

# The investment case for SFM-based projects

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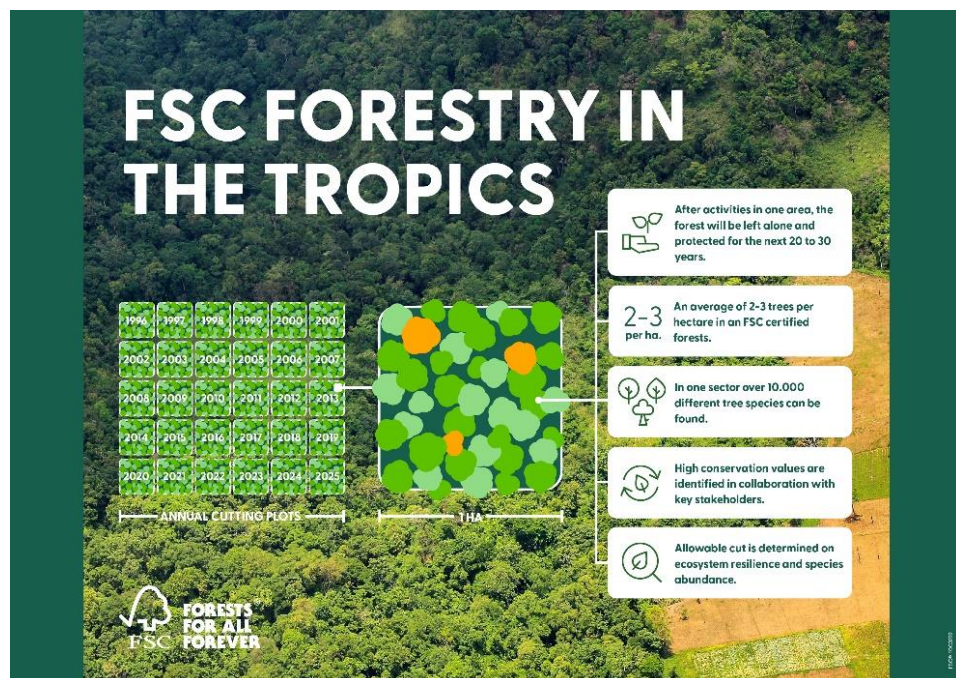


## The investment case for SFM-based projects

*“The most urgent task for a sustainable future and climate change mitigation is to reduce consumption and emissions, but it is also crucial to begin using wood more efficiently for purposes in which wood has a comparative advantage from sustainability and circular economy perspectives.”*

