Increasing Private Sector Impact in the Forest Sector

Leveraging Private Finance in Support of Sustainable Forestry

Presentation to World Forestry Congress

October 22, 2009
Leveraging Investment in the Forest Sector

1. Context and Challenges: The case for doing more
2. Where are we now and lessons learned
3. Strategic framework and initiatives
4. Examples of country level implementation
# The Need: Forests are an Urgent Priority

| Climate Change Mitigation       | • Deforestation causes 20% of carbon emissions  
|                                | • Forests could provide 33% of the GHG abatement required |
| Employment Generation and Livelihood | • 1.6 billion dependent on forests for survival  
|                                | • 11 million directly employed in forestry in organized sector, 2–3 times more in unorganized sector  
|                                | • Tens of millions employed in downstream processing |
| Land-Use Change                | • Growing pressure on land – conversion to Agriculture  
|                                | • Land-use change becoming key socio-economic issue across industries |
Supply and demand shift to emerging markets

Growing share of wood supply (Higher growth rates/lower cost of land and labor)

Growing domestic markets for wood-based products

China alone trades 40-60% of the world’s wood

Increased demand in developed countries

Greater use of wood as biofuel

Green building materials
Implications of Increased Demand for Wood

More pressure on forest resources

Need to build up sustainable supply of wood

Need for wood means increased investment opportunities

Need for International Financial Institutions to be big players in sector. . . but they are not so far

*Significant IFC role as investor and promoter of sustainable standards and benchmarks*
### Forest Challenges

*Agricultural conversion threatens all forest types*

<table>
<thead>
<tr>
<th>Conservation Forests</th>
<th>Natural Production Forests</th>
<th>Plantation Forests</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management needs exceed local capacity</td>
<td>Low profitability</td>
<td>Impatient capital</td>
</tr>
<tr>
<td>Governance and inadequate funding</td>
<td>Lack of scale</td>
<td>Inadequate private sector investment</td>
</tr>
<tr>
<td>No market mechanism to monetize environmental services</td>
<td>Illegal logging</td>
<td>Land tenure and access</td>
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<tr>
<td></td>
<td>Weak governance</td>
<td>Financial crisis</td>
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<td>High reputational risk</td>
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<td></td>
<td>High transaction costs</td>
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<td></td>
<td>No monetization of environmental services</td>
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</table>
### Increasing IFC’s Impact in the Forest Sector

| 1. | The case for increasing IFC engagement in forests |
| 2. | Where are we now and lessons learned |
| 3. | Proposed strategic framework and initiatives |
| 4. | Examples of country level implementation |
Current Investments in the Forest Sector

Portfolio of $1.13 billion...

- IFC Forest Product and Tree Crop portfolio dominated by downstream industries
- 40% of projects in IDA countries
- No tropical forest investment in the last 25 years
- Supported 350,000+ jobs

...across 67 projects

No. of projects 11 10 13 11 2 10

- Industrial Processing 87%
- Natural Forests 0%
- Plantations 13%
What have we learned?

- Forest projects can generate high development impact
- Key risks need to be identified early:
  - Land use and tenure
  - Governance and corruption
  - 3rd party supplier performance
  - Sponsors’ commitment & capacity
  - Project context & stakeholders
- Long time horizon for forest projects (complicated by impatient capital, complexity, high transaction costs)
- Insufficient leveraging of World Bank
- Partnerships to deliver capacity/expertise/finance

Successful forest projects require analyzing & mitigating risks in a holistic manner...
## Analyze and Mitigate Risks in Holistic Way

Understand local context & stakeholder engagement

<table>
<thead>
<tr>
<th>Risk</th>
<th>Mitigation</th>
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</table>
| Unsustainable logging/biodiversity        | • Certification
                                              • NGO partnership                                                        |
| Local communities                         | • Engagement procedures
                                              • Transparency
                                              • Sponsor capacity                                                        |
| Non-performance of 3rd party suppliers    | • Certification
                                              • Training                                                                |
| Sponsor commitment and capacity           | • Extensive sponsor due diligence
                                              • Advisory support to build capacity
                                              • Third party verification                                                 |
| Natural forest conversion                 | • Promote sustainable agriculture benchmarks
                                              • Create value for standing forest                                         |
| Monoculture / “green desert”              | • Water monitoring
                                              • Knowledge of local context/research                                       |

Leverage WBG knowledge
Carbon Finance Remains a Challenge

- Carbon credits are a regulatory commodity
- Kyoto’s Clean Development Mechanism (CDM) is slow and costly for forests
- The Voluntary market (VER) is functioning but small ($65 million for forests)
- Funding for Reduced Emissions from Deforestation & Degradation (REDD) may offer pre-2013 opportunity for conservation
- Forest carbon is not a “silver bullet” for financial viability

<table>
<thead>
<tr>
<th>CDM Market</th>
<th>Overall</th>
<th>Forest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Size</td>
<td>$60 bn</td>
<td>n/a</td>
</tr>
<tr>
<td>No. of Projects in pipeline</td>
<td>4,500</td>
<td>40</td>
</tr>
<tr>
<td>tCO2 equivalent</td>
<td>7.4 bn</td>
<td>37 mn</td>
</tr>
<tr>
<td>No. of projects registered</td>
<td>1,400</td>
<td>&lt; 5</td>
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</table>
Increasing IFC’s Impact in the Forest Sector

1. The case for increasing IFC engagement in forests

2. Where are we now and lessons learned

3. Diversified initiatives

4. Examples of country level implementation
New Approaches - Global

Support projects to reduce forest conversion
- Shift plantations (palm oil, rubber, wood) to degraded lands
- Increase productivity on already converted land (cattle, soy)

