Innovative finance for forestry

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Introduction

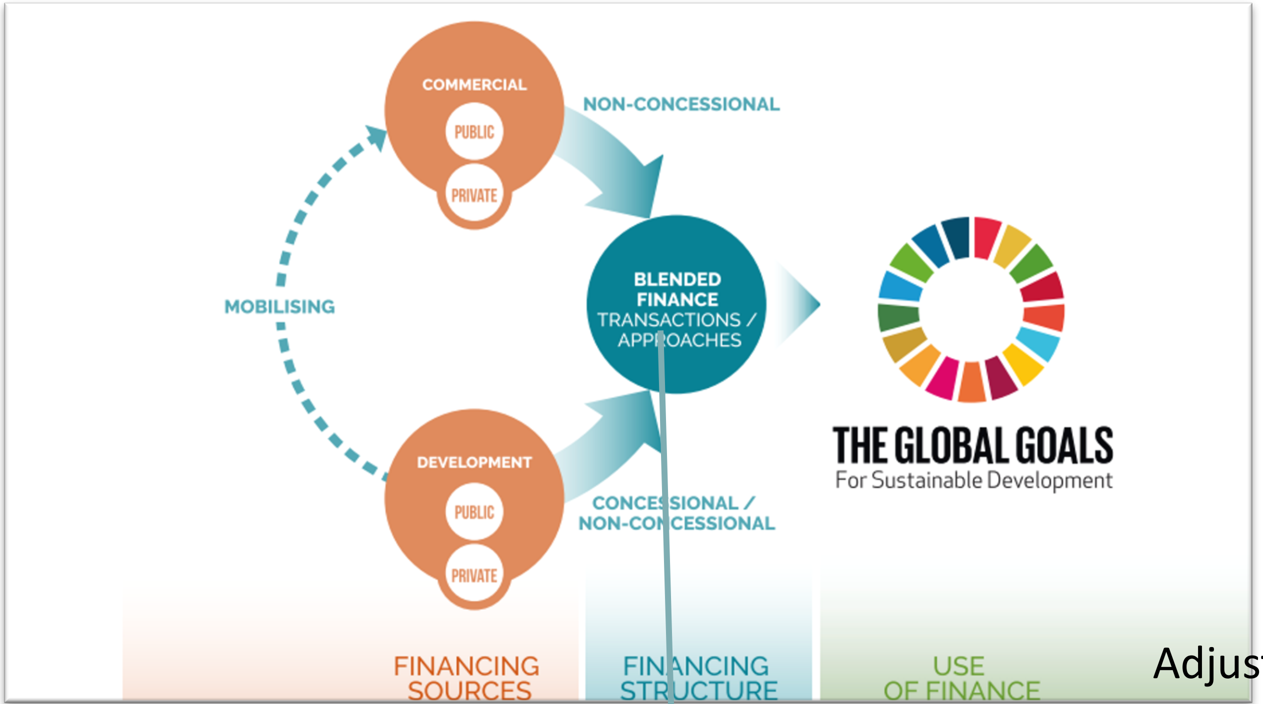
- Forestry is very particular among the economic sectors
  - Production of prime material requires much land and time
  - Land is occupied for a long time
  - Long time span between initial investment and first financial benefits
  - Environmental, climate and social risks perceived to be high
  - Harvesting often in remote areas where state is little present (also for plantations and primary processing plants)
  - Often only direct costs and benefits of wood production and use considered; not indirect costs and benefits, nor over life cycle.
  - Some direct investments were disappointing due to unrealistic expectations of returns
- Therefore considered to have lower than desired returns and high perceived risks
- Innovative finance to reduce risks and, in some cases, boost returns (e.g. Payment for environmental services schemes)

