

Connecting communities, conservation, and markets



Katoomba Ecosystem Services Incubator

the
katoomba
group



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Linking local producers and communities to ecosystem services markets

Around the world, widespread interest is emerging in markets and other mechanisms that recognize the value of nature's services and reward the people or organizations that maintain or restore these ecosystems. Known as Ecosystem Services (ES) payments, these mechanisms are an innovative approach to conserving ecosystems critical to human livelihoods and economic development via directly compensating land stewards for the desired management. Forest Trends and the Katoomba Group have been dedicated to global efforts to promote and design these innovative markets since 1999.

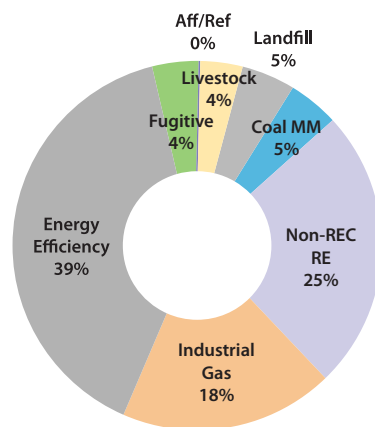
The last decade has seen a powerful upsurge in efforts, both global and local, to put these ecosystem services reward principles to work. Water authorities in New York and Quito are investing in protection of watersheds as a cost-effective means to maintain water quality and stabilize flows. Major companies are looking at standardizing methods for evaluating and offsetting their

impacts on biological diversity under the aegis of the Business and Biodiversity Offsets Program (BBOP).

By far the largest and most dynamic of these markets is the global carbon trade, where volume has surged from near zero in 2004 to roughly \$66 billion in 2007. In this market, the Kyoto Protocol's Clean Development Mechanism (CDM), which rewards industrialized countries for investing in "green" projects in the developing world, funneled nearly \$7 billion into projects of all kinds in 2007, according to the World Bank.

Land use and land-use change projects like forestry (those with most potential benefits for rural poor) accounted for less than 1% of the Kyoto project-based carbon transactions recorded in 2007. This is despite the fact that the mechanisms for using forestry as an offset have proven their effectiveness in the far smaller voluntary market, where land use and land-use change projects account for a much larger share of all transactions.

The fact that deal-flow in the carbon market is currently bypassing important conservation and community-based sustainable development projects in Africa, Asia and Latin America – partly because of high transaction costs – highlights the pressing need for mechanisms to improve access to information services, build capacity, enable players to enter the market and facilitate transactions for ecosystem services for low-income and indigenous communities. We have an historic opportunity to shape these new emerging markets. Yet this window of opportunity is closing quickly. The markets are moving at the rate of international businesses. In the next 5-10 years, the rules and instruments for these markets will be formed and the interests of conservation and low-income communities will be in or out.



Project types - CDM/JI credits sold in 2007

Source: World Bank, State and Trends of the Carbon Market 2008.

Factories or Forests: What's keeping community and forest-based projects from getting to market?

While emissions reduced from a factory smokestack may have the same ton-for-ton impact on the global atmosphere as those from a community forestry project, their contributions to sustainable development are markedly different. Well-designed forestry and land use projects have the potential to improve rural livelihoods, conserve imperiled biodiversity, maintain long-term soil productivity, and protect water sources – while addressing a source of nearly a fifth of the globe's greenhouse gas emissions.

But the promise that many in the conservation and rural development communities see for recognizing additional value for farmers, communities and small enterprises has by and large failed to materialize on a significant scale, despite the multi-billion dollar offset markets. Why?

Part of the answer lies with regulatory and market barriers. The European Union Emissions Trading Scheme (EU ETS), for example, doesn't recognize forestry offsets, and there's still plenty of low-cost "low-hanging fruit" available in other sectors.

There is also, however, plenty of demand for forest-based carbon offsets. Indeed, demand

far outstrips the supply of good forest-based projects with credible offsets, but there is inadequate investment in building the 'pipeline' of these projects to prepare them for market.

Forestry projects, and especially those with a strong community focus, face barriers to tap into global carbon markets, including:

- Scarce technical capacity to design solid, credible offset projects;
- Limited business, financial and marketing experience and expertise within community and NGO project developers;
- Insufficient early stage finance available to bring projects up the 'value curve' and reduce risks;
- Lack of capacity to engage and negotiate in a global market;
- High transaction costs of working with isolated communities, smallholders or small-scale projects.

The Katoomba Ecosystem Services Incubator is a specialized vehicle to provide strategic support to small-scale projects to take advantage of revenue flows. Our aim is to increase high-quality, solid supply of ecosystem services.

