

TECHNICAL BRIEF

# PAY FOR SUCCESS STRATEGIES FOR WESTERN STATES

Environmental  
Incentives 



# PAY FOR SUCCESS STRATEGIES FOR WESTERN STATES v1.0

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## TECHNICAL BRIEF

The Developing Pay for Success Contract Mechanisms for Western States project is funded by a Conservation Innovation Grant from the United States Department of Agriculture to Partners for Western Conservation. Environmental Incentives is the technical lead for the project and the lead developer of this brief. Project partners include Environmental Defense Fund, Nevada Department of Conservation and Natural Resources, Nevada Division of Environmental Protection, Idaho Office of Species Conservation, Utah Department of Natural Resources, and Colorado Department of Natural Resources.

### **Recommended Citation**

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# Introduction

Several Western states are actively investing taxpayer dollars to conserve greater sage-grouse habitat and ensure populations remain viable under state control. Pay for success contract mechanisms reward landowners and conservation professionals for enhancing and maintaining high quality habitat based on the outcomes resulting from conservation projects.

This technical brief defines four pay for success strategies that align economic incentives with regional conservation goals; inspiring landowners and conservation professionals to produce desired conservation outcomes. Project partners have reviewed and provided input on these strategies, and Environmental Incentives has interviewed all project partners to understand the context of each state's greater sage-grouse conservation programs. This information will be used to select one pay for success strategy to develop and test.

This brief includes the following sections:

- **What is Pay for Success?** – Provides an overview of pay for success as a general approach.
- **Why use Pay for Success?** – Highlights how pay for success contract mechanisms can lead to effective and efficient conservation outcomes at large scale.
- **Pay for Success Strategies** – Describes five funding strategies – four pay for success strategies and one status quo funding strategy – in relation to a set of factors that help determine the context in which each pay for success contract strategy is most likely to be successful.

# What is Pay for Success?

Pay for success contract mechanisms link payment to the delivery of verified conservation outcomes.<sup>1,2</sup> Paying for conservation outcomes creates financial incentives for landowners and conservation professionals to determine the most cost-effective ways to achieve and maintain desired conservation outcomes, while reducing the risk of taxpayer dollars<sup>3</sup> funding projects that do not produce desired results. Furthermore, by focusing on outcomes, pay for success contracts create opportunities for investors to finance conservation projects with potential to achieve a return on investment if conservation outcomes are cost-effectively produced.

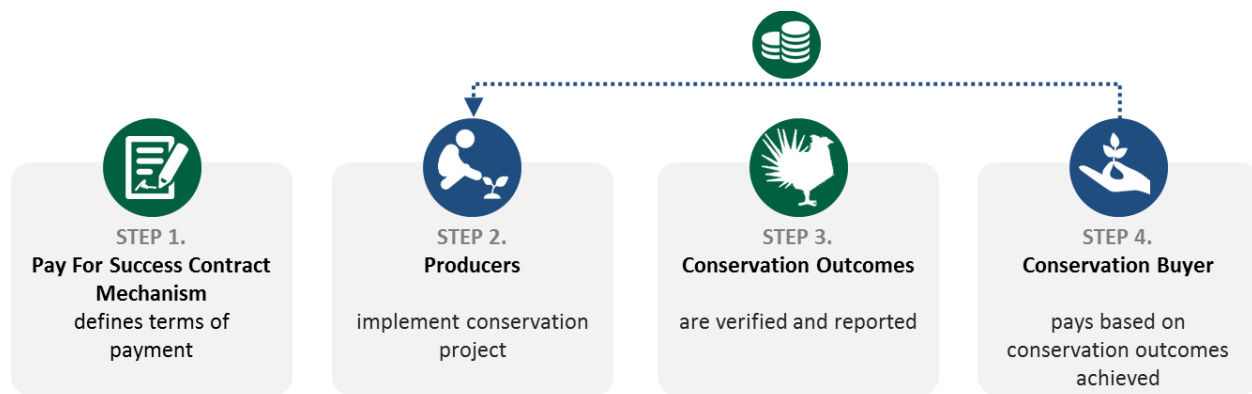


Figure 1: Simplified structure of a basic pay for success contract

## Pay for Success Actors & Components

Pay for success contract mechanisms focus a diversity of actors on the effective use of capital to create verified conservation outcomes.

### Actors

- **Conservation Buyers** are public agencies, foundations, nonprofits, private companies or individuals that spend money on conservation with the intent of achieving defined conservation outcomes. Conservation buyers may be managing a decades-long program supported by ongoing taxpayer dollars or simply making a one-time investment.
- **Mitigation Buyers** are companies or public infrastructure agencies that purchase conservation outcomes to satisfy regulatory requirements.
- **Investors** are private equity managers, investment bankers, commercial bankers or foundation program-related investment managers that finance conservation projects with the intent of achieving a return on investment. Impact investors may require concessionary returns<sup>4</sup>, while mainstream investors require a risk-adjusted market rate of return. Government programs occasionally act as investors using public funds.

<sup>1</sup> Galloway. (2013). Foreword. Community Development Investment Review 9(1): 3-4.

<sup>2</sup> Nicola, D. (2013). Environmental Impact Bonds. Case i3: The Case Initiative on Impact Investing.

<sup>3</sup> Pay for success mechanisms can be used to purchase conservation outcomes that achieve conservation goals or meet mitigation requirements by any public or private entity. The target audience for this brief and project is state agencies investing public funds in conservation.

<sup>4</sup> Concessionary returns are below market rates of return.