Reducing risk by sharing

- Two widespread innovations, although little used for forestry yet:
    - Blended finance: “financing models that combine commercial and other financial sources to stimulate investment with complementary risk and return appetites” (Rode et al. 2019)
    - Green/social/sustainability/climate bonds: fixed income instrument that represents a loan made by an investor to a corporate or governmental borrower, where the proceeds will be exclusively applied to eligible environmental and/or social projects (ICMA 2018). Climate bonds currently mainly related to emission reductions (in forestry: carbon credits)

Blended finance

- Enhance impacts
- Reduce risks by splitting investment in different sections
- Combine parties with different risk and return expectations
- Facilitated by sector wide or region wide funds where projects that meet certain criteria can apply for loans
- Particularly useful for initial stages in developing projects



Adjusted from OECD 2018

- Project
- Fund
- Fund of fund
- Facility (institutional)
- Market
- Project preparation

Example: Tropical Landscape Finance Facility

- Multi-stakeholder group (UNEP, World Agroforestry Centre (ICRAF), investment manager ADM Capital, BNP Paribas and later WWF)
- Core objective: provide sustainable rural jobs, rehabilitate degraded lands and provide clean electricity
- **Grant facility** to channel public funds to provide technical assistance and co-funding/financing for the projects at their early evolutionary stage (e.g. to provide enabling conditions for smallholder involvement)
- **Lending platform** provides long-term debt to sustainable agriculture, forest conservation and renewable energy sectors.
    - Medium Term Note programme (BNP Paribas) for 5, 7 and 15 years,
    - Different risk levels and attracting different type of investors.
    - USAID: 50% guarantee for the $30 million tranche of longer term (15 years) bonds
- For example, &Green blends finance and invests in TLFF through buying notes, whose proceeds can only be used to further invest in jurisdictional projects, while part of the notes are guaranteed by USAID
- Currently used to finance new rubber plantations (Michelin) and conservation areas in Indonesia in the context of a jurisdictional approach

Green/sustainability/climate bonds

- Require institutional issuer (therefore usually more mature organizations)
- Require third party certification
- Promise of fixed return rather than variable profit based: usually less risky, but also lower
- Initial investment does not have to be paid back until the bonds mature.
- In 2018 average size 100 million and average duration 10 yrs (CBI 2019)
- Long-term bonds can be useful when planting fast-growing trees, where the costs are incurred at the beginning of the process and the benefits are reaped only at the first tree harvest
- The land use sector is currently constrained by the lack of good quality (meeting bond criteria) and scalable projects to finance

Example: Sumatra Merang Peatland Project

- Collaboration between Mirova/Althelia (issues bonds, manages fund), Pt Gal (borrower) and Forest Carbon (adviser)
- Verification by Verified Carbon Standard (VCS) and Climate, Community and Biodiversity Standard (CCB)
- Reduce drivers of deforestation through supporting community selected projects and peat land protection and restoration
- Climate, livelihoods (and gender) and biodiversity benefits
- Carbon credits tradable; bond purchasers can opt to be paid in carbon credits or cash.
- Bonds help Pt Gal to comply con environmental standards for its pulp and paper producing plantations

Final remarks

- Innovative finance options can support innovations in the forest sector
- Often combination of options is best solution, with grants important at early stages, followed by concessional loans and blending with commercial money, which may be raised through bonds
- All options require existing strong financial infrastructure in order to achieve scale
- Development money has role in supporting the creation of more locally controlled financial infrastructure

References used

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- OECD. (2018). Making Blended Finance Work for the Sustainable Development Goals, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264288768-en
- Rode J, Pinzon A, Stabile MC, Pirker J, Bauch S, Iribarrem A, Sammon P, Llerena CA, Alves LM, Orihuela CE et al. 2019. Why 'blended finance' could help transitions to sustainable landscapes: Lessons from the Unlocking Forest Finance project. *Ecosystem Services* 37: 100917

Photo Irpan, Tropenbos Indonesia

More information on innovative finance for forest and other land uses at:

https://www.foreststreesagroforestry.org/publications/research-publication/?title=innovative-finance-for-sustainable-landscapes&id=339463394633946

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