BRIEFING REPORT - PART I

Plymouth Habitat Banking Vehicle

PLYMOUTH CITY COUNCIL

1. INTRODUCTION

A Habitat Banking Vehicle for Plymouth – Delivering biodiversity net gain for the future of green infrastructure in the city.

This report sets out the detail of establishing a Habitat Banking Vehicle – *HBV* - (in response to the approved Executive Decision from Cabinet on 8th December 2022). We had previously committed to returning with a detailed Business Case for the HBV but following discussions with Finance colleagues it was felt that a Business Case was not suitable and Briefing Report enabled the information to be provided more clearly.

The proposal set out in this report will provide a positive response to the new duties arising from **Biodiversity Net Gain** policy set out under the Environment Act 2021. The paper recommends establishing a company that, through the new Environment Act Duties, secures a **new stream of private investment** to create a biodiversity 'product' (a Biodiversity Unit) that is **sold to the developer market** and potentially other investors seeking to meet their ESG requirements, **to generate sustainable revenues** to help finance the enhancement and maintenance of the city's green spaces for people and wildlife.

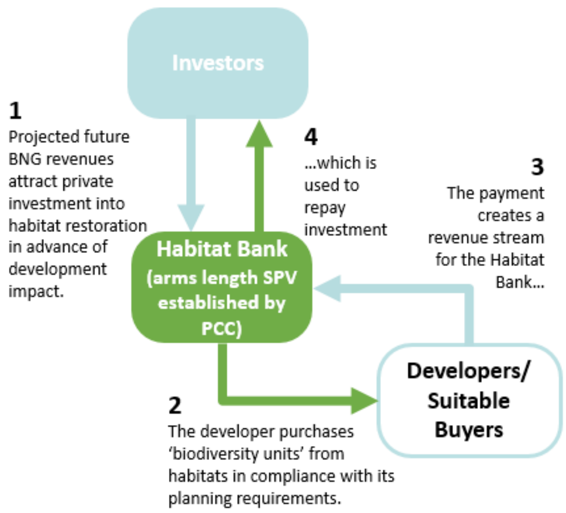


***Figure 1** – Illustrative Habitat Banking Vehicle model – a more detailed structure is set out in Appendix 1*

Habitat banking is one form of green finance. A habitat bank allows investors to finance habitat restoration and creation. The investor receives their original investment returned plus interest and is also rewarded with environmental returns, such as improvements to habitats – woodlands, meadows, rivers etc. – and enhanced access for people.

Habitat banking provides a way for landowners – in this case Local Authorities – to create and/or restore a habitat in advance through investment raised and "bank" the resulting biodiversity units created. These units can then be purchased by developers or other companies seeking to comply with the mandatory 10% net gain or their own ESG requirements. The sale of biodiversity units means the investor who provided the upfront finance gets their initial investment back with interest and information about the social and environmental impact of their funding. The sale of biodiversity units also provides a critical revenue stream for Local Authorities to maintain the newly restored or created habitat for a minimum of 30 years and longer through the creation of an endowment.

Please note due to the nature of the proposition and recommendations this proposal has been treated as an 'Unusual and Innovative Transaction' following the recommendation set out in the Council's procedures. The request to establish the HBV does not in itself have any financial implications for the Council. However, the future potential of the proposal to generate investment funds is why it has been reviewed under the Unusual and Innovative Transaction procedures.

Key points to consider:

- The business case is modelled against pilot delivery in 3 sites (109 hectares) owned by PCC, all figures quoted are relative to that. We have identified further 29 sites (269 hectares) to be included in future phases.
- Work to date and up to the point of establishment of the HBV has been and will be funded through external funds raised from Future Parks Accelerator (FPA) and Natural Environment Investment Readiness Fund (NEIRF).
- The HBV project will report to the soon to be established internal 'Green Finance Working Group' with representation from key corporate functions that will be critical in progressing this work, as agreed at CE Board on 8th November.
- Proposed governance arrangements for the HBV have been structured in partnership with external legal advice which has been fully reviewed by internal legal teams. Governance will be structured to invite input from local economic and environmental stakeholders, while retaining ultimate council control over decision making.
- From the HBV the Council is forecast to generate a net benefit of £193k p.a. (£6m over 30 years) to meet existing income targets ***from the 3 pilot sites***.
- Based on the success of this pilot programme, the HBV could scale up to generate further benefit for Plymouth, with indicative revenues of £25-30m based on scale up across the emerging Local Nature Recovery Network (LNRN), another requirement of the Environment Act. In addition, the HBV stands as a pioneer for a group of Green Finance initiatives that are currently being explored, which have the potential to attract further investment into Plymouth's natural environment and open spaces.
- The governance and contractual arrangements proposed mean that the HBV and investors hold the majority of costs and risks associated with this business case proposal.

2. PROPOSAL

This proposal supports the following Corporate objectives:

- a green sustainable city that cares about the environment
- a clean and tidy city
- a welcoming city

The HBV proposal supports the delivery of the following JLP policies by ensuring that we make the most of new revenue streams and continue to access one-off funding opportunities to enhance the urban forest and green space of the city, engage communities with their local natural spaces and amenity trees whilst increasing the biodiversity value of trees throughout the city.

- DEV026 Protecting and enhancing biodiversity and geological conservation,
- DEV027 Green and play spaces,
- DEV028 Trees, woodlands and hedgerows.

Finally the proposal supports action to deliver against the City's climate emergency ambitions. A climate change decision wheel assessment has been conducted for the proposal a summary of which is below and the detail of the assessment within Appendix 2. This shows that **under all relevant assessment criteria this proposal fully aligns and supports the City's climate ambitions**.

3. CONSULTATION & STAKEHOLDERS

The HBV proposal has been developed through work carried out and funded as part of the Future Parks Accelerator programme and DEFRA's Natural Environment Investment Readiness Fund. Development work to this stage has included

- Engagement with internal stakeholders in PCC across departments including significant input from finance and legal.
- Workshop sessions with external stakeholders including DEFRA, Natural England and other Local Authorities to identify the standard of approach to be taken to Habitat Banking in an urban context
- Discussions with city housing providers and the Housing Delivery team
- The proposal was part of the PCC 2023/24 budget consultation. The proposal for a Habitat Bank received 19 responses with 16 being positive responses and 3 were neutral and were seeking more information.

4. OUTCOMES & BENEFITS

<u>Financial</u>

The proposal to establish the HBV does not in itself have any financial implications but the business modelling currently shows the predicted financial benefits of the approach is likely to be as follows:

- The HBV, if established, would provide a new ongoing income stream to PCC's Environmental Planning and Operations teams for the maintenance of high-quality habitats and offset existing costs. In the short-term an average of £193k p.a. through contracted services for the HBV and long-term through the proposed endowment structure. This represents approximately £6m of revenue for PCC over the life (30 years) of the investment raised for the first 3 pilot sites.

- The HBV is expected to generate an estimated £7.3million in revenues from the 3 identified pilot sites over 30 years.
- This would be realised from an expected external investment of £0.3-4m at year 0.
- Further investment and scale up could see benefits multiply to c. £25-30m if further sites were included in the programme.
- It is proposed that any surpluses generated will be used for the delivery of city priority natural infrastructure projects that respond to the climate emergency and enable the city to adapt to unavoidable impacts of climate change.
- The vehicle will seek low-cost investment from aligned impact investors and offer an investment opportunity to PCC itself.

Non-financial

- Delivery of site enhancement as part of Plymouth's Local Nature Recovery Network.
- Creation of principles and standards for biodiversity offsetting and net gain delivery that also provides maximum social value.
- Delivery of an effective offsetting solution for local development projects supporting the sustainable development of the city as set out in the JLP.
- Safeguarding of public access to high quality nature within the city.
- Creation of new, local jobs within the growing 'green' economy.
- Engagement and collaboration with local eNGOs.
- National recognition for Plymouth as we are increasingly being seen as a leader and pioneer in adaptation to emerging natural capital markets and green finance opportunities.
- Delivering a proof-of-concept for further financially sustainable natural environment investment models.

