



Building a Capital Continuum for

NATURE-POSITIVE INVESTMENTS

September, 2023

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About CPIC: CPIC is a global multi-stakeholder initiative focused on enabling conditions that support a material increase in private, return-seeking investment in conservation. CPIC aims to facilitate the scaling of private sector investments into conservation by creating models for the successful delivery of investable priority conservation projects, connecting pipeline providers of such projects with deal structuring support, and convening conservation project delivery parties with investors to execute investable deals. CPIC's members range from institutional investors to public donors and from private project developers to conservation NGOs.

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Foreword

The growth in conservation finance and investments in nature-based solutions is noteworthy. Yet, they remain substantially below the scale needed to fully harness their potential for climate change mitigation and achieving SDGs, like biodiversity conservation and food security. Currently, only 2% of global climate finance is directed towards conservation finance, and a mere 17% of financing for nature-based solutions originates from the private sector (UNEP, 2022). Given that nature-based solutions account for 30% of the GHG mitigation potential by 2030 and serve as a vital tool for climate adaptation (UNEP, 2022), the increase in nature-based carbon credits in the voluntary carbon market in recent years reflects progress in the Paris Agreement's carbon rulebook.

However, a sole focus on carbon when exploring nature-based solutions limits their full potential. Such a narrow lens can overshadow their myriad benefits, from enhancing biodiversity and promoting equitable livelihoods to poverty reduction and food security. Adopting a holistic landscape approach is essential when designing and developing nature-based solutions projects.

Corporations have contributed to the recent market growth by investing in nature-based solutions as part of their net-zero and nature-positive mitigation strategies. This includes reducing their Scope 3 emissions and using carbon credits for emissions compensation. Yet, the market's recent slowdown, influenced by media scrutiny of the integrity of carbon credits, reveals its fragility.

As we stand in September 2023, a crucial juncture awaits us on our path to a sustainable future. Restoring trust in the voluntary carbon markets and closing the financing gap for nature-based solutions in order to unlock their vast potential calls for innovation, resilience, and a collaborative approach. This paper is designed to guide institutional investors and development finance institutions by providing insights, strategies, and recommendations to navigate existing challenges as well as to capitalize on emerging opportunities.

Aligning with CPIC's forward-thinking vision, this paper represents a call to action to elevate the discourse, broaden the perspective, and commit to the bold, transformative change our planet desperately needs. The challenges are immense, but so are the opportunities. Together, we can turn the tide and ensure nature-based solutions reach their full potential as a cornerstone of climate change mitigation and sustainable development.

The CPIC Steering Committee

TABLE OF CONTENTS

EXECUTIVE SUMMARY	04
1. Current State and Barriers to Investing in Nature-based Solutions	05
Threats from Global Ecosystem Collapse	06
Current State of Nature Finance	06
Closing the Nature Finance Gap	08
Barriers to Scaling up Private Sector Finance for Nature	08
How These Barriers to Scaling Up Private Investment in Nature Can Be Turned into Solutions	11
2. Nature Finance Through the Lens of the Capital Continuum	12
The Capital Continuum Framework for Nature Finance	13
The Role of Investors in the Capital Continuum	15
Relevant Financial Instruments for Nature-Positive Finance	17
3. Recommendations to Solve Challenges at Critical Stages of the Capital Continuum	18
Recommendation 1: Addressing Incubation and Implementation Challenges Through Collaborative Efforts Under the Partnerships for Forests Initiative	19
Recommendation 2: Unlocking Early-Stage Capital Opportunities for Development Finance Institutions (DFIs)	20
Recommendation 3: Adopting Early-Stage DevCo Funding Strategies From Other Sectors to Nature-Based Solutions	22
Recommendation 4: Support investments along the capital continuum by providing appropriate market pricing signals to NbS via the voluntary carbon markets	25
CONCLUSION	28
References	29

EXECUTIVE SUMMARY

Faced with the looming threat of global ecosystem collapse and the risk it poses for the global economy, it is imperative that we urgently divert capital away from activities that deplete and destroy nature, and instead towards sustainable land use and ecosystem restoration. According to the United Nations Environment Programme's State of Finance for Nature report, investments in nature-based solutions (NbS) must increase to \$674 billion annually by 2050 to meet climate, biodiversity, and land restoration targets (UNEP, 2022). This financing gap will not be closed without significantly increasing the participation of the private sector.

Yet, multiple barriers persist, including: systemic economic failures; scalability and replicability constraints of nature-based projects; a lack of investable pipeline with competitive risk-return profiles; mismatch of timelines between funding needs and investor expectations; lack of data-driven impact measurement; and shortages in human capital. These challenges hinder the scaling of private investments in nature-based solutions.

This paper applies the **capital continuum framework** to map the financing journey of nature-based projects. This surfaces funding needs, typical challenges, and the diverse risk-return profiles spanning four unique developmental phases. The paper highlights the need for various tools and financing mechanisms to cater effectively to the needs of the projects as they transition from incubation to market integration. A significant investment gap is evident between the incubation and implementation phases, mirroring the 'valley of death' from the commercial startup arena. If overlooked, numerous nascent nature investments will struggle to grow. This paper highlights the critical role development finance institutions (DFI) can and should play in bridging the chasm.

Four promising market innovations and solutions address current barriers to overcoming this 'valley of death' appear in the paper. Firstly, a case study of the Partnerships for Forests (P4F) initiative explains its approach to tackling incubation and implementation challenges through strategic grant funding paired with technical assistance. Secondly, the paper advocates for DFIs to assume a catalytic role in nature-based solutions by moving earlier in the capital continuum funding cycle. Thirdly, the introduction of Development Companies (DevCos), adapted from the renewable energy sector, is proposed as a pioneering model for early-stage nature investments. These entities aim to minimize risks associated with incubation and early implementation by offering due diligence, commercial structuring, and boots-on-the-ground support to grow local capacity. Last, the role of voluntary carbon markets in fostering investments throughout the capital continuum is discussed, highlighting their potential to provide appropriate pricing signals and liquidity to the market.

We have no time to waste in addressing the twin crises of climate and nature. Presenting both novel perspectives and a range of solutions, this paper endeavors to address investment barriers for nature-based solutions. In this pivotal era, we must harness every available resource, use all the tools in our toolbox. As we navigate the complex landscape of emerging nature markets, this paper argues that collaboration—an approach conducive to sharing learnings and coordinated risk mitigation—is a must. A prosperous, nature-positive future hinges on the concerted efforts of governments, DFIs, and the private sector. Together, they hold the key to filling the capital continuum gap, unlocking the transformative potential of nature-based solutions to drive meaningful change on a planetary scale.





01.

Current State and Barriers to Investing in Nature-based Solutions

Threats from Global Ecosystem Collapse

Our planet's natural ecosystems are severely compromised due to human actions. We have witnessed the loss of half the world's forests, coral reefs, and nearly three-quarters of its wetlands. Two billion hectares of land under human management are degraded, with an alarming 12 million hectares added yearly. Moreover, two-thirds of the world's main rivers have been dammed (UNEP, 2021).

