Long-term sustainable financing mechanism for plantation forestry policy brief

This policy brief summarises options and strategies for a long-term sustainable financing mechanism/ model for plantation forestry development in Uganda to wean the subsector from short term project-based financing borrowing lessons from Uganda, the region (East Africa), Africa and globally. It was prepared by the Ministry of Water and Environment through the findings of a study supported by the Uganda Investing in Forests and Protected Areas for Climate-Smart Development (IFPA-CD) Project with funding from the Word Bank and Government of Uganda.

Lessons from Uganda and other countries show that grants alone are not sustainable in financing plantation forestry. They cannot wean the subsector from short term project-based grant financing and ***other inbuilt mechanisms and incentives are needed to enhance sustainability.*** *However, grant financing has been instrumental in expanding forest plantation areas in Uganda. While the forest cover trend of natural forest has been on the decline between 1990 and 2023, that of the exotic plantation increased especially between 2010 and 2023, and this is attributed to the performance-based Sawlog Production Grant Scheme (SPGS) model alongside other initiatives.*

The challenge and the opportunity

In Uganda, finance is a key barrier to tree planting for both the large and small-scale tree growers. The cost of borrowing is prohibitively high, deterring businesses from pursuing green initiatives especially for the small and medium scale tree growers. There are also other barriers that slow down financing of the plantation forestry subsector. Key among them is the high perceived and real risk in a subsector with long gestation period (5 - 25 years), and a poor risk-return relationship. Addressing these challenges will require Uganda to mobilize 'innovative' financial resources, including from international financial institutions, multilateral development banks, and most critically, the private sector.

At the national level, the forest sector is of significant importance to economic development and environmental sustainability, with the sector contributing an estimated 3.6% of Uganda's Gross Domestic Product (GDP) in 2023. The sector generated 7.4 billion shillings in FY 2022/23, an increase from 4.5 billion shillings in FY 2017/18[1]. Uganda's plantation forests are also an important and treasured asset that provide multiple environmental, social, and economic benefits, meeting the country's needs for wood fuel, timber and poles, providing habitats for flora and fauna, and helping mitigate climate change. Investments in the sector and value addition are therefore expected to generate economic growth, jobs, income, and fiscal revenues through increased economic activities in sustainable forestry and forest-based value chains. At the national level, financing strategies, innovation and improvement in coordination and policy environment are some of the ways that plantation forestry financing challenges can be overcome. Many government policies including the Uganda's national forestry policy and Vision 2040 which promote private sector investments and commercial tree planting could be leveraged upon.

The study analysed a broad category of potential funding mechanisms for plantation forestry in Uganda

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[1] Uganda Bureau of Statistics, 2023; Annual Statistical Abstract

The main types of forestry financing mechanisms analysed are:

- Grant forest financing mechanism: These are financing mechanisms where financial resources are provided in form of grants to support forest conservation and sustainable forest management;
- National Forest Funds (NFFs): These are public domestic funding mechanisms through national budgets, monetary and non-monetary incentives, and direct investment that allow governments to manage and control funding for forestry related activities.
- Private sector investments:
  - Debt /Loan funding: This is funding that needs to be paid back at some stage and that typically attracts interest;
  - Equity funding: This is funding where funders take a stake in the shareholding of the company or venture;
- Innovative financing mechanisms:
  - Debt for Nature Swaps: Debt relief provided to developing countries in exchange for commitments to invest in forest conservation.
  - Market based forest financing mechanisms: These include carbon finance and payment for ecosystem services financing.

Blended finance offers the best option for Uganda

A set of five broad criteria was used to prioritize the various schemes and options for Uganda.

1. Potential to incentivize a lot of players (small, medium and large) in plantation development;
2. Relevancy of the option for transformative action across temporal and spatial scale;
3. Institutional suitability, sufficiency and predictability of delivering the financing option;
4. Congruence with national policy, legal and institutional framework;
5. Likelihood to achieve outcomes.

The study used both the quantitative method of forced ranking and qualitative method of consultation with Ministry of Water and Environment and other stakeholders to prioritize and select the options from which to develop concept papers. Applying this methodology, the following options in order of priority were packaged.

1. National Forest Financing Facility (using multiple financing instruments) in a blending strategy;
2. Equity financing;
3. Debt and grant financing;
4. Debt for Nature Swaps.

