A rubber revolution takes shape in Indonesia

The Tropical Landscapes Finance Facility aims to source projects that transform lives and environments, and to securitize the project loans into bonds that will be sold to investors through the MTN markets. It all starts with a rubber plantation in Sumatra

By: Chris Wright

"For your grand plan on climate change to succeed, people must have livelihood opportunities. Because if their children are dying of malnutrition, all your stories about how nice a forest it will be will make no sense at all to their lives."

Satya Tripathi has earned the right to speak so plainly about the realities and complexities of conservation. He spent several years in charge of UNORCIF, a UN system office established to support work on the conservation of forests and the preservation of biodiversity in Indonesia. Before that he was the UN recovery coordinator for Aceh and Nias for three years, organizing the deployment of $7.2 billion in funds to rescue those regions from a devastating tsunami and years of bitter conflict.

Today he is the executive secretary of the Tropical Landscapes Finance Facility (TLFF), which seeks to combine well-intended money with innovative financial thinking, partnership and practical solutions to both environmental and social challenges. It is in its early days, but if it proves to be successful it could be highly influential around the world.

TLFF has so far backed just one project, but it serves as a useful microcosm of what the facility is intended to do. In 2015, Michelin and Barito Pacific Group, an Indonesian conglomerate with forestry origins that now operates across energy and real estate, announced a joint venture to develop a new kind of rubber plantation. It will take shape across three concessions, covering 88,000 hectares between them, mainly in the Jambi province of central Sumatra and partly in East Kalimantan on the Indonesian part of Borneo.

These are blighted places ruined by rampant deforestation. The idea is to do something different here: to reforest the concessions, planting sustainable high-yielding rubber trees on only about half of the available area and leaving much of the rest as a buffer to nearby national parks where orangutans, elephants and desperately endangered Sumatran tigers roam.

Along the way the plan is to create more than 16,000 jobs.

"Fair wage jobs, not just jobs," says Tripathi. "This is not people working for a dollar a day to produce nice Nikes and Pumas. That doesn't work.

"These people will become custodians and protectors."

THE FIRST POINT TO UNDERSTAND about TLFF is that it is a multi-stakeholder group bringing together a range of different expertise and that it simply would not work if any of those stakeholders were absent.

The founding partners are UN Environment Programme (UNEP), the World Agroforestry Centre, the Hong Kong-based investment manager ADM Capital and BNP Paribas. The World Wildlife Fund is a partner, advising on how and where to set aside high conservation value (HCV) and high carbon stock (HCS) forests, two key metrics of forestry conservation, from planting.

Each partner has its own role, with the UN as a catalyst.

"It was brought together in a spirit of equal partnership," says Tripathi. "Nobody was bigger or better."

So what exactly is the facility?

TLFF consists of a lending platform and a grant fund. The grant fund is certainly important, providing technical assistance and co-funding early-stage development costs, with the United Nations Office for Project Services serving as fund trustee, but it is the lending platform that really takes the financing side forward. This is where ADM Capital and BNP Paribas come in.

Hong Kong-based ADM is a driving force. Long known as one of the pioneers of private debt investment in Asia, it has also had an influential foundation since 2006, designed to use innovative and replicable models of funding to create positive impacts.

It talks about 'unsiloing' environmental challenges, which means collaboration with partners both local and international, and accepting that all environmental challenges in Asia are linked.

"It is impossible to think only of air or water pollution, about protecting our forests, our oceans and their biodiversity, without considering also the development challenges we face in Asia," says Lisa Genasci, who runs the ADM Capital Foundation. "We must consider the trade-offs involved in balancing sustainable growth and conservation, as well as how to finance the change that needs to happen."

ADM runs the lending platform: TLFF's investment committee is chaired by ADM founder Christopher Botsford and includes Genasci. Loans from the platform are intended to provide long-term debt to individual projects in the sustainable agriculture, forest conservation and renewable energy sectors, with some loans made in rupiah and others in dollars.

Then, loans from the platform are securitized and turned into a medium-term note programme run by BNP Paribas, which sells the bonds on to investors in a range of tranches that reach some investor pools not typically associated with green finance. It is planned that the MTN notes will eventually reach at least $1 billion in outstanding paper.

Anything that comes through this programme must meet certain criteria on sustainability.

