



A Supranational Lender's Approach towards Timber Investment

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London, 25 October 2011



The European Investment Bank (EIB)



- The European Union's long-term lending bank
- Set up in 1958 by the Treaty of Rome
- Shareholders are the 27 EU Member States
- Promoting European objectives
- Governance
 - Board of Governors - EU Finance Ministers
 - Board of Directors - Member States & European Commission
 - Management Committee - EIB's executive body

The European Priority Objectives



➤ **Inside the EU**

- Cohesion and convergence
- Small and medium-sized enterprises (SMEs)
- **Environmental sustainability**
- Knowledge Economy
- Trans-European Networks (TENs)
- **Sustainable, competitive and secure energy**

➤ **Outside the EU**

- Private sector / financial sector development
- Infrastructure development
- **Security of energy supply**
- **Environmental sustainability**
- Support for EU presence in Asia and Latin America via FDI



- The EIB's climate action focuses on:
 - low-carbon investments that mitigate greenhouse gas emissions
 - projects that improve adaptation to climate change impacts
- Loans of EUR 20.5bn in 2010 for:
 - Energy / energy efficiency
 - transport
 - water, wastewater, solid waste
 - **Forestry (EUR 1.4bn)**
 - research, development and innovation (RDI)
- Target of 25% in 2011 of total lending



- ❖ Significant global economic, environmental and social impact
 - ❖ 30% of total land area
 - ❖ Worth EUR 200 billion
 - ❖ 50 million jobs
- ❖ Increasingly strategic part of European industrial infrastructure
 - ❖ Raw material (construction and paper)
 - ❖ Clean energy
- ❖ Environmental and social benefits
 - ❖ Ecosystem services and prevention of biodiversity loss
 - ❖ Rural development and job creation
- ❖ Vital part of climate change mitigation
 - ❖ It has been estimated that 40% of tradable carbon credits could be sourced from forests in the next 20 years (UNFCCC)



➤ Investment loans

- Nearly 100 forestry and pulp and paper loans have been handled by the EIB during the past 30 years (1979-2010)
- In-house forestry expertise (i.e. economists and technical experts)
- Large amounts, broad range of currencies, long maturities, attractive interest rates

➤ Investment funds

- To complement and extend lending activity to the forestry sector
- Instrument to consolidate the scattered forest ownership
- More efficient silviculture and harvesting operations
- Attractive returns with value creation driven by biological growth
- Upside potential from carbon and other non timber markets



- ❖ Projects must:
 - ❖ Correspond to at least one of the EIB objectives
 - ❖ Be technically sound (sound investment strategy)
 - ❖ Be financially viable (achieve an acceptable IRR)
 - ❖ Show an acceptable economic return (including externalities)
 - ❖ Comply with environmental and procurement regulations

- ❖ EIB Project cycle
 - ❖ Pre-appraisal: preliminary assessment of the project
 - ❖ Appraisal: in-depth assessment of the soundness of the project
 - ❖ Negotiation: signature of contract
 - ❖ Monitoring: verification of compliance with the contract/requirements



