

Natural Capital Investing

An Introduction to Forestry, Agriculture and Carbon Credits

January 2024



Contents

03	Why read on?
04	Natural capital: from concept to investment
06	The natural capital asset manager landscape
08	Jargon buster: must-know acronyms and terms
09	Further reading: carbon credit considerations
12	Postscript: 'non-renewable' natural capital and the climate transition
13	Key takeaways
14	Appendix: Timberland and Agriculture strategy snapshots

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Why read on?

Strong market fundamentals and climate impact potential have driven a surge in institutional investor demand for ‘natural capital’ such as timberland, agriculture and ‘nature-based solutions.’

In a remarkable swing of ‘real asset’ appetite, natural capital manager searches on behalf of bfinance clients have even outnumbered real estate manager searches for the first time: enthusiasm for this space has provided a stark contrast to the caution surrounding property investment (see [Manager Intelligence & Market Trends, November 2023](#)).

Those allocating to natural capital must keep pace with a rapidly growing and changing landscape of managers and strategies, as well as the accompanying jargon. Investors are seeking to understand risk/return profiles, sustainability credentials and varying approaches to carbon credits. While natural capital investing is not new, its nature has evolved. Investors in agriculture, timber, mining, energy and ocean marine-based activities have historically focused on income and capital appreciation derived from natural resource management and/or extraction. Today’s strategies place more emphasis on sustainability and may feature other return drivers including carbon credits and conservation easements.

This report seeks to support market participants with an overview focused primarily on forestry, agriculture

and ‘nature-based solutions’ (NBS) strategies. It closes with a discussion on carbon credits, given the ongoing questions surrounding quality, return expectations and the integrity of the market.

Facts & figures

>50

institutional-quality managers globally offering natural capital strategies, primarily via commingled funds but also through separately managed accounts.

50%

of global economic output is moderately or highly dependent on natural capital (World Economic Forum).

23%

of global greenhouse gas emissions in 2007-2016 were estimated to come from Agriculture, Forestry and Other Land Use, with deforestation, rice, ruminant livestock and fertiliser use proving particularly notable contributors (IPCC).

USD 384 - 845 billion

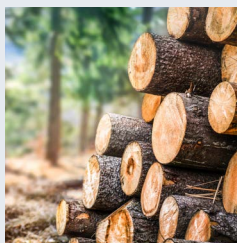
of annual spending is required to safeguard the natural environment (lower estimate from UNEP, higher from The Nature Conservancy). Current spending is USD154 billion per annum (UNEP), of which 17% is private sector.

FIGURE 1: WHAT IS A ‘NATURAL CAPITAL’ INVESTMENT?

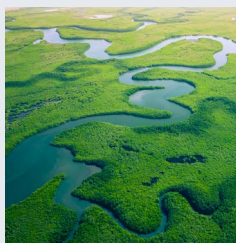
Asset types found in natural capital strategies today



Agriculture
Farmland and/or farm operating platforms



Forestry/ timberland
Existing forests or new plantations; commercial timberland or forest carbon focus



Environmental assets (other)
Other ecosystem assets that sequester carbon (e.g., peatland, mangroves)



Renewable energy
Assets that create renewable energy



Non-renewable natural capital
Fossil fuel energy production, metals, mining

Natural capital: from concept to investment

‘Natural capital’ broadly refers to the planet’s stock of renewable and non-renewable natural resources such as land, air, water, soil, minerals and living organisms.

They are responsible for ecosystem services (see *jargon buster*) that drive the global economy and human wellbeing. Natural capital should not be confused with biodiversity, though the latter is a critical feature of natural capital stability. Indeed, the World Economic Forum estimates that half of global economic output is ‘moderately’ or ‘highly’ dependent on biodiversity.

Despite the language of ‘capital,’ natural capital is yet to gain full acceptance as an ‘economic asset.’ To date, around 90 countries have completed some form of Natural Capital Accounting under the System of Environmental-Economic Accounting (SEEA). This framework and other initiatives, such as the Taskforce on Nature-Related Financial Disclosures (TNFD), are driving progress in the way that nature is valued on the balance sheets of companies and countries.

A natural capital *asset*, in modern industry parlance, involves direct ownership of an asset whose value relies on natural capital. Forests and farms, for instance, rely on soil, water, microorganisms and

so forth to derive economic value. The narrative and role for investors investing in these assets is much larger: they play an instrumental role in safeguarding and enhancing positive environmental and social benefits, and/or reducing the (often heavy) damage associated with land usage. This involves facilitating more sustainable and regenerative practices, supporting carbon sequestration and more.

Jargon buster: ‘ecosystem services’

Direct and indirect contributions of ecosystems to economic systems and human well-being. They can be subcategorised further.

Provisioning services: products such as food, wood, fuel, fibre, water.

Regulating services: flood prevention, erosion control, water quality control, climate regulation.

