

GLOBAL
ENVIRONMENT
FACILITY

LATIN
AMERICA
TERRA CAPITAL FUND

Project Document
June 1997

A

International Finance Corporation
Technical and Environment
Department Environment Division
Environmental Projects Unit

INTERNATIONAL FINANCE CORPORATION
GLOBAL ENVIRONMENT FACILITY

TERRA CAPITAL FUND

PROJECT DOCUMENT

TABLE OF CONTENTS

ACRONYMS, ABBREVIATIONS, AND DEFINITIONS

.....i GRANT AND PROJECT SUMMARY

1. EXECUTIVE SUMMARY.....,

II. PROJECT BACKGROUND AND RATIONALE

III. PROJECT OBJECTIVE.....

IV. RATIONALE FOR GEF FUNDING.....

V. PROJECT DESCRIPTION.....,

VI. PROJECT BUDGET AND FINANCING.....

SCHEDULE A: INCREMENTAL COSTS AND USE OF GEF FUNDS 15

SCHEDULE B: SUMMARY OF DISBURSEMENT ARRANGEMENTS

.....18

SCHEDULE C: TIMETABLE OF KEY PROJECT EVENTS

.....18

ACRONYMS, ABBREVIATIONS, AND DEFINITIONS

Biodiversity	A shortened form of the term "biological diversity" which refers to the large number, variety, and variability of living organisms. Decline in biodiversity includes all those changes that relate to reducing biological heterogeneity, from individual members of a species to regional ecosystems.
EU	European Union
EEAF	Environmental Enterprises Assistance Fund
FMC	Fund Management Company
GEF	Global Environment Facility
IBRD	International Bank for Reconstruction and Development
IDB	Interamerican Development Bank
IFC	International Finance Corporation
Sustainable	When used with respect to a practice, process, system, product development or other item, the term "sustainable" means that the practice, process, system, product, development or other item allows people to meet their current needs without compromising future stocks of environmental capital, such as productive topsoil, clean air, fertile forests, abundant fish stocks, or genetic diversity of both plants and
UN	United Nations

LATIN AMERICA TERRA

CAPITAL FUND

GRANT AND PROJECT SUMMARY

Project Title: Terra Capital Fund (Biodiversity Enterprise Fund for Latin America)

GEF Focal Area: Biodiversity

Region: Latin America

GEF Grant: US\$5.0 Million

Recipient: Terra Capital Advisors, the Fund Management Company. The GEF grant **will** support the Fund Management Company's incremental costs of operating the Fund.

Beneficiaries: The GEF grant will leverage US\$20-50 million of investment in the Fund that in turn will be invested in medium and small scale enterprises in projects with a total cost of US\$40-100 million.

Terms: Grant (Administered by International Finance Corporation)

Executing Agency: International Finance Corporation (IFC)

Fund Capitalization: US\$20-50 million from pension funds, bilateral agencies, International Finance Corporation (up to US\$5 million), and other private sector investors.

Estimated Starting

Date: August 1997

Program Duration: Ten years

Economic Rate of

Return: Not Applicable

EXECUTIVE SUMMARY

1. Terra Capital Fund' (the Fund) will be a private equity fund with a capitalization of US\$20 million to US\$50 million. The Fund will invest in and catalyze private enterprises engaged in commercially viable and environmentally sustainable uses of biological diversity ("biodiversity") in Latin American countries that have ratified the Convention on Biological Diversity. Target sectors include sustainable agriculture and forestry, ecotourism, and other sectors with projects that will sustainably use or protect biodiversity. The Global Environment Facility (GEF) will provide US\$5 million to the Fund Management Company (FMC) for the FMC's incremental operating costs over and above a typical equity fund's costs including the costs of screening and monitoring the biological diversity aspects of the Fund's investments. International Finance Corporation (IFC) is the Executing Agency for the GEF grant funds.

2. The Fund will mobilize investments from the private sector, foundations, and multilateral and bilateral investors. IFC is expected to provide from its own account (i.e., in addition to the GEF grant) 20% of the Fund's capital up to a limit of US\$5 million. The Fund will not be launched and the GEF funds will not be allocated unless a minimum of US\$15 million in capital is raised for the Fund. The Fund is expected to raise a minimum of US\$20 million in investment capital for a first closing and to begin operations later in 1997.

3. The Fund will be managed by a new management company, Terra Capital Advisors, in which Banco Axial, an investment bank based in Sao Paulo, Brazil, and Environmental Enterprises Assistance Fund, a nonprofit environmental organization with investments in Latin America and Southeast Asia, will be the principal shareholders.

4. The US\$5 million GEF grant will leverage an investment of US\$20 million to US\$50 million in the Fund which in turn is expected to invest in projects with total costs of at least US\$40 to US\$ 100 million. Thus the GEF funds will be leveraged at a ratio ranging from eight-to-one up to twenty-to-one (8:1 to 20:1) or more.

In addition to typical investment guidelines, the Fund *will* follow biodiversity guidelines to be established by the Fund in consultation with a Biodiversity Advisory Board drawn from local and regional technical, government, nongovernmental and private sector organizations; the GEF Science and Technical Advisory Panel (STAP); the Government of Brazil; and IFC. The Fund *will* adhere to the World Bank Group Environmental Policies and Guidelines.

6. The use of the GEF funds is consistent with the Convention on Biological Diversity, the GEF Operational Strategy, GEF Council decisions and guidance, and the GEF Instrument.

7. The GEF allocation of US\$5 million for the Fund was endorsed by the GEF Council in October 1995 subject to additional review and endorsement by the Government of Brazil (since the Fund Management Company will operate out of Brazil). Following consultations between the principals of the Fund Management Company, IFC, and the Government of Brazil, the GEF

The Fund was called The Biodiversity Enterprise Fund for Latin America during the Fund's earlier development phase.

Focal Point of the Government of Brazil endorsed the use of GEF funds for the Fund in letters dated March 27, 1996 and June 17, 1996.

II. PROJECT BACKGROUND AND RATIONALE

Private Sector Links to Biodiversity Conservation and Sustainable Use

8. The term biological diversity ("biodiversity") is used to describe the number, variety, and variability of living organisms. Biodiversity is threatened by some forms of development but also protected or used sustainably by others. On the one hand, natural habitats are under threat from increased population, pollution, and expansion of cropland and urban settlement. Industries such as forestry, agriculture, fisheries, and tourism depend on biological resources. These activities often damage the biodiversity of the ecosystems on which they depend. However, other production methods, some traditional and others developed more recently, are designed to ensure sustainable use of the resource base, thus conserving biodiversity. By converting from the commonly used harmful practices to viable practices that help prevent the loss of, minimize impacts on, or sustainably use biodiversity, the private sector can become a principal steward and protector of biodiversity, while continuing to operate profitably and responsibly.

9. More specifically, the private sector can help prevent biodiversity loss by creating new value from ecosystems, diverting pressure from critical biodiversity resources, and practicing low-impact methods. "Biodiversity-friendly" practices are those which:

- Improve biodiversity conservation potential by converting from existing agriculture or forestry practices to low-impact/minimal disturbance practices, such as certified organic agriculture and sustainable or low-impact forestry.
- Extend natural habitats and conduct complementary activities, especially in the buffer zones surrounding natural habitats, such as planting organic/shade-grown coffee on degraded land in buffer zones around a national park.
- Ease pressure on threatened species or habitats, such as the switch from fishing to aquaculture to allow a particular species to recover, or alternative livelihood or buffer zone activities that stem migration into forest lands or reduce overfishing.
- Cultivate under-used agricultural species and wild relatives of domesticated species to maintain the pool of genetic resources, alternative crops, and strains of crops that may be critical for the sustainability of human food resources.
- Extract products from or use intact ecosystems with minimal or no impacts, such as harvesting non-timber forest products (NTFPs) and ecotourism.
- Make habitat preservation an integral part of or a by-product of a business venture, such as ecotourism lodges that are part of a low density regional plan established and maintained in coordination with government, NGOs, and local residents; hotel facilities

gl. 62 L. 101/12 L. 101/12

that support a neighboring marine park; or aquaculture conducted within a coastal zone management plan that maintains large areas of natural habitat.

- Recycle or cleanup industrial, urban, or agricultural wastes that directly affect critical habitat such as a marsh that serves as a flyway stopover for migratory birds.

