FINANCING SUSTAINABLE LANDUSE

Unlocking business opportunities in sustainable land use with blended finance

THE SLU CHALLENGE AND OPPORTUNITY

Growing demand for food and energy is putting increasing pressure on land, threatening our planet's natural resources. In 2014, the Intergovernmental Panel on Climate Change estimated that the agriculture, forestry, land use and land use change sectors (known collectively as AFOLU) accounted for 24% of global GHG emissions in 2010. The need for more sustainable land use is thus an urgent one. The cost of inaction and its effects on climate change are vast. The Eliasch review estimated that halving deforestation rates by 2030 would reduce GHG emissions by 1.5-2.7 gigatonnes CO_2, and avoid more than US$3.7 trillion in damages from climate change. These economic costs would be in addition to the social costs associated with reduced food security and the increased risk of natural disasters, which already claim an estimated 400,000 lives each year.

These crises also imply opportunity. "Natural climate solutions" – particularly forest conservation, avoided deforestation, reforestation and forest landscape restoration – are among our most impactful options to limit global warming. Forest-related activities account for 68% of total carbon mitigation potential of natural climate solutions. In contrast, although the agriculture sector accounts for 62% of all AFOLU emissions, agriculture-based pathways only represent 20% of the mitigation solution annually through SLU. A focus on forest conservation and avoided deforestation and degradation, therefore, will deliver the greatest immediate anthropogenic emissions reduction per hectare. Sustainable agricultural practices, to the extent that production intensification and sustainable livelihoods avoid further deforestation, can also deliver initial impact. In the long-term, the successful incorporation of an integrated reforestation, afforestation and landscape restoration component in SLU has significant mitigation potential and can be one of the most important natural climate solutions going forward. Furthermore, the Business and Sustainable Development Commission's report – "Better Business, Better World" – has estimated that forest ecosystem services specifically will be worth US$365 billion annually, by 2030.

FROM OPPORTUNITY TO ACTION

Private investment is not at the scale needed to tackle the problem. There needs to be a paradigm shift in the way in which (i) private sector investors view investment opportunities in SLU and how (ii) public and philanthropic investors engage to catalyse private capital in the Sustainable Development Goals (SDGs).

The most common refrain in SLU is the lack of 'investable' project opportunities. Indeed, one of the biggest challenges to private sector investment in SLU is identifying currently-investable projects or projects at the 'tipping point' in which to deploy private capital at scale. Forest Trends finds that committed capital in SLU of surveyed funds grew 8x to ~US$8 billion in the decade leading up to 2015; but of that, over 30% remains undeployed because of lack of investable projects.

Many latent SLU investment opportunities with long-term growth potential in developing countries, however, do exist. To capture this economic value, private sector investors need to assess opportunities for what they really are: early-stage SLU venture capital investments. Private investors cannot look at SLU as 'business-as-usual' investment opportunities. Inherent in this sector are higher risk-return profiles and longer development lead times, but also significant long-term growth potential.

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High-potential SLU opportunities by time horizon

	Quick wins *Target 6-12% IRR* *0-5 years*	***Medium term*** *Target 10-15% IRR* *5-15 years*	***Long term*** *Target 10-20% IRR* *10-20+ years*
Sustainable forestry production	• Non-reforestation sustainable timber in developed markets *(New Forests in ANZ; Amata; Symbiosis)*	• Non-reforestation sustainable timber in emerging markets *(New Forests in SEA)*	• Reforestation sustainable timber in emerging markets
Sustainable agriculture production	• Large primary producers • Value-added processing along value chain of sustainable commodities *(&Green Fund; Root Capital)*	• Sustainable smallholder agriculture with off-takers *(TLFF; L3F)*	• Sustainable smallholder agriculture without off-takers
Integrated approach	• Production intensification on large degraded lands *(PECSA silvopastoral cattle intensification)*	• Integrated agroforestry on restored lands	• Integrated reforestation/landscape restoration for sustainable production or conservation
Other non-production revenue streams	• Ecotourism *(KAZA)*	• Payment for ecosystem services • Conservation through carbon and other credits *(New Forests in US)*	• Innovative technologies and support services *(F3Life; Suyo; SSCIV)* • Reforestation/landscape restoration for conservation
Illustrative role of blended finance	Grants for pipeline building and technical assistance / capacity-building	Grants for pipeline building and technical assistance / capacity-building	Grants for pipeline building and technical assistance / capacity-building
	Concessional capital	Concessional capital	Concessional capital
		Performance-based payments	Performance-based payments
		Guarantees	Guarantees
			Design grants for new structures
Illustrative geographies	• United States/Canada • Australia/New Zealand • South Africa • Latin America	• Latin America • Southeast Asia • East Africa	• Southeast Asia/South Asia • Sub-Saharan Africa

Mobilising private capital through blended finance is essential to unlock these market opportunities. By deploying public and philanthropic funds, blended finance can mitigate risks and enhance returns for investors by strengthening jurisdictional industrial policy (this will be key for truly systemic change), supporting pipeline development, providing concessional capital and guarantees and improving market incentives.

This will require greater coordination between public investors, as well as a more direct link between public funding and private investments. At both the global and country levels many parallel donor initiatives provide small-scale grants to NGOs and projects, but the missing link between grants and concessional funding leads to many projects dying off or not reaching scale. Financing SLU requires multi-sectoral coordination to integrate programs into a holistic landscape approach. Global platforms can also play an essential matchmaking role, connecting credible private, public, and philanthropic investors to co-invest in deals.

Finally, development finance institutions (DFIs) and multilateral development banks (MDBs) can more significantly shift focus towards private sector mobilisation, and align incentives for investment managers by setting targets around private investor leverage – both at the investment and portfolio sector levels. In addition, they can work alongside and co-invest with emerging blended finance facilities that can de-risk SLU investments. In SLU, transaction costs and risks (country, business, etc.) are high. While some DFIs are currently considering ways to invest in riskier and more impactful projects (e.g., through dual investment policies), emerging blended finance facilities can play an important role in accelerating this trend by providing lower interest, longer tenors and/or subordination to DFIs.

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KOIS Invest is a social impact investor with a portfolio in Europe and India primarily in education, employment and healthcare, as well as an innovative finance advisory firm with the aim to develop innovative and scalable financing structures channeling public and private financing to tackle some of the most pressing development and environmental issues.

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