

Katoomba Ecosystem Services Incubator



**Connecting communities,
conservation, and markets**

the
katoomba
group



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Linking local producers and communities to ecosystem services markets

Around the world, widespread interest is emerging in markets and other mechanisms that recognize the value of nature's services and reward the people or organizations that maintain or restore these ecosystems. Known as Ecosystem Services (ES) payments, these mechanisms are an innovative approach to conserving ecosystems critical to human livelihoods and economic development via directly compensating land stewards for the desired management. Forest Trends and the Katoomba Group have been dedicated to global efforts to promote and design these innovative markets since 1999.

The last decade has seen a powerful upsurge in efforts, both global and local, to put these ecosystem services reward principles to work. Water authorities in New York and Quito are investing in protection of watersheds as a cost-effective means to maintain water quality and stabilize flows. Major companies are looking at standardizing methods for evaluating and offsetting their

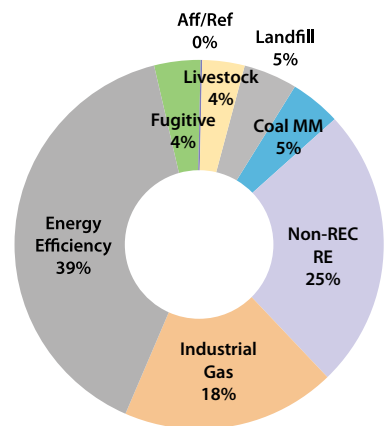
impacts on biological diversity under the aegis of the Business and Biodiversity Offsets Program (BBOP).

Although we also leverage and access investments in biodiversity and water related services, by far the most dynamic and largest of these markets is the global carbon trade, where volume has surged from near zero in 2004 to roughly \$66 billion in 2007. In this market, the Kyoto Protocol's Clean Development Mechanism (CDM), which rewards industrialized countries for investing in "green" projects in the developing world, funneled nearly \$7 billion into projects of all kinds in 2007, according to the World Bank.

The fact that deal-flow in the carbon market is currently bypassing important conservation and community-based sustainable development projects in Africa, Asia and Latin America – partly because of high transaction costs – highlights the pressing need for mechanisms to improve access to information services, build capacity, enable players to enter the market and facilitate transactions for ecosystem services

for low-income and indigenous communities. We have an historic opportunity to shape these new emerging markets. Yet this window of opportunity is closing quickly. The markets are moving at the rate of international businesses. In the next 5-10 years, the rules and instruments for these markets will be formed and the interests of conservation and low-income communities will be in or out.

Land use and land-use change projects like forestry (those with most potential benefits for rural poor) accounted for less than 1% of the Kyoto project-based carbon transactions recorded in 2007. This is despite the fact that the mechanisms for using forestry as an offset have proven their effectiveness in the far smaller voluntary market, where land use and land-use change projects account for a much larger share of all transactions.



Project types - CDM/JI credits sold in 2007

Source: World Bank, State and Trends of the Carbon Market 2008.

Factories or Forests: What's keeping community and forest-based projects from getting to market?

While emissions reduced from a factory smokestack may have the same ton-for-ton impact on the global atmosphere as those from a community forestry project, their contributions to sustainable development are markedly different. Well-designed forestry and land use projects have the potential to improve rural livelihoods, conserve imperiled biodiversity, maintain long-term soil productivity, and protect water sources – while addressing a source of nearly a fifth of the globe's greenhouse gas emissions.

But the promise that many in the conservation and rural development communities see for recognizing additional value for farmers, communities and small enterprises has by and large failed to materialize on a significant scale, despite the multi-billion dollar offset markets. Why?

Part of the answer lies with regulatory and market barriers. The European Union Emissions Trading Scheme (EU ETS), for example, doesn't recognize forestry offsets, and there's still plenty of low-cost "low-hanging fruit" available in other sectors.

There is also, however, plenty of demand for forest-based carbon offsets. Indeed, demand

far outstrips the supply of good forest-based projects with credible offsets, but there is very limited investment in building the pipeline, much less land use carbon projects ready to set up deals with buyers.

