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White Paper

London, 10 June 2015

Unlocking capital for land use and conservation projects

The business case for investing

This White Paper was produced by
European Investment Bank (EIB); **United Nations Environment Programme** (UNEP); **Finance in Motion; Climate Bonds Initiative, Clarmondial**

Objectives

The objectives of the session are:

- to review the *market opportunities for investments in land use and conservation projects*
- to make an inventory of the *various ways finance sources are funding these opportunities* so far and how the various institutions providing them (public, private commercial and non-commercial, financial intermediaries) are coordinated
- to *map these opportunities with the financial instruments* made available by the financing providers
- to discuss the potential of *scaling up* two instruments for these opportunities: *the multi-layered public-private fund structure model and the green/climate bonds*
- to get all the institutions providing finance on the one side, and all stakeholders involved in the management of landscapes on the other, to *agree on their respective roles* and *interest in scaling up these markets* and ideally, to *commit to supporting and developing* the two above instruments.

1. What do participants need to know about the topic?

A landscape is a socio-ecological land system composed of a mosaic of natural and/or human-modified ecosystems whose configuration reflects the past and present activities of the area.

In such identified locations, ecological services provided by nature, crop and livestock production and human activities on land for livelihoods or business purposes compete, interact and are interlinked. Land management also plays a central role in climate action and mitigation. Conservation activities raise more or less critical social/livelihood/opportunity cost concerns depending on the present socioeconomic context. Production for livelihood or commercial reasons raises fundamental questions regarding access to ecosystem services. Economic development raises broad social and environmental aspects in terms of sustainability.

Consequently, *land management requires the collaboration of, and integrated solutions from, landowners and various stakeholders* such as public authorities (national, regional, local), communities, businesses, conservation nongovernmental organizations (NGOs), etc. in order to achieve their multiple, but often contradictory, landscape objectives. In parallel, *public policies and markets must be shaped to accompany* the realization of these targets. Last but not least, two groups are growing increasingly conscious that environmental and social risk linked to land use is both a threat and an opportunity to differentiate products that are generated under verified improved environmental and social performance. These groups are, on the one hand, companies whose inputs directly or indirectly depend on/impact land use and, on the other, financial investors questioning the sustainability of their assets. *This session is about discussing the broad approach of financing this "integrated landscape management".*

<u>*The main market opportunities in land use and conservation*</u> include, but are not limited to:

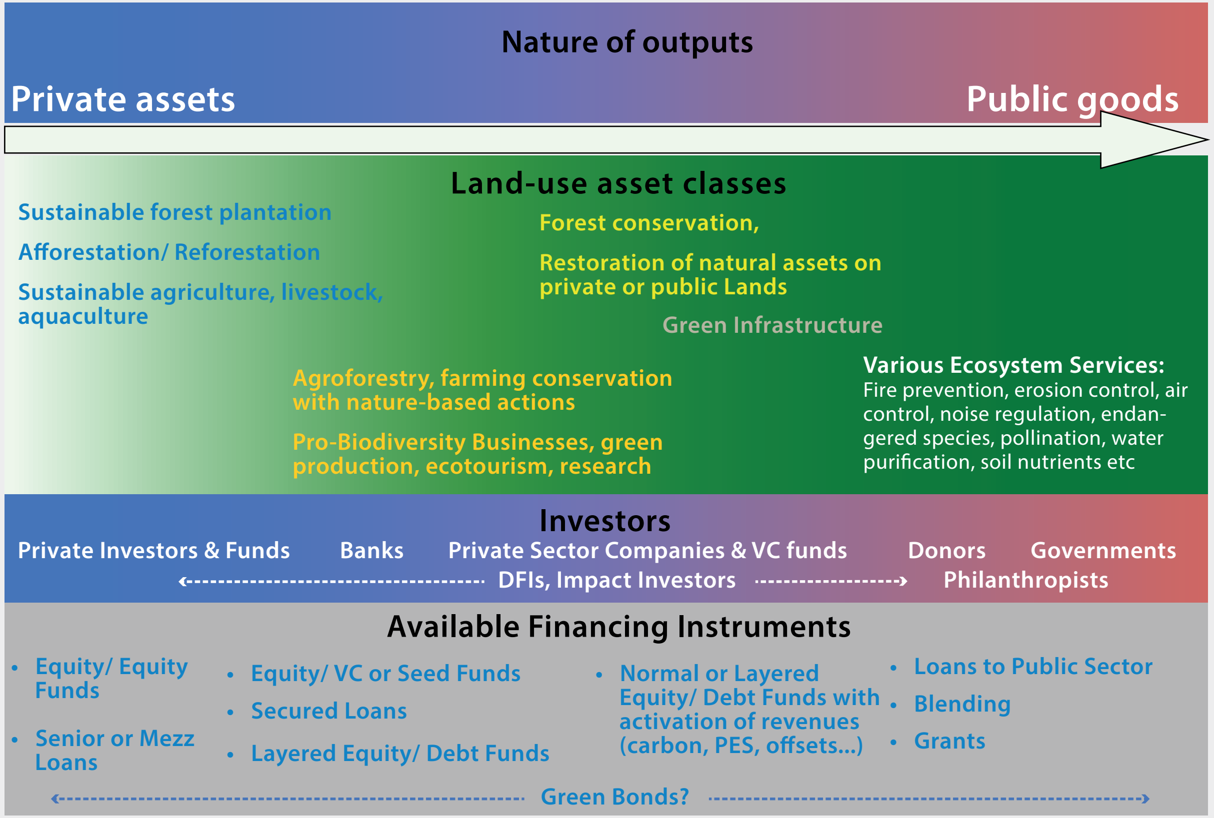
- investments in ecosystems: soils; forests; fresh water; living organisms
- investments in "regulating" green infrastructure: protected areas; habitat corridors; nature-based fire prevention, flood protection and erosion control; nature-based water treatment, purification,