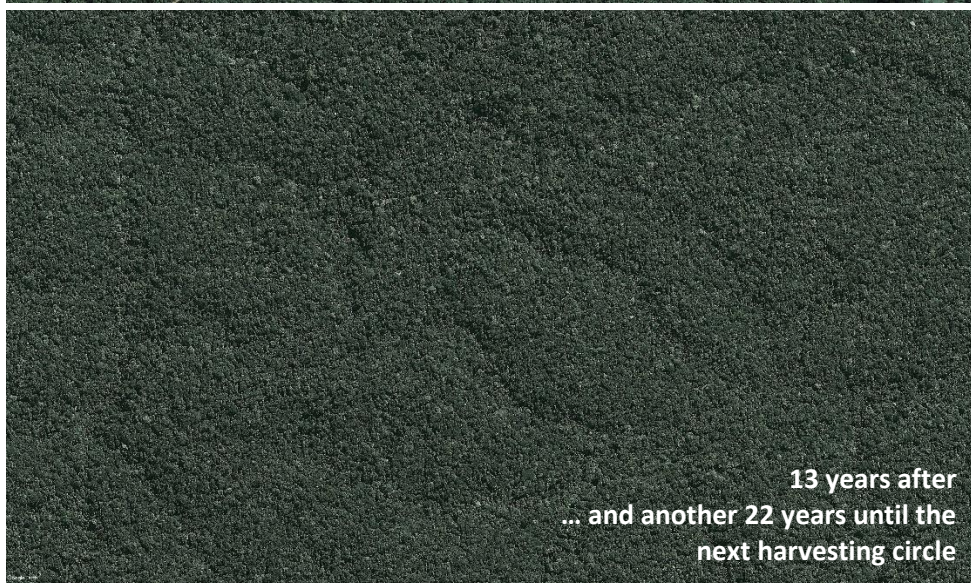
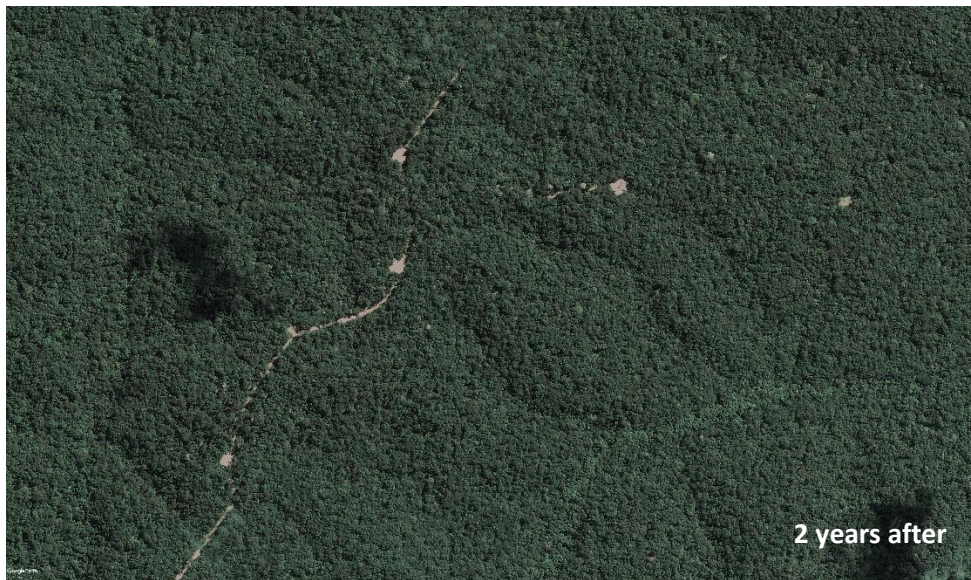
Sustainable forest management (SFM) projects are often overlooked as an opportunity for climate investment, despite their potential to deliver environmental, social and climate benefits. Due to partially poor practices in the past, logging in tropical forests has a bad reputation, even though the sector is undergoing massive changes and SFM operators are improving their practices to meet current sustainability demands. As the demand for timber, climate action, and forest carbon projects is on the rise, we take a closer look at the impact of SFM carbon projects, their investment potential, and some of the misconceptions that surround these projects and the sector as a whole. SFM is one of the best commercial uses of a forest while keeping most ecosystem services intact what, for example, cannot be achieved with a plantation.

The International Tropical Timber Organization (ITTO) defines sustainable forest management (SFM) as *“the process of managing forest to achieve one or more clearly specified objectives of management with regard to the production of a continuous flow of desired forest products and services without undue reduction of its inherent values and future productivity and without undue undesirable effects on the physical and social environment”*.





## Forest recovery in sustainable forest management concessions



## Climate investing today

In the fight against climate change, forests have come to the forefront as valuable carbon storage assets. There is an increasing demand for voluntary carbon credits generated through natural climate solution (NCS) projects, including forest-based offsets. Natural climate solutions offer cost-efficient ways to reduce carbon emissions while providing a range of co-benefits,<sup>i</sup> and they may deliver up to one-third of required emissions reductions by 2030 to meet the Paris Agreement targets.<sup>ii</sup> The total volume of the retired credits (sold to end user) in the voluntary carbon market (VCM) amounted to 151 million tonnes CO<sub>2</sub>eq in 2020 (Figure 1). Newly 'produced' credits (issuances) within the NCS category more than doubled each year between 2016 and 2019, with natural climate solutions accounting for 40% of the total issuances in 2020.<sup>iii</sup>

