Multilateral Investment Fund
Member of the IDB Group

Inter-American Development Bank

MEXICO

Support for Forest Related MSMEs in Ejidos and Communities – Implementation of the Forest Investment Program (FIP) in Mexico"

FOMIN Private Sector
FIP PROPOSAL

CONTENT

PROPOSAL FOR SUBMISSION TO THE FIP SUB-COMMITTEE

Name of Project or Program	Support for Forest Related MSMEs in Ejidos and Communities – Implementation of the Forest Investment Program (FIP) in Mexico”
FIP amount requested	USD 1.8 M private sector loan USD 1.2 grant **TOTAL: USD 3M**
Country targeted	Mexico
Indicate if proposal is a Project or Program	Mexico’s FIP Investment Plan was presented by the Government of Mexico to the FIP for approval, and endorsed by the FIP Sub Committee in October, 2011. The project's goal is to is to improve profitability and financial and social sustainability of CFEs in ejidos and other forest communities while mitigating climate change.

Abbreviations

Whenever reference is made in the document to any of the terms mentioned below, the same will be understood to mean the following:

Term	Meaning
ABG	Access to Basic Services and Green Growth
CCS	Carbon Capture and Storage Division
CIF	Climate Investment Fund
CFE	Community Forestry Enterprise
CONAFOR	National Forestry Commission of Mexico
CONANP	National Commission on Natural Protected Areas
CMF	Capital Markets and Financial Institutions Division
EARA	Early Action REDD+ Areas
Financiera Rural	Financiera Rural, Mexico's public sector rural development bank
FINDECA	FINDECA S.A. DE C.V. SOFOM ENR
FELABAN	Latin American Federation of Banks
FIP	Forest Investment Program
FIRA	Trust Funds for Rural Development
FMCN	Mexican Fund for the Conservation of Nature
GEF	Global Environmental Facility
GHG	Greenhouse Gases
IBRD	International Bank for Reconstruction and Development
IDB	Inter-American Development Bank
IP	FIP Investment Plan
LAC	Latin America and the Caribbean
MIF	Multilateral Investment Fund
MSME	Micro, Small, and Medium-sized Enterprises
NGO	Non-Governmental Organization
PEU	Project Execution Unit
PROCYMAF	Mexican Community Forestry Program

Term	Meaning
PSC	Project Steering Committee
PSR	Project Status Report
REDD/REDD+	Reducing Emissions from Deforestation and Forest Degradation, with the " + " indicating co-benefits
ROA	Return on Assets
ROE	Return on Equity
SCF	Strategic Climate Fund
TA	Technical Assistance
UNDP	United Nations Development Program
USAID	United States Agency for Development
USD	United States Dollars
VPC	Vice Presidency of Countries

One Page Summary: Support for Forest Related MSMEs in Ejidos – Implementation of the Forest Investment Program (FIP) in Mexico (ME-M1079, ME-T1217, and ME-L1139)

Mexico's forests represent an extremely valuable store of natural capital that bears significant economic dividends. 70% of this forest is found in communally owned *ejidos* and communities with high poverty rates and limited opportunities for entrepreneurial development. Sustainable forest management is a means by which these communities can increase their incomes while managing their natural resources for long term productivity. Without the technical and entrepreneurial capacity to profitably and sustainably manage the forest, alternative land uses (low productivity agriculture, unsustainable forest management, etc.) become more economically viable but with severe side effects. As a result, future financial returns from forest resources are reduced or eliminated, Mexico's biodiversity becomes increasingly threatened, and increasing greenhouse gas (GHG) emissions contribute to global climate change.

Many community forestry enterprises (CFEs)[1] are already in operation and seek to improve their business's competitiveness and long term viability. Improved access to finance and technical assistance have the potential to help them meet these business development challenges while making a substantial contribution to climate change mitigation.

While this project is focused on micro and small enterprises, this operation is part of Mexico's Investment Plan for the Forest Investment Program, a multi-project plan to holistically design an approach to the Mexican forest sector. The FIP is governed by an Investment Plan developed by the Mexican government in cooperation with the World Bank and the IDB. Within this investment plan the government requested that IDB/MIF, as a result of its demonstrated past experiences in the sector and focus on enterprise growth, administer the private sector portion of the Investment Plan. This project is the first ever private sector FIP and is expected to develop models for future global replication. It has been developed in cooperation with CMF/FMK, INE/CCS, RND/ESG, the Mexican government, and Mexican forest and private sector entities. This project is part of an overall $41M program implemented by the IDB and MIF. [
The project will provide technical and financial assistance, as well as loans to CFEs to help them create and expand financially and environmentally-sustainable businesses in forest landscapes. In particular, to respond to the variability in CFE readiness, this project will follow a two-tiered strategy in reaching a representative set of CFEs in target states, creating an incubator for higher-capacity CFEs to access Financiera Rural loans[2], while at the same time providing technical and financial assistance to lower-capacity CFEs to build enterprise skills and access lines of credit from an MFI for smaller-scale investments. A CFE lending product will be designed and funded within this project. In addition, the project will strengthen FINDECA, the financial institution,

[1] Community Forest Enterprises are defined for the purpose of this project as small producers organized as legally established entities, i.e. ejidos, communities, and rural micro-enterprises located in low-income forest areas in Oaxaca, Quintana Roo, Campeche, Yucatán, and Jalisco. They typically operate in the areas of agroforestry, silvopastoral production, and timber and non –timber forest products.

[2] FinRural loans (10 Million USD) are not funded in this project; they are supported by the IDB loan **ME-L1120 that corresponds to Project 3 of the IP**. This project simply leverages the existence of these loans by providing technical assistance to the firms who will access FinRural lending products.

by helping them diversify their sources of funding and client base, and helping them design a currency hedge mechanism.

The limited environment for private sector investment in forest MSMEs in Mexico requires the “demonstration” approach being taken in this project and with Financiera Rural, to show that CFE projects are financially viable and have environmental benefits.

The Project beneficiaries will be: 60 Community Forestry Enterprises (CFEs) that provide income to an estimated 4,900 women, men, and children from ejidos and other communities in the states of Oaxaca, Yucatán, Quintana Roo, Jalisco and Campeche, of whom approximately 40% are indigenous people.[3] Indirect beneficiaries include 10,860 inhabitants of the ejidos which contain CFEs who will either benefit from increased return on their investment in the CFE or from community projects funded with proceeds from the CFE.

[3] Estimates based on Guevara, et al study, CONAFOR statistics.

SUPPORT FOR FOREST RELATED MSMEs IN EJIDOS AND COMMUNITIES– IMPLEMENTATION OF THE FOREST INVESTMENT PROGRAM (FIP) IN MEXICO

ME-M1079 (TECHNICAL ASSISTANCE) ME-T1217 (LOAN)

I. Executive Summary

Beneficiary Countries:	Mexico
Executing Agencies:	The Mexican Fund for the Conservation of Nature (FMCN) (Technical Assistance) and FINDECA S.A. de C.V. (Loan)
Target Beneficiaries:	The Project beneficiaries will be: 60 Community Forestry Enterprises (CFEs) that provide income to an estimated 4,900[4] women, men, and children from ejidos and other communities in the states of Oaxaca, Yucatán, Quintana Roo, Jalisco and Campeche, of whom approximately 40% are indigenous people. Indirect beneficiaries include 10,860 inhabitants of the ejidos which contain CFEs who will either benefit from increased return on their investment in the CFE or from community projects funded with proceeds from the CFE.

Financing:	**MIF Non-reimbursable:**	**US$ 3,524,788**
	Counterpart:	**US$ 498,932**
	Co-financing:	
	FIP Grant	**US$ 1,084,997**
	FIP Reimbursable (loan)	**US$ 1,800,000[5] or equivalent in local currency [6]**
	TOTAL:	**US$ 6,908,717**

[4] This figure is based on an estimate of the number of employees per CFE, and their immediate family members who benefit from the income directly.

[5] Under the IDB-FIP agreement, the FIP will retain the credit risk of the loan to the executing agency (FINDECA) rather than requiring the IDB to assume this risk. The IDB will follow its regular standard of care in administering this loan.

[6] The Strategic Climate Fund/Clean Technology Fund Joint Committee is in the process of designing procedures considering a proposal that would allow MDBs to lend FIP funds in local currency. If the IDB/MIF governance approves any such modification and finds it feasible and is able to design an appropriate mechanism for foreign currency disbursement transactions, the MIF may choose to lend to the executing agency FINDECA, in local currency. If such were the case, then any losses/gains from the foreign currency exposure would accrue to the FIP.