Forestry projects, and especially those with a strong community focus, face barriers that have limited their ability to tap into global carbon markets:

- Scarce technical capacity to design solid, credible offset projects;
- Limited business, financial and marketing experience and expertise within community and NGO project developers;
- Insufficient early stage finance available to bring projects up the value curve and reduce risks;
- Lack of capacity to engage and negotiate in a global market;
- High transaction costs of working with communities, smallholders or small-scale projects.

The Katoomba Ecosystem Services Incubator is a specialized vehicle to provide strategic support to projects in a way that facilitates access to the massive financial flows and business interest that have largely been directed elsewhere. Our aim is to increase high-quality, solid supply of ecosystem services.

Community and biodiversity-focused projects need specialized support to get access to dynamic global markets on equitable terms.

Getting to market, increasing local benefits: connecting communities, conservation and markets

The Katoomba Ecosystem Services Incubator was created to address the *supply* side of the current disconnect in ecosystem service markets, with early emphasis on carbon markets. By providing targeted technical, financial and business management support to promising projects with potential for long-term financial viability, the Incubator contributes to catalyzing the nascent ecosystem service market. Latin America is the initial regional focus of Incubator investments given its leading role in ecosystem market and project innovation.

The Incubator strategically invests in the *project development phase* enabling projects to get to the point where they can effectively engage private investors or buyers on solid footing to increase opportunities for equitable outcomes. Though there are notable brokers and investment funds developing

carbon projects (an estimated \$11 billion in private and public carbon funds worldwide), few are focused on maximizing conservation and community benefits. And very limited investment is available for moving projects efficiently through the design and development process to get from promising potential to a marketable commodity.

This focus on investing in the design and development phases of **community and biodiversity-centered projects** sets the Incubator apart from other institutions. The Incubator addresses a niche currently under-served by private-sector participants in the markets and even other NGOs. We target independent potential suppliers and follow an “open-source” approach, consolidating lessons

and sharing tools and methods through the extensive, multi-sectoral Katoomba network (www.katoombagroup.org). And while other NGOs have incorporated carbon and ecosystem services into their agenda, the Incubator’s specialist focus on identifying promising projects, targeting specific gaps and matching the responses to fill the needs allows it to provide effective, efficient support to a broad range of partners. These capacities are further bolstered by the Katoomba network’s unique capacity to draw on leading practitioners in the field, extensive partner networks and the most up to date market information via the **Ecosystem Marketplace’s** (www.ecosystemmarketplace.com) global market linkages.

Incubator Goals

- Increase benefits to communities from ecosystem service deals markets by increasing supply of solid projects
- Leverage new investment flows, demonstrating that community ES projects can provide attractive investment returns
- Catalyze innovation and methodological development, with a focus on REDD
- Strengthen regional capacity to access markets and develop viable projects



The Incubator Approach

The Incubator project selection criteria carefully screen potential project partners. A plan is then co-designed to help overcome barriers to market access through technical, business, financial and marketing support:

Technical and business support for project development drawn from a roster of unique specialists in the Katoomba Group's pioneering network of successful ecosystem services projects, as well as from other consultants and service providers. Advice is provided to meet typical project development needs, including:

- Quantification of ecosystem services benefits using accepted methods and standards
- Technical review and design support to optimize ecosystem services and community development benefits
- Stakeholder engagement and participatory design
- Preparation for approval, validation or certification processes
- Legal assistance and negotiation support
- Development of business plans and financial projections

By providing the experts and technical resources to meet the specialized development needs of projects, the Incubator provides critical support for projects as well as building and reinforcing regional capacity and learning networks.

Financial assistance for startup

By pooling funding from donors interested in leveraging community development and conservation objectives through use of ecosystem service payment mechanisms, the Incubator helps cover some costs incurred by project developers (NGOs and community organizations) in project design. Many excellent project ideas are unable to begin without such support. The Incubator initially provides grants to multiple-benefit projects for development. However, we are evaluating the potential for other project finance arrangements that allow for returns from successful projects, providing additional leverage and ensuring long-term sustainability of the Incubator instrument.

