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Forestry and Climate Change Fund (FCCF)

CONVERGENCE
BLENDING GLOBAL FINANCE

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Executive Summary

As the destruction and degradation of primary forests continue globally, swaths of secondary[1] and degraded forests[2] (SDF) occupy areas between agricultural lands and primary forests. Yet, there is insufficient focus on the economic feasibility and sustainable commercialization of SDF goods and ecosystem services. Against this backdrop, the Forestry and Climate Change Fund (FCCF) was launched with the objective of investing in pioneering business models for natural capital restoration in secondary and degraded forests in Central America and the Caribbean.

FCCF was launched in October 2017 with first-loss capital commitment from Luxembourg's Ministry of the Environment, Climate and Sustainable Development (Class I shares) and risk-protected capital commitment (Class J shares) from the Ministry of Finance, Luxembourg. Class J investors also include Banque Internationale à Luxembourg (BIL), Banque et Caisse d'Épargne de l'État (BCEE) (commonly known as Spuerkeess), Foyer Insurance, and two private investors. The FCCF is complemented by a Technical Assistance Programme (TAP), funded by a USD $2.1 million grant from Luxembourg's Ministry of Foreign and European Affairs and through LuxDev, to generate investment pipeline and develop an understanding of business opportunities in the sector and region.

The FCCF initiative presents several useful insights for institutions and organizations looking to create or invest in blended finance vehicles focused on the forestry sector:

- i Launching a TAP prior to the fund can develop investment readiness of the pipeline and increase likelihood of success for both the fund and investees.
- ii Longer term investments are beneficial to investors in the forestry space, as benefits may be perceived after several years into deployment.
- iii TAP resources should be prioritized to effectively engage with local communities and tailor appropriate investment solutions to local settings.
- iv Institutional investors seek both innovation and familiarity, however as track records are established, concessionality can and should be reduced within a blended structure.

SYNOPSIS

FUND MANAGER	Investing for Development SICAV
FUND VINTAGE	2017
FUND SIZE	$20 million
FUND TERM	15 years
FUND MANDATE	To identify, develop and scale business models that create economic value for secondary and degraded forests.
COUNTRIES OF OPERATION	Costa Rica, Guatemala, Mexico, Nicaragua, Belize
CAPITAL STRUCTURE	**Phase 1** *Technical Assistance Facility* • Grants ($2.1 million) *Forestry and Climate Change Fund* • Class I shares (first-loss equity): $7.5 million • Class J shares (risk protected): $7-8 million • Forest/Climate notes: $4-5 million **Phase 2 (Prospective)** *$43 million in equity and notes*
INVESTMENT INSTRUMENTS	Equity, quasi-equity, secured, and unsecured debt
KEY IMPACTS TO-DATE	• 11,925 ha of SDF under sustainable management • 45,925 t CO^2 carbon sequestered • 19 lesser accepted species of wood commercialized • $2.5 million wood value chain revenue generated

1 Secondary forests are forests regenerating largely through natural processes after significant [or even total] human and/or natural disturbance of the original forest vegetation at a single point in time or over an extended period, and displaying a major difference in forest structure and/or canopy species composition with respect to nearby primary forests on similar sites (Chokkalingam and de Jong, 2001)

2 Logged–over or degraded forests are a forest type in which most or all of the commercial timber has been removed. The extraction in general is done through "conventional logging", without applying the principles of reduced impact logging and the harvest exceeds the natural growth capacity of the system. (Soil Conserv. Soc. Amer. 1970)

Introduction

One-third of the world's tropical forests have been mown down in the past few centuries, and another third has been degraded by logging and development, amounting to significant losses in biodiversity and exacerbating the risks of climate change. With the continued destruction of primary forests, swaths of secondary[3] and degraded forests[4] (SDF) occupy areas between agricultural lands and primary forests. SDF forests differ from forests that have not experienced upheaval due to human actions or natural disturbance, and are at particular risk of conversion to other land uses. Yet, SDFs can be an important source of a range of goods and ecosystem services[5], and have increasingly been recognized as a valuable component of forestry value. According to the Forest Resources Assessment Report 2015, the area of naturally regenerated forests amounts to 2337 million hectares globally and constitutes 58% of the overall global forest area[6]. However, there is still insufficient focus on the economic feasibility and sustainable commercialization of SDF goods and ecosystem services.

Against this backdrop, the Forestry and Climate Change Fund (FCCF) was launched with the objective of investing in pioneering business models for natural capital restoration in SDFs in Central America and the Caribbean.

FCCF is an impact investment sub-fund of the Investing for Development SICAV (IfD). IfD is structured as a *société d'investissement à capital variable* ("SICAV")[7], supervised by Commission de Surveillance du Secteur Financier (CSSF), the Luxembourg Financial Regulator. IfD established FCCF in 2017 as a 15-year fund, recognizing an opportunity to create economic, ecological, and social value from SDFs as well as contribute to climate change mitigation and adaptation, and local economic development. The objective of the FCCF is to create a viable and sustainable business model for timber production within SDFs.

