

# **Ghana: Public-Private Partnership for Restoration of Degraded Forest Reserve through VCS and FSC Certified Plantations**

## **Information Memo**

### **Introduction**

1. This Information Memo (IM) was developed as a follow-up to the review undertaken by the Forest Investment Program (FIP) Sub-Committee of a project proposal entitled “*Public-Private Partnership for Restoration of Degraded Forest Reserve through VCS and FSC Certified Plantations*” submitted by the African Development Bank (AfDB) and for which a FIP concessional loan of USD 10 million has been requested.
2. The key issue the IM tries to address is to explain in more detail how the replicability of the approach proposed in the context of the project will be ensured in the future without the utilization of subsidies proposed in the FIP loan.

### **Background**

3. The purpose of this investment is to place debt finance into a sector still highly dependent on either the availability of public investment flows or private investments through the use of equity only as raising debt locally is virtually impossible given current and historic market dynamics. The proposed approach will therefore place debt under previously un-matched terms into an asset that so far was funded by equity only, and scale the existing plantations from its current size of 5.000 ha to 11.700 ha. The project is the first Public-Private Partnership (PPP) in the sector entered by the Government of Ghana with a private counterpart aiming at fighting deforestation and forest degradation in a forest reserve in Ghana.

### **Justification**

4. The logic behind the placement of FIP and AfDB’s debt into the project is built around the following points:
  - (i) There is no history of institutional investors, pension funds and local commercial banks deploying finance in the country. Being the first PPP in the sector, for which limited investments over the last decades came from the country’s national budget, the banking sector has no history of supporting any engagement in the sector nor the appropriate financial instruments to effectively support the bankability of such assets, which require long-tenors above what is available. The risk perception of these financiers is relatively high due to the lack of established track-record in the sector.

In order for local banks to consider future engagement in the sector for such long periods of time, it is vital that: (a) the proposed approach is viable, (v) the company performs well without the

occurrence of significant environment, social and political risk events that can undermine the credibility of the deal, and (iii) the company repays the proposed loans on schedule.

The banking sector responds to market signals and usually seeks profitable investment opportunities. It is therefore imperative that track record is established and comfort grows among these financial institutions and other investors. This will require a strong engagement from all relevant stakeholders<sup>1</sup> in the country that over time can play some kind of role in improving the investment conditions surrounding the sector that improve the credibility of investment in the sector. The FIP loan will be crucial in supporting the establishment of the much needed track-record by reducing first-mover risks.

- (ii) The scale-up of the existing plantation will only be possible if the company's shareholders are able to leverage their equity and reduce overall risk exposure. The scalability of any business – not only forest assets – are directly linked to the ability of an investor being able to leverage its own equity. Since debt instruments are a reimbursable instrument, it is imperative that the company is able to generate cash to service its debt obligations otherwise debt financiers will not agree to fund such projects. Since the major revenue source of this specific project lies on the value of the trees (the larger they are, the more value they have and for that to happen time is needed), it makes sense from a business point of view to allow trees to grow. This requires grace periods of 7-years or more. The FIP loan played a critical role in enhancing the participation of AfDB as a co-financier of the project by stimulating AfDB's credit committee to approve terms beyond its established limits.
- (iii) The Government of Ghana through its Forest Commission has put in place an appropriate policy, legal and regulatory frameworks to address deforestation and forest degradation and to raise funds to support the sector. The review undertaken in 2012 of Ghana's forest and Wildlife Policy aims at developing sustainable financing instruments to support forestry activities. The PPP outlined in the project proposal is a good example of an innovative framework that aims at effectively engaging private sector in fighting deforestation and forest degradation in Ghana. Through the tripartite Benefit Sharing Agreement signed between the company, the Forest Commission and the population in the vicinity of the project, all stakeholders will obtain a share of the project's revenues. Over time the revenues accruing to the Forest Commission will serve to capitalize a national forest development fund that will play a key role in the future financing of such assets, namely by replacing the value-added to be brought to the project by the FIP loan (subsidies).
- (iv) It effectively addresses key project specific risks (see Project Issues List for more information), it is in line with the principle of minimum concessionality and it avoids creating market distortion. These are all requirements associated with the structuring of private sector FIP financing in the context of the FIP set-asides.

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<sup>1</sup> These include the Government of Ghana, Universities, Banking Sector, Forestry Experts, Pension Funds, Forest Commission, Civil Society Representatives, etc.

(v) In order to promote the replicability of this business model, AfDB will implement a structured engagement plan in which we will develop a case study and materials with which to support and promote forest sector investments in Ghana and West Africa more broadly. Working with FORM Ghana's Forests for Future Conference, we help to educate and raise awareness amongst local banks of the opportunities in the plantation forestry sector and the potential risks and mitigants. We will work with the Ghanaian Forestry Commission to promote the use of the dedicated forest development funds with the aim of highlighting the long term financial returns to forestry investments.

## Conclusions

5. It is AfDB's view that the FIP loan will be instrumental in initiating a Market Transformation in the forest sector in the country. In the short-to-medium term the FIP funding will allow the project to more than double the size of the plantation and to enable a business that will contribute to the allocation of funds to the Forest Commission that shall be used in the future for similar PPPs in the country. In the long-run, FIP will contribute to the development of a sector that is still extremely underdeveloped and underfinanced by testing an innovative financial approach in the national context that will pose profitable opportunities for local commercial banks and other investors to play a role in supporting Ghana fighting deforestation and forest degradation without the utilization of any forms of subsidies.

6. Market transformation is not a phenomenon that occurs overnight. AfDB expects that concessional terms will still be required in the short to medium-term to ensure similar projects are bankable as it is only through awareness and improvement in investment conditions (e.g. sovereign risk improvement, financial markets development, track record, availability of different financial instruments<sup>2</sup>, awareness, continuous public support, etc.) that subsidies will cease from been required.

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<sup>2</sup> Case of the first Pan-African Private Equity Fund (USD 100 million Moringa Fund) that is currently in its investment period and aims at providing equity and quasi-equity instruments in similar operations.