CREDIT SUISSE

INVESTIGATING *the* SCALABLE MODELS *of the* FUTURE

Conservation Finance Practitioners Workshop

Making Conservation Finance Investable

INTRODUCTION

The field of conservation finance is at an inflection point. There is a long and distinguished list of conservation finance deals that have delivered important conservation benefits. As the field moves to the next stage, it will need to migrate beyond donor-driven financing to commercial, investor-driven vehicles. It will also need to move from one-off transactions towards repeatable and scalable models of investing.

Many of the necessary conditions for this transition are in place. These can catalyze and shape the transition of conservation finance into the mainstream. From its roots in NGOs, land trusts, and foundation and donor capital, we see growing interest in conservation finance from institutional investors and intermediaries. These new investable transactions require an alignment of interests of buyers, regulators, NGOs, industry, and specific types of investors.

A two-day workshop held on January 21-22, 2014, hosted by the Federal Reserve Bank of San Francisco, brought together leading practitioners to discuss successful conservation finance deals and innovative transactional structures. The focus was on ideas that are scalable and repeatable and that generate returns for investors. The goal of the workshop was to facilitate the emergence of an investor-driven approach to conservation.

The steering committee, with representatives from Coady Diemar Partners, Equilibrium Capital, The Lyme Timber Company, and Credit Suisse thanks the Gordon and Betty Moore Foundation, the David and Lucile Packard Foundation and the Federal Reserve Bank of San Francisco for their generous support.

The workshop was the start of an exchange of ideas and new network of relationships, not the end. Participants took stock of the field and charted paths forward. New markets develop in stages. Conservation finance solutions and products are emerging over time and through the efforts of many players. That work lies ahead.

JOHN TOBIN
Credit Suisse

AGENDA

Session 1: Some Big Deals and Business Models

Objective to outline different sources of capital and their particular role in deals as well as to understand how exemplary transactions have worked (or not) in detail.

Session 2: The Process to Develop A Market—Developing and Applying Conservation Finance Methods

Objective to look at the different forms and roles of capital, and its authority in the evolution of a market, with a particular perspective on time.

Session 3: Current World of Institutionalized Investments

Objective to define the term "investment grade" in conservation finance and to learn from the experience of actors that have broken through to institutional capital. Also explore the positioning of conservation finance in the traditional asset class framework.

Session 4: The Unique Role of Foundations in Catalyzing Markets

Objective to explore the full gamut of capital tools (grants > PRI > investment capital) and to challenge the current application of these tools to the transactions and to the development of the markets.

Session 5: Removing Barriers and Moving to Landscape Scale

Objective to identify key barriers that currently prevent the scalability of successful models and to agree on approaches that can spur major institutional investments.

Wrap Up Session

Moderated brainstorming exercise: What is the "great idea" to accelerate the conservation finance market?

Impressum

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TAKEAWAYS

CONSERVATION FINANCE IS MOVING UP THE 'S CURVE.' Workshop participants grappled with the challenge of creating scalable projects and replicable business models that meet the needs of institutional investors. Specific conservation markets and products are at different points along the 'S curve' from early-stage, even concessionary, capital to large-scale, market-rate finance. Wetlands mitigation banks are fully investable, for example; many fisheries and oceans projects, not yet. For many participants, the workshop fell short of identifying fully investable deals. "Our best success stories are still working to achieve scale in institutional terms," says **Pat Coady** of Coady Diemar Partners. What projects are ready to move from concessionary financing to mainstream capital in the next 18-24 months?

WALL STREET IS INTERESTED. "We're on the cusp of having the attention of institutional investors and that's good news," says **Peter Stein** of Lyme Timber. The representation at the workshop of Credit Suisse, JP Morgan and Goldman Sachs signals growing client demand and deal-making opportunities and conservation finance product development is a major opportunity for Wall Street banks in 2014. On the eve of the workshop, Credit Suisse (with World Wildlife Fund and McKinsey & Co.) issued "Conservation Finance: Moving Beyond Donor Funding Toward an Investor-Driven Approach." Goldman Sachs convened an Environmental Finance Innovation Summit in February. JP Morgan, The Nature Conservancy and EKO Asset Management, backed by the Moore and Packard foundations, will report on the size of the opportunity in a range of environmental markets later this year. Wall Street "smells something going on," says **Dave Chen** of Equilibrium Capital.