3 Secondary forests are forests regenerating largely through natural processes after significant [or even total] human and/or natural disturbance of the original forest vegetation at a single point in time or over an extended period, and displaying a major difference in forest structure and/or canopy species composition with respect to nearby primary forests on similar sites (Chokkalingam and de Jong, 2001)

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5 An ecosystem service is any positive benefit that wildlife or ecosystems provide to people. The UN identifies four major categories of ecosystem services: provisioning, regulating, cultural, and supporting services. (The National Wildlife Federation, 2022)

6 Defining secondary and degraded forests in Central America

7 SICAV stands for Société d'Investissement à Capital Variable, or investment company with variable capital (also known as an 'open-ended investment company') and which issues shares. With SICAVs, the fund itself is a stock corporation and thus a legal entity. The company's capital depends on the amounts paid in by investors. Shares in a SICAV are bought and sold on the basis of the value of the fund's assets, or net asset value. In accordance with applicable law and regulations, a SICAV can either appoint a separate management company or can be self-managed. (Adapted from the ALFI – Association of the Luxembourg Fund Industry – website.)

Design & Fundraising

IfD launched FCCF to directly address a major environmental challenge in Central America; the ongoing conversion of forest to pastureland. IfD established FCCF as a USD 20 million, 15-year fund in 2017, to create a viable and sustainable business model for timber production within SDFs, as well as contribute to climate change mitigation and adaptation, and local economic development, by investing in entities which provide management solutions to owners of SDFs.

IfD had observed the limitations faced by the financial sector when addressing this and other environmental challenges while managing its first sub-fund, the Luxembourg Microfinance and Development Fund (LMDF). LMDF invests primarily through microfinance institutions (MFIs) in less developed countries (LDCs) which IfD found to be highly vulnerable to environmental threats such as drought and flooding. IfD noticed that MFIs in these geographies were only able to effect incremental changes towards climate mitigation and adaptation, due to a lack of business models for revenue generation and limited efforts in contextualizing solutions for local conditions. IfD conceived of the FCCF as a concrete step towards overcoming these challenges through a dedicated climate finance fund.

In 2014, IfD initiated market scoping and stakeholder consultations on forestry and conservation in Central America to identify local challenges and solutions. Based on this feedback, IfD focused the FCCF on developing a business model related to SDFs. Here, IfD adopted a blended finance approach through the use of first-loss capital, to mitigate for uncertainty and perceived risks held by institutional investors associated with investing in a secondary forest restoration model. These risks include insecure commercial forest rights, lack of business capacity, insufficient organization and scale of return to offset risks, as well as a lack of trustworthy brokers.

In addition to a blended capital structure, the FCCF is supported by a Technical Assistance Programme (TAP), established in October 2015. While technical assistance can be introduced either after or along with the launch of a fund, in the case of FCCF, the TAP preceded the fund setup and launch. This was done for several reasons. First, the TAP was designed to ensure investment readiness of FCCF pipeline borrowers. Investment-readiness activities include the development of business models to test the feasibility of a forest concept based on boosting growth through cultivation and strategic silvicultural treatments; support for potential investees to innovate their core businesses activities, products and services offered; the creation and participation in the FCCF network; engagement with public authorities to facilitate regulatory changes; and promotion of a licensed and certified forest industry. Moreover, introducing the TAP prior to the launch of FCCF served as an instrumental step in the Fund design as it provided valuable insights for elements such as refining the Fund structure, creating a strong pipeline, and defining impact targets. The TAP was solely funded by the Luxembourg Ministry of Foreign and European Affairs (USD 2.1 million).

