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Broadway
INITIATIVE

 **Green Finance**
Institute

finance  **earth**
Formerly
Environmental Finance

Financing UK Nature Recovery

A proposal for putting nature onto a sustainable
financial path in 2021

Coalition partners

 **giving
nature
a home**


**National
Trust**



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This roadmap sets out the Green Finance Institute, Finance Earth and the Broadway Initiative’s proposal for how, in the run up to COP26, the UK can take action in 2021 to put nature recovery onto a sustainable financial footing.

A broad coalition of finance, business and environmental expertise should be brought together to help Government develop a long-term Strategy for Financing UK Nature Recovery.

In the context of the one-year budget settlement, existing funding should be used to establish a Pathfinder Fund for UK Nature, to demonstrate mechanisms that can leverage private investment, and inform the policy and standard setting needed to scale those solutions and create investable markets.

The proposal is endorsed by the RSPB and the National Trust.

Why 2021 is make-or-break for UK nature finance

The UK government has committed to restoring nature within a generation

This commitment is central not only to the UK's strategy to achieve net zero emissions by 2050, but also to tackle biodiversity loss, reconnect people with nature, and increase the country's economic resilience to climate change.

This is not just a UK story

For example, in September, 64 heads of state spanning five continents and representing 28% of global GDP committed to reversing the loss of nature by the end of the decade.¹

The scale of change required needs private investment to help drive the solutions

Until now nature-based solutions in the UK have very largely been paid for by public funding and philanthropy, with only small and piecemeal examples of private funding. Current spending is not reversing nature's decline and the impact of Covid-19 on public finances makes the need to catalyse private investment even more pressing.

Investor demand for nature-based projects is growing exponentially

For example, HSBC has recently teamed up with Pollination to establish a series of natural capital funds through a £billion+ joint venture.²

There is international momentum to develop the enabling policy framework

A Taskforce for Nature-related Financial Disclosures (TNFD) is expected to be launched next year, which may lead to companies around the world disclosing their dependencies and impacts on nature by 2023.³ The Taskforce for Scaling up Voluntary Carbon Markets has developed recommendations on how to accelerate the growth of the global market for carbon credits within the next five years.⁴ Any growth in voluntary carbon markets must be governed by robust standards that ensure quality projects are delivered.

The UK is in a unique position to become a leader in financing nature

Measures such as the Agriculture Act, Environment Bill and UK Government's recent announcement that it will issue a sovereign green bond⁵ pave the way for creating domestic markets, while the Dasgupta international review on the economics of biodiversity, and hosting of COP26, provide the platform in 2021 to establish a global leadership role.

The UK needs a coherent strategy to connect large-scale investment to action on the ground

Private funding and financial innovation in isolation is not sufficient to unlock barriers to large-scale investment into nature recovery. Policy and supportive regulatory frameworks are needed to reduce barriers to investment and capture the private (or internalised) benefits that nature gives us (for example carbon sequestration, biodiversity, flood management, clear water and improved health and wellbeing).

Failing to design a coherent framework for financing UK nature recovery will lock in dependence on public funding for the long term

A green industrial revolution needs to be powered by nature recovery. Unlocking private investment will create a whole new sector, delivering jobs and business opportunities.

1 <https://globalcommonsalliance.org/news/global-commons-alliance/64-heads-of-state-pledge-to-reverse-nature-loss-by-2030>

2 <https://pollinationgroup.com/climateassetmanagement/>

3 <https://tnfd.info/>

4 <https://www.iif.com/tsvcm>

5 <https://www.greenfinanceinstitute.co.uk/uk-government-announces-a-sovereign-green-bond/>