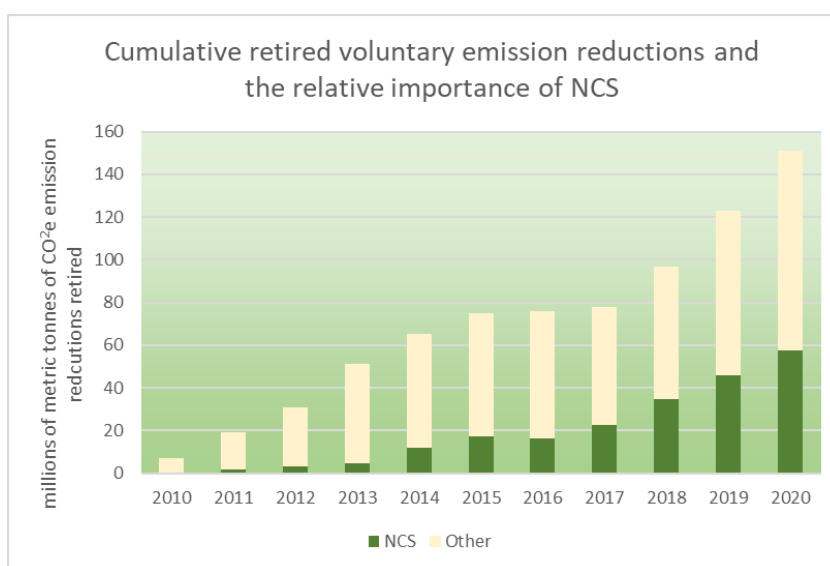


Figure 1: Number of verified emission reductions retired (sold to end user) from 2010 to 2020.

Afforestation, reforestation and revegetation (ARR) projects are mostly certified according to the Verified Carbon Standard (VCS) and are particularly popular among carbon credit buyers.<sup>iv</sup> Sustainable forest management projects, on the other hand, which include Improved Forest Management (IFM) and avoided deforestation and degradation (REDD+) projects on concessions or private land with a logging component, are still considered less attractive. However, as the role of forests is embraced more and more, new avenues open up for SFM carbon projects in tropical forests. The SFM sector has the potential to become an essential partner in the fight against global climate change. This can create much-needed additional carbon revenue streams to finance sustainable forestry operations while delivering the vast range of ecosystem services that the sector is familiar with but has always struggled to convey to other stakeholders.



## Why SFM carbon matters

### **Forest concessions make up an enormous part of the world's forests and cannot be disregarded**

An estimated 70% of all forests in the tropics are legally assigned as production forest, but only 10% are sustainably managed. Tropical forests are an important resource and huge reservoirs of carbon, storing 250 billion tonnes of carbon in their trees alone.<sup>v</sup> Conserving this carbon is of paramount importance to global climate stability. By investing in SFM, carbon investors and buyers can protect enormous tracts of tropical production forest which would otherwise face deforestation/degradation. Considering the vast size of these landscapes, forest conservation strategies for climate change mitigation cannot rely solely on protected areas, but need to include production forests as part of realistic conservation strategies. This highlights the enormous transformational potential of the sector and the urgent need to increase the share of sustainably managed forests.



### **The global demand for wood as a sustainable resource is booming**

Wood products from SFM clearly fit within the principles of the low carbon 'circular bioeconomy', an economic model in which resources are renewable, sustainably managed, recovered and reused. The model is gaining momentum as it is considered a good response to sustainability and climate issues, while meeting the needs of society.<sup>vi</sup> Wood is also one of the few construction materials that can be grown naturally and stores carbon for the duration of its lifetime.<sup>vii</sup> It has a positive impact on the carbon balance, as opposed to other materials such as cement and steel that cause high CO<sub>2</sub> emissions.<sup>viii</sup> At the same time, innovations in wood applications are expected to accelerate, and organic materials may replace fossil-based materials in many industries.<sup>ix</sup> The planned EU carbon tax, presented by the European Commission in 2021 as part of the EU Green Deal, would improve the competitive advantage of timber over other construction materials, as wood products can be carbon neutral or net carbon positive.



