

June 18, 2013

**Response from IFC on Approval by mail: Lao PDR - Smallholder Forestry Program
(FIP)**

Dear Andrea (and Patricia),

First, many thanks for helping facilitate the call with the US and UK last week on their questions on IFC's FIP Laos Program. As agreed, we are enclosing below a public version of the response matrix for posting on the web and circulation to the full FIP SubCommittee.

Laura Gaensly and Joyita Mukherjee

**FIP Lao PDR
Responses to the FIP Sub-Committee - US and UK
IFC June 17, 2013**

QUESTION	ANSWER
<p>US: Description of program activities and private sector partner company.</p>	<p>IFC: The first identified client that IFC will engage with during the pilot phase is one of the largest international forestry companies by sales. The company has demonstrated experience in developing OGS schemes and is fully integrated with upstream forestry operations, as well as downstream processing and product manufacturing. This integration experience provides important expertise to the OGS program in plantation operations, as well as wood product marketing and value added. Currently, the company manages two plantation concessions in Lao PDR.</p> <p>The company has recently been assessed under the IFC Due Diligence requirements, and IFC is comfortable to move forward with collaboration.</p> <p>The other two companies that IFC is considering to engage with for the scale-up phase, as with all participating IFC clients, will need to go through IFC’s due diligence process and are subject to IFC’s Performance Standards.</p> <p><i>Program Objectives</i></p> <p>The business model proposed in the program aims to be both sustainable and profitable through i) gradually developing community based reforestation of degraded and under-utilized land, and ii) using cash crops to cater for shorter term revenue streams while managing for longer term forestry expansion and profit through growth of industrial trees. The program will be implemented in two phases. In the first phase will be a demonstration pilot and will test the viability of the approach before a larger-scale roll out. The pilot will aim to establish a forestry business model using out-grower schemes in Lao PDR.</p> <p>The expected impact of this pilot phase is that 100 hectares become sustainably managed land of which 50% is new forest cover. The remaining hectares shall be used for cash crops generating</p>

additional annual sales revenue. Sustainability will be ensured by the company and farmer groups working together to i) identify suitable land for forestry, ii) establish levels of land security needed to engage farmers, and iii) provide comprehensive technical extension to ensure high levels of tree production and site management to preserve and enhance associated ecosystem services (e.g., soils, hydrology and biodiversity).

Components and Activities

The pilot phase of the program will test the viability of the 2 following components:

1) Farmer Engagement Plan (FEP)

a) Out grower scheme model: The program aims to strengthen the capacity of the partner company in developing commercially viable and environmentally sustainable OGS in Lao PDR aligned to the current company strategy of diversification of wood products and agro commodities. IFC will assist the partner company to develop the business case of the new model, its structure and will commence the development of a FEP. IFC and the partner company will communicate the model concept in the pilot area engaging with the participating communities and stakeholders. The company and IFC will identify communities to work in the pilot area, and will work with community leadership and local stakeholders to secure engagement with interested communities. Socio-economic data of the pilot area is currently being collected and will inform the exercise. The program will ensure the development of detailed and informative contractual arrangements with interested farmers and raise farmer awareness in this area while promoting fair representation of all stakeholders, including women and vulnerable groups.

b) Land security: In order to enhance the success of the proposed scheme and a long term partnership between the company and communities, IFC will work towards establishing land security for the participating farmers. IFC will contract a qualified organization that will work with the Ministry of Natural Resources and Environment (MoNRE), its local agencies and a relevant NGO to support the implementation of the Government's Participatory Land Use Planning Process (PLUP) and subsequent land registration and titling in the pilot area. Support in this area will provide land survey and registration technology, data recording and dissemination, capacity

building to relevant GoL agencies, land rights awareness and development of grievance mechanisms.