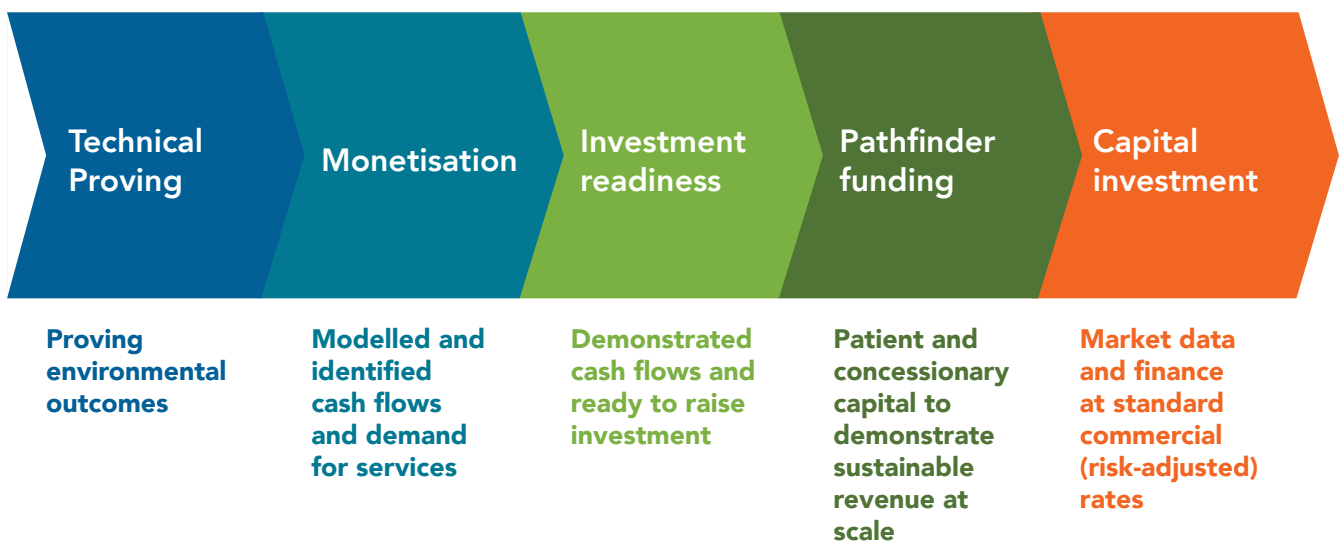
Financing nature recovery

There is a growing consensus that the obstacle to private sector investment in nature is not availability of capital. It is simply that under current policy and regulatory settings, the risks of investing in nature outweigh the expected returns.

To be capable of attracting private finance, nature needs to generate predictable revenue streams. Payments for ecosystem services delivered by nature-based projects have the potential to provide this revenue certainty. However, transacting nature-based projects is currently complex, costly and time consuming. Developing nature-based enterprises, including those providing ancillary services for nature⁶ are also a potential source of revenue for nature recovery, and global leadership for the UK.

Nature-based projects and enterprises typically go through a number of development phases before they are capable of attracting investment (Figure 1).

Figure 1: Phases of nature-based project development



⁶ Ancillary services for nature include technologies that lower the cost of monitoring and verifying environmental outcomes.

Project development phases

Technical proving

Nature-based projects that protect, conserve and restore habitats also have the potential to deliver a range of environmental outcomes. These outcomes include water quality improvement, carbon sequestration and natural flood management. Currently these outcomes have to be proved to a very high level of certainty on a project-by-project basis, in part due to the lack of agreed standards and methodologies.⁷

Science-based standards and methodologies need to be developed which reflect the principle that lack of full scientific certainty should not be used as a reason to delay action.

Monetisation

Once there is agreement about the environmental outcomes that a nature-based project will deliver, there is a need to both find potential buyers for these environmental services, and establish their willingness to pay. To be investable, nature-based projects typically need buyers who are willing to pay for the benefits over the long term.

Regulations requiring businesses such as property developers to achieve net biodiversity gain and nutrient balancing will need to support market-based mechanisms for offsetting through nature-based projects. Similarly, there is a need for practical mechanisms to enable water companies to meet their water quality targets through nature-based projects.

Water companies and housing developers are willing to play their part in nature recovery. But more supportive regulation is needed to ensure that investment in the environment is an opportunity, not a barrier to economic development.

Investment readiness

When agreement is reached about how nature-based projects can contribute to meeting regulatory obligations and voluntary commitments, there is a need to demonstrate cash flows and evaluate the project structures, risks and potential returns required to attract investment. Critically, project proponents need to secure firm commitments from buyers of environmental services to underpin their financial models.

A range of other issues must also be resolved to secure initial investment, including: property rights to the environmental outcomes of projects; apportionment of risk and liability; and obligations to maintain projects to required standards.

