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IFACC
Innovative Finance for the Amazon, Cerrado and Chaco

Investor Landscape for Sustainable Agriculture in the Amazon, Cerrado and Chaco

Opportunities and Design Guidance for IFACC

Introduction

Palladium was contracted by The Nature Conservancy to develop a study of the landscape of investors with interest in providing capital to innovative vehicles financing sustainable agricultural practices in the Amazon, Cerrado, and Chaco, in order to support IFACC signatories in scaling their products and reaching disbursement goals.

Context of the study

Innovative Finance for Amazon, Cerrado and Chaco (IFACC) is an initiative from The Nature Conservancy, the Tropical Forest Alliance, and the United Nations Environmental Program that seeks to expand the use of innovative finance for deforestation and conversion free (DCF) beef and soy in the Amazon, Cerrado, and Chaco biomes.

Although there is growing interest from lenders and investors in such innovative finance mechanisms, challenges to scaling the initiative persist. Through this study, Palladium set out to understand how investors view IFACC's unique ag-financing products to develop recommendations that aim to support IFACC's goal of disbursing $10bn by 2030.

Objectives of the report

- **Understand the landscape of international and domestic investors** who have the potential to offer either concessionary or commercial capital at scale
- **Determine the degree of relevance of IFACC signatories' products to investors' strategies** as they relate to impact targets, risk/return expectations, and structural preferences
- **Provide product feedback** to refine and improve the appeal to investors based on these interviews
- **Offer insight into investors** IFACC may consider engaging with for investor marketing in the future
- Advise IFACC on **approaches to shaping the market** to achieve scale

29 Potential funders interviewed

Risk-Return Spectrum

- Development Finance Institutions
- Corporates
- Foundations
- Family offices and wealth advisors
- Institutional investors

Positive trends in the global investor landscape

The global market for climate and agriculture finance is expanding as investors are growing aware of bankable climate finance opportunities and feel increased urgency to meet imminent net zero and green financing commitments.

Market landscape

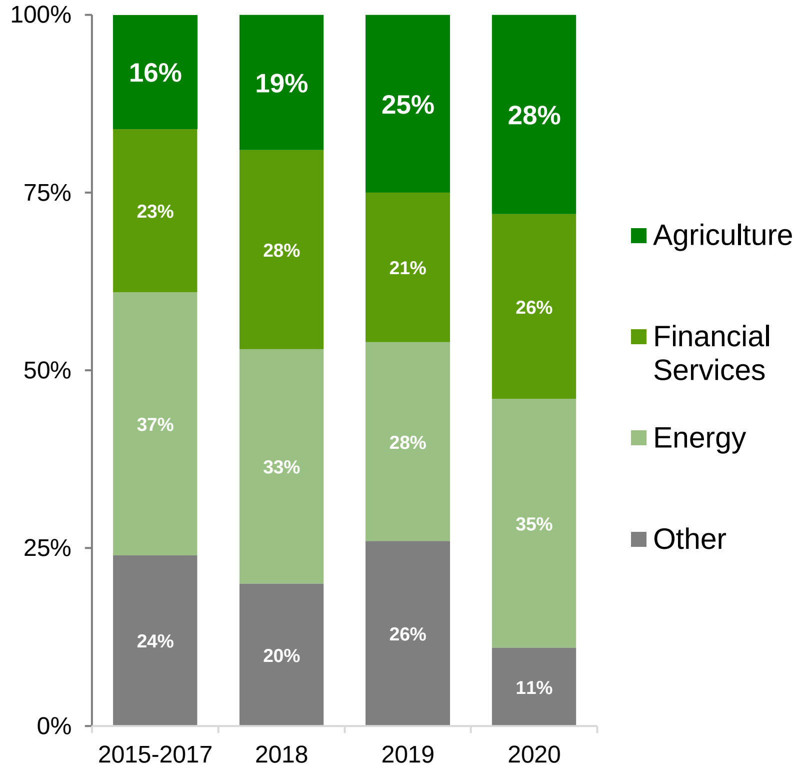
Agriculture is a growing area of investment in global blended finance deals

- A Convergence[1] report published in 2022 estimated that climate transactions account for half of blended finance deals launched per year and attract over two thirds of total capital invested. Agriculture in particular has experienced an increase in deal flow as shown on the graph on the right.
- The climate finance gap persists, however, particularly in emerging markets, as less than 25% of capital is invested outside of developed economies.
- Investors with an impact lens are increasingly valuing the dual impact returns of sustainable agriculture, which include uplifting the livelihoods of ag-reliant communities, in addition to ecosystems conservation and carbon reduction.

