



## CAFI Private Sector Investment Framework

### Background

Central Africa is home to the world's second largest tropical rainforest, which sequesters around 1.5 billion tonnes of CO<sub>2</sub> equivalent to 4% of global emissions each year and provides habitat for over 10,000 plant and animal species. Forest loss is accelerating despite ongoing efforts, as government action alone has not been sufficient to establish an effective balance between the interests of the forest and economic development.

Most of the environmental benefits of intact forests are unpriced externalities, there are currently no real incentives to conserve forests and it is much more attractive for smallholders, loggers and charcoal producers to adopt unsustainable practices and for agro-industrial producers to convert forest into agricultural land to produce tradable commodities, particularly where strong local and/or international demand for timber, charcoal and agricultural commodities is increasing market prices. The result is a market mispricing of natural forest assets and a disincentive to sustainable production. Without a paradigm shift changing how land is managed and how timber, charcoal and agricultural commodities are produced, this problem is expected to worsen as local and global demand rises.

The "Business as Usual" or BAU scenario for Central Africa is therefore for deforestation and forest degradation to be increasingly driven by a destructive extensification of smallholder farms, agroindustry and unsustainable logging for timber or charcoal by private actors.

The challenge ahead is producing more food, charcoal and timber on existing land to reduce the demand for new lands. That is, sustainable intensification rather than destructive extensification. This is essential for stopping deforestation and forest degradation while at the same time meeting food security needs and creating employment. Additionally, when addressing unsustainable charcoal production, alternative cleaner cooking fuels will also be part of the solution.

Based on this, a coalition of donors - the European Union, the Federal Republic of Germany, the Kingdom of Norway, the French Republic, the United Kingdom, the Republic of Korea, the Netherlands, Belgium and Sweden - and the Central African partner countries - the Central African Republic, the Democratic Republic of Congo, the Republic of Cameroon, the Republic of Congo, the Republic of Equatorial Guinea and the Gabonese Republic - entered into a collaborative partnership to establish the Central African Forest Initiative ([CAFI](#)).

CAFI is a unique initiative that catalyzes high-level political dialogue and increased funding to support ambitious reforms and on-the-ground investments to help partner countries reduce emissions from deforestation and forest degradation while alleviating poverty. Today, with the signature of three Letters of Intent (DRC, Gabon and the Republic of Congo), CAFI is funding partner countries to implement programs that enable them to achieve and increase their ambitions to preserve their forests, reduce poverty and move towards economic diversification.

There is a theoretical potential to scale up commercial investment in tropical commodity supply chains while making them "deforestation-free" and socially inclusive at a landscape level. To yield the greatest results, investments should target the major supply chains driving deforestation, including palm oil, maize, cassava, rubber, cocoa, coffee, charcoal, and timber amongst others.



However, at present there are limited flows of finance for forest and land use mitigation in Central Africa. There are three key barriers that impede the flow of finance to greener land use activities (e.g. [Buchner et al. 2012](#)):

1. **Viability gaps.** These arise where the costs of an activity are greater than available revenues, considered on a net present value basis. Private investor viability gaps mean a negative return on investment; for the public sector it is the difference between the economic or political costs and benefits. Where viability gaps are not addressed, the private sector will not invest.
2. **Risk gaps.** These specific investment risks prevent public and private entities from providing climate finance and include, e.g., technology risks, financial risks, political risks, market risks. These risks increase the cost of financing and executing land use activities. They can also put expected revenues at risk. As such, risk gaps can widen viability gaps.
3. **Information gaps.** In some cases, public and private actors lack the knowledge or institutional capacity to make investments, to develop policy frameworks or to design interventions to target specific risks and costs. [Kato et al., 2014](#), identify several possible information gaps including information on technologies, financial structures, and enabling environments.

To successfully scale up investments in green land uses and clean cooking energy, CAFI will keep working with governments on policy reforms that address one or more of these gaps in different land use sectors. At the same time, in June 2023, the CAFI Executive Board decided to launch a **regional private sector facility**.

### **Purpose of the CAFI Private Sector Investment Framework**

The portfolio of the CAFI Private Sector Window is meant to support the achievements of the objectives set out in the CAFI letters of intent.<sup>1</sup> The CAFI private sector investment framework seeks to translate this overall objective into clear guidelines for investment decisions. The framework is composed of:

- The sought outcomes and eligible investments for each sector;
- Specific CAFI grant instruments which implementing organizations can access;
- Performance criteria and indicators to inform the design, assessment, and approval of projects.