There is significant uncertainty about how government funding (through for example the new Environmental Land Management Scheme (ELMS)), and other sources of funding for environmental improvement (such as the Water Industry National Environment Programme (WINEP)) can be combined with private finance to deliver nature-based projects. This is a significant barrier to securing an initial investment.

⁷ The Woodland Carbon Code and Peatland Carbon Code, and the Biodiversity Metric 2.0 are currently the only standards that are available.



Pathfinder funding

When nature-based projects are investment ready, there is a need to identify the most suitable type of initial investor and present the investment opportunity.

However, until there is a solid track record of on-ground demonstration projects, investors will not be able to accurately price the risk of investing in nature-based projects and enterprises.

Mechanisms such as catchment markets, regional aggregation brokers and habitat banks have begun to demonstrate the cash flows available from nature-based projects.⁸ However, these mechanisms need to be proven at investment scale. In the medium term, patient capital/low cost finance will therefore be required to facilitate project development and aggregation, and de-risk private investment.

In the short term, using existing funds, in particular the Nature for Climate and Nature Recovery funds, to provide Pathfinder Funding to support demonstrations at investment scale, will be critical to building confidence and momentum.



Capital investment

Once projects have demonstrated their capacity to generate cash flow at scale, the level of private investment in nature-based solutions will simply be a function of the size of the potential market.

There is clear evidence that significant capital is available, provided there is sufficient certainty in terms of the overall level of demand for Environmental Services and the technical standards and market rules that will apply.

Experience from other environmental services markets, such as air and water quality, renewable energy and energy efficiency show that clear and binding medium-term targets are the most effective way to provide this certainty.

There is a major opportunity following the passage of the Environment Bill to translate long-term statutory targets into regional and local obligations to deliver nature recovery that will drive investment. A regional blueprint is needed to set out how environmental objectives will be translated and integrated at a local level, to avoid decisions about public funding allocations and private investment being made in a siloed and piecemeal way.



The role of Government

The Government has set out its vision for the UK to be a global centre for green finance as a catalyst for a “green industrial revolution”.⁹ Nature recovery must be included in that vision.

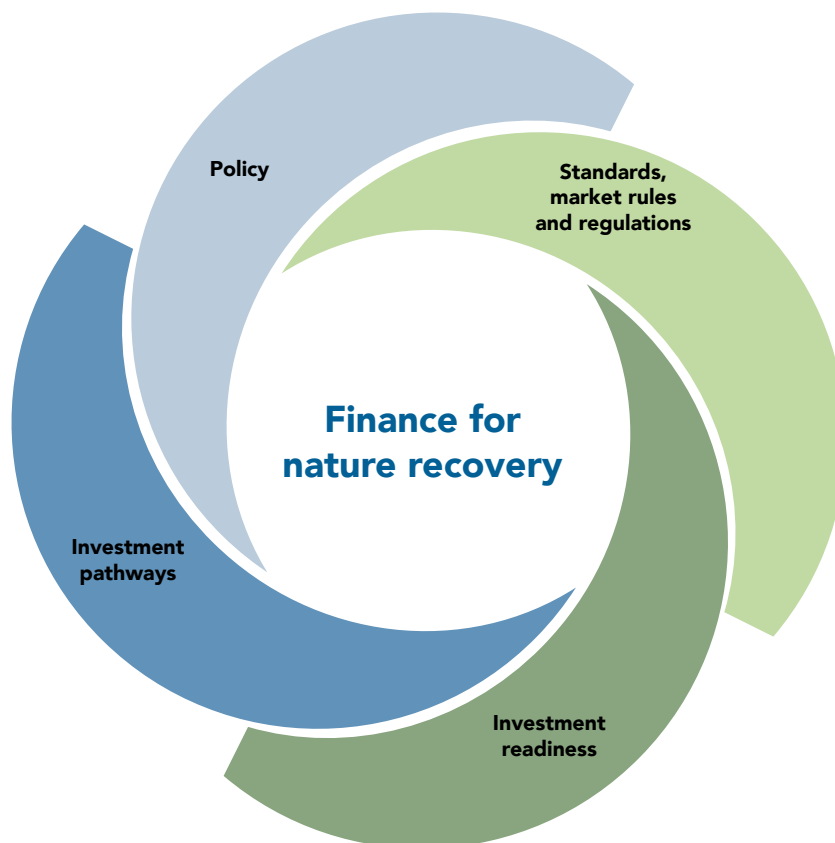
In order to accelerate action, we believe it is important that Government sets out a clear UK-wide strategy for financing nature recovery in order to:

- eliminate regulatory and policy silos and make the most efficient use of existing public funding;
- address the significant barriers to private finance for nature; and
- leverage public funding to de-risk and attract the private finance required.