## ACTORS & COMPONENTS OF PAY FOR SUCCESS

### Key Actors



Conservation Buyer



Mitigation Buyer



Investor



Producer



Administrator

### Components



Conservation Outcomes



Contract Mechanism



Capital



Payment



Certified Credit

- **Producers** are landowners and conservation professionals – including conservation bankers and environmental consultants – that design and implement conservation projects.
- **Administrator** is an entity that can 1) define the methods to measure conservation outcomes, 2) measure, verify, and track conservation outcomes over time, 3) provide template pay for success contract mechanisms and financing terms that balance the needs and risks of all parties, 4) administer long-term stewardship contracts, manage reserve accounts, and make project-scale adaptive management decisions, and 5) connect conservation and mitigation buyers, producers and private investors to facilitate conservation investments and streamline the delivery of conservation outcomes. The functions of the administrator can be performed by the buyer or by contractors; however, the administrator can increase efficiency and improve trust such that they are valuable for long-term programs.

### Components

- **Conservation Outcomes** are measurable units of environmental benefit that serve as the basis for payment in pay for success contract mechanisms.
- **Pay for Success Contract Mechanisms** include solicitations, such as requests for proposals, and contracts between buyers and producers that use conservation outcomes as terms for payment.
- **Capital** refers to financing for project implementation that is intended to be paid back once the producer receives payment from delivering conservation outcomes.
- **Payment** refers to money paid by the buyer to the producer.
- **Certified Credits** represent verified conservation outcomes with assurances as specified in the pay for success contract. Assurances include long-term management plans, financial assurances, endowment accounts, and landowner agreements or easements that exclude incompatible uses of land within the project area.

# Why Use Pay for Success?

Pay for success contract mechanisms align the incentives of buyers and producers to cost-effectively produce and sustain conservation outcomes that achieve regional goals. Linking payments to conservation outcomes, rather than reimbursing expenses, minimizes buyer risk of funding ineffective projects that do not deliver intended results. Furthermore, pay for success contract mechanisms share risk with those in the best position to manage it – producers – while providing financial incentives that inspire innovation, improve the effectiveness, and reduce the cost of conservation. Long-term pay for success contracts and project stewardship accounts establish incentives for producers to sustain conservation outcomes over decades.

Certain pay for success contract mechanisms enable rapid, large-scale conservation in regions where conservation is needed in dozens of locations across a landscape and millions of dollars of conservation spending is expected over several years. The opportunity for financial gain motivates a whole industry of conservation professionals to efficiently identify high potential conservation opportunities, design effective projects, and implement cost-effective conservation practices. Negotiating the legal assurances that must be placed on conservation sites to ensure durability and exclude competing land uses can be complicated, lengthy, and restrictive for public agencies, creating uncertainty and unease with many landowners. Conservation professionals are able to negotiate prices and agreements with landowners and bundle land costs with overall project costs. Pay for success contract mechanisms increase efficiency for buyers by reducing the need for costly and detailed project-by-project reviews that require specialized staff skills, consume limited agency and company staff time, and result in project delays. Therefore, buyers can screen projects for desired attributes and determine a competitive price for conservation outcomes, leaving the details of project implementation to be handled by producers who hold the financial risk for project success.

Pay for success contract mechanisms link ongoing revenue streams to monitoring results that demonstrate if a project is maintaining conservation outcomes. The requirement to submit monitoring information over many years fosters long-term relationships with producers and ensures they provide ongoing effectiveness monitoring information necessary for adaptive management and learning. Buyers and conservation program managers can use conservation outcomes to determine the environmental return on investment, in terms of credits per dollar. Providing effectiveness information to conservation professionals enables the industry to rapidly learn to select and design more effective projects.

## BENEFITS

***Reduces risk of funding ineffective projects***

***Achieves long-term stewardship***

***Enables rapid, large scale conservation with buyer efficiency***

***Supports adaptive management and learning***

***Demonstrates environmental return on investment***

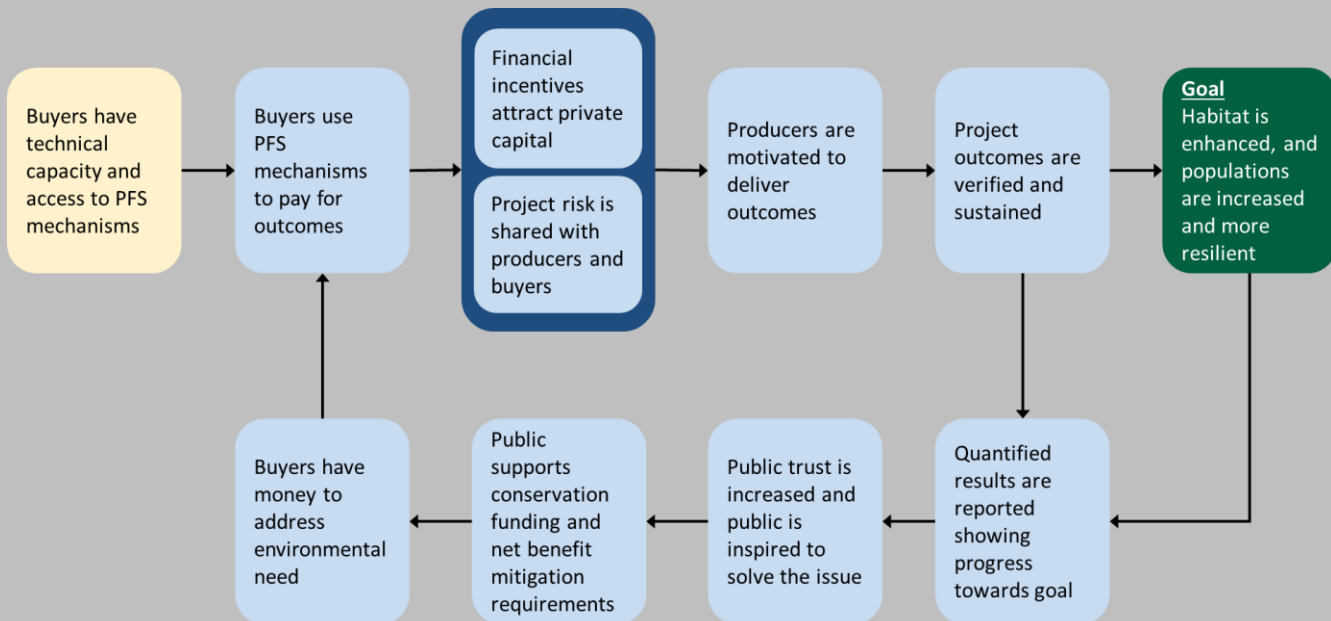
***Leverages private capital to support conservation***

***Inspires public trust to sustain long-term conservation programs & mitigation policies***

## Pay for Success Theory of Change

The following describes the theory of change for how this project enables pay for success mechanisms to significantly improve the effectiveness of conservation spending, and sustain public and stakeholder interest in allocating the resources necessary to achieve priority conservation goals.