EIB Activity – Investment Loans

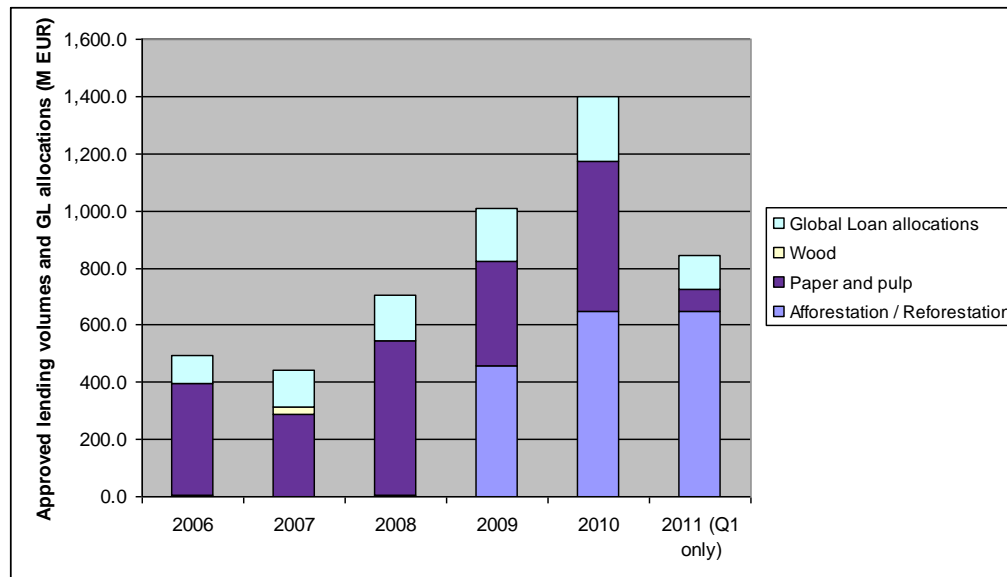


PRIVATE SECTOR	
Pulp and paper, Recycling	Propapier Kapazitaetserweiterung, Germany
Wood industries	Sonae Nettgau, Germany
Afforestation in ACP and ALA	Kolombangara Island Forestry, Solomon Islands. Co-financing with the Commission
PUBLIC SECTOR, EU	
Afforestation, forest management, fire prevention, erosion control, environmental education	Medio Ambiente y Bosques de Andalucia, Spain; Hungary Forests; Medio Ambiente Castilla-La Mancha, Spain. Co-financing with the Commission
PUBLIC SECTOR, NON-EU	
Afforestation, forest management, fire prevention, erosion control, environmental education	Afforestation and Erosion Control, Turkey; China Forestation Programme Loan

Total Loan Amounts (2006-2011)



M EUR	2006	2007	2008	2009	2010	2011 (Q1 only)	TOTAL
Afforestation / Reforestation	3.5	0.0	5.0	460.0	650.0	650.0	1,768.5
Paper and pulp	394.1	289.0	540.6	364.0	525.0	77.8	2,190.5
Wood	0.0	25.0	0.0	0.0	0.0	0.0	25.0
Total investment loans	397.6	314.0	545.6	824.0	1,175.0	727.8	3,984.0
Global Loan allocations	96.0	127.0	160.3	183.0	225.7	117.3	909.4
TOTAL LOANS	493.6	441.0	705.9	1,007.0	1,400.7	845.1	4,893.4
TOTAL INVESTMENT COST	1,480.8	1,323.0	2,117.8	3,021.0	4,202.1	2,535.4	14,680.1





EIB Activity – Investment Funds



- ❖ Investments in Environmental Funds
 - ❖ Relatively recent activity
 - ❖ Niche business, used very selectively
 - ❖ Policy driven and market based

- ❖ The Portfolio
 - ❖ c. 20 environmental (including carbon) fund investments
 - ❖ c. EUR 600m of EIB commitments

- ❖ Key Parameters
 - ❖ Ticket size in the range of EUR 10-50m
 - ❖ Target participation of 10-20%



EIB as Institutional Investor

- ❖ Where we are a mainstream institutional investor
 - ❖ Market returns
 - ❖ Thorough due diligence
 - ❖ Best practice in respect of LP/GP arrangements
 - ❖ Approval process
 - ❖ Representation in non executive fund committees / boards
- ❖ Where we are a different kind of institutional investor:
 - ❖ Very selective, focus on fit with EIB objectives and economic benefit
 - ❖ Compliance with environmental, social and procurement regulations
 - ❖ Can invest time to work with a fund manager from concept stage
 - ❖ Can go into segments not quite mainstream (biodiversity)
 - ❖ Can support first-time teams and established fund managers
 - ❖ Can assume different roles: cornerstone investor / sponsor



- ❖ Fund Manager
 - ❖ Experienced team with track record
 - ❖ Broad network and industry connections
 - ❖ Capacity of rigorous timberland investment analysis

- ❖ Investment Strategy
 - ❖ Maximizing benefits from biological growth through improving forest management and reducing inefficiencies in harvesting/marketing
 - ❖ Reducing investment risk by portfolio diversification (geographical, species, age, end-uses)
 - ❖ Use of local partners in relation to the forest management services, legal services and other related services



Main Environmental Aspects

- Conversion: the project to be financed shall not involve the conversion of natural forests to plantations
- Environmental Impact Assessment: should be considered to projects that include land use changes. Acceptable forest certification shall be considered
- GMO policy: the use of GMOs is not accepted
- Plantation management planning ('mosaic plantation'): the plantation outlay shall draw on mosaic structures with planted areas, natural vegetation, wildlife corridors, buffer zones
- Biodiversity Conservation: a share of the project area shall be set aside for nature conservation purposes, and/or to protect soil and water resources



