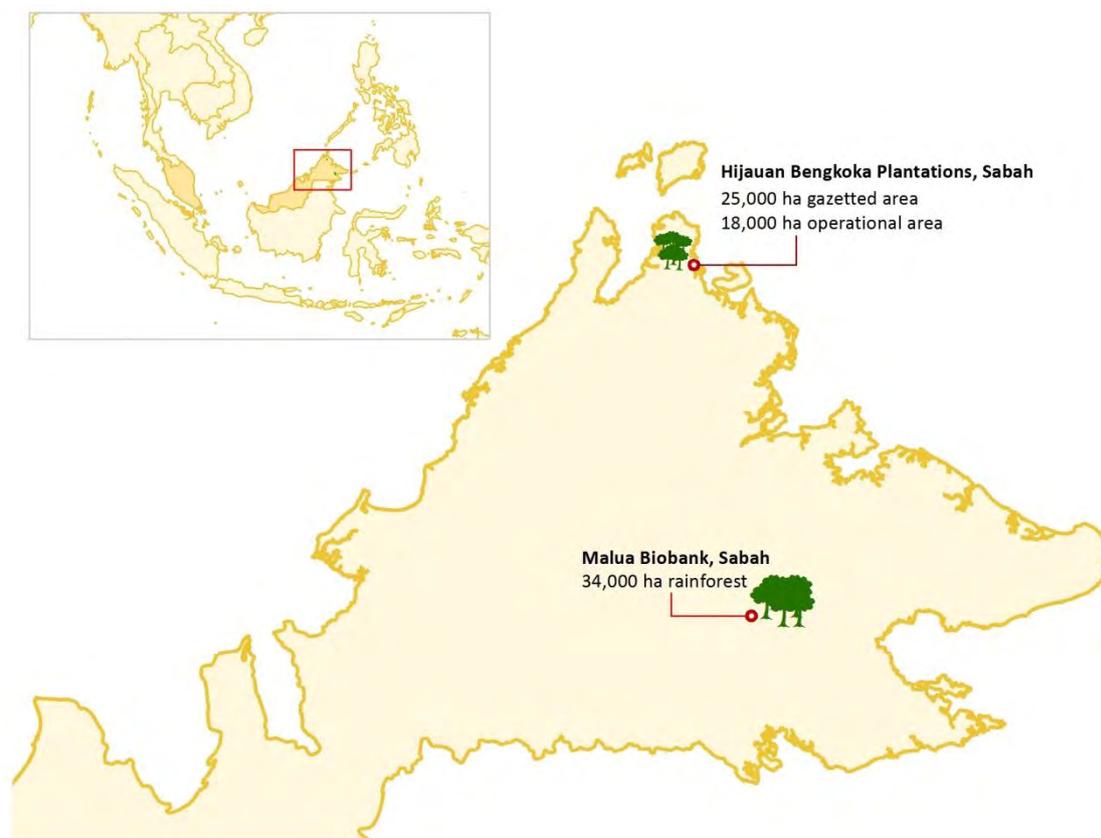
Tropical Southeast Asia is an emerging region of interest for institutional investors. Our Southeast Asian investment strategy focuses on certified plantation forestry with an emphasis on enhancing returns and reducing risk through technological and silvicultural improvements and a rigorous approach to sustainability in the areas of environmental and social management and corporate governance.

Fund Products

- Tropical Asia Forest Fund (TAFF)
- Eco Products Fund (EPF) – While the EPF is managed from and primarily invested in the United States, it has one international investment, the Malua Biobank, located in Sabah, Malaysia.

FY2013 Highlights

- New Forests focused on commencing our investment program in Asia through TAFF, which is the first institutional investment fund dedicated wholly to forestry investment in Southeast Asia.
- In June 2013, New Forests successfully completed capital raising for TAFF with more than US\$170 million in capital commitments and completed the fund's first transaction located on the Bengkoka peninsula in the State of Sabah, Malaysia.
- In June 2013, the Malua Forest Reserve, which is home to the Malua Biobank, was upgraded to Protection Forest Reserve Class I (from Class II Production Forest) by the Sabah State Government. This classification supports the conservation impact of our investment in promoting and protecting Malua's biodiversity and permanently protects the entire forest reserve under State law.



Conservation and Production in Sabah, Malaysia

As of FY13, New Forests manages two assets in Southeast Asia, both located in the Malaysian state of Sabah on the island of Borneo. The Malua Biobank includes 34,000 hectares of Class I Protected Forest, and our investment activities finance the long-term conservation and protection of the forest. In Northern Borneo, TAFF is a majority shareholder in an *Acacia mangium* plantation interest of a 25,000 hectare concession area that includes a 6,000+ hectare Class I forest reserve in its core region, providing watershed benefits to the Bengkoka peninsula.

Environmental Markets in the United States

Forestry investment in North America has evolved to encompass a range of ecosystem services in addition to timber production. US markets for ecosystem services are driven by key federal and state legislation, such as the Clean Water Act, Endangered Species Act, and the California carbon cap-and-trade market. New Forests' environmental markets investment strategy capitalises on our experience as a leading investor in the commercialisation of ecosystem services. This US strategy focuses on mitigation banking (the restoration, creation, protection, or enhancement of wetlands, streams, or habitat for the purposes of compensating for an unavoidable environmental impact) and forest carbon offsets (greenhouse gas mitigation credits generated through sequestering and storing carbon in forests).

Fund Products

- Eco Products Fund (EPF)
- Forest Carbon Partners (FCP)

FY2013 Highlights

- New Forests' Forest Carbon Partners investment program moved into its second phase in FY13, following a public launch in FY12. FCP finances the development of forest carbon offset projects and is targeting the development of projects that will yield more than 20 MtCO₂e of sequestration in carbon credits for the California cap-and-trade program. The extension of FCP will enable significant environmental benefits—improved forest health and management can support watershed protection, water quality improvement, biodiversity conservation, and community benefits.
- The Eco Products Fund mitigation banking portfolio included five banks in FY13. The Buck Creek Mitigation Bank in the state of Indiana underwent restoration activities to restore functional hydrology to a wetland area in FY13, and both our Indiana banks performed well in credit sales. In North Carolina, the first tranche of nutrient credits was released by the regulator for a bank that will offset the effects of fertiliser runoff.



Long-term Outcomes and Protected Areas

All the project sites for New Forests' investments in the US are voluntarily protected or protected under long-term conservation easements. In some cases, properties are held by land trusts or organisations specialising in long-term conservation.

Governance

New Forests is committed to conducting business in a responsible and ethical manner. We have in place a governance and compliance framework driven by regulatory compliance (including for the company's Australian Financial Services Licence); funds management governance, administration, and operational control systems; and a Social and Environmental Management System. Key aspects of New Forests' approach include a body of company policies and procedures and regular compliance training.

New Forests' governance bodies work across the business to promote ethical and responsible decision making; recognise and manage risks; maintain fiscal responsibility; lay a solid foundation for management and oversight; and make timely and balanced disclosures. This governance approach is also closely linked to the involvement of senior management and the New Forests' Board of Directors in ensuring our business' success, including our commitment to responsible investment.

Overview of New Forests' Governance Bodies

Governance Body	Key Responsibilities
Board of Directors	Approve business strategy and responsible for corporate governance and financial management
Executive Committee	Develop and oversee implementation of company strategy
Management Committees	Determine and manage the strategy for each investment, monitor day-to-day operations, and make key decisions related to our assets under management
Investment Committees	Review and approve investments and asset sales for New Forests' funds per Investment Committee charter
Risk and Compliance Committee	Assist the Board of Directors to fulfil its corporate governance responsibilities with key focus on internal controls, risk management, and legal and regulatory compliance.