### **Overall objective/targets and eligible investments for each sector**

#### **Cooking Energy**

The outcome sought by the CAFI Fund is that Sustainable wood energy investments lead to adoption of more sustainable alternatives to current wood energy practices. To achieve this outcome, the private sector must make the following types of investments (note: the list provides examples and is not meant to be exhaustive. Other types of investment which can contribute to the overall objectives can be considered):

1. Improving cooking efficiency such as manufacturing and distribution of improved cookstoves;
2. Improving transformation efficiency (charcoal kilns, etc.);

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<sup>1</sup> In **Glasgow in November 2021** President Félix Tshisekedi of the Democratic Republic of Congo (DRC) and Prime Minister Boris Johnson of the United Kingdom on behalf of the Central African Forest Initiative (CAFI) endorsed [an ambitious 10-year agreement \(2021-31\)](#) to protect the Congo Basin rainforest - the world's second largest. The agreement includes an **investment from the CAFI Fund of US\$500 million for the first five years**.



3. Wood fuel substitution through development of alternative cooking energies to wood fuel, mostly Liquefied Petroleum Gas (LPG);
4. Increasing the sustainable supply of wood-energy through better management of forest resources, increased production outside the forest, such as agroforestry, assisted natural regeneration, etc. (see forest regeneration sector) and enhancing use of agriculture & logging wastes.

**NB:** Renewable energy projects to support value added in sustainable forestry and agriculture value chains, including in connection with special economic zones are discussed in the agriculture and forest industry sectors.

## Agriculture

The sought outcome of the CAFI Fund is that sustainable agricultural practices lead to less land conversion and increased food security. To do this, the private sector must **scale-up commercial investment in Central African agricultural supply chains while making them deforestation-free and socially inclusive at a landscape, jurisdictional and ultimately national level**. Target sectors are the major supply chains driving deforestation, including palm oil, soy, maize, cassava, rubber, cocoa, coffee.

Eligible projects are those that promote sustainable intensification and higher productivity on existing agricultural land to meet growing demand for food. Producing more food on existing land reduces the demand and incentives for deforestation for agricultural production. This is essential for stopping deforestation AND meeting food security, leading to sustainable intensification rather than destructive extensification. Below is a non-exhaustive list of potential investments:

- Deforestation-free “out-grower” schemes are developed for domestic, regional and export markets
  - Working with large brewers & agro-industrial industries to roll-out small and medium scale extension services to achieve climate resilient and deforestation-free local sourcing of malt alternatives for beer brewing including cassava, maize, rice, and sorghum.
  - Working with cooperatives and international buyers to roll-out large-scale extension services to achieve climate resilient and deforestation-free sourcing of coffee and cacao.
  - Working with agro-industrial operators to roll-out large-scale extension services to achieve climate resilient and deforestation-free sourcing of rubber and palm oil.
- Agro-industrial development in savannah areas
  - Medium and large scale irrigated perennial crop plantation development in savannah (Greenfield projects).
- “Sustainable intensification” - Improvement of yields in existing plantations to reduce the need for the expansion of plantations into forests (this applies mostly to palm oil and rubber) and can include CAPEX for:
  - palm oil processing mills;
  - drip irrigation systems;
  - improved “maintenance” of existing plantations through implementation of best agricultural practices;
  - Sustainable energy for processing & storage.

**NB:** In all cases it is expected that projects deploy a strategy to ensure that production is deforestation-free. This will involve alignment with the public investments of CAFI (or others) into land-use planning and land tenure as well as the application of **mandatory monitoring and reporting as well as verification protocols approved by CAFI**.



