Closing the Nature Finance Gap: Practical Solutions to Mobilize Private Investment for Landscape Restoration

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Introduction

Investment in nature-based solutions must double from US $154 billion per year to US $384 billion per year by 2025 for global climate, biodiversity and land degradation targets to remain in reach according to the United Nations Environment Programme's 2022 State of Finance for Nature Report.

Accounting for only 17% of current investment in nature-based solutions, private finance must rapidly scale up to close the nature finance gap, yet sustainable land use investment remains an emerging sector.

In a 2020 scoping study[1], the Restoration Seed Capital Facility (RSCF) found that the investment volume of private sector funds targeting forest landscape restoration aligned activities totaled EUR 2.9 billion. This falls far short of the annual US $36 billion required to restore 350 million hectares of degraded and deforested land in line with the Bonn Challenge. To reach the scale of investment required, public finance must strengthen its capacity to catalyze and de-risk transactions as the private sector develops into maturity.

RSCF was launched in October 2020 as a practical solution to address this challenge. Supported by the governments of Germany and Luxembourg and implemented by the UN Environment Programme and the Frankfurt School of Finance and Management, RSCF aims to unlock private finance for activities that contribute to forest and landscape restoration in ODA-eligible countries – with a focus on Latin America, Africa and Southeast Asia.

RSCF enables more private fund managers and investment advisors to set up dedicated investment vehicles that focus on forest and landscape restoration, build strong pipelines of investable opportunities and increase the number of investments that reach successful financial close. RSCF works to achieve this by providing co-funding for fund, pipeline and project development support through a combination of outright and reimbursable grants.

Scaling up finance for nature

Mobilizing finance for nature at scale requires addressing the current bottlenecks that impede the development of the market. Through discussions with fund managers, investors, project developers and other stakeholders active in sustainable land use finance, several disconnects that continue to hinder the sector have emerged:

- Between large investment ticket sizes and smaller opportunities, which is a particular difficulty for investment opportunities that include small-holder farmers and community-led projects
- Between the urgency of action on climate change and environmental degradation, and the lengthy process to secure the participation of the providers of concessional finance in blended finance products.
- Between the level of environmental and social (E&S) due diligence, monitoring and reporting

[1] The Frankfurt School of Finance and Management and the United Nations Environment Programme, 'Unlocking Investment in Forest Landscape Restoration' https://www.restorationfacility.org/sites/rscf/files/images/scaf/RSCF_Background_analysis.pdf

required and the lack of fund manager and project developer capacity on the ground

RSCF's provision of early-stage fund, pipeline and project development grant financing aims to bridge a number of these disconnects to ensure that more dedicated restoration funds and sustainable land use projects get off the ground, but more needs to be done to overcome the bottlenecks across the sector. Enhanced public and private sector collaboration is necessary to accelerate the deployment of finance at the scale required to close the nature finance gap.

Case study: Arbaro Advisors

Arbaro Advisors GmbH is an investment advisory company with a combination of expertise in impact investing and forestry management, which enables them to select and develop sustainable forestry investments that maximize environmental, social, and economic benefits for all stakeholders.

RSCF is supporting Arbaro Advisors to develop the pipeline of projects of the Arbaro Fund, a sustainable forestry fund that invests in sustainable forestry in Latin America, the Caribbean, and Sub-Saharan Africa. By establishing a renewable resource through sustainably managed, FSC-certified forest plantations, Arbaro provides significant climate change mitigation and adaptation benefits in its target countries.

To date, Arbaro Advisors have successfully closed three RSCF-supported investments for the Arbaro Fund in Peru, Ecuador and Guatemala, resulting in the first reflows to the facility.

RSCF provided project development support in the form of reimbursable grants to enable Arbaro Advisors to achieve strengthened E&S outcomes for each investment:

- In Peru, an investment in forestry company, Maderas Prosperidad, will ensure the integration of sustainable forest management practices including replanting harvested areas, the reforestation of unforested areas and conservation of natural forests and vulnerable ecosystems.
- In Ecuador, an investment in local forestry company, Ecua American Teak, will lead to the implementation of a robust E&S framework to ensure unforested and previously harvested areas are reforested, natural forest areas and vulnerable ecosystems are conserved and plantation worker employment contracts are formalized. With the E&S structures now in place, the project is now moving to FSC certification.
- In Guatemala, Arbaro has established the Forestal del Caribe company to supply FSC certified timber to the local market. On the acquired land in the Izabal region, a former rubber plantation and pastureland will be reforested, natural forests and vulnerable ecosystems will be conserved, and an area of protected natural forest will be put under permanent protection in cooperation with a local NGO.

Through its support, RSCF has enabled Arbaro Advisors to accelerate and expand its efforts in bringing these opportunities to a successful close and contributed to achieving significant E&S outcomes beyond business-as-usual practices.

Case study: Shared Wood Company

Shared Wood Company (SWC) is a French investment management company that sources, designs, and operates large-scale nature-based solutions (NBS) projects in Africa, Latin America and Europe to tackle biodiversity loss, climate change and rural poverty.

RSCF is supporting SWC in their development of investments focusing on forest & biodiversity conservation, sustainable restoration of degraded lands, sustainable forestry and agroforestry value chains.