Cultural services: non-material benefits including recreation, aesthetic, spiritual, tourism.

Supporting services: services required for other ecosystem services e.g., soil formation, nutrient recycling.

Further definitions available on page 8.

Protect and support

Safeguard and enhance benefits to humanity and local communities. These benefits include climate regulation, pollination (essential for crop growth), air and water purification, job creation, safe and healthy supply chains and more.



Reduce harm

Lessen the damage associated with many ‘natural capital’ asset types. Agriculture, forestry and ‘other land use’ are responsible for nearly a quarter of global greenhouse gas emissions (UNCCD); agriculture drives 70% of global freshwater consumption and 80% of annual deforestation, as well as being a key driver of biodiversity degradation. Unsustainable practices also threaten the viability of the assets themselves, making sustainability a key facet of risk management.



Natural capital: from concept to investment continued

Various characteristics may draw an investor to natural capital investing, depending on the strategy, including stable yields, built-in inflation hedges, diversification, carbon credits and current valuation tailwinds (see page 7). We urge investors to develop a broad understanding of the sector *before* determining what a natural capital allocation should deliver. In practice, investors' searches for natural capital strategies involve very different return objectives, asset allocation constructs and ESG/impact objectives. Some seek stable cashflows to match liabilities; some want high annualised returns; some prioritise capital preservation.

The table below illustrates generalised characteristics that allocators may encounter when investing in agriculture and timberland. Alongside this, we show a third category—'natural climate solutions' (NCS)—with a focus on carbon sequestration and/or emission avoidance. As indicated, an investor may find NCS within agriculture or timberland assets, depending on the extent to which the asset manager prioritises sustainability and impact considerations. Strong exposure to NCS can be gained via so-called nature-based solutions (NBS) strategies, as defined on page 6.

FIGURE 2: A CLOSER LOOK AT INVESTMENT CHARACTERISTICS FOR AGRICULTURE, TIMBERLAND AND 'NATURAL CLIMATE SOLUTIONS'

	Agriculture	Timberland	Natural Climate Solutions
What	Acquisition of direct farmland assets or investment in farmland operating platforms	Acquisition of mature forests or construction of new plantations	Projects that protect, better manage and restore nature to reduce GHG emissions and store carbon (see below)*
	NCS in strategies where sustainability and impact are in focus.		
Returns primarily driven by	Commercial operations (commodity price, cost of production, land value). Also: agri-tourism, education partnerships, conservation easements.	Commercial operations (biological growth, timber price, land value). Also: recreation/ grazing leases, mineral rights, conservation easements, carbon credit sales.	Carbon credits and other ecosystem services (e.g. biodiversity credits). Other sources: conservation easements sales, mitigation banking, ecotourism etc.
Typical target returns for Core (net of fees)	Core: 7-8% total return (3-4% yield, 30-50% leverage)	Core: 6-7% (2-3% yield, 20-30% leverage)	Highly variable. 0-1% yield. Carbon credits constitute majority of return.
Risk profile	Core, core-plus, value-add (higher risk agribusiness sector in Private Equity)	Core, core-plus, value-add	Future carbon credit pricing is still somewhat speculative
Carbon credit generation	Low-to-none (carbon calculation technologies and VCM participation evolving)	Moderate-to-high (strategy dependent)	High
Diversification	Low correlation with other asset classes	Low correlation with other asset classes	Very low correlation with other asset classes
Inflation linkage	Strong: food is a major component of CPI indices	Strong: timber is used for many products in CPI	No
Location	Primarily North America & Australasia	Primarily North America, Latin America, Australasia	Various geographies (heavily dependent on type of project)
Potential for impact	High where regenerative agriculture practices are used	High where sustainable practices are used	High (where intended outcomes are realised)

***Natural Climate Solutions: what are they?**

Forest carbon projects

Forest restoration (afforestation or reforestation), Improved forest management (IFM) or avoided deforestation (REDD+). Majority of the return is delivered through removals and/or avoidance credits.

Other environmental projects

Protecting and restoring ecosystems such as coastal wetlands (e.g., mangroves), regenerative agriculture, agroforestry, rewilding etc. Return largely derived from carbon credits; ecotourism may supplement; potential biodiversity credits in future. Public grants may mitigate cost.

The natural capital asset manager landscape

Institutional investors can now access a diverse selection of natural capital strategies, illustrated diagrammatically below.

More than 50 asset management firms are active in the space, often running multiple strategies. There is also a growing list of multi-manager solutions offering further diversification. Though investors will typically invest in commingled funds, a significant proportion of managers will structure separately managed accounts tailored to specific risk and return profiles where there is sufficient scale to permit diversification. The largest fund cohorts are as follows.

