A NEW APPROACH TO FORGING PUBLIC-PRIVATE ALLIANCES AROUND SUSTAINABLE LAND MANAGEMENT

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FOREST TRENDS

Introduction

Today, we face twin challenges of maximizing the effectiveness of publicly funded sustainable land management and identifying incentives to attract private capital to these investments. To do so, there is a need to transform land-use policy objectives into larger-scale sustainable land management and environmental investments.

Given the scale of the challenge, we need to move beyond business-as-usual and find innovative ways to attract private sector investors from both developed and developing countries. Stable and reliable long-term financial flows require greater coordination between public and private sector donors and investors. In particular, host countries need to consider fundamental policy and institutional changes that can transform land-use dynamics, forest governance, and resource flows to local communities.

This brief lays out a new approach for scoping and moving forward with potential public-private alliances around sustainable land management.

Opportunities and Challenges

Successful engagement of various sources of capital requires an understanding and acknowledgement of the terms and conditions that each funding source requires. While investment approaches and philosophies differ, private capital, by definition, seeks direct financial return on its investment that is commensurate with the risk being borne over the investment horizon. Dialogue about private-public partnership must keep this axiom front and center; it both defines the bounds of the possible in terms of seeking private investment and helps to illuminate the risk/return and cash flow considerations associated with different government-designed and -administered programs.

The issue of risk-scoring investment opportunities, including predictability of project cash flows by private investment, can and should be seen by governments and multilateral institutions as a rationale for evaluating the efficacy and efficiency of program design and implementation strategies. In many cases, the private sector will expect clear and straight forward approaches. These fundamental parameters for engaging private capital are likely to necessitate challenging conversations and hard choices, but the reality is that either private capital is “in” with its approach to investing or not engaged.

Engaging private capital offers unparalleled potential for scalable sustainable investment models for forest protection and achieving sustainable land-use outcomes. Without private capital contributions, it is likely that revenues from degradation exceed preservation and that loss of forest lands and healthy productive ecosystems continues largely unabated. For those interested in moving forward, we are finding that the following process is most likely to identify robust opportunities and lead to real investments over the long-term.

Step I: Develop an analytical framework for assessing market- or performance-based environmental policies from an investor perspective

As an initial step to illuminating the challenges and opportunities, it is essential to invest in up-front analysis, such as through the crafting of a multidimensional matrix that describes:

- *on one axis:* major environmental policy 'streams' or 'foci' that are either performance-based and/or premised on private capital participation, and
- *on the other axis:* the different sources of private capital—ranging from demonstration, venture, private equity and institutional—and the risk-and-return criteria that must be satisfied to secure their investment participation.

Populating the matrix will require characterizing the risk characteristics and risk profile that investors would ascribe to these key policy streams in order to develop an initial map of:

- Types of risks prevalent in the policy streams;
- Policy streams that are most likely or unlikely to attract private investment;
- Most likely sources of private capital for specific policy streams based on risk profile and other characteristics;
- Risk mitigants that may be available to secure early-stage investment;
- Risk mitigants that may be required to move from one class of investment capital source to another (e.g., from private equity/family funds to bulge-bracket financial institutions); and,
- Policy development frameworks whose "maturation paths" are designed in a manner that makes the risk profile more attractive over time.

Such a matrix would serve several key purposes. First, it wold establish a systematic framework for analysis and would identify relevant potential solutions and challenges. Second, it would provide a transparent explication of the relationship between policy design and private investment decision-making frameworks, which would enable policy makers to have a clear understanding of how different sources of capital make investment decisions as well as the impact of policy design on investment analysis. Third, the matrix would clearly identify core opportunities for engagement of relevant private investment sources as the basis for developing the broader program's key dialogue streams. Fourth, it would illuminate recurrent risk and risk mitigation themes that enable broadening of the opportunity set and classes of participating investors. And finally, the analysis would identify policy streams where co-investment may be an unrealistic objective due to a mismatch between public policy imperatives and investor risk-and-return requirements.

Step II: Convene a targeted dialogue to identify and catalyze scalable investment opportunities

With this analysis in hand, highly targeted and facilitated dialogues are essential to bring policy makers, private sector investors, and land users together to explore the policy options that are best suited to leveraging private capital to address the public policy concern regarding environmental outcomes.

Specific dialogue topics should be selected based on the findings uncovered in the development of the matrix analysis process. (Illustrative topics are around issues such as REDD+, reducing nitrogen usage, and other cropping and tillage issues, nutrient and sediment loading in key watersheds, and forest management practices.)

These dialogues should be preceded by a concise briefing paper that lays out:

- The sustainable land management issue being addressed,
- The policy tools under consideration,
- The type of risks investors may face, and
- The risk mitigants that may be available.

The pre-event paper should contain a detailed analysis of whether and how the policy mechanism lends itself to translation into an investment opportunity, characterization of the investment risk and, if suitable for private investment, the type of investor thesis with which it may be compatible. For a program that appears compatible with private investment, a preliminary investment risk-scoring algorithm should be developed and the program should be given an initial investment equivalent rating that corresponds to the investment class(es) which the initiative would most closely resemble.

The distribution of a pre-event paper will ensure that all dialogue participants have a common understanding of the requirements each prospective party needs to get satisfied in order to make commitments and determine if the interests can be sufficiently aligned to warrant the development of an initial discussion framework.

The dialogue would then be convened with the following objectives:

1. To improve common understanding of the respective constraints faced by policy makers and investors, paving the way for more productive future interaction;
2. To identify policy design options that may increase the immediate or long-term potential for private sector co-investment and/or private sector investment analysis and risk management techniques that could be applied to the policy to improve its efficiency; and,
3. To assist in the development of a broader analytical framework that helps identify (a) what program designs (and sub elements) have the greatest potential to attract private investment, (b) which private investment tools and practices can be most readily applied to publicly financed programs, and (c) which policy designs foreclose or facilitate a transition to increased private investment.

The dialogue should also be used to illuminate the challenges and solutions to broader objectives of characterizing different policy designs based on their potential to attract sources of private investment and/or benefit from tools used in private investment.

Finally, using the results of the initial dialogue, a longer-term proposal and work plan would need to be created that would culminate in a scoring algorithm that enables users to readily identify different programs' potential compatibility with private investment, as well as clarity on elements that would improve this compatibility over time and, for those programs that cannot be structured to attract private investment, and the types of practices and risk mitigants that can be used to maximize the efficiency of publicly funded activities.

Conclusion & Pathways Forward

The economic upheaval over the last few years has made it vital to develop new, strategic blueprints for private sector investment. At the same time, there are significant developments at the global level in climate change mitigation that present potentially compelling opportunities for investment that can create long-term environmental and commercial value. While climate change poses huge challenges, with such obstacles come unique opportunities for innovative firms to leap to the forefront. The opportunity is to craft a robust process in which all parties feel that their interests and concerns will be openly understood and shared.

The pathway forward is increasingly clear. The opportunities are increasingly ripe. The need now is for some first movers in the public sector to invest in new processes that can drive far greater public-private collaboration and investment in sustainable land management of the future.

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