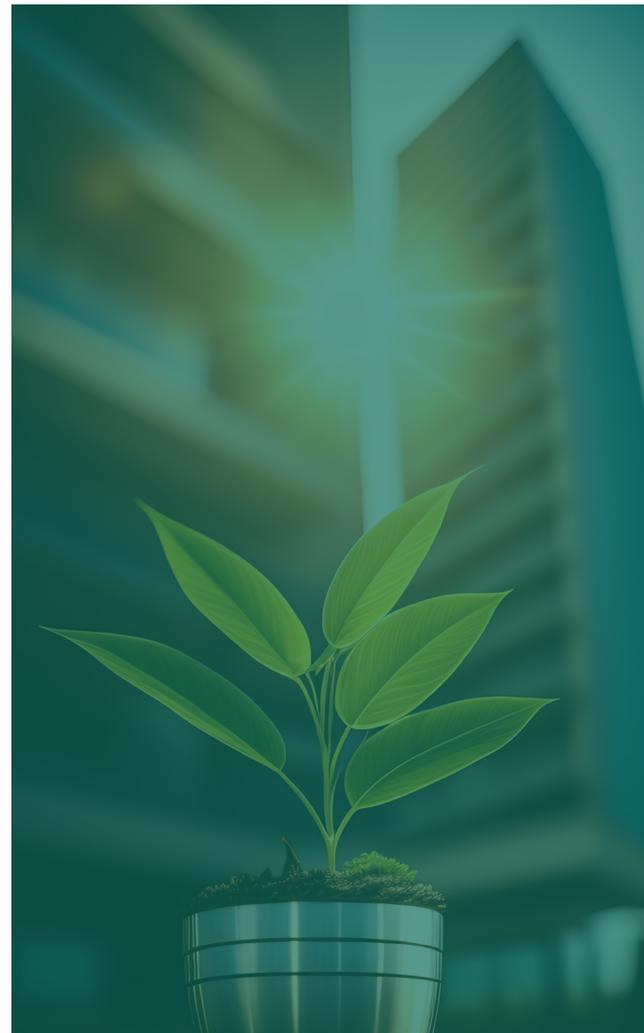
Such rampant degradation poses a systemic risk to the global economy. Over half the world's GDP, approximating \$44 trillion, relies on nature and its countless services (WEF, 2020). One in five countries faces a risk of ecosystem collapse across over 30% of their territories. For some, the cost of biodiversity loss could reach 4% of their GDP annually by 2050 if current trends persist (Roxburgh et al., 2020). This grim outlook underscores the urgency to reallocate financial flows. It calls for urgent action to pivot away from activities depleting and destroying natural capital and towards those that sustainably use land use and restore ecosystems.

Current State of Nature Finance

Current estimates place nature finance between \$78 billion and \$154 billion annually. This finance predominantly comes from public sources such as government budgets, taxation, natural infrastructure investments, and official development assistance (OECD, 2020). Private sector contributions are comparatively meager, ranging from \$6 to \$26 billion each year. These funds mainly originate from sustainable supply chains, forest carbon, biodiversity offsets, ecosystem service payments, water quality trading and offsets, private equity, and philanthropic funding through direct contributions to conservation non-governmental organizations (NGOs) (Tobin-de la Puente et al., 2021).

According to the UNEP's State of Finance for Nature report, investments in nature-based solutions (NbS) must increase yearly to about \$674 billion by 2050, accumulating to \$11 trillion to meet climate change, biodiversity, and land degradation targets. There is thus a significant global financing gap, with current funding only covering 16-19% of these necessary amounts.

Negative financial flows are exacerbating the situation. They range from \$500 million to \$1.1 billion annually from harmful subsidies and governmental fiscal support to activities detrimental to nature, notably in agriculture, fisheries, and fossil fuels (IPBES, 2019). This negative funding is 3 to 7 times greater than our current nature investments, a calculation that does not even account for environmental externalities, which amount to billions of dollars of environmental damages (UNEP, 2022).



What are nature-based solutions?

Nature-based solutions (NbS) encompass approaches that protect, sustainably manage, and restore natural ecosystems to address both social and environmental challenges (Tye, Pool, and Lomeli (2022)). Nature-based solutions have been an emerging solution for the triple planetary crises of climate change, biodiversity loss, and pollution. The International Union for Conservation of Nature (IUCN) defines NbS as actions to protect, sustainably manage and restore natural and modified ecosystems that effectively and adaptively address societal challenges, benefiting people and nature. Although NbS and natural climate solutions (NCS) are often used interchangeably, there is a distinction. NCS underscores climate change benefits, while NbS encompasses a broader spectrum of benefits (Cohen-Shacham et al. (2019)).

Currently, carbon markets offer the most developed revenue streams for NbS. Consequently, this paper focuses on the subset of solutions where carbon can play a catalytic role in building the business case for investments into NbS. Nonetheless, we must remember that nature is regarded as a public good. Only some NbS are tailored for market-based solutions or scaling. Therefore, there will always be a need for public action and philanthropic investments.

Figure 1 Nature-based solutions



Source: IUCN, 2016

Closing the Nature Finance Gap

Growing evidence suggests that delaying action for nature costs twice as much as immediate intervention (Dasgupta, 2021). Understanding what each sector can do to close the financing gap becomes crucial. Governments shoulder a key role —enacting policy reforms, creating regulatory frameworks that introduce financial incentives for reducing negative biodiversity impacts, and increasing funding for nature (Deutz et al., 2020). While policy and regulation are essential for creating a market for natural assets and an enabling environment that incentivizes increased private sector investment, there have been shortcomings in terms of both speed and adequacy. As a result, we must significantly enhance private sector involvement. Specifically, the private sector's contribution to funding needs to make a substantial leap, transitioning from the current 17% to 50% by 2050 while integrating biodiversity impact considerations into their investment decisions.

Political momentum around nature has been growing recently. We witness nature and biodiversity appearing on global agendas spanning governments, civil societies, and businesses. Emblematic of this shift is the United Nations' designation of 2021 to 2030 as the "Decade of Ecosystem Restoration." 2022 heralded the adoption of the Kunming-Montreal Global Biodiversity Framework (GBF) which works to protect the world's land, oceans, and wildlife. It aims to mobilize at least \$200 billion in annual biodiversity-related public and private funding by 2030, including \$30 billion earmarked for developing countries.



Barriers to Scaling up Private Sector Finance for Nature

For an asset class to mature, it typically requires a well-defined investment strategy with a proven track record, a sufficient number of market participants, and a supportive regulatory framework. When it comes to investing in a new asset class, such as nature-based carbon credits and more broadly in nature-positive projects, there are inherent additional risks due to its unfamiliarity and the absence of an established track record. Ultimately, a private investor's decision to invest in a particular deal will depend on whether the risk-return profile is favorable compared to other opportunities.

Since riskier investments are generally associated with the potential for higher returns, and given the uncertainties surrounding future revenue streams and business models, there are limitations to the returns that nature-based projects can currently offer. Consequently, the success of mobilizing significant private capital depends on finding ways to mitigate the risks associated with these investments (Denke, 2023). Liquidity and a thorough understanding of risk-reward ratios are also crucial for investors, together with a viable pipeline of project supply, and most importantly, a well-functioning, high-integrity market for the goods or services, which does not yet exist today for nature-based solutions.

Overall, there are several barriers to scaling private sector investment into nature-based solutions as an asset class (Denke, 2023).

First, the present economic paradigm is riddled with systemic failures. Nature's provisions of public goods and services are undervalued, and there is insufficient regulation for social and environmental externalities. These deter investments in nature-based solutions. Without alignment between policies, the regulatory environment, and climate-nature goals, as well as a redirection of economic incentives for nature-positive outcomes, markets cannot accurately price risks or allocate resources. Consequently, investment and policy decisions become misguided, relying on distorted economic incentives and neglected, underpriced biodiversity risks.

Second, the localized nature, limited scale, and lack of replicability of nature-based initiatives dampen investor interest. Few nature-based solutions projects can mature into large-scale investments worth hundreds of millions of dollars. The widespread fragmentation of land ownership globally means projects are usually small-scale, demanding customization to fit specific regions and ecosystems. This specificity limits their ability to replicate. Furthermore, the specialized and often higher-priced capital that bespoke transactions for these custom projects need surpasses the available pool of catalytic funds, thwarting the sector's growth.