2) Farmer organization and capacity building

a) Farmer groups: With assistance from a relevant partner/NGO and through consultation processes the project will identify how best to organize community participation into Producer Organizations (POs) and define how Community Resource Persons will be developed. A PO governance and operational system will be developed and relevant training will be provided. Furthermore, IFC and the partner/NGO will develop business plans to help the POs become financially sustainable in the medium term and financial literacy training will be delivered. IFC will facilitate participation of eligible finance providers in the OGS to support POs in need, particularly for initial costs, by facilitating the connection of these providers with the interested POs. IFC will monitor the progress of these relationships.

b) Farmer technical capacity building:

IFC specialists will work with the partner company to convert their technical plantation package of the multi-commodities, including site preparation, planting, tilling, fertilization and intercropping, into easy to use media-based tools, adjusted to the profile of participating communities. IFC will train a number of the company's extension staff on the effective use of these tools so that they can on-train farmers and build farmer technical capacity.

Implementation

Program activities will be implemented by IFC. IFC will work closely with relevant departments within government ministries, such as the Ministry of Agriculture and Forestry (MAF), and MONRE. IFC will also work closely with private sector partners, local government agencies and community organizations to implement the program.

IFC has met with the partner company management, staff and extension teams, visited their two plantations and out-grower planting sites, discussed perspectives of the out grower experience with over 120 participating farmers to assess interest in project participation. Farmer technical skills

capacity building and land security were highlighted as key requirements in designing a successful OGS. Moreover, a land security assessment in the two potential sites concessions was conducted by a consultant team. Additionally, quality of contract agreements in the concession sites, community satisfaction with the partner company, farmers' socio-economic benefits and concerns, were assessed. Around 300 farmers, company staff, and about 15 representatives of government agencies were interviewed.

Evaluation

A first evaluation is scheduled for the last quarter of the pilot phase in order to create the foundation for decision making to scale up the program based on transparent and clear recommendations from the pilot lessons learned. The evaluation will be performed by an independent consultant experienced in such assessments, and will involve interviews with communities and all relevant stakeholders. Results will be shared with GoL, the partner company and other partners.

In the expectation that the pilot phase targets are achieved, work will then start to scale up the program to reach as many as 10,000 farmers with the first partner company. These farmers will be supported to sustainably manage an estimated 10,000 ha of land in areas within an economically viable radius from the company's concessions.

Once the approach has been successfully piloted and the lessons learned are incorporated into the program design, it will be scaled up and replicated with other companies operating in the country to achieve an additional 5,000 hectares, for a program total of 15,000 hectares of sustainably managed land, consistent with IFC's social and environmental safeguards.

A second evaluation at the end of the five year program will be undertaken. Program management information will be collected according to IFC reporting requirements.

Community baselines shall be developed every time the program initiates activities within a new province. The community baseline shall be based on a household survey with focus on level and source of income; land availability and use; farming practice and organization; loans taken and

	<p>venues for financing.</p> <p>By end project an impact evaluation shall be performed based on from three building blocks:</p> <ul style="list-style-type: none"> a) GHG emission reduction calculation using the current hectares of land planted with trees with a look to the farmer groups plans for expanding land for forestry under the scheme. b) Profitability analysis of the farmer groups accumulative cost and revenue generation for land under the scheme, including a cash-flow and investment/loan analysis plus a forecast covering expected cost and revenue until after the first forest harvesting. The evaluation shall also look into "the group" as an effective production unit. c) Community participatory impact assessment focusing on the overall intended and unintended significant changes in scheme participants and on the involved communities including where relevant benchmark against the community baselines and update of these using existing data/analysis.
<p>US: We would like to understand better what the OGS model is expected to look like. What species/crops are being promoted and under what management model (industrial monoculture plantation, mixed agroforestry, etc.?) Where is it likely to be located? Are these areas near significant natural forests? What process and what criteria will be used to select the partner company? What can you tell us about the potential partners?</p>	<p>IFC: The lead private sector company engages with farmers in villages within a 20km radius of the company's existing plantations, and promotes the formation of farmers groups, consisting of around 20 farmers who are interested in participating in the OGS. These farmers will identify blocks of land of 20-100ha within their village territory that is agreed with the village and district authorities as being suitable and available for tree planting. The farmers negotiate either individual or collective titles to the land or lease of the land if it is already subject of a community title, to ensure security of tenure.</p> <p>The company is promoting an agroforestry model that combines commercial tree species (currently <i>Acacia mangium</i> x <i>auriculiformis</i> hybrid) intercropped with annual crops using alley cropping.</p> <p>The project is located in an ecological zone where the natural forest is Dry dipterocarp which contains a number of commercially valuable tree species, but has shallow infertile seasonally flooded soils that have become degraded over time due to cutting and removal of trees and over grazing.</p>