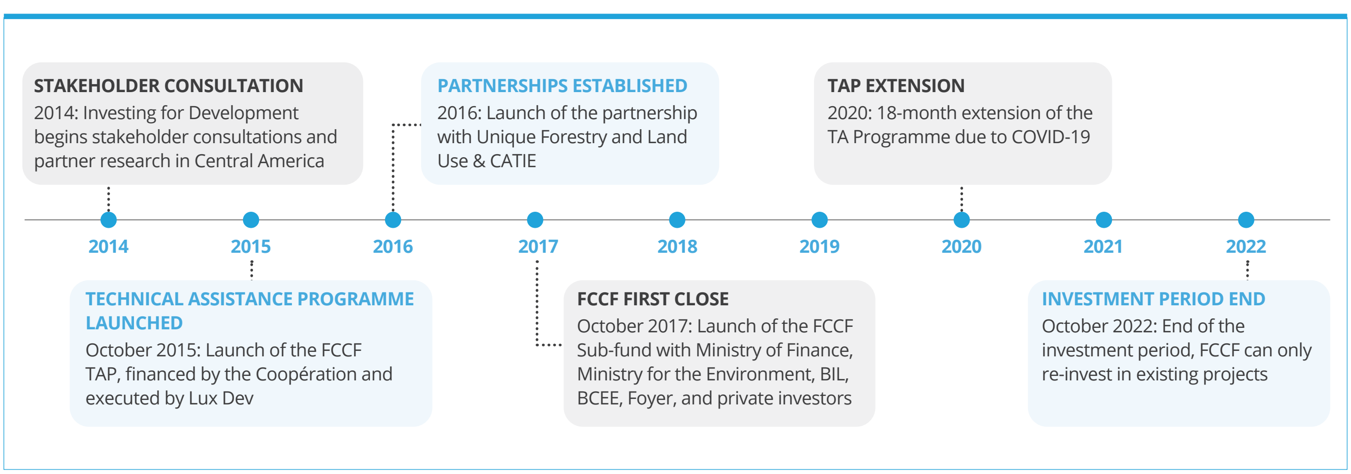

Figure 1: FCCF's key milestones

Phase 1 of the FCCF was launched in October 2017 with first-loss capital commitment from Luxembourg's Ministry of the Environment, Climate and Sustainable Development (Class I shares) and risk-protected capital commitment (Class J shares) from the Ministry of Finance, Luxembourg; Banque Internationale à Luxembourg (BIL), Banque et Caisse d'Épargne de l'État (BCEE) (commonly known as Spuerkeess), Foyer Insurance, and two private investors. Commercial investors in FCCF were already familiar with IfD through the previous LMDF, and were therefore receptive to participating in the FCCF. Investors found the idea of establishing a new ecosystem compelling, with first-loss protection by the government an essential ingredient underpinning their investment decision. Moreover, private sector investors in the Fund found the presence of familiar Luxembourg public sector investors to be a comfort. FCCF was attractive to public investors who saw concessional shares in the FCCF as a smarter use of grant funding, and the benefits investment capital would provide such as greater accountability, deliverability, and a clearer exit from the grant.

While IfD initially envisioned a retail share class, similar to the structure of LMDF, they faced strong resistance from regulators regarding FCCF and as such were not able to provide a retail offering. Challenges included the fact that there were hardly any retail products in the regulated space for SDF investments, and that FCCF was an untested fund entering a new field. As a result, despite regulators acknowledging the security in the capital structure, the notes were restricted to well-informed investors.

Due to the high-risk nature of FCCF, the fund was capitalized with a large pool of first-loss capital, representing 50% of commitments. A high level of risk protection was deemed necessary given the novelty of the sector, geography, and business models. Moreover, unanswered questions regarding potential investment considerations, including ticket sizes, deal structure, and level of risk during fundraising posed a challenge for private investors, who required greater degrees of clarity. IfD required considerable openness during the fundraising and structuring process as they needed the flexibility to adapt during the Fund's operating phase.

Class I and J shares of the FCCF were launched at the same time. The J shares had an extended drawdown schedule (5 years compared to 4 years for Class I).

Structure & Governance

CAPITAL STRUCTURE

FCCF is USD-denominated, multi-tiered closed-end private equity fund with an accompanying technical assistance sidecar (USD 2.1 million). There are two share classes; Class I first-loss shares and Class J senior shares. FCCF may also issue notes in the future, all of which form one single portfolio for investment, in conjunction with the equity.

- **CLASS I SHARES:** provide first-loss protection for Class J Shares in the event of credit events. Class I shares compensate for losses on underlying investments until the tier is exhausted. This tranche appealed to public investors seeking developmental impact and mobilization of private sector dollars into the senior tier. Due to the nascency of the target market, first-loss shares comprise 50% of the total capital stack of the Fund. FCCF raised USD 7.5 million in Class I shares, including commitments from the Ministry of the Environment, Climate, and Sustainable Development of the Government of the Grand Duchy of Luxembourg. The goal for Class I investors is capital preservation (no expected return).
- **CLASS J SHARES:** Class J shares are the senior ranking investment class in FCCF, benefitting from downside risk protection provided by Class I shares. Tranching the Fund brought its perceived risk in line with the risk tolerances of key target investor classes, namely Development Finance Institutions (DFIs) and institutional investors. High Net Worth Individuals (HNWIs) could also subscribe subject to a minimum commitment of USD 200K. FCCF raised USD 7.5 million in Class J shares, including commitments from the Ministry of Finance of the Government of the Grand Duchy of Luxembourg as well as institutional investors such as BIL, Foyer, and Spuerkeess. Expected net IRR for this share class ranges from -4.52% (under the Fund's "stressed" scenario) to 7% ("favourable" scenario).
- **NOTES:** The nominal value per note is USD 1000, targeting subscribers who are HNWIs or institutional investors. Notes may be issued in various tranches bearing either a fixed rate or a floating rate of six months Libor plus a spread which may vary from 1% to 2% across tranches. The notes will have a maturity of eight years from their date of issuance. Noteholders rank senior to all shareholders of the Fund. The aggregate nominal value of the issued notes shall not exceed 30% of total commitments to the Fund.