Uganda Plantation Forestry Financing Facility using blended finance

This option combines public and private capital to address limited financing on the part of government learning from other sectors, in particular agriculture. There are strong justifications for this option:

i. It provides certainty and predictability of financing of forestry sub-sector that has long gestation period;

ii. It provides a middle ground for the government in sustaining and expanding investments in plantation forestry (at reasonably low cost because of blending) at a time when government has other pressing financing needs;
iii. It is one of the financing models the government has lined up among the priority strategies for resource mobilization to fund the National Development Plan IV 2025/26 – 2029/30;
iv. Pooling public and private financing instruments from diverse sources in Uganda and from outside and blending them to support plantation forestry development will directly address the main barriers slowing down commercial plantation development in the plantation forestry sub-sector.

Choice of this option is based on eight cases studies analysed, four of which are highlighted below.

- *Ghana Forest Plantation Development Fund:* The Fund is funded by a fraction of proceeds of the timber export levy (currently 1.5%); grants and loans and the government Consolidated Fund. This enabled the government to increase timber export revenues. In 2023, 51% of total export revenues collected amounting to €68,809,415.56 was from plantation forestry.
- *Costa Rica's Forest Financing Fund (FONAFIFO):* The main source of financing consists of allocating one third of the resources generated by the consumption tax to fuels. FONAFIFO also receives Forty percent (40%) of the amount of income from the Wood Tax. In terms of achievements, in 2023, Costa Rica exported $46.5M in Wood Products, making it the 99th largest exporter of Wood Products in the world. In terms of impact, FONAFIFO has helped Costa Rica to raise its forest cover from 21% in 1980 to 53% today.
- *Indonesia Reforestation Fund:* The Indonesia Reforestation Fund (DBH-DR) is financed through a volume-based levy on timber, which concessionaires must pay for harvesting timber in natural forests. Indonesia is a major global exporter of wood products, particularly plywood and in 2022, it exported USD 5.53 billion wood, making it the 10th largest exporter globally.
- *The Malaysia Forest Plantation Development Sdn Bhd (FPDSB):* FPDSB) was created as a special purpose vehicle through an allocation of RM1.045 billion to promote and implement the plantation development programme in Malaysia.

Key lessons for Uganda from blended financing

- A dedicated fund shields forest management programs from unpredictable national budget cycles, allowing for long-term planning and investment in forestry thereby ensuring stability and predictability;
- They can be leveraged upon to generate additional finances from multiple sources. For the case of Costa Rica, the combined use of Payment for Environmental Services - PES (based on performance), grants, revolving credit and loans through FONAFIFO created a package of financing instruments that have made the forestry sub-sector to be self-sustaining now in finance;
- They generally cover all the stages of the plantation value chain, and accommodate small, medium and large-scale players;
- Although not established, the Tree Fund is provided for in the National Forestry Tree Planting Act Cap. 160 with an aim of promoting tree planting. This fund would serve as a platform for consolidating fragmented funds in Uganda. – e.g., Conditional Grants, Environment Fund, etc.

Potential institutional implementation arrangements

To implement this option, a Uganda Plantation Forestry Facility (modelled as the Tree Fund) could be created using one of the following scenarios. In the first scenario, the government could use one of the existing institutions that are familiar with blended financing (e.g., Bank of Uganda and Uganda Development Bank). In the second scenario, the government can exercise flexibility to create institutions in which it partners with. This mode of delivering blended financing has been seen in the case studies of aBi Finance Ltd and Uganda Energy Credit Capitalisation Company Ltd, discussed later in this policy brief.

Equity financing for plantation forestry development

Equity financing is the second option. Equity investments often operate in the form of funds and investors obtain returns through dividends or capital gains from the sale of equity stakes. Equity financing of forestry plantations in Uganda is highly relevant, offering a sustainable solution for economic development, environmental protection, and social well-being. This approach fosters private sector investment, which is crucial for expanding forest cover and diversifying income sources. Furthermore, this option aligns with the long-term, capital-intensive nature of forestry, providing stable and predictable funding to support sustainable development. Uganda has greatly benefited from equity financing for plantation development especially by big planters such as New Forests Company; Busoga Forestry Company; and Global Woods (Nile Fiber Board Ltd). So, there are good examples to learn from.

The selection of this option is based on analysis of four case studies from Uganda, four from other countries in Africa and one case study outside Africa. Equity is supplemented by debt and grant financing in many of them. A few of those analysed are highlighted below.

Uganda Development Bank (UDB): Presently, UDB is financing three large commercial planters with acreage of over 1,000ha each originally supported by SPGS under a subsidy. UDB is financing them for secondary wood processing and value addition with the understanding that each of them has to replant equivalent acreage harvested. UDB has only offered them debt under commercial terms (12%) for 15 years and with 3 years grace period. In event the borrowing firms become incapacitated to repay their debt, UDB has the option to take equity into the firms.

