Carbon Finance for Community-based Land Use Projects in Africa

A Private Investor's Perspective

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Presented by Leslie Durschinger

COMESA Carbon Finance Workshop

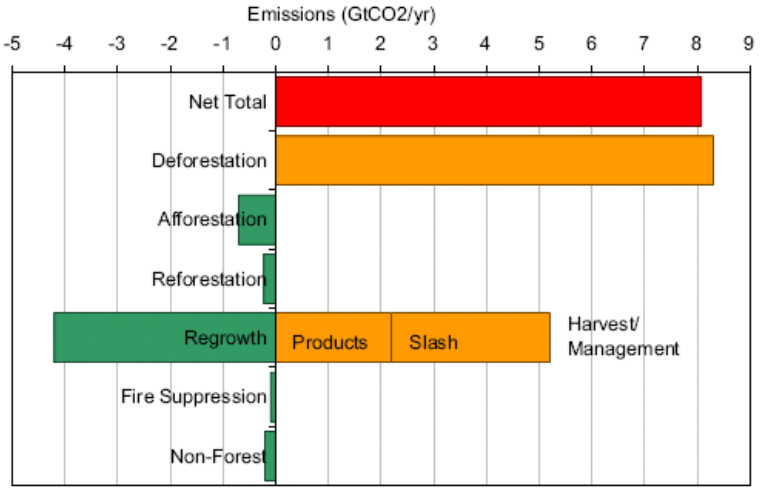
Carbon Offsets from Land-use Projects Lag the Market

- Detrimental land-use actions contribute >18% of global GHG emissions
- However, land-use projects < 1% of the carbon offset market[1]
- Land-use credits trade at a 90% to 30% price discount to other project types
- Projects bring social and environmental co-benefits such as improved water quality, poverty reduction and increased biodiversity

Market constraints for land-based credits are:

- Project developer's limited carbon market expertise
- Complex/high costs to create and measure accurately
- Lack of dedicated early capital/ready buyers
- Limited regulatory recognition

Source of emissions from global land-use change in 2000[2]



1. UNFCCC CDM Distribution of Projects by Scope (03/07), 2. Stern Report

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Investment Potential for Land-use Carbon is Attractive

- Caps will continue to tighten and abatement costs are likely to remain, land-use provides a low to medium cost solution1

- Voluntary market expected to grow to $50b by 2012, land-use projects attractive to voluntary buyers2

- U.S. estimated to be $1 trillion by 2020, provides opportunity to invest early in anticipation of increased regulation and market appreciation, forestry likely to be included:
  - California AB 32 includes forestry offsets for compliance, leading other states
  - The leading federal bill (Lieberman-Warner), as is, would create a $10 - $20 billion market for international forestry offsets (including conservation)

- Potential supply of credits is significant
  - Reforestation of only 1% of eligible sub-tropical land equals $5 billion in carbon annually4
  - Annually, $11 billion in carbon value ($2/ton) is deforested, avoided deforestation is on the Bali roadmap

1. McKinsey 2007 2. Environment Finance *"A trillion dollar marketplace"*, by Gareth Phillips and Assaad Razzouk, March 2007 3. New Carbon Finance, Feb 2008 4. Based on "Carbon Mitigation Potential and Forestry Options in Brazil, China, India, Indonesia, Mexico, Philippines and Tanzania" by Sathaye et al

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Risks of Land-use Differ from Other Project Types
(e.g. industrial gases, renewable energy, etc.)

- Carbon revenue may be the only commercial revenue stream (lack diversification)
- Value highly dependent on stable land tenure and land use laws
- Often implemented by NGOs or governments, not private companies (may lack commercial standards)
- Size of transaction (carbon value) often too small from a commercial perspective, cannot justify due diligence or “on-the-ground” management
- “Owners” of credits are generally not creditworthy thus requiring some intermediary
- Small project size often requires aggregation
- Often rely on changes in land-use practices on land already “owned” (may not be stable over long periods)
- Carbon value dependent on long-term protection beyond time carbon is credited (permanence)

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Potential Investors in Land-use and How They Think

