

## Attracting institutional investors

**Pension funds, endowments and foundations have trillions of dollars to invest. Can they be convinced to direct such investments towards tropical forests?**

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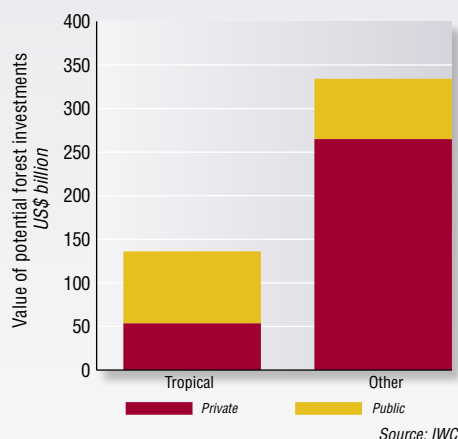
Institutional investors such as pension funds, endowments, foundations and others are characterized by:

- trillions of dollars of capital;
- interest in long-term investments (10–15+ years);
- realistic risk-adjusted return expectations;
- increasing emphasis on triple-bottom-line (economic, environmental and social) returns; and
- focus on total economic return (cash and capital appreciation).

The forest investments of institutional investors have so far been almost exclusively non-tropical. Nevertheless, the tropical forest sector offers significant, if as yet untapped, scope for investment (Figure 1). Planted forests are generally more likely to attract significant institutional investment compared to natural forest management. This is due primarily to the proven track record of planted forests in investment terms, whereas investment conditions in tropical natural forests are less known and not as easily comprehended.

### Untapped

Figure 1: IWC analysis indicates that tropical forests represent significant forest investment potential



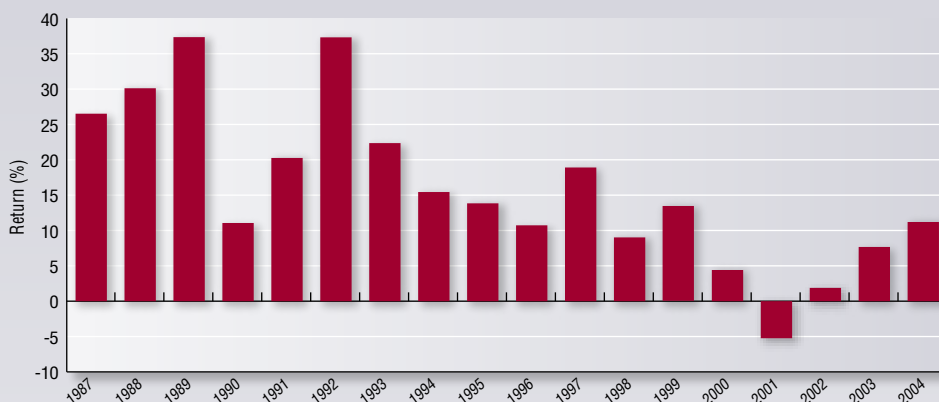
### Forest investments for institutional investors

Forestland investment is attractive to institutional investors because:

- there is a high return-to-risk ratio;
- it increases diversity for large portfolios;
- risk is relatively controllable;
- there is a comparatively low risk of abrupt market change; and
- returns have been largely positive over a long period (see, for example, Figure 2).

### Positive territory

Figure 2: Return on US forestland investment, 1987–2004



Source: National Council of Real Estate Investment Fiduciaries

### Constraints to tropical forest investments

The constraints to investment in tropical forests listed below might be real or perceived, but even if only perceived they form an obstacle to attracting investments.

- Negative image of commercial forestry in the tropics—the general media and public image of tropical forestry is often associated with forest destruction, relocation of indigenous populations, extinction of wildlife, etc
- Low return potential—particularly for sustainable natural forest management
- Lack of management capacity
- Small scale—the industry is often fragmented
- Generally high country risk (tenure, tax, markets, political instability, etc)
- Lack of exit opportunities—investors need to know about the opportunities for getting the money out of an investment at the end of the investment term and under what conditions

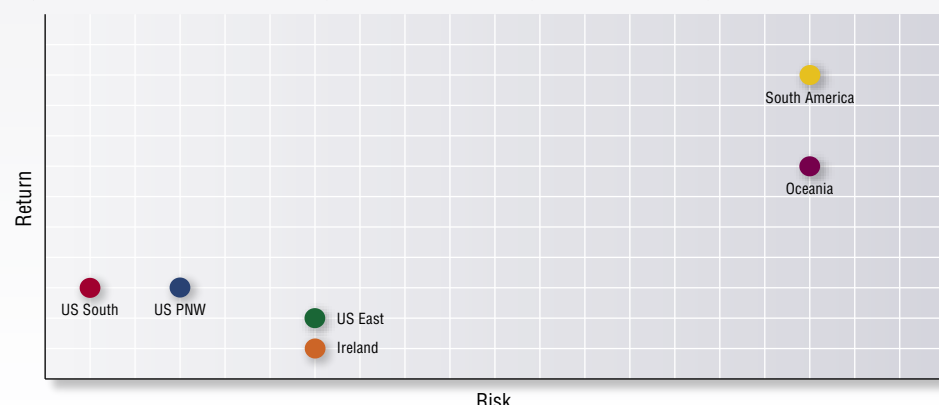
### Approaches to risk control

Risk management is essential to the success of tropical forest investment. Investors must be convinced that:

- careful due-diligence has been performed on all aspects of the triple bottom line;
- the investment is capable of sound financial performance;
- there is a commitment to 'sustainable and responsible investment' as a risk control instrument;

### Good fit?

Figure 3: Do risks and returns for tropical forest investments provide an attractive portfolio diversifier?



Source: IWC

- the investment assists diversification at the fund and portfolio levels;
- the necessary partnerships between managers, government, development banks and non-governmental organizations are in place; and
- exit opportunities have been identified.

### The portfolio fit of tropical forests

Institutional investors look to balance their portfolios with a diversity of investments with attractive returns versus risk. One of the main questions to be answered is: where do tropical forests fit in this framework relative to other investment options (Figure 3)?

### Conclusions

The interest from institutional investors in forest investments is growing every year, but, so far, investments have been almost exclusively non-tropical. Being such a large part of the world's forests, tropical forests should, however, hold significant interest for institutional investors if:

- they offer an attractive portfolio fit in relation to risks and returns; and
- associated risks and uncertainties can be managed.

*This article is a summary of a presentation given at the International Tropical Forest Investment Forum in Cancun, Mexico, on 26–27 April 2006. The full presentation can be downloaded at <http://www.itto.or.jp/live/PageDisplayHandler?pageld=223&id=1213>*

*\*The International Woodland Company is a provider of global forest investment-related services. Total strategic allocation to forest investments by IWC's clients is over US\$2 billion.*