

FMO's investment approach to responsibly managed forestry plantations

This document presents FMO's approach to investing in forestry plantations and how we promote best ESG practices and responsible forest management. We aim to demonstrate how investments in this sector contribute to FMO's purpose and strategy, how we address key environmental and social (E&S) risks, and the capabilities we have developed to invest responsibly in the sector in developing countries. The document begins by explaining why it is so important to support forestry plantations and the vital role they play in protecting our natural forests, people, and planet. It then focuses on the need to finance highly productive forestry plantations, particularly in the Global South.

Introduction

Deforestation is one of the main causes of climate change and biodiversity loss, all of which disproportionately adversely affect vulnerable communities. At the same time, demand for wood is increasing, driven by population growth, income growth, and the transition to a more sustainable economy. Currently, roughly half of the global demand for industrial roundwood (timber in log form that is used for industrial purposes) is met by planted trees, while the other half is taken from natural forests. To better protect natural forests and reverse net deforestation, more responsibly managed forest plantations are needed to meet this rising demand for timber.

Recognizing the need to urgently increase the amount of responsibly managed forests and plantations, FMO has committed to investing up to €1 billion in forestry and sustainable land use by 2030. Our primary focus is on the Global South, where the favorable growing conditions in the tropical and sub-tropical regions make growing trees both efficient and financially sustainable. FMO is aware that forestry operations can be associated with harmful social and environmental consequences. However, we are also convinced that together with our clients, we can introduce and uphold more sustainable practices that contribute positively to our core SDGs: Decent Work and Economic Growth, Reduced Inequalities, and Climate Action.

FMO is well-positioned to make a difference in the sector. As one of the few development finance institutions (DFIs) with dedicated teams specialized in forestry investments, we focus on investing in responsibly and sustainably managed forestry operations. Given the inherent risks in the forestry sector, we maintain a rigorous client selection process, carefully analyzing each project in detail and implementing additional safeguards when necessary. These safeguards are part of the financing contract, implemented by the client and monitored by FMO. This approach allows us to drive and enhance the implementation of environmental, social, and governance (ESG) standards within the forestry sector.

Why investments in responsibly managed Plantation Forestry are needed

Currently, the global area of planted forests (plantations and other planted forests) is estimated to be 294 million ¹hectares. Although this represents only 7% of the global forest area, it provides approximately half of the global industrial roundwood supply. The rest of the global demand is met by harvesting from naturally regenerating forests. Demand for wood is

¹ FAO (2020) Global Forest Resource Assessment 2020: Main Report

expected to grow significantly over the next 30 years, driven by population and income growth, and the transition to a more sustainable economy using biobased materials to replace plastics, steel, and concrete. To meet this expected increase in demand while protecting naturally regenerated forests, an estimated 33 million hectares of additional highly productive plantation forests will be needed by 2050. This growth is expected to come primarily from countries in the Global South, where the conducive growing conditions of the tropical and sub-tropical zones make wood production highly efficient.²

How forestry fits in FMO's Corporate Strategy 2030

In our [strategy towards 2030: Pioneer – Develop – Scale](#), FMO commits to building €10 billion portfolios in both SDG 13 (Climate Action) and SDG 10 (Reduced Inequalities) and reaching Net Zero by 2050, as part of our effort to support inclusive and sustainable economic growth. Forestry is an important element of climate action. Forest plantations have significant carbon sequestration and climate adaptation potential, and there is an urgent need to meet the global demand for timber with sustainably managed forestry plantations.

As FMO, we aim to make a difference in the forestry sector, investing in plantations that can meet our rigorous ESG requirements or are willing and able to get there. That is why in 2022 we launched our updated forestry strategy and shared our ambition to build a forestry portfolio of up to €1 billion by 2030. In addition to investments in existing (brownfield) plantation companies, we expanded the scope of the strategy to cover new (greenfield) plantations given the need for a substantial increase in forestry plantations as well as the significant carbon sequestration potential that such plantations have. Moreover, early-stage involvement in new projects enables us to influence and facilitate the ESG implementation of the project.

Although we are continuously refining our approach to address the many complexities in the sector, forestry is not new to us. As early as 2011, we started investing in forestry, focusing on brownfield forestry plantations as well as vertically integrated companies, which include industrial processing like sawmills and plywood facilities. Plantation forestry – greenfield and brownfield – will remain the cornerstone of our investment approach in the broader forestry sector, based on its climate impact and financial sustainability. This will be complemented by investments in innovative business models targeting nature conservation, restoration, or sustainable use of natural ecosystems. Our forestry investments will also contribute to our goal of promoting biodiversity, as most of the companies that we invest in maintain and regenerate conservation areas, often in excess of what is legally required in the country of operation.