Woodmill Company Ltd: This is a new company established by a group of willing 22 members of UTGA to add value to their mature plantation stock in a co-investment model with New Forest Asset Management Company using private equity. The company will enable members to build economies of scale in processing and marketing, thereby making make money and reinvesting in plantation establishment and processing.

Criterion African Partners: This is a private equity firm that partners with proven management teams at growing companies to enhance productivity and create value for the benefit of all stakeholders in its key focus areas: In Uganda, they have invested in Global Woods AG which has 8,000 ha of pine and eucalyptus in Kikonda Central Forest Reserve.

Africa Forest Impact Platform (AFIP): In December 2022, New Forests along with its investment partners British International Investment (BII), Norfund and Finnfund signed subscription agreements for their investment in a dedicated African Fund called the African Forestry Impact Platform (AFIP) for US$ 200 million. At the same time, it announced AFIP's first acquisition of Green Resources, which is East Africa's largest forest development and wood processing company. In terms of target areas, AFIP will invest in a portfolio of plantation forestry operating companies and related assets in Sub Saharan Africa primarily targeting established assets that can be expected to provide stable and predictable cash flows across a diversified set of markets.

Key lessons for Uganda from equity financing

- Are dominated by very few investors but commands high average in total plantation (38%);
- Have leveraged on forest product certification to appeal to emerging markets for green products including carbon finance;
- The main users of equity are also present in other countries implying that Uganda has to provide attractive enabling environment to remain competitive. The declaration of a ban on timber exports all over a sudden

has for example made some of the equity finance providers exit the market, having sold their interests to others;

- Equity financing and/or in combination with debt and grants is increasing to Uganda but favouring the large already established forestry developers, some with similar investments in Africa and beyond. This type of financing would not favour many small and medium planters;
- At operational level, the combination of equity, debt and grants has helped some investors to blend it so that their investments can be more viable than they would otherwise be without blending;
- Government has not aggressively mobilized it despite its great potential.

Potential institutional implementation arrangements

In this option, the main implementers are the mobilisers of the equity capital. However, the government needs to improve the incentive regime for plantation forestry.

Debt and grant financing for plantation forestry development

Prioritised as the third, this option explored the combination of debt and grants preferably debt being managed as a revolving fund, complemented with other incentives. This model borrows lessons from other countries case studies analysed. For example:

- ➢ Costa Rica's FONAFIFO has provided revolving credit for plantation forestry development and offers attractive terms, sometimes offering up to 20 years of credit repayment; and
- ➢ Malaysia's Forest Plantation Development Sdn Bhd is used by the government as Special Purpose Vehicle to give soft loans for plantation development programs, particularly for forest plantations.

Loans and grants are justified and relevant for forestry development in Uganda because they provide crucial financial resources for long-term planning, investment, and sustainable management of forests. These financial instruments are particularly important as they address the inherent challenges of forestry, which often involve long-term investments and projects that may not fit easily within traditional budgetary cycles. Grants alone may not suffice because they may not be available all the time, but would supplement debt funding.

The choice of this option is informed by lessons from several Banks, UTGA-SACCOs and seven non forestry sector case studies from Uganda and three case studies outside Africa. A few of these are highlighted below.

i. *aBi Finance:* aBi Finance acts as a pool under which different financial instruments (grants, loans and guarantees) are blended to make the package of financing to smallholder farmers and agribusiness affordable. It was established by Government of Denmark and Government of Uganda in 2010.

ii. *Uganda Energy Credit Capitalization Company (UECCC):* UECCC was set up as a credit support institution and as a company limited by Guarantee, with shareholders being Ministry of Finance, Planning and Economic Development (MFPED), Ministry of Energy and Mineral Development (MEMD) and Private Sector Foundation Uganda (PSFU). The objective of UECCC is to provide financial, technical and other support for Renewable energy projects. Like aBi Finance, the government exercised flexibility to allow the formation of UECCC to incentivize the type of finance providers who would not have been found under the budget support as the best mode for mobilizing and unlocking private capital. UECCC has brought on board financial institutions and SACCOs in rural areas to lend to the sector that has inherent high start up costs and risks similar to plantation forestry development.

iii. *Microfinance Support Centre (MSC):* MSC is also a government owned company established in 2001 to manage all Government of Uganda (GoU) micro-credit programs. The institutions specifically targeted for the loans are; SACCOs, Area Co-operative Enterprises (ACEs), MFIs, Co-operative Unions, Producer and Marketing Co-operatives and Small and Medium Enterprises (SMEs).

iv. *Uganda Agricultural Credit Facility (ACF):* The main objective of ACF which is administered by Bank of Uganda is to commercialize agriculture through provision of medium- and long-term financing for projects engaged in agriculture, agro processing, modernization focusing mainly on value addition. The government provides grants to de-risk banks co-funding and banks provide loans. These banks included Uganda Development Bank, Micro-finance institutions (MFIs) and other Credit Institutions.