	<p>“Degraded forest” is difficult to define precisely in quantitative terms, but the name is generally applied to former forest where all or most trees of commercial size and species have been removed and natural regeneration is not occurring (generally due to grazing).</p>
<p>US: We would appreciate more information to demonstrate that the OGS scheme will be financially viable and that it will leave smallholders better off. More information on the expected relationship between the smallholders implementing the OGS and the company, how financing to implement OGC will be provided, where it will come from, and on what terms, would be welcome. Will inputs initially come from the company up front, with repayment expected once the outgrowers sell products, or from other sources? Will outside financing for these activities be sought, and from whom? How likely is it that this financing will be available at rates that make the project viable? What are the expected purchase terms between the company and outgrowers? It would be helpful to see some calculations with different financing/purchasing term assumptions (using informed estimates of likely conditions) that demonstrate that the OGS scheme would be viable. Also, what does the IFC see as the potential pitfalls of this type of project (we understand some OGS schemes have resulted in less than positive outcomes for communities and the environment) and how will they be avoided in this case?</p>	<p>IFC: Much of the information on company-OGS relationships is described above.</p> <p>Details of the financial model are being developed and will be based on the results from the pilot trials during 2013 and revised periodically as more information becomes available. The key factor in developing the financial model is that it is profitable for both the farmers and the companies. There are five elements of the OGS that will be taken into consideration to assess the financial viability of the model. They are: Land, Labor, Inputs (including seedlings), Harvesting and Transport, and Markets. The expectation will be for the communities to provide labor and land, then to potentially take on more elements as they develop capacity and motivation. The partner company will support this progression with IFC FIP program support, including local service providers.</p> <p>The ability of the farmers of to conduct agroforestry will enable farmers to earn some income during the early years before trees reach a size where there are marketable products. Preliminary assessments made to date indicate that for every (\$1) dollar spent by IFC-FIP the program will generate two and a half (\$2.5) dollars of gross profit for the participating farmer. These initial estimates are based on an assumption of a 5-7 year rotation and a combination of industrial trees (e.g., eucalyptus, acacia) and cash crop growth (e.g., cassava, fodders). More precise financial analyses of the OGS and farmer income, however, can be made once the pilot phase proceeds and site specific data becomes available.</p> <p>Furthermore, gross profit optimization makes the following market assumptions and at specific percentage splits, based on company’s input all prices quoted are at mill door: chip mills sold in Thailand for \$21/ton, charcoal sold in Lao PDR for \$100/ton , saw logs for \$55/ton sold in Lao PDR and potentially \$200/ton in Thailand for specific pallet markets, veneer in China sold for anywhere between \$160-\$180/ton.</p> <p>The financial analyses of the OGS and farmer income will be advanced further as the pilot phase proceeds and site specific data becomes available</p>