In FY13, New Forests continued to grow and develop our governance systems and practices to ensure the integrity of our business and meet its growing needs and responsibilities. A new Risk and Compliance Manager was recruited to take on dedicated oversight of corporate governance, risk management, and compliance, including responsibility for developing and implementing an integrated governance, risk, and compliance framework.

Responsible Investment in Forestry & Environmental Markets

By bringing institutional capital to support investment in forestry and environmental markets, New Forests contributes to long-term investment in renewable resources and the conservation and protection of ecosystem services associated with forests. Many institutional investors recognise that their investment choices have impacts on the environment and society. We are pleased to find that many of our clients prioritise understanding the ESG impacts of their investments. Engaging with our clients on ESG issues strengthens the efforts we take as an investment manager to manage risk and strive for improvements in social and environmental outcomes at the asset and fund levels. Ultimately, we believe capital must flow toward land management systems that value both production and conservation functions. Through our investment strategies we address key sustainability opportunities and risks across both forestry and environmental markets assets.

Forestry

Sustainable forest management – where management and use of forest resources supports economic, environmental, and social functions of forests and provides for the long-term viability of the resource – has developed around a body of criteria and indicators that take into account the numerous economic, environmental, and social aspects of forest management. This is supported by policy approaches at international and national levels that seek to help define aspects of sustainable forest management or set standards for supply chain transparency and sourcing requirements. At an operating level, principles of sustainability have been further defined through standards and certification schemes, such as the Forest Stewardship Council (FSC)⁷ and the Programme for Endorsement of Forest Certification (PEFC), which provide a basis for transparent, third-party certification of sustainable forest management.

Global timber trade is undergoing an evolution due to a growing body of legislation from the US, Europe, and Australia requiring the industry to investigate the legality of forest products prior to their sale and trade. Forest certification will be critical to meeting demand in countries with strict legality and import standards. In 2008 the US amended the Lacey Act, constituting the first ban on trading illegally sourced wood products, and similar legislation has followed in other major economies, such as the European Union Timber Regulation and Australia's Illegal Logging Prohibition Act. Other major importing economies, including China and Japan, are also considering stronger measures to ensure the use of only legally harvested materials. In response, countries supplying and manufacturing forest products, many of which are located in emerging economies, are increasingly instituting timber legality systems and entering into partnerships with importing countries to ensure transparency through the supply chain. Together these new laws show that environmental and legal due diligence is no longer just relevant to a small niche environmental market but has now become mandatory in timber supply chains. The transparency provided by FSC certification provides buyers confidence that in procuring an FSC product they are purchasing legal forest products with tracking of the chain of custody from the forest to the consumer. New Forests expects enforcement of timber sourcing regulations will support increased demand for FSC certified products. Certified plantations may take advantage of the tightening in the marketplace and use certification status as a marketing tool to maintain market access and growth in market share.

In addition to changes occurring in the regulation and sourcing of timber products, New Forests also sees fundamental changes in the nature of timber trade and timber uses that may affect timberland investments.

⁷ FSC is not responsible for and does not endorse any financial claims on returns on investments. New Forests Asset Management Pty Ltd is a licenced non-certificate holder, FSC-N002114.

Wood is now used in an ever-increasing array of applications supported by new technologies in bio-energy, bio-fuels, and bio-materials. In FY13, we commenced exploration of new opportunities in clean energy and will continue to work to develop new timber market opportunities. As technology helps drive new markets for timber products, the forest sector is also undergoing changes in traditional timber markets for products such as woodchip for pulp and paper, sawlogs and lumber for housing and construction, and feature timbers for furniture, flooring, and appearance-grade uses. With rising populations and urbanisation in Asia, timber markets have undergone a re-orientation toward meeting new and growing demand in China, India, and elsewhere in Asia. New Forests' position as the only timberland investment management organisation based in the Asia-Pacific region should support the company in developing and implementing leading investment strategies that offer our clients exposure to these dynamic, high-growth markets.

Environmental Markets

The concept of "Natural Capital"⁸ is gaining ground as the global community increasingly recognises the economic value of ecosystem services. New Forests is active in the development of markets for environmental services, such as carbon sequestration and storage, biodiversity conservation, freshwater management, and wetland and stream habitat. In some instances, these markets provide robust opportunities for direct investment, or they may enhance returns from traditional timberland investments.

While some businesses may undertake to conserve or create ecosystem service benefits on a voluntary basis, the scale of these efforts is likely to remain limited where there are not legal or commercial reasons to do so. We see a growing trend toward such price mechanisms and trading schemes, despite many of the challenges that have been faced in implementation. Investing directly into assets whose core revenue streams are derived from environmental markets is generally outside the scope of institutional investment as these markets are still either too small or present uncertain risk return characteristics. However, accessing opportunities to commercialise ecosystem services in association with forestry assets offers the potential to generate multiple revenue streams and can help mitigate the costs of conservation measures. There are also examples of environmental markets that do support direct investment into ecosystem services. For example, mitigation banking in the US has grown into a well-developed industry with a regulatory basis for environmental compensation. New Forests has led the expansion of this US-based mitigation banking model to new markets via its development and management of the Malua Biobank in Sabah, Malaysia. The Malua Biobank, established in 2008, is a 34,000 hectare tropical forest conservation investment that seeks to effectively price the biodiversity attributes of the Malua Forest Reserve. While investing in mitigation banks and biodiversity assets requires significant expertise, there may be attractive investment opportunities to drive the consolidation and professionalisation of the mitigation banking industry in the US and its replication in other countries. Such investments may be particularly attractive to impact investors or institutional investors seeking access to more niche investment strategies that might hedge or compensate for ESG risks elsewhere in their portfolio.

New Forests' ability to develop and execute forward-looking investment strategies is supported by this view of the long-term sustainability of the assets and sectors in which we invest. Alongside the evolution of forestry plantations into an institutional asset class, there is also growing consensus on the need for holistic solutions that integrate production and conservation efforts at a landscape scale, and mechanisms like third-party certification that provide transparency through supply chains to consumers on the underlying source of wood products. A key part of the evolution to a stabilisation of natural forests will be successful

⁸ The concept of Natural Capital extends the notion of economic value to the goods and services provided by the natural environment.

implementation of new markets for ecosystem services like carbon, biodiversity, and water catchment protection. While these eco-markets are still in their early stages, we expect that they will be supported by investors and will in turn reward investors who take a wider view of their responsibilities and the social and environmental outcomes from their investments.

New Forests' Sustainability Approach

New Forests seeks to implement responsible investment practices throughout our business. By including responsible investment within our governance and management structures we ensure senior management and Board-level involvement in ESG oversight. Sustainability programs are monitored through the company's corporate services, and our portfolio management teams include ESG considerations throughout activities of our funds, including acquisition and management of assets. With this approach, the implementation of sustainability and responsible investment practices occurs at all levels of funds management and involves all members of New Forests' staff. New Forests has a corporate Social and Environmental Policy, which has been developed to align with how we believe responsible investment relates to the nature of our investment business and key social and environmental areas of impact. This policy is operationally controlled through the activities and procedures of our Social and Environmental Management System (SEMS). Through the SEMS we focus on management and operational control related to key sustainability areas of our business in order to minimise risk and, where possible, to manage for social and environmental benefits. In this report, we include our Social and Environmental Policy as well as a review of annual SEMS performance and an update on our application of the Principles of Responsible Investment.