To accelerate private investment in UK nature recovery the strategy will need to set out:

- a clear policy framework for private investment in nature (**Policy**);
- robust standards, clear market rules and supportive regulation (**Standards, Market Rules and Regulation**);
- support for the development of business models for investing in nature at scale (**Investment Readiness**); and
- defined pathways to secure private funding for nature (**Investment Pathways**).

Figure 2: Key elements of a strategy to finance UK nature recovery



Key elements of the strategy

Policy



To unlock private finance, a number of policy issues need to be addressed including:

- removing barriers to integrated delivery of action on climate change, environmental improvement, and nature recovery at a local level;
- setting clear rules and practical mechanisms for how public and private funding can be combined to fund nature-based projects;
- deciding on the balance between conventional schemes and the use of market mechanisms in the delivery of public funding such as ELMS; and
- defining the role of planning and environmental regulation in creating demand for nature-based projects.

Clear policies are needed to create confidence and ensure markets deliver high-quality environmental outcomes.

Standards, Market Rules and Regulation



There is a need to fast track the development of a consistent set of technical standards and methodologies for accrediting the environmental outcomes from nature-based projects.

Building on the success of existing mechanisms such as the Woodland Carbon Code, priorities for action include:

- catchment-based nutrient balancing (Phosphorous and Nitrogen);
- natural flood management; and
- carbon sequestration from wetlands and other priority habitats.

Robust technical standards also need to be backed by clear market rules. These rules must set out how credits for environmental services are created, registered and traded in a transparent and open way.

There is also a need to identify where regulation can help to catalyse private investment. It is important that these regulations actively facilitate delivery through market mechanisms while maintaining environmental standards.

Priorities would include:

- biodiversity net gain and nutrient neutrality requirements in planning applications; and
- point source water quality improvement in discharge licenses.



Investment Readiness

Capacity-building and support to develop business cases for nature-based solutions is an important element of the strategy.

The Chancellor's Budget earlier this year confirmed £10 million for a Natural Environment Impact Fund to act as an Investment Readiness Fund ("IRF") to help prepare environmental restoration projects for commercial investment.¹⁰

Although innovative projects in early stage development may be suitable for IRF funding, the success, and therefore priority for funding should be building capacity to:

- demonstrate cash flows from nature-based projects;
- develop the financial and legal models to underpin business cases; and
- identify financial instruments that provide a fair balance of risk and return.

Projects that receive IRF support will provide a pipeline of projects that can access funding through defined investment pathways. However, IRF support alone without clear investment pathways risks building expectations without any realistic prospect of securing private finance.

Investment Pathways



We do not have a clear understanding of the gap between current Government spending on nature recovery and the long-term ambition of the 25-Year Environment Plan.¹¹ But there is no doubt that current spending is not reversing nature's decline,¹² and that the additional finance needed is expected to be in the billions of pounds.¹³ This is not a gap that can be bridged through a bottom-up project-by-project approach to private finance alone.

However, existing funding can be used to kick-start mechanisms that can leverage private sector finance and in the process of doing so, will directly inform the policy and standard setting needed to scale those solutions and create investable markets.

Setting aside a slice of this existing funding to establish a **Pathfinder Fund for UK Nature** for large-scale demonstration projects, will help establish clear investment pathways, mobilise the private sector, and drive project development. This funding is needed to de-risk private investment until there is an efficient market for nature recovery, and would reduce over time as markets develop and mature.