Community projects need specialized support to access ecosystem services markets on equitable terms. There is need for the equivalent of the micro-finance network to support small-scale producers for emerging ecosystem markets.

Getting to market, increasing local benefits: connecting communities, conservation and markets

The Katoomba Ecosystem Services Incubator was created to address the supply side of the current disconnect in ecosystem service markets. By providing targeted technical, financial and business management support to promising projects with potential for long-term financial viability, the Incubator contributes to catalyzing the nascent ecosystem service markets and bringing benefits to small-scale producers. Latin America is the initial regional focus of Incubator investments given its leading role in ecosystem market and project innovation, and expansion to Uganda and east and southern Africa has begun.

The Incubator strategically invests in the project development phase enabling projects to more effectively engage private investors or buyers on solid footing to increase opportunities for equitable outcomes. Though

there are notable brokers and investment funds developing carbon projects (an estimated \$11 billion in private and public carbon funds worldwide), few are focused on maximizing conservation and community benefits. And very limited investment is available for moving projects efficiently through the design and development process to go from promising potential to a marketable commodity.

Three characteristics distinguish the Incubator from other institutions:

- Focus on community and biodiversity-centered projects
- Identification of a portfolio of promising projects
- Extensive partner networks

The Incubator focuses on investing in the design and development phases of community and biodiversity-centered projects. While other NGOs have incorporated carbon and ecosystem services into their agenda, the Incubator identifies a portfolio of projects that enables it to provide effective, efficient support to a broad range of partners and aggregation models. Thirdly, the Incubator benefits from the Katoomba network's capacity to draw on leading practitioners in the field and the most up-to-date market information via the Ecosystem Marketplace's (www.ecosystemmarketplace.com) global market linkages.

Incubator Goals

- Increase benefits to communities from ecosystem services markets by increasing supply of solid projects
- Leverage new investment flows, demonstrating that community ecosystem services projects can provide attractive investment returns
- Catalyze innovation and methodological development, including a focus on REDD, water markets, and bundled services
- Strengthen regional institutional capacity to access markets and develop viable projects
- Build an aggregation model to efficiently support a range of small-scale producers



The Incubator Approach

The Incubator works with project partners to co-design a plan to help overcome barriers to market access through technical, business, financial and marketing support.

Technical and business support for project development is drawn from a roster of unique specialists in the Katoomba Group's global network and other consultants and service providers. Advice is provided to meet typical project development needs, including:

- Quantification of ecosystem services benefits using accepted methods and standards
- Technical review and design support to optimize ecosystem services and community development benefits
- Stakeholder engagement and participatory design
- Preparation for approval, validation or certification processes
- Legal assistance and negotiation support
- Development of business plans and financial projections

By providing the experts and technical resources to meet the specialized development needs of projects, the Incubator provides critical support for

projects as well as building and reinforcing regional capacity and learning networks.

Catalytic seed funding from donors helps cover some costs incurred by the project developers in the initial stages of project design. In many cases, lack of this early-stage pre-market seed support is the major obstacle to project development. We are also exploring the potential for other project finance arrangements that allow for returns from successful projects, providing additional leverage and ensuring long-term sustainability of the Incubator instrument.

Strengthening market access for the ecosystem services created through the portfolio

Along with its partner programs in Forest Trends, including the Ecosystem Marketplace, the Katoomba Group is well-positioned to facilitate contacts with potential buyers and investors for high-quality ecosystem services projects. The Incubator will work with project developers to help them package, position and negotiate their projects, as well as exploring possibilities for 'pooling' ecosystem service suppliers in order to better meet market demand and facilitate access for small producers and community-based projects.



The Incubator provides effective, efficient support to a broad range of partners. Support includes technical, business, and financial expertise.

What do we look for in our projects?

- Multiple benefit projects: Strong community participation, social benefits and positive biodiversity impacts.
- High potential replicability and opportunities for scaling up.
- Significant demonstration effect, impact on development of policy and emerging standards and methods.
- Particular attention to opportunities for community initiatives facing barriers to market access and potential for aggregation
- High potential for sustainable long-term finance with ability to significantly leverage initial Incubator investment.
- Strong, but non-exclusive, emphasis on projects resulting in marketable carbon offsets, ideally leveraging other ecosystem services finance.
- Reasonable (ideally 12-18 months) estimated development time required to bring project to market.