Focus – Responsible Investment

New Forests & the Principles for Responsible Investment

New Forests has been a signatory to the PRI since 2010, demonstrating a commitment to integrating six ESG principles into our investment activities and decision making. Below we provide some highlights of how we applied the Principles in FY13.

P1. We will incorporate ESG issues into investment analysis and decision-making processes.

We updated our Social & Environmental Management System in March 2013 and applied it to all our investment vehicles.

P2. We will be active owners and incorporate ESG issues into our ownership policies and practices.

We implemented certification policies on all New Forests timberland funds and worked with our forestry property managers on key ESG issues on a per-asset basis.

P3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.

We seek ESG disclosures within socio-environmental due diligence, and after investment, we work with property managers and investee companies to ensure ESG disclosures are included in monthly, quarterly, and annual reports as appropriate.

P4. We will promote acceptance and implementation of the Principles within the investment industry.

We disclosed PRI participation within key marketing materials, including general due diligence questionnaires and investment offering documents.

P5. We will work together to enhance our effectiveness in implementing the Principles.

We attended PRI Australia network workshops and events to deepen our involvement with the organisation.

P6. We will each report on our activities and progress towards implementing the Principles.

We participated in the pilot of the new PRI reporting and assessment framework to support its development and future implementation, and we made our Responsible Investment report publicly available online.

Social & Environmental Policy

Responsible and environmentally sustainable management of land and natural resources is at the centre of New Forests' investment philosophy and corporate culture. We are committed to this approach not only for risk management purposes but also because of commercial opportunities associated with innovation in forest management and environmental markets investment.

Guiding Principles

The core of New Forests' Social and Environmental Policy is our commitment to four guiding principles:

- **Responsible Investment:** New Forests is committed to responsible investment in which environmental, social, and governance considerations are integrated into investment decision making. New Forests is a signatory to the Principles for Responsible Investment (PRI) and reports on progress toward implementing the principles through the PRI's assessment process.
- **Third-party Certification:** Management practices will be certified by accredited, independent third parties to globally recognised standards for social and environmental performance in the forestry and environmental markets asset classes, where practical and commercially feasible.
- **Transparency:** New Forests will be transparent in engaging and communicating with stakeholders related to social and environmental issues and sharing decision making criteria and processes with clients and employees.
- **Continual Improvement:** New Forests will practice good environmental stewardship, pursue opportunities to improve habitats and livelihoods where practical and commercially feasible, and will work toward continually improving management practices and communication with stakeholders related to social and environmental issues.

Social and Environmental Management

New Forests applies the principles guiding our Social and Environmental Policy to our entire business, including at three strategic planning levels – corporate strategy and annual business plans, investment strategy and products, and asset-level management strategy. In doing so, we are able to establish objectives and targets for social and environmental management and ensure that we can identify and manage potential social and environmental impacts throughout the investment process. To guide this process and provide external verification at an operating level, New Forests uses third-party certification and standards systems to support social and environmental management, in accordance with the company's Certification and Standards Guidance.

Radiata Pine Plantation and Harvested Area in Australia



Social & Environmental Management System

New Forests' Social and Environmental Management System (SEMS) is a cornerstone of the company's approach to responsible investment. It is designed to ensure effective management of social and environmental issues related to New Forests' investment activities. Our first SEMS policy was approved in February 2011 and set out a framework for the implementation of the SEMS across New Forests' investment programs. Since its launch, we have further developed the system through the experience of implementation, learning while doing, and seeking continual improvement through monitoring and management review. As part of this continual improvement approach, in March 2013 New Forests updated its SEMS framework, which was approved by the New Forests Board of Directors in March 2013 (version 2). The SEMS review process was collaborative, involving staff from all of New Forests' offices. In this second version of the SEMS, we focused on clarifying procedures, roles and responsibilities, and provided further guidance on the use of third-party standards and certification. We also updated the structure of the SEMS policy to enhance alignment with the ISO 14001:2004 guidance on which the system is based.

The SEMS is designed to systematically identify, manage, and report on social and environmental aspects and potential impacts of New Forests' investments. A key aspect of the SEMS is the cycle of continual improvement, which is based around internal auditing and assessment. New Forests applies the SEMS to each of our investment products and so also conducts internal auditing on each fund vehicle. The audits are reviewed by the company's corporate Risk and Compliance Committee, and final audit reports are ultimately submitted to New Forests' Board of Directors, which provides management oversight of the system.

SEMS Continual Improvement Cycle



Certification and Standards Guidance

New Forests' SEMS includes guidance for the use of internationally-recognised third-party standards and certification schemes. As part of product development, each New Forests fund or investment vehicle includes a certification policy that supports New Forests' Social and Environmental Policy as well as the objectives of the investment product. As New Forests primarily invests in forestry, rural land (generally timberland), and environmental markets assets, our policies are designed to address the social and environmental risk factors appropriate to these investment types and the geographies in which we invest and operate. In FY13, New Forests updated our Certification and Standards Guidance and created a related Risk Categorisation Tool to enhance the application of the guidance when designing or implementing a Certification Policy.

The Certification and Standards Guidance of the SEMS sets a minimum standard for the use of third-party certification and standards across all of our funds. For forestry assets, we seek to achieve forest management certification with the Forest Stewardship Council (FSC) for all eligible assets. In cases where an asset is not eligible for full FSC certification, an alternate standard will be selected. An example where this might apply is in regard to the FSC 1994 rule on conversion for assets where New Forests was not involved in the conversion activity but through investment could still be considered liable. For example, because of past

conversion of natural forest areas, a plantation established many years ago might not be viable for certification. However, with investment by a New Forests fund such plantations would still undergo improved sustainable management measures and be independently evaluated for compliance with all other FSC criteria but not attain full certification. In addition, we require that all assets in our Southeast Asian forestry fund achieve compliance with the International Finance Corporation’s Performance Standards (IFC Performance Standards). The SEMS also includes standards guidance for the use of Environmental Management Systems, the IFC Performance Standards, and forest products chain of custody certifications.

Summary of Certification Requirements by Investment Program

	Australia New Zealand Forestry	Southeast Asia Forestry	US Environmental Markets
Forestry	FSC or FSC Alternate (e.g. Australian Forestry Standard)	FSC or FSC Alternate, with verification against all applicable FSC criteria	N/A
Environmental Credits	Where possible, achieve legal requirements for social and environmental performance as defined in protocols, rules, or methodologies under a compliance regime (e.g. Carbon Farming Initiative, New Zealand ETS, or biobanking) For other voluntary environmental markets (i.e. biodiversity, water), identify appropriate recognised standard	For carbon achieve Verified Carbon Standard (VCS) plus Climate, Community & Biodiversity Standard Alliance (CCBA) certification for voluntary carbon projects (unless compliance schemes develop) For other voluntary environmental markets (i.e. biodiversity, water), identify appropriate recognised standard	Where possible, achieve legal requirements for social and environmental performance as defined in protocols, rules, or methodologies under a compliance regime For other voluntary environmental markets (i.e. biodiversity, water), identify appropriate recognised standard
Land	There is not yet a certification standard for responsible investment or management of rural land assets. New Forests seeks to manage all land assets in compliance with relevant government laws, regulations, and best management practice guidelines for the jurisdiction and land uses concerned.		
Forestry Processing/ Infrastructure	The IFC Performance Standards or other Environmental Management Systems standards, such as ISO14001:2004, may be required depending on the social and environmental risks of the investment and the location of the asset.		

