

# **Landscape Recovery public payments: what to consider as you develop your business model and blended finance plans**

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## Introduction

**This guidance is for Landscape Recovery projects only. It does not apply to other agri-environment schemes and does not set a precedent for schemes across Defra.**

Read this guidance to help you as you develop your business model and blended finance plans for your Landscape Recovery project.

To help you consider suitable options for public funding in your project, this guidance explains the options available for:

- payment mechanisms (how public funds are structured, for example, a grant, guarantee or a loan),
- public payment methods (how the payment rate could be set for different aspects of your project and what could trigger a payment to be made).

We've included specific information that projects have asked for during the project development phase (PDP). You should read this guidance with the business model and blended finance plan guidance published in August.

## Public payment methods and mechanisms

As requested in the Landscape Recovery handbook and guidance, your business model and blended finance plan should include information on:

- what form of public funding you need (the mechanisms)
- how much public funding you need (the amount)
- when you want it to be paid (the methods)

Public payments aim to support you to deliver your project objectives and make sure your project is financially viable. We want to facilitate projects using innovative payment methods and mechanisms that are suited to your project.

This is different from other schemes (for example, Countryside Stewardship and Sustainable Farming Incentive) that set out activities with fixed payment rates.

The following information covers what to consider when thinking about how to use public funds, for your Landscape Recovery project.

## Types of costs in your project

Consider what types of financial needs you may need funding for. It can help you choose the appropriate payment methods and mechanisms. To assist with this, project financial needs can be thought of in three categories:

- **capital:** upfront costs to start the project and begin interventions in the landscape for example, costs to excavate material required to create a wetland, or to buy and plant a woodland

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- **operational and maintenance (O&M):** costs to run the project (salary costs of project manager) and ongoing costs to maintain and continuously improve your project outcomes, for example, to manage a habitat over time or maintain land in a certain condition
- **revenue streams for outcomes:** income sources of the project that can help meet the above costs, for example, ecotourism or guarantees for measurable and verifiable units of biodiversity improvement, water quality, or carbon credits

Public payments used to partly meet these needs can also be used to reduce the risk for private sector investment.

## Public payment mechanisms available

You can choose to use any of the following public payment mechanisms and include them in your financial model.

You may choose to use several of these payment mechanisms across the life of your project to ensure financial viability.

### Grants

Grants are a form of non-repayable financial support. Most Defra agri-environment schemes are funded by grants.

Grants can be provided for:

- capital costs, to meet the costs of creation and restoration work (for example, the construction costs to create a wetland or re-meander a river)
- O&M costs, to meet regular annual expenditure such as staff salaries or regular habitat maintenance costs
- outcomes that are measurable and verifiable for example, carbon sequestration, educational visits, water quality improvements, improved soil health, public access (this could be particularly useful where markets are not developed so that we do not risk crowding out the private sector)

### Guarantees

Guarantees are a form of financial support that give confidence you can access payments where you deliver a pre-agreed outcome, with payment at a pre-agreed rate.

Guarantees, similar to the [woodland carbon guarantee](#), can be used for 'price floors'. In this instance, public payments can be accessed where you are unable to sell those outcomes to the private market.

We want you to be better off under a private market arrangement than a public payment arrangement, where possible. We also want to make sure we are not exposed to large financial liabilities and that we do not crowd out private finance. This means we will look to provide partial guarantees that cover a proportion of the outcomes the project expects to deliver at a pre-agreed rate. You can then use this guarantee or go to the market if the price is better.

Guarantees, can be structured as grants or contracts and can be provided as:

- support for O&M costs, supporting revenue over the life of the project (this could be a guarantee to provide a fixed annual amount in grant format, to meet ongoing operational costs of the project)

- floor prices for outcomes, specifically where outcomes have an emerging private nature market, are verifiable, and the rate can be set below what we think an efficient market should pay (for example, this could be a pre-agreed payment for an amount of water quality improvements you deliver, which you can access if there is no private buyer for those improvements)

Note, we will not provide loan guarantees or underwrite capital loans in Landscape Recovery.

## Loans

A loan is a form of repayable finance where you would agree to repay the borrowed amount plus interest and any arrangement fees (in fixed amounts over the life of the loan). This mechanism can be useful where you already have secured sources of regular income but lack the funds for upfront construction activities. It can also cover operational costs where these have been wrapped up into your capital needs.