Palladium's research found 105+ investors that currently have a broad mandate to invest in agriculture, including those investing in South America

- The interested investor groups include development finance institutions (DFIs) and foundations, family offices and wealth advisors, corporates, and institutional investors, each with a different set of investment mandates and risk-returns expectations.
- In addition to agricultural production, these investors also expressed interest in investing in sustainable practices throughout the agricultural value chain, including agricultural goods processing, cold storage, packaging, etc.

Agriculture is increasing as a percent share of total blended finance deals globally[1]



Source: 1. Convergence, State of Blended Finance Report (2022)

Funder categories able to invest in IFACC-aligned products

Palladium segmented investors into five groups based on sources of capital, impact return preferences, financial return preferences, and the type(s) of capital they are capable of deploying.

Impact-first investor

Finance-first investor

Funder categories

DFIs/Development facilities: Strong focus on emerging markets and have the highest expectations for impact additionality amongst funders/investors. They have both direct and indirect financing capabilities, are able to provide large ticket sizes, and may anchor funds. *Capital: equity/quasi-equity, senior and/or subordinated debt, guarantees, grants/TA*

Corporates: Possess a range of different tools to invest from, including corporate venture capital, corporate social responsibility funds, and stand-alone corporate foundations *Capital: equity (corporate venture capital), grants/TA (corporate foundations)*

Foundations: Mission-driven, philanthropic asset owners that deploy capital to opportunities which further their mission (i.e. health access, food systems, coral reef protection) *Capital: grants/TA, sometimes program-related investments (low-cost financing that furthers some aspect of their programs/mission)*

Family offices & wealth advisors: Diverse funder group that range from impact-first investors to those seeking strictly commercial returns; many have specific social or environmental returns mandates; tend to provide smaller tickets, prefer to follow more experienced funds. *Capital: equity, senior/mezzanine debt*

Institutional investors: Traditionally invest senior capital and expect market returns as investment opportunities are compared against other competitive products being offered in the market; can also structure blended finance vehicles, or support distribution *Capital: equity, sometimes senior debt*

Rationale for selection

DFIs/Development facilities, Corporates and Foundations:

- Public and philanthropic investors are key providers of concessional capital, or funds with below-market return expectations that help lower the cost of capital or 'de-risk' the structure for commercial investors.
- These funders can participate at earlier stage of product development as they have experience with blended finance structures and seek to create a catalytic effect through their investments by improving the risk/return profile to attract private investors.
- In addition to first-loss debt or equity, concessional capital providers may also provide guarantees or risk insurance to achieve these goals.

Family offices & wealth advisors:

- Given the diversity and multitude of local and international family offices and advisors, they can unlock a significant amount of private capital in support of innovative initiatives. Their small nimble nature often allows for greater flexibility, faster diligence and decision making.

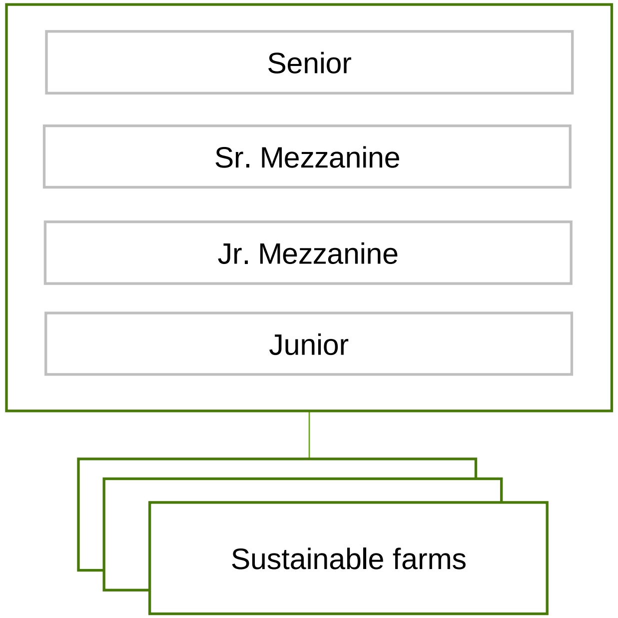
Institutional investors:

- Institutional investors bring in commercial capital and generally participate at the scaling stage of product development. They generally prefer senior tranches with market returns.