Promote global standards
- Step-up role in commodity roundtables
- Foster industry best practice standards

Increase forest access to carbon market
- Pilot projects to establish methodologies and standardization
- Help clients access post-Copenhagen market

Build strategic partnerships
- NGOs/donors/DFIs
- World Bank for country-specific collaboration
New Approaches - Regional/Country-Specific

- Foster creation of sustainable forest SME clusters
- Exploit forest eco-service opportunities
- Invest in plantations & forest industries
- Promote large scale certification
- Address land tenure issues (BEE)
- Invest in biomass energy

Three examples of implementation at country level
A closer look at two of these new approaches…
Foster Creation of Sustainable Forest SME Clusters

Identify & Build Clusters of wood processors

- Consolidate and upgrade inefficient processing facilities
- Use proximity to achieve scale for investments (equipment upgrades, cogen)

Build Capacity around Anchors Trading Cos/Buyers

- Build linkages to buyers and promote certified tropical timber
- Provide training and technical assistance

Provide A2F

- Establish facilities to fund:
  - Equipment leasing (e.g. for reduced impact logging)
  - Biomass/renewable energy
Rationale:

- Limited private investment in new plantations
- Individuals / industry only invest in “ready” markets
- Benchmark: Uruguay plantation development model
  - IFC: Return on equity and diversification
  - Maximize IFC catalytic role and development impact
Increasing IFC’s Impact in the Forest Sector

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**Amazon Brazil**

**Challenges**
- Confusing legal framework and land titling
- Governance
- Competition with illegal logging
- Scale and Profitability
- Agriculture conversion
- Lack of SFM knowledge and capacity

**Opportunities**
- SME Clusters
- Sustainable agribusiness
- Create value in standing forest
- Plantations on degraded land
- Pilot non-timber forest products

**Conservation Forests**
- Sustainable agribusiness
- Standards via roundtables

**Natural Production Forests**
- SME clusters
- Renewable /cogeneration
- Expand certification
- PES/non-timber products
- Downstream industries

**Plantations & Farm Forests**
- SME clusters
- Invest in plantations
- Downstream industries
### Challenges
- Peat swamp forest conversion produces high GHG emissions
- Land degradation from land use change
- Forest certification
- Perverse public policies/governance

### Opportunities
- Reforestation of degraded lands
- Sustainable forest management of natural forest
- Reduce carbon emissions through access to carbon project financing
- Sub-national land allocation processes

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<tr>
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<tbody>
<tr>
<td>• Sustainable agriculture</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Promote conservation set-asides</td>
<td></td>
<td></td>
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<tr>
<td>• Improve Business Enabling Environment for land allocation in collaboration with WB</td>
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<tr>
<td>• Expand certification</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Provide capacity building / equipment leasing for Reduced Impact Logging</td>
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<td></td>
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<tr>
<td>• Facilitate new investment in fiber / tree crop plantations on degraded non forest, non peat lands</td>
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<td></td>
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<tr>
<td>• Integrate CDM and private financing to rehabilitate degraded lands</td>
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Mozambique

<table>
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<th>Opportunities</th>
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<tr>
<td>• Governance and enforcement</td>
<td></td>
</tr>
<tr>
<td>• Illegal logging / Fuel wood</td>
<td></td>
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<tr>
<td>• Land concessioning</td>
<td></td>
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<tr>
<td>• Lack of infrastructure</td>
<td></td>
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<tr>
<td>• Lack of skilled labor</td>
<td></td>
</tr>
<tr>
<td>• Regarded as one of top 5 destinations worldwide for large scale timber &amp; fiber investments</td>
<td></td>
</tr>
<tr>
<td>• Strong interest from global players</td>
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<tr>
<td>• Ideal climate and low production costs</td>
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<tr>
<td>Improve regulatory framework for allocation of commercial agriculture/plantation forestry land</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Infrastructure development</td>
<td></td>
<td></td>
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<tr>
<td>Invest in plantations</td>
<td></td>
<td></td>
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<tr>
<td>Launch AS program to work with investees on community development and out-grower schemes</td>
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How do we measure success?

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<tr>
<td>• Number of ha under sustainable agriculture</td>
<td>• Number of ha under sustainable management</td>
<td>• Number of ha in new plantations</td>
</tr>
<tr>
<td>• Sector standards agreed by RSPO Roundtables</td>
<td>• Value of financing facilitated by AS</td>
<td>• Dollars invested</td>
</tr>
<tr>
<td></td>
<td>• Number of SMEs</td>
<td>• Number of projects</td>
</tr>
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**Overarching Metrics:**
- Number of jobs created (direct/indirect)
- Financial returns
- Reduced GHG emissions
IFC’s Forest Sector Vision

Position IFC as a global leader in Forest Sector

Increase IFC contribution to climate change mitigation

Support efficient land use

Reduce deforestation/ increase afforestation

Enhance development impact of forest sector (job creation/forest dependent peoples, SMEs)

Promote global standards in the sector

Develop innovative & diversified portfolio of forest projects with suitable risk-return profile
IFC’s Business:
Investment Services

**Senior Secured Lending**
- Senior secured lending
- Long-term maturities, with suitable grace periods

**Structured Finance/Risk Management Products**
- Partial credit guarantees
- Securitization
- Bond underwriting
- Convertible debt
- Subordinated debt
- Other Tier II instruments

**Senior Debt**

**Mezzanine Finance**
- Convertible debt
- Subordinated debt
- Other Tier II instruments

**Equity Investments**
- Common shares
- Preferred shares

**Syndications**
- Loan syndications
- Equity syndications

**Trade Finance**
- Guarantees to issuing banks
- 250+ confirming and issuing banks
- $500 million program

**Sustainable Finance**
- Carbon finance
- Renewable energy