Third, the supply of investable projects that offer a competitive risk-return profile does not meet the demand. Many nature-based business models are still labeled as 'early stage' or 'emerging', making them riskier and deterring a broader range of investors. It is crucial to differentiate between the actual risks of these investments, such as country or currency risks (typical to investments in emerging economies) and operational risks (typically highest in the initial years), and the uncertainties tied to an emerging asset class, which can amplify perceived risks. The uncertainties revolve around where the market and regulatory landscape is evolving and the long-term sustainability of projected economic and environmental outcomes for these projects. The uncertainty decreases as the asset class matures, reducing the overall risk perception. Increased media scrutiny and fears of bad press regarding unsuccessful projects further intensify investment hesitations. In terms of returns, as the true economic value of nature often remains unrealized under the current economic paradigm, many nature-based projects exhibit weak or insufficient cash flows. Even when these projects generate revenue, the financial returns frequently fall short of market expectations, necessitating blended finance to make these investments attractive. Carbon revenue, a more established avenue for monetization than the nascent biodiversity markets, remains insufficient. Many projects struggle to break-even at present carbon prices, with the added volatility of carbon markets deepening the sense of unpredictability.

Fourth, nature-based solutions projects often experience a mismatch in their funding needs and investor timelines. Early-stage projects, inherently rife with risks, demand modest investments and a prolonged timeline to scale. Investors willing to commit for the entire project duration grapple with multifaceted challenges. Project development and registration can span years, with funds deployed intermittently throughout this phase, and potential revenues may only start post-development. Considering that investors predominantly earn revenues from funds deployed rather than committed, the financial viability of these investments remains tenuous. They must allocate resources for due diligence and maintain readiness during the early stages - a pronounced "long J-curve," all while potentially drawing fees from a modest investment amount. While in the implementation phase an additional step-up investment is required, these projects can span 15 to 30 years, surpassing most investors' timelines, save for those specialized in infrastructure or agriculture.

Fifth, a lack of standardized, data-driven impact measurement and reporting standards for nature-based solutions provides another obstacle to attracting large-scale investment. The absence of an agreed-upon method and universally endorsed methodology for accounting for natural capital renders the monitoring and verification process costly, inefficient, and susceptible to 'greenwashing.' This lack of standardization around nature outcomes has inadvertently led to a narrow focus on carbon, sidelining monetization opportunities for other vital impacts like biodiversity or water. Moreover, much of the existing data on nature-based projects relies heavily on anecdotal evidence. Environmental and restoration champions, who are involved with on-the-ground projects, often lack the technology to provide data-driven insights. To attract large-scale private capital, there is a clear need for objectively verifiable indicators to build the evidence to demonstrate the impact of these projects.

Last, there is a shortage of human capital and financial expertise tailored to deliver nature-based projects at scale. This sector needs dedicated personnel and localized entrepreneurship to innovate and develop new solutions for nature-based projects. On-the-ground organizations, predominantly NGOs, frequently lack staff with sufficient financial acumen, limiting their ability to present investment propositions to the standards of large institutional investors. This capacity gap and uncertainty surrounding future revenue streams and market risks give investors a strong negotiating position. This often culminates in project dismissals due to inadequate financial planning or inking agreements with unfavorable terms and inequitable benefit sharing.

Addressing these hurdles demands innovative solutions in the near-, medium-, and long term. While certain solutions primarily require public sector action, others can find traction through private sector initiatives. Yet, the most potent catalyst for this sector's evolution lies in robust cross-sectoral collaboration, as subsequent chapters will demonstrate.



How Barriers to Scaling Up Private Investment in Nature Can Be Turned into Solutions

Near-term:



Create de-risking mechanisms to help the growth of the nascent market for nature-focused investment transactions. Numerous nature-based solutions (NbS) models are categorized as 'early stage' and, therefore, high-risk. This, coupled with the uncertainty around how the market and regulatory environment evolve, makes broad investor appeal challenging. Therefore, de-risking mechanisms, such as blended finance and innovative approaches, are needed to support the sector until it reaches maturity.



Provide traceability and credible data for impact measurement and reporting. Complexities around agreed-upon methods for measuring various nature impacts and lack of relevant data make monitoring and verifying results expensive and inefficient and allow for 'greenwashing.' This has skewed focus primarily toward carbon and hindered potential monetization of other positive impacts, like biodiversity and water conservation. Emerging frameworks, such as the Taskforce for Nature-related Financial Disclosures (TNFD) and evolving technological solutions, promise to help build evidence.

Medium-term:



Aggregate demand to address limited scale and replicability of nature-positive projects. Addressing the constraints of scale and replicability in nature-based solutions projects is paramount. As the sector professionalizes and establishes a more substantial track record, we might witness organizations start to become adept at consolidating multiple small-scale projects, presenting a diversified investment portfolio for investors.



Increase local capacity and financial expertise. There is a shortage of dedicated human capital to develop new solutions for NbS projects, limiting the capacity of the sector to grow. New organizations may emerge with the explicit mission to support local entrepreneurship and nature champions.



Market mechanisms to increase liquidity and solve for a mismatch of expectations. Projects usually have long J-curves and can take 15 to 30 years to reach their full potential, which exceeds typical investment horizons. A solution for this could be increasing the liquidity of NbS investments. This would enable investors with a higher risk appetite to invest in the early stages and transfer their assets to follow-on investors at a premium.

Long-term:



Correct systemic economic failures through regulation. Undervaluing the goods and services ecosystems provide in our economy deters proper market signals and investment into maintaining natural capital. In the interim, these can be corrected by providing price signals through long-term commitments from buyers and, in the long run, through government regulatory and legislative action.



02.

Nature Finance Through the Lens of the Capital Continuum

Capital Continuum Framework for Nature Finance

The capital continuum,¹ when applied to nature finance, provides a structured framework to map the journey of projects through various developmental stages—each with distinct funding needs, risk profiles, and optimal financing mechanisms. Given the hurdles faced when scaling up NbS investments, this framework underscores the significance of nurturing early-stage, high-risk transactions with the right financing blend of instruments. It paves the way for these projects to evolve into commercially viable and scalable solutions. The capital continuum encompasses the entire journey of the nature-based market, tracing its path from incubation through implementation, scale-up, and culmination as a mature, market-rate project and asset class. This concept acknowledges that nature finance is not a one-size-fits-all domain—it demands a variety of financial instruments, each designed to address the unique demands and challenges inherent to each phase of development. Moreover, this framework is a valuable analytical tool for finance providers to better understand and identify strategies that yield the most impact across the capital continuum. (See Table 1).

Table 1: Context, challenges, and needs in different stages of the capital continuum

Stages	Context	Challenges for Investors (Risk-Return)	Funding and Technical Assistance (TA) Needs of Projects
Development	Innovative ideas and early-stage projects are conceived, often by grassroots organizations, startups, or NGOs. At this stage, activities and business models are identified, together with preliminary financial feasibility models and relevant regulatory and policy frameworks.	At this early phase, the risk of failure, abandonment, or material change in strategy is very high, and the return profile may not yet be clear, making it difficult to attract private investors. Funds deployed at this stage are highly catalytic and needed to create a sound business model for the future.	Projects need funding for feasibility, research, stakeholder engagement, and piloting. TA: Mostly needed at this stage to, for example, identify and structure suitable business models, test feasibility, and set an impact measurement system.
Implementation	Projects have demonstrated feasibility and business potential on paper, and now need to demonstrate and refine their models through pilot projects. In addition, they must demonstrate the ability to expand their scope to transition to the next stage – away from being perceived as early-stage and high-risk and toward a commercially viable business or project with a proven track record.	At this stage, risk is still relatively high as the projects carry significant implementation and operational risks, and uncertainty remains about whether the projected impact can be achieved and scaled.	While projects at this stage may begin to earn revenue, they typically are not profitable yet. They need funding to continue operations and further expand operational expenses (opex) and capital expenses (capex), including for training, operations, certification, and monitoring and evaluation. TA: Needed for demonstrating the proof of concept, strategic guidance for further commercial scaling up and optimization and identifying appropriate sources of finance corresponding the stage of business development.