### PAY FOR SUCCESS THEORY OF CHANGE



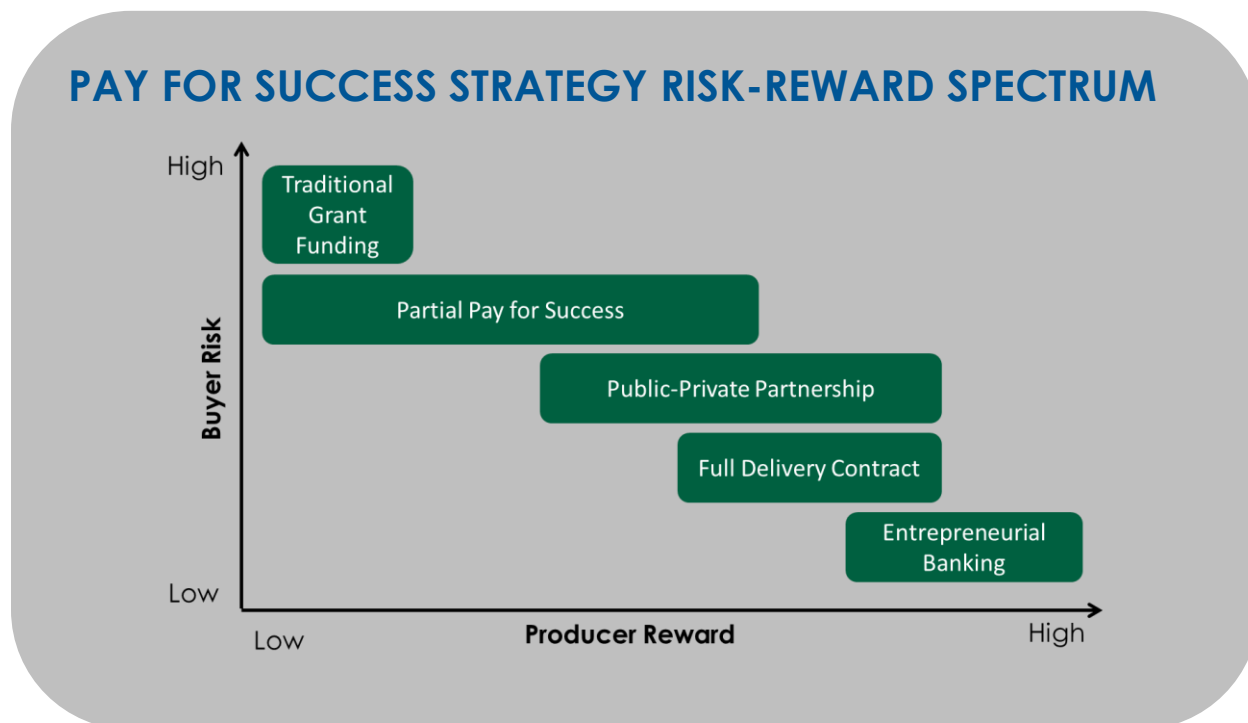
The goal of the Developing Pay for Success Contract Mechanisms for Western States project is to **build technical capacity and create pay for success contract mechanisms** that **enable buyers to pay for conservation outcomes**. Pay for success contract mechanisms **attract private capital** to finance conservation projects and **share risks** between buyers and producers, **creating incentives for producers to deliver conservation outcomes**. By linking payments to outcomes, buyers and sellers **verify and sustain project outcomes** through ongoing stewardship, **resulting in enhanced habitat**, as well as **increased and more resilient populations of target species**.

Publicly **reporting quantified results** demonstrates progress toward achievement of regional conservation goals, which in turn, **increases public trust and interest** in achieving long-term conservation goals. This quantified feedback enables public audiences to check progress in a manner that is understandable, similar to checking the score of a favorite sports team. This understanding **increases public support to fund conservation programs and increases their support for compensatory mitigation policies** that require net benefit for development impacts to habitat. Therefore, buyers **have sufficient funds to achieve regional conservation goals**.

# Pay for Success Strategies

This section describes traditional grant funding and four pay for success strategies: Partial Pay for Success, Public-Private Partnership with Project Seed Funding, Full Delivery, and Entrepreneurial Banking. Each strategy described varies in terms of the potential risk to buyers of spending funds without the intended conservation outcomes and the potential financial reward for producers from cost-effectively producing conservation outcomes, as demonstrated in the Pay for Success Strategy Risk-Reward Spectrum.

***This technical brief employs a broad definition for pay for success: any contract mechanism that links a meaningful portion of payment to the production of verified outcomes.***



Each of these strategies may be appropriate given the context of the conservation program’s familiarity with pay for success, the environmental issue, and funding availability. In regions lacking experience with pay for success strategies, it may be necessary to start with a strategy in which buyers bear more risk, such as a Partial Pay for Success. Once the definition of conservation outcomes is well defined and buyers, landowners, and a network of conservation professionals understand how to price risk, Full Delivery Contracts or Entrepreneurial Banking can increase buyer efficiency of securing conservation at scale.