Fund Development

10. The Fund concept was developed by IFC following early consultations with groups indicating an interest in a biodiversity fund including Latin American and international NGOs, potential investors, and the World Bank's Global Environment Division. IFC, in part through a feasibility study (sponsored by IFC and the Heinz Endowments), and later the FMC identified investment possibilities for the Fund. The findings of the feasibility study and the FMC are summarized in the next section. The FMC has been responsible for structuring and implementing the Fund.

Market Rationale for the Fund and Biodiversity Investment Opportunities

11. Market Rationale: The investment focus of the Fund is premised on the expectations that: a) growing environmental awareness among consumers is creating a strong and growing demand for environmentally sustainable practices and products; b) businesses are discovering attractive growth opportunities in biodiversity-linked industries and believe that they can derive benefits from adopting new, environmentally friendly processes, including long-term cost savings and more efficient environmental risk management, and access to growing niche markets; c) the feasibility work found that there are business opportunities in Latin America with the potential for both economic and biodiversity benefits and that while the volume of biodiversity products is still small relative to the overall size of the relevant market, the production of these products is increasing rapidly; and d) the Fund will invest in companies selling biodiversity-linked products into these growing markets.

12. Scarce Funding: To introduce sustainable practices on a broad enough scale to ensure significant biodiversity benefits, financial support for small and medium-scale enterprises (SMEs) engaged in these sectors is needed. However, private sector biodiversity projects face a scarcity of financing alternatives. To date, financial support for biodiversity-linked projects has come mainly in the form of subsidized funds such as grants or low-interest loans from NGOs, foundations, and multilateral and bilateral agencies. Private equity capital for SMEs is scarce throughout Latin America. Similarly, local commercial banks have little interest in lending to this sector due to a lack of familiarity with it. If local bank debt is available, it is for very short terms and at prohibitively high interest rates. Multilateral institutions, including IFC, as well as bilateral organizations and foundations, either find most of these projects too small for direct financing or target microenterprises. Finally, foreign private equity/venture capital funds seek larger investments or focus on the energy or telecommunications sectors. Therefore, a private equity fund is one of the few viable approaches □ o mobilizing private capital to help entrepreneurs start and expand biodiversity-linked businesses.

13. Investment Opportunities: The following descriptions illustrate the types of sectors and projects in which the Fund may invest. The presence of project examples is for illustrative purposes only and does not necessarily imply that the Fund is considering a particular investment. Statistics are based on information for the most recent year for which such information is available. However, because biodiversity-linked industries are in the nascent stages of development, statistics and other information concerning those industries are difficult to obtain and may be unreliable. Different sources may report different statistical or other information about a particular industry based on, among other things, the inclusion or exclusion of different businesses within a particular industry. There can be no assurance that market projections will be achieved.

14. Conservation activities, government policies, and market demand for "environmentally certified" products are expanding markets for businesses in agriculture, forestry, tourism, and other sectors with projects that sustainably use, minimize adverse impacts on, or help to conserve, protect, or take development pressure off biodiversity resources. Some food companies, for example, are positioning themselves to attract environmentally conscious consumers. International food companies have recently purchased organic food marketing and baby food companies in the United States and Europe. Goods labeled as environmentally friendly have been introduced for a variety of products such as tropical timber, guitars, bananas, tuna, and other seafood. In addition, certain Latin American, European, Japanese and United States companies reportedly are moving into the organic coffee business in Latin America. The Government of Argentina's agricultural export promotion program features organic producers.

15. The statistics in Table 1 indicate that world demand for biodiversity-linked products stemming from sustainable agriculture, sustainable forestry, non-timber forest products, and ecotourism should continue to grow during the next decade.

Table 1: Biodiversity Sectors					
Sector	Products	Principal Suppliers	Principal Consumers	Indicators of Size of Market	Projected Growth p.a.
Sustainable Agriculture	Organic fruits, vegetables, coffee, beef, etc.	Argentina, Brazil, Chile	Europe, US, Latin America, Japan	US/Europe US\$ 10 billion	20-25% p.a.
Aquaculture	Shrimp, shellfish, fish.	Brazil, Ecuador, Chile	US, Europe, Latin America	20% of world fish output (US shrimp imports alone are US\$2.3 billion)	10-15% p.a.
Sustainable Forest Management	Selectively harvested timber, plantation of local species	Brazil, Guyana, Surinam, Andean countries	U.S. Europe	Less than US\$50 million (wholesale) for certified tropical timber to US & Europe	50% p.a.
Non Timber Forest Products	Palm, nuts, teas	Brazil, Bolivia	Latin America, Europe, US	US\$450 million wholesale value from Amazon	10-20% p.a.
Ecotourism		Costa Rica, Ecuador, Brazil, Belize	US, Latin America, Europe	Part of nature tourism industry	10% p.a.

16. **Sustainable Agriculture:** Sustainable agriculture is low-impact agriculture which minimizes the use of chemical inputs and employs organic fertilizers, crop rotation, and integrated pest management. Certified organic agricultural products are a subset of sustainable agriculture and generally use no chemical inputs in production and processing. Organic products are certified by certification services following industry, association, and Government standards. Examples of certified-organic crops and value added products include coffee, cacao, olive oil, fruits, vegetables, beef, and cotton. From 1990 to 1995, there has been approximately 20 percent annual growth in sales of certified organic agricultural products in the United States. Certified organic agricultural sales reached an aggregate of US\$2.8 billion in the United States in 1995 and US\$6.8 billion in Europe in 1994 (latest years for which figures available). Natural food supermarket chains are expanding rapidly in the United States. Organic produce is now featured in supermarket chains in Brazil. This sector also includes crops certified by Rainforest Alliance's EcoOK program and other low-impact, high-output techniques that integrate biodiversity considerations into production (as described in recent World Bank publications).'

New Hope Communications Inc., Natural Foods Merchandizer, June. 1996. p. I

For example. Srivastava, Smith, and Forno. Biodiversity and Agriculture Intensification 1996.

17. **Other Agricultural Crops:** Latin America is the source of many underutilized plant and animal species, and agricultural by-products, which are attracting greater attention. The Andean region, for example, is home to roots, fruits, grains, vegetables and legumes whose use dates back to pre-Colombian times, some of which may present investment opportunities today. Other examples include naturally colored cottons; castor seed (for oils, resins, and plastics substitutes); fruit trees; wool from alpaca; and recycling of agricultural wastes into paper, animal feed, and other uses of biomass.

18. **Aquaculture:** The cultivation of aquatic species can be undertaken using sustainable practices that minimize negative impact on the local environment. In some cases, aquaculture is being used to restore wild stocks and to provide employment opportunities and an economic rationale for safeguarding the surrounding environment. The aquaculture industry, one of the fastest-growing agricultural sectors worldwide, now accounts for about twenty percent of world fish output; production is expected to continue to grow to meet rising demand for seafood products as wild catches decline or remain stable. In response to environmental challenges, some aquaculture companies are seeking to define and to practice sustainable farming. Examples include farming of native scallops and other mollusks in Chile and in the Ilha Grande archipelago in Brazil, which help to repopulate depleted native stocks and provide an economic incentive for maintaining the region's water quality; cultivation by research institutes and private companies in Brazil of some Amazonian fish threatened by overfishing; and the adoption by some shrimp farmers in Latin America of environmentally sensitive techniques (e.g., hatchery production of post-larvae, careful siting of farms within a coastal zone management plan to avoid overcrowding and preserve natural habitat, medium-density production, and better water management).

19. **Sustainable Forest Management:** Timber production from "sustainable" operations includes wood that has been certified as coming from low-impact logging of existing forests (where carefully selected trees are cut) or plantations of mixed local species on degraded land. With careful mapping, selective logging operations can reduce associated damage, lower fuel costs, leave more trees for later harvest, and require less cutting per hectare. Certification may be obtained from independent auditing companies or NGOs. International standards have been developed by the Forest Stewardship Council ("FSC"), an international certifier of certification organizations. Several European buyers have established certified timber purchasing mandates. Major wood buyers and furniture makers in the United Kingdom, Belgium, Japan, and the United States have formed buyers groups to ensure that their supplies come from certified sources. From 1992 to 1995, there has been about 50 percent per year growth in sales in the United States and Europe of environmentally certified tropical timber. The United States and European tropical lumber markets had a total value of US\$2.68 billion in annual sales in 1991.