5. RISKS

A simple summary risk table is presented here with a fuller risk register presented in Appendix I which provides greater detail on risk mitigation.

Risk summary	Mitigated risk level (Low/ Med/ High)	Suitable mitigation/ control in place or planned (Y/N)
Investment cannot be raised to capitalise the HBV	Low	Y
The Environment Act secondary legislation is delayed or materially changes, affecting the outcomes of the biodiversity net gain market	Low	Y
The HBV is not designed and structured correctly to meet PCC's requirements and compliance	Low	Y
Repayment risk to investors for external financing raised falls on PCC	Med	Y
Lack of demand for BNG units or an inability to sell BNG	Low	Y

units		
Project operation and maintenance risks e.g. contractor failure	Low	Y
Covid-19 (or other unforeseen macroeconomic events) delay project delivery and take-up of services.	Low	Y
Implication of requirement for BNG affecting viability of housing development particularly affordable housing	Low	Y
Risk of property issues e.g. existing rights over the land or covenants against using it except for particular purposes, existing designations or conflict with existing rights holders. This could interfere with the principle of granting a lease to HBV for that site	Med	Y
Risk that the HBV becomes insolvent	Low	Y

6. GOVERNANCE

Governance arrangements for the HBV have been designed with support from external legal counsel and full engagement of PCC legal team. At all times transparency and maintaining PCC control of decision making has guided this work.

Establishment phase and Green Finance Working Group

Governance of the establishment phase of the project is co-ordinated through the Green Finance Working Group, established in response to the emergence of a number of green finance initiatives that PCC is currently progressing. The working group includes representatives of the key corporate functions required for the success of this programme. The HBV project as a whole will report to this group. This will expand on the project-focused approach taken to date and will oversee the programme of work around green finance initiatives. This will require continued and sustained support from Finance and Legal in particular during the establishment phase. The HBV project will also continue to benefit from the support of an FCA approved fund manager throughout this process.

Following the establishment of the HBV, members of the Green Finance Working Group will act as an advisory body, and will advise the appointed Member representative for the HBV.

Corporate Structure & Governance

The proposed corporate structure consists of two companies, the HoldCo and the HBV.