Objectives	The impact of the project is to improve profitability and social and financial sustainability of CFEs[7] in ejidos and other forest communities while contributing to climate change mitigation. The results will be that Community Forest Enterprises (CFEs) increase their productivity while leveraging or preserving the natural capital of forest lands.
Financial conditions of the FIP Loan	Senior Loan up to US$1,8 million is proposed. Term: the loan will have a term of nine (9) years, including a grace period of five (5) years applicable only to principal and not to interest. Disbursements: funds of loan will be disbursed in four tranches, in accordance with the project needs. First tranche of at least US$750.000 should be made within 13 months after signature of the contract. The total will be disbursed no later than 60 months after the first disbursement.
Execution Timetable for the TC:	For all grants: 60 months for project execution and 60 months for disbursement. Each EA will sign one contract with the Bank. Each contract will govern the use of both MIF and FIP finance.
Special Contractual Conditions:	Operating Procedures for the project must be developed prior to the second disbursement. As a condition precedent to the first disbursement of the FIP Loan, FINDECA must submit, to the Bank's satisfaction, (i) the Credit Regulations for the FIP loan component approved by its governing authorities and (ii) the provisioning policy for the credit line based on recommendations of the consultants hired to develop the products.
Exceptions to Bank Policies:	None.
Environmental and Social Review	These operations were screened and classified as required by the IDB's safeguard policy (OP-703). Given the limited impacts and risks, the proposed category for the project is C.

[7] Community Forest Enterprises are defined for the purpose of this project as small producers organized as legally established entities, i.e. ejidos, communities, and rural micro-enterprises located in low-income forest areas in Oaxaca, Quintana Roo, Campeche, Yucatán, and Jalisco. They can operate in the areas of agroforestry, silvipastoral production, and timber and non –timber forest products.

Risks and mitigating factors	The loan portion of project presents a series of risks, most notably: (i) currency exchange risk; (ii) liquidity risk; (iii) interest rate risk; (iv) inflation risk. The grant portion of the project presents the following risks: (i) logistical and operational risks; environmental and natural disaster risks; and, (iii) business development risks. Section VII, Risks and considerations, deals with each of these risks individually, describing the mitigating factors and other considerations for handling them.

II. Background And Justification

A. THE IMPORTANCE OF FOREST MANAGEMENT ON COMMUNAL LANDS IN MEXICO

2.1 Mexico's forests represent an extremely valuable store of natural capital that bears significant economic dividends. 70% of this forest is found in communally owned *ejidos*[8] and communities with high poverty rates and limited opportunities for entrepreneurial development. Sustainable forest management[9] is a means by which these communities can increase their incomes while managing their natural resources for long term productivity. Without the technical and entrepreneurial capacity to profitably and sustainably manage the forest, alternative land uses (low productivity agriculture, unsustainable forest management, etc.) become more economically viable but with severe side effects. As a result, future financial returns from forest resources are reduced or eliminated, Mexico's biodiversity becomes increasingly threatened, and increasing greenhouse gas (GHG) emissions contribute to global climate change.

2.2 Many community forestry enterprises (CFEs) in operation in Mexico seek to improve their business's competitiveness and long term viability. Improved access to finance and technical assistance have the potential to help them meet these business development challenges while making a substantial contribution to climate change mitigation.

B. GHG EMISSIONS FROM LAND USE CHANGE IN MEXICO

2.3 According to the latest official estimation,[10] in 2006 Mexico emitted 709 million tons of carbon dioxide equivalent (Mt CO_2e). The country is ranked twelfth in the world based on total GHG emissions and is the second largest emitter in the LAC region after Brazil. The third highest source of emissions in Mexico is the Agriculture, Forestry and Other Land Use sector (AFOLU) sector, which represents 16.3% of total emissions.

2.4 Deforestation rates in Mexico for the period of 2005-2010 were an average of 0.24% for all types of forests, representing 155,000 hectares per year. Although the rates have been stable, there is a pronounced heterogeneity expressed in significantly higher rates for particular regions in the country. Forest degradation[11] has become a critical issue, as rates of

[8] Communally owned lands in Mexico that are managed for agricultural or forestry production.

[9] While SFM is generally understood to be focused on timber production, the project seeks to support a broad range of forest based activities including, but not limited to agroforestry, silvopastoral systems, sustainable tourism, non timber production and timber production. In addition, other opportunities outside the forest sector will be explored (such as agriculture) in order to address the drivers of deforestation and forest degradation in EARA.

[10] Fourth National Communication to the United Nations Framework Convention on Climate Change, 2009.

[11] Deforestation refers to the conversion of forest to another land use or the long-term reduction of the tree canopy cover below the minimum 10% threshold; forest degradation refers to changes within the forest which negatively affect the structure or function of the stand or site, and thereby lowers the capacity to supply products and/or services.

conversion of primary forest to secondary forests are estimated at a rate of approximately 44,000 hectares per year for the same period.[12] In addition to the high socio-economic costs and GHG emissions, the loss of critical ecosystems for biologically important species has been significant.

C. THE FOREST INVESTMENT PROGRAM AS A PROMOTER OF IMPROVED FOREST MANAGEMENT IN MEXICO

2.5 While this project is focused on micro and small enterprises, this operation is part of the FIP IP[13], and part of a package of projects to bring technical assistance and credit to all forest enterprises, large and small. The project is related to project 3 of the FIP "Financing Low Carbon Strategies in Forest landscape" **(**ME-L1120), executed by IDB/CMF. For the purposes of this document the MIF project described herein will be known as FIP project 4.

2.6 The Forest Investment Program (FIP) is a program under the Strategic Climate Fund (SCF), one of the International Climate Investment Funds (CIF) which supports developing countries in their efforts to reduce emissions from deforestation and degradation, promote sustainable forest management and enhance forest carbon stocks. Mexico represents one of three pilot programs in the LAC region[14]. The FIP is governed by an Investment Plan developed by the Mexican government in cooperation with the World Bank and the IDB. The National Forestry Commission (CONAFOR) is the FIP focal point in Mexico. Within its Investment Plan the government requested that MIF, as a result of its demonstrated past experiences in the sector and focus on enterprise growth, administer the private sector portion of the program. Mexico's Investment Plan approved by the FIP on October 31, 2011. The IP has the core objectives of reducing emissions from deforestation and forest degradation, promoting sustainable forest management and enhancing forest carbon stocks in Mexico. The IP's strategy consists of promoting management of natural resources in forest and non-forest areas in productive mosaics at the landscape level, through building and strengthening institutional and local capacity and supporting sustainable investments. The IP includes four projects that total US$60 million: Projects 1 and 2 (US$42 million), channeled through the IBRD; which was approved by the FIP in October 2011 and is currently being executed by CONAFOR as overall coordinator and focal point of the IP; Project 3 (US$15 million), channeled through the IDB (ME-L1120 and ME-G1002); which were approved in August 2012, and is currently being developed by Financiera Rural and CONAFOR; and Project 4 (US$3 million) channeled through the MIF, which constitutes the present project. As part of the FIP IP this project is complementary to projects 1, 2, and 3 of the Mexico IP, and as the first private sector operation of the FIP anywhere in the world, this MIF project is path-breaking and will provide models for regional and global replication. The IP and the lessons learned from its implementation will be important contributions to

[12] Food and Agriculture Organization (FAO) (2010). (http://www.fao.org/forestación/fra/67090/en/)

[13] Available in the Technical Files.

[14] The other pilot programs are in Peru and Brazil and are under design.

the national policy for the Reducing Emissions from Deforestation and Forest Degradation in Developing Countries program currently being developed.[15]

2.7 In order to attain a higher transformational impact through its interventions, the IP targets specific strategic priority areas at state and forest landscape level which have been denominated Early Action REDD+ Areas (EARA). The criteria used by the Mexican government to identify and select EARA include: (i) areas with important forest blocks under high pressure for forest cover and forest carbon loss; (ii) areas with high environmental value; particularly, biodiversity and hydrological value; (iii) areas with socio-economic development demands assessed based on national poverty indicators; and (iv) areas with sufficient presence of local stakeholders with relevant experiences for implementing innovating models able to produce results in the short term.

2.8 In Mexico, an estimated 70% of forests are owned by ejidos and communities under a collective land tenure system. The diverse economic and social mosaic in the forest landscape has led the government to support communities to manage their forest resources through a series of community-based incentives and advisory programs.[16] The community forestry approach is seen by the government as a central piece of its social development and poverty alleviation strategies in forested regions and will also likely serve as a foundation of Mexico's national policy for REDD+.