Key lessons for Uganda from debt and grant financing

- Have been used by planters with grasps of the potential business case of their establishments (e.g. big planters) and are likely to leave out small and medium planters.
- It is very opportune for the government to build upon the Financing Institutions and SACCOS growing interest to finance forestry interventions building from their experiences of lending to agriculture under other arrangements like the Agricultural Credit Facility and Abi Finance.
- With commitment, the government can partner with willing development partners to pool resources for plantation forestry development using a trust originally (as it did in aBi) or a company limited by shares as is the case for UECCC.
- While mobilizing sustainable financing is very urgent, it has come out from both national and global experiences that it must be anchored in an enabling environment, enforcement of market standards, strong institutions and systems for monitoring, reporting and verifying how the financial resources are utilized.

Potential institutional implementation arrangements

Institutions such as Uganda Microfinance Support Centre could be explored as implementing intermediary partners through which a revolving fund for forestry could be established or anchored to. Alternatively other suitable institutions could be identified to offer a forestry revolving fund, including one that could easily allow NGOs to provide grants.

Debt for Nature Swap (DNS) financing for plantation forestry development

The fourth option explored is Debt-for-Nature Swaps (DNS) specifically to constitute one of the models for plantation forestry and at the same time strategically used to unlock carbon finance for forestry. Debt-for-nature swap is as an agreement where a creditor country forgives a portion of a debtor nation's foreign debt in exchange for a commitment to invest in specific environmental projects or conservation efforts. Debt-for-nature swaps had been used in over 30 countries and had restructured USD 2.5 billion of debt and released USD 1.2 billion into conservation projects by 2022[2]. As an indebted country, Uganda would balance its interests for commercial forestry while at the same time reducing its burden for debt. Uganda's public debt stock stood at UGX 96.1 trillion (about US$ 25.3 billion) by December 2024, with UGX 59.3 trillion (61.7%) in external debt and UGX 36.8 trillion in domestic debt (38.3%). Uganda's high debt could be a barrier to investment in wood plantation development and in helping to mitigate impacts of climate change.

The selection of this option is based on analysis of nine debt for nature swaps, two in East Africa, two from rest of Africa and five outside Africa. This financing option will address the following financial

[2] https://napglobalnetwork.org/innovative-financing/debt-for-nature-swaps/

cum-development barriers such as the limited flexibility for the government to raise additional resources internally and externally due to current high debt levels.

Key lessons for Uganda from Debt for Nature Swap

- They present an excellent method of converting burdensome, budget-restricting debt into meaningful environmental and climate actions;
- They can be used as either transition financing option to debt recovery and/or unlocking other friendly financing instruments (e.g., grants);
- They support the government in remaining on course in meeting its obligations (e.g., for climate change action) as government overcomes debt crisis;
- They can accommodate strategy for performance-based financing (as long as this is negotiated between debtor and creditor country);
- They are not well understood in Uganda;
- They tend to take a long time to negotiate and implement because of their complexity and the involvement of multiple stakeholders.

Potential institutional implementation arrangements

This option could jointly be implemented by the Ministry of Finance Planning and Economic Development and Ministry of Water and Environment. This is in line with the National Climate Change Act providing that on matters of climate financing, the Minister responsible for finance shall work in consultation with the Minister responsible for climate change.

Moving forward

Lessons from Uganda and other countries show that grants alone are not sustainable in financing plantation forestry. However, they have been catalytic in opening space for entry of other financing instruments (e.g., equity, debt, guarantees, joint-ventures, and equity). Therefore, there is need to establish a long-term financing mechanism to promote and ensure sustainable investments in small, medium, and large-scale plantation forestry for economic development, environmental protection and social well-being.

The options explored in this policy brief and lessons from the countries where they have been successfully implemented provide a good way forward for Uganda. They have unique ways of systematically influencing and supporting a wide range of players in plantation forestry development and its value chains. A lot of gains could be made by picking the most favourable option (the Uganda Plantation Forestry Financing Facility using blended finance in this case), try it out, pick lessons and adjust along the way as other countries such as Ghana and Costa Rica have done. It should also be emphasised that given the vulnerability of the subsector to risk due to its long-gestation period, investing in creating an enabling policy and regulatory framework for plantation forestry remains a bedrock for attracting financing from multiple players.