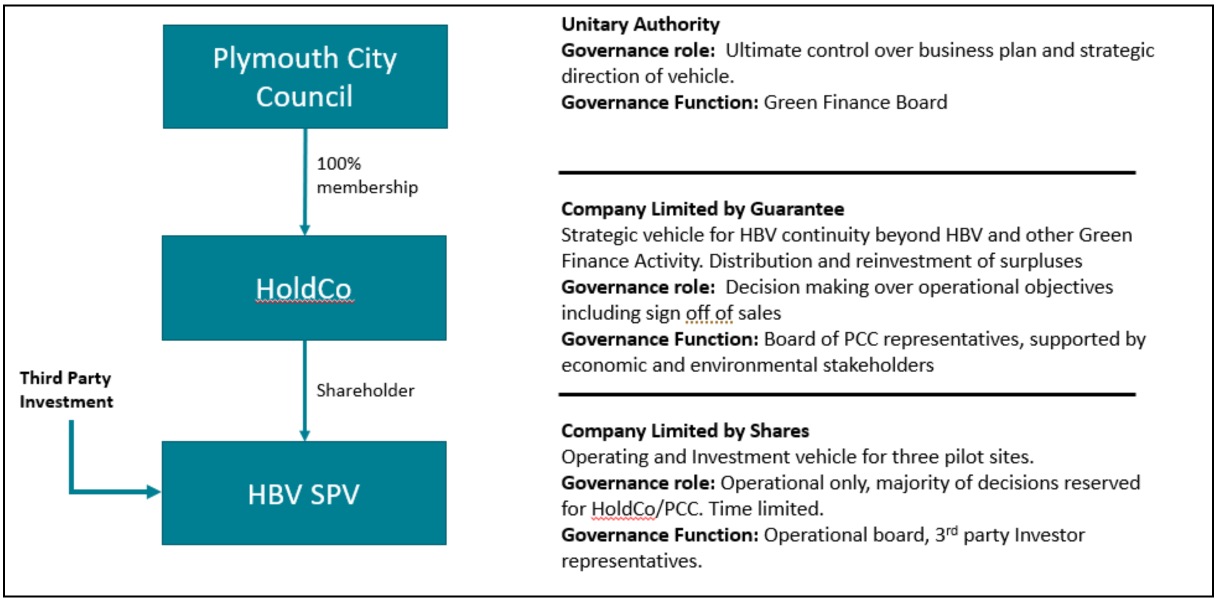


Figure 2 *– Illustration of proposed corporate structure for the HBV*

The HoldCo

The HoldCo is established as a not for profit company limited by guarantee. The HoldCo has one member, PCC. The HoldCo is established with a board of directors appointed by PCC. Directors of the HoldCo report to the Member (PCC) representative, acting as sole controller of the HoldCo. The board of directors is responsible for strategic decision making, including:

- Sales, pricing and marketing strategy
- Sales of biodiversity units to local buyers
- Review of, and reporting to PCC on the operating performance of the HBV
- Use of surplus generated by the HBV, including reinvestment in Plymouth's green estate. This will include scope to progress further green investment programmes for example in sustainable urban drainage opportunities.
- Respecting other "Reserved Matters" set out in the HBV's Articles of Association/the Shareholders Agreement entered into between Holdco, the HBV and any third party shareholders to meet agreed PCC requirements.

HoldCo board composition will allow PCC to retain control of the vehicle while demonstrating both environmental and economic credentials to investors and commercial counterparts. The PCC Member Rep would have the delegated authority on behalf of PCC to invite or terminate board membership. It is proposed that the initial board would consist of 3 PCC officers and 2 external appointments. One from a suitable environmental NGO and one from a suitable Investment background.

The HoldCo board will meet bi-annually and as required once the entity is established. In the first year(s) of operation the HoldCo board is expected to meet more frequently.

The HBV

The HBV will be established as a company limited by shares. The company is established with a sole shareholder, the HoldCo, but is designed so that PCC may sell the majority stake (up to 74.9%) in the company to a third party, without divesting control which will be protected by a list of "reserved matters" which can only be decided upon with Holdco (and, therefore, PCC) approval as key shareholder giving Holdco "Golden Share" status. The board of directors of the HBV has a limited role and is limited to operational items including:

- Negotiating and approving spend on operational contracts

- Negotiating sale of Biodiversity Units
- Approving spend on reactive site maintenance

Directors of the HBV report to the shareholders, the HoldCo and any third party equity investors in the HBV (if any). Directors will consist of an executive of PCC officers, and may also include investor representation in time if the HoldCo choose to follow this route

HBV board composition will allow PCC to retain veto control of the vehicle while acting in good faith with investors. Reserved matters agreed in the company Articles of Association or Shareholder Agreement will provide PCC with ultimate control over the operation of the vehicle. The Articles of Association can only be changed with a special resolution, requiring HoldCo approval to pass and the Shareholder Agreement can only be varied with the approval of all Shareholders (PCC as sole Shareholder of HoldCo). The following PCC representatives have been identified to sit on the HBV Board:

1. Philip Robinson (PCC)
2. Zoe Sydenham (PCC)

PCC Governance

The Green Finance Working Group will continue to act as an advisory group to the Member Rep of the HoldCo on behalf of PCC. The Member Rep through the HoldCo will have course to direct the activities of the habitat banking vehicle through a series of reserve matters defined in the articles of the HoldCo. Proposed Reserved matters detailed in the proposed company articles will limit the ability of the HBV to act without PCC approval, these restrictions include:

- Raise funds
- Employ personnel
- Enter into lending of guarantee arrangements
- Sign new lease agreements
- Sell BUs to unapproved purchasers
- Change approval and governance procedures.