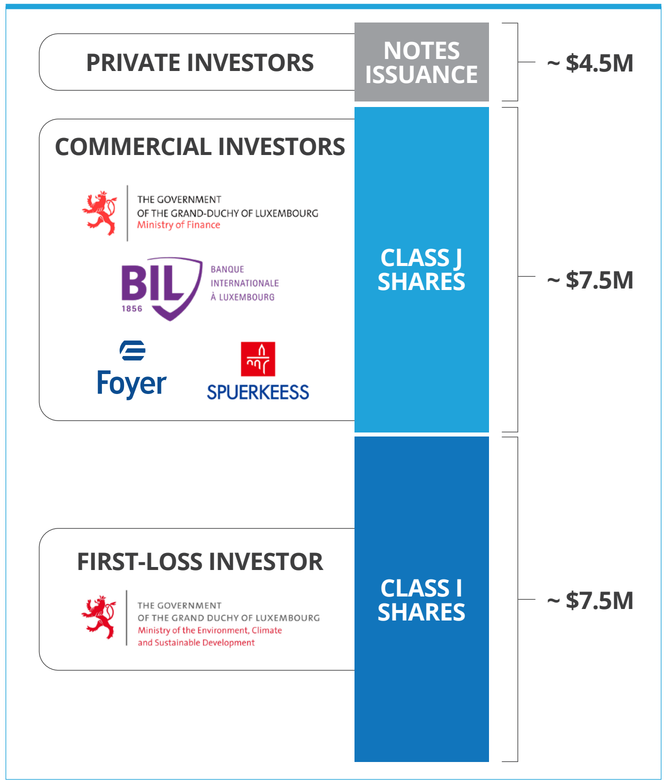

Figure 2: FCCF's capital structure.

TECHNICAL ASSISTANCE

The FCCF is complemented by a TAP aimed at generating investment pipeline and an understanding of business opportunities in the sector and region, required to enable the Fund to invest, in both investees and fund management. The TAP was structured and funded prior to the FCCF. The TAP was launched in 2015 with the support of a USD $2.1 million grant from Luxembourg's Ministry of Foreign and European Affairs and supported by LuxDev through 2022.

The TAP's objective is investment-readiness: to identify and support local forest management entities that are potentially eligible for an investment by the FCCF by improving their technical, organizational, and entrepreneurial skills. TAP activities are carried out by staff at FCCF, Unique Forestry, and Land Use GmbH (a German forest consultancy), the Tropical Agricultural Research and Higher Education Center (CATIE, a regional institute for agricultural development and biological conservation in Central America and the Caribbean), as well as local consultants.

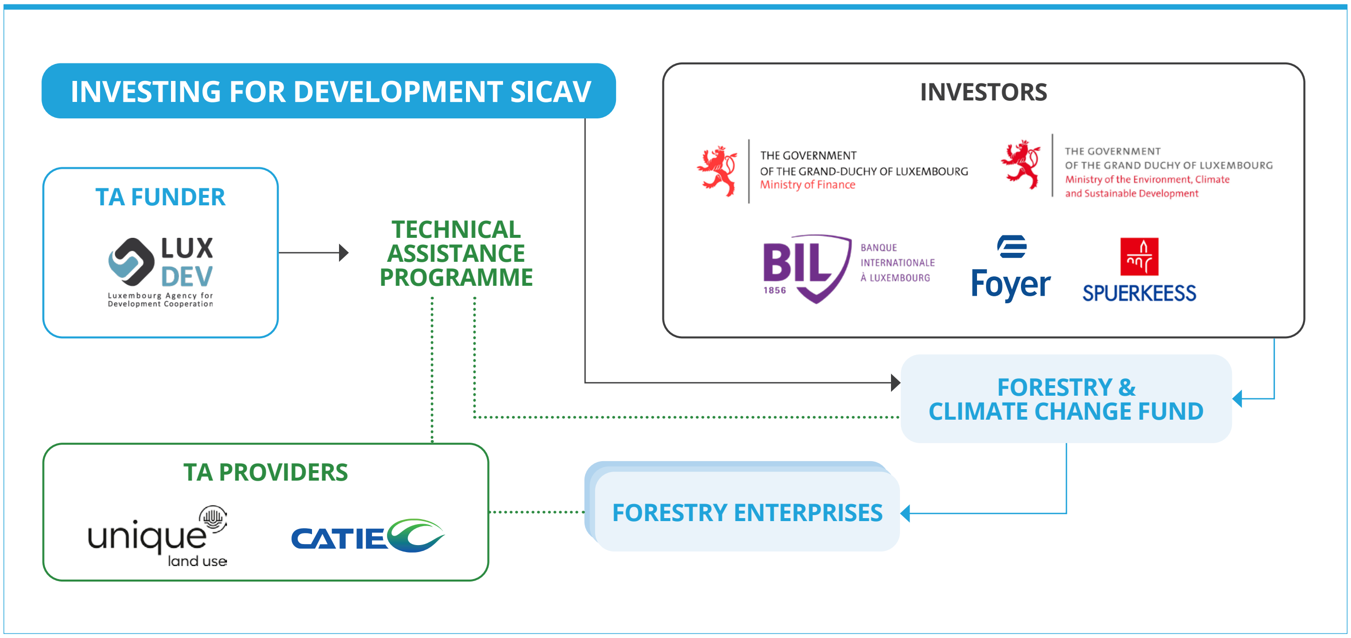

Figure 3: FCCF's TAP structure and activities.