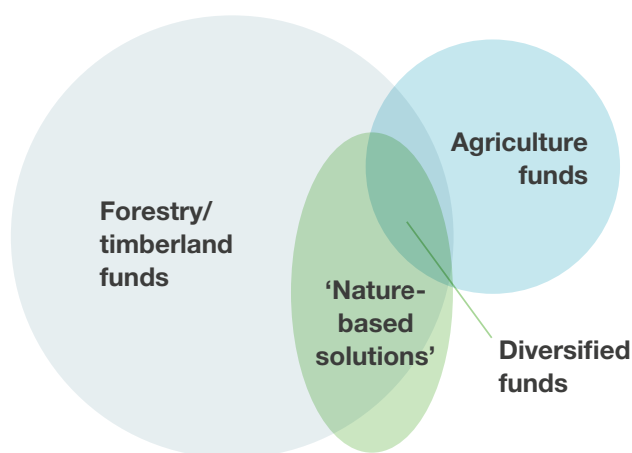
- **Timberland or forestry** funds constitute the most mature group, featuring a well-established roster of both open and closed-ended vehicles.
- **Agriculture** funds became more prominent after 2010 when extremely low developed market government bond yields spurred a rise in demand for ‘real assets’ that would deliver stable long-term yields. This rise that was quantified and discussed in a [2017 article](#).
- **Diversified** funds include timberland, agriculture and potentially other asset types (e.g., ‘natural climate solutions’ and/or renewable energy).
- **‘Nature-based solutions’ (NBS)** funds have emerged recently and rapidly: virtually all commingled funds in this group have been launched after 2021, though corporates have been investing in carbon projects for a number of years through manager partnerships (these mandates often form the track record of fund offerings).

In **timberland**, we find fund offerings spanning the risk-return spectrum: the more value-added strategies feature more active management than we see in the core/core-plus segment, as well as exposure to other areas of the timber production and supply chain—downstream or upstream—such as timber mills. We also find a growing trend in favour of carbon credit creation in forestry. Timberland funds raising capital in late-2023 are illustrated further in the Appendix (page 14).

Among **agriculture** funds, the lower-risk end of the spectrum features strategies with a high proportion of buy-and-lease assets: here the focus is on renting out properties to operators, limiting direct exposure to commodity prices and harvest volume risk. On the riskier side, we find significant involvement in direct farming operations. If we stretch beyond ‘real assets’ to look at private equity, we also find a thriving agribusiness sector investing in the latest technologies to lower operational emissions in the asset class. Carbon credit creation is less evident in agriculture strategies, though the picture will evolve as the methodology for calculating carbon in soil improves and third-party verification standards become more established.

Over time, we have seen managers in both the agriculture and timberland sectors showcasing and formalising their approaches to sustainable farming and forestry. The **nature-based solutions (NBS)** cohort takes this a step further, prioritising the protection and restoration of ecosystems (including biodiversity benefits) while addressing societal challenges such as food and water security to enhance human wellbeing.

FIGURE 3: NATURAL CAPITAL FUND COHORTS



The natural capital asset manager landscape continued

As shown above, the nature-based solutions cohort overlaps with the timberland and diversified fund groupings. Within timberland, NBS feature significant exposure to carbon projects; they also generally seek to produce 'co-benefits' alongside carbon credits. Within agriculture, NBS may invest in degraded land in need of rejuvenation, agroforestry and more. NBS may also include urban solutions such as green roofs and urban heat and flood mitigation. Carbon credits

are discussed in more detail in the following section of this report.

Firms offering NBS funds may well also run a separate, more conventional timberland or natural capital strategy. Investors should pay careful consideration to how multiple strategies operate side by side.

Hot topic: risk management

The ability to assess and manage the wide variety of risks in play is often a key differentiator between stronger and weaker managers in the natural capital sector. Allocators should consider fund managers' approaches to the following areas during asset selection and management:

Commodity price volatility

- Assess exposure to price risk
- Ensure appropriate diversification
- Mitigate through active management

Harvest volume risk

- Assess risks posed by storm/fire/disease/pests/weather.
- Diversification by species/geography
- Modern silviculture/farming techniques
- Due diligence on water quality/quantity, access to surface and sub-surface water

Renter risk

Where assets are leased:

- Extensive tenant due diligence, strong understanding of underlying operators and their risk exposures
- Rental pre-payment requirements
- Letters of credit

Valuation risk

- Disciplined comprehensive underwriting of property values
- Market liquidity assessment

Climate change and environmental risks

- Assess approach to certification schemes, physical climate risks and wider environmental risks such as watershed management, waste management etc.
- Affects all categories above

Social and governance risks

- Land rights, land conversion, illegal logging, local communities, labour standards
- Bribery, corruption, political risks

Hot topic: valuation considerations

There has been some controversy and uncertainty surrounding valuations in the timberland and agriculture sectors. We note a significant current disparity between market pricing and appraisers' valuations, which is affecting benchmarks and creating challenges for buyers.

