NatureVest: Natural Capital Investment Solutions to Transform The Way We Protect Nature

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THE MODERN CONSERVATION MOVEMENT HAS ACHIEVED SIGNIFICANT results since its inception, combining science, policy, advocacy, and philanthropy to create a movement that is global and mainstream. Yet while we are winning many battles, we are losing the war, and the overall environmental situation is deteriorating steadily on many counts. With global population estimated to peak around 2050, we must quickly maximize the pace, scale, and effectiveness with which we protect natural systems for the human communities that rely on them.

One of the main challenges we face is a critical deficit in capital directed toward conservation. Estimating the total cost of protecting global biodiversity is extremely difficult; estimates range from $76 billion per year for the conservation of terrestrial biodiversity to more inclusive estimates of up to $440 billion per year (McCarthy et al. 2012, James et al. 2001, Parker et al. 2012, Secretariat of the Convention on Biological Diversity 2014, Spencer Meyer, personal communication). As of 2010, only about $50 billion was being spent on conservation activities each year through government and philanthropic funding. To add to this imbalance, the majority of financing for global biodiversity conservation is delivered in the world's largest developed economies, yet the majority of the world's biodiversity is in the developing world, which receives significantly less financing (Parker et al. 2012, 31). Even if government or philanthropic funding were to double over the next decades (which is unlikely given current political and economic realities), there would still be a massive gap between the cost of conservation and the amount of financing available.

Fundamentally, this gap results from a systematic misallocation of capital in the global economy, which does not incorporate the economics of nature. While not all capital flows are destructive to the environment, the environment plays very little, if any, role in most current investment decisions.

As a result, global development aid does not address the underlying ecological causes of hunger and poverty—even when a more systemic view of solutions would lead to investment in climate change resilience and adaptation. Insurance companies do not invest in mitigating the risk of environmental disasters—even when preventive investment in ecological solutions would save them money in the long term. Infrastructure bankers invest in steel and concrete, not water and land—even when natural solutions may be cheaper and offer greater community benefits.

Reallocating global capital to incorporate nature will require a shift in thinking on how we conceive conservation. The traditional approach in recent decades has involved fencing off nature preserves to preserve and protect unique ecosystems and species. However, while this is an important component of conservation, it is not fully sustainable in the long run. We cannot just fence off all the important natural resources on the planet: we are using them. They provide water and food for human populations, fuel and fiber for our industries, grazing lands for our animals, climate regulation, water purification, and soil conservation. The challenge moving forward is to figure out how to operate sustainably in these places, to protect entire ecological systems, rather than just specific spots. This will require a fundamental change in our image of nature, from something "pretty" that we need to fence off and admire to a vital asset of capital, one that it is in all of our interests to protect.

Unless and until we succeed in deploying a meaningful percentage of private capital flows toward conservation outcomes, we will continue to lose the war for conservation. We need to attract a different kind of capital—impact capital—to fill the gap in financing for conservation. In this way, we can assure financial returns for investors while at the same time demonstrating meaningful environmental impact.

To succeed, capital markets, businesses, and governments must invest in nature as the long-term capital stock of a sustainable, equitable, and more efficient economy. When the value of natural capital is realized, local governments invest in restoring wetlands because they offer a more adaptable and sustainable way to control floods than building levies, often at a lower cost. Businesses and municipalities invest in upper watershed conservation because it is a cheaper way than water treatment facilities to ensure the water quality they need for their citizens and factories, while providing numerous benefits of health and well-being to communities. Regional governments join together to protect thousands of miles of coastline because they buffer sea-level rise and protect food sources, while also preserving local economies. And investors support natural resource management that leads to truly sustainable community economic development activity.