¹ Karin Berardo of Integrity Global Partners has been developing the Capital Continuum framework for sustainable infrastructure over the past decade. The life-cycle model applies to infrastructure projects, company investments, and emerging investment sectors. In this chapter, it is adapted specifically to apply to nature-based projects.

<p>Scale Up</p>	<p>Having established a viable business model with a proven track record on the ground, projects now aim to show that scaling their activities ensures financial viability and achieves the anticipated social and environmental outcomes, thus making them attractive for substantial private investments.</p>	<p>At this stage, project risks are reduced. However, obtaining financing for large-scale expansion remains a challenge if traditional investors perceive high risks related to relatively new business models such as NbS. NbS often rely on carbon credit revenues, that are still limited by market liquidity and price transparency.</p> <p>In addition, scaling often involves tackling a range of regulatory and policy challenges, including continued risk around land tenure, permitting, and emerging host country carbon rules. Establishing the right governance model amongst the stakeholders in the landscape has been key to unlocking finance and managing the risks inherent to operating at the landscape level.</p>	<p>Capital is needed to scale projects to landscape level, including projects that enhance and stabilize value, such as processing plants for local agri-produce, market access solutions, or replicating the project model in other regions.</p> <p>TA: Needed for overcoming challenges that are related to scaling, documenting lessons learned and ensuring that the impact is measured and verified accurately.</p>
<p>Institutional Finance and Market Integration</p>	<p>At the mature and sustainable stage, projects can reach a large scale and demonstrate a proven revenue model that generates returns that are competitive with other investment opportunities. These projects contribute to the maturation of nature markets and are essential to access the nearly \$1 trillion per year that is required to be deployed in this sector.</p>	<p>These projects are characterized by a lower risk/lower return ratio might still be considered as too risky by certain investors. This perception largely stems from apprehensions surrounding the novelty of this asset class.</p> <p>A strategic approach to mitigate such concerns involves segmenting the risk within project financing so that the segment with lower risk is funded through more risk-averse institutional capital, and higher risk tranches are mitigated through credit enhancements, guarantees and concessionary layers of finance.</p>	<p>At this stage projects have matured into financially sustainable enterprises. Nonetheless, access to conventional commercial capital can still pose a challenge, as many projects may not fit traditional investment criteria for tenor, exit timelines or risk/return expectations.</p> <p>Ensuring the long-term viability of these projects while maintaining their environmental and social objectives can be a delicate balancing act.</p> <p>TA: Still may be needed, but its nature and recipients vary. In emerging sectors, especially ones as novel as NbS, there is an enduring need for TA to support frontier impact sectors.</p>

The Role of Investors in the Capital Continuum

Nature-based solution (NbS) projects undergo a series of transformations across various stages of their capital development continuum. Each stage presents specific financial demands, associated risks, and a set of prospective financiers.

Technical assistance (TA) in the nature sector, while often perceived as a one-off initial booster to kick-start projects, is required throughout the capital continuum due to the highly complex nature of projects.



Incubation Stage

At the incubation stage, capital predominantly comes from philanthropic sources, channeled as repayable or outright grants. Considering the nascent state of projects, they should primarily rely on grants, whether as forgivable or recoverable funding. Should private funds be allocated, careful structuring is essential to achieve reasonable risk-adjusted returns with fair loss-sharing mechanisms. Provisions should be in place to ensure equitable community benefit sharing. This, however, might pose challenges given the lack of understanding of the full business case and financial model.

Key investors at this phase include governmental bodies, foundations, and philanthropic organizations. Their primary contribution is in the form of outright or repayable grants. For NbS projects demonstrating significant carbon potential, high-net-worth individuals, seed and angel investors, and venture-stage private capital can play an important role.



Implementation Stage

When projects transition into the implementation phase, capital deployed tends to shift towards equity or equity-like investments. Notable instruments might include carbon collateralized loans or prepayment Emission Reduction Purchase Agreements (ERPA) for carbon credits. The stage also welcomes concessional capital or credit enhancement to safeguard against potential downside risks. This can be especially relevant for unproven financing models targeting biodiversity or gender credits.

In this stage, impact financiers, private equity firms, and corporate buyers play a pivotal role. Energy companies and other carbon investors have been major financing sources for carbon-focused projects.



Scale-Up Stage

Projects in this stage aim to scale up to their full potential. Efforts center around enhancing and stabilizing value through avenues like localized agricultural processing facilities, market access solutions, or replications of models across diverse geographies. The capital infusion predominantly depends on private equity paired with concessional or blended finance. Instruments like junior equity, guarantees, thematic bonds (green or sustainability-linked), debt-for-nature swaps, or nature-performance bonds become more prevalent.

Development Finance Institutions (DFIs), multilateral banks, philanthropic entities, high-net-worth individuals, impact investors, banks with a clear social or environmental mission, or private equity funds lead the investment frontier during scale-up.



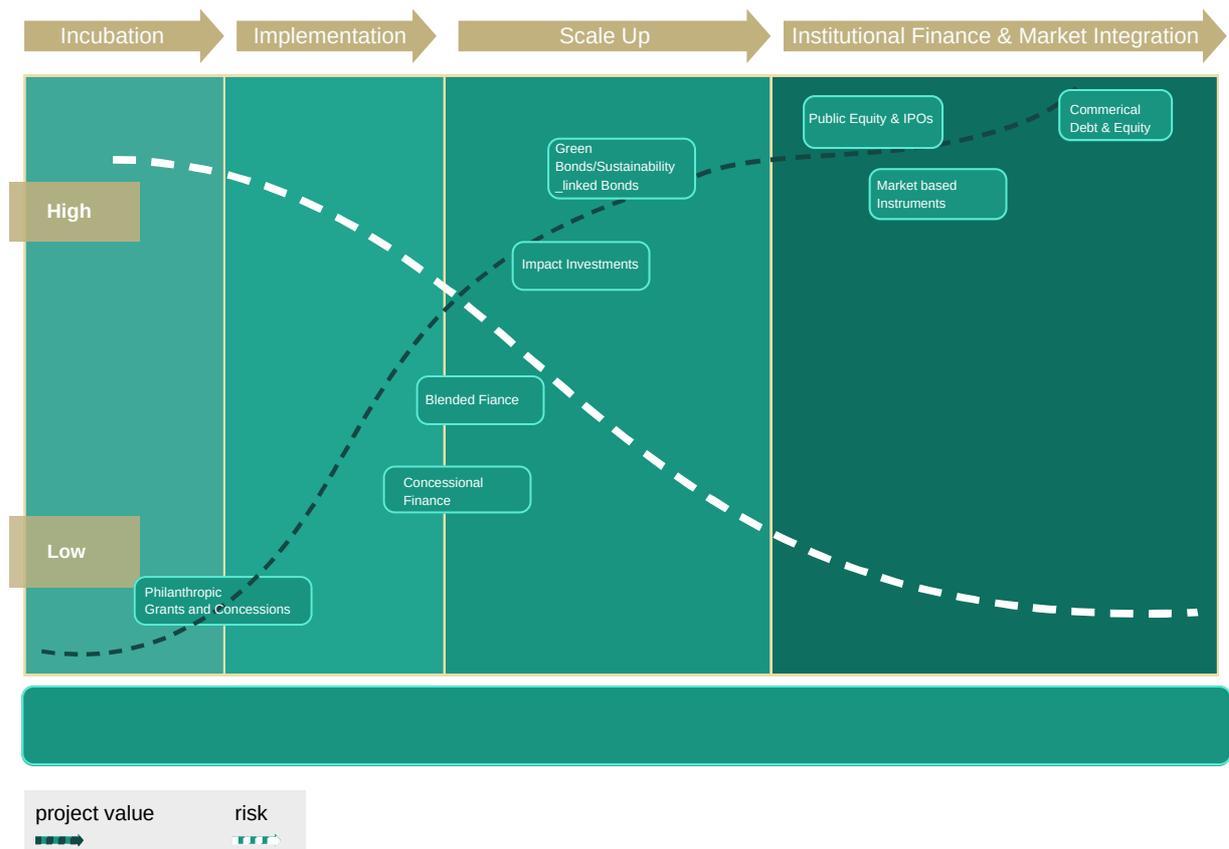
Institutional Finance and Market Integration

