Global Landscapes Forum

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White Paper

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Connecting financial tools and landscapes

Aggregators and strategic interventions

CLARMONDIAL CREDIT SUISSE Climate Bonds F3 Life

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Objectives

This White Paper is related to a working session that considers the role of debt in financing sustainable landscapes: how it can be utilized, innovations in structuring, tools and other approaches to change the availability and cost of capital. We will look at the role of banks, non-bank financial institutions (NBFIs), capital markets (bonds), private debt solutions, corporate and concessional funders (e.g. through program-related investing, subordinated tranches, guarantees, etc.). We will also look at innovations in risk assessment and management that can help to reduce the cost of debt (e.g. credit tools, insurance products). By providing the audience with a holistic view of how debt can be used, and innovations around credit delivery and pricing, this session aims to stimulate discussions and the creation of new partnerships.

The session sets out to discuss the following questions:

- How can debt be used to finance sustainable landscapes?
- How can debt-market trends and opportunities be harnessed to promote sustainable landscapes?
- How can we reduce the cost of capital for sustainable landscapes?

Context

There is much general talk about landscape finance, but few specific examples of how such approaches may be structured to meet the needs of landscape actors. The various categories of finance, including private and public debt and equity, and different forms of concessional funding, are advanced and complex subjects, and the focus of this session is primarily on debt-based financing.

The term 'landscape finance' is relatively ambiguous. A landscape approach is essentially one where different actors in a specific geographical area are coordinated, i.e. integrated land management. These different actors (stakeholders) in a landscape include government entities, individuals (producers, consumers, traders), farmer groups, local small- and medium-sized enterprises, multinational corporations, international financial institutions, banks and NBFIs. Thus landscape finance can take many different forms depending on the exact constellation of actors and activities, from lending to smallholder farmers to a sovereign funding its agricultural development budget. It can include early stage to mature, risky to less risky, short-term to long-term financing, on and off balance sheet, private and public capital markets and all variations in between. What is imperative is that a financing approach is fit for purpose, i.e. that a financing structure or approach is based on a real need that is developed with the perspectives of the financed and the financier in mind. Additionally, 'who' finances is also a function of 'who' and 'what' is to be financed.

In many emerging market landscapes, individuals and small local groups (including cooperatives) have the most immediate potential for impacting land use and have a central role to play in maintaining landscape functions. These individuals and small groups often find it difficult to access affordable finance. From both the perspective of a landscape management role, as well as representing groups such as smallholder farmers, an **aggregator** thus becomes important. By 'aggregator' we mean an organization that groups smaller organizations and/or individuals into a legal entity.

In order for any sort of funder to finance an initiative, they need a legal entity with which they can transact. Such an entity will have a capital structure, usually a mix of equity and debt. Equity investors buy shares and thus gain an ownership stake in the entity, i.e. they become shareholders. Creditors buy a right to a future stream of payments, which typically includes interest, from the debtor. Financial market rules put

creditors in a preferential position with respect to repayment, and this plus the relative predictability of debt repayment, makes it generally less risky (and usually more attractive) for investors. This is borne out by the size of the global debt market, which is about twice that of the global equity (stock) market. This preference for debt and debt-like investment opportunities may be amplified in riskier investments, e.g. in emerging markets, where equity positions may be perceived as more difficult to monetize (via sale of the shares – i.e. "exit" – or dividends).

Entities may raise debt through capital markets (e.g. bonds and commercial paper) and through private debt programs and vehicles. Generally, the factors that a debtor and a creditor will consider include the following, and these influence the cost of capital – i.e. the cost to the borrower (debtor) of that money by influencing the perceived risk to an investor (creditor).

These factors also influence the type of investor (creditor) that can provide finance, and how much money might be available. While it is easy to dismiss local providers for not providing cheap enough capital, it is also important to bear in mind that they have fiduciary obligations that they are obligated to meet.

