Unlocking Investment In Forest Landscape Restoration

Survey done in the context of scoping the baseline conditions to the establishment of the Restoration Seed Capital Facility

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1. Foreword

Land clearing for agriculture, mining and infrastructure development has led to the complete loss of about 30 percent of global forest cover and the degradation of a further 20 percent of it. The World Resources Institute (WRI) estimated that more than 2 billion ha of land is degraded globally. IPBES (2018) estimated that between 2000-2009 land degradation was responsible for global emissions of 3.6-4.4 Gt CO_2 / year. To address the challenge of restoring degraded land, governments and other stakeholders around the world have signed up to the Bonn Challenge, the New York Declaration on Forests and the Sustainable Development Goals.

There is a large gap between the amount of funding required to restore degraded land and the amount available. Figures vary according to the level of ambition, but The Bonn Challenge, for example, estimates that about USD 36 billion is needed annually to restore 150 million hectares.

Private finance is critical, but hardly channelled to restore degraded land at present. More importantly, private investment can promote and support the establishment of new business models and new forms of land use that will combine forest restoration, forest protection, and sustainable production of commodities.

This market analysis was conducted between May 2019 and March 2020 by the Frankfurt School of Finance and Management and the United Nations Environment Programme in the context of establishing baseline conditions prior to the establishment of a seed capital facility dedicated to land-use activities aligned with the objectives of Forest Landscape Restoration (FLR).

The scoping exercise primarily focused on providing an analytical overview of the current landscape of private investment in land use activities that incorporate elements of ecosystem restoration, with a focus on FLR. Following an initial screening carried out in 2018 where 139 funds were identified globally that are active in sustainable land use (broad based criteria). These were further screened down to a short-list of 26 funds that are specifically targeting FLR-aligned activities in the geographic areas relevant to the facility.

In addition, the scoping exercise also assessed the various support schemes available to private operators such as project developers and fund managers in this area of activity.

2. Key Takeaways

• Raising new investment funds targeting FLR-aligned activities remains challenging and typically requires long lead times. This is due to the lack of familiarity of investors with this type of investment, the long timeframes until projects generate returns, and the need to demonstrate a strong pipeline to attract investors;

• For existing funds, the project development process is also highly time- and resource-consuming. Potential investment projects need to be carefully screened and often require significant involvement of the fund managers to bring them from the raw idea stage at which they usually encounter projects to the point when they become an investable proposition. The need for this intensive involvement from the fund managers creates a bottleneck as they typically only have limited resources to deploy, notably due to the still relatively small size of the funds that they manage. As a result, fund managers can only consider a small number of project opportunities at any given time.

• The amount of investable capital to the sector is limited due to its relative novelty and investors' lack of familiarity with the sector. Development finance institutions, which may have seemed natural early investors in this area, are often reluctant to fund land use activities and typically require as high or higher returns on investment as private investors. As a result, the pool of investors in these funds is still small;

• The geographical concentration of activities remains very high, with a strong focus on Latin America (and within that, particularly on Central America and a few countries in the North Western part of South America). The few funds that invest in Africa are similarly focused on a limited number of countries, while investments in Asia remain very rare.

3. Funds currently investing in FLR-aligned activities

3.1. Status of funds

There are currently 13 funds in the fundraising stage (either seeking to achieve first, secondary or final closes) with a combined value of EUR 1.5bn. Of these 13 funds, only five have secured an initial financial close. Across all funds considered, only 20% of fundraising targets have been met. In addition to the funds covered in the analysis, two additional potential investment funds were being scoped for feasibility during the period of analysis.

The number of funds solely focused on investing currently is relatively small given the amount of funds that have recently become fully committed (see below). Alongside the six funds which have reached financial close (combined assets of EUR 785m), the five funds which have secured an initial close of EUR 306m bring the total investable universe to just over EUR 1.1bn.

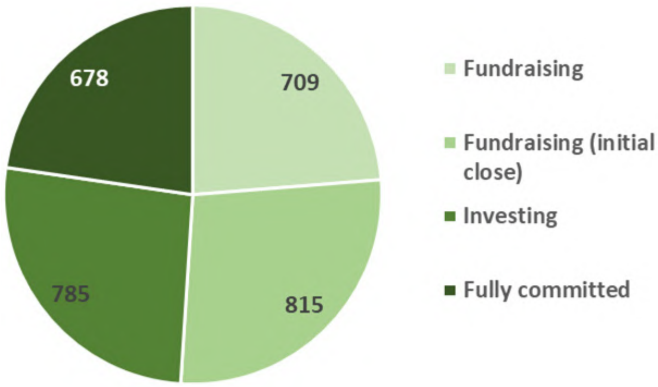
This amount falls far short of the scope and needs of the sector, highlighting the significant challenges involved in turning FLR-aligned activities into investable opportunities and having these opportunities recognised by investors.