Policies to Protect Biodiversity and Primary Forests

- ❖ EIB consistently seeks to **emphasise planting in degraded areas**, particularly in tropical areas
- ❖ Exclusion of **commercial logging on primary moist forests**
 - ❖ For the EIB, effective monitoring of these activities is particularly difficult
 - ❖ Illegal activities – logging, hunting or biodiversity destruction – are extremely difficult to prevent
 - ❖ Privately promoted projects in fragile environments in countries with weak governance imply huge transaction costs for the Bank
 - ❖ There are tremendous reputational risks for the Bank in being associated with these – usually small – projects.
- ❖ Exclusion of **conversion of natural forest to plantations** (establishment of oil palm plantations on natural forests or peatlands)
- ❖ EIB supports EU initiatives such as the Forest Law Enforcement, Government and Trade (FLEGT), a licensing system aiming at stimulating sustainable forest management and prevent illegal timber production



Main Social Aspects

- Avoid involuntary resettlement
- Steer clear of deterioration of living conditions of communities in or within the vicinity of the project area
- Avoid destruction of socially or culturally important sites or objects
- Where necessary, a share of the project are shall be set aside to ensure the maintenance of livelihoods and cultural values of local communities
- The local stakeholders should have the right to make decisions regarding their resources based on transparent information
- A social action plan involving neighbouring communities have to be adopted



- ❖ Current:
 - ❖ Forest investments have potential to generate sufficiently high and stable return with steady and predictable cash flow

- ❖ Immediate future:
 - ❖ Climate change mitigation and the development of the market for CO₂ are bound to add to revenue streams attached to forestry including carbon credits and bio-energy
 - ❖ In many cases, forest investment is the prerequisite for efficient carbon neutrality
 - ❖ REDD: sustainable management of forests and ecosystem services



Global Demand for Forest and Forest Products is growing

- ❖ Global demand will continue growing despite current slowdown in US and Europe as the importance of emerging markets is increasing
- ❖ Increased demand for biomass heat and power as substitution to traditional fossil fuels
- ❖ In mature countries pulp & paper demand on average stagnating (about 0.5% p.a.) leading to capacity closures. However, paperboard demand is still growing in mature western markets
- ❖ Emerging markets offer long term market growth potential and cost competitive fibre
- ❖ Paper will be produced where the market prospects are best and pulp close to fibre source
- ❖ New pulp mills in Latin America and Asia, and possibly Russia



Forest Products, Increasing Demand Driving Forces

- ❖ Main demand drivers: population development, increase of unit consumption as GDP growth in emerging markets, few alternative products and new demand
 - ❖ World's population is expected to jump to 8.2 bn in 2030
 - ❖ In China and India, GDP growth and demographic changes will have a very strong positive impact on demand
 - ❖ New demand for forest products: wood for construction, bioenergy / bio fuels, chemical wood products, smart materials and special fibres