¹ European statistics from Carl Haest, Global Partners (Belgium.), □ 1996.

s Statistics from the UN Food and Agriculture Organization; Aiken and Sinclair, "From Capture to Culture: Exploring the Limits of Marine Productivity," World Aquaculture, Sept 1995, at 26, Christiansen, "Cultivating the World's Demand for Seafood," New York Times, March 1, 1997, pB 1.
e T. Lent, "Buying the Solution: Demand for Better Forest Products is Growing Supply is Growing," Tomorrow, Apr- Jun. 1995, p. 60.

7 (P.N. Varangis, R. Crossley and P. Brega, CA.. "Is There a Commercial Case for Tropical Timber Certification?" World Bank Policy Research Working Paper No. 1479, Jun. 1995, pp. 10 and 17.

The World Bank estimates that 5-10 and 10-20 percent of the demand for tropical hardwoods in the United States and Europe, respectively, will be from certified sources in five years, as compared to less than one percent now.⁸ These figures do not include Asian markets, temperate zone woods, and plantation forestry. In Latin America, forest industries may benefit from an anticipated decline in log production in Africa and Asia because of extensive logging. Several companies in Latin America are following sustainable forest management practices and some of these companies produce doors and flooring for local and export markets. There are also opportunities for forest service companies which provide seedlings and planting services for reforestation using local species.

20. **Non-Timber Forest Products (NTFPs):** NTFPs include nuts, fruits, palm oils, and other products that have been selectively harvested to allow them to regenerate with minimal impact on intact or wild forests and other ecosystems. While this sector remains small and fragmented, opportunities for investment include projects in and near forests, equipment for processing NTFPs, and marketing companies. Product opportunities include natural rubber, palm oils, resins, fibers, nuts, fruits, dyes, latex, tannin chemical extracts, ornamental plants, and spices. Non-timber forest products, such as essential and edible oils, are part of the natural products industry, which grew from US\$4.64 billion in United States sales in 1991 to US\$9.14 billion in 1995.⁹ Sales are important in certain regions: the wholesale value of the 25 most important NTFP species in the Brazilian Amazon was about US\$450 million in 1992.¹⁰

21. **Ecotourism:** Ecotourism directly links the growth in nature-oriented recreational travel (including leisure, adventure, and educational activities) to pristine areas and the preservation of their biodiversity. Some ecotourism projects allocate a percentage of their profits or land to help preserve natural habitats (e.g. forests and coral reefs) and are designed to minimize negative impacts on biological resources. Ecotourism is a small but growing part of the world nature tourism market (which includes all outdoor, nature-based tourism). There are no reliable figures available for nature-based tourism or ecotourism and estimates range widely (depending upon the definition and source). Although estimates for nature-based tourism are as high as US\$238 billion in global annual sales in 1994, ecotourism is a small fraction of this total.⁷ Potential centers of ecotourism in Latin America include Argentina, Ecuador, Costa Rica, and Brazil. Some Latin American governments are adopting policies to promote ecotourism. In addition, ecotourism societies, NGOs and governments are developing guidelines to ensure the uniform development of the industry. Examples of projects include hotel developments in Brazil in the Atlantic forest area, the Amazon, and the Pantanal which are tied to preserving adjacent ecologically sensitive land or aquatic resources and which can serve as a base for regional tourism activities such as forest visits and the viewing of rare orchids, plants and birds; and smaller ecotourism hotels in Peru, Argentina (Patagonia), and Ecuador.

s Ibid. p.10.

⁹ New Hope Communications, Inc., Natural Foods Merchandizer, June, 1995. at 3.

¹⁰ E. Richardson, Research and Extension Prospects for Fuel and Food-Related Extracted Products, report No. 007/BIRDIII to the Instituto Interamericano de Cooperacao para Agricultura, 1995.

⁷ Brandon. "Ecotourism and Conservation: A Review of Key Issues." World Bank Environment Department paper No. 033. Apr. 1996, ch. 2. at 3, citing McKinsey Group, 1991; Lindbergh. "Quantifying Ecotourism - Are Reliable Statistics in Sight?" The Ecotourism Society Newsletter. quoting statistics provided by the World

III. PROJECT OBJECTIVE

22. **Fund Objective:** The purpose of the Fund is to attract commercial capital into biodiversity-linked projects. The Fund's underlying premise is that private sector participation in the sustainable use of biodiversity is indispensable for the long-term conservation of biodiversity. By developing economic value from biodiversity, the users and owners of biodiversity will have an incentive to protect these assets in the long run. The Fund's objective is to realize long-term capital appreciation through equity or quasi-equity investments in enterprises in Latin America that sustainably use or protect biodiversity. The Fund will catalyze and encourage biodiversity business opportunities by bringing together investment management expertise, advanced sector know-how, and both local and foreign investment capital and make these resources available to small and medium-sized businesses in biodiversity-linked sectors. *

23. **Demonstration Effect:** The Fund will be the first institutional effort at investing in private sector biodiversity projects in the world. The success of this project will have an important demonstration effect with respect to the viability of such projects and will be a catalyst for further investment in businesses and funds with a similar focus. The FMC and Biodiversity Advisory Board will help to establish and disseminate standards and best practices.

IV. RATIONALE FOR GEF FUNDING

24. **Global Environment Objectives:** The Convention on Biological Diversity challenges countries to seek and encourage new financial resources, including private sector resources, to implement the objectives of the Convention. The problems recognized by the Convention will not be solved unless economic reasons for protecting and sustainably using biodiversity are developed and unless the private sector contributes its vast technical, managerial, and financial resources and expertise. The Fund will respond to the challenge of the Convention, demonstrate a new financing method, and leverage the investment of entrepreneurs and co-investors in projects with biodiversity benefits, projects that would likely not have been financed, at least in the near to medium term. *

25. **GEF Operational Strategy:** The GEF Operational Strategy contains objectives, operational programs, examples, and language that support the use of GEF funds by the Fund. The Strategy calls for "establishing long-term funding mechanisms for long-term biodiversity protection;" "strategic," "cost-effective," and "demonstration" projects; "innovative measures;" and projects that help countries achieve biodiversity objectives through "successful integration of biodiversity programs into the wider economic, social, and cultural context." The Strategy notes that "activities that involve biodiversity management within the productive sectors of an economy are likely to lead to long-term sustainability" and "several sectors, such as forestry, agriculture, fisheries, and tourism draw upon biodiversity assets." The Strategy indicates that "incremental costs of activities for conservation and sustainable use of biological resources ... will include ... promotion of sustainable production and use of natural products, such as non-timber forest products, wild relatives of domesticated species, and agrobiodiversity products... development of environmentally sustainable nature-based tourism." The Fund's activities may

come under both "long-term protection and sustainable use of biodiversity" and "short-term response measures" and the Fund's investments may fall under one or more of the four "operational programs" of the GEF (addressing four types of ecosystems: arid and semi-arid; coastal, marine, and freshwater; forest; and mountain ecosystems). The Fund will help to remove market barriers to the financing of private sector projects with biodiversity benefits.

V. PROJECT DESCRIPTION

26. **The Fund:** The Fund is expected to be a US\$20-50 million fund with an initial term of ten years and an option for three one-year extensions. Although the FMC will be based in Brazil, the Fund will consider investments in all Latin American countries that have ratified the Convention on Biological Diversity. The Fund will have a Board of Directors designated by the principal shareholders. The Board, or an Investment Committee (both of which will include IFC), will approve investments recommended by the FMC. The Fund's legal structure and domicile would be determined by investor requirements and tax considerations. The Fund is likely to make 10 to 20 investments during the first five years of the life of the Fund. The Fund will provide a portion of the investment costs for small and medium-sized projects with total costs likely to be in the US\$500,000 to US\$ 10 million range. During the latter years of the Fund's 10-13 year life, the Fund will distribute to investors proceeds from the sale of its investments. The Fund's investments will be sold through a variety of "exit mechanisms" including public stock exchange listings and private sales to strategic investors.

27. **Potential Investors:** The Fund is expected to raise between US\$20 and US\$50 million in committed capital. A first closing will be held at about US\$20 million in committed capital, a level estimated to be sufficient to support the operating costs of the FMC. Prospective investors for the first closing include, in addition to IFC, private sector investors, Latin American pension funds, bilateral agencies, and development banks. A second closing would be expected within 12 months of the first closing and would aim to raise the Fund's aggregate capital commitments up to US\$50 million. The Fund would target a broader investor base for the second round, including institutional and private investors in the North America, Europe, Japan, and Latin America.