We do note positive fundamentals, depending on the specific sectors and assets. The World Bank estimates that demand for timber will quadruple by 2050. Tailwinds supporting pricing include population increase, demand from an expanding roster of climate-oriented buyers, the growing use of timber to construct energy-efficient buildings and notable supply chain shifts (e.g. well-funded timber firms moving towards owning more of their supply following the pandemic).

That being said, there will be both winners and losers among the investors and asset managers involved.

Jargon buster: must-know acronyms and terms

Afforestation, Reforestation and Revegetation

(ARR): establishing new forest plantations (afforestation) and undertaking restoration (reforestation and revegetation).

Agroforestry: land-use systems where trees, shrubs, palms, bamboos are used on the same land management units as agricultural and/or forestry assets to protect the carbon quality of soil.

Biodiversity Net Gain (BNG): a metric to show the increase in biodiversity in a given area. The UK now requires property developers to deliver a 10% gain for every new development.

Ecosystem services: direct and indirect contributions of ecosystems to human wellbeing (see page 4).

Improved Agriculture Land Management (IALM):

regenerative agriculture practices, including enhancing crop diversity and minimising chemical use and soil disturbance. 'Sustainable farming' emphasises IALM.

Improved Forest Management (IFM): forest management activities which result in increased carbon stocks within forests and/or reduce greenhouse gas emissions from forestry when compared to business-as-usual practices. This can include projects such as delaying planned harvests, reducing the harvest level, or other practices such as continuous cover forestry.

Mitigation banking: the system of debits and credits to ensure that environmental harm to streams and wetlands by development projects is made up by restoring wetlands, streams and natural habitats.

Reduced Emissions from Deforestation and Degradation (REDD+): removing planned deforestation threats and addressing the drivers of forest degradation and deforestation. This is mostly focused on developing countries and delivers avoidance credits.

Carbon jargon

One carbon credit represents one tonne of carbon (CO₂e). When purchased, credits give a company permission to generate one tonne of CO₂ emissions. The principle behind the carbon credit market is that companies reduce emissions over time to lower the requirement (and expense) of purchasing credits. There are two markets for carbon credits: compliance and voluntary.

Compliance markets are the result of capped emissions allowances, regulated by governments. Credits are used to meet mandatory emission reduction targets: they are generated by a central authority and auctioned to participants. There are now 30 compliance credit markets (USD 850 billion in 2021).

Voluntary carbon markets ('VCM') provide entities with a (decentralised) market to purchase credits to offset their emissions of their own accord (i.e. not for regulatory obligations). Credits are project-based and can be created from natural or technological sources. The VCM stands at around USD 2 billion – a 14x increase since 2017 (The Climate Trust). Voluntary credits fall into two categories, 'avoidance' credits and 'removal' credits, discussed further on page 10.

Verification of credits requires the developer to collect data to prove the legitimacy of the project. This is verified by a third party such as Verra, Gold Standard, American Carbon Registry ('ACR') etc. Each verifier has a distinct methodology and jurisdictional presence.

Carbon ratings agencies such as Sylvera, Calyx, BeZero etc. play a role in evaluating whether a credit is truly representative of a ton of (CO₂e) reduction or removal.

Bodies working to improve the **integrity** of offsets include as the supplier-focused Integrity Council for the Voluntary Carbon Market (**ICVM**) and the buyer-focused Voluntary Carbon Market Integrity Initiative (**VCMI**).