Typically, this kind of finance is provided through commercial organisations such as banks or funds. In some cases, there are government-funded lending institutions such as the UK Infrastructure Bank, the British Business Bank, and more recently the Big Nature Impact Fund that could be a source of this type of funding for projects.

Where these commercial organisations and government-funded lending institutions cannot provide the necessary capital on manageable terms, we could look to provide a loan to fill this gap.

An example of this could be where a project secures investment from communities or organisations that meet 80% of the project needs. The project might also build an income stream from ecotourism, carbon credits and [biodiversity net gain](#) (BNG). The project might then secure a public loan to meet the remaining 20% of project needs, which would be repaid from the income stream over the life of the agreement.

Commercial lending organisations often have a minimum amount they are willing to lend. This may be too high for your project to access, and a set interest rate which may be too high for your project to repay. In those instances, where the commercial lending market is not providing appropriate investment to support your project, public funds could be used to fill that need. You will need to provide us with evidence to show that the commercial lending market is not able to provide loans on terms that work for your project in this case.

Whilst loans may not be our preferred payment mechanism given their complexity, we want to be open to them where they fulfil a specific purpose.

## Public payment methods available

The other aspect to public payments is the method to set a value and when to make a payment.

There are several ways we can do this but, in all cases, the aim of public payments is to make a project financially viable.

The rate and when a payment is made can be divided into:

1. **Action-based payments** that cover the cost of delivering an action. Typically, action-based payments will cover you for the costs of performing the projects' actions for example, fencing costs. We will benchmark your proposed costs against similar actions in other public

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schemes. We are willing to accept different rates subject to you providing sufficient detail and evidence on costs. We are open to paying a portion of these costs in advance of the action taking place, where you outline why advance payments are needed. This could include cash flow projections, bank statements, and audited accounts.

**2. Outcomes or results-based payments** are set at a portion of the social value of actual or expected outcomes (ecosystem services):

- results are the quantity and condition of natural capital assets
- outcomes are the measurable and verifiable ecosystem service being delivered

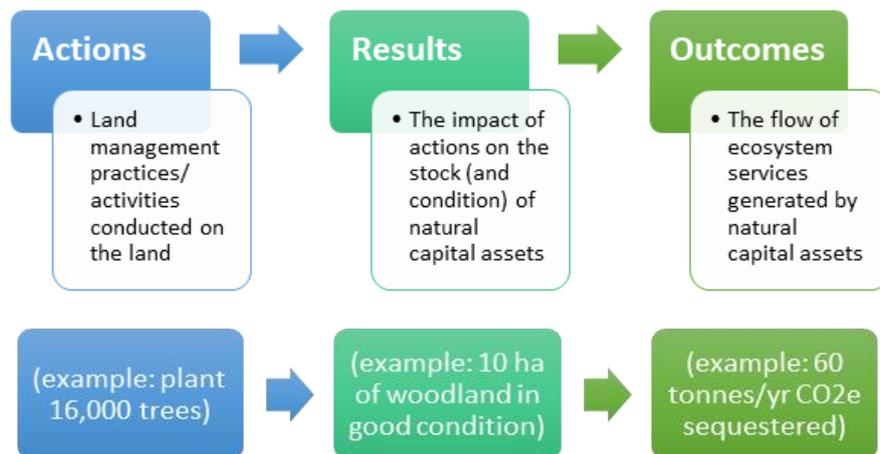
Where you want to use this kind of payment method, in your land management plan, monitoring and evaluation plan and business model and blended finance plan, you should include:

- the outcomes you expect to deliver
- when they are expected to be delivered
- what outcomes you expect to link to payments.

You will need to forecast the delivery of your outcomes and results in your plans. You will also need to monitor and verify their delivery in implementation.

Where you are considering payment by outcomes or results, think about how to mitigate the risks of outcomes not being achieved due to something out of project control (for example, extreme weather). Include details of how you plan to mitigate this risk in the risk management part of your project management and governance plan.

The diagram below shows the simplified relationship between actions, results, and outcomes. Where we make payments by results or outcomes, the more confidence we have that the outcome is delivered, but the greater the time is between the action being carried out and the payment being made.