2.9 The project focuses on five of the eight states with the highest net forest loss (Oaxaca, Yucatán, Quintana Roo, Jalisco and Campeche). These areas include 1,768 ejidos and communities, which contain 4,277 localities of under 2,500 inhabitants, and a total population of 556,624 (of which 50% are women). These municipalities are primarily poor, reflected in average poverty rates of 75%[17] with significant lags in health and education.[18] In addition, 40% of municipalities are considered indigenous.[19]

2.10 The project builds on preparation studies developed in project ME-T1210, the Forest Investment Program Preparation Grant, approved February 29, 2012. This preparation grant, financed with FIP trust fund resources, funded a baseline and analytic study, local indigenous consultations, and consultant assistance with the preparation of this document.

D. DIMENSIONS OF THE PROBLEM

2.11 Intensive productive activities leading to accelerated deforestation rates are weakening the Mexican ecosystem and generating increased GHG emissions while crowding out possibly

[15] Mexico's Vision on REDD+: Heading Towards a National Strategy

[16] Around 3,000 *ejidos* and communities (10% of total) have forestry as their main activity. An estimated 2,380 communities use forest management plans, and about 50 are independently certified (*Censo Ejidal*).

[17] Census 2010 and CONAFOR data crossed with geographic targets and project preparation study (Guevara 2012).

[18] Based on a study for this program, 30% of EARA population lack access to health services and have an average of 5.3 years of schooling.

[19] Defined as 40% or more of the population five years or older that speaks an indigenous language.

more efficient and profitable uses of forest resources. Forest conversion and degradation is negatively impacting income and livelihoods among the estimated 12-13 million people that inhabit Mexico's forest areas, about half of whom belong to one of the country's 62 indigenous groups.

2.12 The direct causes of deforestation and degradation in the project region include:

a. Forest conversion to commercial agriculture, food crop and meat production on community and ejido lands in tropical rainforests, temperate, and oak forests.
b. Deforestation of secondary forests of tropical dry forests due to illegal logging, over-exploitation, and the expansion of urban infrastructure for human settlements.
c. Conversion of mangrove ecosystems and wetlands by unplanned urban development and the establishment of tourism infrastructure in coastal areas.
d. Illegal logging for firewood and charcoal production for domestic use (rural population living in poverty conditions), as well as for other industrial processes;
e. Selective extraction and over exploitation of high commercial value species (mahogany, cedar, some conifers, and non-timber products such as *xate*); and
f. Inefficient and unsustainable forestry practices and purchase-and-sale contracts of standing timber with intermediaries and forest timber industry.

2.13 The underlying causes of deforestation and degradation in the project region include:[20]

a. **Economic:** (i) Short term higher marginal benefits of activities that deforest and degrade do not consider the positive environmental externalities of low carbon activities and concrete benefits such as access to higher-value markets.. This is partially due to the fact that the higher incomes and social benefits that sustainable low carbon activities can provide (principally forest management) are less familiar than those that deforest and degrade (such as extensive livestock farming and agriculture); (ii) there is little or no availability of financial services for sustainable forestry related activities, which implies a liquidity restriction to the productive units for the initial investment.

b. **Institutional**: (i) a lack of coordination between agricultural, livestock, and forest policies and the inadequate implementation of incentives and subsidies to promote sustainable agricultural and livestock activities generate indirect impacts that exacerbate land use change; (ii) absence of land use planning and implementation of economic and ecologic zoning; and, (iii) weak institutional capacity to enforce forest management regulations.

[20] Based on Forest Investment Plan of Mexico and ad-hoc study, Guevara, et al.

c. **Social:** (i) the general lack of technical and management skills at the *ejido* and community level for conducting forest operations contributes to high levels of risk for investments; (ii) weak governance and organizational structures within *ejidos* and communities; and (iii) land tenure conflicts due to unclear demarcation of territory.

2.14 The factors limiting the financing of sustainable forest enterprises as a means for the reconciliation of economic profit for communities and ejidos and global environmental benefits are listed below. Projects within the FIP Investment Plan seek to address these problems.

a. Lack of institutional capacity to manage financing for investments. (addressed by FIP projects 3 and 4)
b. Land tenure issues generate uncertainty and limit access to collateral. (addressed by FIP project 2)
c. Lack of financial services adapted to local needs due to limited knowledge and experience of the financial sector (addressed by FIP projects 3 and 4).
d. Lack of technical capacity in sustainable business and technical and administrative management (addressed by FIP projects 3 and 4).
e. Lack of access to markets, especially higher value markets for processed wood products due to challenges of ensuring consistent supply and quality (addressed by FIP projects 3 and 4).

2.15 The forestry sector has had limited access to financial services and loans, representing 0.01 % of total loans by the banking sector[21], and, as highlighted by a recent survey, only 16% of the ejidos and communities have applied for a loan, the vast majority for agriculture and herding activities. In a study prepared for this project by an external consultant funded through the FIP preparation grant (Guevara et al.), the main difficulty cited by ejido or community members in forming a business was a lack of finance (45%) followed by technical capacity (41%).

E. THE PROJECT

2.16 The project will provide technical and financial assistance, as well as loans to Community Forest Enterprises (CFEs) to help them create financially and environmentally-sustainable businesses in forest landscapes. In particular, to respond to the variability in CFE readiness, this project will follow a two-tiered strategy in reaching a representative set of CFEs in target states, creating an incubator for higher-capacity CFEs to access Financiera Rural loans[22], while at the same time providing technical and financial assistance to lower-capacity

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[21] Ibid,

[22] FinRural loans are not funded in this project; they are supported by the IDB loan **ME-L1120 that corresponds to Project 3 of the IP**. This project simply leverages the existence of these loans by providing technical assistance to the firms who will access Finrural lending products.

CFEs to build enterprise skills and access lines of credit from a microfinance institution for smaller-scale investments. The limited environment for private sector investment in forest MSMEs in Mexico requires the "demonstration" approach being taken in this project and with Financiera Rural, to show that CFE projects are financially viable and have environmental benefits.

2.17 **Beneficiaries:** EARA encompass some 1,768 ejidos and communities, which contain 4,277 municipalities of 2,500 inhabitants or less, and a total population of 556,624 (half of which are women). The municipalities are primarily poor, with average poverty rates of 75% and significant lags in health and education compared to national averages. In addition, 40% of municipalities are indigenous[23]. The project CFEs will be selected from these areas, and given the average number of employees, their family size, and the total average membership in each ejido, it is estimated that 4,900 people will directly benefit from the project, with an additional 10,860 indirect beneficiaries living in the vicinity.[24]

2.18 Forestry is heavily dominated by men, and in Mexico women rarely hold leadership roles at the community level, especially formal positions related to forest management. An evaluation of a Mexican government community forestry program (PROCYMAF) showed that less than 10% of interviewed women in project communities felt they had benefited from the project. Women's role in forestry projects is typically isolated to participation in workshops and focused on issues such as non-timber forest products. In Mexico, where high rates of migration have reduced the number of working-age men, the project will include gender integration as part of the overall strategy. Specific benchmarks will be set for improving gender equity in forestry as a result of project interventions. Activities will include: ensuring that the administrative and business development work of women in CFEs is recognized and compensated, ensuring that women can equitably access forest credit products, and sex-disaggregation of the impact and result level indicators of the project.

2.19 **Alignment with MIF Agendas and Priorities.** This project is aligned with the Natural Capital agenda because it supports enterprises and communities in (i) using natural capital more sustainably, and (ii) converting natural capital into greater flows of profit, wages, and employment by improving production, distribution, packaging, marketing and branding. The project will actively identify lessons learned and knowledge generated through monitoring of impacts and by dissemination of results via the Executing Agencies, Fondo Mexicano para la Conservación de la Naturaleza A.C. (Mexican Fund for the Conservation of Nature-FMCN) and FINDECA, S.A. de C.V., IDB-MIF systems, and via national channels.

2.20 The project is aligned with the country strategy, specifically the sections related to support to the objectives to increase finance to the agricultural sector and to support the implementation of climate change adaptation and mitigation strategies at the national and sub-national levels. It is also consistent with the IDB's goals in assisting the Mexican government in implementation of the Forest Investment Program, and has been included in

[23] Defined as 40% or more of the population five years or older that speaks an indigenous language.

[24] CONAFOR and executing agency estimates.

the Country Program Document for 2013. The project has been developed with the strong support and involvement of INE/CCS and is relevant to the Bank's Climate Change Strategy.