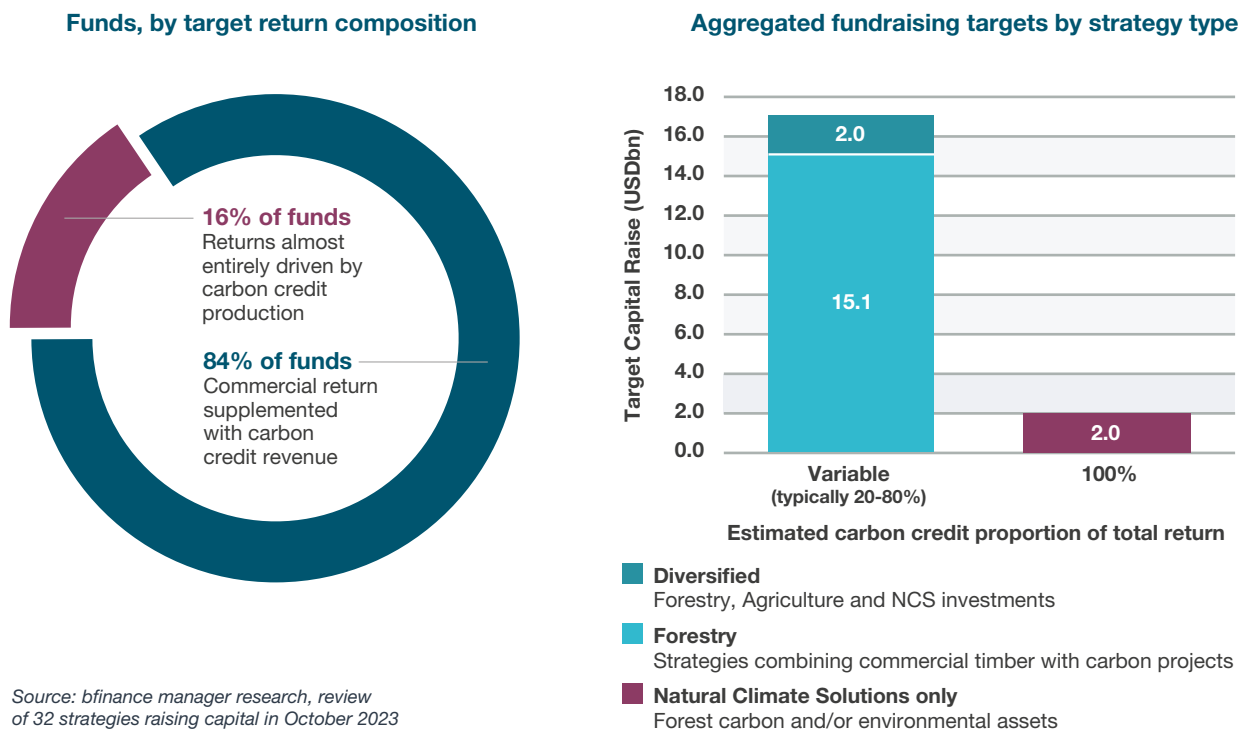
Further reading: carbon credit considerations

Funds generating carbon credits

The past two years have seen a proliferation of funds targeting an allocation to carbon projects and other NCS investments. The charts below depict 32 commingled funds currently targeting an allocation to such projects. This group has high overlap with 'nature-based solutions,' though not all NBS strategies generate carbon credits. Collectively, these 32 funds are seeking to raise about USD19 billion in equity commitments. Strategies with larger exposures to natural climate solutions assets tend to offer very low or no yields: returns are typically projected to begin materialising no earlier than the three-year mark when credits can begin being generated and sold.

The charts below distinguish between two strands of carbon credit-generative funds: those for whom carbon credits represent virtually the entirety of target returns (16% of funds, 11% by target capital raise) and those that base target returns on more conventional mechanisms, supplemented with carbon credits. In some cases, managers in the latter group may not include carbon credits in the target return figures at all, instead treating credits purely as potential additional upside.

FIGURE 4: FUNDS GENERATING CARBON CREDITS RAISING CAPITAL AT OCTOBER 2023 (COMMINGLED FUNDS ONLY)



Where target returns are heavily driven by carbon credit production...

- ...funds typically provide optionality to investors on whether credits are sold to corporates or used by the LP.
- ...managers often have restrictions on the types of LPs that can access to the fund.
- ...fund lives are typically long (10-25 years).
- ...funds usually have a carbon credit generation target, often linked to a component of carried interest.

Further reading: carbon credit considerations continued

The role of carbon credits in climate mitigation

In order to limit global warming to 1.5°C above pre-industrial levels, scientists estimate that 6-to-10 billion tonnes of carbon dioxide will have to be removed from the atmosphere each year by 2050 in addition to significant reductions in emissions.

High integrity carbon offsets and credits can play a crucial role here. According to Griscom et al (*Natural Climate Solutions*, 2017), natural climate solutions—as defined on page 5—could provide more than a third of the total ‘mitigation’ required by 2030 (Figure 5). As noted on page 8, the Voluntary Carbon Market (VCM) now stands at around USD 2 billion and the Taskforce on Scaling the Voluntary Carbon Market expects the figure to reach USD 50 billion by 2030.

Exposure to carbon credits: natural capital investment versus direct purchase

The VCM does enable institutional investors—and others—to purchase exposure to offsets via brokers. An investor could even use an ETF if they wished to make a more speculative investment in this space. Alternatively, asset managers who run strategies generating a substantial volume of carbon credits may provide their LPs with optionality on whether the credits associated with their stake are sold or retained.