## Forest Industry

The relevant outcome of the CAFI fund is that **forestry sector and protected areas** institutions and stakeholders have the capacity and the legal framework to promote, monitor and enforce sustainable management of forests. When specifically focusing on private investment this outcome can be achieved by the **creation/expansion of forest industries which create added value and jobs through transformation of timber and sources from sustainably managed and legal forests concessions** in a way, and at a rate, that maintains their biodiversity, productivity, regeneration capacity, vitality, and their potential to fulfil, now and in the future, relevant ecological, economic and social functions, at local, national, and global levels. Below is a non-exhaustive list of potential investments:

- Forest Concessions to achieve forest certification (legality and/or sustainable management certification) (e.g. FSC, PEFC, LegalSource, etc.);
- Forest Concessions Transitioning to Reduced Impact Logging for Climate Change mitigation (RIL-C) in line with best international standards (very long-term investment);
- Cogeneration of electric power with sawmill waste to support wood transformation & rural electrification (CAPEX for new plants);
- Transformation factories or equipment for sustainably sourced wood (CAPEX for new investments and even new factories).

## Ecotourism and other innovative approaches to Forest Conservation

The overall objective is to support an **increase in forest areas under a protection under different viable economic and financial models** and find ways of reducing the pressure on forests by creating employment and revenue opportunities related to standing forests. Below is a non-exhaustive list of potential investments:

- Ecotourism infrastructure CAPEX;
- Ecotourism OPEX - marketing, etc.;
- Conservation concessions or other private conservation projects looking to operationalise payment for environmental services (long term investments).

## Landscape Restoration, Reforestation & Afforestation

This specific sector or set of activities supports CAFI's sought energy, forestry and agricultural outcomes. The first by increasing supply of wood fuel from outside natural forests, the second by increasing supply of timber from outside natural forests, and the third by restoring soil fertility through improved practices (e.g. agroforestry). The private investment support by CAFI will include amongst others:

- Small and medium scale agroforestry (e.g. acacia mangium/cassava);
- Large scale agroforestry - 7 years investment minimum;
- Large scale forest plantations (e.g. fast growing species for charcoal or low quality timber OR precious woods or a mix - long term investment);
- Degraded site restoration.

## Specific CAFI grant instruments for implementing organizations

CAFI will channel its grant resources through 3 instruments each with specific rules which are detailed below:

1. Project development instrument for the development of "bankable projects". Under the project development window implementing organizations (IOs) use CAFI grants to support early development of projects including to pilot novel technology and approaches and remove the risks and information gaps to investment.



2. Investment instruments to deploy a blended finance approach. With these, IOs use CAFI grants to share risks or provide below market interest rate loans and/or other concessional terms such as longer tenors and grace periods. While it is important to be realistic and recognise that attracting purely private finance will probably not be the first step, CAFI's current grant model is purely cash-out and will be improved by starting to take a portion of first losses.
3. Payment for environmental services instrument (or performance-based grants) to price-in the externality by providing an explicit value on forest carbon and biodiversity. Under the PES window, IOs can access CAFI performance-based payment ex-post for verification of the environmental services provided by their investments. Under this window, no advances are provided, all payments are made after the independent verification of results.

### **Project Development Grant Instrument**

A critical element for the success in structuring private investments at scale in support of the CAFI Lols' objectives is the ability to create a large enough portfolio. Project development support will be required for speeding up the growth and success of early-stage companies that offer potential.

The project development window is capital that CAFI IOs can provide in the form of grants, redeemable grants or 0% loans in promising prospective companies to help them grow in manner that is aligned with CAFI objectives and in a way that influences these businesses toward entering a DFI portfolio or the Forest Performance Bond portfolio in the future. The maximum investment period will be set at 5 years after which projects are expected to:

- 1) Transition to loans (or equity) offered by the IO with the use of the CAFI investment grant instrument or under more commercial terms of the IO (or another financial institution) or the terms that will apply to the proceeds of the Forest Performance Bond series; OR
- 2) Meet all the eligibility and MRV requirements to access the CAFI Payment for environmental services instrument (performance-based grants).<sup>2</sup>

The number of projects that meet these two criteria will be the indicator of success of the project development window.

CAFI's project development support will help IOs accelerate the development of business opportunities and support the heavy transaction costs of originating in these countries. IOs will be able to focus attention on the region despite the higher risks and transaction costs. The project development would provide support for a transaction specific proportion of the fees, costs and expenses related to the evaluation, research, due diligence, acquisition, holding, financing and valuing of any Potentially Eligible High Impact Project, up to a maximum of 5 million USD. The request for preparation grants should be justified by the expected number of investments in the underlying portfolio of the participating IO. An estimation of the preparation grants amount per investment sub-project should be provided.