When looking at past and present investment transactions, it appears that existing funds tend to either invest into brownfield expansion projects or directly into companies rather than in greenfield projects.

Out of the seven funds that are currently fully committed, six have fund managers or investment advisers currently raising second funds which have a combined volume of EUR 670m.

The 26 funds assessed in this analysis have a combined total volume across different asset classes and geographies of EUR 2.9bn.

Figure 1: Status of funds in the sector (EUR m)



3.2 Fund size

Considering the size in amounts under management by the various FLR-aligned funds, it appears that an important share of these funds (28%) are of comparatively small size (≤ 50 m Euro), raising concerns about their long-term ability to cover their costs without grant funding or other forms of support.

On the other hand, follow-on funds that are in the pipeline tend to be of larger size (> 250 m EUR) and always exceed the size of the initial funds that preceded them. This phenomenon appears to mirror the developments seen in the renewable energy investment sector in the past and demonstrate the confidence of fund managers and investment advisers regarding their ability to put larger amounts of capital to work. It also highlights the potential medium- to long-term benefits of supporting first time fund managers as a strategy for scaling up this sector.

Table 1: Number of Fund by size and stages

Fund size EUR m	Fund-raising	Fund-raising (initial close)	Investing	Fully Commit-ted	Total
≤50	3	1	1	2	7
51-100	2		3	1	6
101-150	1	2		3	6
151-200		1		1	2
201-250			2		2
251-300	1	1			2
> 300					0

3.3. Investment geographies

The geographic focus of existing funds dedicated to FLR-aligned reveals where most projects are currently being developed. Compared to funds in the renewable energy or SME sectors which tend to have a strong regional or in some instances sub-regional focus, funds in this sector tend to have much broader geographical scopes, although in practice most projects are still being developed in a limited number of countries.

Table 2: Number of Fund by size and stages

Geographic mandate	Number of funds	EUR m
Latin America	7	704
Latin America, Africa, Asia	7	574
Latin America, Africa	3	300
Africa	6	670
Asia	2	423
Global	1	300

70% of identified funds in the sector have Latin America as a geographic focus. While some funds exclusively focus on the region, funds that have a broader geographical focus typically also have the majority of their funds invested in this region. This is primarily due to the greater maturity of the sector in the region leading to stronger capacity in the local stakeholders and better investment readiness of the potential projects.

After Latin America, Africa has the second largest number of mandates on a fund level, however investments are relatively scarce. There are two funds that are either currently investing or have recently reached the fully committed stage with a focus on Africa. One additional Africa-focused fund has recently reached a first close. This fund is a follow-on fund to another Africa-focused fund that made seven investments, three of which were in South Africa. Outside of these Africa-focused funds, only one broader scope fund has a strong African focused investment portfolio.

Both Asia-specific funds come from the same manager, with a first fund currently fully committed and the follow-on fund which is currently going through the fundraising process. The first fund is fully invested in three projects across Laos, Malaysia and Indonesia. Few of the broader scope funds have significant project portfolios in Asia.

3.4. Sector investments

The funds active in the sector typically follow a broad sectoral mandate that will typically involve agroforestry projects, sustainable agriculture and forestry. Some of the funds include restoration and conservation as part of their mandates but most funds will not have these as their main or single strategy. This situation reflects the difficulty in generating a sufficient pipeline of such projects with attractive revenue-generating potential.

Greenfield investments remain rare, with most funds focusing on brownfield expansion projects. This is mostly due to the repayment profiles of greenfield projects which can take anywhere between three to fifteen years to generate stable revenues. At present, funds in this sector cannot limit themselves to a narrow focus on specific activities without facing a significant deployment risk. Most funds hence pursue a broader mandate to accommodate a greater range of opportunities.

To further assess sectoral investments, 69 transactions were analysed across ten funds[1] to ascertain the type of investments made. The transactions included 42 in Latin America and the Caribbean, 20 in Africa and 7 in Asia.

The most dominant form of investment currently is via company level transactions. Four firms have plantation-level investments, with a primary focus on cacao. Natural habitat transactions are at first glance surprisingly high but are also slightly skewed due to a single fund that made 13 of the transactions based on pre-payment for long-term carbon credits.