F. MIF Added Value

2.21 MIF was selected as the first private sector FIP implementer due to its experience in developing projects related to forest-based MSME development and credit. The MIF's reputation and experience with similar projects will help the operation to leverage local partners and support. The Social Enterprise Program in Guatemala (GU-S1015), used a similar mechanism and generated significant results in terms of MSME productivity as well as through replication (partially in response to the successes of the project, a $17.5 million line of credit was approved by the Guatemalan Development Credit Authority in 2011). A regional initiative in five countries supported by the MIF (ATN/ME-12087-RG), helped increase competitiveness of 80 forest SMEs. Finally, the Maya Biosphere Reserve Environmental Services Program (ATN/ME-10610-GU) – a globally-significant model for the incorporation of payments for REDD+ in forestry MSME development – is producing important lessons related to the cost-effectiveness of natural forest management and enterprise in reducing GHG emissions. The training manuals and credit products of these interventions have already contributed to the structuring of the project's activities and the actual credit manuals and training guides from these past projects will be shared as widely as possible, in alignment with any conditions of use of the products.

III. Objectives and Description

A. Project Goal and Purpose

3.1 The impact of the project is to improve profitability and financial and social sustainability of CFEs in ejidos and other forest communities while mitigating climate change. The results will be that Community Forest Enterprises increase their productivity while leveraging or preserving the natural capital of forest lands. The Project´s potential success should demonstrate to other CFEs and to the financial sector that investing in sustainable forest management can be profitable.

3.2 To achieve these results, the Project will contain the following components: (i) Selection of CFEs and TA Partners; Definition of baselines; (ii) Accelerator for Financiera Rural loans, connecting market ready MSMEs to finance (executed by FMCN), (iii) TA for non-market ready MSMEs (executed by FMCN), (iv) Loans executed by FINDECA and the institutional strengthening of FINDECA. (v) Dissemination and knowledge management (executed by FMCN and FINDECA).

B. Description of Components

Component 1: Selection of CFEs and TA Partners; Definition of Baselines (executed by FMCN). (MIF: $337,177; FIP: $19,942; Counterparts: $45,533)

3.3 This component will build upon the FIP/MIF project preparation study to bridge the gap between the general characterization of project areas during project scoping and the need to focus project efforts on specific CFEs. The total population living in potentially eligible communities within the project area is more than 500,000 people. This project phase will entail the selection by FMCN of local project implementers to provide technical assistance to CFEs on sustainability and products, the CFE clients with whom they will work, the creation of a specialized business skills/financial task force to provide business development skills assistance to CFEs, and the development of a profile of each CFE and community to accurately target project interventions and measure project impact relative to baselines.[25]

3.4 FMCN will select five local providers with a local presence, environmental management experience, and existing relationships with ejido and other rural communities in the project's forest regions to carry out on-the-ground project activities related to product development and environmental management. These providers constitute the bulk of the technical assistance

3.5 FMCN will choose 60 CFEs based on criteria including: current and potential viability of business opportunities, social and entrepreneurial organization, creditworthiness or potential thereof.

3.6 FMCN will prepare plans for monitoring and evaluation, followed by data gathering on baselines to characterize the CFEs' financial and entrepreneurial wherewithal, members' incomes, gender statistics, and other individual measures; forest resources available and under management, and proxy measures of CO_2.

3.7 FMCN will contract a financial and business skills development task force to diagnose and address the entrepreneurial challenges facing each CFE. This task force complements the technical providers in the provision of a holistic package of technical assistance.

3.8 Expected Products: (i) Mapping of the existing financial products for CFEs within each EARA; (ii) 60 CFEs chosen; (iii) 5 technical providers of environmental/market technical assistance chosen; (iv) 1 financial/business skills development task force created; (v) 1 monitoring and evaluation plan developed; (vi) 1 baseline of species richness, gender, hectares under management plans, CO2 tons captured or reduced.

Component 2: Accelerator for Financiera Rural loans, connecting market ready SMEs to finance (executed by FMCN) (MIF: \$568,677; FIP: \$319,942; Counterparts: \$45,533)

3.9 A 10M USD IDB/FIP loan that has already been approved (ME-L1120, part of Project 3 of the Mexico FIP) will create a financing line dedicated to "low carbon strategies in

[25] The technical assistance provided by the project will consist of two parts: sustainability, product, and market technical assistance provided by local partners in each state, and business development skills (BDS) training provided by a task force of BDS professionals that will focus on legal, accounting, and management skills.

forest landscapes." This will be managed by Financiera Rural[26] to benefit some of the existing "market & finance-ready" CFEs in Mexico. These loans, for more market-ready small-to-medium sized enterprises[27], will be supported by the project currently under consideration through technical assistance created in this component.[28] The TA activities designed in this component will focus on the needs of these market and finance-ready businesses and will complement Financiera Rural activities. Where possible, manuals, training materials and lessons learned from the aforementioned prior MIF projects will be used to inform project activities.

3.10 In years 2-5 of the Project, 45 CFEs will receive training through local implementors contracted by FMCN to improve their already significant capacity to manage their businesses for financial and environmental sustainability over the long term. This capacity will be expressed in the revision (or creation, where necessary) of both business plans and management plans (i.e. forest resource management plans).

3.11 CFEs' with improved capacity will gain access to finance provided by Financiera Rural, based on credit analysis by Financiera Rural.

3.12 Expected Products: (i) 45 market-ready CFEs receive technical assistance to help them access Financiera Rural credit; (ii) 45 market-ready CFEs develop land management plans.

Component 3: TA for non-market ready MSEs (executed by FMCN) with support of Financiera Rural). (MIF: $1,045,177; FIP: $526,942; Counterparts: $45,533)

3.13 Unlike the more market-ready CFEs considered in Component 2, the targets of this component are those micro-small enterprises with a less developed and less sophisticated organizational, entrepreneurial, and environmental capacity, and with little or no access

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[26] A Mexican public financial institution that supports rural development.

[27] The definition of MSME in Mexico is clearly defined, but the range for small businesses is large. Component 2 will focus on businesses on the higher end of the scale of small business, and medium sized businesses. Component 3 will focus on micro businesses and the lower end of the scale of small business. These definitions fall with the the IDB Group's definitions for MSMEs.

Definitions of SMEs in Mexico (source: el Diario Oficial de la Federación June 30, 2009)

Size	Sector	Range of number of employees	Range of annual sales (millions of pesos MX)
Micro	All	Up to 10	Up to $4
Small	Commerce	From 11 to 30	From $4.01 to $100
	Industry & Services	From 11 to 50	From $4.01 to $100
Medium	Commerce	From 31 to 100	From $100.01 to $250
	Services	From 51 to 100	From $100.01 to $250
	Industry	From 51 to 250	From $100.01 to $250

[28] MSMEs will be selected for the program based on their organizational, financial, and environmental capacity and potential for growth.

to traditional finance. Activities of this TA include (i) strengthening governance and organizational structures; (ii) training in bookkeeping and finance; (iii) business planning and linkage to markets; and (iv) development of land management plans. These interventions will help CFEs create viable projects for financing, present loan applications, and manage associated financial and technical responsibilities. Manuals, training materials and lessons learned from the aforementioned prior MIF projects may be used to inform project activities.

3.14 In years 2-5 of the Project, 15 CFEs will improve their low-level capacity to manage their businesses for financial and environmental sustainability over the long term through technical assistance from local providers and a financial task force contracted by FMCN. This capacity will be expressed in the revision or creation of both business plans and management plans (i.e. forest resource management plans).

3.15 This component is targeted so that CFEs with improved capacity can gain access to finance provided by FINDECA, through a lending facility to be developed within FINDECA in Component 4 of this project.

3.16 The ongoing and improved viability and creditworthiness of these CFEs will be confirmed if additional credits are granted by FINDECA, and/or by Financiera Rural, as the businesses grow to a level similar to the CFEs receiving credit in Component 2.

3.17 Expected Products: (i) 15 CFEs receive technical assistance to increase profitability[29], formalize their activities and structures, and develop creditworthiness; (ii) 15 CFEs adopt business plans; (iii) 15 CFEs develop land management plans for their businesses; (iv) 15 CFEs apply for FINDECA credit; and (v) 10 CFEs become preferred clients[30] of FINDECA or become creditworthy to receive Financiera Rural credit

Component 4: Loan and institutional strengthening of FINDECA (executed by FINDECA). (MIF: $516,700 (grant); FIP loan: $1,800,000; Counterparts: $316,800)

3.18 In contrast to the lending facility created by the IDB/FIP for Financiera Rural, which is focused on small and medium sized, more market-ready enterprises, under this component FINDECA will develop a credit line specifically for CFEs with little or no access to traditional finance. This activity will be funded with $1.8 million of reimbursable funding, from the FIP (see financial terms in section VIII). The component also includes TA for the institutional strengthening of FINDECA, the private sector financial institution that will be granting the credit. Such TA will finance the development and refinements of FINDECA financial products tailored to CFEs. FINDECA will develop and market the credit product to eligible CFEs (most of them the same CFEs that will receive technical assistance in Component 3), building on its experience with lending to rural communities involved in the agriculture, timber, and forest product sectors.