Perhaps the most efficient way to achieve success in increasing support for conservation would be for central governments to act quickly and decisively, as they have at times to address other serious issues. For example, the majority of today's United States mortgage market is guaranteed by the US government, which values the social benefits of home ownership and has seen government-sponsored mortgage enterprises return more dollars to the US Treasury than they received. Similarly, robust government support for investing in conservation could safeguard the natural world and the health and well-being of today's and future generations. Yet while we continue to pursue policy strategies to increase public support for conservation and conservation investing, we must also focus on creating ways for private investment capital to achieve measurable conservation impact at scale.

The growing market for impact investments offers an important opportunity. Impact investing involves investments into companies, organizations, or funds intended to generate a social or environmental impact in addition to a financial return (Global Impact Investing Network 2014). This concept operates on the principle that there is a spectrum of possible opportunities for investors, ranging from pure philanthropic contributions that expect no return on investment to for-profit conservation investments at the market rate that expect a healthy commercial return on investment. While there is already quite a bit of activity at either end of the spectrum, significantly increasing the availability of natural capital will require a heightened focus on the middle of the spectrum, with investments at below-market or concessionary rates where investors are willing to accept a reduced rate of return in exchange for a high impact on the natural world.

This field builds on the legacy of social investing, which has long sought to correct market failures by actively investing in community development, affordable housing, and socially responsible companies. "Impact Investments: An Emerging Asset Class," the 2010 Global Impact Investing Network report, which was published in collaboration with JPMorgan Chase and the Rockefeller Foundation, cemented the reality of impact investing as a legitimate offering for mainstream investment firms. In 2012, "Gateways to Impact," a survey of investment advisors by the Calvert Foundation, Deutsche Bank and the Rockefeller Foundation, reported that more than one-third of mainstream investment advisers are strongly interested in sustainable investments, and 69 percent of advisers saw sustainable investments as an opportunity to grow their practice.

Many impact investors are interested in a socially responsible investment strategy, seeking to achieve a positive social impact alongside an environmental impact and some level of financial return.

These investors aim to leverage their investment portfolio alongside their philanthropic giving to support the change they seek in the world. For example, foundations have long practiced a strategy of program-related investments (PRIs), return-seeking financial investments made to further support the programs and areas where they make charitable grants.

Yet today, impact investors seeking to invest in the natural systems that support sustainable human development and livelihoods find few products available. While there are myriad opportunities in renewable energy, clean technology, and natural resource extraction, there are fewer options for investing in sustainably managing natural systems for human well-being and ecological integrity—such as green infrastructure for municipal water supplies, sustainable cattle ranching for restoring grassland ecosystems, improved fisheries management regimes for food security, and revitalizing vacant urban lands for storm water management and community open space.

NATUREVEST

To address both the shortfall in capital for conservation and the lack of available, viable investment vehicles, The Nature Conservancy has launched NatureVest, its global program for natural capital investment. NatureVest will work to increase the market for investing in nature, both by developing a pipeline of transactions and products and by building the field of natural capital investing through investor outreach and education, convening of partners, and original research.

Developing a Pipeline of Transactions and Products

To attract impact capital to conservation, NatureVest is working to create a portfolio of investment products as proof of concept that conservation outcomes can generate a financial return.

Initially, our target investor market will be so-called impact-first investors. These include individuals, institutions, and family offices that seek to catalyze new impact investment markets and are willing to take financial returns below those that a conventional investor would accept for such an early-stage concept, or, to put it another way, to be undercompensated for the perceived risks of the investment because of the conservation impacts it will achieve. NatureVest is working closely with colleagues within The Nature Conservancy and across the conservation and sustainable development community to identify impact capital opportunities, target strategic partners, source investors, and execute transactions.

