Options for Near Term Financing for Reducing Emissions from Deforestation and Forest Degradation (REDD)

REDD Funding needs will increase over time and vary in nature. In the short term, interim funding is needed for readiness (phase one) and capacity reforms and investment (phase two). Over time, substantial, and substantially increasing funds will be needed. In addition, a critically important characteristic is the certainty/predictability of continued funding.

To meet these different needs, multiple funding sources should be explored. To provide the substantial and sustainable funding that will be needed *in the long term,* the most obvious sources include loan, grant and guarantee financing from multilateral development institutions, bilateral donors, and carbon auctions/sales.

In the near term, if direct funding cannot be obtained, then it may be possible to use anticipated longer term flows or assets. Four types of such "frontloaded" funding could be explored:

(1) **REDD-specific bonds of existing multilateral development banks**. For example, the World Bank could issue REDD bonds against long-term assets specifically granted to the Bank for this purpose. This approach would rely on existing institutions with existing capacity to borrow at low rates from the capital markets. Although it would take some time to arrange for the grant of long-term assets from donors, once established/funded this would also be a flexible way to obtain funding when needed. At the same time, MDB policies and requirements – such as financing only to member governments – would need to be met as funds are disbursed.

(2) **An international finance facility-REDD**. A specific IFF could be established, with its own regulatory status and rating, and again using long-term assets grant for the purpose of funding it. This approach would also frontload funds as needed – indeed would make sense only where there is a clear need for frontloaded funding – and would provide flexibility around the use of proceeds. However, establishing an IFF is not a small task, and entails additional complexity and transaction costs compared to other options. In addition to costs related to market access, significant costs will be incurred to establish and run the new entity with its own legal framework, governance and process for the use of funds. An IFF, like REDD bonds, could benefit from specific investor interest.

(3) **Niche market/private investment structures**. One example would be a structure allowing the use of forest revenues (including carbon) generated from REDD programs to pay the returns on REDD bonds issued by an MDB. This approach could be tailored to support specific programs, to limit risk to bondholders (for example by guaranteeing principal). This could provide an attractive investment for socially conscious investors, using existing MDB issuance capacity, at the same time channeling investment funds through private sector financial institutions. Investment details and structure may be difficult to establish; this is an approach that would need to be piloted to explore feasibility.

(4) **Revenue enhancement/risk mitigation**. A fund could be established to lower the risk to bondholders or local and international private sector investors interested in financing REDD programs. The fund could, for example, provide revenue enhancement in the short to medium term for long-term REDD investments; guarantee a certain level of return on financing structures such as the example in (3) above; buy down the interest rate on REDD program loans.