Building the Incubator: Initial Portfolio and Next Steps

The Incubator aims to address a broad range of evolving market needs and opportunities for innovation, but we see particular promise in project types that have the potential to drive policy change, create financial leverage and go to scale, including:

- Projects reducing emissions from deforestation and degradation (REDD)
- Integrating ecosystem services payments with certified sustainable forestry or agricultural operations
- Using carbon finance to leverage more incipient ecosystem services markets (e.g hydrological services, biodiversity offsets)
- Creating vehicles for aggregation of small-scale producers and projects to facilitate market access



Phase I: Initial portfolio

The start-up phase (2-year) investment of \$2.2 million is required to:

- Support another 10-12 projects in the 'pipeline' and bring them successfully to market;
- Expand the portfolio model to Africa (Uganda, Ghana)
- Develop solid evaluation and monitoring criteria for the portfolio projects and the Incubator Instrument itself, including a Social and Environmental Return on Investment Indicator;
- Assess and incorporate methodologies, tools, standards and best practices into portfolio
- Establish strategic alliances with key partner institutions bringing additional technical and business expertise to the Incubator;
- Draft a business plan defining strategy for leveraging increased private finance and ensuring long-term sustainability;
- Disseminate results and lessons learned from projects and into ongoing processes like REDD.

Phase II: Building financial sustainability

Technical support and grant-making provide important flexibility in supporting innovative projects and ensuring that partners have the possibility to maximize benefits to them. But long-term sustainability and scalability of the Incubator model require financial mechanisms and agreements that ensure that it can continue to support new projects. By the end of 2009, the Incubator aims to provide support to a portion of its portfolio on a contingent cost-recovery basis, allowing for successful projects to pay back a portion of their proceeds to the Incubator allowing funds to be rolled over into new projects.

Scaling up to an aggregation model

Growth potential and increasing demand may present the opportunity for the Incubator to become an independent self-financing business. With a solid track record and strong capacity, the Incubator should be well positioned to involve additional investment partners and create a vehicle that invests in projects throughout their life cycle, including implementation and onward sale of offsets.

Priority Investment Lines

- REDD- Reduced Emissions from Deforestation & Ecosystem Degradation
- Integrating ecosystem services with certified sustainable forestry and agriculture
- Using carbon finance to leverage or bundle emerging ecosystem services markets (hydrological, biodiversity)
- Aggregation vehicles for small-scale producers and projects

About us

Katoomba Group

www.katoombagroup.org

Katoomba Group, a part of the family of initiatives of Forest Trends, which includes the Ecosystem Marketplace, is a global network of practitioners working to promote the use and improve capacity for developing ecosystem services payments. The Katoomba Group addresses key challenges to developing markets and payments for ecosystem services, from enabling legislation through establishment of new market institutions, to testing methods for successful project design. The Group works through strategic partnerships for analysis, capacity building, information-sharing, investment, market services and policy advocacy.

EcoDecisión

EcoDecisión is a Latin America-based firm focused on developing innovative tools for funding and sustaining biodiversity conservation. EcoDecisión is a regional leader in the fields of conservation finance and payment for ecosystem services.

EcoDecisión's work has put it in the forefront of environmental services payments in Latin America for over 10 years, working with local and international partners to promote initiatives that make conservation economically viable. EcoDecisión has been a pioneer in watershed protection finance, forest-based carbon offset projects and policy, conservation endowment funds, and incentive agreements.

Uganda Carbon Bureau

<http://ugandacarbon.org>

The Uganda Carbon Bureau provides professional support to project developers, carbon credit buyers, development agencies, financiers and the public to ensure that biodiversity and social impacts are carefully assessed and innovatively treated in projects developed in the voluntary and compliance carbon markets. The Bureau is currently designing a carbon offset portfolio, based on credits from Ugandan projects, for use by Ugandan companies, organizations, individuals and event managers.

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Incubator sponsors



Current Portfolio

The Incubator provides targeted support to projects based on their potential to generate significant community and biodiversity benefits, to innovate in ways that drive markets to meet the needs of these critical participants, and move to market. Partners are carefully selected based on their demonstrated capacity to effectively manage and execute projects.



Monte Pascoal – Pau Brasil: Establishing an ecological corridor in the Atlantic Forest

Brazil

Focused on the establishment of a ~1000-hectare reforestation project within an ecological corridor in Brazil's Atlantic Forest, the Katoomba Group worked with The Nature Conservancy, Rainforest Alliance, and local partners to facilitate the institutional configuration of entities to design a carbon offset for Jacques Vabre, the French branch of a multinational coffee corporation. Katoomba initiated brokering of the arrangement between the buyer, technical and managerial support institutions, international certifiers and their Brazilian counterparts with the aim of achieving a project that incorporates social and biodiversity benefits with high integrity carbon offsets. In addition, Katoomba participated alongside the parties during legal and contracting negotiations, which resulted in the buyer agreeing to purchase an extra 20% carbon credits from the project as risk mitigation for potential losses. The project is currently undergoing certification in accordance with the standards of the Climate, Community and Biodiversity Alliance (CCBA), and there is interest in replicating the approach in other regions of Brazil's Atlantic Forest.