Potentially Eligible High Impact Projects are those sub-projects of the underlying portfolio that meet the high impact criteria and that the IOs consider not yet to be investable in accordance with their standards but which have a high likelihood of developing into a project that is investable under the terms used by the CAFI IO in its regular business model.

High Impact means an investment activity that offer high potential to perform against one or more performance criteria and indicators of this investment framework and has at least one of the following characteristics:

- a) Support smallholder financing with direct farmer or farmer organization credit risk borne by the Borrower;

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<sup>2</sup> In order to ensure that investors factor in this revenue stream, a specific CAFI project document (PRODOC) approval procedure would be set-up to ensure that companies that receive investments from the project development or investment window automatically access the Payment for environmental services.



- b) support early stage businesses defined as having less than 3 years of audited financial statements;
- c) investment activities mainly supporting women or disadvantaged people such as indigenous people, minorities, refugees;
- d) first time borrowers; or
- e) investment activities in unconventional practices (e.g. RIL-C, conservation concession, irrigated palm oil).

The size of the project development support would be determined based on demand from private sector companies interested in engaging with CAFI in a sustainable intensification pathway following a call for proposals that will be launched jointly between CAFI and all the participating IOs.

### Investment Grant Instrument

The purpose of the investment window is to make strategic and efficient use of CAFI funds to fund projects that would otherwise not be eligible for funding and/or to enlarge the total amount of resources available to fund such projects. As such, the **additional funding leveraged by CAFI investment (or co-financing ratio)** is a performance metric for this window.

IOs can use the grants provided in the investment window to blend with their own financial resources in order to:

- Address risk gaps - de-risk investments compensating for the higher (perceived) risk of the CAFI countries, or to
- Address viability gaps - increase the level of concessionality of the financing they extend to projects and programmes.

They do this blending according to their own procedures using the instruments that are at their disposal such as below market interest rate loans and/or other concessional terms such as longer tenors and grace periods, guarantees, junior tranches in funds, first loss equity, subordinated debt, etc.

### Payment for Environmental Services (PES) or “Performance-based Grants Instrument”

The goal of Payments for Environmental Services (PES) is to address viability gaps by providing a financial recognition for the value of the forest carbon and biodiversity benefits that private sector activities generate.<sup>3</sup>

Table 1 provides a list of eligible activities and payment modalities. The table also specifies whether these activities are included in the CAFI PES programme or will need to be developed in addition to it.

To operationalise this, the project document will include a performance-based payment agreement annex. Under such an agreement, **CAFI (“environmental service payer”)** takes the obligation to pay the **Implementing Organization (“investor”)** an amount determined by a set of objective indicators reflecting the impact desired by CAFI. The investor, expecting future performance-based pay-out, can invest in high impact projects implemented by **private companies (“environmental service providers”)** to achieve the agreed results. The achievements of the outcome indicators are

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<sup>3</sup> It will be regional in scope but will build on the DRC Payment for environmental services programme under development. It will use the same performance metrics as well as monitoring reporting and verification protocols for the same activities. However, it is important to note that the Payment for environmental services could have different delivery mechanisms (see 2 options presented below). Furthermore, the Payment for Environmental Services will add additional payment-linked indicators for specific investments not covered by the DRC PES programme in sectors such as wood fuel energy, or the timber industry.



assessed by an **independent verification body** which provides a recommendation on the pay-out to be made by CAFI to the IO.

There are two ways through which IOs can use this funding: (1) the implementing organization can keep these resources to cover for the risks and the concessionality associated with their investment, or (2) the implementing organization can pass-on these performance-based payments to the companies of the underlying portfolio. Note that these options are not mutually exclusive, and a mix could be implemented.

Note that the existence of long-term PES contracts between the investor and the environmental service providers provides greater assurance to CAFI regarding the permanence of the environmental services provided and this will be reflected in the price paid. Other innovative ways to ensure permanence can also be proposed.

In all cases, no advances are made. CAFI will be making payments “ex-post” based on verified performance thus transferring the performance risk to the implementing organizations. Indeed, the achievements of the outcome indicators are assessed by an independent verifier which provides a recommendation on the pay-out to be made by CAFI to the IO according to a specific methodology to be developed at PRODOC stage and validated by the independent verification body prior to PRODOC signature.