Strengthening market access for the ecosystem services created through the portfolio

Along with its partner programs in Forest Trends, including the Ecosystem Marketplace, the Katoomba Group is well-positioned to facilitate contacts with potential buyers and investors for high-quality ecosystem services projects. The Incubator will work with project developers to help them package, position and negotiate their projects, as well as exploring possibilities for 'aggregation' or 'pooling' ecosystem service suppliers in order to better meet market demand and facilitate access for small producers and community-based projects.

The Incubator's specialist focus on identifying promising projects, targeting specific gaps and matching the responses to fill the needs allows it to provide effective, efficient support to a broad range of partners.

Building the Incubator: Initial Portfolio and Next Steps

Management Structure

The Ecosystem Services Incubator operates as a program of the Katoomba Group, a not-for-profit organization, and is managed in partnership with EcoDecisión, a private firm specializing in conservation finance, and longtime partner in the Katoomba network.

The Katoomba Incubator works with multiple donors and investors to pool resources for innovative and well-structured projects in its portfolio. Early donors making this possible include the Blue Moon Fund, the Overbrook Foundation, Citigroup Foundation, the Mitsubishi Foundation, the World Bank, the Global Environmental Facility (via UNDP), the UK Department for International Development (DFID), and GTZ (the German Technical Cooperation Agency).

At this stage the Incubator's primary aims are to bring projects to market, build technical and management capacity, and establish the tools, resources and processes for efficient project development. Direct grants to projects in the portfolio are provided on a non-refundable basis.

Initial Portfolio

The Incubator aims to address a broad range of evolving market needs and opportunities for innovation, but we see particular promise in project types that have the potential to drive policy change, create financial leverage and go to scale, including:

- Projects reducing emissions from deforestation and degradation (REDD)
- Integrating ecosystem services payments with certified sustainable forestry or agricultural operations
- Using carbon finance to leverage more incipient ecosystem services markets (e.g hydrological services, biodiversity offsets)
- Creating vehicles for aggregation of small-scale producers and projects to facilitate market access

What do we look for in our projects?

- Partners with excellent reputation and solid technical and institutional capacity.
- High potential for sustainable long-term finance with ability to significantly leverage initial Incubator investment.
- Reasonable (ideally 12-18 months) estimated development time required to bring project to market.
- Multiple benefit projects: Strong community participation, social benefits and positive biodiversity impacts.
- High potential replicability and opportunities for scaling up.
- Significant demonstration effect, impact on development of policy and emerging standards and methods.
- Particular attention to opportunities for aggregating small-scale and community initiatives otherwise facing barriers to market access.
- Strong, but non-exclusive, emphasis on projects resulting in marketable carbon offsets, ideally leveraging other ecosystem services finance.
- Focus on Latin America, aiming for diversity within the region to enhance demonstration and multiplier impacts.



Priority Investment Lines

- REDD- Reduced Emissions from Deforestation
- Integrating ES with certified sustainable forestry and agriculture
- Using carbon finance to leverage emerging ES markets (hydro, biodiversity)
- Creating aggregation vehicles for small-scale producers and projects

For this start-up phase a 2-year targeted donor investment of \$2.2 million is required to:

- Support a portfolio of 10-12 projects and bring them successfully to market;
- Build a solid technical and managerial team and consolidate Incubator operations and procedures;
- Develop solid evaluation and monitoring criteria for the portfolio projects and the Incubator Instrument itself, including a Social and Environmental Return on Investment Indicator;
- Assess and incorporate methodologies, tools, standards and best practices into portfolio
- Establish strategic alliances with key partner institutions bringing additional technical and business expertise to the Incubator;
- Draft a business plan defining strategy for leveraging increased private finance and ensuring long-term sustainability;
- Disseminate results and lessons learned from projects through the Katoomba Group network.