"What we've done, with UNEP, is create a framework," says Frank Kwong, head of primary markets for Asia Pacific at BNP Paribas in Hong Kong. "By lending money to you through TLFF, there are various covenants in there which do not allow you to do deforestation. A large portion of the plantation must be devoted to wildlife and a portion to improve schools, hospitals, the livelihood of farmers."

Then there are the 16,000 jobs.

"It's going to be a mini city," Kwong says. "It will improve lives, give people jobs, lift people out of poverty; so it ticks a lot of boxes from an environmental and social point of view."

These are big promises and they need to be monitored; and this is where the UNEP and the World Agroforestry Centre are vital. There are teams committed to doing environmental, social and governance (ESG) supervision for the life of the bond, with regular reporting on UNEP's own website on the progress of everything from the financing to the trees and the people.

In February, the first loan from TLFF was announced – $95 million to the Michelin/Barito venture, whose formal name is PT Royal Lestari Utama. The significance of this modest facility was that it was the first in Asia to be funded by a project bond issued to support a corporate and it marks the first chunk of a multi-tranche facility.

GETTING INVESTORS COMFORTABLE with a bond like this, particularly over long durations, is difficult and at this stage yet another actor was brought in. USAid, which represents the US government, has provided 50% credit enhancement on the financing.

"If we were to look at the transaction purely on a private-sector basis, it would be pretty challenging," says Kwong, hence the need for USAid. This enabled BNP Paribas to tranche the loan into multiple series, including a $30 million 15-year tranche that, thanks to the USAid backing, is rated triple-A by Moody's.

USAid is not on the hook for the whole thing: on a whole loan basis, 50% is not government enhanced, but is senior secured risk ranked pari passu.

In addition to the 15-year piece, which matches the planned duration of the whole project, there are seven and five-year pieces, and each appeals to different groups.

"The triple-A risk goes very quickly to life insurance companies," says Kwong.

Impact funds have also been important buyers, as one would expect.

"Those are the key investors into these projects," says Kwong. "They don't function like investors in green bonds: they actually don't care about that. It's nice to have a stamp saying it's a green bond, but they need real impact analysis to be done. They need covenants requiring us to provide impact reports on these projects."

These are what he calls "real, dark green investors" and they are principally in Europe.

But what is most striking of all is the distribution of the five-year bonds.

"That was taken up by family offices and private banks," says Kwong. "That piece is more geared towards high-yield bond investors."

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Frank Kwong, BNP Paribas

On a 15-year project, five-year is the lowest risk, since the project is expected to start generating cash flows in years three to five, at which point Michelin can start off-taking money and cash comes in to refinance the five-year bonds.

Private wealth has not normally been prominent in green impact finance, so this is important.

"Private wealth and family office is still very much a yield-driven game, but they like to focus on ESG," says Kwong. "If you have the combination of a product that pays market yields and an ESG focus on it, it grabs their attention."

The private wealth investors were not getting the USAid-guaranteed triple-A piece. But still the presence of that guarantee elsewhere in the structure was very useful.

"Even though the investors themselves were not buying the guaranteed tranche, the fact that you know a government agency has done the site supervision and due diligence is helpful," Kwong says. "It's another pair of eyes looking at the project. If you cannot do due diligence on the project yourself, it is helpful to know that UNEP and USAid have done so."

For the long-term success of this idea, however, more projects will be needed. Most projects individually are too small for big investment banks to want to take to investors.

"Nobody is financing $20 million projects, because a big corporate bank like us would not be giving a $20 million loan. It's too small," says Kwong. "So if we don't work with a third party to do the lending on an aggregate basis, these projects will never materialize. That's the change factor."

This is where ADM Capital comes in.

"There are opportunities at the $10 million to $15 million dollar range and a few at the $95 million to $100 million range, which is where we need to be for an MTN programme," says Genasci at ADM. "We are looking to create funds or lending platforms for sustainable agriculture and renewables that would allow us to aggregate the smaller opportunities. These would also offer a takeout for the entire facility."

But the first issue is a good starting point and has a useful demonstration effect.

"One of our objectives was to be able to show that you could structure these types of projects at scale," says Genasci. "Another is to show institutional investors that there are projects that are safe to invest in."

Also, although the Indonesian government was never directly involved, it is at least on the same side as TLFF's backers.

"This is extremely crucial and anybody who is trying to replicate it needs to know: you can't do this without government support," says Tripathi. "They don't need the money – the money is there – but the government needs to be an enabling partner. And they have been, 100%."