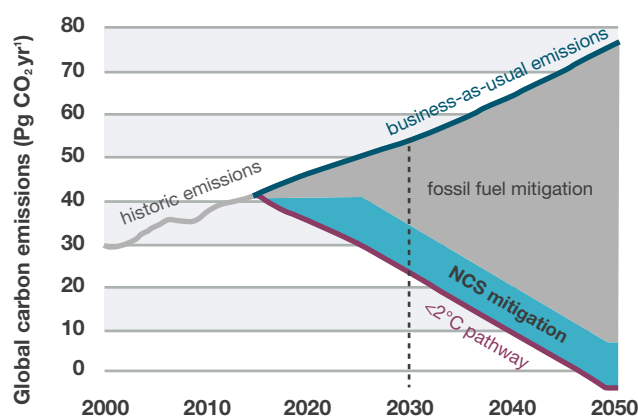
We consider investment in the underlying assets to be a superior approach for obtaining carbon credits (if carried out appropriately) as it provides transparency, wider impact potential, better risk mitigation and diversified return drivers. A direct connection with the assets generating credits has become even more attractive in light of recent controversies. Companies such as Nestlé and EasyJet, for example, have been called out over the authenticity of their offsets. Greenpeace has been highly critical of the carbon credit market. A recent report from Carbon Direct highlighted that fewer than 10% of projects currently meet or exceed their standards of ‘high quality.’ Criticisms have spurred improvement, with guidance provided by integrity-focused entities such as the ICVM and VCMI (page 8), but the subject remains a challenging one.

Investment in natural climate solutions does not itself guarantee that the carbon credits generated will be of high quality. Recent asset manager due diligence indicates broad dispersion in the approaches being undertaken by investment managers: investors must handle the subject with care.

Obtaining ‘high quality’ carbon credits

Asset managers generating carbon credits through the assets in which they invest typically assert that they are seeking to generate ‘high quality’ credits that are likely to command a higher price and mitigate potential reputational risks for their investors. Investors should think carefully about what ‘quality’ means and how to validate the manager’s strategy during due diligence.

FIGURE 5: THE ROLE OF NATURAL CLIMATE SOLUTIONS (NCS) IN ACHIEVING A <2°C PATHWAY



Source: *Natural Climate Solutions, Griscom et al, 2017 (published in The Proceedings of the National Academy of Sciences)*

Investors can consider whether credits are **verified** by well-recognised third parties. Carbon credit registries and carbon credit ratings agencies continue to emerge, largely managed on a non-profit basis (see page 8). Their methodologies and practices, however, have in some cases been subject to criticism and negative press attention.

Further reading: carbon credit considerations continued

Attributes that are typically scrutinised when seeking to determine the quality of a carbon credit include **additionality, permanence** and **co-benefits**.

Additionality indicates that emissions reductions and removals exceed 'business as usual'; analysis of this subject should include management of 'leakage,' since emissions could be moved to a different location. Permanence should be assessed in the context of the asset manager's strategy, the duration of the holding period and the strategy for exit, as well as the way in which they manage risks such as physical climate events (e.g. wildfires), pests and diseases. Co-benefits include biodiversity improvement and community contribution.

Investors should carefully examine an asset manager's philosophy around quality and permanence, their expertise and resources (including managing projects on the ground), and the way in which their investment and risk management processes address carbon credits within the wider strategy.

One further quality-related consideration is whether managers are generating '**avoidance**' credits (reducing emissions by preventing activities which would release GHG) and/or '**removal**' credits (based on increasing carbon sequestration for permanent storage). Natural sources of avoidance credits include avoided deforestation (REDD+ projects) and Improved Forest Management (IFM). Natural sources of removal credits include afforestation and reforestation, IFM or

evolving technologies such as carbon capture and storage (see page 8 for definitions). To date most carbon credits issued globally have been generated through **avoidance** projects (Figure 6 illustrates the distribution of 310 million nature-based credits). Yet their effectiveness has been questioned: it is challenging to prove the extent to which emissions are avoided beyond 'business as usual' (or, in the language of impact investing, to demonstrate 'additionality'). As such, there has been a 20% drop in the issuance of avoidance credits according to a 2023 Carbon Direct report. Today, investment managers developing carbon credits through natural capital strategies—the group illustrated on page 9—tend to be more focused on removal credits derived from sources such as afforestation, reforestation and IFM. That being said, a removal credit is not inherently of high quality: variability is high, particularly for IFM-based credits.

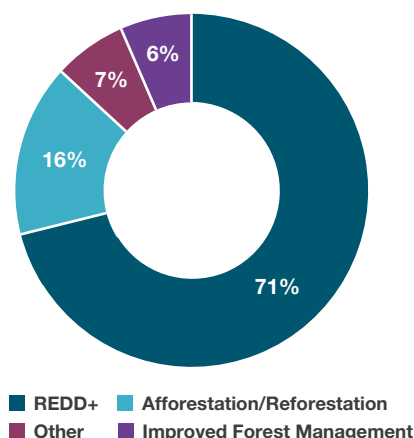
Understanding carbon credit pricing and manager returns

As noted on page 9, asset managers vary considerably in their approach to the returns that may be generated by carbon credits, ranging from those that do not include carbon credits in their target returns at all—though they may provide additional upside—to those for whom target returns are entirely predicated on carbon credit generation.