[29] Each CFE provides income, on average, to approximately 120 people.

[30] A FINDECA specification for return customers.

3.19 Where possible, credit manuals, training materials and lessons learned from the aforementioned past MIF projects will be used to inform project activities.

3.20 Credit line resources shall be directed to finance fixed assets and working capital necessary for the implementation of productive activities that promote sustainable territorial management such as forestry harvesting and processing of timber, protected agriculture, aquaculture, agroforestry, organic farming and beekeeping, amongst others. Activities to be financed should be technically, financially and environmentally viable. It is estimated that the credit line will start operating in the second year of the project after FINDECA has developed and refined financial products through the project's technical assistance and the TA for non-market CFEs foreseen in component 3 begins to produce results.

3.21 As stated in footnote 6, the loan may be denominated in US dollars or local currency. If financing is denominated in US dollars the borrower may face challenges related to managing the exchange risk. For this reason, one activity in this component will be the development of a currency hedge mechanism that FINDECA will make use of during project execution, if so needed.

3.22 To bolster FINDECA's engagement with women and other vulnerable groups in sectors that have traditionally been male-dominated (like forest management), a microfinance product will be designed as part of this component. However, the credit to be granted via this product will not be financed or executed within the current project. FINDECA will seek to fund the deployment of this MFI product through their own funds or other sources such as Financiera Rural credit.

3.23 <u>Expected Products:</u> (i) 1 currency hedge mechanism adopted by FINDECA; (ii) 1 short-term credit product for working capital created (manuals, criteria) and marketed to CFEs; (iii) 1 medium/long-term credit product for fixed assets created (manuals, criteria) and marketed to CFEs; (iv) 15 CFEs have received credit from FINDECA; (v) Portfolio at risk beyond 30 days (PAR30) of FINDECA is not above 5%; (vi) 1 microfinance product designed for vulnerable populations (women/indigenous) within forest zones; (vii) $1.8 million in loans placed; (viii) At least 10 CFEs take a subsequent credit.

Component 5: Dissemination and knowledge management (executed by FMCN and FINDECA). (MIF: $300,737; FIP: $19,942; Counterparts: $45,533)

3.24 The objective of this component is to increase knowledge, awareness and coordination among key stakeholders regarding the a) viability of investment in CFEs in Mexico as an economic development and climate change mitigation tool; b) the potential creditworthiness of CFEs at different levels of entrepreneurial sophistication; c) the potential for access to credit to increase profits and individual income; d) the role of private sector forestry and financial industries in mitigating climate change.

3.25 *Audiences.* (1) Members of participating and non-participating CFE communities; (2) Organizational peers of FINDECA who are involved in similar rural and microcredit lending; (3) Private sector financial providers and financial institutions that have not traditionally lent to the forest products sector; (4) The domestic forestry sector: state and federal agencies, civil society, *Expo Forestal*, etc.; (5) Other international audiences in the climate change mitigation and forestry sectors (6) The seven other country teams carrying out the FIP in Latin America, Africa, and Asia.

3.26 The main knowledge products of this project will be credit product manuals, methodologies, and didactic materials; case studies of innovative elements of the project including on the role of women and lower-capacity MSE's; a project website, audiovisual product, fact sheets, and a technical study of the project's approach, results, challenges, and replicability prepared for the FIP donors.

3.27 The project will actively identify lessons learned and knowledge generated through monitoring of impacts via FMCN´s learning communities, IDB-MIF knowledge platforms, and national channels. As CFE access to finance is expanded, the project will disseminate experiences throughout Mexico and Latin America via proactive media relations. The dissemination component of the project will also enable presentations by communities and counterpart financing agencies at national forestry forums such as the *Expo Forestal* in Mexico.

3.28 Knowledge dissemination will seek to demonstrate to financial institutions that lending to CFEs is a profitable business opportunity. These audiences will be reached through project outreach to local and regional banks, microfinance institutions, and Bank, MFI, and MIF networks (FELABAN, Foromic, etc.). The project will also hold workshops for these audiences.

3.29 Since the Mexico FIP is the first FIP project to develop a private sector component it is expected that the project will serve as a model for future FIP private sector interventions. The project's model will be disseminated through a report to FIP donors at the annual FIP donors meeting, and to other national governments designing FIP programs with MIF/IDB support (for example, Peru).

3.30 <u>Expected Products:</u> (i) one didactic information product/year; (ii) one annual report on project achievements/year; (III) one technical study of project knowledge and execution best practices; (iv) Dissemination of results via FMCN´s learning communities, CONAFOR, and IDB-MIF knowledge platforms; (v) one workshop with CFEs in Mexico to disseminate results; (vi) one workshop with financial providers to disseminate results; (vii) five presentations by communities and counterpart financing agencies at national forestry forums such as CONAFOR/Financiera Rural events and *Expo Forestal* in Mexico; (viii) four presentations in international events by project stakeholders (MIF/IDB/FIP events, etc.); (ix) five case studies completed; (x) audiovisual knowledge product (video or similar).

3.31 FMCN will manage the budget for these activities. FINDECA shall be required to share knowledge products and information for case studies as necessary, in line with confidentiality requirements.

IV. Cost, Financing, and Sustainability

4.1 **Summary cost table.** The Project's estimated total cost is US$ 6,908,717. The MIF will provide up to US$ 3,524,788 in non-reimbursable funds and co-financing and counterpart resources will be US $ 3,383,929, which will come from the executing agencies, Forest Investment Program funds, and other project partners. Unless otherwise indicated, as in component 4, funds will be disbursed to FMCN. Component 4 resources, both loan and grant, will be disbursed to FINDECA.

4.2 FIP resources for this Project will be received from the World Bank, in its capacity as trustee of the SCF. As explained above in paragraph 2.6, the IDB is an Implementing Entity of the SCF. Pursuant to Resolution DE-123/12, the Board of Directors of the IDB authorized the Donors Committee of MIF to approve the use of SCF resources when such resources are being used to co-finance a MIF operation. FIP resources will be administered by the IDB pursuant to the terms of a Financial Procedures Agreement (FPA) signed between the IDB and the WB, as authorized by the Board of Executive Directors in Resolution DE-9/11 (document GN-2604). The Office of the MIF will be responsible for actively collaborating with other IDB departments (such as ORP/GCM, FIN and LEG) in complying with the fiduciary, reporting, administration and other legal requirements established in the FPA, to ensure that IDB can comply with such obligations on a timely fashion. Furthermore, as stipulated in the FPA, the use of FIP resources should be consistent with the approvals granted by SCF governing bodies for this project and the applicable policies and guidelines issued by the SCF. Pursuant to such policies and guidelines, FIP resources include certain fees to assist in the defrayment of project costs, which are duly identified in the budget of this operation. Availability of FIP resources for this project is subject to the WB transferring such resources to the IDB, pursuant to the terms of the FPA.

PROJECT BUDGET IN US$

Component	MIF	FIP	Counterparts	Project Total
Component 1: Selection of CFEs and TA Partners; Definition of Baselines	$337,177	$19,942	$45,533	$402,652
Component 2: Accelerator for Financiera Rural loans, connecting market ready MSMEs to finance	$568,677	$319,942	$45,533	$934,152
Component 3: TA for non-market ready MSMEs (executed by FMCN with support of Financiera Rural).	$1,045,177	$526,942	$45,533	$1,617,652
Component 4: Loans executed by FINDECA, and strengthening of FINDECA. (All funds in this component will be directly disbursed to FINDECA.)	$516,700	$1,800,000 (reimbursable)	$316,800	$2,633,500
Component 5: Dissemination and knowledge management	$300,737	$19,942	$45,533	$366,212
Project Administration	$298,093	$198,229	$0	$496,322
Midterm and Final Evaluation	$60,000	$0	$0	$60,000
Contingencies (2%)	$61,331	$0	$0	$61,331
Ex-post review of procurement and disbursements	$50,000	$0	$0	$50,000
Subtotal	**$3,237,893**	**$2,884,997**	**$498,932**	**$ 6,621,822**
Percentages (excluding audit, agenda, strengthening, and impact evaluation activities)	49%	43%	8%	100%
Mid-term and Final Audit (FMCN and FINDECA)	$75,000	$0	$0	$50,000
Technical support/strengthening for EA (FMCN and FINDECA)	$20,000	$0	$0	$20,000
Agenda account	$30,000	$0	$0	$30,000
Impact evaluation account (5%)	$161,895	$0	$0	$161,895
Project total	**$3,524,788**	**$2,884,997**[31]	**$498,932**	**$6,908,717**

4.3 **Sustainability**. Project sustainability is embedded as the central pillar of the project strategy, to create CFE capacity to access financial services and successfully manage loans for CFE development. Project success relies on assisting CFEs to be self-sustaining and competitive in the marketplace. Furthermore, successful project implementation will mean that partner CFEs have adopted and are actively applying the set of technical tools to be delivered – including business and marketing plans, finance and accounting systems, inventory and quality control tools, and the "auto-diagnostic" tool – and that CFEs are fully capable of managing business alliances and new investments. Moreover, such improved

[31] It does not include $USD 115,000 requested for the Project preparation Grant

capacity to access financial services among CFEs will demonstrate the viability of such investments, sparking increased willingness among private sector actors to extend credit to the sector.