## Contextual Factors Influencing the Appropriateness of Pay for Success Strategies

Each strategy description includes (1) a narrative and diagram showing how the actors and components interact to complete a transaction, and (2) the context in which the strategy is most likely to succeed at aligning incentives of multiple parties to produce cost-effective conservation outcomes. The six contextual factors listed below are considered for each pay for success strategy.

CONTEXTUAL FACTORS		RANKING AND CRITERIA
<b>Total Expected Demand Over Time</b>	High	Greater than \$3M from both conservation and mitigation buyers
	Medium	\$1M – \$3M from both conservation and mitigation buyers
	Low	Less than \$1M from both conservation and mitigation buyers
<b>Predictability of Demand</b>	High	Defined funding vehicle or program that allocates funds annually or more frequently on a predictable schedule
	Medium	Expectation of demand over several years, but not during any specific timeframe
	Low	Expectation that demand may only arise once within a period of several years
<b>Producer Access to Capital</b>	High	Existing producers have experience accessing sufficient capital to finance project costs
	Medium	Producers understand that they can seek capital to finance project costs, but lack experience securing capital and expect the learning curve to be costly or risky
	Low	Producers believe that they do not have opportunities to secure capital sufficient to finance project costs
<b>Project Risk of Producing Outcomes</b>	High	High uncertainty whether actions will result in intended outcomes
	Medium	Moderate certainty that actions will result in intended outcomes
	Low	Near certainty that actions will result in intended outcomes
<b>Acceptable Rate of Return</b>	High	No legal or social limits for producers gaining profit from producing cost-effective conservation outcomes
	Medium	Revenue beyond cost is allowable, but social norms create pressure for profits to be limited to a socially accepted level
	Low	Legal restrictions cannot allow any revenue greater than direct costs
<b>Quality of Quantified Unit of Conservation Outcomes</b>	High	Methods are clearly documented and results are trusted as a relevant representation of desired outcomes
	Medium	Methods exist and have been vetted by key stakeholders, but results have not been proven reliable through transactions that show a relationship between the quantified outcomes and desired environmental improvement
	Low	Methods do not exist or are draft and have not been vetted by stakeholders

# TRADITIONAL GRANT FUNDING

Traditional grant funding does not meet the definition of pay for success, and is provided here as a reference point to illustrate how the pay for success strategies differ from this model of funding. Because this is not a pay for success contract mechanism, the term funder is used instead of buyer, and project proponent is used instead of producer.

Traditional grant funding entails a funder that pays a project proponent for actions based on a predefined scope of work. The payment schedule is typically linked to direct cost reimbursement and may include markups for overhead costs and an acceptable profit. If profit is allowed, it is linked to the project cost, providing an incentive for the project proponent to increase costs in both the proposal phase and through change orders. Since the project proponent is paid for actions and payments are not linked to outcomes, the funder bears all project risk projects.

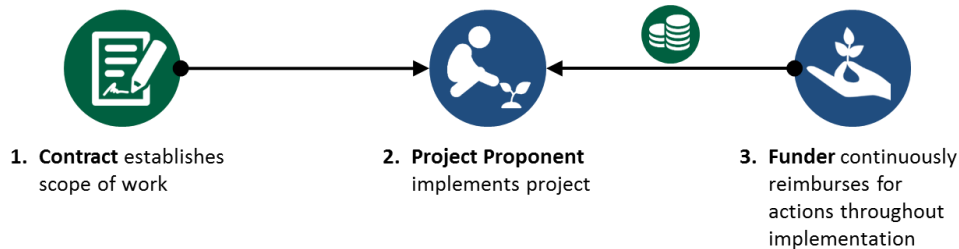
## DISTINGUISHING CHARACTERISTICS

***Pays for actions rather than conservation outcomes***

***All risk is held by funder***

### How it Works

1. **Contract** between the funder and project proponent defines a scope of work. The scope of work establishes the tasks to be completed, the timeline for completing those tasks, and payment terms based on costs incurred.
2. **Project Proponent** implements the scope of work defined in the contract and the funder incrementally pays as costs are incurred throughout implementation.



## When it Works

Traditional grant funding may be appropriate when the amount of funding is small and thus the cost of defining a method to measure conservation outcomes would consume much of the available funds.

Traditional grant funding may also be appropriate to test conservation actions that have a high risk of not producing intended outcomes, but are innovative and employ potentially useful techniques. Therefore, funding this type of innovative, high risk project could act as a beta test and provide the evidence and experience needed for it to be applied with low risk by producers involved in pay for success contracts.

FACTORS	RANKING	RATIONALE
<b>Total Expected Demand Over Time</b>	Low	If funding amount and the components for pay for success do not already exist, traditional grant funding may be appropriate because the marginal benefits to setup pay for success components do not justify the costs.
<b>Predictability of Demand</b>	Low	May be appropriate if the funding is a one-time effort. Producers are not likely to invest the upfront effort necessary to identify quality projects, evaluate project risk, and submit competitive proposals for a one-time pay for success solicitation.
<b>Producer Access to Capital</b>	N/A	Outside project finance capital is not necessary with this funding strategy.
<b>Project Risk of Producing Outcomes</b>	Low or High	Traditional Grant Funding is appropriate when there is high certainty that project will deliver intended results, thus there is little risk to the funder. Alternatively, this strategy may be appropriate for applied research projects that serve as an adaptive management experiment to test new methods with theoretical expectation of success, but limited real world application.
<b>Acceptable Rate of Return</b>	Low or Medium	Profits are typically restricted to established procurement policies for time and materials or cost plus fixed fee contracts.
<b>Quality of Quantified Unit of Conservation Outcomes</b>	N/A	Quantified units of conservation outcomes are not needed. However, grant funded projects can provide a useful opportunity to test conservation outcome units without worry that a draft unit will inappropriately influence payments in the context of a pay for success mechanism.