The TAP funding was used to build trust, relationships, expertise, and know-how among the investees. This led to the creation of a FCCF network, based on the knowledge offered by the programme.

TAP activities also funded technical and business studies, plans, and analyses, as well as training, capacity building, and ongoing technical assistance. The TAP also supported development of business models to test the feasibility of a forest concept based on boosting growth through cultivation and strategic silvicultural treatments and supported potential investees with innovating their core businesses activities, products, and service offerings. The TAP financed concept notes, pre-feasibility studies, and investment proposals in view of future investments, as well as capacity building alongside the FCCF's financial investments.

The TAP also funded engagement activities across the potential pipeline, and with public authorities. It created the FCCF network for supported organizations to exchange expertise. The TAP also engaged with public authorities in its target countries to facilitate regulatory processes, such as the recognition of the feasibility of managing secondary forests in Costa Rica by local authorities, by issuing the accompanying legal instruments (e.g., Decrees, Operative Manuals). Additionally, TAP activities also supported the pursuit of globally recognized licensing and certifications in the forestry sector, such as the Forest Stewardship Council certification.

The TAP was crucial in guiding the FCCF and stakeholders through a steep learning curve of sustainable forestry businesses in the region, increasing competencies, enabling more strategic decision-making, and facilitating networks of cooperation in the industry. Under the TAP, Unique developed a monitoring and reporting framework for the Fund, which also demonstrates the climate impact of the projects, which is highly relevant for follow-on investments. In Phase 2 of the FCCF, TAP activities aim to mobilize market demand for the timber products, and increase knowledge management, systematization, and documentation to strongly tie TAP services to outputs and outcomes of the FCCF investments.

Operationally, a great benefit of the TAP was the flexibility of the funding, and the early establishment of the TAP prior to the FCCF. When technical assistance begins simultaneously with the fund, this creates immense pressure to invest and show results. Establishing the TAP earlier allowed lead-up time where a lot of pipeline development and groundwork was done, from refining the model to defining targets and determining what could be considered "investable". Investment-readiness was essential in an underdeveloped and underserved sector, given many opportunities were not yet investment-ready. Having a flexible and early deployment of the TAP allowed for more efficient and effective operations of the Fund.

LEGAL STRUCTURE & GOVERNANCE

The FCCF is incorporated as a 15-year impact investment sub-fund of the IfD SICAV, a société d'investissement à capital variable, incorporated under the laws of the Grand Duchy of Luxembourg and subject to Part II of the law of 17 December 2010 relating to undertakings for collective investments, supervised by Commission de Surveillance du Secteur Financier (CSSF), the Luxembourg Financial Regulator. This is a common umbrella structure in Luxembourg, which allows for the creation of multiple underlying sub-funds with varying targets and strategies, each of which is represented by one or more classes of shares.

The sub-funds are distinguished by their specific investment policy or any other specific features disclosed in the relevant sub-fund particulars. The IfD SICAV and its sub-funds constitutes a single legal entity. However, the assets of each sub-fund shall be invested for the exclusive benefit of the shareholders of the corresponding sub-fund and the assets of a specific sub-fund are solely accountable for the liabilities, commitments, and obligations of that sub-fund.

The management team of the IfD SICAV manages the FCCF. The IfD Board selected and retained Unique Forestry and Land Use GmbH (Unique) as the investment adviser to FCCF, prior to the establishment of the Fund. The Board established the following committees whose role is to support and make recommendations to the Board, or take decisions within certain limits as determined by the Board, in their areas of activity:

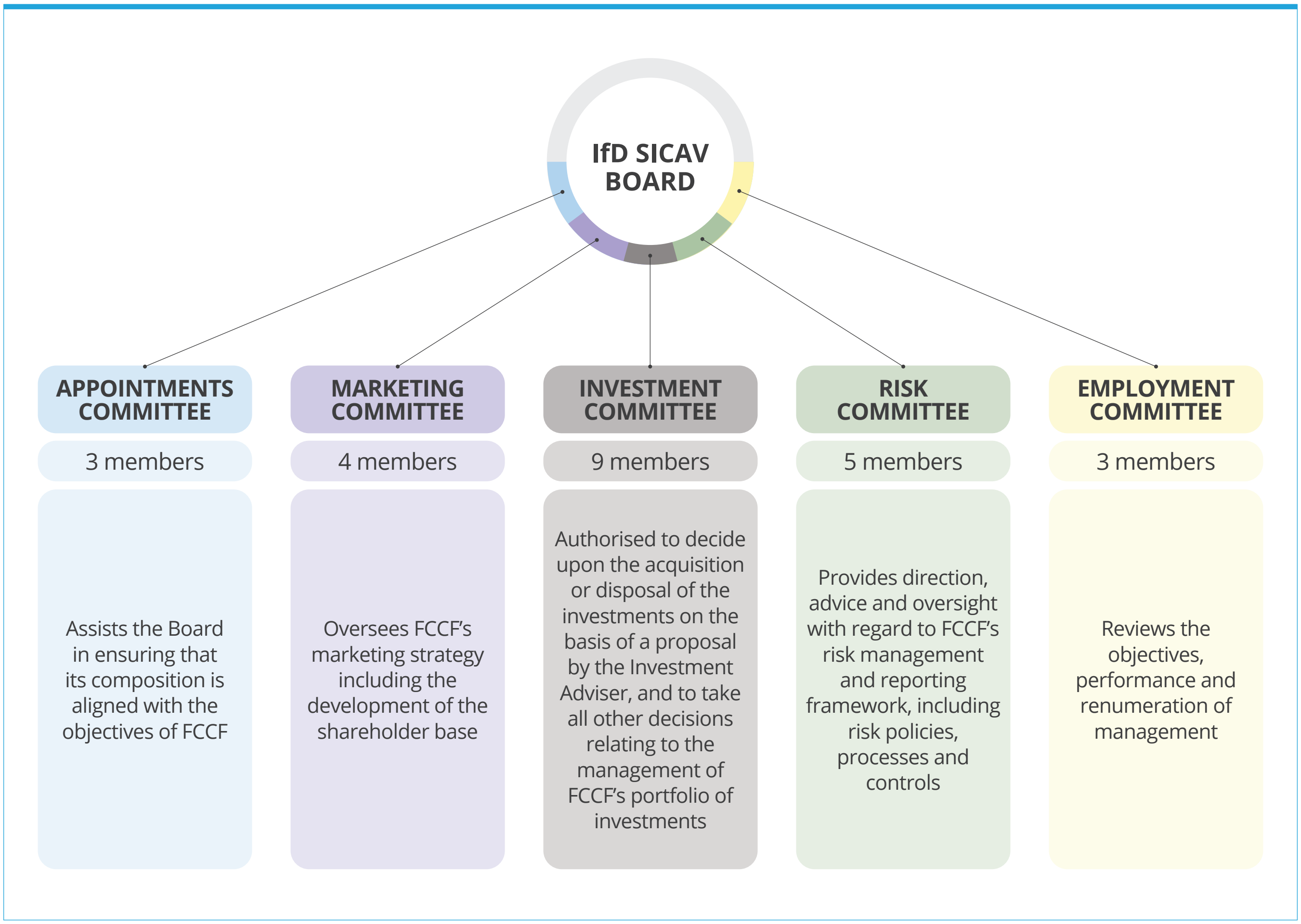

Figure 3: FCCF's TAP structure and activities.

Operations

INVESTMENT STRATEGY

FCCF identifies, develops, and scales business models which create economic value for SDFs, with a primary geographic focus on tropical Central America. FCCF mainly invests in entities which provide management solutions to owners of SDFs. FCCF does not acquire land or forests directly. It finances entities which enter into partnerships with landowners and communities who have proven tenure or use rights of secondary and degraded forests. The range of investment opportunities for FCCF include:

- financing SDF management entities, including companies developing activities based on the management of SDFs;
- entering into partnerships with local landowners controlling SDFs;
- refinancing intermediate entities engaged in the financing of SDF management; and
- investing in entities active in or developing activities based on the value chain of timber or non-timber forest products derived from SDFs, for example entities involved in the transformation and commercialization of timber products.

At the outset, FCCF sought to establish a diversified investment portfolio of 10 – 12 entities with a focus in three main areas:

i. Sustainable management of SDFs in partnership with a variety of landowners (communities, medium sized owners, small forest owners), evidenced through certifications (e.g., from the FSC), and adherence to FCCF's developing environmental and social standards;

ii. Economic viability. FCCF invests in forestry companies and entities focusing on existing SDFs, preferably aged 15 - 20 years, so that operations can generate income quickly. The minimum potential size of operations is 1000 hectares, to ensure that overhead and development costs are economically in reasonable proportion to the forestry resources. Such size is often achieved by grouping together smaller and medium sized forest owners. Forests should also have a species composition which has commercial value in markets that are accessible (distance, road infrastructure) at reasonable costs. Finally, there should be an existing local organizational structure and a certain level of administrative competence;

i. Potential for scale and value as examples for others to follow.

INVESTMENT PROCESS

FCCF invests directly and indirectly in a diversified portfolio of forestry companies, community forestry entities, and owners of small forests, focused on SDF management.

At the investment stage, FCCF invests through various types of financial instruments depending on individual investment characteristics (the "SDF Investment Instruments"), including but not limited to the following:

- Equity or quasi-equity instruments or convertible debt
- Secured or unsecured senior or subordinated debt instruments
- Guarantee or (re-)insurance contracts to reduce project, counterparty, political, natural, or currency risks.