Jargon buster: 'business as usual' (BAU)

Carbon credits can only result from projects where reduced CO2 emissions or carbon removals are above and beyond 'business as usual' levels. Forests are inherently carbon 'net-negative' but this does not mean that they can necessarily be used to generate credits. There are concerns around the methodologies used to establish a BAU baseline. This can raise question marks over credibility, particularly for 'avoidance' credits.

FIGURE 6: NATURE-BASED CREDITS BY PROJECT TYPE (310 MILLION CREDITS ISSUED 2020-2022)



Source: J.P. Morgan Asset Management, January 2023

Further reading: carbon credit considerations continued

Some strategies provide optionality for investors to take different approaches depending on their needs, either retiring credits against their own net zero goals or approving their sale for additional return. Some strategies, however, only generate credits for sale and may bake this into the overall return target (typically adding around 200-250bps).

Predicted returns are highly dependent on expectations for carbon pricing. This remains an uncertain and challenging subject. Supply and demand factors, policy changes, a lack of global consensus on the use of credits, varying quality and even changing energy prices are contributing to high volatility in the carbon credit market. All asset managers involved in this sector (unsurprisingly) forecast a rise in carbon prices supported by the inherent need for climate mitigation to meet internationally agreed and nationally mandated goals. It is imperative for investors to understand the methodology and mechanisms that managers use to price carbon. More sophisticated managers

support their pricing analysis with internally developed forward-looking models leveraging both external data and on the ground expertise in carbon projects. Overall, based on recent analysis, we view most managers' price forecasts as relatively conservative.

An additional return-related consideration is the higher cost required to produce the (typically more valuable) removals credits and the potential J-Curve relating to reforestation/afforestation projects in the early years while the trees grow.

Watch out for sustainability

Although asset managers working on carbon credit generation are typically oriented towards ESG/sustainability considerations more broadly, credibility on this subject varies greatly and should never be assumed. As ever, investors should pay close attention to ESG risks and considerations in both developed and emerging markets, and in particular the manager's approach to mitigating the potential effects of climate change in the specific regions.

Postscript: 'non-renewable' natural capital and the climate transition

Metals and mining—or 'non-renewable' natural capital—are rarely discussed in the context of natural capital investing, though there is a significant cohort of funds targeting unlisted assets in this sector.

Yet without mining companies and the minerals that they produce, there can be no clean energy transition. The global shift to an energy system based on renewable energy sources is expected to lead to an ongoing and sharp increase in demand for critical minerals. Solar plants, wind farms and electric vehicles require more minerals to build than their fossil fuel-based counterparts. Since 2010, the International Energy Agency (IEA) estimates that the average amount of minerals needed for a new unit of power generation capacity has increased by 50%, due to the rising share of renewables in the overall energy mix.

The mining sector has some serious, inherent environmental and social challenges that can make it extremely hard to square with a responsible or sustainable investment strategy. Many investors will already be familiar with ESG-related concerns in the mining sector within public market portfolios.

As key enablers of the energy transition, mining funds may have an opportunity to attract sustainability-oriented investors, but only if they (and the entities in which they invest) appropriately manage their impact on the environments and communities in which they operate. We do anticipate improvement in practices and note promising signals from the relevant managers/funds in this regard.

Key takeaways

There is a rapidly growing and increasingly diverse roster of natural capital investment strategies, with more than 50 asset managers now active in this sector. A well-rounded fund universe provides investors with a viable gateway to achieve financial objectives and also make tangible progress towards meeting the Paris Agreement.

Various characteristics of natural capital investing may appeal: long-term stable yields, inflation sensitivity, low correlation to other asset classes and carbon offsets can all be found, but profiles vary greatly depending on the strategy used. We urge investors to develop a broad understanding of the sector before determining what a natural capital allocation should deliver and the preferred approach to implementation.

Carbon credit quality is highly variable: investors should scrutinise managers' approaches to this subject with care. In an analysis of 32 commingled funds that seek to produce carbon credits we find a broad spectrum of approaches in generating credits and their subsequent treatment within the overall return profile of a fund. Not all credits are created equal, and the specific objectives of investors should be reflected in the manager selection process.

ESG considerations are imperative to success in this sector, particularly the management of physical climate risks, biodiversity and engagement with local communities. Not all asset managers are equally sophisticated in terms of approaches and resources.

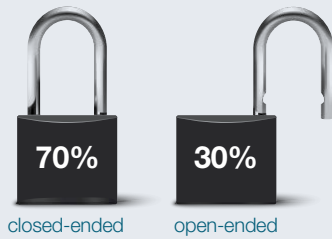
Appendix: Timberland and Agriculture strategy snapshots

The infographic below shows some additional insight on timberland funds available to investors now (though separately managed accounts are also

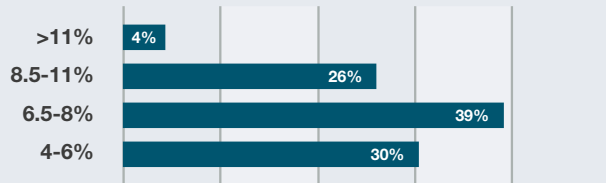
available). Investors should handle managers' claims about sustainability, carbon and 'impact' with care: not all approaches are sufficiently robust.