Next steps: Building financial sustainability

Technical support and grant-making provide important flexibility

in supporting innovative projects and ensuring that partners have the possibility to maximize benefits to them. But long-term sustainability and scalability require financial mechanisms and agreements that ensure that the Incubator can continue to support new projects. By the end of 2009, the Incubator aims to provide support to a portion of its portfolio on a contingent cost-recovery basis, allowing for successful projects to pay back a portion of their proceeds to the Incubator allowing funds to be rolled over into new projects.

Growth potential and the need to go to scale may present the opportunity for the Incubator to become an independent entity, either as a business or not-for-profit organization. With a solid track record and strong capacity, the Incubator should be well positioned to involve additional investment partners and create a vehicle that invests in projects throughout their life cycle, including implementation and onward sale of offsets.

Current Portfolio

The Incubator provides targeted support to projects based on their potential to generate significant community and biodiversity benefits, to innovate in ways that drive markets to meet the needs of these critical participants, and move rapidly to market. Partners are carefully selected based on their demonstrated capacity to effectively manage and execute projects.



Monte Pascoal – Pau Brasil: Establishing an ecological corridor in the Atlantic Forest

The Nature Conservancy, local partners, and the Rainforest Alliance

Brazil

Focused on the establishment of a ~1000-hectare reforestation project within an ecological corridor in Brazil's Atlantic Forest, the Katoomba Group helped facilitate the institutional configuration of entities to design a carbon offset for Jacques Vabre, the French branch of a multinational coffee corporation. Part of a larger conservation program, the project involves a member landowner of a community association. Katoomba initiated brokering of the arrangement between the buyer, technical and managerial support institutions, international certifiers CCBA and their Brazilian counterparts with the aim of achieving a project that incorporates social and biodiversity benefits with high integrity carbon offsets. In addition, Katoomba participated alongside the parties during legal and contracting negotiations, which resulted in the buyer agreeing to purchase an extra 20% carbon credits from the project as risk mitigation for potential losses. The project is currently undergoing certification in accordance with the standards of the Climate, Community and Biodiversity Alliance (CCBA), and there is interest in replicating the approach in other regions of Brazil's Atlantic Forest.



Pico Bonito: Combining REDD carbon and FSC-certified forests

EcoLogic Development Fund

Honduras

Communities with experience managing their forests under Forest Stewardship Council (FSC) standards have developed technical, organizational and managerial skills that provide a powerful platform for engaging with PES markets. The 1250-hectare Las Camelias community forestry concession is an FSC-certified forestry operation in the buffer zone of the Pico Bonito National Park in Honduras, one of Central America's most important protected areas. EcoLogic Development Fund (EDF) has been a global leader in developing forest-based carbon projects under the Clean Development Mechanism. Incubator support will enable EDF to work with Las Camelias to field test a new avoided deforestation methodology, develop practical community-based monitoring methods, and establish transparent mechanisms for community benefit sharing in offset sales. This project will lay the groundwork to move rapidly to market with offset sales and create a platform enabling rapid replication to other community forestry areas around Pico Bonito and elsewhere.

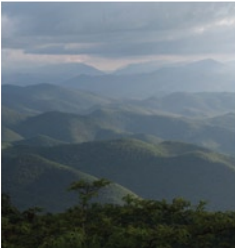


Sierra Gorda Biosphere Reserve: Carbon finance for community reforestation

Bosque Sustentable / Grupo Ecológico Sierra Gorda

Mexico

For nearly 20 years the Grupo Ecológico Sierra Gorda has been working with thousands of rural families in the Sierra Gorda Biosphere Reserve, developing an innovative model of community development within the most ecosystem-diverse protected area in Mexico. Since 1990 Sierra Gorda and its sister organization, Bosque Sustentable, have been supporting extremely poor upland communities of the reserve in reforestation and restoring over 400 hectares.