In addition to generating higher yields and meeting the growing demand for timber without contributing to deforestation, responsibly managed plantations offer significant climate and environmental benefits. One of the key advantages is their potential for carbon sequestration, particularly when new plantations are established on degraded land. By absorbing and storing carbon dioxide, these plantations help mitigate climate change. Moreover, plantation forestry provides valuable co-benefits such as generating raw materials for various industries and creating jobs, particularly in rural areas.

Besides the direct connection to Decent Work and Economic Growth (SDG 8) and Climate Action (SDG 13) outlined above, forestry operations can also contribute significantly to Reducing Inequalities (SDG 10) by increasing access to economic resources and opportunities for rural populations, which are often economically marginalized. As forestry projects mature, they offer a variety of jobs, including work in nurseries, plantation management, harvesting, logistics, and industrial processing. These developments not only

² FAO (2022) Global Forest sector outlook 2050

result in direct job creation but can also generate broader community benefits by contributing to the establishment of public infrastructure, fire management programs, and access to basic services such as public health and education. Moreover, forestry plantation projects can enable alternative income generation such as agroforestry systems, non-timber forest products, and eco-tourism for the benefit of local communities and Indigenous people. This unique combination makes forestry one of the few sectors where climate mitigation can go hand in hand with for-profit business models in the private sector.

How we select our forestry investments

While the need for more forest plantations is clear, FMO is aware of the harmful social and environmental consequences that can occur with large-scale forestry operations if not managed well. To ensure we work with clients and investees committed to high environmental and social standards, we have a comprehensive E&S risk management system grounded in international best practices, as outlined in our [Sustainability Policy](#). This framework guides us in assessing and managing E&S risks within a client's project and organization.

Our customers should be willing and able to apply international best practices in terms of ESG. Our process begins with an initial screening to ensure potential investments do not involve activities listed in our Exclusion List, such as operations that would harm High Value Conservation Areas (HVCAs). After the screening, we categorize each project based on its ESG (Environmental, Social, and Governance) risks, in such a way that higher-risk projects receive more thorough evaluation and oversight. The IFC Performance Standards (PS) serve as our foundational framework for due diligence, guiding our investees' practices

We also encourage our forestry customers to implement internationally recognized certifications, such as those from the Forestry Stewardship Council (FSC) or the Program for the Endorsement of Forest Certification (PEFC).

E&S challenges in the Forestry sector and how we address these

FMO is more than just a bank. We collaborate closely with our customers and investees to support their efforts in improving their ESG practices. While we acknowledge that no investment is entirely risk-free, we strive to minimize ESG risks through careful due diligence and ongoing collaboration. Our process involves a comprehensive analysis of project risks, enabling us to develop appropriate safeguards and mitigation strategies. To provide a clear understanding of this process, we have highlighted below the most significant risks potentially associated with forest plantations and described how specific mechanisms within our system are employed for their assessment and mitigation. This list is not exhaustive and is presented in no particular order. Ultimately, the materialization of these risks and the safeguards required to be adopted by each project depend on various factors, and the continuous collaboration and work with our clients help us navigate these complexities.

1. **Deforestation and Soil Degradation:** The establishment of large plantations can lead to deforestation through land conversion and soil degradation due to high nutrient uptake, soil compaction, and the inappropriate use of fertilizers and pesticides. Such unsustainable practices could threaten natural ecosystems and soil health. Within our influence, we strive to prevent deforestation elsewhere by farmers who previously used or owned land now designated for forestry plantations. To address the risk of deforestation, FMO does not allow the conversion or degradation of High Conservation Value Areas (HCVA), as stipulated in our exclusion list. Through Land Use Cover Change (LUCC) analysis, we assess adherence to FSC cut-off dates. We aim to have processes in place to identify potential soil impacts and implement mitigation measures to minimize soil disturbances

and compaction, prevent soil erosion, and protect soil quality. This is addressed through Environmental and Social Impact Assessments (ESIA) or alternative management plans when necessary.