# PARTIAL PAY FOR SUCCESS

Partial pay for success provides an initial payment to the producer to cover some or all of the costs to implement the conservation project, and a secondary payment once conservation outcomes are verified. This strategy reduces the producer's risk of investing in a project that does not produce intended results and losing invested capital. Additionally, the partial pay for success contract structures the secondary payment such that the producer is motivated to deliver conservation outcomes so that it can maximize payment. The secondary payment reduces the conservation buyer's risk of funding an ineffective project, but the conservation buyer still assumes a significant portion of risk of the financial loss if the project does not deliver intended results. The amount of risk sharing is determined by the portion of funding that is paid upfront versus the portion paid upon verification of conservation outcomes.

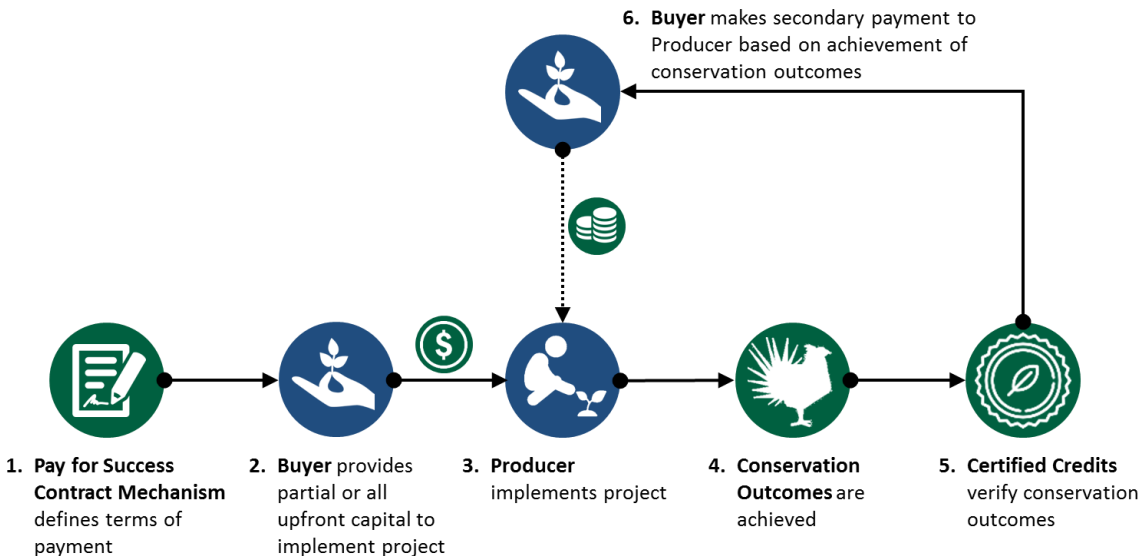
## DISTINGUISHING CHARACTERISTICS

**Conservation buyers provide partial funding for project implementation**

**Producers receive a secondary payment depending on conservation outcomes achieved**

### How it Works

1. **Pay for Success Contract Mechanism** includes a project solicitation and contract that defines credit requirements and terms of payment for both upfront primary payments and secondary payments upon verification of conservation outcomes.
2. **Conservation Buyer** provides upfront capital to producer to cover a portion or all of implementation costs.
- 3-5. **Producer** implements project and achieves **Conservation Outcomes**, which are verified as **Certified Credits**.
6. **Conservation Buyer** pays the producer depending on verified conservation outcomes and as specified by the terms for secondary payments.



## When it Works

Partial pay for success may be appropriate when

- There is limited confidence in the quality of the conservation outcome unit, thus buyers and producers are not willing to use it as the primary term of payment, or
- Producers have limited access to capital and a broader contingent of conservation professionals with experience accessing capital are not likely to engage because of uncertainty of the amount and predictability of demand.

FACTORS	RANKING	RATIONALE
<b>Total Expected Demand Over Time</b>	Low or Medium	This is an appropriate mechanism to create incentives for producers to achieve conservation outcomes when the scale of conservation is low and sufficient buyer staff time and expertise exists to engage in the details of project selection, design, and evaluation.
<b>Predictability of Demand</b>	Low or Medium	This strategy can be used for one-time investments.
<b>Producer Access to Capital</b>	Low	Buyers provide upfront funds for conservation projects; project finance capital is not needed.
<b>Project Risk of Producing Outcomes</b>	Low or High	If the project risk is low, the buyer risk is low.  However, if project risk is high, this strategy may be appropriate for applied research projects that serve as an adaptive management experiment to test new methods with theoretical expectation of success, but limited real world application. This strategy would provide the opportunity to structure the secondary payment as an option to continue implementation if the project produces desired outcomes.
<b>Acceptable Rate of Return</b>	Low or Medium	Profits are typically restricted to established procurement policies for time and materials or cost plus fixed fee contracts.
<b>Quality of Quantified Unit of Conservation Outcomes</b>	Low or Medium	A conservation outcome unit is needed; however, if the secondary payment is modest the buyer and producer may accept a unit that has not been proven. Partial pay for success is an opportunity to test a conservation outcome unit because it focuses the producer and buyer on using the unit, but limits the risk that a draft unit will inappropriately influence significant amounts of payment.

## Variation: Long-Term Stewardship Contracts

A simple application of partial pay for success reimburses the producer for initial project implementation costs as the primary payment and provides a secondary payment to cover ongoing stewardships costs, contingent upon the verification that the project is maintaining a defined level of conservation outcomes. This approach does little to limit the risk to buyers, but provides a moderately meaningful incentive for producers to access the ongoing stream of revenue associated with the secondary payment.



# PUBLIC-PRIVATE PARTNERSHIP: PROJECT SEED FUNDING

The term public-private partnership can be used to describe any relationship between a public entity and private actors. This project seed funding public-private partnership strategy describes a specific type of public-private partnership in which a public entity acts as the conservation buyer and uses public funds as capital to finance conservation projects. The certified credits generated from the project are intended to be sold to a mitigation buyer. Upon sale of credits, public funds are paid back. If the credits are not sold, the public funds are not repaid but the conservation outcomes are maintained for the contract duration.

