



CAFÉ SELVA NORTE

COFFEE AGROFORESTRY IN PERU

Financing to enable climate-smart coffee agroforestry systems

POST-INVESTMENT

- Project operator:** ECOTIERRA
- Vehicle:** Urapi Sustainable Land Use³
- Business model:** Coffee, agroforestry (timber) and carbon credits
- Financing:** Debt and equity

CONTEXT

Coffee cooperatives in the project area face significant barriers to continue their growth and transfer value created to smallholder producers. There is a lack of availability of processing facilities, causing quality loss and high transportation costs. Cooperatives have limited resources available to reach appropriate markets and to invest in processing infrastructure to ensure quality and traceability, which causes producers to receive lower prices. On the producers' side, coffee plantations are often old and unproductive as well as poorly protected against the effects of climate change, leading to declining yields and low income. They have little or no access to affordable long-term credit to renovate, expand or improve processes or infrastructure on their farms, and a lack of knowledge and poor management practices to adapt to climate change. Altogether, this leads producers into a vicious circle of migratory agriculture, deforestation, soil erosion and a preventable loss of income.

To overcome the barriers identified, private investment is required. As such, an investment of US \$14.5 million over the next four years is being made to finance:

- Secured-term loans to participating cooperatives for on-lending to smallholder farmers, in order to transition from degraded lands to agroforestry and forestry systems;
- Equity investment in a newly constructed processing plant to cover construction costs and part of the operational expenditures. This includes improving processing and commercialization services of the participating cooperative, of which ownership shares will be fully transferred to the participating cooperatives over time;
- Investment to securitize and trade carbon credits generated by regeneration of degraded land in agroforestry systems and forest protection.

3. Received an investment from the LDN Fund



SMALLHOLDER/ COMMUNITY ENGAGEMENT

This project is bringing an innovative credit and service product in direct partnership with local cooperatives whose members, individual smallholder farmers, have secured land rights. As such the project aims to improve key areas of the coffee value chain by increasing the production, quality and commercialization of its products, thereby reducing land degradation and increasing forest cover.

PAYBACK/REVENUE MODEL

The three investment activities are recovered through repayment of the loans by the producers (including interest), through the sale of coffee, agroforestry products (e.g. timber revenues later in the project), and carbon credits, with dividends paid out of the commercial returns of the processing plant (resulting from fees paid for the services provided by the mill). Moreover:

- The microcredit is structured to match the cash flow needs of the producer, allowing repayment when cash is at its peak, to be repaid over a five-year term with the bulk of the loan reimbursement only required toward the end of the term loan.
- Sale of the shares owned by the fund in the processing plant to the participating cooperatives at a pre-established price, which is the investment made plus an inflation factor. All the dividends to the cooperatives will initially be used for the purchase of the shares owned by the fund.
- The carbon project will be verified in the first few years of the project to issue the initial carbon credits. But the biggest benefits become available towards the end of the project, because the project produces only ex-post carbon credits.

RISK MANAGEMENT

Several risk-mitigation strategies are deployed to reduce risks associated with this finance case:

- To reduce internal risks such as defaults, bankruptcy, poor governance and delays, safeguards are put in place including the participation of multiple cooperatives, collective guarantees on the carbon offsets and coop sales volumes, disbursements by milestone, and transfer of members to another coop in case of bankruptcy of their coop.
- To mitigate risks around decreases in commodity and carbon credit prices, the revenue base is diversified (coffee, timber, carbon, as well as revenues from mill and commercialization), and rescheduling of debt is made possible.
- To reduce natural risks, the project focuses on supporting climate-smart agriculture and reducing land degradation, as well as providing technical assistance to producers.
- Use of technology (MINKA) for monitoring of progress and impact and use insights for adaptive management.

INVESTMENT

This finance case concerns an investment of US \$14.5 million in the project as a combination of debt through a special-purpose vehicle (SPV) and as private equity in a newly created limited company (LC) for the processing plant. Through the SPV, the fund makes loans to cooperatives for on-lending as microcredit to their members to pay for the transition towards sustainable land use. The LC builds new infrastructure and purchases the necessary equipment. All assets belong to the LC. Initially, the LC will be co-owned by the fund and the participating cooperatives, while controlled by the fund. On termination of the project, assets will be transferred to the cooperatives following a transition plan with a clearly defined exit value. The overall expected internal rate of return of the project is around 12%.