This move towards a more forest-based economy means there is a need for more forest under better management, with a focus on wood production and carbon storage in combination with social and environmental benefits.

### **Opportunities for new carbon projects are on the rise**

The political climate towards forest carbon projects is changing in many countries, and opportunities and supporting legislation for the development of carbon projects on the voluntary carbon market are on the rise. New methodologies and technological advances foster cost-efficiency while widening the range of projects that can claim voluntary carbon credits. As the demand for carbon projects is increasing and may surpass the supply of existing projects, now is the time to look beyond traditional conservation and reforestation projects and explore alternative investment opportunities like SFM carbon projects.



## Five common misconceptions about investing in SFM carbon

### 1. Logging is unsustainable and investing in SFM leads to reputational risk

Logging in tropical forests generally has received a lot of negative publicity in the past, with the sector being accused of almost everything that has gone wrong in those forests. But the main drivers for deforestation nowadays are the conversion of forests for other land uses including infrastructure, forest fires, illegal and unsustainable logging, fuelwood harvesting, mining, and climate change. Since the nineties of the last century, the SFM sector has progressively gained professionalism. Timber harvesting practices in natural forest concessions have taken a huge leap from the destructive behavior of the past, and the forestry sector has moved away from timber mining towards a more integrated approach to forest management aimed at producing high-value forest products. Also, it has become clear that most deforestation was in fact due to clearing for agriculture.



In forestry, the concept of regulating harvests based on the biological potential of the forest has been refined. Trees in natural forests are a mix of several age classes, and by balancing the removal of a commercial age class with the regeneration that will replace it during a rest period, sustainability is achieved. A forest managed in this way is perennial, with its ecosystem functions and the majority of its biodiversity intact.

The need to provide proof of sustainability to buyers has sparked the development of independent third-party forest certification schemes like FSC™ and PEFC™. These guarantee legal and responsible sourcing of timber and other forest products and include various measures to protect biodiversity, water quality, wildlife habitat, and other resources. Certification puts high demands on forest managers and reduces the profitability of timber as a stand-alone business. While continuously held under a magnifying glass, the SFM sector is maturing into a sector operating at the forefront of responsible business conduct. Third-party certification of SFM projects warrants their quality and offers a secure base for investment.

### 2. SFM carbon projects do not provide an attractive return on investment

By diversifying the forestry sector to include environmental services and/or non-timber forest products, innovative business concepts have been created that strengthen the business case for SFM. Carbon credits can serve as attractive add-ons to day-to-day forestry operations, while generating additional revenue for conservation purposes. The booming carbon and natural climate solutions (NCS) market, with increasing price trends, will lead to higher demands for SFM-based carbon credits, improving the project's long-term viability. In addition, while the market is only pricing carbon right now, efforts to combine carbon credits with payment for other ecosystem services such as biodiversity are underway, allowing for the creation of high-value carbon projects in sustainable forest management that are both financially attractive and impactful.



### 3. SFM carbon projects have no social and environmental benefits

SFM operators have the responsibility to conserve the forest and its biodiversity in their concessions through special High Conservation Values (HCV) protection and anti-poaching measures. Several studies have highlighted the potential of well-managed production forests to provide the same – or even higher – level of habitat and biodiversity protection compared to national parks.<sup>x xi xii</sup> This is because SFM operators often have more financial resources and operational capacity to protect their areas.



Front-running SFM operations are known to offer community benefits when operating in remote areas where the public sector is weak and limited financial resources exist. In practice, this means that SFM companies offer not only (in)direct employment but in some cases also medical care, education, power supply, infrastructure, and agroforestry development, for example.