We recommend that:

- action based payments for capital and O&M, are best funded through grants
- outcome or result based payments are funded through a guarantee or grant

There is also potential for loans to deliver funding for actions and capital needs. We are open to other combinations and will consider the risks and benefits of these as part of our assurance and analysis processes prior to any negotiations.

## **Combining mechanisms and methods**

There may be advantages to your project, land managers, investors and Defra to proposing a combination of public payment mechanisms and methods. We are willing to explore these proposals with projects through our negotiation discussions.

## **Additionality**

Additionality means that the action or outcome delivered would only have occurred with the payment, for example, it is additional to what would have happened under existing arrangements.

Our position on additionality meets our aims of allowing land managers access to multiple revenue streams which increases the viability of projects. It also supports delivery of multifunctional landscapes and rewards land managers for different outcomes delivered on their land.

This position only applies to land in Landscape Recovery and should not be taken as a precedent for other public schemes.

## **Blending public and private finance**

One revenue source to consider is private nature markets. These enable private investment in nature, through creating units or credits for ecosystem services (environmental outcomes) that can be bought and sold. You can read a [recent blog](#) which outlines what government is doing to scale up these markets.

We want you to be able to access and combine public funds with private investment and private income. We want to use public funds to support this whilst protecting our value for taxpayer money, ensuring project viability, maximising multi-functional land use, and supporting the growth and integrity of nature markets. For this to happen, we have developed a position on 'additionality' - how these revenue streams interact with each other – for you to use when building your financial model.

## **Additionality for public funds**

There are two types of additionality that can ensure your project is delivering environmental improvements that would not have happened otherwise.

Your land management plans will indicate any existing legal agreements on land in the project area and what the obligations are. With this information we can ensure legal additionality. This ensures credits cannot be issued where the activity providing ecosystem services, is being carried out to meet a legal obligation.

For example, if you already have a contractual agreement with a forestry company to create and manage woodland for ten years on a land parcel, we will not fund the planting or management of that woodland. However, we could discuss enhancing that woodland beyond what is legally required and paid for (for example, planting wildflowers or creating ponds), and management costs after year ten.

Financial additionality looks at whether a project would be viable without a certain funding source. We will assess your proposals to ensure that public funding is necessary to make the project financially viable and is therefore 'additional'.

Using both legal and financial additionality ensures that public and private payments do not pay for the same outcome. It also minimises the risk of public and private payments paying for the same action, avoiding double funding.

## **Engaging in private nature markets**

Where your project wishes to access private nature markets, you will need to pass any additionality tests associated with those market schemes. Public payments will affect the extent to which you will pass any financial additionality test and can then sell units. You should show how you have considered this in your financial model.

We want to support the creation of landscapes that provide multiple ecosystem services. One way to do this is by recognising and rewarding land managers for delivery of different outcomes and benefits from a parcel of land.

Therefore, in LR, you can stack private payments for different outcomes on a parcel of land, so long as you meet the rules set out by individual nature markets. Voluntary credits should be stackable so long as the relevant additionality tests and individual scheme rules are met.

## **Managing risks with emerging nature markets**

You may wish to engage with less-established market codes such as the [Soil Carbon Code](#), [Agreena](#) and [Wilder Carbon](#). These schemes may either be developing market rules or have not set out clear rules on additionality and stacking. This means there is a risk they may not align to the principles for high-integrity markets that are being developed by the British Standards Institute. It could mean that in the future, the code is not recognised as one of high integrity.

Where you choose to engage with these codes to sell credits, you should get appropriate legal and business advice on how you can manage, exit, or adjust a private agreement in the future. This would allow you to continue to sell outcomes, should an improved code be developed, or the code you sign up to, fail any future accreditation.

## **Principles for additionality in Landscape Recovery**

Where market rules on financial additionality are not provided by the private nature market codes, we recommend that you use a set of principles to help you meet financial additionality:

1. Public and private funds can be used for the same action only where neither fund would deliver the action alone (financial additionality, minimises double counting).
2. Private and public funds should not be used to deliver actions already legally required in the project area (legal additionality).
3. Public funds should only be used for actions or outcomes, where they are necessary to make the project financially viable (financial additionality).
4. A single unit or credit for an ecosystem service or outcome cannot be sold twice (market integrity, avoids double counting).