As projects mature in this phase, capital often comes from instruments like green or sustainability-linked bonds, market-based instruments funding ecosystem services, public equity, commercial debt, and private equity.

Institutional and retail investors, banks, and asset managers dominate the investment arena.

While for simplification purposes, this paper describes four distinct stages, various financing mechanisms can be used for multiple stages (See Illustration 1).

Figure 2: The capital continuum for nature-based solutions



Source: Karin Berardo, Integrity Global Partners

In the current investment landscape, there is a discernible gap, or "valley of death," between the stages from incubation and initial implementation to scale-up. While a number of mechanisms, as depicted in the above chart, exist to support the scale-up of nature positive investments, there is a shortage of innovative mechanisms designed to seamlessly transition NbS investments from their incubation—where they are supported by grant funding—toward more commercial-oriented capital in the scale-up phase. Simply put, many early-stage nature investments that could be ripe for further financing to expand their operations are left underserved.

Relevant Financial Instruments for Nature-Positive Finance



Concessional Finance entails providing loans or investments with advantageous terms, like lower interest rates, extended repayment periods, grace periods, potential loan forgiveness upon meeting specific conditions, or recoverable grants linked to performance. These terms are typically offered by DFIs, philanthropic program-related investments, and banks with a focus on environmental and social impact.



Blended Finance involves merging public and private funds, often combining philanthropic or concessional finance with commercial capital, to target market deficiencies and attain social or environmental objectives. Doing so can reduce investment risks, enticing private sector participants and stimulating capital flow towards nature-based projects. Stakeholders in blended finance range from governments and DFIs to philanthropic groups, impact investors, and banks.



Green or Sustainability Bonds are debt instruments issued by various entities to fund projects with positive environmental or social impacts. They ensure that investments adhere to specific criteria, often verified by third parties. Detailed impact frameworks specify how funds will be distributed and ongoing monitoring and reporting obligations. These bonds provide fixed income to investors through regular coupon payments, coupled with the return of principal upon bond maturity. They can also fund further stages of a project's expansion. A diverse range of investors, including impact and institutional investors, are drawn to green bonds. They suit large-scale projects or enterprises with environmental sustainability angles and predictable cash flows.



Debt-For-Nature Swaps are transactions where participating countries or entities agree to buy and eliminate a portion of another country's debt at a reduced rate. In return, the recipient country commits to investing a specified sum in conservation efforts or making similar conservation pledges. The proceeds from this Debt-for-Nature (DFN) exchange can serve as the initial funding for environmental funds. Stakeholders are typically governments, conservation organizations, multilateral banks, or DFIs.



Nature-Performance Bonds operate like debt-for-nature swaps, involving restructuring a lending company's debt in return for pledges towards conservation initiatives. The distinction lies in that these bonds can be issued and restructured based on achieving specific performance targets linked to nature and climate objectives. Investors can include high-net-worth individuals, impact investors, and institutional investors.



Public Equity and Initial Public Offerings (IPOs) involve issuing publicly traded equity shares on open market exchanges that enable access to a wider pool of investors and the ability to raise large sums of capital for greater expansion and impact.



Commercial Debt and Private Equity are standard market-based financing, which requires a return on investment commensurate with the market rate for the level of risk involved.



03.

Recommendations to Solve Challenges at Critical Stages of the Capital Continuum

This chapter introduces market innovations and potential recommendations across various stages of the capital continuum that can effectively address the previously outlined barriers and shortcomings.

Recommendation 1: Addressing Incubation and Implementation Challenges Through Collaborative Efforts Under the Partnerships for Forests (P4F) Initiative

Overview

Launched in 2015, Partnerships for Forests (P4F) is a seven-year, \$120 million public donor-funded program spanning 15 countries. Its core objectives include promoting deforestation-free commodities, reducing pressure on forests, and enhancing local livelihoods.

The Incubation Model

At the heart of P4F's strategy lies in its distinctive incubation model, which deploys tailored grants and technical assistance (TA) to nature-focused investments. This model is instrumental in steering investments from conceptualization to market readiness. Crucially, grants and TA support innovative projects that catalyze investments and knowledge development, adhering to the principle of additionality.

P4F's incubation mechanism intends to move nature-based business models toward commercial viability. This favors the project developers and provides Development Finance Institutions (DFIs) an avenue to bridge the gap between the implementation and scale-up stages in the capital continuum.

Achievements and Impact

To date, P4F has leveraged over \$1 billion USD, supporting more than 100 forest partnerships involving businesses, local communities, and governments across 22 commodity markets. This has translated into the sustainable use of over four million hectares of land and reducing or avoiding over 90 million tons of CO₂e emissions.

From P4F's journey, two fundamental lessons emerge:

- The scarcity of commercially viable investments surpasses the available investment capital.
- Grants and TA are indispensable in building a pipeline of commercially viable investments.

Collaboration and Future Prospects

Recognizing the importance of P4F's experience, FMO (a Dutch development bank) secured funding from the UK government and embarked on structured workshops with P4F to distill these crucial lessons. As an outcome, FMO is integrating a technical assistance facility into its "Mobilizing Finance for Forests" (MFF) fund. Launched by the UK government and FMO in 2021, the fund is focused on countering deforestation and unsustainable land use practices.

While the full impact of this collaboration is yet to unfold, it is clear that it serves two critical objectives:

- Mitigating risks linked to nature investments through the design of the TA facility.
- Creating a conducive environment for the capital continuum, allowing a smooth transition from incubation and acceleration to maturity and sustainability. In the following stages of such initiatives, an early and direct link with the follow-on capital would be an important lesson learned for accelerating the growth.

Recommendation 2:

Unlocking Early-Stage Capital Opportunities for Development Finance Institutions (DFIs)

Collaboration at the Crossroads

In the face of immense challenges, there is a crucial need for the public, private, and non-profit sectors to collaborate. Within this dynamic context, we explore the pivotal role of DFIs in moving from primarily investing in the scale-up stage to the implementation/incubation stages on the capital continuum.

DFIs: Engines of Economic Development

Development Finance Institutions (DFIs) are specialized financial institutions that aim to catalyze economic development in countries and regions, particularly in emerging economies. Their contributions are instrumental in fostering sustainable economic growth, alleviating poverty, and tackling developmental issues. Yet, DFIs confront substantial hurdles in adequately supporting the nascent nature-based solutions market.

