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White Paper

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Land Degradation Neutrality Fund project

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Responsible Investing

UNCCD
THE GLOBAL MECHANISM

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What do participants need to know about the topic?

Land degradation as a major issue

An urgent global problem needs to be addressed: the extent and severity of land degradation worldwide is worrying, and the negative impact on our environment, people and the economy cannot be ignored. Land degradation has significant impacts on societies and economies as it leads to food insecurity, carbon emissions, biodiversity loss, increased pests, reduced availability of clean water and increased vulnerability of affected areas and their populations to climate change. Today, the pressure on land has reached such a critical point that serious doubts have been raised as to the capacity of land to meet the demands of a growing population.

On the other hand, **solutions for tackling land degradation bring benefits of multiple environmental, social and financial dimensions**. Stopping land degradation is a major step toward mitigating climate change, as soil is the second largest carbon storage after the ocean. Land management is also at the heart of many other sustainability issues – it is the instrument that connects the dots between challenges such as food security, poverty, gender equality, water availability and biodiversity. Managing land wisely would allow the world to simultaneously address and alleviate these other global problems.

Land Degradation Neutrality (LDN) as a priority

LDN became a global news headline in 2015: that year, the target of achieving LDN by 2030 was officially set as part of the United Nations Sustainable Development Goals (SDG 15.3). This means ensuring that the amount of healthy and productive land that each country depends on for ecosystem services (such as food, water and temperature regulation) remains at least stable going forward. That same year, the UN Convention to Combat Desertification (UNCCD) adopted LDN as the vehicle for driving implementation of the convention.

To achieve LDN by 2030, large amounts of financial resources need to be mobilized for land rehabilitation and degradation avoidance. As public resources alone will not suffice, it is necessary to find ways to massively engage private capital. The UNCCD, through its operational arm the Global Mechanism (GM), decided to tackle the LDN challenge by promoting the creation of an independent fund to support initiatives that aim to contribute to LDN: the LDN Fund project. In December 2015, the GM selected Mirova, a Natixis Group management company dedicated to sustainable investment, as the Fund structuring partner and co-promoter of the LDN Fund.

Why is the LDN Fund project relevant?

The six months following the announcement of the partnership between Mirova and the UNCCD were dedicated to assessing project feasibility by analyzing the market and the need – or not – for the LDN Fund.

The LDN project team worked to improve understanding of the LDN market through a two-pronged approach:

- A market study was conducted by the LDN team, supported by an independent consultant. This top-down approach intended to assess the current state of land degradation in the world, identify the existing initiatives as well as projects and players on the field and eventually conclude whether there is a need for an initiative such as the LDN Fund project.
- In parallel, approximately 50 projects contributing to LDN were analyzed by our team. This bottom-up approach resulted in a better understanding of the projects and their issues and opportunities, as well as what role the LDN Fund could play once it was created.

The LDN market to date consists primarily of sustainable land use investments, and, to a smaller extent, projects for land degradation rehabilitation. It is still in the early development phase, with various players along the value chain playing different and evolving roles.

Pioneer fund managers and project developers have paved the way of this nascent market with viable LDN investments aimed at generating social, ecological and financial wealth, essentially decoupling economic growth from land degradation and from the old industrial model of extraction.

The market needs many more of these investments to achieve the LDN target. Key themes that emerged from market observations include insufficient funding for LDN investments, a lack of track record at the manager and sector levels and a shortage of investments with risk-adjusted returns that appeal to private investors.

Growth of the LDN market entails overcoming the challenges of raising and deploying capital that targets scalable profitable projects.

Just as importantly, enabling conditions that would allow the LDN Fund to succeed are improving: country leaders are becoming aware that properly managed LDN investments can bring long-term benefits that outweigh investment costs. Their support for LDN investments is demonstrated by the quickly growing number of countries that are setting commitments at national, regional and international levels to combat land degradation.

The LDN Fund concept

Considering the current market challenges and opportunities, the LDN Fund could be the source of catalytic capital that has thus far proved elusive to fully unlock the potential of private capital. The LDN Fund could in particular utilize different investment strategies to develop a well-structured program that invests globally at scale. It could also play a pivotal role in complementing existing funding sources and channeling further capital into the sector.

The LDN Fund project intends to complement and leverage existing initiatives by creating a link between the bottom-up approach (projects developed on the field) and top-down initiatives (government targets, institutional initiatives, etc.)