Sample IFACC products tested with investors

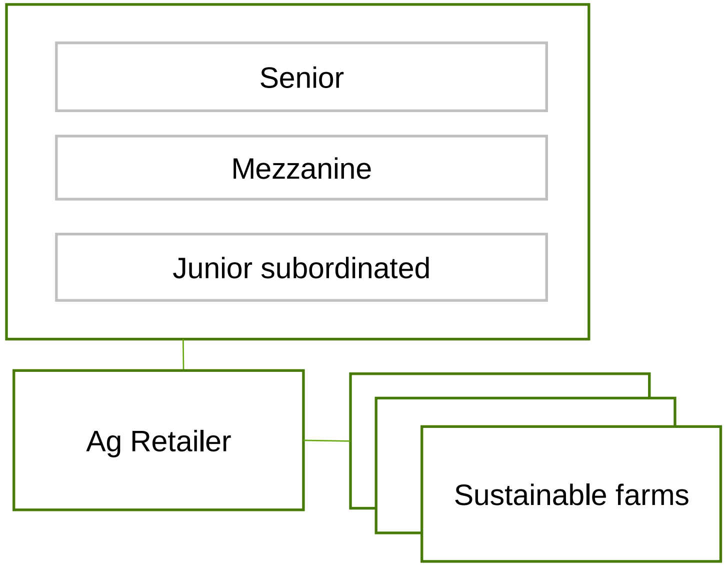
Palladium tested three types of product structures with investors to gather specific feedback on impact alignment, key terms, risk tolerance and return preferences. These structures were arbitrarily selected to show the wide range of IFACC-aligned products that could be considered by investors.

Long-term debt facility for pastureland recovery



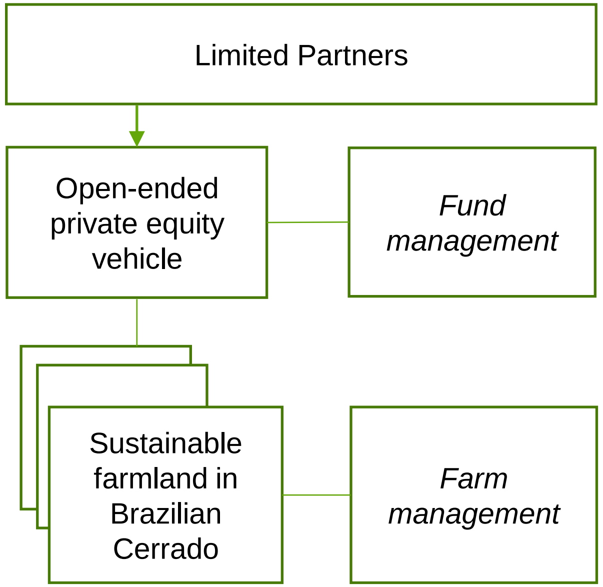
Target Fund Size: $100-200mn
Term: 12 years
Vehicle: FIDC
Use of funds: Capex for deforestation and conversion free agriculture, degraded pasture recovery

Securitization of agricultural receivables



Target Fund Size: $20mn (pilot)
Term: 0.5, 2, or 4-year tenors
Vehicle: FIDC
Use of funds: Short- and long-term production finance for DCF agriculture

Farmland investment fund



Target Fund Size: Up to $300mn
Term: Minimum 7 years
Vehicle: Open-ended fund
Use of funds: Farmland acquisition and inputs for degraded farmland conversion

Investor alignment with IFACC products

Many capital providers aligned with IFACC’s mission showed meaningful interest in IFACC’s product set; within this group, however, certain restrictions posed by investor mandates narrow the pool of capital available to signatories.