<p>UK: We would like to see more detail on how the out grower scheme will work in practice. What options have been or will be considered? Since there is no microfinance or credit component associated with the project proposal, we assume that inputs, advice etc will be provided by the company. There are a number of potential socio economic risks associated with this approach which should be analysed. Whilst the proposal refers to safeguards and performance standards, we think it is important to spell these out. In particular it would be helpful to understand how different models have worked elsewhere in the region.</p>	<p>Finally, an assessment of potential socioeconomic and environmental risks against IFC Performance Standards and mitigation measures has been developed by IFC specialists following IFC's policies and procedures.</p>
<p>US: We note that the project document asserts that the OGS scheme should result in reduced pressure on natural forests. We would like more analysis on this point, in particular on the question of whether good returns in the OGS could potentially increase pressure to clear additional land. Are there natural forests in the vicinity of the OGS scheme areas? How will potential deforestation/degradation of natural forests in these areas be monitored and handled?</p> <p>UK: We would like to see more analysis around the assumption that the small holder plantations will take pressure off remaining areas of natural forest. Are there examples of this being the case to draw upon from the region? Are there risks of perverse incentives to clear more land should the</p>	<p>IFC: The program will be implemented on lands that have already been deforested and settled, and are unlikely to be reforested by natural means. Additionally, the program aims to prevent further conversion of forests to agriculture. IFC's policies on social and environmental sustainability will be applied. Furthermore, IFC will not work with any company involved in conversion of natural habitat, including forest. IFC guidelines also restrict engagement in forestry operations to companies that are implementing sustainable management practices to one or more globally, regionally or nationally recognized standards as demonstrated by independent verification or certification.</p> <p>Moreover, all participating clients will need to go through IFC due diligence process and are subject to IFC Performance Standards. Besides financial, legal and credit due diligence, integrity due diligence is an essential component of IFC's overall due diligence efforts for any engagement with outside parties. The Integrity Due Diligence (IDD) Procedure is a framework for identifying and documenting the potential risks associated with unethical and illegal activities which include environmental, social, governance and financial crime issues such as child labor, corruption, fraud, and money laundering. The Performance Standards, which have recently been updated, include: Assessment and Management of Social and Environmental Risks and Impacts; Labor and Working Conditions; Resource Efficiency and Pollution Prevention; Community Health, Safety and Security;</p>

<p>scheme prove attractive to farmers?</p>	<p>Land Acquisition and Involuntary Resettlement; Biodiversity Conservation and Sustainable Management of Living Natural Resources; Indigenous Peoples; and Cultural Heritage. For information on IFC Performance Standards see: www.ifc.org/sustainabilityframework.</p> <p>With natural intact forest being located only on steep and rocky slopes of the eastern mountain range in the pre-identified intervention sites, intensive tree production by farmers would not likely be feasible. Furthermore, the OGS is expected to provide a source of income from cash crops for participants. Based on this, farmers should have less incentive to grow other crops through shifting cultivation in more remote locations. Such behavior will be monitored during the pilot phase. It will also be important for the partner company to apply safeguards to not associate with farmer based tree production involving the clearing of natural forests.</p>
<p>US: We would appreciate more information on how the potential emissions reductions/enhanced removals were calculated. What activities do these reductions/enhanced removals come from? What assumptions were used in their calculation?</p>	<p>IFC: The emission benefits in the proposal have been calculated using the Carbon Assessment Tool for Afforestation and Reforestation (CAT-AR), which was developed by the Centro Agronómico Tropical de Investigación y Enseñanza or CATIE (Costa Rica) for the World Bank (WB) as part of the “Pilot Program for Assessment of Greenhouse Gas (GHG) Intensity of Core Development Activities”. The model used for the Lao plantation project takes account of several sources of emission reductions and assumptions used are based on a target of 15,000 hectares over five years. Local Yield tables for Eucalyptus and Acacia indicate that the growth of the trees in existing young company plantations corresponds with the yield class that will achieve a maximum mean annual increment of around 16 m³/ha/an after 7 or 8 years. In addition, there is an average of about 10 tons/ha of carbon in the residual biomass on the land that is cleared for the plantations. If this is left to decay (especially via fungi and termites as happens currently) it will produce emissions of both CO₂ and methane.</p> <p>As indicated in the proposal, the program will in the first year look at additional sources of emissions reductions and opportunities for removals.</p> <p>One opportunity is to more effectively use the residual biomass prior to plantation establishment. Converting it to charcoal using improved technology provides additional income for the farmers and reduces emissions indirectly by avoiding the need for the farmers to cut much larger quantities of wood from the surrounding forests to make the same amount of charcoal with current inefficient</p>