Fund overview

Figure 1 presents a global view of how the LDN Fund would be set up.

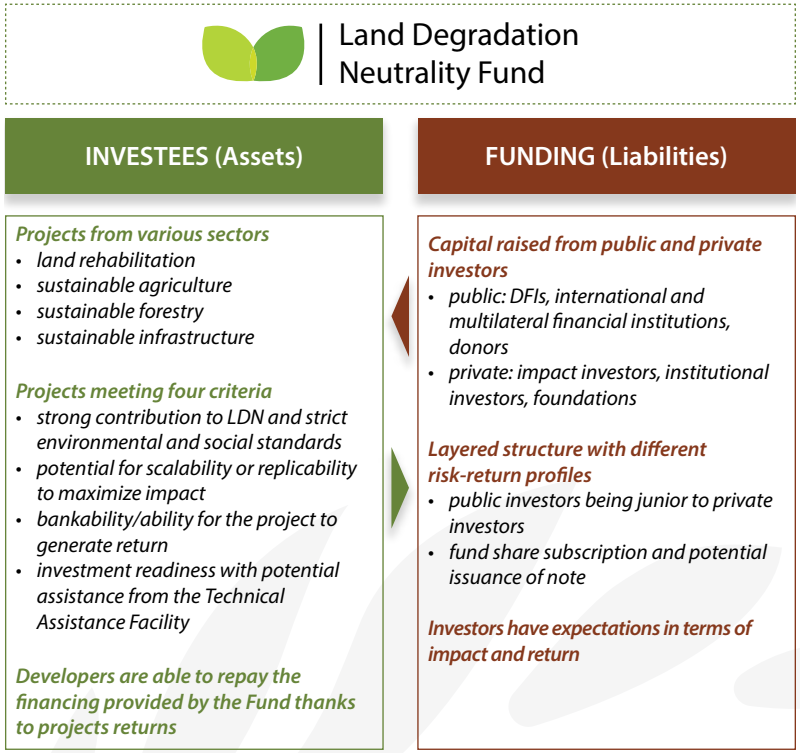

Figure 1. Setup of LDN Fund.

Regarding funding, we believe there are already many factors that could enable the LDN market to "cross the chasm" and attract capital from more mainstream private investors. As the world moves from a voluntary, philanthropically driven conservation model to one that is more pragmatic and market-driven, it follows that funding for the world's LDN investments would also need to come not only from public and philanthropic funding but also the private sector. Public investors and donors with a greater tolerance for risk would invest in junior and mezzanine shares of the Fund. These shares would take any first losses resulting from the Fund's underlying investments, effectively building a risk cushion for private impact investors, institutional investors and pension funds looking to invest in SLM/LDN projects but who may be concerned about such a fund's inherent risk.

On the assets side, we observe that the main trends of land degradation are heavily tied to land-use change (deforestation) and unsustainable agricultural practices (crop mismanagement or unsustainable grazing management). As a consequence, reversing these trends by promoting sustainable forestry and agriculture practices will be key to combating land degradation. Sustainable land management strategies in forestry and agriculture can include reforestation, sustainable forestry management, agroforestry, crop production that ensures long-term soil health and sustainable grazing management such as grazing rotations. Depending on the condition of the land, productive land uses could require initial complementary approaches of land restoration (for degraded or abandoned land) and reclamation (for previously industrially contaminated land) before developing long-term sustainable land management practices.

Fund investment approach

Investments made by the LDN Fund should be aimed at generating social, ecological and financial wealth. Thanks to the immersion in the LDN market, we were able to refine the LDN investment approach, which would be based on three main types of investment:

1. **Working with industries on transforming their supply chain**. In the face of rising supply chain disruption and commodity price volatility risks, as well as reputational concerns, companies such as those in the food and beverage, timber and textile sectors are, albeit from a low base, also accelerating their commitment to sustainability. The LDN Fund could be a partner and support such projects.
2. **Scaling up existing projects**. Pioneer developers and fund managers operating in the field have already launched projects that have demonstrated their success. The LDN Fund intends to leverage existing initiatives. Teaming up with these players and working with them on making their projects grow in size and integration would be the second kind of investment type.
3. The LDN Fund would also aim at supporting **small-scale projects** by teaming up with other funds and, potentially, microfinance institutions. The precise form is still being discussed by potential partners.

The LDN Fund is expected to provide long-term financing for impactful land use transformation for all three types of investments noted above.