USE OF TECHNICAL ASSISTANCE

The TAF provides additional support to this investment in order to reduce certain investment risks and maximize the projected impact of the project. The assistance provided includes:

1. Building capacity of cooperatives and strengthening of women leadership to reduce risk and strengthen potential for sustained impact. Special attention is given to gender equality and empowerment. The amount of capacity building required is beyond what can be commercially expected from a private-sector partner;
2. Support in producing hybrid coffee varieties to ensure higher climate change resilience and a stronger market position of cooperatives and smallholder producers;
3. Value chain commercialization study to increase returns from timber production in the agroforestry system, to diversify income to cooperative members and reduce risks of defaults, for example;
4. Support in establishing an LDN baseline and related monitoring to allow for adaptive management to maximize credible environmental and social returns from the project.



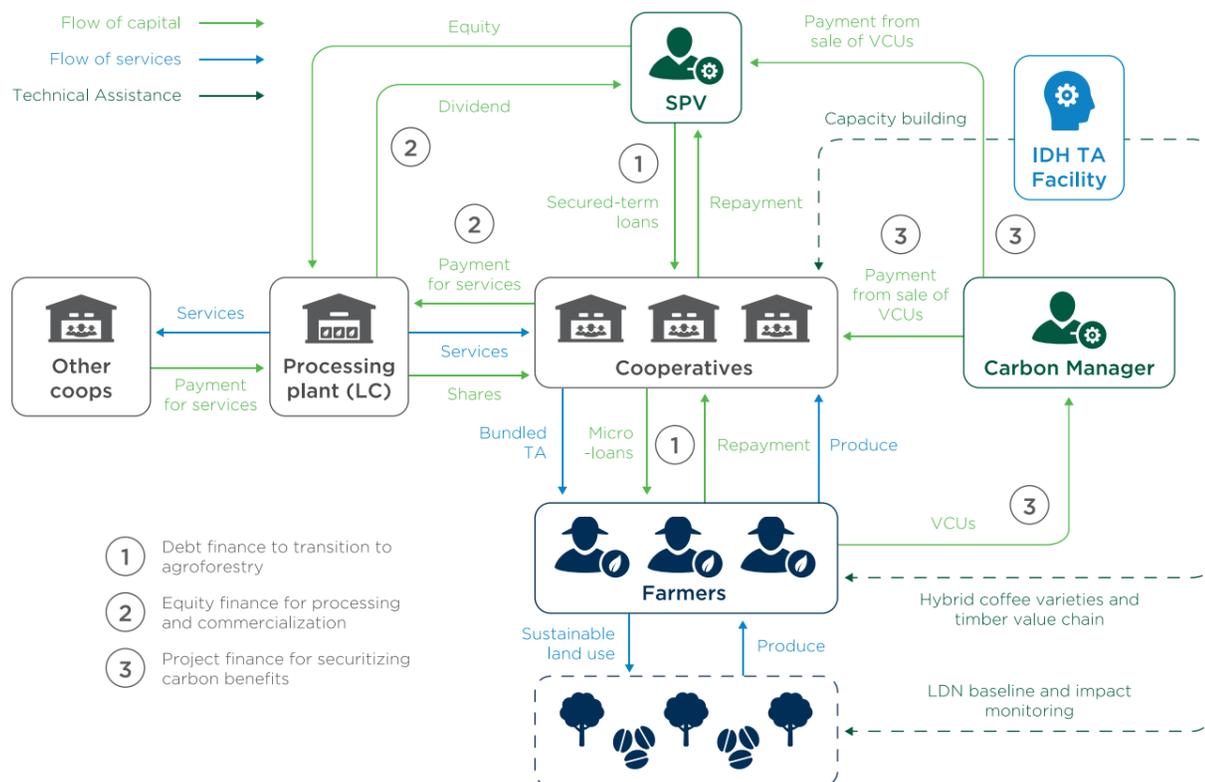
PROJECTED IMPACT

- **Restoration of degraded land***: 8,250 hectares
- **Protection of forest**: 12,300 hectares
- **Producers reached**: 2,000
- **Emissions reduction**: 1.29 million MtCO₂eq

* The agroforestry system includes a mix of local tree species, also taking soil improvement, pollination and biodiversity into account.



FLOW OF CAPITAL AND SERVICES



Credit: Guillaume Nadeau