Additional information about New Forests’ management approach and progress related to certification and standards is discussed below in the **Supply Chain Sustainability** section (page 26).

2013-14 SEMS Outlook

The SEMS 2.0 issued in March 2013 included enhanced guidance for management review, which builds on the original review system that focused on annual internal audits for each fund. The new management review mechanism is aimed at the system level, and follows the ISO 14001 guidance that top management shall review the SEMS at planned intervals to ensure its suitability, adequacy, and effectiveness. In FY14, New Forests will complete management review including an update to significant aspects and impacts of our system and review of system performance and efficacy.

Sustainability Targets

New Forests' targets for sustainability are incorporated in business plans, investment mandates, and are reported in our public Sustainability Reports, such as this one. As our business grows, New Forests' sustainability targets continue to evolve. With our approach to sustainability now firmly rooted within our overall governance framework, New Forests' sustainability targets seek to encompass more sophisticated and ambitious goals in line with our overall business planning.

Status of FY13 Sustainability Targets

FY13 Target Activities	Status
<p>Enhance staff alignment with sustainability and responsible investment objectives</p>	<p>As part of year end FY13 employee performance reviews, we introduced a new requirement for sustainability or responsible investment criteria. This ensures that the allocation of responsibilities for sustainability outcomes or management of issues that could have social and environmental impacts are included as part of employee objectives. This mechanism should increase accountability and provide alignment between staff interests and management of sustainability impacts.</p>
<p>Increase transparency and visibility of our sustainable and responsible investment activities</p>	<p>Key actions over the year include the creation of a sustainability focus on our corporate website. In this, we describe our approach to responsible and sustainable investment as well as provide our Social and Environmental Policy. For the first time, our Principles for Responsible Investment (PRI) Responsible Investment Report is accessible directly on our website for download. By providing this information online, New Forests has extended our transparency to a wider range of stakeholders.</p>
<p>Develop framework of measurable sustainability indicators</p>	<p>We continue to develop our sustainability reporting practices, including through the investigation of third-party systems and guidance for sustainability and other reporting. In FY13, we participated in local and regional events to support development and promotion of metrics and approaches for standardised sustainability reporting. In this report, we include some measurable indicators based on quantitative metrics for measuring ESG impacts, and we will continue to develop our internal and external reporting on sustainability indicators as well as promote development of such indicators for alternative and real assets.</p>
<p>Perform within the 1st or 2nd quartiles for all PRI assessment criteria</p>	<p>Due to the pilot assessment year for the PRI's new reporting framework and the changes in assessment methodology, the context for this performance goal has changed. Through our participation in the pilot, we received top marks in the highest scoring tier, which was equivalent to >90% scoring. Note that this scoring was indicative only as part of the PRI's pilot and testing.</p>

Over the coming year, New Forests seeks to continue its progress in demonstrating responsible investment in our asset classes and distinguishing ourselves as a sustainable and responsible investment manager. In FY14, our key sustainability targets include:

Develop a Corporate Sustainability Plan for the New Forests group of companies.

New Forests' business is growing across each of our investment programs and the geographies in which we invest. This expanding business exposes the company to new and more significant areas of social and environmental impact. By creating a Corporate Sustainability Plan we will enhance our ability to plan strategically for the identification of key sustainability issues for our business and to develop systematic approaches towards managing for optimal sustainability outcomes. The need for this plan stems for the continuing evolution of our business and our ability to integrate sustainability within our business plan and targets. The new Corporate Sustainability Plan shall be overarching across our business, incorporating elements such as corporate responsibility, sustainability leadership in our investment industry, and delivering effective, improved on-the-ground outcomes for our investments and stakeholders.

Increase engagement with clients, property managers, and investee companies to enhance monitoring and review of ESG performance.

As an investment manager, we can collaborate with other actors in our investment supply chain to assess and monitor ESG issue management and performance. We are fortunate to have a diverse group of institutional investment clients, some of whom have deep experience in ESG risk management and assessment, and all of whom have a need and right to understand the sustainability of their investments with New Forests. By working with these clients to understand their requirements and expectations, we may also gain from their experience. At the asset level, New Forests already works with our third-party property managers and directly with the companies in which we invest to set sustainable management targets and ensure ESG issues are managed responsibly and reported accurately. Further collaboration with property managers and investee companies will enhance the consistency and extent of these efforts.

Forestry Landscape in Australia



Social & Environmental Impacts

New Forests' business is at the forefront of addressing some of the world's most pressing social and environmental issues, including climate change, loss of biodiversity and other ecosystem services, and growing global demand for commodities and primary materials. Managing these sustainability issues can promote a shift toward sustainable investment that balances economic, environmental, and social pressures on the land, and in particular forests. Because the mitigation of sustainability risk factors requires innovation and significant expertise, New Forests views our experience in developing and executing investment strategies that focus on these key themes to be a competitive advantage. In this section, we report on New Forests' management approach and impacts relating to material sustainability issues facing our business: climate change, biodiversity, supply chain sustainability, and engaging with local communities. While our focus is on disclosing our management approach for material sustainability issues, we also present measurable and defined impacts where possible.

Climate Change

New Forests' business addresses climate change impacts both directly and indirectly throughout each of our investment strategies. We have been active and early proponents for the inclusion of forestry-based activities in the response to climate change, advocating at policy levels ranging from state, to federal, to international. Beyond that, our investments have real and tangible impacts on terrestrial carbon sequestration and storage, which is essential for mitigating climate change.

Carbon management has become the most prominent ecosystem service related issue and is an increasingly mainstream investment consideration. New Forests views our material climate change impact as being the storage and sequestration of carbon in the forests we manage as timberland investments and the carbon offsetting benefits of our forest carbon offset projects. In plantations, carbon is sequestered as trees grow and long-term storage benefits accrue both in the plantation and in harvested wood products. In forest carbon offset projects, such as those developed through Forest Carbon Partners, carbon benefits are verified and sold for use to help businesses meet emissions reduction goals and compliance requirements. Forest Carbon Partners was developed by New Forests to invest in the development of high-quality carbon offsets for the Californian carbon market, which reached full implementation in 2013. In addition to providing quantifiable carbon abatement, the projects financed through Forest Carbon Partners provide many associated co-benefits to landowners and local communities. For an example of co-benefits in forest carbon projects, read our **Focus – Forest Carbon and Community Benefits** (page 21).