- Types of Potential Private Investors
  - **Carbon Developers** (support full development and implementation of project, often equity investors in project)
  - **Carbon Fund** (mostly interested in acquiring carbon assets some may provide technical support)
  - **Intermediaries** (banks or brokers who may make short-term investments or represent other buyers)
  - **Quasi-donors** who provide investment-based structures for project funding
- Motivations
  - As fiduciaries they are required to make a return on investment, which may conflict with community and country benefits
  - Use a risk and return framework to make and compare investments
  - As long as other projects types offer more attractive risk and return options, land-use will take back-seat
  - Willingness to buy/fund carbon directly from projects (primary buyers) depends on technical expertise, perceived medium-term value and availability of secondary market buyers.
  - May have limited networks to source and oversee projects

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Carbon Readiness: Preconditions for Developing Carbon

Before a project can consider or engage in seeking carbon revenue, the following conditions are required:

- Project developer has created in-country capacity with:
  - Governments (national and local)
  - Communities
  - Local NGOs
  - Project development funding
  - Technical implementation expertise
- Project plan is “relatively” developed and partially funded
  - Detailed plan of project actions
  - Budget for overall project activities has been created

Only then can carbon eligibility and measurement work to register credits begin (w/development time ~3 – 9 months)

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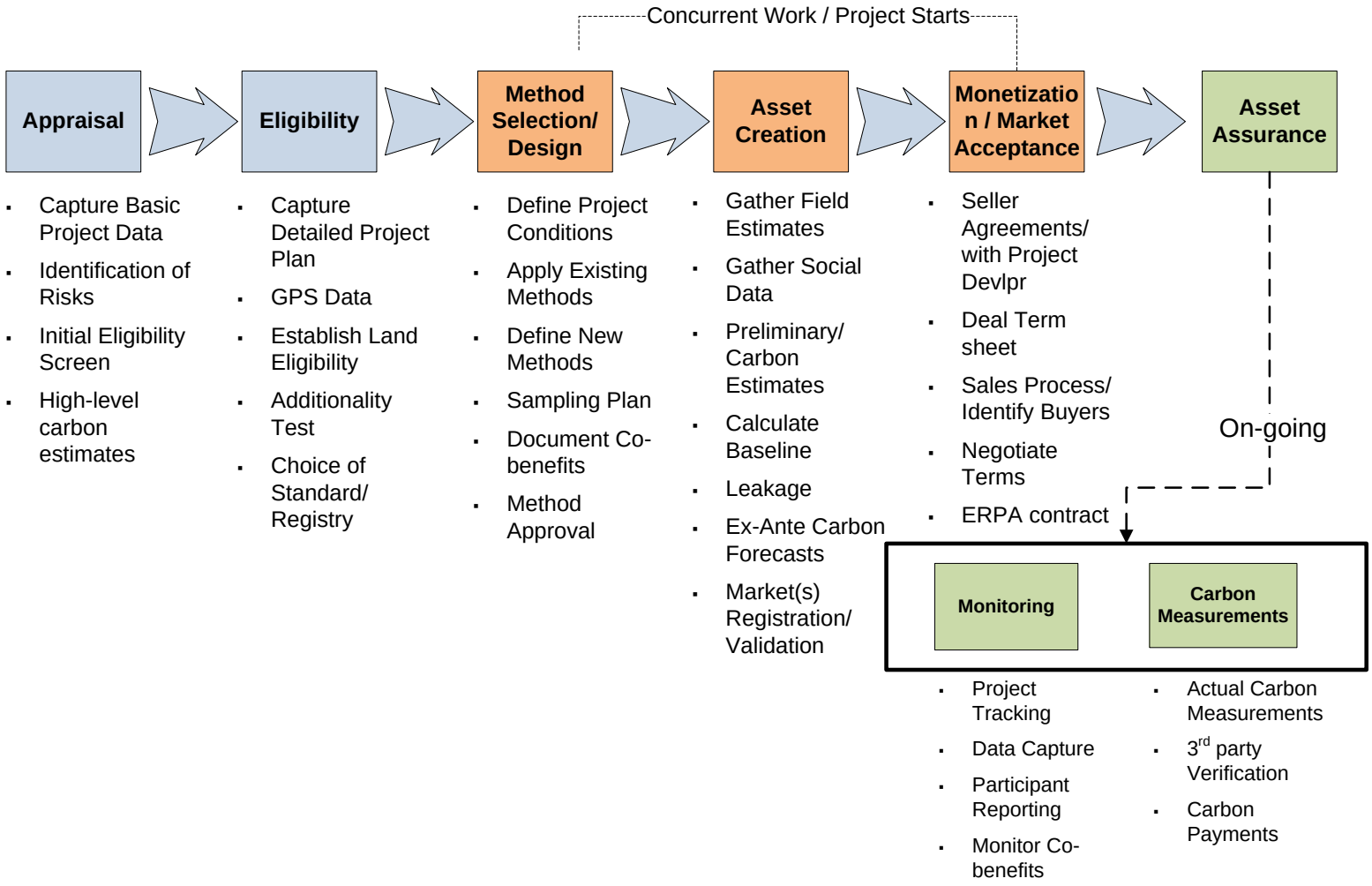
Carbon Offset Creation Requires Technical Measurement and Carbon Market Expertise