There are many complex reasons for the lack of a diverse supply of viable investment opportunities that deliver conservation outcomes. These are primarily driven by the fact that most natural resources have no economic value attached to them, and thus damages to these resources are not borne as a cost by farmers, firms, or investors. Solving this problem in the long term will require a range of public policy interventions, from requiring corporations to disclose their full profit and loss with natural capital incorporated to mandating that ratings agencies assess the risk of an investment based on its potential environmental impacts. However, in the absence of such interventions, it is still possible in the short term to construct a portfolio of transactions that can ultimately support commercial capital at scale. At the pilot stage, these deals are risky, but once successful, they can be replicated and scaled up. NatureVest is focusing on advancing opportunities in several different categories, including:

1. investments that create economic and environmental value through improved management but have startup transaction costs that are too high for conventional investors to be willing to provide initial support;
2. investments that take advantage of new or existing policy frameworks to demonstrate a new transaction structure that supports conservation outcomes; and
3. investments that reduce environmental impacts and have lower rates of return than comparable conventional investments (for example, sustainable timber harvest-

ing with lower yields than conventional harvesting) but offer higher conservation value to investors for whom this is a priority.

These types of opportunities allow NatureVest to create a pipeline of concepts that, if proven successful, can be socially and environmentally sustainable business models for more conventional sources of capital.

The following are some examples of potential deals that can support impact investment for measurable conservation impact.

Sustainable Finance for Marine Conservation in the Seychelles

With an economy based on tuna, tourism, and a low-lying island geography, the Republic of Seychelles is particularly vulnerable to the threats of climate change. Increasing incidences of severe storms and rising sea levels are battering coastal areas that attract important tourist dollars, warmer ocean temperatures are diminishing fish stocks, and increasing ocean acidity from rising carbon levels is destroying coral reefs that buffer the force of storms and provide vital habitat for numerous marine species.

NatureVest is working with the government of the Seychelles to engineer up to a $30 million sovereign debt swap in exchange for a commitment to invest in climate adaptation and marine conservation projects. Through a combination of debt forgiveness, debt refinancing to reduce interest expense, and allocation of interest payments to a conservation trust fund, the transaction will provide debt relief for the Seychelles while creating a sustainable financing mechanism to invest in long-term climate resilience and marine conservation. Conservation activities include expanding and improving management of marine-protected areas, improved coastal zone management, fisheries and marine policy, and regulatory protection regimes, and coral and mangrove restoration projects. Once complete, this project will result in the Indian Ocean's second-largest marine reserve.

Kenya Livestock to Markets

Overgrazing has become an increasingly serious issue in the northern rangelands of Kenya. Growing cattle populations and herd sizes, combined with volatile weather patterns, have placed increasing pressure on natural resources, resulting in an escalating incidence of erosion and poor soil quality, diminishing both cattle productivity and habitat for wildlife, including elephants and rhinos.

NatureVest is working with the Northern Rangelands Trust in Kenya (NRT) to expand the Livestock to Markets program, which supports local cattle-herding communities that agree to adhere to improved grazing practices. Since 2006, NRT has used grant capital to buy cattle directly from these local communities at reasonable prices, fatten the cattle on nutrient-rich grasses, and sell them directly into Nairobi at higher grades and prices than the herders could otherwise have obtained, generating important financial, social, and conservation outcomes. A new loan will enable Livestock to Markets to increase annual purchases from 1,000 to 10,000 cattle, and provide funding to the local communities to cover sustainable ranching operations, as well as social outcomes like local education and healthcare.

Urban Green Infrastructure

More than 700 cities in the United States are under an Environmental Protection Agency mandate to control storm water pollution. At the same time, municipal budgets are stressed, and access to capital markets constrained. Through investing in green infrastructure for storm-water management, cities have reduced capital expenses compared to construction of grey infrastructure (for example, sewerage and water treatment) and see lower operating expenses by encouraging interception, infiltration, and evaporation of water before it requires wastewater management. Yet green solutions are often small and distributed, with high transaction costs and performance risk. A pay-for-performance mechanism that borrows from traditional infrastructure public-private partnerships and the recent Social Impact Bond innovation can deliver green infrastructure for storm-water management to municipalities at lower cost, while transferring performance risk to private investors. (Social Impact Bonds are not bonds, but a relatively recent financial innovation that establish a performance contract between a nonprofit and a government agency to deliver a sought-for public outcome. Several bonds have been structured in the US and the UK around reducing recidivism rates. Investors provide capital to implement a social intervention, and if the outcome is achieved, the government repays investors. This transfers the risk of a new intervention to investors and away from taxpayers.) Already, Prince George's County, Maryland, and Philadelphia, Pennsylvania, have issued or will issue requests for proposals for counterparties to deliver green infrastructure in a pay-for-performance contract structure. NatureVest will work with municipalities to facilitate investment in natural infrastructure by supporting the development of private financing mechanisms.