In 2006 and 2007, Sierra Gorda successfully completed the sale of carbon offsets from these projects to buyers in the voluntary market, and seeks to expand carbon finance for existing and new plantations. To enhance the viability of this offset offering, Sierra Gorda and Bosque Sustentable are integrating small-scale community restoration projects with larger native-species commercial plantations with the aim of having them certified under Climate, Community and Biodiversity (CCB) standards. Incubator support will enable these organizations to complete design documents, verify carbon project stocks and projections and secure CCB certification – essential steps in moving these projects to market and creating a new livelihood and conservation alternative for the traditional inhabitants of the biosphere reserve.



Restoration of Amazon rainforest in the Surui indigenous territory

Rede Povos da Floresta & Organização Metareilá do Povo Indígena Suruí Paiter

Brazil

The Surui indigenous people, numbering approximately 1,000, live within a 248,000-hectare territory in the Amazon rainforest of the state of Rondonia in western Brazil. A small percentage of the Surui territory has been deforested, and their forests are under strong threat of encroachment for timber extraction. This project proposes to catalyze carbon financing to promote the conservation of biodiversity and indigenous rights, through a combination of:

- Restoration of 1500 has of degraded pasture through reforestation with native species;
- Conservation (avoided deforestation) of over 240,000 has of remaining native forest.



Incubator support will contribute to building capacity of indigenous communities to manage reforestation projects and administer carbon finance, and should serve as a key demonstration project to be leveraged through partner organizations for other indigenous territories in the country.



Gran Reserva Chachi: Combining biodiversity incentives and REDD carbon for the protection of indigenous territories

Conservation International and Chachi indigenous communities

Ecuador

Since 2006 the Chachi indigenous people have worked with Conservation International and GTZ (the German technical cooperation agency) to establish an innovative model for community-based conservation. At the heart of the Ecuadorian portion of the megadiverse Chocó bioregion Chachi communities have declared conservation areas totaling 7,200 hectares, funded in part through conservation incentive agreements. Under these agreements, the Chachis receive financial support for alternative development initiatives and public services, chosen by the communities themselves, in exchange for reserve creation and management.



To date the key ecosystem service driving funding is biodiversity conservation, but funds are insufficient for long-term sustainability. By integrating carbon finance for avoided deforestation, biodiversity finance would be leveraged and the area could be significantly expanded to neighboring communities who have expressed strong interest in the incentive agreements. Incubator support is allowing the project to develop the technical analyses needed to consolidate this market opportunity, including baseline establishment and carbon stock assessments.

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To support our work or learn about other partnership opportunities with the Katoomba Group, please contact
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www.katoombagroup.org

About us

Katoomba Group

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A program of Forest Trends, the Katoomba Group is a catalytic network of individuals working to promote the use and improve capacity for developing ecosystem services payments and compensation deals. The Group serves as a forum for the exchange of ideas and strategic information about ecosystem service transactions and markets, as well as for collaboration between practitioners on advancing ecosystem services projects and programs.

The Katoomba Group addresses key challenges to developing markets and payments for ecosystem services, from enabling legislation through establishment of new market

institutions, to testing methods for successful project design. The Group works through strategic partnerships for analysis, capacity building, information-sharing, investment, market services and policy advocacy. Specifically, the Katoomba Group:

- Identifies gaps in environmental services compensation theory and/or practice and will tackle key obstacles not being addressed by other players
- Shares intelligence about new developments related to markets and environmental services payments
- Addresses significant challenges related to payments for ecosystem services, such as mobilization of private sector buyers and enabling progress on policy frameworks

EcoDecisión

EcoDecisión is a Latin America-based firm focused on developing innovative tools for funding and sustaining biodiversity conservation. EcoDecisión is a regional leader in the fields of conservation finance and payment for ecosystem services.

EcoDecisión's work has put it in the forefront of environmental services payments in Latin America for over 10 years, working with local and international partners to promote initiatives that make conservation economically viable. EcoDecisión has been a pioneer in watershed protection finance, forest-based carbon offset projects and policy, conservation endowment funds, and incentive agreements.

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