Figure 2: Transactions by region and sub-sector

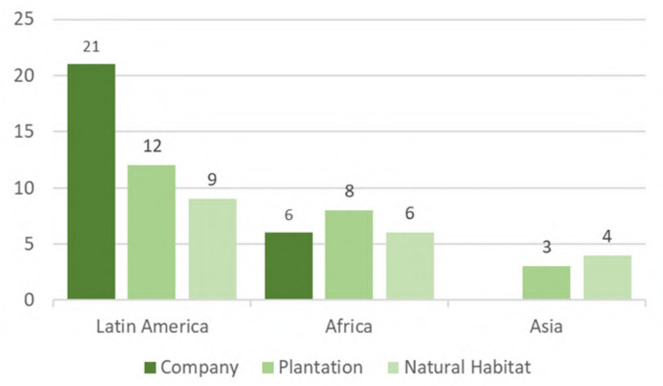


Table 3: Transactions analysed by country and region

Country	Region	Number of projects
Peru	South America	5
Brazil	South America	4
Colombia	South America	4
Guatemala	Central America	4
Kenya	Africa	4
Costa Rica	Central America	3
Indonesia	South East Asia	3
South Africa	Africa	3
Ecuador	South America	2
India	South Asia	2
Mali	Africa	2
Nicaragua	Central America	2
Panama	Central America	2

[1] The funds analyzed are those that do not utilize intermediaries but rather deploy capital directly to either a project or company.

3.5. Fund instruments

Across the funds analysed in this scoping exercise, the most predominant form of financing is equity. The combined value of the equity funds considered is EUR 1.7bn although several of the funds are either fully committed or in different levels of fundraising. Based on available information, there is approximately EUR 560m in investment capacity (funds currently investing and funds that have reached first close) although over half of that amount was within a single fund, showing the limited investment capacity currently available to the sector. Of the funds with current investment capacity, only one is focused on Africa and none on Asia.

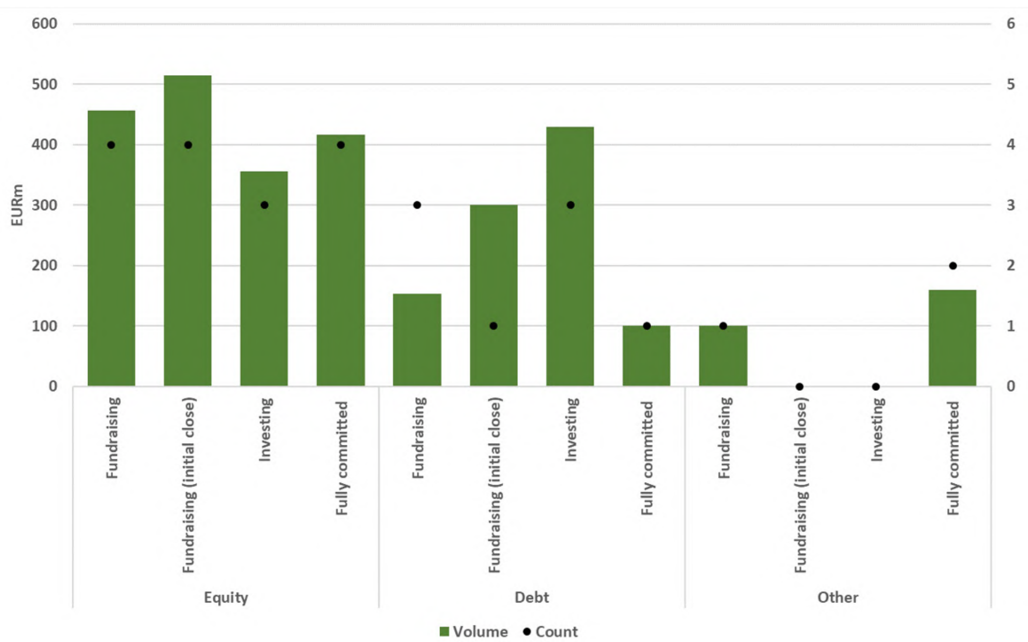
Typically, the larger equity funds are seeking deals in the EUR 5 – 20m range although some funds will consider larger deals depending on their size. At fund level, they will seek to make approximately 10 – 15 investments which is similar to comparable investment funds in other sectors.