Performance-based grants or PES replace the “traditional” monitoring of process with evaluation of impact as the basis for providing funds. There are significant advantages of impact monitoring as opposed to process monitoring:

- There is flexibility of implementation for the service provider because the contract does not need to list specific actions or a specific sequence of action. Instead, the obligations relate to achieving the outcomes. This reduces the administrative burden.
- Since the payment is fixed for the duration of the project and not subject to the cost of inputs, the IO and its private sector partners have an incentive to create savings through efficiency gains which they can retain in exchange for taking on the increased risk of achieving results.
- CAFI is no longer compelled to make full payment for insufficient results on the grounds. CAFI transfers these risks to other partners.
- Impact evaluation becomes an activity with significant material value because it underpins payments; this will likely result in more credible, systematic and standardised impact assessments.

The payment level per unit of results will be determined case-by-case based on studies and benchmarking exercises carried out during PRODOC development. It will be set prior to PRODOC signature, the payment calculation methodology will be validated by the independent verification body and included in the performance-based payment agreement. Three main methods can be used to establish the payment per unit of results:

- Activity-based approach. If the schedule of activities to be implemented towards the achievement of the result is known, it is technically not difficult to calculate the cost of implementing these activities. The total budget for activities, plus a certain level of profitability, provides a fair benchmark for projects.
- Replacement value: As a general rule, the payment per unit of result should not exceed the estimated cost that CAFI would incur if the result were instead achieved using conventional up-front grant project implementation methods. Therefore, the total amount of the performance-based payment could be set as equal to or less than the estimated costs of similar projects using conventional implementation methods, thereby creating savings for



CAFI. This however may be difficult to establish given that we lack independently verified information on the quantity and quality of results achieved by conventional projects.

- Financialising the environmental impact. CAFI can agree on providing a set value for the environmental impact of a project (e.g. \$/tCO<sub>2</sub>e). This may allow to provide resources to the most cost-effective projects. However, setting such a value may be difficult and lead to overpayment.

Attention should be paid to ensure that the IO does not receive multiple payments from different funding sources for the achievement of the exact same result (i.e. “double payment of results”). Such double payment could happen if some private sector projects of the IO’s underlying portfolio engage in carbon markets (or biodiversity markets in the future). In such cases, the IO should not claim payment for environmental services to CAFI for those same results. This should not be confused with blending multiple funding sources to achieve a set of results, which is fine provided it is transparently presented to CAFI.





**Table 1. CAFI Payment for Environmental Services Instrument (performance-based grants): Eligible Activities and Payment Modalities.**

Sector	Sub-Sector	Payment-Linked Indicator	Quality Requirements
Energy	Improved cookstoves	\$/# of improved cookstoves in use	To be decided based on simplified CDM methodology
Agriculture	Small-holders or out-grower schemes	\$/ha of deforestation-free perennial crop establishment	Established by CAFI PES operations manual
	Large scale agro-industrial plantations	\$/ha of plantation established in savannah areas	In accordance with land-use planning and agricultural best practices
Forest Industry	Forest Concessions	\$/ha sustainable certified management concessions \$/ha certified under RIL-C	Certification delivered by FSC, PAFC To be decided based on simplified existing RIL-C methodologies
	Sustainably sourced wood transformation and added value	To be developed	To be determined based traceability best practices
Forest Conservation	Conservation concessions, private reserves or set-asides in other concessions	\$/ha under effective conservation	Established by CAFI PES operations manual (Deforestation sliding scale)
Landscape restoration	Agroforestry	\$/ha for agroforestry plantation establishment or transition	Established by CAFI PES operations manual (plantation density, allowed species, maintenance requirements, etc.)
	Reforestation	\$/ha for plantation establishment	Established by CAFI PES operations manual (plantation density, allowed species, maintenance requirements, etc.)
	Assisted natural forest regeneration	\$/ha of ANFR	Established by CAFI PES operations manual (fire break maintenance and absence of fire, tree enrichment)
	Natural Forest Regeneration	\$/ha of NFR	Established by CAFI PES operations manual (fire break maintenance and absence of fire)

**NB:** In green the activities for which standardisation of the payment-linked indicator, quality requirements, payment amount and payment calendar will be established by end of 2023 in the CAFI PES programme operations manual.