V. Executing Agencies and Mechanism

A. Rationale for Two Executing Agencies:

5.1 As this project considers both technical/environmental management and finance issues, executing agencies specializing in both areas are involved in project execution. FMCN, through on-the-ground partners[32], will provide the environmental management and entrepreneurial technical assistance and capacity building components of the project, while FINDECA S.A. de CV will build on its experience with lending to rural producers to increase access to finance to CFEs. Each institution will sign contracts with the IDB for the budget components that finance activities under their responsibility. FMCN will be assigned the technical assistance budget for components 1,2,3, and 5. FINDECA will be assigned the technical assistance and loan budgets under component 4.

B. Executing Agency- FMCN

5.2 The Mexican Fund for the Conservation of Nature (FMCN) is a civil organization that achieves its mission by channeling financial resources, principally from bilateral and multilateral agencies and private foundations, to on-the-ground conservation projects throughout Mexico.

5.3 FMCN has more than fifteen years of experience financing and supervising conservation projects throughout Mexico. FMCN's flexible and transparent decision-making structure, strict financial controls, and experienced and highly trained technical staff enable the Fund to identify and assist local organizations in carrying out effective, results-based projects. As a result of this experience and understanding of Mexico's needs and challenges, FMCN assists donor institutions to ensure that their resources contribute to the conservation of Mexico's natural resources in an effective and equitable manner. FMCN has received funding from governmental and private national and international donors such as GEF-World Bank, United States Agency for International Development, United States Forest Service, the Spanish Agency for International Development, Packard Foundation, and The Gordon and Betty Moore Foundation, among others.

5.4 In addition to providing funding to community groups and local and national conservation institutions throughout Mexico, FMCN works closely with local institutions to build capacities and consolidate strong and effective civil society organizations. FMCN is in a strong position to leverage opportunities, foster exchange and create links between organizations throughout the country.

[32] The local providers and the business skills task force.

5.5 FMCN has over 40 employees and in 2010 channeled approximately US$6 million to support field activities through three institutional programs: 1) coastal and marine environments, 2) protected areas, 3) forests and watersheds. FMCN works closely with local institutions and civil society organizations to develop initiatives that contribute to conservation and sustainable use of natural resources and biodiversity. FMCN has four offices to facilitate operations and a closer relationship with their partners: the main office in Mexico City; the office within CONANP (the National Protected Areas Commission); an office in Xalapa, Veracruz; and an office in La Paz, Baja California.

5.6 In addition to the key partnerships at the national scale with CONAFOR and Financiera Rural, as well as with FINDECA, the FMCN will work closely with a range of public, private and civil society partners including community organizations to be engaged for enterprise development, as well as "supra-community" alliances (e.g. unions, second-tier groups, cooperatives) formed to improve CFE performance and access to services. Secondly, national and local NGOs in the focal states partnering with communities will be important allies. Additionally, allied projects working on complementary efforts in focal areas supported by bi- and multilaterals (e.g. IBRD-led FIP projects, GEF/UNDP project, USAID's M-REDD program) will be important collaborators, leveraging investment and synergies where work commences in aligned focal sites.

C. Executing Agency- FINDECA S.A. de C.V.

5.7 FINDECA is a non-regulated financial institution in Mexico, headquartered in Oaxaca and with an office in Chiapas. It was founded in June 28, 2007, and is categorized as a Financial Society of Multiple Objectives (Sociedad financiera de objeto multiple SOFOM), a non-regulated but legal financial institution. It was incorporated as a Sociedad Anónima de Capital Variable SA de CV. FINDECA's mission is to provide affordable financing to help develop the organized rural sector in the south - southeast of Mexico, by financing productive projects that incorporate sustainable use and conservation of environmental areas certified by recognized independent parties. Their focus is to facilitate access to finance for MSMEs in rural areas who historically have had difficulty obtaining financing. For 5 years it has been funding rural MSMEs, ejidos, and communities in the states of Oaxaca, Chiapas, Guerrero, Quintana Roo and Puebla. It has 20 employees, of whom 60% are operational; it has an average placement of US$1.3 million per year in credit. FINDECA's forestry activities are most prominent in ejidos and communities, including loans for extraction and industrialization of wood, production of tree seedlings; extraction and industrialization of chicozapote chicle resin (*Manilkara zapota*), and commercial timber species enrichment.

5.8 FINDECA was selected as the executing agency for the credit portion of the project due to its experience lending to the target market, its connections to ejido and other businesses in the areas of intervention of the project, its willingness to serve this market and to collaborate with FMCN, CONAFOR, and Financiera Rural, and due to the absence of other institutions willing to pilot CFE credit products at this time.

5.9 Both executing agencies have expressed their interest in working together in the project, coordinating activities and information to achieve project's objectives.

D. Executing Mechanism

5.10 **Project Execution Unit.** Two separate project coordinators will be required to coordinate work within a Project Execution Unit (PEU) created to implement the proposed project. It will consist of a Technical Coordinator working with FMCN, supported by a Technical Assistant responsible for administrative tasks, and a Technical Coordinator working with FINDECA. Both coordinators will report to the Project Steering Committee (described below). FMCN's coordinator will oversee the Financial and Entrepreneurial Task Force and the 5 Technical Providers working on the ground with project clients. FINDECA's coordinator will work with the Credit Committee tasked with loan placement and management, and will work with a part-time consultant (hired by and reporting to the MIF) for purposes of supervision of the FIP credit.

5.11 **Project Steering Committee.** The project will require a Project Steering Committee (PSC) be established to oversee project operations and the PEU.

a. **Membership:** The steering committee and members' respective roles and voting privileges will be as follows: (i) FMCN, *Chair* – voting member; (ii) FINDECA - voting member; (iii) Financiera Rural – voting member; (iv) CONAFOR – voting member; (v) MIF (HQ and COF)[33] – observer; (vi) IDB (INE/CCS)– observer.
b. **Duties**: The committee will be responsible for general project coordination, oversight of the link between loans and technical assistance, coordination with the Credit Committee to develop selection criteria and choose CFEs for participation, development of selection criteria for coordinators and decision/approval of same.

5.12 **Disbursement by Results**. Project disbursements of the TC funds will be contingent upon verification of achievement of milestones, which will be agreed upon between the Executing Agencies and the MIF. Achievement of milestones does not exempt the Executing Agencies from the responsibility of reaching the logical framework indicators and the Project's objectives. According to the Performance and Risk-based Project Management approach, disbursement amounts will be based on the project's liquidity needs for a maximum period of 6 months. These needs must be agreed upon between MIF and the Executing Agency and will reflect the activities and costs scheduled in the annual planning exercise. The first disbursement will be issued upon achievement of Milestone 0 (conditions precedent) and subsequent disbursements will be issued as long as the respective conditions have been met: i) MIF has verified that milestones have been achieved, as agreed to in the annual plan; and, ii) the Executing Agency has justified 80% of all cumulative advances..

5.13 **Procurement and contracting FMCN:** For the procurement of goods and contracting of consulting services, the Executing Agency will apply the IDB Policies (GN-2349-9 y GN-

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[33] HQ participation to be covered by FIP MDB Fees.

2350-9). Given that the Diagnostic of Executing Agency Needs (DNA) generated a **medium level of need/risk** classification, the project team has determined as stipulated in Appendix 4 of these IDB Policies, the Executing Agency which belongs to the private sector, will use the private sector procurement methods specified in Annex 1 of the Operational Guidelines for Technical Cooperation Projects (OP-639). In addition, the review of procurement and contracting processes for the project will be conducted **ex-post** and on a **semi-annual** basis. With project resources, the IDB/MIF will contract consultancy services to support and train the Executing Agency in procurement areas that require further strengthening as identified through the DNA.. Before project contracting and procurement begins, the Executing Agency must submit the project Procurement Plan for the IDB/MIFs approval which should be updated annually and when there are changes in the methods or goods or services to be procured.

