Terra GLOBAL CAPITAL

Programa Regional de Cambio Climático | USAID DEL PUEBLO DE LOS ESTADOS UNIDOS DE AMÉRICA | FCMC Forest Carbon, Markets and Communities | IDB Inter-American Development Bank | UN-REDD PROGRAMME

PRIVATE SECTOR INVESTORS: TYPES, MOTIVATIONS, SOURCES AND FINANCING INSTRUMENTS

WORKSHOP ON BUILDING MULTI-SOURCE REDD+ FINANCING STRATEGIES

Antigua, Guatemala

July 17 and 18, 2014

Potential Funding Sources for REDD+

Who has the Capital to Make your REDD+ Program Financial Viable?

There are multiple sources of funds for REDD+

- Public Grants and Assistance
- **Multilateral/Bilateral and National Development Banks (commercially oriented)**
- **Private Financial Institutions**
- International/Regional Banks
- **Private Equity Investors**
- **Companies who Source Sustainable Forest/Agricultural Products and/or Use Emission Reductions**
- Insurance Providers
- **Capital Markets**

Terra GLOBAL CAPITAL

DFI (Development Finance Institutions)

Commercially Oriented Public Finance

Who are DFIs

These can include international development finance institutions such as OPIC, IFC, FMO, and other regionals (IDB, AfDB, ADB)

Typical Financial Instruments

- Loans
- Loan guarantees
- Fund investments (including first loss provisions)
- Political Risk Insurance
- Equity

Typical Motivations and Conditions

- Development outcome oriented
- Return of capital is priority
- Transaction sizes for generally large > $10 million

Private Financial Institutions

Domestic, Regional and International Sources

Who are Private Financial Institutions

Commercial banks, investment banks and microfinance institutions that provide financing, some of them operate specific credit lines provided by national development banks, multilaterals and bilaterals

Typical Financial Instruments

- Loans
- Debt structuring and placement
- Leasing
- Trust management
- Trust guarantee holder

Typical Motivations and Conditions

- Some have actual capital to invest
- Others are intermediaries
- At local level, may be key to small holder applicable financial instruments

Private Equity Investors

Most "Expensive" but Will Take Risks

Who are Private Equity Investors

Covers a board spectrum of investors that include private equity funds, impact funds (including foundation and endowments), individual investors, and microfinance entities

Typical Financial Instruments

- Equity
- Convertible Loans
- Prepaid ERPA

Typical Motivations and Conditions

- Interested in attractive upside (if financially driven)
- Interested in principal returned and sustainability value (PRI)
- Investments can be distributed with milestones
- May have management "step-in rights"
- May invest via diversified funds or directly in programs

Terra GLOBAL CAPITAL

Companies who Source Sustainable Forest/Agricultural Products and/or Use Emission Reductions

Who are Supply Chain Companies

Private companies that recognize that sustainable sourcing of agricultural products is critical to their business' success who many provide funds (beyond the revenue from commodity purchase) and potentially emissions reduction purchases

Typical Financial Instruments

- Long term guaranteed purchase contracts to be used as collateral guarantee for loans
- Technical assistance support
- Provide in-kind up front funding (seeds and key inputs)
- Supply chain investment
- ERPAs (with and without pre-payment)

Typical Motivations and Conditions

- Private sector comes in many "favors"
- Companies that are "greening ag/timber supply chain"
- Voluntary reductions in carbon footprint that are unrelated to supply chain
- Industry mandates (e.g. airlines)

Capital Markets

Option of Some Countries not Others

What are Capital Markets

Funding options are present in capital markets nevertheless capital countries vary in the level of market development and depth of institutional investors

Typical Financial Instruments

- Pubic equity issuance
- Muni/corporate bond issuance
- Investable entity bond issuance

Typical Motivations and Conditions

- Generate financial returns for their investment portfolios
- Diversity risk
- Hold regulated market assets
- Require greater liquidity over private markets
- Larger size > $25 million