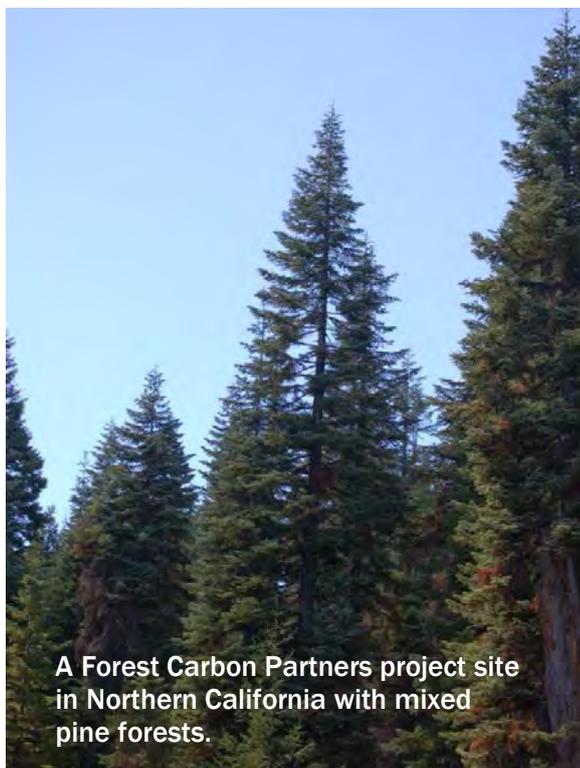
Sustainable plantation management presents an opportunity to adapt to decadal scale changes in climate by changing genetic material or species from rotation to rotation or by shifting management regimes. Investors who have concerns about climate change may need to look carefully at the forestry asset class for both risks and opportunities. Physical impacts will emerge from potential climatic shifts that could affect forest productivity and present risks like fire, windstorms, droughts, floods, and insect or disease epidemics. These phenomena will often be more acute at the extremes of species ranges or climatic conditions.

In addition, as policymakers address climate change, there are likely to be commercial implications for forestry investors. We generally view a carbon price as an opportunity for forestry investment; however, it is important to recognise that in some cases carbon scheme rules may be introduced that alter asset values and returns. These impacts may be positive, negative, or oscillate depending on the carbon price. For example, in some cases forestry may be included as part of a covered, or regulated, industry subject to carbon reporting, caps, or prices. Businesses that emit greenhouse gases purchase carbon offsets to

compensate for their emissions, and sustainably managed forests can provide a large-scale source of carbon abatement through carbon sequestration and storage as trees grow. In New Zealand the forest sector is included in the country's emissions trading scheme, allowing forest owners to participate and receive carbon credits for the carbon accumulated in their standing forest and through new forest growth. On the other hand, New Zealand forest owners may have a carbon liability for harvesting timber (i.e. the forest owners have to pay for the carbon value of the forest when it is cut as this is considered an 'emission'). California is the world's first regulatory carbon market to include forest offsets for meeting compliance requirements (without including forests as a covered sector), and New Forests has been an early and active investor in California's carbon market both through the Eco Products Fund and Forest Carbon Partners. An additional way that forestry investments may be affected by carbon policy is through indirect demand creation. An example of an indirect effect would be where a carbon price on a regulated industry makes production of materials such as steel and cement less favourable from a total cost perspective than using wood-based products. Wood is the lowest carbon-embodied building material and may enjoy a competitive advantage relative to other products, depending on the level of a carbon price and comparative costs of production. Ultimately, the competitive dynamics across sectors may also change as a result of a carbon price and are likely to vary based on the rules that are established for carbon.

Finally, renewable energy and fuel initiatives may also have strong impacts on forestry investments as bio-energy and bio-fuels technologies continue to achieve scale and increased commercial viability. Biomass from trees could become a significant fuel source for electricity, a source for liquid fuels (both cellulosic ethanol and biodiesel as well as new second generation fuels), and the basis for charcoal and biochar materials that can be both fuel and reductants. Even bio-materials like biodegradable resins, fibres, and plastics could rise in a world of expensive and increasingly scarce oil reserves.

Focus – Carbon Markets



A Forest Carbon Partners project site in Northern California with mixed pine forests.

Carbon Markets & New Forests' Investments

New Forests has been an early and active investor in carbon markets, focusing on carbon offsets from sustainable forest management and forest conservation. While carbon markets continue to emerge and mature in different jurisdictions, our investment strategies include opportunities in the following markets:

Australia's Carbon Farming Initiative

Australian offset program including forestry offsets

New Zealand Emissions Trading Scheme

NZ government program including compliance forestry and offsets

California Cap-and-Trade

State compliance program allowing offsets from forestry across the US

Voluntary Market

Global market for forestry offsets, such as from Verified Carbon Standard

Q&A on the Yurok Tribe CKGG Improved Forest Management Project

New Forests' Forest Carbon Partners (FCP) investment vehicle finances and develops forest carbon offset projects for the California carbon market. FCP works with family, industrial, and tribal landowners to create carbon offset projects that deliver real value – increasing and diversifying revenue for timberland owners. This work also delivers a reliable, high-volume supply of offsets to businesses regulated under the California cap-and-trade system. To explore some of the social and environmental benefits of The Yurok Tribe/Forest Carbon Partners CKGG Improved Forest Management, New Forests spoke with Nathan Voegeli, Staff Attorney, Yurok Tribe Office of the Tribal Attorney.

When did the Yurok Tribe first get interested in undertaking an improved forest management carbon project on the Yurok Tribal land?

The Yurok Tribe began to seriously consider a carbon project in 2010, as a creative means to recover a portion of the Tribe's ancestral territory. Previously, the Tribe owned very little of its former land base as much of it was stolen around the turn of the 20th century. Starting a carbon program would also create an avenue for the Tribe to derive income from the land, while at the same time decreasing timber harvests, reducing runoff, and improving the water quality of the Klamath River and its tributaries.

Could you describe the process the Tribe went through to make the decision to begin its carbon project?

The Yurok Tribal Council made an extensive effort to educate Tribal members and the local community about the benefits and drawbacks of a carbon project and used the feedback to evaluate whether a carbon project was an appropriate fit.

What are some of the social benefits you see from forest carbon projects?

The projects have made it possible for the Tribe to regain access to a significant part of its traditional territory. The restored forests are once again becoming populated with a wide variety of subsistence foods and medicinal plants. The additional revenue is being used to support Tribal departments programs, such as social service programs, for which there is a great need.

How has the carbon project changed land use or land use planning on the Tribe's land?

The Tribe's carbon projects, which are part of a larger land use plan, have enabled the Tribe to drastically improve forest health through culturally appropriate forest management practices, which include encouraging biodiversity through planting numerous tree, shrub, and grass species; implementing controlled burns to reduce parasite problems; and decommissioning old roads, which dump sediment into the Klamath River.

What are some of the environmental benefits you see in the project?

The Tribe's carbon projects enable the Tribe to increase the rate at which it can restore the forests to the way they were prior to European arrival. The Tribe uses traditional forest management practices to increase forest diversity, which in turn supports a wide array of native flora, fauna, and megafauna. Rehabilitating these crucial watersheds also helps reduce salmon-choking runoff, improves water quality, and offers tribal members, who are part of the environment, additional access to traditional resources.

Biodiversity

Biodiversity encompasses the diversity of genes within species, the diversity of species, and the diversity of the world's ecosystems. Biodiversity conservation is an important consideration in managing the forests we invest in and of the environmental markets projects we develop and manage. Our business involves a wide range of natural, semi-natural, and created habitats occurring within and around the boundaries of our assets and projects under management. As our investments are physically located in geographically and biologically diverse areas, our operational activities present a range of possible biodiversity impacts. New Forests has recognised biodiversity as a key environmental aspect of our business for many years, including formally integrating it as an area for management within our SEMS. Biodiversity management is explicitly

included within all the third-party certification schemes and standards used by New Forests, including forest certification standards, the International Finance Corporation Performance Standards, and regulatory standards for mitigation banking and carbon offsets. The principles and criteria and requirements of these systems represent a minimum standard for managing biodiversity across our investments.

Habitat protection and restoration is one of the ways that biodiversity may be directly promoted and improved by our investments. As the scale of our assets under management has grown, so too has the area we manage for conservation benefits. For a review of the area of habitat protected or under conservation status in FY13, see our **Focus – Protected Areas** (below left).