5.14 **Procurement and contracting FINDECA:** For the procurement of goods and contracting of consulting services, the FINDECA will apply the IDB Policies (GN-2349-9 y GN-2350-9). Given that the Diagnostic of Executing Agency Needs (DNA) generated a **high level of need/risk** classification, the project team has determined as stipulated in Appendix 4 of the IDB Policies, the Executing Agency which belongs to the private sector, will use the private sector procurement methods specified in Annex 1 of the Operational Guidelines for Technical Cooperation Projects (OP-639). In addition, the review of procurement and contracting processes for the project will be conducted **ex-post** and on a **quarterly** basis. With project resources, the IDB/MIF will contract consultancy services to support and train the Executing Agency in procurement areas that require further strengthening as identified through the DNA Before project contracting and procurement begins, the Executing Agency must submit the project Procurement Plan for the IDB/MIFs approval which should be updated annually and when there are changes in the methods or goods or services to be procured.

VI. Monitoring, Evaluation, and Knowledge Return

A. Monitoring and Evaluation

6.1 The MIF Country Specialist in Mexico will be responsible for supervision of the project. The PEU and the Steering Committee will provide information to the MIF regarding the accomplishments of the Expected Results of the productive and financial activities. Supervision of FIP loan will be contracted by the MIF to a consultant with demostrated expertise in finance, who will oversee the execution of the loan component during 5 years. The MIF will hire the expert with FIP-provided funds permitted to cover MDB fees.[34]

6.2 The evaluation of the expected impacts in terms of reduction in emissions will be based on estimates by CONAFOR under a comprehensive REDD+ Monitoring, Reporting and Verification System (MRV) currently in development with the support of the Government of Norway. The attribution of carbon benefits to individual actions is complex, particularly given that multiple activities may be undertaken in the same territories within Early Action REDD+ Areas, including the three other FIP projects. In this regard, an ex post cost benefit

[34] This will be a part-time consultant contracted for approximately one week per year to review the health of FINDECA's portfolio related to this project, and to report on the disbursement and repayment of the FIP loan.

analysis will be conducted to identify the program's specific contribution to emission reduction and other environmental co-benefits.

6.3 FMCN will establish a baseline against which it will monitor progress of all CFE's involved on a biannual basis. Additionally, the beneficiaries of the TA will be required to present biannual reports to FMCN that show the variations in the technical processes and the finance received. The TA providers (consultants and support organizations) hired by FMCN will report progress on training, technical assistance and agreements with the beneficiaries. FMCN will use an online system for recording and evaluating the project's technical and financial progress.

6.4 **Project Status Reports:** FMCN and FINDECA will each be responsible for presenting Project Status Reports (PSRs) to the MIF within thirty (30) days after the end of each semester, or more frequently and on such dates as the MIF shall determine, by providing at least sixty (60) days advance notice to the Executing Agencies. The PSR will contain information on Project execution, achievement of milestones, and completion of Project objectives as stated in the logical framework and other operative planning instruments. The PSRs will also describe Project issues encountered during execution and outline possible solutions. Within ninety (90) days after the end of the execution term, the Executing Agencies will each submit a Final Project Status Report to the MIF, which will highlight results achieved, project sustainability, evaluation findings, and lessons learned. In addition, an Annual Supervision Report (ASR) will be also prepared to report on the yearly progress of the loan component of the project until the loan is completely repaid.

6.5 FMCN and FINDECA will establish and maintain adequate accounts of their finances, internal controls, and Project file systems, according to the financial management policy of the IDB/MIF.

6.6 **Financial Management and Supervision FMCN**: Given that the Diagnostic of Executing Agency Needs (DNA) generated a **medium level of need/risk** in financial management, the review of supporting documentation for disbursements will be conducted **ex-post** and on a **semi- annual** basis. With project resources, the IDB/MIF will contract consultancy services to support and train the Executing Agency in financial management areas that require further strengthening as identified through the DNA. Ex post reviews of FMCN will include an analysis of the Financial Statements that the EA should prepare annually as part of its financial management. The costs associated with this contract will be financed with the MIF contribution resources according to IDB procedures. During project execution, the frequency of ex post reviews for procurement processes and supporting documentation for disbursements as well as the need for additional financial reports can be modified by the MIF based on the results of the ex post review reports conducted by external auditors during the project execution.. The Executing Agencies will contract independent auditors to carry out the ex-post reviews of the procurement processes and of supporting documentation. The scope of these ex post reviews will include the revision of the financial statements that the Executing Agencies shall prepare within the financial management practices. The associated costs will be financed with the MIF contribution to the Project according to IDB procedures. The frequency of the ex-post reviews of procurement processes and supporting documentation for disbursements can be modified by the MIF based on the results presented in the auditor's reports during the Project execution.

6.7 **Financial Management and Supervision FINDECA:** FINDECA will establish and will be responsible for maintaining adequate accounts of its finances, internal controls, and project files according to the financial management policy of the IDB/MIF. Given that the Diagnostic of Executing Agency Needs (DNA) generated a **medium level of need/risk** in financial management, the review of supporting documentation for disbursements will be conducted **ex-post** and on a **semi- annual** basis. With project resources, the IDB/MIF will contract consultancy services to support and train the Executing Agency in financial management areas that require further strengthening as identified through the DNA

6.8 The IDB/MIF will contract independent auditors to carry out the ex-post reviews of procurement processes and of supporting documentation for disbursements of FINDECA. Ex post reviews will include an analysis of the Financial Statements that the EAs should prepare annually as part of their financial management. The costs associated with these contracts will be financed with the MIF contribution resources according to IDB procedures. In addition, the IDB/MIF will contract a mid-term audit of all project expenditures from both EAs (at 18 months), and a final audit of both EA expenditures.

6.9 During project execution, the frequency of ex post reviews for procurement processes and supporting documentation for disbursements as well as the need for additional financial reports can be modified by the MIF based on the results of the ex post review reports conducted by external auditors during the project execution.

6.10 An external consultant will supervise the loan portfolio and execution of the FIP funds to be used by FINDECA to provide credit to CFEs. The consultant will be hired by and will report to the MIF.

6.11 **Baseline and Evaluations**. A baseline will be established at the start of the Project. A baseline diagnostic will be established with all CFEs that will be assisted under this project, including metrics that can used to measure project impacts. In monitoring impacts per key indicators outlined above, the baseline diagnostic will be revisited annually to assess change. Over the long term, installation of local capacities for such monitoring will be delivered through technical trainings.

6.12 The project team will assist CONAFOR in an impact evaluation that is planned for all four components of the FIP. This evaluation will attempt, as much as possible, to disaggregate results at the project level for FIP projects 1,2,3 and 4 and to attribute these results to interventions, where possible.

6.13 A final evaluation will be conducted within three months of the end of the execution period, or at 95% of the disbursement of resources. The final evaluation will review, among other aspects: (i) the extent to which activities were completed; (ii) level of achievement of Project objectives and corresponding indicators described in the logical framework, including the benefits achieved with the implementation of the project; (iii) executing agency performance; (iv) quality of consultations; (v) main obstacles encountered in provided technical assistance and finance to CFEs and how obstacles were managed; (vi) level of satisfaction of final beneficiaries with the services received; and (vii) lessons learned and best practices identified and replicated.

6.14 In evaluating the outcomes of this project and considering lessons learned for future interventions, the questions to be considered will include: (i) Is a combined technical assistance and access to finance approach effective? (ii) How can top-down projects of national and international importance most effectively engage with rural producers and meet their needs? (iii) Which productive forest activities most effectively compete with alternative (and more carbon intensive) land uses, and how can these best be matched to local conditions and market conditions? (iv)What incentives and methods of engagement were most effective in encouraging CFEs to access and make use of credit sustainably? (v) Which were the major setbacks in implementing the project, and which alternatives worked to solve them? (vi) What impact does the difference in concessionality between public and private lending have on beneficiaries?

6.15 **Closing Workshop.** At least four (4) months before the end of the execution period, a Closing Workshop will be organized by the executors with the participation of FMCN, FINDECA, Financiera Rural, CONAFOR, the beneficiaries, IDB/MIF personnel, sector representatives, and any other staff to be agreed upon by the IDB/MIF, to jointly evaluate Project outcomes, identify additional tasks to ensure the sustainability of actions initiated under the Project, and identify lessons learned.