2. **Biodiversity Loss:** Converting natural ecosystems into monoculture plantations poses significant risks to biodiversity and ecosystem services. Natural ecosystems are areas where native plants and animals coexist in balance, with minimal human interference. Transforming these delicate systems into uniform plantations can disrupt the complex web of life and ecological functions that have evolved over time. This is particularly important in regions with relatively weak conservation policies and limited enforcement. To address these risks, our due diligence process includes the analysis of biodiversity studies and site assessments. We request our clients to implement environmental management strategies that prioritize biodiversity conservation, sustainable land-use practices, and the maintenance of ecosystem services. When relevant, our clients are required to adopt offsetting mechanisms to ensure critical habitats are protected and no net losses occur in any type of natural ecosystem.
3. **Water Resource Depletion and Pollution:** Forest plantations can help regulate hydrology by reducing floods and increasing water infiltration. However, they may also consume more water than previous land uses, reducing availability for ecosystems and communities. The improper use of agrochemicals can lead to soil and water contamination, especially where regulations are weak. To address these risks, we request our customers or investees to demonstrate that methodologies like landscape-level water balance have been used, and that plantations do not harm water resources. Additionally, we ask customers to minimize water contamination risks by implementing Integrated Pest Management Systems. This approach helps reduce water pollution by excluding prohibited agrochemicals, minimizing pesticide use, incorporating alternative pest control methods, and carefully monitor that agrochemicals are applied only when necessary.
4. **Land Rights and Community Conflicts:** The expansion of forestry plantations can lead to land rights conflicts with local and Indigenous communities due to traditional land claims, potentially causing social unrest, especially in areas with weak legal frameworks. There is also a risk of impacting cultural heritage, which requires careful management. To address these risks, FMO requests customers or investees to demonstrate that their ESIA includes the evaluation of social and cultural impacts, ensuring cultural heritage is considered in planning. Engaging with communities to gain Broad Community Support (BCS) and ensuring Free, Prior, and Informed Consent (FPIC) for Indigenous groups, in line with IFC Performance Standard 7 criteria, are crucial steps in managing and preventing these conflicts.
5. **Economic Inequities and Local Livelihood Impacts:** Forestry plantations can boost national economic growth through employment, trade, and taxes, but may not benefit local communities, raising concerns about economic inequities. Land conversion for plantations could disrupt traditional livelihoods, increasing poverty and food insecurity. Occupational Health and Safety (OHS) risks, such as exposure to heavy machinery and chemicals, could heighten local populations' vulnerability, especially in areas with limited economic opportunities. To address these risks, FMO requests customers to identify potential negative impacts and propose mitigation measures as part of investment management plans. This includes encouraging clients to have effective community engagement, to support independent farmers with capacity building and implement other social programs in line with the needs and input of stakeholders. Additionally, FMO promotes the implementation of OHS practices and inclusive economic models that prioritize local benefits and worker safety.

- 6. Carbon Storage Capacity and Carbon Credits:** Forest plantations can capture and store carbon, facilitating the generation and sale of carbon credits. These supplemental carbon revenues can play an important role in the financial sustainability of forest conservation and afforestation efforts, ensuring proper benefit sharing with communities. However, carbon measurement schemes still face integrity issues on both the demand and supply sides, and questions have been raised about the lower carbon storage capacity of plantations compared to fully developed natural forests. To address these risks, FMO evaluates the adoption of Greenhouse Gas (GHG) assessments by our customers, as they provide a robust framework for accurately evaluating carbon stocks and sequestration potential. We also expect that generated carbon credits are of high quality, meeting stringent standards for additionality, permanence, and accountability. Additionally, we expect a Community Benefit Sharing Plan to be in place when appropriate.

We lay down the appropriate strategies to address the identified risks in Environmental and Social Action Plans (ESAPs) which form part of the legal contracts with our customers. The implementation of these ESAPs is closely monitored. The client's engagement and our continuous monitoring are central to our approach, also involving frequent calls and visits, annual ESG performance reports, independent external monitoring and implementation of remedial actions when necessary.

Why FMO is well positioned to invest in forest plantations

FMO has been investing in emerging markets for over 50 years, gaining valuable experience in navigating and managing complex risks and trade-offs. We have successfully collaborated with the private sector to raise sustainability standards, which is particularly crucial in forestry, where local legislation can be insufficient or weakly enforced. As we build our track record in forestry investments, we continuously learn important lessons that strengthen our investment approach. We also share these insights with the broader forestry investment community, exemplified by our recently published "[ESG Guide for Forestry Investments](#)."

FMO has a fit-for-purpose policy framework, supported by significant in-house expertise, to make impactful investments while addressing risks and aligning outcomes with our three focus Sustainable Development Goals (SDGs). Our role extends beyond risk management; we support our customers and investees to operate and grow transparently in an environmentally and socially responsible manner through our robust E&S framework and technical assistance offerings.

Lastly, FMO can provide long-term funding in debt and equity and has access to concessional funding from multiple donors specifically aimed at forestry investments. Concessional funding is essential for risky investments in countries without an established forestry industry or in relatively young and unproven business models. Through our progression model, we can continue supporting our investees from an early stage, providing long-term finance that allows these companies to scale and achieve financial sustainability while contributing positively to climate mitigation and adaptation.

About FMO

FMO is the Dutch entrepreneurial development bank. As a leading impact investor, FMO supports sustainable private sector growth in developing countries and emerging markets by investing in ambitious projects and entrepreneurs. FMO believes that a strong private sector leads to economic and social development and has a 50+ year proven track-record in empowering entrepreneurs to make local economies more inclusive, productive, resilient and sustainable. FMO focuses on three sectors that have high development impact: Agribusiness, Food & Water, Energy, and Financial Institutions. With a total committed portfolio of EUR ~13 billion spanning over 85 countries, FMO is one of the larger bilateral private sector development banks globally. For more information: please visit www.fmo.nl