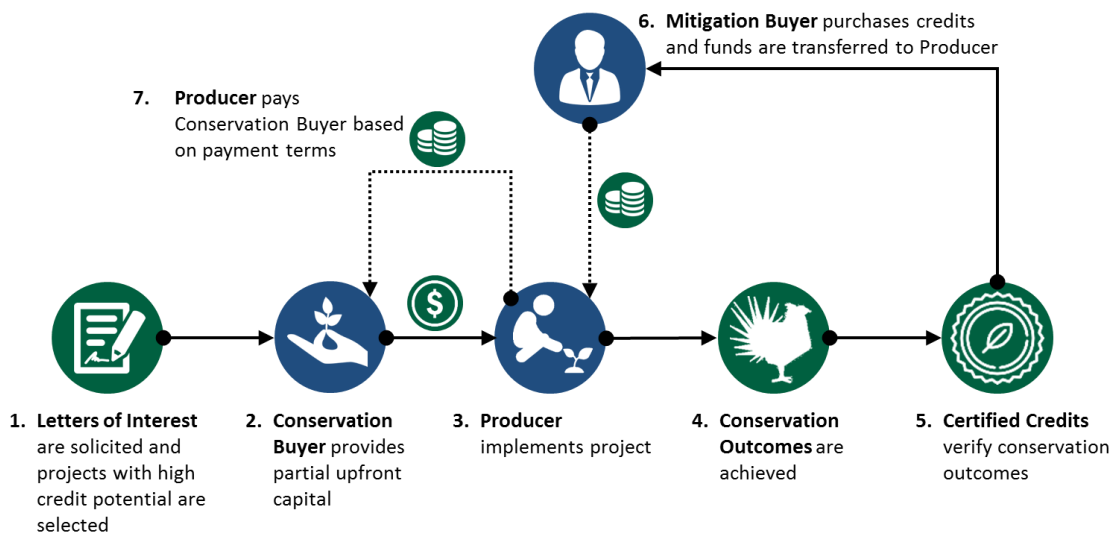
## DISTINGUISHING CHARACTERISTICS

*Conservation buyer acts as an investor, providing upfront capital for producer to implement project*

This project seed funding public-private partnership strategy requires the public entity to rigorously scrutinize projects before committing capital to finance project implementation. This strategy eliminates or reduces the need for the producer to secure private capital. The upfront funding available to producers can be less than the full cost of the project because producers stand to profit from the sale of credits to mitigation buyers.

### How it Works

1. **Letters of Interest** are solicited by the conservation buyer for proposed projects from potential producers. The conservation buyer selects projects with the highest conservation potential and then works with the producer to refine and finalize the project scope.
2. **Conservation Buyer** provides upfront capital to enable the producer to implement the project.
- 3-5. **Producer** implements project and achieves **Conservation Outcomes**, which are verified via **Certified Credits**.
6. **Mitigation Buyer** purchases the credits generated to satisfy regulatory compliance requirements. Funds from the credit transaction are transferred to the producer as a secondary payment for project implementation.
7. **Producer** pays back the conservation buyer for the upfront capital provided in Step 2, based on agreed-upon payment terms, and keeps any remaining funds.



## When it Works

The primary benefit of this strategy is that it creates the inception of credits in markets with unproven demand, thus supports industry involvement by creating a pool of credits that can be easily accessed to meet mitigation requirements and streamline permitting. This strategy does not increase efficiency for public conservation buyers to deliver conservation at large scale.

FACTORS	RANKING	RATIONALE
<b>Total Expected Demand Over Time</b>	Large	Project seed funding public-private partnerships are useful when the expected market for conservation credits is expected to be large, but is unproven.
<b>Predictability of Demand</b>	Low	This strategy is only necessary when predictability of demand from mitigation buyers is low, but has the potential to increase as regulators and industry learn to use credits to efficiently meet permitting requirements.
<b>Producer Access to Capital</b>	Low or Medium	This strategy is not necessary if producers have access to private capital to finance projects.
<b>Project Risk of Producing Outcomes</b>	Low to High	Because the public entity is taking on much of the financial risk, producers are willing to experiment with highly uncertain projects.
<b>Acceptable Rate of Return</b>	Medium to High	The ultimate profit for the producer comes through negotiation of a profitable price for credits with the mitigation buyer. If the acceptable and potential return is high the producer should be willing to take on greater financial risk and require less upfront capital to implement the project.
<b>Quality of Quantified Unit of Conservation Outcomes</b>	High	The unit of conservation outcomes must be vetted and trusted by stakeholders and regulatory agencies in order to serve as basis for regulatory compliance.

## Variation: Blended Capital Financing

Public funds can be used to partially finance projects in combination with investor capital. Innovative financial structures enable a relatively small amount of public funding to reduce the risk for producers and investors, attracting significant capital to markets with moderate predictability for demand.