28. **The Fund Management Company:** The Fund will be managed by a new FMC, Terra Capital Advisors, the principal shareholders of which will be Banco Axial S.A. and Environmental Enterprises Assistance Fund (EEAF). IFC and Dr. Marcelo Andrade will also be shareholders in the FMC. The FMC will identify, structure, negotiate, and implement Fund investments; monitor financial and biodiversity aspects of Fund investments; provide valueenhancing technical assistance to portfolio investee companies; execute divestitures of portfolio investments; and report on the Fund's investments. The FMC's fee will be within typical industry norms and include a management fee paid annually to cover operating costs (estimated at 2.5% of invested capital) and a performance incentive tied to the Fund's net realized gains.

29. The FMC's partners combine experience in venture capital, biodiversity project management, and commercial banking with relationships with a wide range of stakeholders and NGOs throughout Latin America:

- Banco Axial is a new (1996) investment bank based in Sao Paulo, Brazil, providing **investment banking services** to medium-scale enterprises. A central component of Banco Axial's strategy is to serve Latin America's environmental sector. Axial is managed by a team with strong banking and investment project transaction experience. Axial's principals have hands-on agricultural experience in Latin America and are active in Brazilian and international environmental NGOs.
- EEAF, a nonprofit environmental organization created in 1990 and based in the United States, manages US\$ 15 million in funds dedicated to environmental investments in emerging markets. EEAF has made 22 investments to date mostly through its wholly-owned affiliate in Central America (Empresas Ambientales de Centro America), but also in the Philippines, Indonesia, and Poland in ecotourism, forestry, renewable energy and energy efficiency, organic agriculture, agricultural waste recycling, and pollution control projects. EEAF is staffed with experienced private sector professionals who understand the priorities of profit-making and environmental issues. EEAF received a loan from the IFC/GEF Small and Medium Scale Enterprise Program for investments in Central America and Southeast Asia. *increasing.*
- Dr. Marcelo Andrade is the founder of Pro-Natura International, one of the first international environmental organizations founded in the Southern Hemisphere (1986). Pro-Natura has its principal offices in Rio de Janeiro and Paris, France, and manages conservation projects funded by international organizations, governments, and the private sector in Brazil, Central America, West Africa and elsewhere.

30. The FMC will be staffed by largely Latin American professionals with both financial and biodiversity expertise. John Forgach, Executive Vice President of Axial, will manage the day-to-day activities of the Fund. Mr. Forgach, Brazilian, has had a successful international career in finance and trading, and is actively involved in wildlife conservation through START, a Brazilian NGO for the care and translocation of confiscated wildlife. Brooks Browne, the President of EEAF, will, with other EEAF staff, serve as the Fund's venture capital advisor. Previously, Mr. Browne served as President and Chief Operating Officer for Allied Capital Advisors, a publicly traded company that manages 5500 million in venture capital funds. Dr. Andrade will focus on project identification. In addition, key FMC hires will include investment officers and a biodiversity or technical expert.

31. **Biodiversity Advisory Board:** The Biodiversity Advisory Board will consist of individuals selected by the FMC from a variety of groups (such as research, scientific, NGO, business, and government organizations) and one person from the GEF's Science and Technical Advisory Panel (STAP) Roster of Experts. The Biodiversity Advisory Board will also include a representative of the Government of Brazil (appointed by the Government of Brazil) and an IFC representative (appointed by IFC). The Biodiversity Advisory Board will have two roles: a) the biodiversity investment criteria to be used by the Fund will be established by the FMC in consultation with the Biodiversity Advisory Board; and b) the Biodiversity Advisory Board will be called on by the FMC for advice on particular investments to be made by the Fund.

32. **Investment Guidelines:** The Fund will operate under investment guidelines to be established by its Board of Directors. It is expected that such guidelines will take into account the following criteria: Investments will be made on commercial terms to support private companies, in both start-up and expansion stages, with restructuring, modernization, expansion, acquisition, and new product development. The investment criteria will include potential for solid returns on investment and sustainable uses of biodiversity. The Fund will leverage its resources with other co-investors including local banks and investors and strategic, technology, or marketing partners. The Fund will normally invest only in companies where management and co-investors have a proven track record. Pilot projects in research and development for new technologies will generally not be considered. The Fund is likely to have other specific guidelines in areas such as single company exposure limits.

33. The Fund will focus on investments in the sectors discussed above, including sustainable agriculture, sustainable forestry, ecotourism, non-timber forest products and other sectors and projects (e.g., certain types of wastewater treatment and alternative livelihood projects) that have a direct link to the sustainable use or conservation and protection of biodiversity. ? ,
dubious?

34. The Fund anticipates considering investments in biodiversity companies and projects in need of investment at various stages of the product cycle, from production to processing, marketing and distribution, such as: small and medium-sized businesses in start-up or expansion phases; established businesses that want to convert to sustainable practices; cooperatives seeking links with processing and marketing companies; and service companies that certify business operations as satisfying specified environmental criteria and market environmentally sustainable products.

35. **Biodiversity Criteria:** The biodiversity investment criteria will be established by the FMC in consultation with a Biodiversity Advisory Board. The biodiversity criteria will be consistent with the GEF Operational Strategy, applicable national laws and policies, the World Bank's Environmental Policies and Guidelines, and may include international environmental standards or best practices for agriculture, forestry, and tourism. A link to the sustainable or environmentally sensitive use or preservation of biodiversity will be made for each investment by the Fund.

36. The Fund will describe and document the link to biodiversity in each of its investments. The analysis may include a typical "with and without" the project analysis and a review of likely alternative uses. For example, cutting down a forest to grow organic coffee is not biodiversity-friendly; however, planting organic/shade-grown coffee on degraded land in buffer zones around a natural forest is biodiversity-friendly (extends forest cover and habitat, improves soil fertility). In some cases the link to biodiversity benefits will be strong, as in the example of shade coffee or in cases of selective logging of secondary forests or NTFP projects that do not disturb forest habitat. In other cases, the effects are less certain and may be uncertain. For example, the culture of Amazonian fish is cited by some experts as having biodiversity and economic benefits for the region.¹ Aquaculture can take pressure off wild-caught fish if buyers switch to the farmed

✓
local benefits.
100
X
100

north-eastern Brazil and Andean countries. Moreover, projects will help to preserve natural habitats, contribute to a cleaner environment, and promote the sustainable use of biodiversity resources, all of which are long term development goals for Latin America.

VIII. PARTICIPATION

42. The Fund will engage in a variety of participation, outreach, and consultation activities:

- The Fund will bring together private sector, foundation, and bilateral and multilateral investors and will engage medium-sized enterprises by investing in their projects.
- The Biodiversity Advisory Board will include members from universities, NGOs, business groups, government ministries, and the STAP roster of experts.
- Investment project reviews and implementation will include consultation with local communities and other stakeholders when appropriate.
- The design phase of the Fund included consultations with local, regional, and international NGOs; foundations; scientific, agriculture and forestry certification, ecotourism, and private sector organizations; FUNBIO (the Brazilian trust fund for small biodiversity projects); ministries of Latin American governments; and bilateral and multilateral institutions.
- The FMC will consult with, and in some cases may co-invest with, other sources of financing in the region such as commercial banks, government development banks, trust funds, NGOs, and bilateral and multilateral institutions.

IX. LESSONS LEARNED

43. Most GEF-eligible private sector Biodiversity projects identified by or brought to IFC are too small for direct investment by IFC. IFC has been seeking ways to invest in smaller and medium sized projects through financial intermediaries such as banks, investment companies, and NGOs. The IFC/GEF Small and Medium Scale Enterprise Program is an example. The proposed Fund will co-finance projects that are in general larger than those targeted by the SME program. The lessons learned from IFC's extensive participation in venture capital and investment companies during the past 20 years, the experience of the handful of other environmental investment funds, and the lessons learned from GEF and other biodiversity projects (both public and private sector) will be incorporated in the design and supervision of the proposed Fund.¹³

X. RISKS AND ISSUES

¹³ IFC's experience is described in the 1996 IFC publication "Investment Funds in Emerging Markets" by Laurence Carter.