Terra GLOBAL CAPITAL

Equity Investments

Provide Upfront Funding for a "Piece of the Action"

Characteristics of Equity

- Equity investors put funding into a business or project seeking financial returns by taking an ownership stake in the investment entities
- Investment entity will:
  - i) pay a percentage of future profits/dividends back to the investor,
  - ii) appreciate in value over the cost basis until the investor's planned exit
- Equity ownership may also be assigned to implementing partners or managers that contribute "sweat equity" or contributed assets
- Investors are motivated by the higher rates of return from the "upside exposure" to the investment's success through sharing in future annual profit
- Equity investor takes the most risk due to being "junior" to loan providers in the capital structure
- May have management step-in rights

ERPA Investments

Quick Summary

Characteristics of ERPAs

- Bilateral contract negotiated between buyer and seller
- "**Spot agreement**" that contractually defines the terms for the purchase and delivery of already verified/issued emission reductions
- **"Forward purchase agreement**" in which price and terms are agreed today for future delivery once emission reductions
- **"Pre-paid forward agreement"** is a forward contract where an upfront payment to made prior to delivery of emission agreement, used to provide financing until the cash flow from operations is positive

Common Investors Terms for Prepaid ERPAs

- Prepayment will only cover the first/early credit vintages issued by the project
- Disbursement of pre-payment funds is made in staged payments on achievement of ERPA milestones
- Payment and distribution of prepayment funds in accordance with milestones are managed through an independent intermediary, referred to as an escrow agent
- Where ERPAs for forward purchases with a credit worthy counterparty are in place, prepaid ERPA terms will be improved
- Investor will want to secure "senior" rights to the first issued emission reductions will be a critical aspect of negotiations, particularly when there is no collateral that may be offered against the settlement of pre-payment

Terra GLOBAL CAPITAL

Private and Public Sector Loans

Loans at Multiple Scales Important to REDD+ Finance

Characteristics of Loans (commercially oriented)

- Lenders provide capital in return for a pre-agreed interest rate, usually paid routinely over the period of the loan
- Lenders are motivated by investments with a known stream cash flows to pay interest and minimizing the risk of principal repayment
- Exposure of a loan is less risky than an equity investor's position given the fixed interest repayments and the loan ranking ahead of equity capital for repayment
- Tranches of loans may be "senior", "junior" and "mezzanine" that describe the priority of repayment
- Loan structures of interest for REDD+
  - Loans Collateralized with ERPAs
  - Loan products for small holders
  - Loans to PPP to enhance equity returns
  - Loan Guarantees

Capital Markets Financial Instruments

Requires Finanicals Regulation and Depth of Market

Leverages domestic institutional investors under public markets structures

- Public equity
- Issued debt

Equity unlikely in many countries

- Limited domestic equity buyers

Debt Issuance through “Green Bond” possible in some countries

- Bond is a debt instrument issued by a borrower (the “issuer”) for a fixed term and usually at a fixed interest rate
- Where capital markets have proven buyers of muni and/or corporate bonds
- Issuer can be a private corporation, a government entity, or a special purpose entity might be of public or private organization
- General obligation bonds, fund the general operations of the issuing entity and are secured by the general funds and cash flows of the issuer
- Project finance bonds fund a single project/asset or bundle of related projects/assets are financed

Assessing Capital Structures and Leveraging Multiple Financing Instruments

ERPA Forward Contracts Commodity Purchase Agreements	**Reduces risk to equity investors, lenders and prepaid ERPA buyers**
Loans as component of finance	**Increase equity investors return with use of leverage**
Long term stream of public fee/tax allocation	**Increase equity investors return and lowers lenders risk**
Grants that support start-up or other on-going costs	**Increase equity investors return through funding startup costs**

Terra
GLOBAL CAPITAL

Contact Us

Please contact us for more information or to arrange a meeting:

info@terraglobalcapital.com

www.terraglobalcapital.com