Through their operations, SWC aims to sequester or avoid carbon emissions equivalent to at least 40 million tons of CO2 equivalent. SWC further aims to restore at least 40,000 ha land and protect 500,000 ha of endangered ecosystems. In addition, their operations will improve the livelihoods of an estimated 30,000 farmers.

The co-financing provided by RSCF requires that grant funding is matched by the partner on a dollar-by-dollar basis, thereby doubling the envelope of resources available to maximize positive E&S impacts. Through this co-operative approach to blended finance, RSCF provides material additional support to accelerate the deployment of private investment to forest landscape restoration, contributing to the Bonn Challenge, the Sustainable Development Goals and the UN Decade on Ecosystem Restoration.

Closing the nature finance gap

While challenges remain, the increasing awareness of nature-related risks and the growing interest in nature investment opportunities within the finance sector is encouraging. Nature is now prominent on the finance agenda and attracting new players to the market. Corporations for example are increasingly investing directly in dedicated restoration funds and sustainable land use projects. The potential for high integrity carbon markets to diversify project revenue streams continues to draw significant investment to the sector.

In RSCF's view, to effectively scale up finance for nature restoration, sustainable land use and conservation, the following must be addressed:

1. Expanding access to public finance with shorter timelines and lower transaction costs

Rising interest in nature finance from private investors is reducing the need for public or quasi-public entities such as Development Finance Institutions (DFIs) to act as senior investors in dedicated investment vehicles, at least for investment strategies with heavy reliance on carbon revenues. However, DFIs still have a crucial role to play in providing capital on terms that will help to crowd in private finance and supporting various forms of transaction de-risking, which remains a crucial element in attracting investment.

However, the length of negotiation, due diligence and approvals processes that fund managers experience with major development finance institutions is increasingly out of step with both the expectations of private investors and the urgency of the climate and ecosystem degradation crises that must be addressed.

In order to expand access to public finance and accelerate the deployment of concessional finance tools to sustainable land use, concessional finance providers should seek to harmonize their processes and requirements, which are often complex and mutually contradictory, greatly increasing the burden of compliance for fund managers and delaying project development.

2. Building capacity to adhere to stringent standards, reporting and compliance requirements

Complex sustainable land use deals often require novel financial structures and detailed individual E&S assessments that translate to high transaction and development costs. Where appropriate, the sharing of due diligence materials amongst fund managers can help to reduce costs and accelerate investment processes for other investors considering a common investment.

The high standards of financial reporting and E&S compliance obligations also require increased capacity within project developer teams and stakeholders on the ground. More capacity building and technical assistance are required to ensure that project developers can meet increasingly extensive investment criteria and provide project pipelines for larger ticket size investments. Standardized E&S reporting templates and policies could also help in easing and accelerating the investment process with local stakeholders.

3. Strengthening the public policy framework

The adoption of the Global Biodiversity Framework at COP15 created clear goals, quantitative targets and time-bound commitments to accelerate the mobilization of nature finance.

In particular, Target 19 requires signatories to, "increase the level of financial resources from all sources [domestic, international, public and private] to implement national biodiversity strategies and action plans, by 2030 mobilizing at least USD 200 billion per year, including by:

A) Increasing total biodiversity-related international financial resources to USD 20 billion per year by 2025 and USD 30 billion per year by 2030
B) Significantly increasing domestic resource mobilization
C) Leveraging private finance, promoting blended finance, implementing strategies for raising new and additional resources and encouraging the private sector to invest in biodiversity, including through impact funds and other instruments
D) Stimulating innovative schemes such as payment for ecosystem services, green bonds, biodiversity offsets and credits with environmental & social safeguards..."

Signatory states must now implement these Framework targets to increase nature-related funding, expand public finance tools, reform harmful subsidies regimes and strengthen domestic policies that incentivize the protection of nature. Governments must build upon the Framework and reduce country level risks to further stimulate increased private investment in the sustainable land use sector.

Stimulating private debt and equity investments into agriculture, forestry and other key sectors that simultaneously contribute to international restoration (via the United Nations Convention to Combat Desertification), biodiversity (via Nation Biodiversity Strategies and Action Plans and the Global Biodiversity Framework) and climate (via Nationally Determined Contributions) targets can create multiple economic, environmental and social opportunities for governments in both developed and emerging markets. However, strengthened public policy frameworks that incentivize the restoration of degraded lands and intensified use of existing productive lands through tax, subsidies and trade reforms are required to fully realize these opportunities.

Conclusion

Strengthened collaboration between the public and private sectors is critical to supporting the development of the nature finance market, closing the nature finance gap and meeting global climate, biodiversity and land degradation targets.

There is an opportunity for sources of concessional finance to be more market-responsive and creative in the deployment of capital. In parallel, the private finance sector must continue to identify and develop innovative and commercially viable business and finance models that deliver improved E&S outcomes for sustainable land use projects.

RSCF will continue to work with fund managers and investment advisors to understand the challenges to unlocking private finance in sustainable land use and support the acceleration of investment with grant-financing that drives the development of more dedicated restoration funds and strong project pipelines.

Learn more

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