Indeed, the government made sure to send the right signals. It was formally launched by

Darmin Nasution, the coordinating minister for economic affairs, in the ministry's office.

"He said: 'I will launch you from my ministry to let people know how important this is to us and how much we value it,'" Tripathi recalls. "We were launched in the ministry despite having nothing to do with the government."

Siti Nurbaya Bakar, minister of environment and forestry, was at the launch. "We fully support the Tropical Landscapes Facility, which is in line with Indonesia's sustainable development aspirations," she said then.

Darmin added: "The Indonesian government realizes that we can only achieve the Sustainable Development Goals through holistic policies such as integrated landscape management."

These words have been important in helping the programme get underway without impediment.

WHAT IS STRIKING ABOUT THE initiative is that it would not work with any one of the constituent pieces taken away. BNP Paribas cannot securitize enough loans to create a meaningful bond without an aggregation of projects; so it needs ADM. ADM cannot issue loans with sufficient sustainable fortitude to convince end investors without the independent verification of UN agencies. The UN cannot catalyze the sort of initiatives it wants to without the support of the government. The government cannot provide the sort of credit enhancement that USAid can. The endangered animals that need to be considered during the plantation development cannot be properly protected without the World Wildlife Fund. The state of the forest itself cannot be monitored without the World Agroforesty Centre. And so on.

The most important link of all is Tripathi's argument that forestry cannot be sustainably restored unless people are directly engaged with it. To get that right you first have to understand why deforestation takes place at all.

"This is how we've lost millions of hectares to illegal gathering, not because some crafty people are gathering their resources to cut down the forests but because millions around the world are so impoverished they become easy victims," says Tripathi. "The only way to take people away from that it is to give them a productive argument."

And what is that productive argument? Creating a situation where there is no need to engage in deforestation to get ahead. And here Michelin, with its technology, becomes vital too. "Michelin brings agricultural techniques around the development of rubber that double the efficiency in terms of use of land in Indonesia," says Genasci. "Being able to help smallholders improve efficiency on their own land, rather than opening up new land, will be key to the conservation component of the project."

Put another way, people go and burn land they don't own because they feel they cannot

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get enough out of the land they do own. Often they have borrowed the money to plant crops in the first place and are under intense pressure to repay it. If they can improve the yield from their own land and, better still, get concessional funding from the grant fund or at least a more forgiving loan from the platform than they would get from local money lenders, the pressure to deforest is reduced. "There is complexity to these landscapes," says Genasci.

"A critical component of the project will be winning hearts and minds of people living in and around the concessions," says Genasci. She says a second tranche of financing for the up-coming second financing for the RLU plantation venture will include financing for a community partnership programme that would include smallholder finance covering 7,000 hectares of land. "The integrated environmental and social benefit is not just an add on. It's critical to the success of the entire project."

"The guiding principle is that it must have a significant social and climate impact, not one or the other. Both must be there. Otherwise it does not work: it is a technical solution that is bound to fail," says Tripathi.

For all the parties TLFF fits into bigger overall objectives around climate finance and it certainly tallies with the broader ambitions of the Paris Agreement and the Sustainable Development Goals. For example, UNEP and BNP Paribas signed a commitment to bring about $10 billion of funding by 2025 in commercial projects with a measurable environmental and social impact in developing countries. It was signed by Erik Solheim, executive director of UNEP and apparently a champion of TLFF internally at the UN, and BNP Paribas chief executive Laurent Bonnafé.

But ultimately these big numbers come down to the micro level and to individual projects, which is why the plantation could be so important. None of it has been particularly easy. "The biggest challenge has been working through the structure of the project," says Genasci. "There was no template."

And one cannot yet say that it has worked until it is clear that it is delivering solid commercial outcomes. It should do, however. At maturity the plantation will represent 10% of natural global rubber purchased by Michelin and the venture should be delivering an annual rubber yield of 1.7 tonnes per hectare, more than double the current Indonesian standard of 0.8 tonnes.

Tripathi says a key to getting started was to think about things differently.

"You need to trust people," he says. "Normally when you start these things, especially with the UN, you are getting into something that might be a problem, so we spent a lot of time not focusing on the opportunities but on limiting challenges, hedging the reputational downside.

"My point was: what is the downside? We're all coming together with mutual respect and if it doesn't work out we go our different ways." EM