Focus – Protected Areas

Habitat Protection & Restoration in FY13

*Over **44,000 hectares**, or approximately 12%, of our Australian estate is classed as protected forests in management plans and/or under legal requirements. In Australia, High Conservation Value (HCV) areas identified in the forest certification process in FY13 include approximately **4,000 hectares**. In Tasmania, **36 hectares of new streamside reserves** were created in FY13 through a stream rehabilitation program.*

*In Malaysia, the forest management plan for Hijauan Bengkoka Plantations, acquired in FY13, includes more than **1,000 hectares of HCV** in forest reserves, buffer zones, wetlands and waterways, areas of cultural significance, and other conservation areas. The gazetted area also includes a **6,000+ hectare Class I forest reserve**.*

*Also in Malaysia, the Malua Forest Reserve – home to the Malua Biobank – was re-classified from production forest to fully protected Class I forest reserve covering **34,000 hectares** in June 2013.*

*Mitigation banks managed by New Forests in the United States included over **8,000 hectares of wetlands and 1 million stream feet** within their boundaries, which are to be managed for long-term conservation.*

*During FY13, Forest Carbon Partners expanded to more than **30,000 acres of protected forestland** included within its active projects.*

The Malua Biobank is our flagship biodiversity investment, providing for long-term conservation of the 34,000 hectare Malua Forest Reserve, which is home to several key species of threatened and endangered species, including orangutan, Bornean elephant, Bornean gibbon, clouded leopard, and banteng (wild cattle), among others. In FY13, New Forests continued work to develop the market for Biodiversity Conservation Certificates, including through engagement with industry groups focusing on sustainability in timber and palm oil supply chains as these are key industries with impacts in the Malua region. In November 2012, Malua Biobank announced collaboration with four oil palm companies for Wildlife Conservation Agreements. The agreements included training and launching of a wildlife warden program for oil palm plantation employees to help combat illegal hunting in and around the Malua Forest. The Wildlife Conservation Agreements will extend the Malua Biobank's anti-poaching efforts, which are also resourced through on-the-ground activities of 13+ field staff and rangers financed through the conservation investment of the Eco Products Fund.

In Australia, plantation forestry properties often include a mix of vegetation types and land use areas within a property, and many property titles are often aggregated into a larger asset. This means that for each plantation estate, there will be non-plantation forest areas that may still have significant biodiversity value and provide important habitat or ecosystem services. At a minimum, all remnant native vegetation is demarcated in GIS⁹ and legally or voluntarily protected and cannot be converted into plantation. Beyond

⁹ Geographic Information System

conferring protected status to these areas, active forest management of each property can enhance the protection of these areas through providing management oversight, fire protection benefits, and allowing for strategic protection or enhancement measures. For example, typical biodiversity conservation activities may include controlling noxious and invasive weeds and feral animals or erecting stock-proof fences to reduce burdens on sensitive native vegetation and allow for regeneration of native flora.

Our forests are also assessed for High Conservation Values (HCV) using an internationally-recognised approach for responsible land management that plays an important role in many sustainability standards schemes. The HCV approach¹⁰ was developed by the Forest Stewardship Council and assesses biological, ecological, social, and cultural values across six HCV types, covering a range of conservation priorities. Through the approach, outstanding or significant HCVs can be identified, managed, and monitored such that the HCVs are maintained or enhanced. In our forestry investments, HCVs are incorporated within forest management plans developed by property managers and portfolio companies. HCV areas are an important focus for maintaining and enhancing biodiversity values alongside commercial plantation forestry. It can be challenging to consistently assess and monitor HCVs. In the case of our largest asset in Australia, there was no available framework to consistently record HCV status on the whole estate, and instead a new methodology was developed in FY13 to enable our property managers to assess and monitor the area year to year. This approach is described in **Focus – Identifying Biodiversity Values and Impacts** (page 24).

Native Australian Blue Gum is a Major Plantation Species



Blue gum (*Eucalyptus globulus*) is a fast-growing tree native to Tasmania and Victoria in Southern Australia. Over the past 30 years, blue gum has emerged as the primary hardwood plantation species grown in Australia, providing a basis for the country's sustainable plantation-based hardwood chip exports.

¹⁰ See <http://www.hcvnetwork.org>.

Habitat restoration and protection is also a key environmental benefit of our environmental markets investments in the United States. Mitigation banks restore wetlands and waterways, such as streams, in order to provide ecosystem services that compensate for unavoidable environmental impacts elsewhere. The process is regulated by the US Army Corps of Engineers and is legislated under the US Clean Water Act. The ecological benefits of these banks are measured against specific standards to determine ecological function, and typical units of measurement include the linear stream feet of waterways restored and acreage of wetlands restored, further denominated by the type of wetland or stream. Mitigation bank sites are entered into long-term conservation covenants that ensure areas restored are managed for perpetual conservation. Forest carbon projects also include provisions for ensuring long-term management of biodiversity and habitat benefits. These include the use of conservation easements, third-party certification schemes, and permanence provisions for offsets.

Focus – Identifying Biodiversity Values and Impacts

A Consistent Approach for Native Vegetation Assessment in Australia

New Forests' Australian plantation estate spans all six Australian states and the major plantation forestry regions in the country. One of the challenges of managing across such an expansive area is exposure to different regional policy settings and different views on environmental issues. As part of FSC certification, forest management must include an assessment of the High Conservation Values (HCV) of the forest management units. Typically forest managers or independent experts use pre-established protocols to assess and rate what are known as HCV areas and create management plans to ensure the HCV areas are managed sustainably. As of 2013 there is no single Australian standard for implementing plans efficiently and with a high degree of reliability, meaning that methods vary from one forest manager to another, or even from property to property. This creates a challenge for ensuring consistency and designing management objectives across a large and diverse forestry estate.

To address this challenge and provide consistency to the assessment and management of high conservation values, a new rapid assessment method for surveying and mapping remnant vegetation was developed. PF Olsen (Australia) Pty Ltd, which manages the FSC Group Certification Scheme that includes New Forests' hardwood estate properties, commissioned and piloted the method throughout 2013 in order to support good conservation outcomes. Specifically, the tool looks at the "biophysical naturalness" of sites and is being used to assess and monitor areas of remnant vegetation within forest management units. Remnant vegetation areas range from degraded grasslands to intact primary forest; understanding the condition of these areas is vital to their management. Some of the factors assessed include the presence of native and non-native species, the presence of weeds or noxious species and feral animals, the distribution of flora throughout the site, tree health, the presence of tree hollows, indicators of previous fires, indicators of impacts of grazing, and evidence of slashing or firewood collection. These attributes are scored, yielding a quantitative assessment ranking from 1 to 5 on the degree of natural health of the site. This ranking will support management decisions for the properties and provide a baseline for assessing site improvements and health over time.

Coupled with systematic collection of photographs and periodic external expert review, this monitoring method is designed to provide a transparent, repeatable, and scientifically valid method for areas to be monitored efficiently and regularly. The tool will be applied across the existing hardwood estate at marked survey points as part of forest management, which will allow monitoring of the sites' conditions over time. Field testing of the method has occurred in Western Australia and the Green Triangle region of Victoria. It is planned that throughout 2014 every FSC-certified property in the group scheme will be monitored using this method in conjunction with a complementary assessment of fire hazard rating. Monitoring the condition of vegetation is important so that the forest manager can objectively demonstrate that they are achieving the FSC goal of maintaining or enhancing natural biodiversity.