	<p>methods. Although CO2 is produced when the charcoal is burnt, because less wood is used for a given amount of charcoal overall emissions are reduced. The possibility of the output being used as Biochar is being investigated, which would reduce emissions further and improve soil conditions.</p> <p>Another opportunity is to assess the positive effects of the outgrower scheme on REDD in natural forests adjacent to the plantations. This indirect benefit will be a challenge to demonstrate and quantify, but will be assessed. The monitoring, reporting and verification of REDD effects is still at early stages of development in Lao PDR. This is a topic that will benefit from close cooperation with the other two MDB programs, which are addressing REDD more directly.</p>
<p>US: We would appreciate more information on what activities the \$3 million will be spent on. The document contains descriptions of the activities, but it would be good to understand how much will be spent on each activity, and the breakdown between the pilot phase and the scale-up phase.</p> <p>UK: The proposal does not provide any breakdown of costs which is something we usually expect from project proposals.</p>	<p>IFC: The pilot phase will require US \$1 million from FIP grant resources for the implementation of technical assistance as described in the Proposal document and above. The remaining US \$2 million of FIP resources will be used to scale-up the program. It is expected that the \$3 million of the total program will leverage approximately US \$4 million in the form of in-kind and parallel contributions from participating private sector companies and partners.</p>
<p>UK: Is there any reason why the company that is likely to be the client in this project cannot be named?</p>	<p>IFC: For confidentiality reasons and as specified under the policies and procedures agreements between the Climate investment Funds and IFC, IFC cannot name its potential clients before the CIF funding is approved by the respective TFC or Sub-Committee. In line with IFC's procedures under the CIF, formal agreements with clients can only be made after the IFC's program proposal and request for funding are approved and resources are "in house". As requested by the CIF policies, IFC will inform the TFC and Sub-Committees client's names and final details of the sub-projects at the time of the financial closure of the project.</p>

<p>UK: Are we correct in assuming that the due diligence process will only commence on approval of the project?</p>	<p>IFC: The partner company has gone through the stages of IFC’s integrity due diligence process. Additionally, the company is subject to IFC Performance Standards.</p>
<p>UK: On a specifically technical point, are the plantations that are being considered going to result in extensive areas of monoculture? What are the implications for biodiversity and for livelihoods reliant on other forest products that are currently available from “degraded areas”.</p> <p>The proposal refers to supporting agroforestry systems; is a <i>Taungya</i> like system being contemplated?</p>	<p>IFC: The plantation compartments of mainly Acacia and Eucalyptus trees are being established in a mosaic of planted and natural vegetation. In the sites, some intact natural vegetation occurs in riparian and steep sloped areas, which will be conserved. As well, cultivation of non-timber forest products such as rattan and bamboo are being promoted as part of the OGS.</p> <p>Ongoing degradation in the plantation concession areas included previous aerial bombardment during the 1960s and 70s, commercial logging in the 1980s and 90s, uncontrolled and continuous local logging, shifting cultivation, wildfire, and cattle grazing over the past decade has led to soil exposure and erosion, and little opportunity for regrowth of natural forest vegetation.</p> <p>Finally and as mentioned above, the plantation areas are located in the valley bottom to the west of the Annamite (Xai Phou Luang) Mountain Range. Much of the mountain slopes remains under natural forest cover, with some shifting cultivation evident.</p> <p>The taungya system consists of growing annual agricultural crops along with forestry species during the early years of establishment of forestry plantations (World Agroforestry Center). This system will be a key feature of the OGS and during the initial phase various crop types and combinations will be tested, with an additional assessment of fodder for improved cattle production.</p>