collection and retention; ecotourism and recreational areas

- investments in sustainable cultivated resources: afforestation/reforestation; crops; livestock; agroforestry; aquaculture
- investments in environmental market (sometimes called offsetting) instruments: carbon sequestration credits; mitigation banking/biodiversity offsetting credits; water certificates; permits and rights certificates
- investments in value added by "greening" the supply chain (e.g. agriculture or agri-food business, timber logging etc) with premium paid to producers and demand growing due to change of consumption patterns.

The following chart proposes a *summary of the nature of investors, investment vehicles and instruments that finance the range of outputs from landscape and/or conservation management projects.*

Outputs, investors, instruments



Not highlighted in this chart are the following features:

- Above all, depending on its specificities, a project requests the *"right" coalition of investors that best fits with the appropriate financing structure*.
- In multi-layered risk structures, donors or governments provide *catalytic first-loss equity*.
- Some loans can be in the form of ring-fenced project finance loans.
- Some loans would be derived from *debt-for-nature* swaps used to forgive foreign currency denominated debts of willing governments in exchange for investing the local currency proceeds into environmental/conservation projects.
- *Mezzanine loans* could be subordinated loans or convertible loans/bonds.
- *Securitization vehicles* could complement the list of instruments: they may benefit from equity support or, for some tranches, credit enhancement from donors, governments or development finance institutions.
- All these instruments have *longer durations* than those used in other sectors, either because land-use projects take a long time to make a profit, or because policy makers take a long time to fully implement structural measures. Both justify market cautiousness.
- **EIB** will list the various cases of financing instruments in which it is invested or which it has issued or is intending to consider due diligence on: (i) private equity funds for forestry management like Dasos or Arbaro, for REDD+ and sustainable commodities like Althelia, for urban-located derelict industrial lands like Ginkgo or Brownfields, for integrated landscape management like the Land Degradation Neutrality Fund or Eco-Business Fund; (ii) funds, facility or structures in other sectors that are replicable for land use: the EU-28 Natural Capital Financing Facility credit enhanced by the EC; energy efficiency multi-layered funds.
- **Finance in Motion (FiM)** will elaborate particularly on its multi-layered impact investment funds.
- **Credit Suisse** will describe its experiences in issuing conservation notes/bonds, particularly for the benefit of the Althelia Fund.
- Finally, **Climate Bond Initiatives (CBI)** will explain why standards are paramount to investors in green/climate bonds and will report on its progress with partners in the development of standards for climate/green bonds for the agriculture/forestry/land-use sectors.