Debt funds currently deploying capital into the sector (either investing or with an achieved first close) have combined assets under management of approximately EUR 530m. This is nearly entirely accounted for by the three largest funds, one with EUR 250m of assets under management and two with 100m each. When compared to equity funds, debt funds pursue a very different strategy that focuses on providing capital to local partner financial institutions to on-lend to their existing clientele. This enables the debt funds to achieve larger ticket sizes and lower transaction costs compared to sourcing individual transactions.

One fund (recently fully committed) has deployed its capital in a hybrid manner, where they utilise profit sharing loans to invest on a project level for restoration projects – resulting in investment characteristics that are closer to equity than to debt. This fund also has a term of 8 years, closer to what is typical in private equity strategies, whereas most large debt funds are either open-ended or with significantly longer terms.

A unique strategy that is neither equity nor debt is pursued by one fund manager that typically pre-finances activities and receives payments in the form of carbon credits. The funds raised to date have relied on large private companies to provide financing to the fund and in return receive carbon credits. They are currently raising a follow-on fund that will generate financial revenue for investors from the commercialisation of carbon credits in addition to providing the credits to corporate investors in the fund.

Figure 3: Financial instruments by stage



4. Initiatives promoting private investment in forest restoration

In addition to reviewing the landscape of investment funds currently active in FLR, the scoping exercise also reviewed initiatives that offer support to investors and funds active in FLR-aligned activities to identify potential areas of overlap with the Restoration Seed Capital Facility. The following initiatives were identified:

- **Restoration Seed Capital Facility** (UNEP and Frankfurt School of Finance and Management): Provides co-funding (as grants or conditional grants) to fund managers or investment advisors to either raise new funds dedicated to FLR-aligned activities, or to support pipeline and project development in such funds.

- **Partnership for Forests** (Palladium, Systemiq): Provides grants and Technical Assistance (TA) to public-private partnerships in forests and sustainable land use to help them get to market.

- **International Climate Finance Accelerator** (Innpact): Programme for impact & climate finance fund start-ups. Notably provides financial support, working capital loans, and capacity building to first-time fund managers.

- **The Lab** (CPI): Identifying, developing and supporting transformative sustainable finance ideas to drive private investment to the low carbon economy. Provides analysis, stress-testing, and guidance. Access to network of investors.

- **Green Invest Asia** (USAID): Provides support for financial institutions focusing on sustainable agriculture and forestry to find concessional and investment capital. Also support on ESG management and pipeline identification (matchmaking).

- **Asia Natural Capital Design Funding Window** (Convergence): Feasibility (grant) and proof of concept (repayable grant) funding for natural capital focused blended finance solutions in Asia.

- **Dutch Fund for Climate and Development Origination Facility** (WWF, SNV): Project identification and feasibility development through grants and TA. Only for activities originating from the Fund's landscape strategies.

- **Landscape Finance Lab** (WWF): Incubator for sustainable landscapes. Structure, de-risk, launch, and fund sustainable land use deals at landscape scale.

Areas of focus of selected support initiatives (Dark green: yes; Light green: partially; White: No):

	Forest focus	Works through fund managers	Provides financial support	Supports fund development	Supports project development
RSCF FLR					
P4F					
ICFA					
The Lab					
GI Asia					
Asia NCDFW					
DFCD Origination					
Landscape Finance Lab					

5. Conclusion

The scoping survey reviewed the current landscape of private investment in land use activities that incorporate elements of ecosystem restoration and initiatives that offer support to investors and funds active in FLR-aligned activities.

The analysis reveals that fund managers in this sector still face a number of barriers that slow the deployment of capital to investments that support FLR. Investors are still scarce as the sector is unfamiliar to many of them and the time needed to realise profits is long. Project identification and development is also a challenge for fund managers as they typically need to get heavily involved to ensure that projects suit the requirements of their investment funds.

The Restoration Seed Capital Facility was designed to help overcome these barriers by providing the catalytic capital that fund managers need to raise and deploy capital to FLR-aligned activities faster.

The Restoration Seed Capital Facility will provide co-funding to fund managers or investment advisors to either raise new funds dedicated to FLR-aligned activities, or to support pipeline and project development in such funds.

It will help pave the road for scaling up and accelerating the sector by supporting emerging actors and promising projects, allowing proven models to scale up, and encouraging greater attention from investors.

This market-driven and pragmatic approach to engaging with the private sector while still upholding the obligation to take care of the land and its people offers a powerful way to support the UN Decade on Ecosystem Restoration 2021-2030, the Sustainable Development Goals, the REDD+ strategy, national climate targets (NDCs), the Bonn Challenge, New York Declaration on Forests, and post-2020 Biodiversity Framework.

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Implementing partners:

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