Consideration	Impacts on the cost of capital	Relevance to landscape restoration
The amount borrowed (principal), interest and predictability of timing	It may be harder to get attractive borrowing rates for smaller amounts due to transaction costs. Higher interest rates entice investors but also reflect higher risk.	Small loans, spread over a large area (e.g. in a landscape) may be more expensive to finance due to distances and infrastructure challenges. Thus they may require higher interest rates to compensate investors.
Who the debtor is, and their track record	Well-regarded debtors, with good operational and credit history, can borrow at cheaper costs.	There may be a mix of actors in the landscape, from governments to private companies to individuals.
Collateral/security posted for the loan, or other forms of assurances	Creditors may require collateral for the loan. High quality, significant collateral may help to reduce the cost. The type of collateral is important, in that the more liquid the collateral (e.g. cash), the easier to monetize in case of defaults.	Various actors in the landscape will have access to different forms of collateral. In the long term, if land is posted as collateral, the quality of that land may impact its value and thus the ability to access debt finance using it as collateral.
The currency the loan is denominated in	Multiple currencies in a transaction increase potential risk, i.e. providing loans in hard currency to a company only doing business in an exotic emerging market currency.	Most landscape funding is likely to be required in "exotic" local currencies, which bears a currency risk or leads to additional currency hedging costs.
Any insurance or risk mitigants	Government entities and other types of supporters may provide guarantees, insurance or other forms of risk mitigants to reduce the cost of the loan.	Non-commercial actors may help landscape actors access finance at cheaper rates.
Capital opportunity costs and regulations	The alternative options for creditors must be considered and will impact their interest in making money available for landscape restoration. Local regulations, e.g. on capital adequacy and types of lenders also impacts availability of debt.	Regulations have a significant impact on availability and interest of creditors to make funding available for landscape restoration. Also, these projects are competing for funding with other projects in the same country and similar projects in other countries.

How can debt be used to finance sustainable landscapes?

When examining a landscape, it may be useful to look at different types of actors and their activities within a specific landscape when designing a financing strategy. These might include asking questions such as:

- What types of land-based production takes place, what should take place and what are the financing needs of these activities?
- What do the revenue streams from land-based production look like? What is their timing?
- Which types of legal entities exist in a landscape and if and how do they? Could they use additional finance?
- How are different activities in a landscape currently financed? Who uses private debt, who uses bank or NBFI debt, who accesses the capital markets?
- Where is finance currently available from in the landscape, and what influences the terms of that finance?

This type of information is needed in order to understand where the most **strategic intervention** points might be and to develop a suitable strategy, and subsequently structure. For example, this might be providing long-term debt to farmers' cooperatives for tree crop rejuvenation, or providing guarantees to local creditors to enable them to lower the cost of local capital. It may also be in the form of new tools to help creditors, insurers and other relevant local counterparts better assess the short and long-term risk profiles of debtors. The concrete measures required to design and implement landscape finance depend on the specific local needs.

How can debt-market trends and opportunities be harnessed to promote sustainable landscapes?

This can be viewed from two interrelated perspectives: access to capital and perceived risk. Low interest rates in developed countries as a result of government interventions after the financial crisis has increased investors' interest in other products that can generate financial returns. Thus, we have seen increased interest in corporate bonds, private debt and 'impact fixed income'. Innovations in financial technology or fintech and emerging regulations are making it possible to aggregate and raise debt (e.g. through peer-to-peer lending platforms) and develop new ways of assessing credit worthiness. Improved credit worthiness information can help to bring down perceived risk and thus cost of capital.

How can we reduce the cost of capital for sustainable landscapes?

The cost of capital is a function of many different factors related to perceived risk and opportunity costs. Many needed landscape interventions are in emerging markets, in exotic local currencies, working with lesser known counterparts (e.g. smallholder farmers, small local businesses) and in untested business models and markets (e.g. new land management practices). These unknowns increase the risk to investors and thus the cost of capital. Approaches that can address part or all of these issues can help to reduce the cost of capital. This might be in the form of financial resources (e.g. subordinated tranches, guarantees), information and tools, structuring (e.g. bringing in insurance, "borrowing" credit rating from an international financial institution), and dedicated testing and learning. Different actors can be involved in helping to address these, e.g. a government may provide a guarantee, companies may develop tools for screening and financial advisors and partners may help to develop and realize new structures and partnerships.

Background documents

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The Investment Case

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