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Conservation Finance

ISSUE An estimated US$300-400 billion is needed annually to preserve healthy terrestrial and marine ecosystems, and the clean air, fresh water, and biodiversity on which we all depend. However, only US$52 billion is currently flowing towards projects supporting conservation, while the private sector manages an estimated US$300 trillion in assets. Impact investors and, to some extent, commercial investors, are demonstrating interest in pursuing business opportunities in the broad area of sustainable use of natural resources, but the financial challenges can be daunting. The key challenge to be addressed is ensuring that scarce public resources are deployed in a way that catalyzes the required redirection of finance for achieving conservation outcomes. In this regard, blended finance has attracted significant interest in recent years.

In the climate change mitigation space, the GEF and other International Financing Institutions have successfully used blended finance models over the past two decades to pioneer and scale-up financing of new technologies in renewable energy, energy efficiency, urban transport, and other related fields. As sustainable energy technologies began achieving significant cost reductions and countries put in place enabling policy environments (e.g., feed-in-tariffs, power purchase agreements), the opportunity for private sector investment expanded greatly. However, mobilization of private capital for blended finance schemes involving biodiversity and natural resources management—or Conservation Finance for short - is still incipient.

Conservation finance includes *investment mechanisms that activate one or more cash flows generated by the sustainable management of an ecosystem, which in part remain with the ecosystem to enable its conservation, and which in part are returned to investors*. The most commonly used financial instruments for blended finance are: 1) guarantees, which provide protection from various forms of risks of capital loss for investors; 2) debt, typically in the form of subordinated or concessional debt (or both); and 3) equity, typically in the form of junior equity accepting higher risks for lower financial returns.

Despite the considerable potential for mobilizing investments, conservation finance faces major barriers associated with scale, aggregation, and costs of the intangible benefits of ecosystem services. Except for some large conservation forestry funds in developed markets, most conservation finance deals and funds

are relatively small. Furthermore, the relatively long-term nature of returns and the uncertainty of environmental markets that provide conservation revenue streams represent major barriers for potential investors. Nevertheless, early experiences involving NGOs and philanthropies, impact investors, and the public sector are beginning to demonstrate the potential for new types of investments, to aggregate up into asset classes that are more attractive to commercial investors. What is needed now is for the public and private community to collectively address how the financing that generates returns is blended with grants and other resources. The policy dimension also needs to be addressed to ensure that appropriate enabling conditions are created.

SOLUTION

The potential for asset managers to structure investments that can tap into project cash flows to generate attractive risk-adjusted returns is increasingly attracting the interest of investors towards conservation finance, although many barriers remain. Most conservation finance investments are focused on climate change mitigation, but few environmental benefit outcomes in areas beyond climate change have thus far been directly pursued. Carbon credits from forestry or other land-use projects are among the most widely used for mobilizing conservation finance. Investments in environmental commodities, such as carbon credits, ecosystem services such as wetland restoration credits, or more conventional food and fibre commodities are gaining traction. Payments for ecosystem services have also contributed to conservation finance, with instruments such as tradable credits, tax benefits, or direct payments for environmental benefits (e.g. habitat restoration, carbon sequestration, and nutrient management).

A number of investment funds are already paving the way for mobilizing private capital toward conservation finance. For example, Conservation International and the Frankfurt-based advisory firm Finance in Motion, and German state development bank KfW, in 2014 launched the eco.business Fund, which works with financial institutions in Latin America and the Caribbean to provide debt financing to sustainable agriculture, aquaculture, forestry, and tourism enterprises. Recently, Mirova began market-testing its Land Degradation Neutrality Fund project, which will blend public and private finance to address land degradation by investing in agriculture, forestry, and other projects that promote sustainable land management, as well as conservation and land restoration projects.

In addition to land-based investments, conservation finance is also addressing the need for investments to promote sustainable fishing and marine conservation practices. For example, The Meloy Fund, implemented by Conservation International and RARE, will establish the first fund for sustainable small-scale fisheries in Southeast Asia to improve the conservation of coral reef ecosystems by providing financial incentives to fishing communities in the Philippines and Indonesia to adopt sustainable fishing behaviors and rights-based management regimes. Recently, Althelia, with the support of Conservational International and with technical and scientific advice from the Environmental Defense Fund, launched the Sustainable Ocean Fund as an impact investment vehicle that can deliver marine conservation, improved livelihoods, and attractive economic returns.

Despite these achievements, significant challenges remain in how to achieve scale by replicating those successful examples in faster and broader manner.

LOOKING AHEAD

The GEF has a long history of using blended finance in environmental areas. Many of the early successes are in climate change mitigation areas including renewable energy and energy efficiency. Recently the GEF has started to move towards the frontier space of natural resources management. GEF support for conservation finance can play a key role in encouraging international collaboration and cross-country learning as a pre-requisite for scaled-up impacts. For example, the Risk Mitigation Instrument for Land Restoration project, managed by the Inter-American Development Bank, combines a GEF investment of US$15 million with US$120 million in co-financing to deploy innovative risk mitigation instruments to restore degraded lands in Latin America through investments such as sustainable management for increased ecosystem

services, landscape regeneration, intercropping, shade-grown systems, high-value forest products, and silvo-pastoral systems.

The main barriers for scaling up conservation finance include the lack of capacity, the small size of projects, the heterogeneous nature of projects, and the lack of enabling environments. In order to address these barriers, interested actors have come together to create the Coalition for Private Investment in Conservation (CPIC). The CPIC was launched at the IUCN World Conservation Congress in September 2016, with the intent of increasing deal flow into global priority conservation projects.

The GEF and Rockefeller Foundation recently joined forces to initiate work on the CPIC Conservation Finance Initiative, which will focus on scaling up and demonstrating the value of blended finance in conservation using financial blueprints jointly developed by experienced investors and banking institutions alongside experts in on-the-ground project design in biodiversity and natural resources management. The Conservation Finance Initiative, to be managed by IUCN, combines a GEF investment of US$8 million non-grant with US$2 million of grant funding from Rockefeller Foundation, and is expected to mobilize up to US$100 million of private sector investment. The aim is to overcome hurdles to private sector investment in natural resources management and improve the conservation and sustainable use of biodiversity by demonstrating innovative finance blending models.

The use of blended finance in natural resources management and conservation is not a panacea that can be exclusively relied upon to drive the needed transformation in global economic systems. Yet it holds great prospects for mobilizing private capital and is therefore an important element in the package of available instruments focused on investing in the global commons. Broader support for appropriate policy frameworks that can help improve predictability and support low-emission investments are critically important, as are support for institutional strengthening and targeted capacity building in both the private and public sectors. At the same time, there are many opportunities to expand the use of blended finance. Doing so will require continued innovation on the ground to help countries and private sector partners match the right types of financial instruments to specific projects goals and objectives, including in the natural resource management sectors. Support for project preparation, along with aggregation and bundling of projects that can attract large-scale investors will also be needed in many cases.