All investments made to date have been in shares and equity-type securities, and subordinated loans, capex loans, and working capital loans.

FCCF may invest up to 100% of its net assets in non-listed securities and may control or hold up to 100% interest of a single investment; however, FCCF prefers to hold a 50% stake in its investments and reserve 50% for local partner ownership, to ensure alignment of objectives and a greater sustainability of the investment.

INVESTMENT ACTIVITY TO-DATE

IZABAL WOOD COMPANY

IZABAL WOOD Co.

BACKGROUND: Izabal Wood Company (IWC) is an integrated forest management and wood product manufacturing company with operations in the northeastern region of Guatemala. The company specializes in tropical wood, producing a range of semi-finished products for a variety of uses.

ROLE OF FCCF: FCCF partnered with the Izabal Group to establish IWC in 2019 as a blended-capital response to pervasive deforestation in the region. FCCF and Izabal Group are equal equity partners through a symbolic commitment of USD 12K. FCCF also provided USD 1.5 million in debt financing, through working capital, capex, and subordinated loans. IWC also accesses FCCF's technical assistance through in-kind services to support environmental certifications, networking, and grant funding for the capture and study of non-traditional wood species to improve their business model.

IMPACT: While COVID-19 delayed operations, IWC has been able to consolidate its wood transformation operations and has received additional funding to ramp up its functioning business model. IWC has not yet been able to unlock FCCF's available financing lines for forest management, due to challenges in reaching agreements with local landowners, but plans to continue these efforts in a second phase. Through establishing a mill and moving up the wood value chain, IWC sources FSC-certified wood from concessions across Guatemala and exports its lower-footprint wood products across Europe and North America.

Phase 1 of the FCCF ended in October 2022. FCCF concludes this period with USD 6.5 million in ten investments since inception, across Costa Rica, Guatemala, Mexico, and Nicaragua. It made its final investment, in October 2022, in a portfolio company in Belize. As of December 2022, the total investment is USD 7.1 million, with open commitments to investees at USD 10.1 million. IfD expects the current portfolio to require the Fund's entire capital.

FCCF's highest exposure is in Costa Rica, where the holding constitutes 27% of the Net Asset Value (NAV). Holdings in Guatemala total 25% of the NAV. FCCF continues to maintain a limited exposure of 0.1% NAV to Nicaragua, a country which, besides its political risks, is monitored and subject to sanctions by the Financial Action Task Force.

FCCF felt the consequences of the COVID-19 pandemic disruptions across its portfolio. To date, the companies focused on forest management and primary transformation have seen delays but ultimately benefited from strong prices and higher transportation costs around the globe (rendering timber imports from distant countries expensive). Companies focused on finished products have suffered more due to logistics and unforeseen delays in developing markets due to shocks to both human resilience and supply chains. Additionally, increases in energy and transport costs, have adversely affected the portfolio as well.

Figure 5: FCCF investments in phase 1.

As of September 2022, total net assets remained largely stable at USD 10 million pending the draw-down of the remaining Class J commitments. FCCF continues to close the gap between the financial income from the portfolio and total costs, with USD 248 thousand in interest income during the first six months and USD 292 thousand in costs. This compares to annual interest income of USD 223 thousand during the entire previous financial year. The net variation in unrealized losses has been reduced to a loss of USD 0.5 million (compared to USD 1.1 million loss during the previous financial year). This leads to a loss on operations of USD 0.5 million, mainly driven by the current valuations. In line with the Fund's waterfall, Class I shares absorb the loss to protect the initial investment value of Class J shares and end the financial year with a NAV per share of USD 45.46 whereas Class J shares NAV is USD 100.00.

Additionally, FCCF launched a new forest credit product as a result of learning about the essential roles communities play in forest conservation. The new product allows the forest dependent community to acquire machinery to lessen their dependence on third party service providers and increase their income, while the community themselves developed and implemented a forest management model focused on establishing regeneration of overexploited high value species (mainly mahogany) through active gap management in Southern Mexico. This new community credit product is also a tool and methodology for FCCF to engage with communities playing a vital role in the protection of tropical forests.

IMPACT

FCCF's Theory of Change was developed in conjunction with the Fund's Environmental and Social Management System and the Fund's Environmental and Social Principles Statement. FCCF's Theory of Change is comprised of three key pillars:

NATURAL CAPITAL: locally owned SDFs are under management and deforestation rates are reduced. Active management improves forest growth, biodiversity value, species composition, and carbon stocks.

WOOD VALUE CHAINS: Sustainable value chains for SDF wood develop. Value chains finance the sustainable management of SDF and renumerate forest owners in line with opportunity costs.

EQUITY AND INCLUSION: The value generation in the SDF value chain is fairly distributed to small and medium forest owners and local and indigenous communities. The share of women in the investee workforce increases.