Challenges at the Starting Line

DFIs encounter challenges that mirror those faced by institutional investors. They view nature-based projects as high-risk endeavors, primarily due to their lack of a substantial track record, limited investment readiness, modest ticket sizes, and comparatively lower returns. Although DFIs possess a higher risk tolerance than their institutional counterparts, the inability to accurately gauge risk in the nature-based sector, coupled with the elevated risks of emerging markets where most opportunities reside, obscures the feasibility of these investments. Additionally, DFIs must adhere to strict Environmental, Social, and Governance (ESG) guidelines and other safeguards. This creates further hurdles for local organizations and NGOs to overcome, particularly when working with limited resources and budgets.

Mission-Driven Dilemma

DFIs traditionally center their efforts on promoting economic development and poverty reduction in developing countries, focusing on economic growth, job creation, and infrastructure development. This mission often lacks explicit reference to climate or nature-related objectives. For instance, the World Bank's mission is exclusively geared toward humanitarian goals stating: "To end extreme poverty by reducing the share of the global population living in extreme poverty to three percent and to promote shared prosperity by increasing the incomes of the poorest 40 percent of people in every country."

Natural capital is significant for low-income countries, which often rely heavily on it for their economic growth (Tobin-de la Puente and Mitchell, 2021). Many of the world's poor, over a billion people, rely on forests for sustenance and food security (Garnett et al., 2018). However, when ecosystems degrade, they can weaken social resilience, increasing communities' vulnerability to climate risks and causing loss of resources provided by nature (Tye, Pool, and Lomeli, 2022).

Sustainable development, poverty alleviation, and food security are deeply intertwined with successful nature-based solutions. This interconnection offers DFIs a unique opportunity to champion nature-based solutions that are pro-poor, gender-inclusive, and community-centric. Specifically, in the context of carbon projects, a holistic high-integrity approach is needed where people and biodiversity are not treated as co-benefits but as a core value proposition.

For DFIs to fulfill this catalytic role in financing nature-based solutions, they need to change their mission statement as a first step. We have seen positive examples where DFIs have been able to adapt their strategies to the new Global Goals. For example, British Investment International (BII), previously Commonwealth Development Corporation (CDC), referenced climate change mitigation and adaptation in its 2022-2026 strategy. However, the focus has mostly been on renewable energy transition or large-scale forestry and agriculture projects, which might inadvertently harm biodiversity. Most recently, though, the tide is turning, with growing DFI interest in nature-based solutions. A recent paper from the Mobilizing Finance for Forests (MFF) program explores the role of investors in nurturing a high-integrity voluntary carbon market, signifying heightened DFI interest and future involvement (MFF, 2023).



Mitigating Risk: A Prerequisite for Catalytic Impact

To enable DFIs to assume a more catalytic role in nature-based solutions and bridge the “valley of death” in the capital continuum, a mandate reassessment is urged by numerous stakeholders. DFIs often harbor overly commercial targets and a pronounced risk aversion. Initiatives to reduce risk aversion should include a critical review of DFIs’ capital adequacy ratios—a pivotal indicator of their risk tolerance. An independent expert review has suggested that these ratios are excessively conservative and could be reduced without compromising these institutions’ credit ratings. Such a move would bolster the capital available for lending to developing countries, particularly for climate action and green growth (AfDB, 2023 Economic Outlook Report).

Additionally, specialized funds or allocations with a higher risk appetite could provide another viable solution (LSE, 2023). This strategy might entail dedicating a portion of the DFI’s balance sheet to higher-risk investments while maintaining an acceptable average portfolio risk rating. Collaborative measures with donors on blended finance, as showcased by ADB Frontiers and ADB Ventures, present alternative pathways.

Reducing Profitability Targets: A Shift Towards Impact

Simultaneously, donor countries can contribute to this end by reducing profitability targets set for DFIs. A prominent example is the British International Investment (BII, formerly CDC), which revised its profitability target from 10.6% to 3.5% for its Growth Portfolio and aimed to break even on its entire portfolio. Such measures enable investments in areas with heightened risks and allow for the potential for losses.

A Coordinated Approach to Unlocking DFI’s Potential

Re-evaluating investment mandates, permitting higher risk allocations within portfolio allocation strategies, and fostering enhanced collaboration among DFIs can pave the way for DFIs to play a more pronounced role in investing in nature-based solutions. These initiatives could enable DFIs to engage in innovative approaches such as investing in DevCos, as described below, thereby propelling them up the capital continuum and enabling them to play a more catalytic role during the challenging early stages of nature-based project development.

Recommendation 3: Adopt Early-stage DevCo Funding Strategies from Other Sectors to Nature-based Investments

Addressing the pressing investment challenges in nature-based solutions demands innovative strategies. Incubator and accelerator approaches, though pivotal in cultivating capacity and fostering local entrepreneurship, fall short of the rapid scaling demands of this sector. Insights from other sectors present promising alternatives.

Development Companies (DevCos) are private entities adept at early-stage project development. Historically utilized in sectors like renewable energy and infrastructure, their strategies can be adapted for nature-based solutions.

Overview

Within the realm of renewable energy, DevCos predominantly concentrate on project incubation and initial implementation stages. These stages encompass tasks such as land acquisition, resource assessments, stakeholder engagement, policy and permitting analysis, and preliminary financial modeling, all geared towards attaining project bankability. In the NbS context, DevCos can de-risk projects through due diligence, commercial structuring, proof of concept activities, and boots-on-the-ground support to project developers during implementation. This assistance can be invaluable for project developers and local implementing organizations lacking the financial, legal, or technical expertise to structure investable project propositions for institutional investors. While the capital expenditure remains relatively small during this stage, the risk of finding the project to be infeasible can be high. Hence, it is essential for DevCos to build a credible and competent team with rich experience across its target region. They must carefully manage early-stage budgets against specific performance milestones and aggregate early-stage work across a diverse portfolio of projects.

DevCo Operating Model

DevCos provide sustainable funding for early-stage projects, ensuring that developers do not need to rely on venture capital for renewable energy or, in the NCS context, on extractive pre-payment structures that price carbon credits before all risks and benefits are fully known. By offering risk-tolerant short-term capital to roll out early-stage projects, DevCos are compensated when they sell or place projects with longer-term lower-risk capital.

Given the early market stage of the NbS asset class, blended finance plays an important role in scaling DevCo solutions. In particular, DFI support helps to ensure high-integrity ESG safeguards, transparency, and reporting requirements are built into DevCo operating processes. Strategically placed DFI investments can support emerging but critical NbS activities like biodiversity, gender-lens finance, and complex community-based revenue-sharing models. The role of DFI funding in NbS projects parallels the important role that policy mechanisms and concessional financing played in catalyzing the renewable energy sector. This support, via grants and performance-based loans for near-term liquidity was essential for the sector's commercialization.

Another key advantage of well-designed DevCos is their ability to build effective partnerships and employ the multi-disciplinary teams required to deploy regionally specific expertise in targeted NbS activities, such as reforestation, agroforestry, and conservation. Often, investors cannot employ large in-house expert teams, and engagements with external consultants can pose challenges when interests and incentives are not aligned. Access to a large, multidisciplinary team is critical to success in the NbS sector.

DevCos constitute an important part of the broader investor ecosystem to address many of the investment barriers experienced in the early stages of the capital continuum. DFIs can support DevCos by actively collaborating with other DFIs and NGOs to leverage each other's capabilities. This includes ongoing technical assistance, local capacity building for conservation innovators and host governments, and collaboration with local scientific bodies and academia. Consequently, DFIs distribute the financial and risk burdens of investing in nature-based projects with DevCos.