CONSERVATION NGOS AND INSTITUTIONAL FINANCE ARE COMING TOGETHER. Environmental and other non-governmental organizations are shifting from "Just Say No" to "Let's Make a Deal." But deeper connections are needed to break down silos. "The deep greens ask, 'Is this really conservation?'" says **Joe Whitworth** of Freshwater Trust. "The finance guys ask, 'Is this really finance?'" Indeed, NGOs will require "a dramatic cultural shift," says **Eric Swanson** of Forest Trends. "We need to deeply engage mainstream financial firms to reach the scale of investment needed to save the planet."

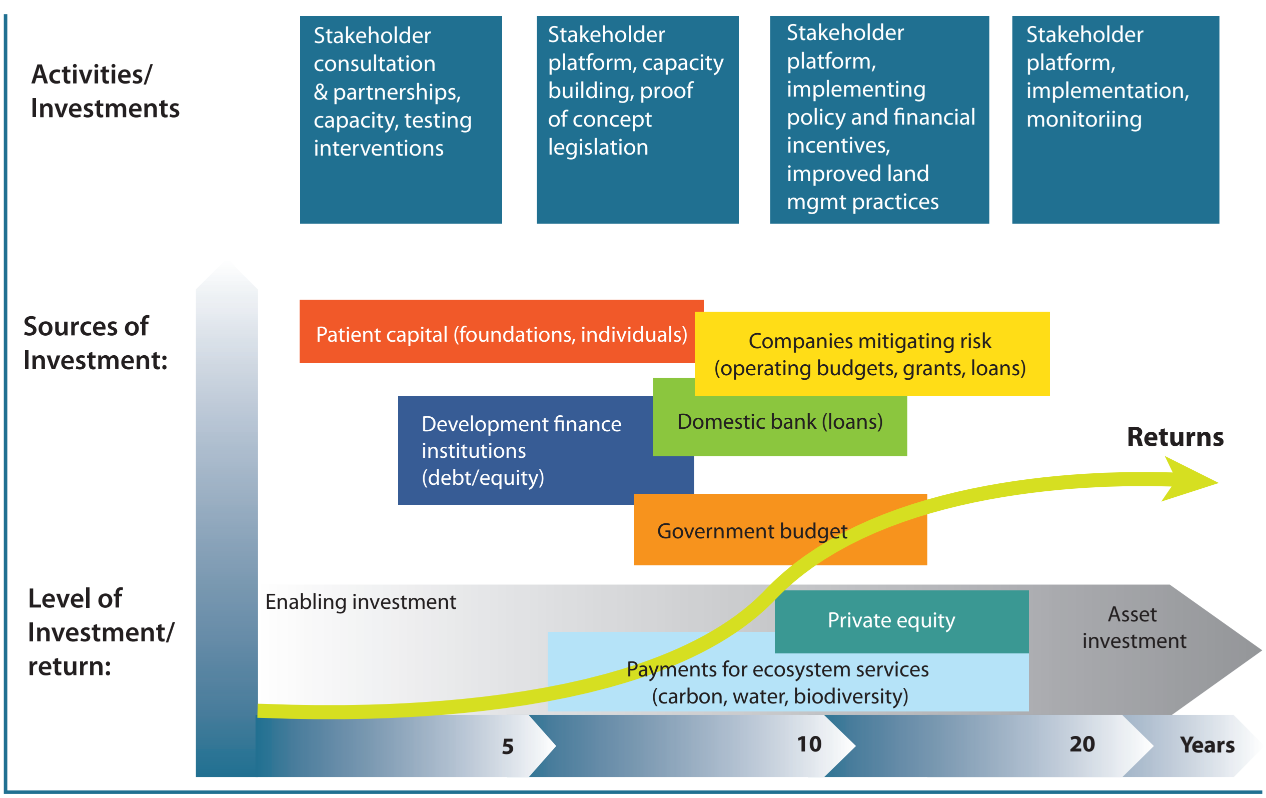
EARLY-STAGE RISK CAPITAL IS CRUCIAL. "These deals are small and hairy and unfamiliar and therefore seem risky, says **Charlotte Kaiser** of The Nature Conservancy. "The need for patient, not short-term, money to buy down risk is beyond the capacity of the capital market to provide." Foundation funds can have a catalytic, multiplier effect; **Susan Phinney Silver** of the David and Lucile Packard Foundation cites Packard's program-related investment, or PRI, for Ecotrust Forest Management that helped bring in New Island Capital Management as a commercial investor. **Tom Trinley** of the Gaylord and Dorothy Donnelly Foundation suggests foundation investment committees could carve-out allocations of say, $10 million, for first-fund conservation finance managers. **Fabian Huwyler** of Credit Suisse calls for venture capital-style risk capital for conservation finance.

