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New Markets for the Green Financial EcoSystem

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While the focus today is on greenhouse gas reductions, there are many more emerging and maturing environmental financial markets that are often overlooked by investors. We believe that the new compliance driven EPA and other federal regulatory agencies will actually unlock the value of other environmental financial markets and represent new opportunities for investors to protect the environment. It is important that as business metrics begin to permeate socially responsible investment it will make increased sense by non-profits to start considering market-driven solutions, not only to do good but also to continue their own financial sustainability in today's new economic environment.

One area ripe for financialization is the living ecosystem of air and water quality, as well as habitat. Forests, wetlands, and other ecosystems are the arena for this change. However, for these schemes to deliver environmental value on a meaningful scale, they must utilize financial mechanisms that bring buyers and sellers of ecosystem services together in a transparent market that is easily-accessible to all participants and also generates clear price signals that can be used to develop business plans and manage risk. Only when these financial mechanisms are in place can the true value of nature's services be identified and incorporated into the global marketplace. The institutional investment community can start looking at ecosystems as underlying assets and cash-flows

There's been no shortage of media attention on carbon exchanges that make it possible to execute trades in standardized carbon offsets that have already been created and sanctioned. Lesser-known, however, are companies like Mission Markets, Climex, World Energy Solutions, and the NGO Defenders of Wildlife—all of which either have or are developing platforms that in one way or another help developers find investors who are interested in the unique attributes of individual ecosystem preservation projects like biodiversity offsets and wetland mitigation banking. The incorporation of nature's economic value versus costs of its destruction will need to be refactored as the creative forces of our economy become focused on the preservation of nature rather than on its destruction.

Government Mandates Create the New Alpha

Governments around the world have begun taking the steps necessary to bring the value of nature's services into our economic system, and scores of green entrepreneurs have responded by setting up forest and agricultural carbon offset projects, species banks, water quality trading schemes, and wetland mitigation banks. Many of these schemes have been with us for decades, and we are now seeing the emergence of new schemes that promote payments for terrestrial and marine ecosystem services, sustainable fisheries and agriculture, microfinance, Community Development Finance Institutions (CDFIs), and the growing "Lifestyles of Health and Sustainability" (LOHAS) sector.

These mechanisms have all yielded promising results. Microfinance and community investment have been able to raise billions of dollars in this manner, albeit still not in sufficient amounts. The wetland and conservation banking markets have also benefited from the Clean Water Act and Endangered Species Act in the United States. But if we are to develop the scale needed to fund real change, we must develop private capital market mechanisms that incentivize mainstream investors to fund them. That means attracting growing number of investors willing to act as "patient capital." These are double- and triple-bottom-line investors and not mere speculators. With the recent economic and capital markets turmoil, there has been a shift in what investors perceive as "market-rate returns." Investors who once required 15 percent returns per year are now leery of the volatility that such returns generate, and are open to investments projected to yield 3%-7% per year.

These are figures currently being offered in various social and environmental markets, making them more attractive in comparison to past mainstream investments. The existing sub-sectors of conservation finance include wetland mitigation banking, habitat or endangered species banking, water quality and water temperature credit transactions, carbon sequestration projects, conservation easements, TDRs (transferable development rights), marine protected areas and marine conservation agreements. Below is a list of some new innovative financial structures being created to more effectively support and monetize the social and environmental markets:

- **Water Footprint Credits & Water Restoration Certificates** that support various water usage projects globally.
- **Marine Impact Credits** that support marine protected areas and various estuary and marine conservation and fisheries projects.
- **Stormwater Runoff Credits** that support the reduction of storm-water runoff from impervious surfaces.
- **Community Quota Entities** that support local sustainable fishing communities.
- **Social Enterprise Royalty Trust Securities (SERTS)** where social enterprises pay out a portion of their revenues as a dividend to their shareholders.

- **A Low Profit Social Limited Liability Corporation or L3C** a company through which PRI and market-rate return investors can co-invest and support social enterprises and distribute cash flow and returns according to the investors' interests.

The market for both terrestrial and marine conservation finance offers participants a wide array of opportunities to generate both financial return on investment and to direct environmental and social impact in the support of vital habitats. With the exception of the marine conservation sector, these markets share a common characteristic: the generation of a tradable or transferable credit or right that produces the financial return.

Investors that may be most receptive to investing in these emerging markets are state pension funds, foundations, family offices, investment advisors and financial intermediaries, faith based organizations and private equity investors. The opportunity for long-term financial returns coupled with local community or national environmental and social impact provides valuable public image and stakeholder benefits making the conservation finance sector particularly attractive. But there are barriers for these markets including lack of standardized financial and environmental metrics, limited transparency, market fragmentation, limited ability to more effectively monetize credits beyond the current traditional buyers, and most importantly no centralized marketplace (exchange) to efficiently facilitate transactions between buyers and sellers

Creation of an Asset Class

Carbon market development has been the catalyst for global environmental market development. The next phase of the ecosystem services education process has begun with increased information and discussion regarding the next big environmental markets after carbon: water and biodiversity markets, and their associated risks and opportunities for investors. Eventually, consultants, financial advisers and investment banks will advise clients on how best to allocate capital to the ecosystem markets in a similar fashion as carbon.

The reporting of financial returns data within the ecosystem service sector at-large is currently very limited, as information regarding price history and transactions are not published. The profession of wetland and habitat banking is very competitive, and information is kept closely held. This is an advantage if you have access to this information—but to scale beyond a niche market, ecosystem professionals will need to be more open to disclosing these details. When this information becomes more accessible, investors will be able to use it as the basis of decision making.

Apart from carbon markets which is global, the ecosystem services sector is very geography-specific. The credits generated by wetland or habitat projects are not easily fungible as credit transactions are only valid within a specific geographic region or "Service Area." This does limit the liquidity of eco-credits to parties focused in a specific area. Thus ecosystem market transactions are more similar to real estate investing than they are to a natural resource investment.

Conversely, carbon credits are extremely fungible. From both the atmosphere and the market's perspective, one metric ton of carbon dioxide captured or avoided in China is equal to the same in Texas. To begin sourcing potential transactions, organizations like Defenders of Wildlife have created databases and useful tools such as The Conservation Registry that can assist organizations seeking to identify potential conservation project funding opportunities nationally.

A Centralized Ecosystem Marketplace

The key to bringing all these services into an actionable framework is the development of a centralized platforms or marketplaces where investors, service providers and landowners can meet and transact. Currently, if an investor or developer wants to transact a species or wetland credit, they need to first contact a habitat banker, their local Department of Fish & Wildlife Services, or an Army Corp of Engineers office. Once credits are located, the buyer negotiates the transaction in a private bilateral agreement, which is not only time consuming but is not a process that lends itself to the creation of an investable asset class.

Regional and national electronic market places will serve to facilitate ecosystem credit transactions and provide much greater transparency and price discovery. The Willamette Partnership, Bay Bank, and SpeciesBanking.com are creating regional platforms for these markets. Mission Markets Inc. is creating a comprehensive electronic marketplace that will provide platforms for these transactions and link to other regional exchanges adding liquidity and visibility for credits and/or environmental projects. Stand by! These markets are ready to accelerate in coming years as a new asset class for investment emerges.

Peter Fusaro will hold his next "Introduction to Carbon Trading & Finance" seminar at the NYU Torch Club on September 15th (www.pgsenergy.com)

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