44. **Mobilization Risk:** While several investors have indicated an interest in the Fund, there is a risk that the amount raised from investors will be lower than the targeted amount. The Fund will require a minimum of US\$15 million to close. ٢٥

45. **Deal Flow Risk:** There is a risk that the number of projects in the US\$500,000 to US\$ 10 million size may be fewer than anticipated which could slow disbursements from the Fund and put pressure on the Fund to make lower-quality investments. ٢٥

46. **Management Risk:** Few fund management companies in Latin America have venture capital management or biodiversity experience. However, the FMC combines investment and commercial banking, venture capital, and environmental NGO experience. IFC, through its seats on the Investment Committee and Board of Directors of the Fund and the Biodiversity Advisory Board, will monitor the financial, biodiversity, and environmental activities of the FMC.

47. **Public Relations and Biodiversity Definition Risk:** There may be a lack of consensus among NGOs, governments, and others as to what constitutes an appropriate biodiversity investment, the acceptable biodiversity impacts of investments, and the relative priority of biodiversity problems. This lack of consensus and differing expectations about the Fund may increase the amount of time devoted by the FMC to public relations. The lack of consistent, accepted guidelines for the sustainable use of biodiversity is also a risk, particularly for ecotourism projects. Stakeholders, investors, and governments should keep in mind that the proposed Fund will be a demonstration, first of its kind, effort. Lessons learned from the experiences of the Fund will help the international community to define best practices, impacts, and sustainable uses.

48. **Biodiversity Risk:** Despite rigorous screening by the FMC, review by the Biodiversity Advisory Board, and the adoption of best practices by investee companies, investment projects may create unintended negative impacts on biodiversity resources. As a risk mitigation strategy, Fund investments will be monitored and evaluated for compliance with relevant standards. The Fund will terminate investments in any project that deliberately causes biodiversity damage.

49. **Exit Risk:** The Fund may have difficulties in selling or "exiting" its investments. The Fund's investments in unlisted companies are subject to less liquidity and greater risks than those inherent in listed companies. To partially mitigate this risk, an exit mechanism will be structured for each investment prior to the Fund's investment in an enterprise.

Schedule A INCREMENTAL COSTS AND USE OF GEF FUNDS

Type of Incremental Cost

1. According to discussions with and guidance from the GEF Secretariat, private sector

projects may incur "direct incremental costs" and/or "incremental risks." The incremental costs or risks can be incurred by either an individual enterprise or by an intermediary providing financing to several enterprises. The type of incremental costs to be financed by the GEF in the case of Terra Capital Fund are the "intermediary direct incremental costs" incurred by the Fund Management Company (FMC), an intermediary. In general, intermediary direct incremental costs may be the additional costs of training and new procedures, and the higher administrative costs of processing and supervising an unfamiliar portfolio in a financially responsible way. The baseline situation is the normal costs of banking or the normal costs of a financial intermediary in the country or region concerned.

Broad Development Goals

2. The overall development goal is to leverage investment into biodiversity-linked projects that will be financially sustainable and produce biodiversity benefits. The Fund's underlying premise is that private sector participation in the sustainable use of biodiversity is indispensable for the long-term conservation of biodiversity. The countries of Latin America from which Fund investments may be selected are countries that have acceded to or ratified the Convention. Many of these countries (including Brazil, the location of the FMC) have corresponding national biodiversity plans that reference the role of the private sector. Government ministries and agencies, NGOs, and other stakeholders are actively working with the private sector to implement national biodiversity and other environmental objectives in Latin American countries. These countries are seeking the financial additionality and leverage of private sector investments in projects with biodiversity benefits.

Global Environmental objectives

3. The global environmental objectives are outlined in paragraph 24 above.

Baseline

The baseline or business as usual case is that a fund like Terra Capital Fund (with both financial and biodiversity objectives bringing together investment management expertise, sector know-how, and both local and foreign capital and making these resources available to small and medium-sized businesses) simply would not be created absent the GEF funding because of the direct incremental costs faced by the FMC (the intermediary). The proposed Fund would not be created and would not attract investor interest for several reasons: 1) the uncertainties inherent in investing in new biodiversity-linked market sectors and in projects that must meet both financial and biodiversity criteria; and 2) the FMC's unusually high annual operating costs which are likely to be at least double those of a typical investment fund because of the high project

identification, review, and transactions costs for biodiversity-linked projects (for example, biodiversity-specific project screening, review, monitoring and evaluation are not part of a typical fund manager's activities) and due to the relatively small size, regional scope (most funds are country or sub-country specific), and innovative nature of the Fund. Thus without the GEF grant funds to leverage the creation of the Fund, the biodiversity-linked companies in the region that might be eligible for the Fund would have to seek and compete for scarce long term capital from national development banks, international organizations, and the few investment funds operating in the region. As noted earlier, these banks and funds focus on larger or more traditional manufacturing and industrial, or infrastructure, projects.

The Alternative

5. The alternative is the proposed Terra Capital Fund. The GEF grant funds will help to remove or reduce the second constraint listed above to creating the Fund. The GEF funds will cover the FMC's annual operating costs that are over and above those of a normal or typical equity fund. The GEF funds will not be used to make direct Fund investments in the investee companies or investment projects. Rather, by covering the higher-than-normal Fund operating costs, the GEF funds will make it possible for the actual investments by the Fund to be made on commercial terms. In addition, it is expected that over time the investment activities of the Fund will, to the extent they succeed, help to alleviate the first constraint listed above.

Incremental Costs and Scope of the Analysis

6. The incremental costs for this project are the additional operating costs incurred by the FMC due to the Fund's specialized focus on biodiversity. The costs of managing the Fund *will* exceed the normal operating costs of a private equity fund due to the limited availability of information on investing in biodiversity-related enterprises as well as the need to evaluate and monitor the biodiversity impact of each investment. The baseline situation used in this case is hence the normal cost of managing an investment fund. *The GEF funds will only be used to and the incremental costs of the intermediary (the FMC; the GEF funds will not be invested in any of the companies financed by the Fund*

7. The \$5 million GEF grant figure was derived as follows: A private equity fund manager typically charges an annual fee to a fund of 2% to 3% of committed capital to cover fund management costs (if the fee is higher than this, it becomes difficult to attract investors to the Fund due to the adverse impact on their expected returns). This fee covers staff, office/overhead, travel, legal, and other costs of making investments and managing a fund. However, because of the additional biodiversity-linked operational costs, the total annual operating budget of the FMC is expected to average up to 5% of the committed capital in the Fund, or US\$1.0-1.2 million per year. Estimation of this budget is based on standard industry practices, IFC's extensive experience with investment funds in emerging markets (number of investment officers, trips, and other expenses per project) and estimates of the additional work load and costs required for the biodiversity aspects of the FMC's work. Thus, the proposed 2.5% FMC fee is expected to cover about half of the operating costs of the FMC, and the US\$5 million GEF grant (which averages

to US\$500,000 per year over the life of the Fund) will cover the balance (i.e., the incremental costs related to operating a biodiversity-oriented investment fund).

8. The additional costs incurred by the FMC due to the Fund's focus on biodiversity are expected to include: 1) the incremental staff, consultant, and travel expenses for identifying, screening, evaluating, structuring, and supervising biodiversity-linked projects; 2) biodiversity monitoring and evaluation; 3) maintaining the Biodiversity Advisory Board and establishing biodiversity guidelines for use by the Fund; and 4) stakeholder consultations and technical assistance. However, an exact breakdown between the FMC's "normal" and "biodiversity" costs is not possible because many of these costs are interrelated. While certain types of additional biodiversity costs are readily identified (e.g., establishing biodiversity guidelines for use by the Fund, maintaining the Biodiversity Advisory Board, and monitoring the biodiversity aspects of projects), others are more closely linked with the general operations of the FMC and hence harder to quantify as separable incremental costs (e.g., identifying eligible projects, structuring projects to meet biodiversity considerations, and working with smaller or newer ventures that offer promising biodiversity benefits). Nonetheless, such indirect incremental costs are additional to those of a normal investment fund.