The methodology described above was developed by Natural Resource Management Pty Ltd.

Engaging with Local Communities

Investing in forestry and environmental markets can present a wide range of issues of possible concern to local communities, and the people who live in and near the assets we manage are key stakeholders of our business. Throughout FY13, New Forests analysed social impacts of potential investments in the United States, Australia, New Zealand, Malaysia, Indonesia, and Vietnam. Under our SEMS requirements, social factors must be evaluated in the due diligence phase of all acquisitions and help determine an investment's risk categorisation. This helps us identify potential or current social issues that may require risk mitigation or special attention in investment structuring and asset management. While our investment strategies may have very different types of impacts on local communities, we find engaging with local communities to be one of the most important management factors of all of our investment strategies.

In Australia, New Forests is now one of the country's largest timberland managers with more than 370,000 hectares of land and plantations under the ownership of investment trusts managed by New Forests. This effectively makes the company a significant private landowner in Australia,¹¹ and in several local government areas New Forests would be the largest, or among the largest, landowners. As a major landowner New Forests' management activities will drive local employment, infrastructure, land taxes for local governments, and even innovation, research, and local small business opportunities. Community engagement activities are principally guided by the stakeholder engagement processes undertaken by our third-party property managers and overseen by New Forests' Australian stewardship manager. These activities ensure our management is transparent and that appropriate disclosures are made in a timely and accessible manner. As New Forests works across a wide area in Australia, we encounter a variety of sustainability issues that are of high importance and impact for regional Australian communities, such as stable employment opportunities, land and food security, and the vibrancy of local Australian communities. We believe that by managing timberland investments well, our business will continue to support local communities. For example, our investments contribute to the forest sector and its direct and indirect employment, including through more than 380 employees of the softwood sawmills owned by Timberlink Australia and a planned upgrade at its Tarpeena site that will reduce per-unit production costs and make the business more competitive and therefore more stable as an employer. In addition, through ensuring high-quality forest management, we provide services such as pest and weed control, fire risk reduction, and fire preparedness and equipment that promote environmental health and support regional safety and community objectives. These activities are well aligned with achieving positive forestry outcomes as well as being a good neighbour.

As our Southeast Asian investment program began investing in FY13, consideration for local communities has been a priority within both the due diligence and post-acquisition phases of the Tropical Asia Forest Fund. Many tropical timber plantations have indigenous and local communities living in or near them. We believe best practice includes the process of obtaining free, prior and informed consent (FPIC) from affected communities before establishing new plantations and ensuring local communities' rights are respected and upheld where plantation companies are already operating. The right to FPIC is recognised by intergovernmental organisations, international bodies, conventions, and international human rights laws, and there are a number of FSC-certified forestry operations in emerging markets that have obtained community consent. New Forests includes detailed legal review of land tenure and stakeholder consultation including with all relevant indigenous peoples' groups and NGOs as part of due diligence. For example, in the first Tropical Asia Forest Fund acquisition, due diligence activities included a land tenure study by a local expert, consultation with locally active NGOs, and a dedicated ESG due diligence field trip with a team of

¹¹ Note that New Forests itself does not own land in Australia, but rather is the manager of investment trusts that own land and other assets.

social and environmental experts who evaluated the investment against the FSC Principles and Criteria as well as the IFC Performance Standards. The information gathered in due diligence has contributed to a robust Certification Action Plan that guides our long-term oversight of the social and environmental management issues for the investment.

In the United States, the land-based footprint of both mitigation banking and forest carbon offset projects requires due consideration of the role of these investments in local communities. The environmental markets projects we undertake and manage in the US must fit within regional land use planning goals and typically provide ongoing benefits to local communities through the provisioning of important ecosystem services. In some cases, the projects themselves deliver direct benefits through enabling communities to meet larger objectives for regional planning, recreation, development, and land use. In FY13, a key focus for New Forests has been to progress the development of Forest Carbon Partners' initial projects, which involve non-industrial timberland owners in California and the Northeast, and include projects with Native American tribes, such as the Yurok Tribe as presented in **Focus – Forest Carbon and Community Benefits** (page 21). These projects are leading as the first compliance-based carbon offset projects on indigenous land in the United States. As such, the regulatory system did not originally support the inclusion of projects on Native American tribal land as these areas have sovereign status. New Forests worked closely with the Yurok Tribe and other tribes, legal advisers, and other stakeholders to develop and submit proposals that ultimately led to the inclusion of tribal land as eligible for hosting forest carbon projects.

Supply Chain Sustainability

Investors, consumers, and the general public are increasingly concerned with supply chain sustainability. In the forest sector, supply chain sustainability is generally assured through forest certification, which has already been discussed in this report. Certification is a major focus for New Forests because it provides transparency that our investments meet strict guidelines for appropriate management of social, environmental, and economic factors. As described above, New Forests has established Certification and Standards Guidance that sets minimum standards for the assets we manage. Through this approach, certification helps create long-term asset value as well as support commercial opportunities for the timber produced by our assets.

During FY13, New Forests achieved significant milestones in terms of forest certification. The largest asset under New Forests' management, the Forestry Investment Trust, achieved FSC certification in February 2013 as part of an FSC group scheme.¹² At the time of writing, all of New Forests' assets in Australia have core forestry properties managed under FSC certificates, and

Focus – Memberships & Engagement

Supporting Industry Sustainability

New Forests is a member of key industry groups and participates in related events and forums to advance sustainability in forestry, environmental markets, and some commodity markets. Key memberships include:

Forest Stewardship Council A.C.

New Forests Pty Ltd & New Forests Asia (Singapore) Pte Ltd

Forest Stewardship Council Australia

New Forests Asset Management Pty Ltd

Carbon Disclosure Project & Forest Footprint Disclosure Project

New Forests Pty Ltd

Australian Forest Products Association

New Forests Asset Management Pty Ltd

National Mitigation Banking Association

New Forests Inc.

Principles for Responsible Investment

New Forests Pty Ltd

¹² Eligible properties of the Forestry Investment Trust are included in the FSC certificate SCS-FM/COC-004290.

the softwood radiata pine plantation assets also have Australian Forestry Standard certificates. In June 2013, New Forests' Tropical Asia Forest Fund acquired a majority interest in a Malaysian plantation, Hijauan Bengkulu Plantations, which has FSC certification and sells certified timber to Malaysia, India, and China.¹³ By certifying our plantations today, or acquiring already certified plantations, our investments will likely have a strategic advantage in timber marketing opportunities as well as gain from the other sustainability benefits of forest certification.

Focus – Forests & Sawmill Supply Chain Certification

Integrating Sustainability in Softwood Supply Chains

In FY13, New Forests acquired the company's first timber processing facility with the acquisition of Timberlink Australia Pty Limited. As such, we also had our first sawmilling assets subject to our Social and Environmental Management System (SEMS) and have applied close sustainability oversight through the ownership transition and into the active ownership of the company by the Australia New Zealand Forest Fund. Our SEMS manager has acted as an observer and adviser to the Timberlink Australia Board of Directors and has coordinated with the company's staff on SEMS training and New Forests' sustainability programs. Timberlink Australia is now in the process of improving its Safety, Health, Environment, and Quality system to encompass all the elements of the IFC Performance Standards. Combined with the successful achievement of certification to the FSC Chain of Custody program (in addition to pre-existing certifications under the Australian Forest Standard), these measures will help ensure both social and environmental considerations are integrated throughout the Timberlink Australia business and support oversight by the Australia New Zealand Forest Fund and New Forests. Timberlink Australia is now a leading provider of FSC-certified plantation forest products to some of Australia's major retailers, with products including outdoor decking and building materials as well as structural grade lumber for Australian homes.