Investor alignment with IFACC

29 capital providers were selected for interviews based on their combined interest in investing in ag-production, ability to invest in South America, and ability to invest into funds or facilities:

Interest in ag-production + Can invest in Brazil, Argentina, and/or Paraguay + Indirect investments into funds/facilities

Of the 29 capital providers interviewed, ~13 expressed willingness to further consider IFACC products for investment

- Emphasis of key environmental impact theses were important in securing this interest (e.g. farmland management to prevent deforestation, supporting DCF supply chains)

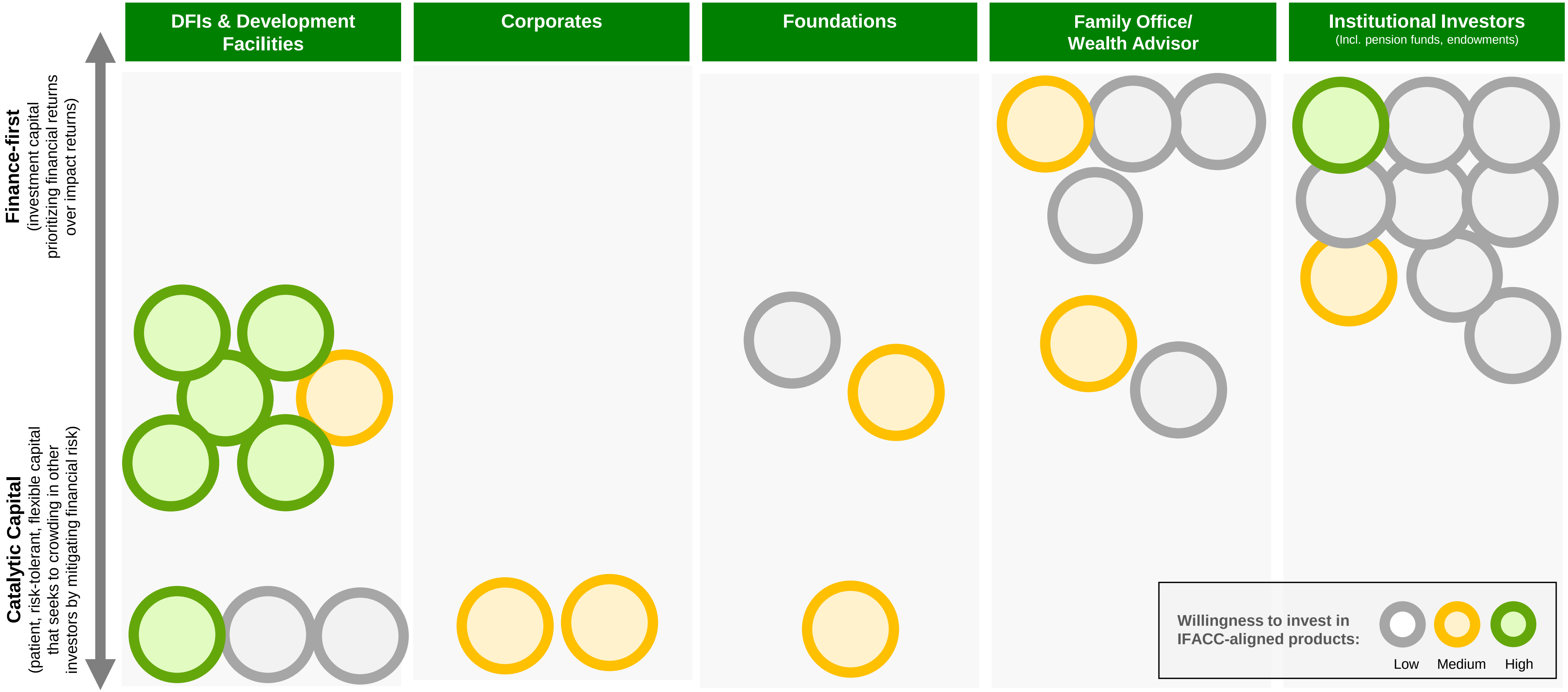
However, some capital providers have investment mandates which restrict them from considering IFACC products, including:

- Preference for direct investments into companies/projects over indirect investments into funds or facilities
- Preference for investing in more familiar single tranche debt vehicles or publicly listed instruments
- Preference for higher, more competitive returns across the capital stack
- Some investors’ may be limited to ticket sizes that are either too big (>$100mn as less than 30% of a fund) or too small (<$1mn)
- Inability to invest in funds with single-country strategies due to lack of diversification and country specific risks

Key takeaway: While there is a substantial number of capital providers aligned with IFACC, the capital market for agriculture finance is an emerging one that has not yet reached the scale needed to support IFACC’s $10bn goal of disbursements by 2030.