Smallholder-based SFM projects can offer community benefits through livelihood contributions from carbon payments and ecosystem services.<sup>xiii</sup> For SFM carbon projects, biodiversity and community benefits can be solidified by adding CCB (Climate, Community and Biodiversity Standards) certification to carbon certification.<sup>xiv</sup>

Considering the often vast size (250'000-1'000'000 ha) of forest concessions, bringing productive forests under sustainable and improved management will have major positive impacts on forest and biodiversity protection as well as carbon storage. Additional revenues from the sales of carbon credits can provide SFM operators with the economic means to finance environmental and social conservation measures.

### 4. Additionality of SFM-based carbon projects is hard to demonstrate

In the absence of sustainable forestry interventions, land use scenarios in unmanaged forests may include deforestation and degradation in the form of unsustainable logging and the illegal extraction of trees for timber, fuelwood and charcoal. Practising proper sustainable forestry comes at a cost which cannot always be bridged by timber prices, and additional income from carbon credits can help to keep the forest standing. The additional income comes with an increasing number of checks and verifications further ensuring that the good work is kept up. In addition, the performance standards are continuously improved to incorporate recent scientific information and methodological improvements, and validated SFM carbon projects provide a growing body of arguments and data to substantiate SFM's additionality claims.





## 5. Avoided carbon emissions or removals from SFM carbon projects quickly lose their effect

SFM projects typically concern long-term concession titles and management plans developed by experienced forestry operators, which strengthens the case for SFM as a permanent climate



solution. Rotations in natural forest management typically cover 20 to 30 years, and durability of projects is guaranteed by certification. Climate, Community & Biodiversity (CCB) certification, which can be used in conjunction with FSC and VCS certification schemes, can help to develop even more robust projects with long-term social and environmental benefits. These projects have a higher value in the market as compared to ‘regular’ carbon credits, and can – when carefully

designed – improve livelihoods, create employment, protect traditional cultures and endangered species, help to secure tenure to lands and resources, increase the resiliency of ecosystems, and help to combat climate change.

### Selecting a credible project

Investments in sustainable forestry need to be done with due care to identify those projects that deliver on the promise of sustainability, climate relevance, social impact and biodiversity conservation. Credible certification of the forest operations according to the standards of FSC and PEFC as well as carbon credits are a key element in the identification of suitable projects. Fortunately, this is an already well-developed practice. Transparency may sometimes still be an issue. Forest managers should also be transparent in sharing information on the resource under

#### **Box 1. Indicators of credible SFM carbon projects**

- The forest is a verified legal source (all permits are in place)
- Certification of sustainable production (FSC or PEFC)
- Certified carbon credits (VCS and CCB certification)
- Verified ecosystem services (e.g. FSC)
- Credible social programmes supported by specialised civil society organisations
- Transparency about social and environmental performance
- Transparency about the resource and its management

management and the activities that are planned without holding back. Complete openness allows third parties to understand what is happening in the forest and removes doubts about additionality and permanence of forest carbon projects.

When investing in SFM carbon projects, we suggest looking for the indicators of credible projects presented in Box 1. Not all of these are essential for sustainable forest management practices, but indicators like certification and transparency are signs of quality SFM carbon projects.

## Conclusion

**In conclusion, there is an urgency for investment in the SFM sector to support the sustainable management and conservation of the vast areas of production forests in the tropics and to meet our global demand for forest resources. SFM-based carbon projects can deliver risk-adjusted returns, while generating positive environmental and social impacts. Using the indicators for credible SFM carbon projects will support credible projects with tangible impacts. Success stories do exist – the opportunity lies in scaling them up.**

## End notes

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The report concludes that there is an urgency for investment in the SFM sector to support the sustainable management and conservation of the vast areas of production forests in the tropics and to meet our global demand for forest resources. SFM-based carbon projects can deliver risk-adjusted returns, while generating positive environmental and social impacts. Using the indicators for credible SFM carbon projects will support credible projects with tangible impacts. Success stories do exist – the opportunity lies in scaling them up.