9. As noted above, the proposed FMC budget has been carefully reviewed by IFC capital markets and environmental specialists, and IFC management believes that the additional costs represent an efficient use of GEF funds. Furthermore, as the project is implemented, IFC will consider both the specific biodiversity-related expenses and the general biodiversity aspects of the Fund's operations when approving the annual allocation of GEF funds to the FMC (please see Schedule B for expected annual disbursements). If the costs incurred by the FMC in excess of 2.5% are not deemed to be justified by IFC (i.e., if the additional costs relate to excesses or inefficiencies in the operation of the FMC instead of the biodiversity focus), IFC will reduce the subsequent funding from GEF accordingly. IFC will use its extensive experience as an investor in equity funds as a guide in reviewing the FMC's operations and budgets.

10. In a mature industry sector, the incremental costs are more likely to be provided or absorbed by the FMC or the Fund's investment projects as a normal business expense. It is hoped that the demonstration effect and lessons learned from the Fund will: a) increase market and investor awareness and acceptance of biodiversity-linked projects and investment funds, b) help to establish and encourage the refinement and further use of biodiversity guidelines and best practices (once established and in use these guidelines will likely reduce the due diligence costs of other biodiversity investment funds), and c) encourage the formation of larger funds and projects (thereby also reducing FMC costs as a percentage of invested capital and allowing the FMC to absorb some of the biodiversity-linked due diligence costs as a normal cost of business).

Process of Agreement

11. Grant funds will be advanced to the FMC in annual installments upon approval by IFC from the World Bank administered GEF Trust Fund. IFC **will** monitor the FMC's use of the GEF grant funds. The FMC **will** be required to keep separate accounts of the uses of the GEF grant funds and provide suitable administrative and accounting reports to IFC. IFC **will** report

annually in writing to the World Bank Global Environment Division and the GEF Secretariat on the use of GEF funds by the FMC, including both an accounting of the funds being expended and an assessment of whether the FMC is using the GEF funds in an appropriate manner. Yearly adjustments to the budget will be approved by IFC. Budgets in years 1-3 are expected to be somewhat higher (while investments are identified and screened) and somewhat lower in years 8-10 (while investments are supervised).

Schedule B SUMMARY OF DISBURSEMENT ARRANGEMENTS

The US \$5 million GEF grant will be disbursed from the GEF Trust Fund in annual installments to the Fund Management Company (FMC) during the ten year life of the Fund upon approval of an annual FMC budget by IFC. The expected disbursement schedule will be US\$700,000 for years 1-3, US\$500,000 for years 4-7, and US\$300,000 for years 8-10.

Schedule C TIMETABLE OF KEY PROJECT EVENTS

Time taken to prepare the project	3 years
IFC management approval granted to project concept	October 1995
GEF Council Endorsement ~'	October 1995
Project will become effective when US\$15 million to US\$20 million is invested in the Fund ✓ (termed the "first closing" of the Fund).	

INVESTMENT NUMBER 7466

**GEF Trust Fund
Project Grant Agreement**

between

TERRA CAPITAL ADVISORS LIMITED

and

INTERNATIONAL FINANCE CORPORATION

**Acting on behalf of
INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT
as an Implementing Agency of the Global Environment Facility Trust Fund**

Dated as of October 27, 1998

<u>Article or Section</u>	<u>Item</u>	<u>Page No.</u>
ARTICLE VI		11
Events of Default		11
Section 6.01. <u>Events of Default</u>		11
ARTICLE VII		12
Miscellaneous		12
Section 7.01. <u>Notices</u>		12
Section 7.02. <u>Evidence of Authority</u>		13
Section 7.03. <u>English Language</u>		13
Section 7.04. <u>Indemnification</u>		13
Section 7.05. <u>Remittance of Funds</u>		14
Section 7.06. <u>Term of Agreement</u>		14
Section 7.07. <u>Jurisdiction</u>		14
Section 7.08. <u>Successors and Assigns</u>		14
Section 7.09. <u>Counterparts</u>		14
<u>SCHEDULE 1</u>		16
<u>INCREMENTAL COSTS AND USE</u>		16
<u>SCHEDULE 2</u>		18
<u>Form of GEF Grant Disbursement Request</u>		18
<u>SCHEDULE 3</u>		22
<u>Form of GEF Grant Disbursement Receipt</u>		22
<u>SCHEDULE 4</u>		24
<u>Form of Certificate of Incumbency and Authority</u>		24
<u>SCHEDULE 5</u>		26
<u>Form of Letter to Auditors</u>		26

ARTICLE I

Definitions

Section 1.01. Definitions. In this Agreement, unless the context otherwise requires, capitalized terms (other than for grammatical reasons) shall have the meanings assigned thereto herein. Capitalized terms not defined herein shall have the meanings assigned thereto in that certain Shareholders Agreement referred to in Article III hereof.

Section 1.02. Interpretation. In this Agreement, unless the context otherwise requires:

- (a) headings and underlinings are for convenience only and do not affect the interpretation of this Agreement;
- (b) words importing the singular include the plural and vice versa;
- (c) an expression importing a natural person includes any company, partnership, trust, joint venture, association, corporation or other body corporate and any governmental or semi governmental authority or agency;
- (d) a reference to a Section, Article, paragraph, party, Annex, Exhibit or Schedule is a reference to a Section, Article and paragraph of, and a party, Annex, Exhibit and Schedule to, this Agreement;
- (e) a reference to a document includes an amendment or supplement to, or replacement or novation of, that document but disregarding any amendment, supplement, replacement or novation made in breach of this Agreement; and
- (f) a reference to a party to any document includes that party's successors and permitted assigns.

ARTICLE II

The GEF Grant

Section 2.01. Amount. IFC agrees, in its capacity as administrator and manager of funds from the GEF pursuant to the Arrangements, to make available

their terms, (ii) the Recipient shall have performed all of its obligations theretofore to be performed under the Terra Capital Program Documents, and (iii) the fulfillment, in a manner satisfactory to IFC, prior to or concurrently with the making of such first disbursement, of the following further conditions:

- (a) no Event of Default or potential Event of Default as specified in Section 6.01 of this Agreement has occurred and is continuing and there is no default or anticipated default by the Recipient;
- (b) since the date of this Agreement nothing has occurred which might materially and adversely affect the Recipient's business prospects or financial condition, or make it improbable that the Recipient will not be able to observe or perform any of its obligations under the Terra Capital Program Documents, nor has the Recipient incurred any material loss or liability;
- (c) the Recipient has provided, and IFC has approved, an annual budget of the Recipient with respect to the Terra Capital Program;
- (d) the Recipient shall have opened the GEF Grant Account in form and substance satisfactory to IFC;
- (e) a copy of the authorization to the Recipient's auditors referred to in Section 5.01(b)(iii), in the form of Schedule 5, shall have been furnished to IFC;
- (f) the evidence of signature authority and specimen signatures referred to in Section 7.02, in the form of Schedule 4, shall have been furnished to IFC;
- (g) the proceeds of the disbursement are not in reimbursement of, or to be used for, expenditures in the territories of any country which is not a member of IFC or the IBRD or for goods produced in or services supplied from any such country; and
- (h) the Company shall have entered into binding subscription agreements with investors representing Capital Commitments (as defined therein) of at least US\$15 million. ✓

Section 2.04. Conditions of Subsequent Disbursements. The obligation of IFC to make any disbursement subsequent to the first disbursement of the GEF Grant shall be subject to the performance by the Recipient of all its obligations theretofore to be performed under the Terra Capital Program Documents and to the fulfillment, in a manner satisfactory to IFC, prior to or concurrently with the making of each such disbursement, of the following further conditions:

foregoing, if upon cancellation of the GEF Grant any disbursed but unused portion thereof is subject to a binding contractual obligation ("Contractual Amount") in favor of any third party previously entered into prior to such cancellation in compliance with the provisions of this Agreement, the Recipient shall not be required to remit the Contractual Amount.