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Required of Sellers of Carbon Credits

- Seller should be the legal owner of credits or an agent or aggregator (often the project developer) that is AUTHORIZED to act on behalf of owner
- Seller signs the ERPA and is legally responsible to meet terms and conditions of the carbon contract
- Unclear in many countries who owns the credits, generally considered land owner, long term land tenants and/or implementer of the project activities
- Project developers should negotiate agreements with owners (and governments) that cover the development of the carbon credits to clarify responsibilities, decision making, risk acceptance and economics of carbon transactions
- Project developers often have significant decision making authority over carbon transactions
- If the government is not the seller, they should be included early in the process to ensure support of required project approvals and carbon ownership
- Once sold, carbon assets must be managed/protected beyond sale period

Current Market for Land-use Projects Slowly Developing

- Trades happening - but there are few and limited to a small subset of potential market participants and “quality” varies
- Prices are deeply discounted compared to other credits types $2-$10/ton (primary market) compared to primary CERs $13-23/ton
- Regulatory acceptance, which drives value, is unclear (but moving in a positive direction)
  - REDD on Bali roadmap more clarity expected in 18 months, still has national versus sub-national/project debate
  - Japan/Australia and mandatory programs should favor land-use
  - Potential U.S. bills include some international forestry offsets
  - EU slowly opening to idea of forestry
- Voluntary demand is growing and favors forestry, yet but small in comparison
- Measurement standards development and adoption just taking hold
- Traditional financing and insurance options limited usage
- While investor interest is increasing, few have experience or are committing capital

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Opportunities and Challenges - Part Chicken and the Egg Syndrome

- Limited supply of qualified projects exist or find their way to potential investors
- Technical measurement is of growing interest, but few focus on accurate enough carbon accounting for capital markets
- National approaches may solve some issues, but could demotivate or postpone project level work
- Government support for clarification of legal carbon rights, land tenure and land use laws, carbon “support” services, and forest definitions is inconsistent across countries
- Donor funding rarely apportioned with a direct link to carbon credits
- Investors are often non-locals and lack capacity to access required information cost effectively
- Perceived (or real risk) considered high by most investors

KEY: Building a Sustainable Bridge between Communities and Capital Markets for Social and Environment Good

Trying to access funding in any scale from international carbon market participants for African land use projects will require:

1. Increasing the number of projects that are “carbon ready”
2. Making potential investment projects more assessable and less risky to investors
3. Finding committed investors that understand (i.e. can value) and are motivated to invest to “prime-the-pump” over next 5 -10 years
4. Building mechanisms that combine donor and investor funding to reduce/cushion risks and provide key start-up and capacity building funding
5. Ensuring that both community and investors interests are represented

These can provide framework for COMESA to evaluate alternatives

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Framework to Evaluate Potential Alternatives for COMESA

Increase Carbon Ready Projects	More Accessible /Less Risky	Committed Investors for African Land-use Projects	Structure/Leverage Donor Funds	Ensure Interests Represented
▪ Centralized access to pipeline of projects ▪ Technical support for project planning and prep ▪ Carbon development support offered to qualifying projects	▪ Land tenure clear and records easily assessable ▪ Land use laws assessable and support sustainably ▪ Coordinated government support for forest definitions, carbon approval process, fees ▪ Leverage of "subsidized" insurance products for carbon projects	▪ Dedicated private pool of capital with mandate to invest and drive secondary market value ▪ OR Consortium of buyers with commitments to invest ▪ Funding mechanism supported by risk reducing donor funding ▪ Innovate with insurance products	▪ Funding committed to building capacity for projects ▪ Funding committed directly to projects for start-up or "gap" funding ▪ Funding used directly with private investors to cushion risks	▪ Mechanism for projects to ensure non-carbon benefits ▪ Minimum community benefits requirements ▪ Recognition of investor right to make returns for risk taken

Addressing these challenges can build a sustainable stream of carbon finance to benefit communities

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