In January 2013, The Australia New Zealand Forest Fund purchased two sawmills located in the Australian states of South Australia and Tasmania. These two sawmills, now part of Timberlink Australia Pty Ltd, are the major timber customers for pine plantations also managed by New Forests, and are the company's first investment in forestry processing assets. Upon acquisition an important priority for management was to ensure that FSC Chain of Custody certification was achieved (see **Focus – Forests & Sawmill Supply Chain Certification** text box above). Timberlink Australia was awarded FSC Chain of Custody certification (DNV-COC-000719) in June 2013, which enables the company to label FSC products and ensure transparency through the supply chain, so that consumers can identify and choose products that support responsible forest management.

Sometimes factors beyond our control as an investment manager create challenges to complying with the Certification Policies that New Forests designs and pursues for each of our funds. We approach these situations with flexibility and consideration for the ultimate objectives we are aiming to achieve. For example, throughout FY13 the assets in our Australia New Zealand Forest Fund were in progress toward being certified as well-managed forests under the FSC Forest Management standard. This involved a lengthy process of stakeholder consultation and external third-party auditing, the timing of which can be difficult to control and has sometimes resulted in delays to the issuance of certificates. In these cases, delays to certification did not present an adverse sustainability outcome as the forests were already being managed with rigorous systems and procedures in place.

Another ongoing challenge for our Australian plantation assets is a conflict between the FSC Principles & Criteria, which limit the area of existing plantation that can be converted to non-forest use, and the need for

¹³ Hijauan Bengkulu Plantations Sdn. Berhad holds FSC certificate SCS-FM/COC-00142P.

managing our forestry estates to account for highest and best use where long-term forest management is not commercially viable. Managed Investment Schemes (MIS) in Australia used tax incentives in the 1990s and early 2000s to rapidly expand the hardwood plantation area, often reaching into areas that are not optimally suited for long-term forestry when taking into account economic, environmental, and social concerns. As nearly all MIS companies are now collapsed and ownership is transitioned to more long-term investors, it is estimated that as much as 40% of existing Australian hardwood plantations are unlikely to be re-grown after harvest and instead will be reverted back to agricultural land use. New Forests believes returning non-commercial areas to productive use is in keeping with sustainable practice that supports appropriate land use within a regional context. In FY13, FSC Australia was awarded funds to support the development of a country standard for FSC forest management in Australia. New Forests remains engaged as a member of both FSC Australia and FSC International and supports development of guidance and standards that accommodate responsible forest management in Australia and elsewhere.

Fortunately, New Forests continues to see increasing interest from our timber customers in procuring certified timber. Some of the world's leading consumer brands and the companies that supply them have now instituted procurement policies requiring FSC certification. Whether stimulated by government policy, consumer pressure, activist and environmental groups, or other motivations, major paper and wood buyers are now seeking large volumes of certified timber products. In Southeast Asia, we can clearly identify supply chain sustainability initiatives that have drawn timber supply from our certified forest area. In **Focus – Forests, Certification, and Commercial Value** (see text box below) we present the results from our examination of the commercial benefit of FSC certification in competitive timber markets, which is a direct result of supply chain requirements from consumer brands.

Focus – Forests, Certification, and Commercial Value

The Growing Commercial Value of FSC Certified Timber

New Forests is committed to pursuing FSC certification for all eligible forests as part of our Social and Environmental Management System. This year we also worked actively to determine whether we could achieve commercial benefits in Asia from FSC certification through improved timber prices. In June 2013, New Forests' Tropical Asia Forest Fund (TAFF) acquired a majority interest in Hijauan Bengkoka Plantations Sdn Bhd (HBP). HBP has cutting rights over an Acacia mangium plantation located in northern Sabah, Malaysia. In addition, HBP holds a stake in a joint venture called Acacia Forest Industries (AFI) that conducts replanting across the plantation area, which is part of a Sabah government-owned forestry concession. HBP and AFI became FSC certified in June 2011. HBP now sells acacia pulp logs and saw logs. The market for acacia products is expanding with key uses for outdoor furniture and high-quality print and writing papers.

The issue of a price premium for FSC certified products has been a contentious subject, and many think a premium is not possible especially for lower grades of timber like acacia. New Forests decided to explore whether or not HBP receives a price premium for logs being sold to the company's key export markets in Vietnam and China. To do this we compared HBP's sales to the sales of its closest competitors. This external comparison was necessary because HBP's customers all required FSC timber in 2013, and therefore it was not possible to make a comparison between customers requiring FSC certification and those not requiring certification. In our comparison against competitors, we considered a selection of grades of logs and found a 10% to 15% increase in price for FSC certified product over non-certified product from competitors. Although this comparison looked at only a snapshot of the 2013 market, New Forests is encouraged by the findings and will continue to monitor the prices and market advantage. One factor to consider is whether the observed higher prices are really a premium or if local competitors are selling their non-certified timber products at a discount to maintain market share. We expect demand side legislation such as the European Union Timber Regulation and the US Lacey Act will change buyers' procurement practices.

What's next for New Forests' sustainability programs?

New Forests' business has grown in part due to the company's commitment to sustainable approaches for forestry investment, and we believe our continued success will require us to maintain and expand this focus on responsible investment. Identifying ESG opportunities and risks is of particular salience in real assets investment, where the impacts of many key sustainability issues are both tangible and of growing significance. By applying our SEMS throughout the business, New Forests has taken an approach of identifying material issues that matter to our business, our clients, and other stakeholders and employing appropriate management controls to deliver the outcomes we need for successful investments. In this way, we manage for positive climate, biodiversity, supply chain, and social outcomes that will ultimately provide not only benefits to our investments but more broadly to the forest sector and the individuals who rely on it for timber products, employment, and other ecosystem services.

New Forests instituted its corporate sustainability program at the end of calendar year 2010, and we have worked to improve and grow this program systematically and strategically in the three years since then. As an investment management business, the value of assets we manage combined with capital committed to our investment funds has increased roughly four-fold over the same period, from December 2010 to end of June 2013. We have also expanded our investment fund products from one New Forests branded fund to a family of New Forests funds across our three investment regions. This means that both the scope and scale of our investments is growing significantly, and so too is our exposure to sustainability issues. As New Forests is now actively managing assets and investing in Australia and New Zealand, Southeast Asia, and the United States, we also expect to be able to produce additional case studies and increase our experience in managing for sustainability within our investments. We believe these case studies – examples of on the ground progress in responsible investment and sustainable forest and asset management – can be important contributions to the growing community of responsible investors.

Our investment activities must continue to reflect New Forests' values and our responsibility to be a sustainable business economically but also sustainable in environmental and social outcomes. Throughout FY14, we will focus on the materiality of sustainability impacts of our business and their relevance to our organisation's stakeholders. The development of our first Corporate Sustainability Business Plan will involve individuals from throughout New Forests to ensure a well-rounded approach to setting goals and incorporating the sustainability issues of importance from each area in which we invest. It will also include input and consultation with external stakeholders, and we invite feedback from shareholders, clients, customers, and others with an interest in our business.

Contact

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