Textbox 3: Integrity Global Partners NbS DevCo

The Integrity Global Partners (IGP) DevCos are positioned alongside investors to build a pipeline on the investors' behalf. By providing these services to investors, IGP DevCos are particularly well positioned to overcome many of the challenges that institutional investors and DFIs face in terms of entry barriers into the NbS market.

IGP DevCos are evergreen facilities that build long-term value for investors. They allow investors to participate in earlier phases of the capital continuum while prioritizing their primary operating model through take-out financing. Through the DevCo model, projects are aligned with pre-identified investors upfront and implement their investment criteria from the start. Therefore, incubated projects do not lose significant time raising follow-on funding to scale as they progress along the capital continuum.

Furthermore, by leveraging its team of carbon and structured finance experts, IGP DevCos also utilize commercial instruments to supplement grants and thereby enhance cost recovery through multiple revenue streams for the investor.

The table on the next page provides a summary of how IGP DevCos address many of the inherent challenges and barriers in the market.

Challenge	Solution
<p>Insufficient bankable projects: Limited scale and lack of replicability of nature-based projects deters large-scale private investment</p>	<p>The Integrity DevCos source and consolidate projects from multiple smaller project developers that otherwise would remain unknown to institutional investors as they typically lack legal structuring expertise, financial resources, and the ability to access investors. IGP DevCos screen for quality and act as the “architect of the deal”, doing the necessary due diligence and financial structuring, co-designing the projects, complementing any technical and capacity gaps, and packaging the projects to meet predefined investor metrics (e.g., IRR).</p>
<p>Timing of funding needs for nature-based solutions projects often does not align with investors’ criteria</p>	<p>IGP DevCos create blended revenue streams across different project activities to smooth revenues that could include multiple carbon credit issuance profiles alongside complementary revenues over a holistic landscape approach.</p>
<p>Lack of data-driven impact measurement and reporting standards and on-going performance management</p>	<p>IGP DevCos retain a residual interest in the project to assure ongoing project de-risking and performance risk management throughout the project's lifetime. By providing ongoing monitoring and reporting to the investor, IGP DevCos reduce reporting burdens on local developers and provide investors with real-time/unbiased information, enhancing value compared to intermediaries focusing only on the deal execution. The IGP DevCos aspire to provide the highest possible integrity for project design and revenue share arrangements to mitigate reputational risks for investors.</p>
<p>Human capital: Lack of multi-disciplinary in-house teams at the investor side and lack of human capital and financial expertise among developers hinders nature-based projects to scale</p>	<p>Through IGP’s hub model, it efficiently accesses world class experts to provide tactical technical solutions just-in-time. Moreover, by staying involved in projects throughout their lifetime (or at least during the investment tenor) and providing capacity building and local staff to the local implementing partners, IGP DevCos address a key human capital barrier for many early stage NbS projects.</p>

Recommendation 4: Support Investments along the Capital Continuum by Providing Appropriate Market Pricing Signals to NbS via the Voluntary Carbon Markets (VCM)

Fostering Collaboration around Investments Along the Capital Continuum

Voluntary carbon markets (VCM) and the new Sustainable Development Mechanism (Article 6.4 of the Paris Agreement) alongside other results-based mechanism can provide an important role in correcting the market price signal for CO₂ emissions and removals which will be discussed in this chapter.

As the capital continuum framework outlines, many nature-based projects utilizing these mechanisms require early-stage risk capital for project finance. Currently, philanthropic organizations or government grant programs have limited capacity and are the primary providers of such capital. However, Development Companies (DevCos) and Development Finance Institutions (DFIs) who have repositioned their strategies could bridge this gap, funneling investments at this crucial stage. For a seamless transition of investments through the capital continuum, these early-stage capital providers must collaborate with other institutional investors, who typically focus on more mature stages of investment.

The Vital Role of Pricing Signals and Liquidity

Both the Paris Agreement and the Montreal-Kunming Global Biodiversity Framework (GBF) underscore the critical role of the private sector in achieving global climate and biodiversity goals. Yet, for the above-mentioned results-based mechanisms (and environmental markets at large) to effectively drive change, they require robust, long-term pricing signals and associated liquidity. A reliable pricing signal diminishes investment ambiguity, thereby improving the investment case, while liquidity enables an exit strategy for early-stage investors. The accelerating pace of voluntary corporate climate action driving up demand, catalyzed by the climate crisis and the looming NDC (Nationally Determined Contributions) gap, accentuates the urgency of addressing these concerns (Trove Carbon Credit Investment Report, 2023).

Although mandatory emission trading schemes (ETS) and local biodiversity offset initiatives have seen significant growth, they fall short of providing a consistent global pricing signal. Until governments strengthen regulations and build out broader Payments for Ecosystem Services (PES) pricing schemes, a need for a readily available financing mechanism to channel private sector investments is paramount. Carbon finance, provided it adheres to rigorous integrity standards, can serve as this effective mechanism, facilitating our transition to a net-zero and nature-positive world (WEF, 2023).

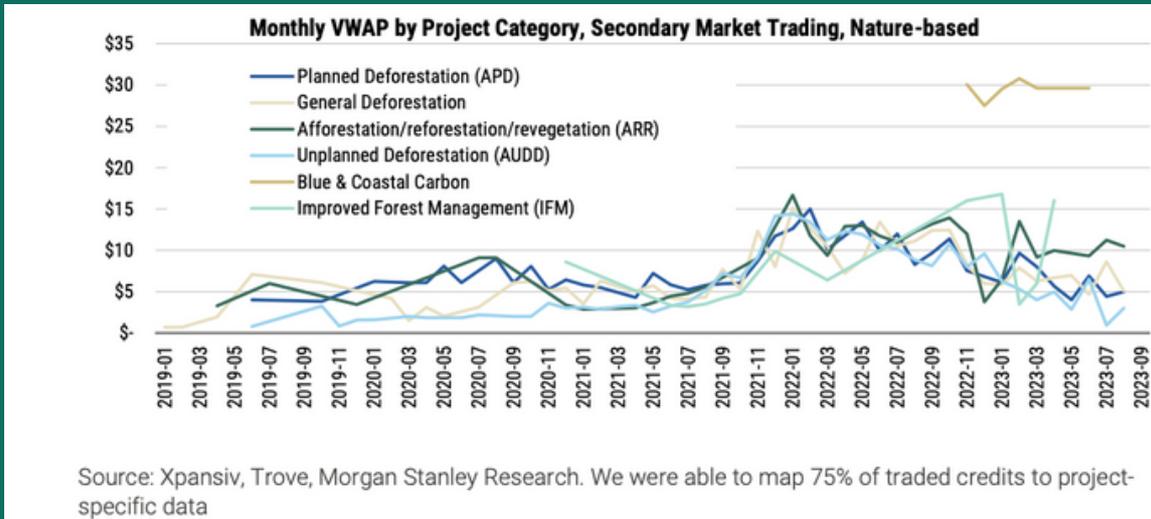


Unlocking the Potential of Voluntary Carbon Markets

In the face of current market turbulence—exacerbated by limited regulatory oversight and a lack of transparency and accountability among market participants—it becomes crucial to investigate how the market's integrity can be ensured. Rapid market expansion can swiftly revert to a suboptimal standard, where quality is compromised. This highlights the urgent need for enhanced integrity and safeguards. Efforts in this direction are already underway with the support of the Integrity Council for the Voluntary Carbon Market (IC-VCM) and the Voluntary Carbon Market Initiative (VCMI), among others.

However, we must also recognize the carbon markets' pivotal role in addressing environmental externalities. Between 2020 and 2022, a modest upswing in carbon market prices, transitioning from just below \$5/tCO₂e to over \$15/tCO₂e, catalyzed a remarkable capital infusion. The primary markets saw figures that eclipsed \$10 billion. As a result, the secondary market experienced a fourfold surge, amounting to \$2 billion by 2021. This rapid growth demonstrates the agility of private capital when a price signal that aligns with environmental objectives is set.