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- You can combine public and private income streams through nature markets, as long as they meet the rules set out for that market (particularly additionality tests). You must mitigate any risks that come with the agreement for example, not being accredited to future BSI standards (recognition of multi-functional land use).

## Keeping track of your outcomes

You will need to maintain and share with us, information on what units are being created and sold, from what parcels of land and what codes are being used. This is so they cannot be resold in the future should any new codes or registers be developed.

In the interim, before private schemes develop market infrastructure to track sales of outcomes, your land management plan, monitoring and evaluation plan and financial model, can be used to track and register outcomes being sold.

## Scenarios

The following scenarios are designed to show clearly the kinds of conditions you could expect to apply to ensure additionality of public and private payments:

Scenario	1	2	3	4
Private pays for	Action	Action	Outcome(s)	Outcome(s)
Public pays for	Action	Outcome(s)	Action	Outcome(s)
Conditions	<p>Only allowed where actions are complementary and additional, to avoid double counting and safeguard public funding.</p> <p>The same action can be partially funded by both public and private, where neither is enough to cover the full cost alone</p>	<p>Allowed subject to conditions.<sup>1</sup></p>	<p>Allowed where the outcome is not used for regulatory compliance for example, biodiversity net gain (BNG)<sup>2</sup></p> <p>Requires projects to follow market rules on additionality<sup>3</sup></p>	<p>Only allowed where outcomes are complementary and additional or different (for example, carbon and biodiversity) to avoid double funding</p>

<sup>1</sup> For example, government provides a floor price (similar to the Woodland Carbon Guarantee) or uses Payment by Results. Private money provides the capital to deliver the outcome and public money is used to provide the revenue stream for a given outcome. Best used for specific outcomes where the market does not exist or is nascent.

<sup>2</sup> Compliance markets should require the polluter to pay the full amount of generating the offset, to adhere to the polluter pays principle.

<sup>3</sup> Similar to the England Woodland Creation Offer and Peatland Grant schemes, that allow projects to access the WCC and PC and sell carbon outcomes. In the WCC, government pays for an activity and if it passes a legal and investment test, the outcome (a carbon unit) can be sold.

## **Payments for activities required by designations and regulations**

We want to fund projects that will deliver more than is required from any designation or regulation, to achieve long term environmental outcomes.

### **What we mean by designations**

Designated nature sites include, but are not limited to, Sites of Special Scientific Interest (SSSIs), Wetlands of International Importance (Ramsar), Special Areas of Conservation (SACs) and Special Protection Areas (SPAs). These sites may require ongoing maintenance or restoration to bring them into 'favourable' condition and improve them further.

The responsibility for ensuring favourable condition is for government and public bodies. Previously, we have offered financial incentives (through agri-environment schemes) to support land managers to manage designated sites appropriately on our behalf.

### **What we mean by regulations**

Farming and land management activities are regulated to safeguard our environment and to protect the health of animals, plants and people. This is achieved through around 150 pieces of legislation and known as the regulatory baseline for agriculture. Both agricultural regulations (for example, slurry management) and non-agricultural regulations (for example, forestry regulations) may apply to your project. Where there is a requirement for land managers to meet the regulatory baseline for agriculture, they will not receive specific funding for this.

### **What we will fund**

We want projects to be ambitious, so we will be open to paying for actions that deliver outcomes in exceedance of requirements from designations, for example, going beyond 'favourable' condition.

We will also remain open to paying for actions that are part of an agreed suite of activity to meet and exceed a regulated outcome, for example, 'good' water status or 'favourable' condition.

### **What we will not fund**

We cannot pay for specific actions to comply with prescriptive regulatory requirements. Where individual land managers need funds to meet regulatory requirements (for example, reactive tree or animal health measures) existing funds should be used, such as [woodland tree health](#) grants.

We also cannot pay for meeting the regulatory baseline.

### **Determining payments in scope**

As part of the blended finance plan, we expect projects to outline the actions and outcomes delivered by public funding. The land management plan also asks for information on what areas of land are subject to either regulation or designation. Once these plans have been submitted, we will check the planned actions and associated payments are aligned to our position. This will form part of our deliverable analysis.

**If you have any questions about this information, please let your project liaison officer (PLO) know.**