STANDARD BENCHMARKS WILL HELP DEFINE VALUES. The standardization of "currencies" that allow everyone to speak the same language will help build a broader investment base. Benchmarks can help establish the value of specific benefits. What is the conservation equivalent of #2 Corn or West Texas Intermediate, wonders **Dave Chen**? Measuring the cost of kilocalories allows riparian restoration to compete with cooling towers, says **Joe Whitworth**. Wetlands have similarly mature standards, notes **Todd Gartner** of World Resources Institute. "With a more robust conversation, financiers can understand what you are financing," says **Kyung-Ah Park** of Goldman Sachs.

POLICY CAN CREATE MARKETS AND CATALYZE CAPITAL. "The constraint on our business model is the availability of public money" to pay for conservation easements, says **Peter Stein**. The same is true for New Market Tax Credits, says **Bettina von Hagen** of Ecotrust Forest Management. In contrast, regulatory frameworks for mitigation credits and offsets create a private-capital market without public funding. Developers seeking a more predictable permit process, "will pay for high-quality compensatory mitigation," says **Adam Davis** of Ecosystem Investment Partners. The U.S. Department of Agriculture is working to develop new ecosystem services markets through a half-dozen agencies, says Deputy Undersecretary **Ann Mills**, including with loan guarantees and demonstration projects to enhance financial incentives for conservation. Beyond wetlands, workshop participants are working on mitigation opportunities in the Endangered Species Act, water quality and nutrient management.

THERE IS PLENTY OF ROOM FOR NEW FINANCIAL PRODUCTS. Do we want more innovation, or less? To fit investors' needs, conservation finance products need to be 'plain vanilla,' though creating and identifying cash flows requires considerable ingenuity. **Jennifer Pryce** of the Calvert Foundation wants to know "how to use CDFI's and fixed-income to channel money into land conservation." **Ben Vitale** of Wastewater Capital Management wants to know "what can

Investment needs and finance actors over time



Source: Adapted from Financing Strategies for Integrated Landscape Investment (2014) be done with loan guarantees, first-loss funds and other ways to de-risk investments." **Kyung-Ah Park** sees the need for third-party credit rating if we are to bring in institutional investors looking for investment grade, plain-vanilla opportunities and suggests a clearinghouse of conservation finance projects in the pipeline could more efficiently match interested investors with opportunities. **Dave Chen** sees a need for a merchant banking function for raises of $200-400 million. **Evan Smith** of the Conservation Fund wants to explore ways conservation can monetize reduced government outlays, such as through better wildfire management. "Can we turn future avoided costs into something we can use now?"

