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	

The Market Premise: Demand is Growing

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

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Forest Challenges

Agricultural conversion threatens all forest types

Conservation Forests

- Management needs exceed local capacity
- Governance and inadequate funding
- No market mechanism to monetize environmental services

Natural Production Forests

- Low profitability
- Lack of scale
- Illegal logging
- Weak governance
- High reputational risk
- High transaction costs
- No monetization of environmental services

Plantation Forests

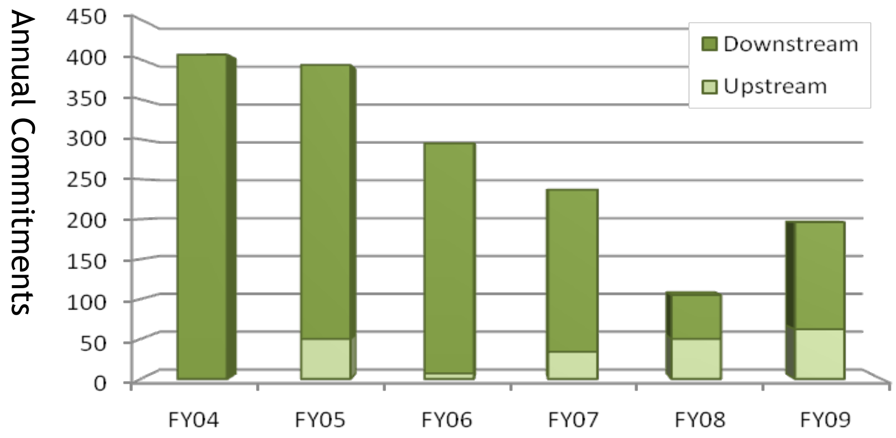
- Impatient capital
- Inadequate private sector investment
- Land tenure and access
- Financial crisis

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

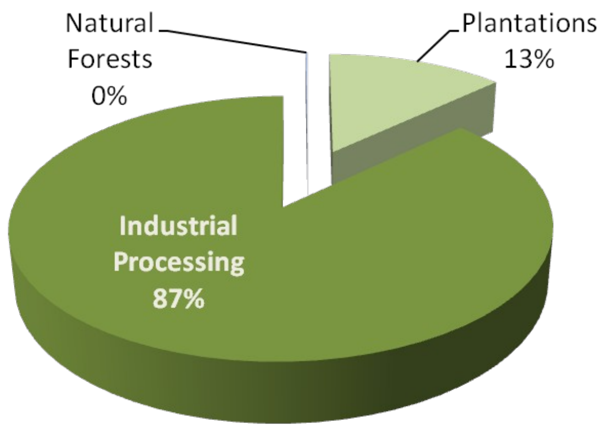
Current Investments in the Forest Sector

Portfolio of $1.13 billion…



No. of projects	11	10	13	11	2	10

…across 67 projects



- 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

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

Risk	Mitigation	
Unsustainable logging/biodiversity	• Certification • NGO partnership	Understand local context & stakeholder engagement Leverage WBG knowledge
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	

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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**

CDM Market		
	Overall	Forest
Size	$60 bn	n/a
No. of Projects in pipeline	4,500	40
tCO2 equivalent	7.4 bn	37 mn
No. of projects registered	1,400	< 5

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3. Diversified initiatives
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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

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Ramp-up Investments in Forest Plantations

Phase 1: Preparation
FY10 - FY12

- Select high potential countries
- Identify BEE obstacles / solutions
- Engage stakeholders to design 10-15 year program

Phase 2: Investment
FY11 - FY15

- Market / industry validation
- Enroll partners (Industry players, funds, DFI's, e.g. CDC) to share investment

Phase 3: Exit Strategy
FY14 - onwards

- Sell IFC stake to strategic/ PE investors

OR

- Roll IFC investment into integrated mill project or sell to industry players

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

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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	Natural Production Forests	Plantations & Farm Forests
• Sustainable agribusiness	• SME clusters	• SME clusters
• Standards via roundtables	• Renewable /cogeneration	• Invest in plantations
	• Expand certification	• Downstream industries
	• PES/non-timber products	
	• Downstream industries	

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Indonesia

Challenges

- Peat swamp forest conversion produces high GHG emissions
- Land degradation from land use change
- Forest certification
- Perverse public policies/governance

Opportunitie

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

Conservation Forests	Natural Production Forests	Plantations & Farm Forests
• Sustainable agriculture • Promote conservation set-asides	• Improve Business Enabling Environment for land allocation in collaboration with WB • Expand certification • Provide capacity building /equipment leasing for Reduced Impact Logging	• Facilitate new investment in fiber / tree crop plantations on degraded non forest, non peat lands • Integrate CDM and private financing to rehabilitate degraded lands

Mozambique

Challenges

- Governance and enforcement
- Illegal logging / Fuel wood
- Land concessioning
- Lack of infrastructure
- Lack of skilled labor

Opportunities

- Regarded as one of top 5 destinations worldwide for large scale timber & fiber investments
- Strong interest from global players
- Ideal climate and low production costs

Conservation Forests	Natural Production Forests	Plantations & Farm Forests
		• Improve regulatory framework for allocation of commercial agriculture/plantation forestry land • Infrastructure development • Invest in plantations • Launch AS program to work with investees on community development and out-grower schemes

How do we measure success?

Conservation Forests	Natural Production Forests	Plantations & Farm Forests
• Number of ha under sustainable agriculture • Sector standards agreed by RSPO Roundtables	• Number of ha under sustainable management • Value of financing facilitated by AS • Number of SMEs	• Number of ha in new plantations • Dollars invested • Number of projects

Overarching Metrics:

- Number of jobs created (direct/indirect)
- Financial returns
- Reduced GHG emissions

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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 S

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

ance/ Risk M

- Partial credit guarantees
- Securitization
- Bond underwriting

Mezzanine

- Convertible debt
- Subordinated debt
- Other Tier II instruments

Equity

- Common shares
- Preferred shares

Syndications

- Loan syndications
- Equity syndications

Trade

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

Sustainable

- Carbon finance
- Renewable energy