# FULL DELIVERY

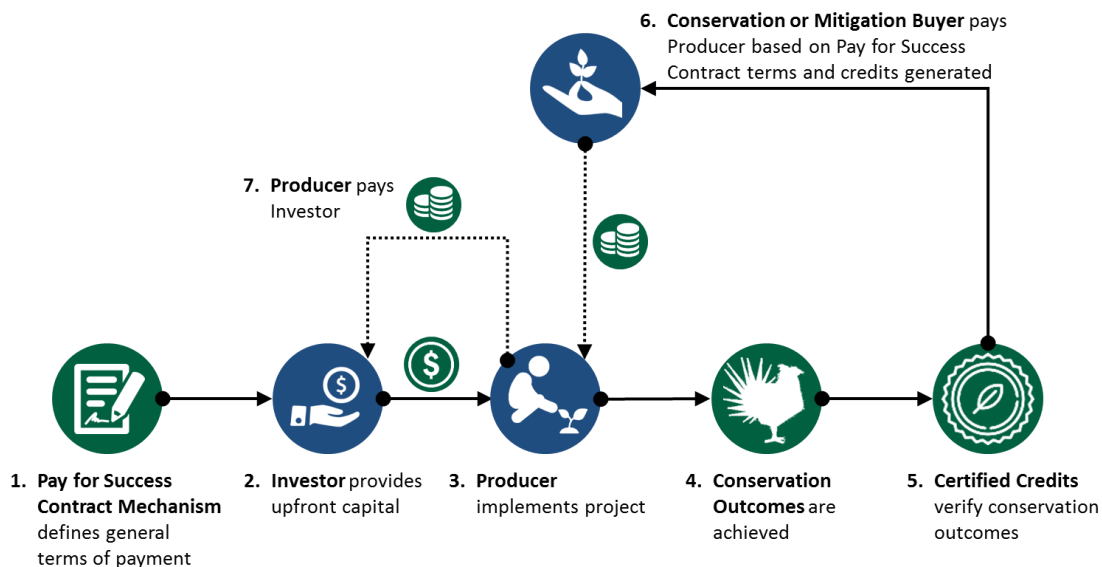
Full delivery contracts tie payments to measurable environmental outcomes. This strategy requires private capital to finance project implementation. Conservation or mitigation buyers pay the producer an agreed-upon price per credit after conservation outcomes are verified and all requirements are met for certified credits.

This approach minimizes the risk to buyers while providing the producer with a credit purchase contract they can use to secure capital to finance project implementation. The financing for this project can be considered an environmental impact bond or green bond. The contract terms may specify the maximum number of credits the buyer is expected to purchase. If the project generates more credits, the producer has the option to sell the excess credits to other willing buyers using the entrepreneurial banking strategy (described next).

This approach secures large-scale conservation and achieves significant efficiencies for buyers and producers.

## How it Works

1. **Pay for Success Contract Mechanism** includes a project solicitation and a credit purchase contract that defines credit requirements and price per credit to be paid upon verification of conservation outcomes.
2. **Investor** supplies the needed upfront capital to implement the project.
- 3-5. **Producer** implements project and achieves **Conservation Outcomes**, which are verified as **Certified Credits**.
6. **Conservation or Mitigation Buyer** pays the producer based on the terms defined in the pay for success contract.
7. **Producer** pays the private investor based on financing terms defined between the two parties.



## DISTINGUISHING CHARACTERISTICS

*Private investors finance project implementation*

*Buyers pay an agreed price per credit upon verification*

*Variations can be used as the structure for an upfront in-lieu fee or revolving fund program*

## When it Works

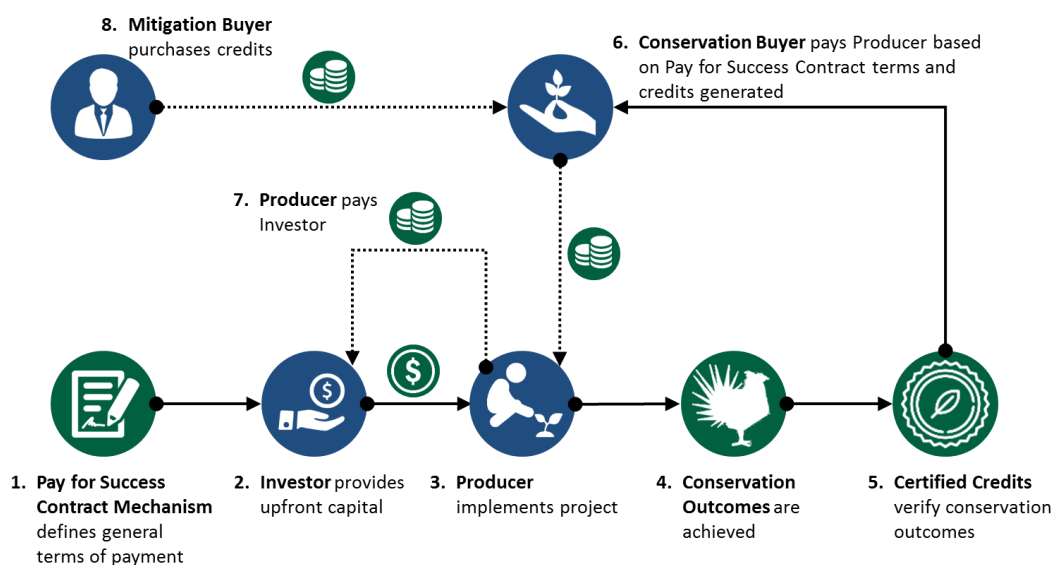
In regions with a clearly defined quantified unit of conservation outcomes, the full delivery strategy is simple and scalable. Producers are attracted to compete for full delivery contracts when they have moderate to high certainty they can design projects to achieve conservation outcomes, and they expect sufficient demand to warrant establishing the relationships and expertise to access private capital.

FACTORS	RANKING	RATIONALE
<b>Total Expected Demand Over Time</b>	High	Anticipated funding for conservation must be sufficient to warrant producers and investors incurring the costs of understanding the regional needs and building relationships.
<b>Predictability of Demand</b>	Medium to High	Demand for conservation outcomes must be sufficiently predictable to warrant producers and investors incurring the costs of understanding the regional needs and building relationships.
<b>Producer Access to Capital</b>	Medium to High	Private capital is essential to fund upfront project implementation costs. If total funding and demand are sufficient, new conservation professionals will be attracted to the region, therefore moving access to capital from low or medium to high.
<b>Project Risk of Producing Outcomes</b>	Medium to High	Project risk must be able to be managed in order to meet the due diligence requirements to access private capital.
<b>Acceptable Rate of Return</b>	Medium to High	Potential for an attractive margin of return is required to attract private, return seeking investors.
<b>Quality of Quantified Unit of Conservation Outcomes</b>	Medium or High	The unit of conservation outcomes must be vetted and trusted by buyers and producers in order to serve as basis for payment. If the buyer is seeking regulatory compliance, the unit must be accepted by regulators.