FIGURE 7: TIMBERLAND STRATEGIES FUNDRAISING AT OCTOBER 2023

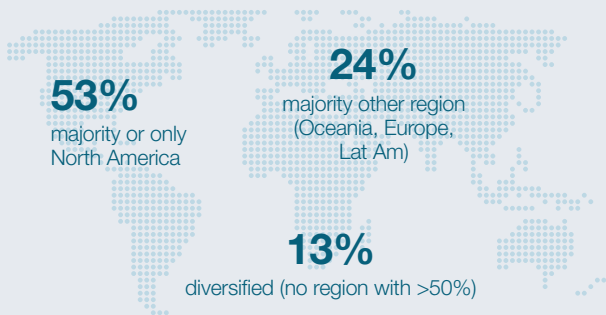
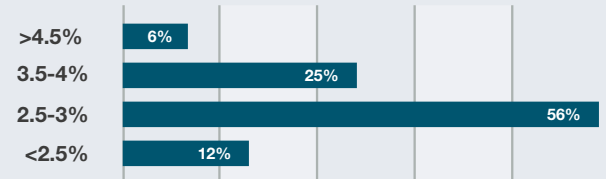
TIMBERLAND



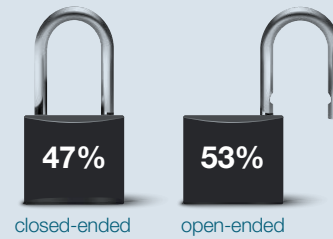
Target return (mid-point), net of fees



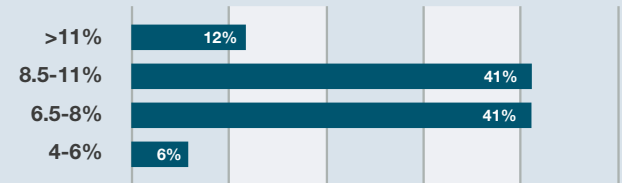
Target cash yields, net of fees



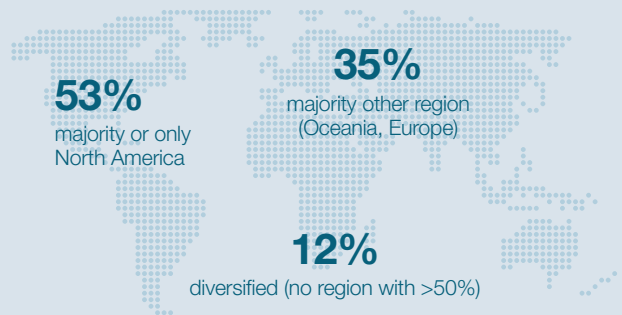
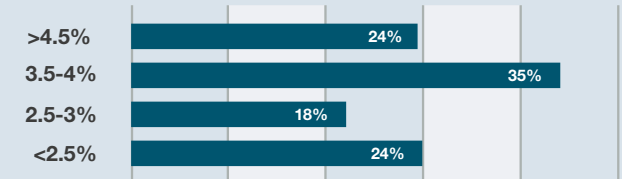
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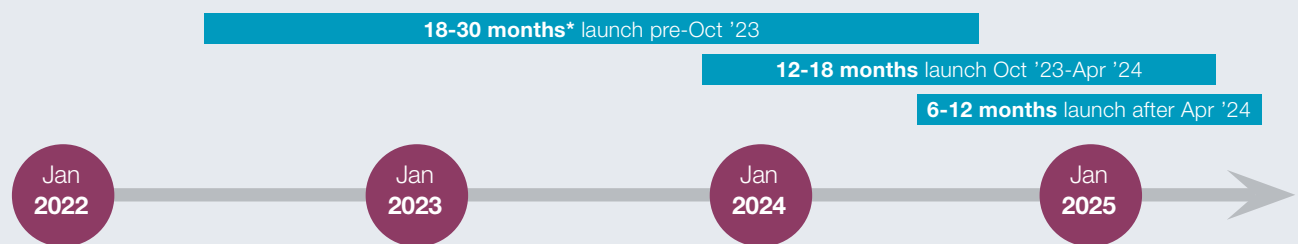
Target return (mid-point), net of fees



Target cash yields, net of fees



Expected fundraising period (closed-end funds)



Investors should consider the implications of longer-than-anticipated fundraising periods on strategy.

*Exception: one fund expecting 12-months.

Source: bfinance manager research, strategies raising capital in 2023. Return and yield figures are targets only and do not represent strategy/manager performance.

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