¹⁰ HMT, Budget 2020

¹¹ National Audit Office, *Achieving government's long-term environmental goals*, (November 2020)

¹² Natural Capital Committee, *Final Response to the 25 Year Environment Plan Progress Report*, (October 2020)

¹³ GreenPeace UK, CAFOD, Friends of the Earth, Green Alliance, Islamic Relief, the WI, RSPB, WWF *Government Investment for a Greener Fairer Economy*, (September 2019)
IPPR, *The road to COP26*, (November 2020)

Wildlife and Countryside Link, *Comprehensive Spending Review Submission*, (September 2020)



A pathway to sustainable finance

Financing nature recovery will drive the development of a domestic environmental services sector that can become a major source of economic activity and employment.

It will enable farmers and landowners to diversify their incomes, support regional development and help to level up economic opportunities across the country. It will also provide wider social and economic benefits including public health and wellbeing.

The UK is well positioned to harness the power of markets and private investment in nature-based solutions. Demonstrating what can be achieved at a domestic level, will position the UK as a global leader in financing action on climate change and nature recovery.

The Government's recent commitment to establish '*10 long-term Landscape Recovery projects over the next four years*'¹⁴ is a first step, but must be delivered in a way that leverages private finance and investment, or risk locking in dependence on public funding for the long term.

Developing a long-term **Strategy for Financing UK Nature Recovery** and establishing a **Pathfinder Fund for UK Nature** would also be key elements of the Government's response to the Dasgupta Review, and provide concrete demonstration of action to help position the UK in the lead up to COP26 next year.

There is a need to bring together the finance sector, environmental NGOs and the business community to help Government develop the Strategy and Pathfinder Fund.

14 HM Government, *The Ten Point Plan for a Green Industrial Revolution*, November 2020.

A way forward

A cross-sectoral coalition should be established to develop the **Strategy for Financing UK Nature Recovery** which could be launched in the lead up to COP26. The coalition would bring together the finance sector, environmental NGOs and the business community to identify the actions needed to address the barriers to private investment in nature, and the incentives required to catalyse the level of private investment required to make a significant contribution to the delivery of the 25-year Environment Plan.

The Strategy would provide an overall framework to inform and guide work already underway within Government. This would include the development of the Investment Readiness Fund (IRF), ELMS design, the review of the Water Industry National Environment Programme and mechanisms set out in the Environment Bill such as biodiversity net gain and local nature recovery strategies.

Cross-sectoral expertise also needs to be mobilised to help the Government design the **Pathfinder Fund for UK Nature**, using existing funding to support demonstration projects that will: build momentum on-the ground; lower the barriers to private investment; and generate the revenue streams to finance that investment.

The **Pathfinder Fund for UK Nature** would complement the IRF by providing access to patient and flexible finance for projects that have become investment ready through the IRF's support.

Key milestones to COP26

2020

Q4

- Create an action plan for the first 100 days of 2021 covering early actions to help unlock private finance for nature, setting the pathway for the longer term Strategy

Q1

- Work with the Scottish and Welsh Governments and the Northern Ireland Executive on a UK-wide approach to financing nature recovery
- Establish a cross sectoral coalition to oversee the development of a:
 - Pathfinder Fund for Nature
 - Strategy for Financing UK Nature Recovery
- Establish a secretariat to support the work of the coalition
- Establish work streams and confirm budget

2021

Q2

- Call for Phase 1 Pathfinder Demonstration Projects (from existing funding)
- Summit on Draft Strategy

Q3

- Industry conference - review of Draft Strategy

Q4

- Final Recommendations for the 2021 Comprehensive Spending Review
- Launch of Final Strategy - in the lead up to COP26

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Broadway Initiative

The Broadway Initiative brings together all sectors of the economy and society to work together on the frameworks, plans and partnerships needed to meet net-zero emissions and wider environmental goals.

Members come from the worlds of business, NGOs, professional bodies, governance, policymaking and academia.

Green Finance Institute

The Green Finance Institute is an independent, commercially focused organisation backed by government and led by bankers, that convenes and leads sectoral coalitions of global experts, that identify and unlock barriers to investment towards impactful, real-economy outcomes, to benefit our environment, society, and business.

Finance Earth

Finance Earth (formerly known as Environmental Finance) is a leading environmental impact investment organisation, offering corporate finance advisory and fund management services across conservation, natural capital and renewable energy. Finance Earth manages over £50m of blended impact funds; and works domestically and internationally with leading environmental NGOs, government bodies and corporates to create high quality, impact-led, investable solutions.