BUILDING THE FIELD OF NATURAL CAPITAL INVESTING

Developing products for investors is just one part of the solution. Building a robust platform for impact investment in conservation requires education, research, and extensive engagement with potential investors. There is a mutually reinforcing learning process that must take place in order for investors to find and invest in suitable products. Building a community of conservation impact investors can help deepen our understanding of how commercial investment, concessionary capital, and philanthropic goals intersect.

Further research is needed to expand the base of knowledge about the market for natural capital, as well as to reach a wider audience to increase awareness of and support for impact investing in conservation. In late 2014, NatureVest, in collaboration with EKO Asset Management Partners and JPMorgan Chase, released a report, "Investing in Conservation: A Landscape Assessment," that for the first time quantified the current size of the natural capital impact investment market. Philanthropic support for the report was provided by the David and Lucile Packard Foundation and the Gordon and

Betty Moore Foundation. The research found that between 2009 and 2013 nearly $23 billion of private capital was invested in projects that provided conservation benefits, defined as habitat conservation, sustainable food and fiber production, and water quality and quantity conservation. Private investment represented nearly $1.9 billion of that, with the rest coming from multilateral finance institutions. Private investment is projected to triple to $6 billion in the next five years. Future research will be aimed at addressing barriers to increasing the market and ways to remove those barriers. Potential topics include financing green infrastructure for coastal resilience, restoring vacant lands as a mechanism for natural storm-water infrastructure, identifying the role of soil carbon offsets in sustainable grasslands management, or investing in urban trees to support air quality and reduce energy use.

To elevate awareness of investment opportunities that support natural capital, NatureVest facilitates connections among investors, nongovernmental organizations, government officials, and other stakeholders. For example, partnering with existing forums such as the World Economic Forum, the Clinton Global Initiative, The Forum for Sustainable and Responsible Investment, Social Capital Markets, Confluence Philanthropy, the CREO Syndicate (Cleantech, Renewable Energy and Environmental Opportunities), US Water Partnership, and Mission Investors Exchange can provide us with opportunities to further develop the natural capital agenda, as well as to create forums specifically focused on subjects such as investments in sustainable fisheries, agriculture and timber, coastal resilience, storm-water finance, and freshwater. Investor gatherings with family offices, foundations, endowments, pension funds, multilaterals, and sovereign wealth funds are also key for converting interest in natural capital investment into capital deployment and creating demand. Our work with public officials around the world at the municipal, state, and federal levels seeks to create government support for natural capital investing, and partnerships with other nonprofits can help source investment opportunities and create a platform for natural capital impact investing.

NatureVest's online hub (www.naturevesttnc.org), which is part of The Nature Conservancy's website (www.nature.org), will be a central clearinghouse for financial news on natural capital investment and will provide an important virtual forum for NatureVest stakeholders and partners to share experiences and speed up the development of this vital market for conservation investment.

While there will always be an important role for philanthropy in the conservation field, the challenge moving forward is to create impact investment opportunities that the market cannot find today. That is where NatureVest comes in, using the relationships and knowledge of The Nature Conservancy and its partners to identify opportunities that are not obvious to the market and make them market obvious and market ready. Through these activities, NatureVest is working toward a future in which a robust marketplace of ideas and opportunities allows and encourages investors to support the sustainable use and conservation of the world's water, seas, soil, and air.

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