Indicative investor alignment with IFACC

Interviews revealed strong alignment among catalytic capital providers but suggest a greater challenge in attracting more commercial investor groups. The full report gives a detailed view of each investor's profile and product feedback.



Opportunities to refine and improve alignment of IFACC products

The full report offers detailed guidance to improve alignment with interested capital providers through adjustments to product fundamentals in two main areas: impact narrative and product structure.

Guidance on adjustments to product fundamentals

Demonstrating impact additionality is critical to attracting catalytic capital

- Impact funds, Foundations and Family Offices are increasingly prioritizing financial together with impact returns; hence the bar to securing concessional capital from these and other sources is high
- Signatories should be able to quantify attribution between sustainable ag practices and stated impact targets (i.e. decreased deforestation, carbon reduction)
- Social impact beyond climate should be emphasized, such as positive economic impact on farming communities, or contribution to food security and sustainable agriculture value chains

Certain structural features, if not adjusted, may further narrow the pool of potential investors, such as:

- Fund term: funders have expressed preference for fund terms of 7-9 years on average, while longer fund terms turn away investors with 10-year funding mandates
- Size of subordinate tranches: signatories may need to consider increasing the size of subordinate layers to secure enough risk-capital to attract private investment
- Macro risk: funds denominated in USD would be more attractive to investors concerned with currency risk created by inflation and economic instability

IFACC signatories may consider aligning products to the specific preferences of the types of investors they choose to market to:

- **DFIs** are the main source of concessional capital in the market but require clear demonstration of impact additionality and attribution; unlocking their commitments entails intensive and lengthy due diligence processes.
- **Corporate funders** are potential sources of concessional capital to finance sustainable supply chains, but require early, strategic engagement and impact investing training.
- **Foundations** require time to understand structures and impact as they are least familiar with the types of vehicles offered within IFACC's product set; they increasingly seek financial returns in addition to impact generated.
- **Institutional investors** despite climate impact interest invest into senior tranches that offer market-rate returns and look for greater product scale.
- **Family offices and wealth advisors** show greatest variation on preferences due to different client portfolios, but generally demand dual impact and financial returns.
- **Domestic investors** are best placed to understand local risks and needs of the ag sector to support the initiative, and to invest in local currency funds.

Recommended next steps for IFACC

To unlock the scale of capital needed to reach IFACC's $10bn target by 2030, signatories and the IFACC initiative may consider the strategies outlined below:

1. **Engage in in-depth, fund-specific discussions with highly aligned capital providers identified in this study**
   - High and medium-aligned investors identified in this study have indicated that they are open to considering IFACC products; when engaging with these investors, signatories should be prepared to address their areas of concern outlined in the individual investor profiles in the report that are specific to their product/fund

2. **Better align product structures and terms to target investor mandates or preferences, and market trends**
   - Signatories may choose to incorporate select feedback captured in in this study

3. **Strengthen messaging on impact additionality of IFACC's products**
   - This report provides several pathways to do this, including quantifying attribution between sustainable ag-practices and stated impact targets and incorporating positive social outcomes in addition to environmental outcomes. Signatories may reference IFACC's guidance on KPIs.

4. **Ensure that market differentiation of the products is clearly highlighted**
   - Investors are not aware of the drawbacks of state-subsidized agriculture finance (e.g., small ticket sizes, short tenure, difficult to access). These limitations should be drawn out to position IFACC products as a solution with clear demand and opportunity to scale.

5. **Advocate for greater investment into this sector**
   - Leverage the IFACC platform, including:
     - The collective interest, capabilities, and readiness of IFACC signatories to deploy climate-positive capital
     - The credibility and relationships of TNC, TFA, and UNEP
   - Encourage key actors to expand investment, including:
     - Governments to allocate substantially more flexible capital to sustainable agriculture;
     - DFIs to deploy additional funds focused on sustainable agriculture and reduce transaction costs;
     - Institutional Investors and Corporates to be more proactive in delivering on their commitments to green supply chains and Net Zero by supporting innovative IFACC-aligned mechanisms.

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