IfD SICAV is a signatory to the Operating Principles for Impact Management, an initiative pioneered by International Finance Cooperation (IFC), and has applied these principles to FCCF. Key environmental and social indicators are defined for each investment in line with the Theory of Change. IfD's remuneration policy is such that the management team's variable remuneration is partly contingent on IfD SICAV's environmental and social performance.

Investees are contractually required to provide relevant data to Unique. The investee receives detailed information on the indicators to be monitored and reported on. This data is aggregated into reports twice a year, which are monitored by IfD's fund management team and compared to baseline assessments. Any concerns are escalated to the managing bodies of FCCF, who will decide on the best course of action, to ensure that expectations can be reached. The performance is also monitored at the Investment Committee level and any concerns emerging from the reports are reviewed.

To date, FCCF impacts aligned to its Theory of Change are summarized in the table below:

THEORY OF CHANGE PILLAR	IMPACT
NATURAL CAPITAL	• USD 3.01 million committed to sustainable forest management • 6,270 ha of SDF secured for management • 3 forest management certifications achieved • 26,750 tCO2 sequestration of greenhouse gases
WOOD VALUE CHAINS	• USD 6.07 million committed to value chain companies • 5xFSC chain of custody certifications • 28,231 m3 roundwood volume processed to date • USD 1.8 million group revenue to date • 29 lesser-known species commercialized
EQUITY & INCLUSION	• 81 jobs created • 17% of employees are female • 73% of people employed from the communities • 6 communities directly and/or indirectly impacted • 6 landowners FCCF has invested in

FCCF activities also effected change at the public level. An engagement with public authorities to facilitate regulatory processes has influenced positive outcomes, such as the recognition of the feasibility of managing secondary forests in Costa Rica by local authorities, followed by appropriate business enabling requirements (operational and legal).

FCCF continues to learn and adapt from its own investments, for example by developing the new community credit product previously discussed. Additionally, FCCF believes that its investees should also be able to learn from the examples of other investments, and therefore an annual workshop is organized by the Fund (not held in 2020 due to COVID-19), bringing together lessons learned within the various projects to build the forestry ecosystem in Central America. A final impact report of its first investment period will be published by FCCF later this financial year.

Key Insights

The FCCF initiative presents several useful insights for institutions and organizations looking to create or invest in blended finance vehicles focused on the forestry sector.

Establishing a TAP pre-launch can be an important strategy for success when investing in new and underdeveloped sectors:

Having a TAP prior to the set-up of the Fund not only developed investment readiness of the pipeline, but also supported IfD in identifying clear investment criteria, impact metrics, and consequently increased the likelihood of success for the Fund and its investees. Although the TAP's achievements have not yet resulted in the FCCF fully securing a strong portfolio of bankable sustainable forestry enterprises based on SDFs, prior to the TAP there were zero investment-grade opportunities in sustainable forestry in the region. This demonstrates robust technical assistance is essential to building up new portfolios in this space.

Fund terms must balance impact and investor preferences, particularly when operating in the forestry sector:

Longer term investments are beneficial to investors in the forestry space, as benefits may be perceived several years into deployment. In the FCCF's 15-year closed-ended fund structure, benefits are structured to kick in towards the end of the fund life; as such, a 15-year term does not optimize the gains from the investments. There is therefore a direct trade-off between time and impact, particularly with forestry investments. While 20-year vehicles would be more optimal, this is limited by investor term restrictions.

TAP resources should be prioritized to effectively engage with local communities and tailor appropriate investment solutions to local settings.

Changes in cultural contexts take time, particularly those associated with changing land use traditions. During all investment phases, from engagement with public authorities, landowners, other supply chain actors, NGOs, employees, and local monitoring agents, FCCF and its investees recognized the essential roles communities play in forest conservation.

Trusted fund managers can be a key ingredient when mobilizing commercial investors to blended finance vehicles:

Commercial investors in FCCF were familiar with IfD through their participation in the blended LMDF. Investor familiarity with both IfD and blended finance through the LMDF provided commercial investors with the confidence to participate in a frontier fund in secondary forests, despite the novel nature of the sector. While blended finance was an essential ingredient, through the provision of first-loss capital, a trusted fund manager was the true catalyst behind interest from commercial investors.

CONVERGENCE
BLENDING GLOBAL FINANCE

CONVERGENCE is the global network for blended finance. We generate blended finance data, intelligence, and deal flow to increase private sector investment in developing countries.

BLENDED FINANCE uses catalytic capital from public or philanthropic sources to scale up private sector investment in emerging markets to realize the SDGs.

Our **GLOBAL MEMBERSHIP** includes public, private, and philanthropic investors as well as sponsors of transactions and funds. We offer this community a curated, online platform to connect with each other on blended finance transactions in progress, as well as exclusive access to original market intelligence and knowledge products such as case studies, reports, trainings, and webinars. To accelerate advances in the field, Convergence also provides grants for the design of vehicles that could attract private capital to global development at scale.