Therefore, for these markets to fulfill their intended purpose effectively, not only is there a need for rigorous integrity standards, but two additional core elements are indispensable: long-term price signal and robust liquidity.



A Critical Juncture for the Voluntary Carbon Market

As the voluntary carbon market transitions into its next phase, the importance of price signal for high-integrity nature-based solutions for carbon and biodiversity, along with other environmental assets, is more crucial than ever. Market actors must commit to purchasing these assets at appropriate prices to facilitate the flow of transition finance that will be required for the long-term sustainable transformation of landscapes. It is widely recognized that high-quality carbon credits require prices well above \$5/t.

Regrettably, the absence of regulatory pressure and increased skepticism about the impact of these credits have shaken market confidence. Yet, the voluntary carbon market is the preeminent financing mechanism readily available to drive private sector action and to channel urgently needed capital to the ground.

Therefore, there is an urgent call for credible market participants to step in, reinvigorating confidence in the market. Without the involvement of institutional investors, many corporations have ventured into the early stages of project development. This approach is neither scalable nor resource-efficient. However, DFIs, alongside other investors willing to allocate early-stage funding to the next generation of high-integrity nature-based projects, have the potential to restore market confidence. They can provide a much-needed price signal to the market by making long-term funding commitments. This would help mitigate the current uncertainty surrounding future prices. Simultaneously, governments and philanthropic donors can act as a last resort, establishing a minimum floor price to cover breakeven investment costs. Such pricing signals would entice broader institutional investor participation further along the capital continuum. These investors, distinct from mere commodity traders, can amplify the market by combining carbon and biodiversity revenues with real asset investments, consequently reducing associated risks compared to standalone project finance investments.

This model has already been successfully applied in other sectors. For example, in the renewable energy sector, governments historically provided feed-in tariffs, tax incentives, and compliance targets to level the playing field against fossil fuel-based energy sources, a critical factor in the European renewable energy transition. As a result, today, renewables are integral components of the investment portfolios of institutional stakeholders.

Charting a Course Forward

Prioritizing risk mitigation during the early stages of the capital continuum is crucial to scaling up nature-based solutions markets. However, the return aspects are of equal importance. Environmental markets, such as the voluntary carbon market, can contribute to pricing externalities, thereby bolstering the business case for emission reductions, removals, and nature-positive transformations. Therefore, advanced market mechanisms can play a critical role in our journey toward a sustainable and nature-positive future. By providing long-term price signals, liquidity, and financial incentives, the market can attract the necessary private capital to drive environmental transformation.

In the current market landscape, DFIs can take on a catalytic role in bridging the financing gap until a suitable long-term pricing signal emerges, thus reinforcing the market's evolution to its subsequent phase. It is a journey that leads toward a global compliance market that ultimately will be essential to address the challenges of the climate crisis and nature loss.



Conclusion

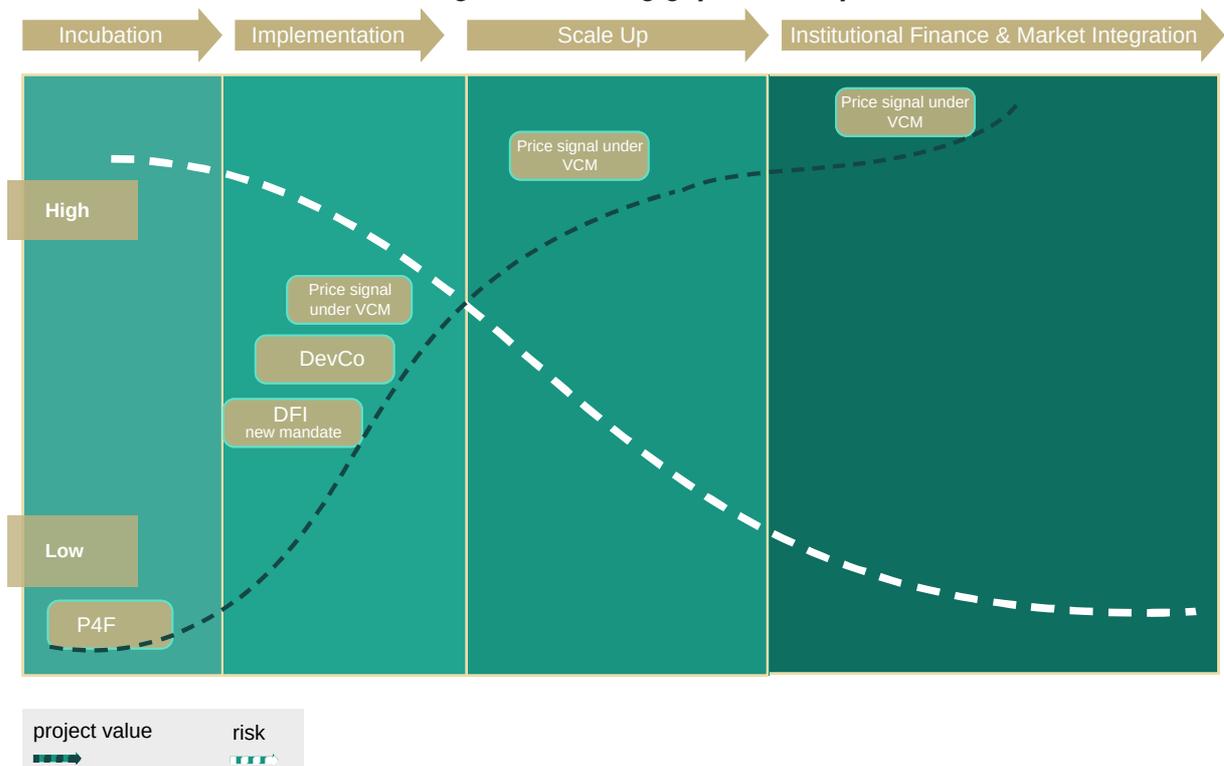
Addressing the intertwined challenges of climate change and biodiversity loss demands urgent action. This paper presents a new perspective and proposes solutions to address investment barriers for nature-based solutions and mend existing fractures along the capital continuum. Success depends on fostering a collaborative spirit among all relevant stakeholders. Instead of operating in isolated silos, focusing solely on individual mandates tied to specific investment stages, a more holistic, integrated perspective is needed. Such a perspective promotes a cross-continuum collaboration among investors. By doing so, public and private investors can ensure seamless transitions across incubation, implementation, and scale-up stages, ensuring a consistent flow of capital for nature-based projects.

Every available tool and strategy should be harnessed in our pursuit of a sustainable future. As we navigate this complex landscape, sending clear, unequivocal signals and incentives to the market becomes imperative. While environmental markets, including carbon and biodiversity, are foundational to a nature-positive future, they are not a panacea or silver bullet.

The collaborative approach laid out in this paper marks the initial endeavor of the Coalition for Private Investors in Conservation to engage proactively with the DFI sector. The aim is to foster trust and collaboration, cultivate a shared lexicon, and promote mutual knowledge exchange. DFIs can catalyze positive transformations in conservation and sustainable development through such endeavors, forging a pathway towards more effective and impactful investments in emergent markets. The journey towards a sustainable and nature-positive future necessitates the collective efforts of governments, development finance institutions, and the private sector. Together, we can unlock the transformative potential of nature-based solutions to drive meaningful change on a planetary scale.

In summary, the below chart provides a representation of recommended solutions and their place on the capital continuum.

Figure 3: Recommendations for closing the financing gap in the capital continuum



Source: Authors

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