Pico Bonito: Combining REDD carbon and FSC-certified forests

Honduras

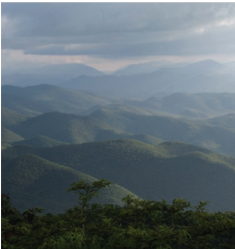
Communities with experience managing their forests under Forest Stewardship Council (FSC) standards have developed technical, organizational and managerial skills that provide a powerful platform for engaging with PES markets. The 1250-hectare Las Camelias community forestry concession is an FSC-certified forestry operation in the buffer zone of the Pico Bonito National Park in Honduras, one of Central America's most important protected areas. EcoLogic Development Fund (EDF) has been a global leader in developing forest-based carbon projects under the Clean Development Mechanism. Incubator technical support will enable EDF to work with Las Camelias to field test a new avoided deforestation methodology, develop practical community-based monitoring methods, and establish transparent mechanisms for community benefit sharing in offset sales. This project will lay the groundwork to move rapidly to market with offset sales and create a platform enabling rapid replication to other community forestry areas around Pico Bonito and elsewhere.



Sierra Gorda Biosphere Reserve: Carbon finance for community reforestation

Mexico

For nearly 20 years the Grupo Ecológico Sierra Gorda has been working with thousands of rural families in the Sierra Gorda Biosphere Reserve, developing an innovative model of community development within the most ecosystem-diverse protected area in Mexico. Since 1990 Sierra Gorda and its sister organization, Bosque Sustentable, have been supporting extremely poor upland communities of the reserve in reforesting and restoring over 400 hectares.



In 2006 and 2007, Sierra Gorda successfully completed the sale of carbon offsets from these projects to buyers in the voluntary market, and seeks to expand carbon finance for existing and new plantations. To enhance the viability of this offset offering, Sierra Gorda and Bosque Sustentable are integrating small-scale community restoration projects with larger native-species commercial plantations with the aim of having them certified under Climate, Community and Biodiversity (CCB) standards. The Incubator will provide support to enable these organizations to complete design documents, verify carbon project stocks and projections and secure CCB certification – essential steps in moving these projects to market and creating a new livelihood and conservation alternative for the traditional inhabitants of the biosphere reserve.



Restoration of Amazon rainforest in the Surui indigenous territory

Brazil

The Surui indigenous people, numbering approximately 1,000, live within a 248,000-hectare territory in the Amazon rainforest of the state of Rondonia in western Brazil. A small percentage of the Surui territory has been deforested, and their forests are under strong threat of encroachment for timber extraction. This project proposes to catalyze carbon financing to promote the conservation of biodiversity and indigenous rights, through a combination of:

- Restoration of 1500 has of degraded pasture through reforestation with native species;
- Conservation (avoided deforestation) of over 240,000 has of remaining native forest.



The Incubator will support the capacity building of this community to manage reforestation projects and administer carbon finance, and should serve as a key demonstration project to be leveraged through partner organizations for other indigenous territories in the country.



Gran Reserva Chachi: Combining biodiversity incentives and REDD carbon for the protection of indigenous territories

Ecuador

Since 2006 the Chachi indigenous people have worked with Conservation International and GTZ (the German technical cooperation agency) to establish an innovative model for community-based conservation. At the heart of the Ecuadorian portion of the megadiverse Chocó bioregion Chachi communities have declared conservation areas totaling 7,200 hectares, funded in part through conservation incentive agreements. Under these agreements, the Chachi receive financial support for alternative development initiatives and public services, chosen by the communities themselves in exchange for reserve creation and management.

To date they have received funding for their biodiversity, but the funds are insufficient for long-term sustainability. By integrating carbon finance for avoided deforestation, biodiversity finance would be leveraged and the area could be significantly expanded to neighboring communities who have expressed strong interest in the incentive agreements. The Incubator will help support the development of the technical analyses needed to consolidate this market opportunity, including baseline establishment and carbon stock assessments.

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- Demonstrate an aggregation model to efficiently support a range of small-scale producers

To support our work or learn about other partnership opportunities with the Katoomba Group, please contact
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