What are the current challenges in relation to the topic? Which concrete measures do we propose to overcome these challenges?

Investors need to be convinced

Natural capital has been emerging for some years as an investment class. It relates to natural resources finance, agriculture and forestry investments, conservation finance and more widely real asset investments. LDN finance relates to this more global asset class but with a specific environmental and social edge.

These investments are still considered alternative, hence risky, and investors need to be convinced. The market is also new and lacks a track record, as do asset managers. The funds we have observed in the field are often first-time funds, even if the teams are experienced. Moreover, the geographic scope of the Fund is global, with projects often located in developing countries. Whereas this aspect characterizes natural capital investments – the location of natural resources cannot be chosen or displaced – it is not favored by investors. Nevertheless, there is a great momentum and support from project operators, large corporations, NGOs and public institutions contributing to the emergence and progressive maturity of the LDN sector that can encourage the commitment from private investors.

We have so far witnessed a really strong interest coming from both public and private investors for the LDN Fund project. Investors understand the need for such a fund and seem convinced that it could achieve both financial returns and environmental and social benefits, which are gaining in importance in their eyes. We are firmly convinced that massive amounts of capital can be unlocked and invested in land restoration and conservation.

We believe that several elements are crucial to fully convince potential investors to accompany the LDN Fund project:

- showing a strong pipeline and demonstrating the robustness of underlying projects' business models
- "keeping it simple" and using existing schemes and structures known by investors
- onboarding donors that will provide first loss capital in order to reduce risk and provide technical assistance. This support should counterbalance the lack of track record and accelerate market maturity.

The ability to deploy capital is limited so far, due to a lack of track record

The typical project supported by the LDN Fund should meet the following four criteria:

1. significant contribution to land rehabilitation and/or land degradation avoidance and high environmental & social contribution
2. size: as the LDN Fund intends to be a large fund, projects should themselves have an important initial size or a potential to scale up
3. readiness-to-invest: the LDN Fund does not intend to offer subsidies so potential projects should already have reached maturity stage (with potential for preliminary technical assistance provided through the Technical Assistance Facility)
4. financial profitability.

Our double market analysis (bottom-up and top-down) showed that such projects are difficult to find. They are often too small or not mature enough, and need some time and help to become eligible.

To overcome this issue, we envision two main approaches:

- creating a Technical Assistance Facility included in the setup of the Fund that will help projects to mature and structure
- leveraging public and private money and initiatives that could help developers and projects reach their full potential.

The multi-stakeholder approach requires important coordination work

Co-promoted by a private investment manager and a UN Convention, the LDN Fund project aims at being an investment fund achieving financial returns but also serving a public good objective. In doing so, it would work hand in hand with many stakeholders, including international organizations, project developers, corporations and civil society, notably NGOs. It is thus crucial to favor constructive dialogues with these players. This is a major challenge that needs to be taken into account in the structuring process of the Fund.

To gain stakeholder support, the LDN Fund team worked very hard to:

- consult with stakeholders and include their feedback during the Fund creation process through an ad hoc advisory group
- factor social and environmental criteria into project selection and reporting. The standards are currently being refined and discussed with experts in order to assess their relevance and robustness.
- participate in conferences and relevant forums like the GLF to continue the collaborative approach that was adopted at the beginning of the project.

What are our proposed milestones for implementation?

The first semester of 2016 has been dedicated to the analysis of investment cases, refinement of the Fund's structure, defining of investment schemes and securing public financing and anchor investors. This first phase will close in the summer of 2016, marking the beginning of formal implementation with a focus on broader and proactive fundraising.

The LDN Fund should be launched in late 2016.

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Who carries responsibility for/ can support implementation?

The LDN Fund project is co-promoted by the GM and Mirova, and will be managed by Mirova once it is created. The project is supported by the whole Natixis Group as well as the UNCCD.

Innpact assists the promoters in the Fund structuring.

An Advisory Group has been created to accompany the structuring phase. It is made up of senior members among LDN stakeholders, and, as a discussion circle, enables the team to gain feedback from members and consult them on specific topics.

On the project side, the LDN Fund intends to adopt a collaborative approach and complement and leverage existing initiatives. The Fund is expected to partner with other fund managers and financial institutions, including local banks and microcredit agencies, to increase scale and impact.

More generally, the Fund is also expected to partner with all types of entities involved in sustainable land management, ranging from consultants, non-governmental organizations, development financial institutions, local and national authorities, corporations, etc.

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