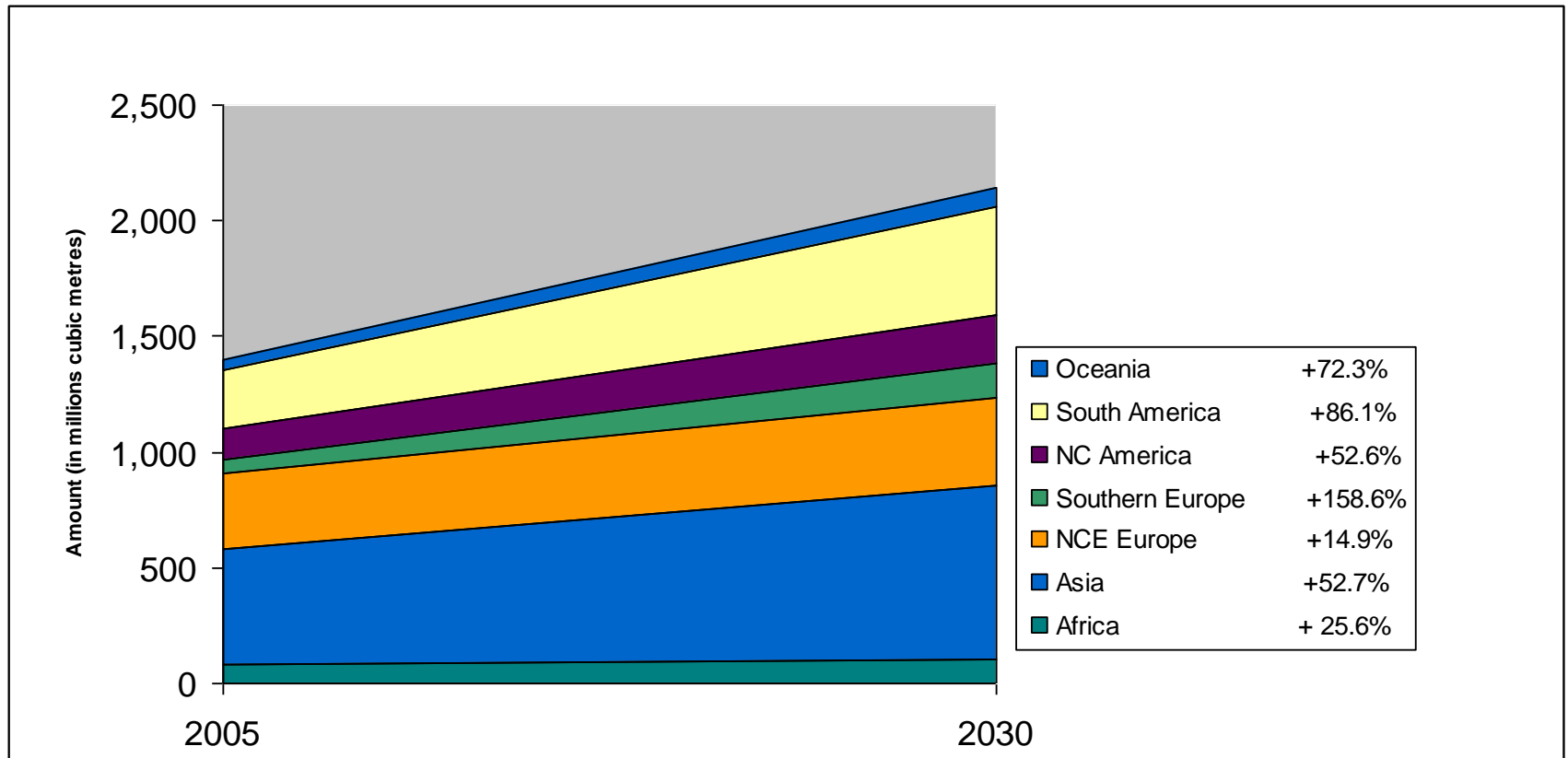


Wood Supply Trends to Meet Increasing RW Demand

- ❖ Industrial RW requirements will grow from 1.8bn m³ in 2007 to more than 2.5bn m³ in 2030
- ❖ Supply from natural forest will be capped because of increasing conservation pressures, REDD, deforestation, forest fragmentation, and growing costs of accessing to forests
- ❖ Most of the RW supply increase (700m m³) will be sourced from forest plantations and improved management of natural forests in boreal zone
- ❖ RW supply increase will come mainly from forest plantations area expansion and from productivity improvements obtained by scientific research, genetic improvement, better site species matching growth, particularly in high yielding, fast-growing, short rotating crops
- ❖ Production of forests plantations in 2030 is expected to be 1.9bn m³ increased from 1.2bn m³ in 2005 according to higher productivity (increase of 1% annually) FAO's scenario



RW Global Production in Planted Forest (2005-2030)





Area Required for Forest Plantations

- ❖ In 2010 total forest plantation area reached 264m ha of which 200m ha of productive forests
- ❖ **Around 80m ha additional should be planted until 2030**
- ❖ Huge plantation investments are needed and the expansion is expected to be driven by Asia (China and Indonesia), Europe and Latin America (Brazil, Uruguay and Chile)



EIB's Challenges in Forestry

- ❖ Promote Timberland funds as bio-energy suppliers and forestry management efficiency increase vehicles
- ❖ Promoting wood pellets manufacture and diffusion
- ❖ Create forestry industry clusters (industrial production, energy and carbon credits)
- ❖ Financing forestry plantations in degraded tropical areas, adapting sustainable forestry standards
- ❖ Financing the production of sustainable fuel wood (mainly Africa),
- ❖ Sustaining forest fire prevention (mainly Southern Europe)
- ❖ Promote carbon forestry revenues
- ❖ Financing and promoting REDD and biodiversity conservation



Forestry Carbon Markets/Funds

- ❖ Forests and forest-based industries have a strategic role in climate change mitigation
- ❖ Forests provided recognized Certified Emissions Reductions (CERs) in the CDM and JI United Nations Framework Convention on Climate Change mechanisms, although they are difficult to obtain
- ❖ Forests provide alternatively Voluntary Emissions Certificates
- ❖ However, LULUCF activities and CERs are not included in the EU European Trading Scheme
- ❖ Increasing number of new initiatives related to forest carbon funds and REDD projects



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THANK YOU