2. What are the current challenges in relation to "unlocking capital for land use and conservation projects"?

- *Lack of knowledge* of bankable land use and conservation projects *by investors* in general
- Nature of risks unclear and beyond the reach of "usual" risk assessment tools used by professional investors
- Investors' requirements for *"quick results"* (which often also include liquidity constraints plus the Basel III framework for banks) vs. *long-term horizon* needed for such landscape projects
- *Small and scattered* known opportunities and pilot projects relative to the minimum size and constraints of institutional investors
- High transaction and monitoring costs
- *Environmental and social regulations* and *market structures* (asset investments and financial) still *under-developed* in various countries and sectors; as well as legal frameworks (especially land tenure, environmental liability assignments, low enforcement capacity)
- Lack of coordination (silos) at *public level* in many countries i.e. national, regional and local authorities and also various agencies, often leading to absence of coherent planning for land use in critical locations
- *Low planning capacity* (and/or political unwillingness) of public authorities
- Budgetary constraints of public authorities
- *Lack of collaboration between stakeholders* (public planning, NGOs, local communities, businesses, etc.) due to absence of measurable targets; then, while non-negligible in global quantity, too scattered involvement of donors and official international public finance institutions
- Weaknesses of many NGOs for the economics of projects
- *Lack of professional project promoters/managers*
- *Low capacity and unwillingness of financial intermediaries to adapt to landscape project challenges* (short term vs. long term, bundling micro/small projects, stringent conditions applied to borrowers with high equity and/or collateral requested etc.)
- *Unavailability of "private" insurance* tools often justified by the difficulty to demonstrate the materiality of causes and damages.

3. Which concrete measures do you propose to overcome these challenges *(financial tools and instruments, broad frameworks, policies, etc.)*?

Broad frameworks:

- As most landscape projects are "integrated" land use/conservation projects that are public–private partnerships (PPPs), establish knowledge sharing around the variations of such financing mechanisms and lessons learned
- Strengthen each component and the chain "Science–Environment–Economics/Finance–Social" knowledge for landscape management
- Encourage legal and regulatory framework integrating/making coherent all "siloed" sectoral policies
- Ensure that laws and penalties are enforced where they are already applicable to demonstrate political will.

Multiply the use of market-based incentive mechanisms at landowners'/farmers' level in order to activate their revenues and/or provide them capital for change:

- Premium paid for certified production
- Carbon credits
- Payments for Ecosystem Services
- Various cash payment/penalties to encourage shifts in practices
- Rationalize public finance involvement: Quantity? When and how?

Appropriately fund capacity building and coordination of stakeholders i.e. planning authorities, project promoters/developers, other stakeholders such as NGOs, local business associations, etc.

Enabler of investments:

- *Better measurement of environmental and social impacts* (indicators)
- Progress in setting up broadly acceptable *valuation of externalities* in investments
- *Knowledge sharing of business cases* in land-use management: not only business models, but also communication by/mobilization of all stakeholders to keep the momentum and foster involvement of financial institutions and investors willing to join
- *Build partnerships (including financing capacity building) with financial institutions – first and foremost the local ones* in order to take up challenges.

4. Open questions

- *Commoditize the use of public finance to reduce private sector risk* (and thus catalyze their investments) for first-loss protection. Particularly scale up **the use of multi-layered cases presented by FiM**. Look also at partial guarantees, seed capital, etc. to see if non-public donors could do the same.
- *Analyze the potential of and develop standards* (in order to reach the requested scalability, tradability, liquidity, etc.) for *"green/climate bonds" dedicated to finance land-use and conservation projects*. **Discuss the experiences of Credit Suisse and the ongoing work led by CBI.**

5. What are the proposed milestones for implementation? Who *(organizations, sectors, stakeholder groups, etc.)* carries responsibility for/can support implementation?

- *Aim:* Grants providers (governments, philanthropy), promoters (corporations, NGOs, landowner structures, etc.), investors (institutional including pension funds and insurance companies), financial institutions and supranational and national development finance institutions:
    1. will agree on their respective roles and interest to develop these markets
    2. ideally, will commit to develop and support identified categories of transactions.
- *COP 21: ?*
- *Thereafter: ?*

Background documents

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Coordinating partners

Strategic partners

Funding partners

Authors