INCUBATION OF NEW PRODUCTS AND FUNDS COULD ACCELERATE THE FIELD, by seeding success stories and expanding the deal pipeline. An "environmental finance capital alliance" could support first time fund managers with research and development, back office functions, standard-setting and other heavy lifting, **Dave Chen** says. Lyme Timber, for example, seeded the first investments of Ecosystem Investment Partners. "That gave them a track record," says **Peter Stein**. An incubator could help mitigate a looming shortage of talent to structure projects, suggests **Carl Palmer** of Beartooth Capital. "The range of skills to pull off these deals is pretty extraordinary," **Adam Davis** says, requiring knowledge of conservation real estate, capital formation and the science of restoration.

KEEPING TRACK OF DEALS AND PRODUCTS WILL MEASURE AND VALIDATE PROGRESS. "Count those capital flows over time," recommends **Jim Levitt** of Harvard Forest. "It's boring, clerical and very important." A starting point could be an inventory of investable products, tagged by their position on the 'S' curve, suggests **Logan Yonavjak**, a Master of Forestry candidate at Yale University. Two good places to start are The Ecosystem Marketplace produced by **Michael Jenkins** and his team at Forest Trends and the Summary of Natural Infrastructure Finance Mechanisms by **Todd Gartner** and team at WRI.

UPCOMING:

- Mission Investors Exchange National Conference (May 13-15)
- Yale Conservation Finance Boot Camp (June 2-6)
- Social Capital Markets conference (September 3-6)
- National Land Conservation Conference (September 18-20)
- National Workshop of Large Landscape Conservation (October 23-24)
- IUCN World Parks Congress (November 12-19)
- ACES—A Community on Ecosystem Services (December 8-11).

IS "CONSERVATION FINANCE" THE RIGHT BRAND? "We need a different term," says **Jennifer Morris** of Conservation International. JP Morgan Chase talks about "natural capital." **Michael Jenkins** likes "natural infrastructure." Others suggest "sustainable investing." **John Tobin** of Credit Suisse thinks "conservation finance is a fine brand...I think it's important that the sector do more to get the message out. Where is the yearly public conference? Where are those op-eds that have 'Conservation Finance' in the title? Where are those products that people can see?"

LOCAL VALUE-CREATION IS KEY. Workshop participants want to emphasize 'working lands,' not 'forever wild.' In the Brule-St. Croix Legacy Forest project, "Biodiversity couldn't be mentioned, conservation easements couldn't be mentioned," **Peter Stein** says. "We had to focus on rural economic development." Freshwater Trust doesn't emphasize watershed restoration to its local utility clients, says **Joe Whitworth**. "We just say, 'In compliance. Saves money.'"

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CREATING A MARKET WILL REQUIRE COLLABORATION—AND COMPETITION. Having three or four restaurants on a block can build business for everybody, notes **Dave Chen**. As an example of collaborative field-building, **Jennifer Pryce** cites "gender lens investing," which now can count 20 products in the capital markets and an ongoing conversation about "the women effect." **Peter Stein** suggests that many conservation finance players could take advantage of a common platform around policy, messaging, communications and monitoring of the field's track record. **Fabian Huwyler** warns that major financial competitors may not be keen to collaborate, even at this early stage.

NEXT STEPS. In multiple combinations, participants at the meeting are evaluating and collaborating around approaches to some of pressing challenges in the field. The workshop discussion, and in particular the wrap-up session surfaced five high-potential workstreams for the coming year. An update on work stream activities can be found on www.conservationfinance.ch. Inquiries regarding participation can be directed to **Leigh Whelpton** of the Conservation Finance Network (info@conservationfinancenetwork.org).

This year's series of conferences, panels and other events highlighted above provide a platform for continuing our discussion, advancing our activities and building the market. We are considering a follow-up Conservation Finance Practitioners Workshop in early 2015. For updates and notices about conservation finance practitioners gatherings, see www.conservationfinance.ch.

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FEDERAL RESERVE BANK OF SAN FRANCISCO

January 21–22, 2014