ARTICLE III

The Terra Capital Program

Section 3.01. Objective. The Terra Capital Program consists of the creation of Terra Capital Investors Limited, a British Virgin Islands limited liability company (the "Company"), and its operation as a specialized investment vehicle to seek private equity investments in private sector enterprises engaged in the sustainable and commercially viable use or enhancement of biodiversity in Latin America, and the creation of the Recipient to provide the necessary management and related services to the Company. The Terra Capital Program will also encompass the expected future creation and operation of Terra Capital Mutual Emerging Company Investing Fund, a mutual emerging company investment fund in the Republic of Brazil (the "Brazilian Fund"), which shall have the same purpose and objectives as the Company. Management and related services to the Brazilian Fund will also be provided by the Recipient (through its subsidiary). The Company and the Brazilian Fund (upon its creation) will operate in accordance with their respective charter documents and the following related agreements and other instruments: (i) the Shareholders Agreement between the Company, its shareholders and any other party named therein, (ii) the Brazilian Joint Investment Agreement between the Company, the Brazilian Fund, the Recipient, and any other party named therein (in the case of the Company, prior to the inception of the Brazilian Fund, as such agreement is made applicable to the Company by virtue of the provisions of the other agreements herein listed), (iii) the Terra Capital Investors Limited Investment Advisory Agreement between the Company, the Recipient, and the other parties named therein, (iv) the Investment Guidelines for the Company and the Brazilian Fund and (v) the Biodiversity Criteria. For purposes of this Agreement, except if the context otherwise requires, references to the Company shall mean and be interpreted to include, following its creation, the Brazilian Fund.

all the
to be
Brazilian Company.

all legal
docs.

Never prepared.
as no agreement
completed. only legal
docs. legally to do
w/ the funds
etc.

Section 3.02. Application of Funds. The funds of the GEF Grant shall be applied exclusively to the costs expended on the Terra Capital Program in accordance with Schedule 1 hereto.

proposed investment under the Terra Capital Program; (ii) evaluate and document the proposed investment in terms of the Biodiversity Criteria, including consistency with the GEF Operational Strategy; and (iii) submit the biodiversity documentation and evaluation pursuant to (i) and (ii) above to the Biodiversity Advisory Board for comments (for a period of ten (10) days). The biodiversity documentation, evaluation and comments (if any) pursuant to (i), (ii) and (iii) above shall be made available to the Investment Committee for consideration in the investment approval process. The Recipient shall also monitor and evaluate the net biodiversity impact of each such investment at least on a yearly basis. The annual report provided by the Recipient in accordance with Section 5.01(c) shall satisfy the requirement of this Section.

ARTICLE V

Covenants

Section 5.01. Covenants. Unless IFC shall otherwise agree, the Recipient shall:

(a) maintain separate books of account and other records adequate to monitor and record the expenses incurred for the GEF Grant;

(b) as soon as available but, in any event, within one hundred and twenty (120) days after the end of each fiscal year, furnish to IFC for transmittal to IBRD:

(i) two (2) copies of its complete financial statements and the financial statements of the Company for such Fiscal Year (which are in agreement with their respective books of account and prepared in accordance with U.S. generally accepted accounting principles consistently applied or, in the case of any Brazilian entity, generally accepted accounting principles in Brazil, consistently applied), together with an audit report thereon, all in form satisfactory to IFC;

(ii) a copy of any management letter or other material communication sent by the Recipient's auditors to it or to its management in relation to its financial, accounting and other systems, management and accounts that bear materially on the Terra Capital Program; and

ARTICLE VI

Events of Default

Section 6.01. Events of Default. If one or more of the events specified in this Section ("Events of Default") shall have happened and be continuing:

- (a) default shall have occurred in the performance of any obligation of the Recipient under this Agreement and any such default shall have continued for a period of thirty (30) days after notice thereof shall have been given to the Recipient by IFC; provided that if such default is not capable of being cured within thirty (30) days and the Recipient is diligently pursuing such cure, the thirty (30) day period shall be extended to ninety (90) day;
- (b) following the notification procedure set forth in Section 2.02(b), IFC shall have determined that the Recipient used or applied any of the proceeds of the GEF Grant to or for purposes different from those of the Terra Capital Program;
- (c) any authority having jurisdiction shall have imposed any tax or duty on the GEF Grant or in connection with the GEF Grant Agreement, and GEF or IFC shall have failed to remove such imposition after a diligent challenge thereof;
- (d) any government or governmental authority shall have condemned, nationalized, seized, or otherwise expropriated all or any substantial part of the property or other assets of the Recipient, the Company, or the Brazilian Fund, or of their capital, or shall have assumed custody or control of any property or other assets or of the business or operations of the Recipient, the Company, the Brazilian Fund, or of their capital, or shall have taken any action for the dissolution or disestablishment of the Recipient or any action that would prevent the Recipient, the Company, or the Brazilian Fund or their officers from carrying on their business or operations or a substantial part thereof; or
- (e) the Recipient or the Company or the Brazilian Fund shall (i) commence a voluntary case under any other applicable law relating to bankruptcy, insolvency or appointment of a receiver or trustee for the benefit of creditors (collectively, "Bankruptcy Action"); (ii) file an answer or other pleading admitting or failing to deny the material allegations of a petition filed against it in any Bankruptcy Action or acquiesce or fail to timely controvert the material allegations in any involuntary Bankruptcy Action; (iii) be subject to the entry of an order for relief in any involuntary Bankruptcy Action which order is not vacated within forty five (45) days; (iv) seek relief as a debtor under any

For the Recipient:

Terra Capital Advisors Limited
c/o Banco Axial
R. Dr. Fernandes Coelho, 85-5 and Sao Paolo S.P.
Brazil 05423-040

Attention: John Forgach

Alternative address for communications by facsimile:

(55-11) 870-1614

For IFC:

International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
United States of America

Attention: Director, Technical and Environmental Department

Alternative address for communications by telefax:

(202) 974-4349

Section 7.02. Evidence of Authority. The Recipient shall furnish or cause to be furnished to IFC evidence, in the form of Schedule 4, of the authority of the person or persons who will, on its behalf, sign the requests and certifications provided for in this Agreement, or take any other action or execute any other document required or permitted to be taken or executed by it and the authenticated specimen signature of each such person.

Section 7.03. English Language. All documents to be furnished or communications to be given or made under this Agreement shall be in the English language or, if in another language, shall be accompanied by a translation into English certified by a representative of the Recipient, which translation shall be the governing version between the Recipient and IFC.

Section 7.04. Indemnification. The Recipient hereby agrees and covenants to indemnify and hold harmless IFC and IBRD from and against any and all claims, demands, suits, causes of action, proceedings, losses, judgments, liabilities and expenses (collectively "Losses"), incurred by IFC and/or IBRD, including,

KIRKPATRICK & LOCKHART LLP

1800 MASSACHUSETTS AVENUE, N.W.
2ND FLOOR
WASHINGTON, D.C. 20036-1800

TELEPHONE (202) 778-9000
FACSIMILE (202) 778-9100
www.kl.com

ROBERT H. ROSENBLUM
(202) 778-9464
ROSENBRH@KL.COM

February 5, 1999

BY HAND.

Legalization Section
The Brazilian Embassy
3009 Whitehaven Street, N.W.
Washington, D.C. 20008

Re: Consularization of a Notarized Agreement

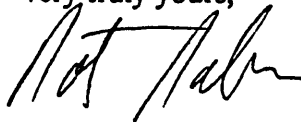
Dear Sir or Madam:

I enclose, for consularization by the Brazilian Embassy, an executed and notarized document entitled "GEF Trust Fund Project Grant Agreement." I also am enclosing a check in the amount of \$20.00 for the consularization process. Once the agreement has been consularized, which I understand should take about two business days, please call me and I will have a messenger pick up the agreement immediately.

Thank you for your assistance with this matter. Please feel free to call me with any questions or comments, and once the agreement has been consularized, at (202) 778-9464.

With regards,

Very truly yours,



Robert H. Rosenblum

Enclosures

INTERNATIONAL FINANCE CORPORATION

By A. Marmol
Authorized Representative

Washington, D.C.

Subscribed and sworn to before me
this 27th day of Jul. 19 99

S. P. Adicula
Sylvia P. Adicula
Notary Public District of Columbia
My Commission Expires July 31, 2003

SCHEDULE 1

Page 2 of 2

While certain types of additional biodiversity costs are readily identified (e.g., establishing biodiversity guidelines for use by the Company, maintaining the Biodiversity Advisory Board, and monitoring the net biodiversity impact of projects), others are more closely linked with the general operations of the Recipient and hence harder to quantify as separable incremental costs (e.g., identifying eligible projects, structuring projects to meet biodiversity considerations, and working with smaller or newer ventures that offer promising biodiversity benefits). Nonetheless, such indirect incremental costs are additional to those of a normal investment fund and are eligible for funding under the GEF Grant upon reasonable justification by the Recipient.