VII. Project Benefits and Risks

A. Program Benefits and Development Impact

The project seeks to improve the profitability, and the financial and social sustainability of CFEs while mitigating climate change. At least 60 community forest enterprises (CFEs) will increase their profit while reducing pressure on forest resources. In doing so, they will show an average of 6% increase in annual gross profit, 4,900 people will increase income from CFE, and 10,680 community residents indirectly benefit[35] from CFE income. The estimated direct impact of the program is a reduction of GHG of 104,903 tCO_2e, equivalent to the capture of 28,610 tons of carbon in the project area during the 5-year execution period.[36]

7.2 As CFEs increase their productivity while leveraging or preserving the natural capital of forest lands, 700 people will gain employment, with 210 employees in specialized posts

[35] Benefit means that the community enterprise invests in community infrastructure that is used by the whole community (social security, health clinics, schools, infrastructure, etc.) These types of investments are common.

[36] It is important to mention that these estimations could change as the result of the implementation of the Monitoring, Reporting and Evaluation System that is still under development by CONAFOR Ultimate carbon results will be based on the National MRV system. The attribution of carbon benefits to individual actions is complex, particularly given that multiple activities may be undertaken in the same territories within Early Action REDD+ Areas, including the three other FIP programs. The proposal is to eventually substitute this number by an analytical method to statistically assess the contribution of the Program's activities and investments in the overall carbon outcomes as derived from the National MRV.

in the process of managing 90,750 hectares. 60 CFEs will implement land management plans. CFEs will experience a 3% increase in ROE, with 45 CFEs receiving at least one credit from Financiera Rural and borrowing an aggregate of at least $5 million. 15 CFEs are expected to receive at least one credit from FINDECA, and FIP loans will represent 10% of FINDECA's portfolio.

7.3 Tracking the above detailed indicators will demonstrate both direct and indirect impacts of project interventions among beneficiaries. Changes in overall enterprise performance will detail the impact of technical assistance activities more broadly, while tracking specific indicators related to areas where financial services are channeled (e.g. increased yields due to sawmill upgrade[37]) will show fine-scale, direct impact of project interventions.

7.4 The project is expected to have a positive impact on women beneficiaries due to its specific focus on generating employment opportunities for women. The project will specifically aim for the inclusion of women in key decision-making roles through participatory workshops to be organized as part of technical assistance around enterprise governance and administration. Moreover, creation of new employment opportunities in finance and administration, as well as through the diversification of production, will generate positive benefits for female community members. Impacts will be measured through tracking sex-disaggregated indicators related to employment, including the number of specialized posts created for women. In addition to the main project tasks, FINDECA will bolster its capacity for engagement with women and other vulnerable groups in sectors that have traditionally been male-dominated (like forest management) through a microfinance product to be designed in Component 4. However, the credit to be granted via this product will not be financed or executed within the current project.

B. Risks and considerations

7.5 Several important risks could undermine the project's ability to achieve success, including:

7.6 **Logistical and Operational Risk: (**i) A lack of producer interest in accessing Financiera Rural or FINDECA finance due to availability of government subsidies, poor financial capacity or other reasons can impact the demand for the loans; this will be mitigated by creating a marketing strategy for the loans within the context of the project's TA, holding awareness-raising sessions, etc. (ii) Bureaucracy may create delays in product harvesting and sales; mitigated through having CONAFOR participate in the steering committee and the ongoing development of FIP projects 1 and 2[38]; (iii) Catastrophic natural disturbances such as tropical storms or fires that may lower productive capacities and impede compliance. (iv) Because the program is linked to other projects of the FIP, which are being executed by CONAFOR and Financiera Rural, any negative development of these other projects or the lack of coordination between the agents could affect the Project.

[37] This reduces the number of trees necessary to produce the same amount of timber products, reducing pressure on forest stocks.

[38] Risks related to SEMARNAT support to CONAFOR cannot be mitigated within the project

Mitigated by the participation of these two entities in the steering committee for maximum coordination; (v) Lack of credit placement and the possibility of defaulted loans by the CFEs due to the technical complexity of the activities to be financed; mitigated through good design of products and use of past models from MIF projects as a base for credit design (vi) Possible rejection or cancellation of projects in execution due to institutional and cultural factors of ejidos and communities; mitigated through having a strong consultation prior to design to inform the implementation of the project and by selecting local partners close to the communities that will give "tailored" assistance to the beneficiaries and finally thorough monitoring and evaluation.

7.7 **Financial Risk of Loan:** By agreement, the FIP will retain the financial risk in lending to the project executing agency (FINDECA) for on-lending to CFEs rather than requiring the MIF to assume this risk. **Business development risks:** (i) Beneficiary CFEs' business development may not lead to increased employment, or employment may increase without increasing employee skill level; (ii) CFEs fail to increase area under management from baseline; (iii) Market demand for timber and non-timber products is insufficient to support CFE expansion; (iv) Despite Technical Assistance, CFEs fail to become creditworthy. These factors should be mitigated by implementing strong TA through components 3 and 4, including a detailed analysis of existing skills, market demand, and business opportunities.

7.8 **Environmental and environmental impact measurement risks:** (i) Leakage and lack of additionality.[39] (ii) CFEs undertake monoculture or plantation farming. (iii) The development of the CONAFOR REDD+ MRV system is delayed, making baselines difficult to establish. (iv) CFEs forestry practices are non-sustainable and result in net emissions. These factors should be mitigated by having a respected forestry organization as an executor (FMCN) and the ongoing participation of CONAFOR in the steering committee.

7.9 **Risk of natural disasters:** (tropical storms, drought or flooding in Oaxaca/Chiapas could devastate the coffee crop, leaving FINDECA with a large non-performing portfolio in coffee). Mitigating factors: While this risk is difficult to mitigate, FINDECA has long experience dealing with coffee crops and has learned that in the zones of the project climate variations have not, to date, dramatically impacted harvests.

7.10 **Currency exchange risk:** A major devaluation of the Mexican peso could undermine the repayment capacity of CFEs to FINDECA[40] as well as the quality of its assets, thereby compromising its ability to repay its financial liabilities in foreign currency as the case of the FIP loan. Mitigating factor: If procedures allow, MIF will lend to FINDECA in pesos. If not, with TA resources directed to FINDECA, the borrower will conduct a study to analyze and adopt a currency hedge mechanism for the FIP loan. **Credit risk**: Rapid portfolio growth coupled with the incursion in new financial products can result in a deterioration of portfolio quality and increased default risk. Considerations: FINDECA has experience and small portfolio allocated with clients similar to the CFEs (specially

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[39] Leakage refers to the phenomenon where an intervention decreases forest emissions in one locality, only to cause the drivers of emissions (illegal logging, for example) to simply move elsewhere. Additionality is the value added of the intervention; an apparent lack of additionality suggests that the intervention did not lead to a net emissions reduction.

[40] As a result of problems related to commercializing products.

ejidos) in a couple of credit operations. Mitigating factors: With TA resources during the first year of execution, FINDECA will hire consultants to develop the new financial products and to establish manuals, credit regulations and processes according to the best practices of the market.[41] To this end, the MIF will seek to share when possible, credit manuals, training materials and lessons learned from past successful experiences of forestry projects related with low-income population to inform project activities.

7.11 **Liquidity risk:** If demand for forestry financial products for CFEs rises the availability of FINDECA to satisfy the full market can be restricted due to FINDECA's dependency on external financing. Mitigating factors: FINDECA is working to diversify its financing sources and has begun conversations with national and international financial providers to support additional lending upon development of the model.

7.12 **Portfolio concentration risk:** Currently FINDECA has a strong portfolio concentrated in coffee crops. Consideration: FIP loan resources will be a source of diversification of funding for FINDECA and will help them diversify the placement of their portfolio.

7.13 **Entry barriers and competition risk:** Competition and entry of other players in the market of forest credits could make FINDECA's products less attractive.. The forest credit market in Mexico has been limited for years. Over time, as the project is successful and the business model proven it is hoped that more FIs will enter the market. However, given that the latent demand is large and the current level of service is low there should be ample room for new market entrants.

VIII. Environmental and Social Aspects

8.1 The project will have positive environmental benefits due to improvements in forest management and avoidance of conversion of primary forest to other land uses. These changes should conserve biodiversity and mitigate climate change by reducing CO_2 emissions. In addition, as part of project preparation, an Indigenous Assessment was conducted in all target geographic areas with indigenous populations in conjunction with the IDB's indigenous safeguards team. The consultation had full participation of civil society and other key actors. Three workshops were carried out in the region involving more than 100 ejidatarios and communal land owners including speakers of the main indigenous languages: Mixteco, Zapoteca, Mazateco, Chinanteco and Maya. Participants' perspectives regarding forest conservation, obstacles to accessing credit and perceived risks were identified as well as recommendations to facilitate access to financing and capacity building and technical assistance priorities.

8.2 In accordance with the Bank's toolkit, this project has been classified as a category "C" operation.

[41] This consultancy will build upon, where possible, the results of a similar mechanism developed for Financiera Rural.