## Variation: Upfront In-Lieu Fee Program or Revolving Fund

The full delivery strategy can be used to accumulate a pool of credits by an administrator and then sold to mitigation buyers in need of compensatory mitigation credits. The funds received from the mitigation buyer can then be reinvested in additional credit projects creating a revolving fund to support an in-lieu fee program. Steps 1 -7 depict a full delivery contract and Step 8 shows the purchase of credits by the mitigation buyer.

8. **Mitigation Buyer** purchases credits to satisfy regulatory compliance needs.



# ENTREPRENEURIAL BANKING

Entrepreneurial banking is a pure form of pay for success in which private sector organizations fund conservation projects and buyers purchase conservation outcomes after they have been certified as credits. Public agencies or an administrator is needed to review, certify, and monitoring conservation projects. However, all financial agreements are private transactions made between the producer and investors for capital, and between producers and buyers for purchase. This pay for success strategy is used in conservation and mitigation banking, in which a mitigation buyer purchases sufficient credits to satisfy permit requirements from a producer (in this case a mitigation banker) who has developed a conservation project that produced conservation outcomes and certified credits in advance of the sale<sup>5</sup>.

## DISTINGUISHING CHARACTERISTICS

*Private funders pay for project implementation*

*Mitigation buyers pay private funders and producers*

*Conservation buyers administer programs, but do not fund project implementation*

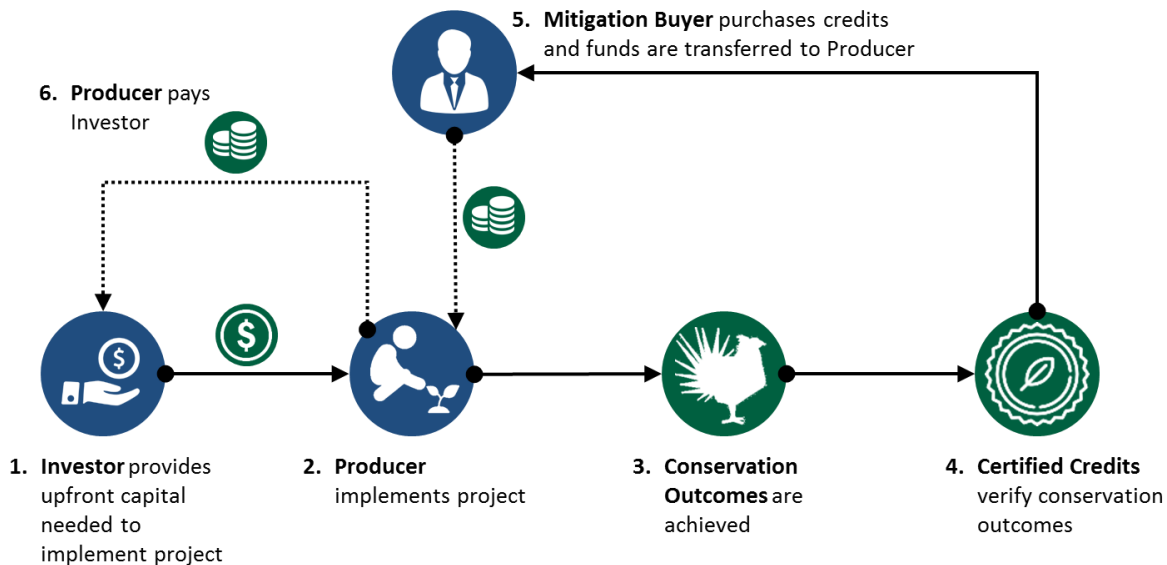
*Mitigation buyers are not responsible for project implementation*

*Provides opportunities for financial return on investment*

Entrepreneurial banking maximizes buyer efficiency and can be scaled to meet demand for large-scale conservation.

### How it Works

1. **Investors** provide upfront capital needed to implement the project.
- 2-4. **Producer** implements project and achieves **Conservation Outcomes**, which are verified as **Certified Credits**.
5. **Mitigation Buyer** purchases credits to meet permit requirements. The funds from the credit purchase are transferred to the **Producer**.
6. **Producer** pays investors based on terms defined between the two parties.



<sup>5</sup> Environmental Protection Agency. (No Date). Mitigation Banking Factsheet. Available at: <https://www.epa.gov/cwa-404/mitigation-banking-factsheet>.



## When It Works

Entrepreneurial banking is a proven strategy in contexts where significant and predictable demand for compensatory mitigation exists, and regulatory agencies agree to use quantified units of conservation outcome and certified credits as a mechanism to meet permit requirements. Conservation buyers can also purchase credits using the entrepreneurial banking strategy.

FACTORS	RANKING	RATIONALE
<b>Total Expected Demand Over Time</b>	High	Producers and investors require significant, and typically demonstrated, demand for conservation credits before they risk developing a bank without a contract from a buyer.
<b>Predictability of Demand</b>	Medium to High	Ongoing demand is required for multiple producers to become interested in a market, which creates price competition and contains the price of credits.
<b>Producer Access to Capital</b>	High	Producers must have access to private capital in order to secure the financing needed without the security of a signed contract from a buyer.
<b>Project Risk of Producing Outcomes</b>	Low to Medium	Project risk must be relatively low in order to meet the due diligence requirements of private investors. Producers may create banks with moderate risk if the risk-return profile is attractive and the banker can mitigate risks through phased projects or alternative revenue strategies, such as land sale.
<b>Acceptable Rate of Return</b>	High	Margin of return is required to attract private, return seeking investors.
<b>Quality of Quantified Unit of Conservation Outcomes</b>	High	The unit of environmental benefit must be vetted and trusted by stakeholders and regulatory agencies in order to serve as basis for regulatory compliance.