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Intermediaries Are a Missing Ingredient in Conservation Finance.

Note: The article below covers an event hosted by Conservation Finance Network (CFN). The 6th Conservation Finance Practitioner Roundtable was held using Chatham House Rules, which require that quotes be anonymized. Select panelists from the session agreed to do on-the-record interviews. The Conservation Fund is a partner of CFN's and is represented on this website's leadership committee and review team.

Financial intermediaries can make new markets come alive, according to a key discussion from CFN's 6th Conservation Finance Practitioner Roundtable. From April 25-26, conservation, agribusiness, and impact investing experts gathered at the McKnight Foundation offices in Minneapolis, to share how they are building financing for conservation practices into mainstream agricultural systems.

The discussion of financial intermediaries was sparked by the panel "Copying the S-Curve." The panel featured experts specializing in clean energy and affordable housing. This panel sought to analyze how lessons learned from the growth of these sectors could be applied to conservation finance markets by focusing on the question, "How do practitioners scale ventures into investment-grade opportunities?"

CFN interviewed panelists Ben Healey, Catherine Godschalk, and Sean Penrith for this article. They each agreed during the panel and in follow-up interviews that the presence of intermediary institutions is part of what made their respective sectors able to grow and create nationwide impact.

What Is an Intermediary?

Ben Healey, director of clean energy finance at Connecticut Green Bank, defined an intermediary as "any number of institutional players that can help arrange capital such that project developers can then have access to it."

Banks are classic examples of intermediaries. One function of a traditional banking structure is pooling capital from different sources. The bank can then act as an access point for individuals or organizations that need financing. Essentially, a bank is an agent that plays a role in connecting the supply of capital with the demand for funding.

There are several examples of existing intermediaries in the conservation finance space. Penrith and Godschalk both mentioned The Conservation Fund's Conservation Loans Program. Solvitect, a credit aggregator described in a recent CFN piece on the new Stormwater Retention Credit Program in Washington, D.C., is a great example of an innovative intermediary seizing on an emerging opportunity.

However, each of the panelists agreed that a fundamental missing piece from the conservation finance market are the kind of intermediaries that can connect projects on the ground to the largest capital markets.

“When it comes to conservation finance, the entire infrastructure still needs to be built,” said Sean Penrith, CEO of Gordian Knot Strategies.

The panelists supplied expert analysis of the value of impact sector-specific intermediaries during the event and in follow-up interviews. They emphasized that intermediaries serve key functions beyond capital collection and allocation, most importantly by providing market infrastructure that helps to structure, package and scale transactions.

Through this process, intermediaries become the backbone of a growing market.

What Opportunities Are Emerging?

The conservation finance field is wide open for intermediaries. Project aggregators with field expertise are needed to serve the substantial interest at the investor level. As CFN has previously reported, there is substantial interest in the conservation space within the impact-investing world. The infrastructure may still be developing, but building out intermediary institutions represents a massive opportunity for entrepreneurs willing to take the leap.

Panelist Catherine Godschalk, vice president of investments at Calvert Impact Capital, said, “We need on-the-ground discovery to understand what is going on – to unlock, de-risk and solve problems.”

In doing so, intermediaries encourage the replicability and standardization that spread impact throughout a sector. They can help seed and grow projects on the ground while providing access to the kind of large-scale financing that new markets need to truly grow.

“How do you move beyond everybody needing to understanding your beautiful snowflake of a project?” Healey said. “The capital markets just want to make big decisions and allocate large sums. You make projects simple, replicable, scalable. That’s the intermediaries’ job. They can take the risk on the front end and then move it forward.”

How Do Intermediaries Provide Replicability and Standardization for Investors?

“An intermediary can deliver a service on a turnkey basis for both buyers and suppliers,” Penrith said. In this case, the buyers are capital markets and the suppliers are project developers while the service is the package of impact projects that the intermediary sells.

When asked for an example of how a successful intermediary can build an industry, Penrith said the emergence of energy service companies (ESCOs) is one of them. “In commercial industry and for commercial building owners, it is a clear advantage to have energy-efficient buildings.”

However, at the individual-building level, it is not always worth the upfront cost for the building owner to install efficiency upgrades. The payoff from lower energy bills accrues slowly over time. While energy-efficiency projects yield savings over time, they can be inconvenient or unfamiliar at the individual level.

Intrepid entrepreneurs recognized the opportunity at hand. “Along came the ESCO model,” Penrith said. “[ESCOs] were established to pay for the upgrades and manage them. These companies were paid through energy savings achieved.”

Key to the ESCO business model is attracting enough project-level business to scale revenues over time. ESCOs developed expertise and created replicable energy-efficiency projects. By streamlining the upgrade process, ESCOs found a niche and became hyper-efficient in that space.

Importantly, ESCOs were able to package their projects as investable securities. With successful pilot projects and steady future streams of cash flows through energy cost savings, the ESCO model proved to be an attractive investment.

ESCOs had replicated their base revenue model to the point that projects were standardized, understood and packaged. Thus, they were able to attract the attention of capital markets to scale operations to the next level. With the help of large-scale financing, ESCOs created even greater impact on energy use.

"This is a great example of an intermediary providing a service on a turnkey basis," Penrith said.

How Can Projects Bridge the Gap to Capital Markets?

There was wide consensus among Roundtable attendees that one of the keys to building the conservation finance sector is finding ways to access capital markets. Godschalk said, "We think the role that private capital has to play in solving our environmental challenges is massive. We will require massive amounts of scale to solve the world's problems."

Intermediaries need to play a part in channeling those funds to conservation projects. They accomplish this by acting as the conduit between major investors and concrete impacts.

"Fundamentally, in developing a market-based solution, the problem is not a lack of capital. It is that the capital does not have a path into financing projects," Healey said.

Large financial institutions investing billions in capital do not want to get bogged down in the details of individual investments. In well-developed markets, investors depend on financial intermediaries to provide on-ramps to investment opportunities and to source interesting ideas.

As an example, Godschalk said her firm has a role as an intermediary on the capital continuum. "There are two levels of intermediation that are critical to moving capital efficiently from the private sector into impact opportunities. The first level [consists of] market-serving intermediaries, like Calvert Impact Capital, who structure products that can tap existing capital markets."

What On-the-Ground Expertise Makes These Investments Work?

As the go-between for capital and projects, intermediaries also work at the project level. Godschalk said, "Market-serving intermediaries provide capital to the second level of intermediaries, community-serving intermediaries. Community-serving intermediaries offer products to serve businesses operating on the ground in communities."

"At this level, intermediaries are closer to the community and the science, and understand the… risk that the capital takes," said Healey.

Intermediaries are able to de-risk and standardize projects to connect them to the waiting capital markets. According to Godschalk, intermediaries serve a variety of functions at this on-the-ground level; they provide upfront venture and risk capital showing they have a stake in the outcome, advise and guide project developers, and help structure projects to make them more attractive to investors.

Because intermediaries have deep familiarity with their investment ecosystems, they are well-positioned to design investable products that meet their clients' needs. Market-serving intermediaries know what capital markets require in terms of risk-adjusted returns. Community-serving intermediaries know what the project on the ground needs.

Healey went further. “The capital markets need to see some kind of package. That package can only be sold by [an] expert.”

The previously described ESCO model exemplifies how an expert intermediary can package and sell small projects to the capital markets.

“Community-facing intermediaries take capital and solve for requirements on the ground of highly local or sector-specific risks.” Godschalk said. “This community-serving intermediation is critical to a well-functioning market and is what the conservation finance sector needs more of.”

Conservation Finance Network

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