REDD+ and Green Bonds: Upfront capital at scale for low emission development

REDD+ Finance Workshop for Central America: Antigua, Guatemala
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Introduction

• Opportunity to build on:
  • Existing effort and investment from tropical forest countries
  • Warsaw commitment to Results-Based Finance (“RBF”/”PFP”) for REDD+ (e.g. German REM, WB Carbon Fund, UN GCF)
  • Investor interest in ‘Green Bonds’
  • Growing private sector focus on sustainable commodity supply chains

• How to integrate these themes to transform the economics of low emission development for countries and private sector operating models?

• RBF can help transform the economics. But at scale of multi-year national strategies for low carbon energy and sustainable food production, multiple $100millions required. Therefore need to source from capital markets where most of the world’s money is sitting

• Upfront capital can then flow down to support policy and leverage further private investment at a local level

• Bond investors are big but simple! Don’t want complexity. Just yield and credit rating

• Commodity buyers want scaled-up sources of sustainable supply
Upfront capital for National REDD+ Plans

- Use limited public funds to leverage capital markets (e.g. pension funds) via Treasury Bond instrument.

- Most efficient to utilize government credit ratings where possible.

- Countries with weaker credit ratings would need additional support from e.g. World Bank/MIGA to make Bonds attractive to investors. This can take the form of political risk insurance or partial risk guarantees.

- The proceeds from a Green REDD+ Bond would be devoted specifically for National Plans to support low emission rural development, ‘green growth’ and REDD+ targets.

- Investors would simply receive interest payments guaranteed by the government as with a normal sovereign Treasury bond.

- RBF or ‘Payments for Performance’ over a period of 10-15 years for meeting emission reduction targets would subsidize the interest costs.
Simple Treasury bond cash flows for USD 250 million bond at 5.5% interest*

*Bonds generally pay coupons semi-annually rather than annually. This figure is simplified to annual payments for illustration.
REDD+ Bond cash flows for USD 250 million bond at 5.5% interest and US$ 5 carbon price

Payments for Performance over a period of 10-15 years for meeting emission reduction targets would subsidize the interest costs.
Investment grade tropical forest country governments have long-term US$ borrowing rates of 4-7% which they use to raise funds for investing in their domestic economies and infrastructure.

The purpose of the Green REDD+ Bond structure to allow governments to invest in sustainable agriculture and conservation at a much lower cost of capital.

This would help make low emission development economically competitive compared to ‘business-as-usual’.
Table 2: Illustrative Cash Flow Detail for Forests and Climate Change Treasury Finance

<table>
<thead>
<tr>
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<th>REDD+ Bond (10 year)</th>
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<tbody>
<tr>
<td></td>
<td>Year 1</td>
</tr>
<tr>
<td></td>
<td>2015</td>
</tr>
<tr>
<td>Nominal Size of Bond (US$)</td>
<td>400,000,000</td>
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<tr>
<td>Coupon cost</td>
<td>5.50%</td>
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<tr>
<td>Emission Reductions (10 years)</td>
<td>75,000,000</td>
</tr>
<tr>
<td>Donor Payment per tonne CO2e (US$)</td>
<td>5</td>
</tr>
<tr>
<td>Post Carbon Coupon Cost</td>
<td>-15,500,000</td>
</tr>
<tr>
<td>Post Carbon Coupon Costs as %</td>
<td>-3.88%</td>
</tr>
<tr>
<td>Implied net Principal to be repaid</td>
<td>245,000,000</td>
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For example:
Utilize $155mm for direct costs of e.g. conservation and support for indigenous communities
Utilize $245mm for investment in agriculture (debt finance etc.)
Required return on $245mm is Zero% for all bond cash-flows to be repaid without cost to Treasury
Green REDD+ Bonds: an instrument to support Warsaw Framework for REDD+ & Financing for Food Production, Forest Conservation, Emissions Reductions and Improved Livelihoods
Conclusion

• Green REDD+ Bond is simply a mechanism that supports an integrated approach

• Donor governments could make RBF commitments to pay for VERs and tropical forest governments could simply borrow funds and make investments as per usual without issuing a bond labeled as ‘Green’

• However, an explicit ‘Green REDD+ Bond’ mechanism has advantages:
  ➢ Alignment of interests between donor and tropical forest governments. Commitments on both sides
  ➢ LATAM governments are using fiscal resources already. Helpful to package and show them to the world
  ➢ Commodity buyers would like to see commitment to low deforestation in jurisdictions/regions
  ➢ Institutional investors want simple investment grade ‘Green Bonds’ rather than complex funds
  ➢ Growing demand for ‘Green Bonds’ could start to see them trade at lower yields than normal bonds. Globally we may see incentives such as partial risk guarantees emerge to encourage investors

• Large scale capital is needed TODAY for REDD+ goals. Warsaw commitment to RBF can create future revenues but does not source capital today

• Green Bonds could link global REDD+ benefits to local ecosystem services; and transform the net cost of capital for LATAM countries to invest in natural infrastructure and development, supporting policies and incentives for sustainable private sector operating models
Gracias


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