IFC APPROVAL AND REVIEW OF GRANT BUDGET

Grant funds will be advanced to the Recipient in quarterly installments in advance based upon prior approval by IFC of the annual budget of the Recipient (or proposed revisions thereto which are approved in advance by IFC) pursuant to Section 5.01(d). IFC will monitor the Recipient's use of the GEF Grant funds. The Recipient will be required to keep separate accounts of the uses of the GEF Grant funds and provide suitable and timely administrative and accounting reports to IFC.

IFC will consider the direct and indirect incremental costs related to the Company's focus on biodiversity, as described above, when approving the annual allocation of GEF funds to the Recipient. If the costs incurred by the Recipient in excess of 2.5% are not deemed to be justified by IFC (i.e., if the additional costs relate to excesses or inefficiencies in the operation of the Recipient instead of the biodiversity focus), IFC will reduce the subsequent funding from GEF accordingly. IFC will use its extensive experience as an investor in equity funds as a guide in reviewing the Recipient's operations and budgets. Budgets are expected to be somewhat higher in years 1-3 (while investments are identified and screened) and somewhat lower in years 8-10 (while investments are supervised).

References in this Schedule to the "Company" shall be deemed and interpreted to mean both the Company and the Brazilian Fund

SCHEDULE 2

Page 2 of 4

("Bank") with the Bank's correspondent in [New York]* for further crediting to the Recipient's account as follows:

Terra Capital's Bank Address:

Number of Terra Capital's Account:

Bank's Correspondent Address:

[New York], United States of America

Number of Bank's Account with Correspondent:

4. There is enclosed herewith a signed, but undated receipt for the amount of the GEF Grant hereby requested to be disbursed and the Recipient authorizes IFC to date such receipt with the date of actual disbursement by IFC.

5. For the purposes of Section 2.03 and 2.04 of the GEF Trust Fund Project Grant Agreement, the Recipient hereby certifies as follows:

- (a) no Event of Default or potential Event of Default as specified in Section 6.01 of this Agreement has occurred and is continuing and there is no default or anticipated default by the Recipient;
- (b) nothing has occurred which might materially and adversely affect the Recipient's business prospects or financial condition, or make it improbable that the Recipient will not be able to observe or perform any of its obligations under the Agreement, nor has the Recipient incurred any material loss or liability;

*The Recipient is responsible for obtaining any Central Bank approval, if required, for any off-shore deposits.

SCHEDULE 2

Page 4 of 4

If any of these certifications are no longer valid as of or prior to the date of the disbursement hereby requested, the Recipient will immediately notify IFC and will repay the amount disbursed upon demand by IFC if disbursement is made prior to the receipt of such notice.

Yours truly,

Terra Capital Advisors Limited

By

Authorized Representative*

* As named in the Recipient's Certificate of Incumbency and Authority (see Schedule 4).

SCHEDULE 4

Page 1 of 2

Form of Certificate of Incumbency and Authority

(Section 7.02 refers)
[To be typed on letterhead of
Terra Capital Advisors Limited]

[Date]

International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
United States of America

Gentlemen:

Certificate of Incumbency and Authority

With reference to the GEF Trust Fund Project Grant Agreement signed between us, dated October 27, 1998 (the "GEF Trust Fund Project Grant Agreement"), I the undersigned [] of Terra Capital Advisors Limited (the "Terra Capital") duly authorized by its Board of Directors, hereby certify that the following are the names, offices and true specimen signatures of the persons, each of whom will be, and shall continue to be (until you receive authorized written notice from the Recipient that they, or any of them, no longer continue to be), authorized:

- (1) to sign on behalf of the Recipient the requests for the disbursement of funds provided for in the GEF Trust Fund Project Grant Agreement;
- (2) to sign any certificate provided for in the GEF Trust Fund Project Grant Agreement; and
- (3) to take any other action required or permitted to be taken, done, signed or executed under the GEF Trust Fund Project Grant Agreement or any other agreement to which IFC and the Recipient may be parties.

SCHEDULE 5

Page 1 of 2

Form of Letter to Auditors
(Section 5.01(b)(iii) refers)

[To be typed on letterhead of
Terra Capital Advisors]

[Date]

[Auditors]

[Address]

Ladies and Gentlemen:

Terra Capital Advisors (the "Recipient") hereby authorizes and requests you to give to International Finance Corporation ("IFC") of 1818 H Street, N.W., Washington, D.C. 20433, United States of America, all such information as IFC may reasonably request with regard to the audited financial statements of the Recipient with respect to the Terra Capital Fund Program, which the Recipient has agreed to supply under the terms of the GEF Trust Fund Project Grant Agreement between the Recipient and IFC dated _____ (the "GEF Trust Fund Project Grant Agreement"). For your information, a copy of the GEF Trust Fund Project Grant Agreement is enclosed.

The Recipient authorizes you to send the audited accounts of the Recipient in respect of the Conversion Program to IFC to enable the Recipient to satisfy its obligations to IFC under Section 5.01 (b)(iii) of the GEF Trust Fund Project Grant Agreement; when submitting the same to IFC, you are also requested to send, at the same time, a copy of your full report on such accounts in a form acceptable to IFC. The Recipient also authorizes you to communicate directly with IFC at any time regarding the Recipient's accounts and operations in respect of the Terra Capital Fund Program.

SCHEDULE 5

Page 2 of 2

For our records, we should be obliged if you promptly furnish us a copy of every letter which you receive from IFC and a copy of each reply thereto made by you regarding the Terra Capital Program.

Yours truly,

Terra Capital Advisors Limited

By

Authorized Representative

cc: International Finance Corporation
2121 Pennsylvania Avenue, N.W.
Washington, D.C. 20433
United States of America

Attention: Director, Europe Department

product and if it provides alternative livelihood to fishermen. But if aquaculture encourages further exploitation of the wild fish, the impact on the wild stock may be negative. In some additional cases, the project's link to biodiversity will be indirect. Examples may include boat tours promoting wildlife viewing and scientific research or biodiversity-linked businesses that also support university and NGO programs directed to biodiversity conservation. Demonstration projects of various kinds generate benefits if others follow in their stead.

37. **Environmental Criteria:** The Fund will adhere to the World Bank Group's

environmental policies and guidelines. IFC will assess the FMC's capability to carry out environmental reviews on each investee company and periodically review the Fund's and the FMC's activities as part of IFC's supervision work. Staff of the FMC will be required to attend a standard IFC training program on the Bank's Environmental Policies and Guidelines.

38. **Monitoring and Evaluation:** The FMC (with the assistance of technical experts) will monitor and evaluate the financial, environmental, and biodiversity aspects of the Fund's investment projects and provide an annual report to shareholders (including IFC) and the GEF on biodiversity issues/benefits. Monitoring and evaluation criteria and methods will be established in consultation with the Fund's Biodiversity Advisory Board and IFC.

VI. PROJECT BUDGET AND FINANCING

39. **FMC Operating Budget:** The GEF will provide US\$5 million to the FMC for the FMC's incremental operating costs over and above a typical equity fund's costs. The other portion of the FMC's operating costs will be covered by a management fee expected to be 2.5% per year of the US\$20-50 million of capital invested in the Fund. The project budget is outlined in Schedule A, the incremental cost appendix. As discussed in Schedule A, IFC **will** administer the GEF funding on the basis of appropriate review and reporting procedures. This administrative role is in addition to IFC's role as an investor in the Fund and a shareholder in the FMC. IFC will report annually to the World Bank Global Environment Division and the GEF Secretariat on the use of GEF funds by the FMC. } 15

40. **Incremental Cost:** Described in Schedule A.

VII. PROJECT SUSTAINABILITY

41. The Fund will demonstrate the economic viability of private sector biodiversity projects and funds and **will** be a catalyst for further investment in biodiversity-linked businesses. The project will also establish one of the few venture capital management companies in the region and a company with the capability to screen projects for both investment and biodiversity objectives. The FMC is expected to manage additional funds with an environment/biodiversity focus in the future. The expertise offered to investee companies by the FMC will help strengthen nascent biodiversity sectors. The FMC's advice and assistance in strategic planning and financial and sectoral management **will** promote the adoption of sustainable practices in commercially viable ways. The Fund's investments are expected have a development impact throughout the region and mobilize capital and help create jobs, often in rural areas with high rates of unemployment and poverty and in financially under served regions of Latin America, including how much of full time work is on agriculture.