Such restrictions allow PCC to retain a high degree of control over company operations at arms-length. The appointed PCC Member Rep will have authority to make decisions on behalf of HoldCo up to “Key Decision” level (as defined in the Council’s Constitution). This appointment is set out in the recommendations.

Governance of Land Ownership and Contractual arrangements

PCC will be a counterpart to the HBV in commercial contracts for the provision of services (including for land restoration works and provision of administrative services to the HBV by PCC) and under the terms of a Lease to the HBV of the Habitat sites meeting S123 LGA 1972 requirements. These duties fall to the Member Rep.

7. FINANCE

Development cost (ahead of investment raise) = £181k. This development cost is funded by the budget from external grant funding raised through the Natural Environment Investment Readiness Fund. Therefore there is negligible cost to PCC through some core staff time to inform development. In addition, the establishment of an endowment fund will provide for long-term financial security for Plymouth's green spaces included in the pilot, providing support for ongoing maintenance funding and reducing the pressure on central funds.

There is therefore negligible financial risk to PCC through the development of an HBV.

From the HBV the Council is forecast to generate a net benefit of £193k p.a. (£6m over 30 years) to meet existing income targets ***from the 3 pilot sites***.

The business model for the HBV has the ability to blend cash flow scenarios to support mission-aligned development schemes and still achieve sustainability.

The HBV is estimated to have revenues of £7.3m from the sale of BNG units, excluding the endowment. The sale strategy includes a blended mix of Land Banking and Habitat Banking units.

Procurement

The delivery of works by external agencies will be procured in compliance with procurement law.

8. RECOMMENDATIONS

That Cabinet:

1. Approves creation of vehicles/ company structure, as outlined in the Briefing Report
2. Approves the appointment of the following officers to serve as of Directors of HBV as:
   - Philip Robinson (Service Director for Street Services)
   - Zoe Sydenham (Natural Infrastructure Projects and Partnership Manager)
3. To appoint Strategic Director for Finance (David Northey) to act as Member representative in respect of the Holding Company ("HoldCo") and to exercise all voting rights on behalf of the Council as Member of the company, including the appointment and termination of Company Directors and subject to Key Decisions (as defined by the Council's Constitution) being reserved to the Leader/ Cabinet and take any necessary action to protect, safeguard and effectively manage the Council's interest in the HoldCo.
4. Delegate to the Strategic Director for Finance (David Northey), the authority to approve or enter into all relevant documentation and agreements on behalf of the Council in relation to the HoldCo and HBV.

Appendix 1 – Risk Register

Risk Register					
Potential Risks Identified			***Likelihood***	***Impact***	***Overall Rating***
Risk	**Investment cannot be raised to capitalise the HBV.**		**Low**	**High**	**Medium**
Mitigation	**PCC will develop the HBV in partnership with Finance Earth, an FCA-authorised investment advisor and fund manager, who will work with PCC to design the HBV to meet investor needs. Finance Earth will engage with a select group of target impact investors to determine interest and requirements at key points throughout the design process. Funded through NEIRF.**		**Low**	**Medium**	**Low**
Calculated risk value	**£0 (no direct PCC expenditure; grant funded NEIRF)**	***Risk Owner***	**Chris Avent**		
Risk	**The Environment Act secondary legislation is delayed or materially changes, affecting the outcomes of the biodiversity net gain market**		**Low**	**Low**	**Low**
Mitigation	**JLP Dev26.5 states that net gains in biodiversity will be sought from all major developments. As such some demand is expected to continue under local policy. The Defra Biodiversity metric rewards the early delivery of projects through a time discount factor; as such delays will have a reduced impact on the economics of the proposed vehicle.**		**Low**	**Low**	**Low**
Calculated risk value	**£0 (no direct PCC expenditure; grant funded)**	***Risk Owner***	**Chris Avent**		

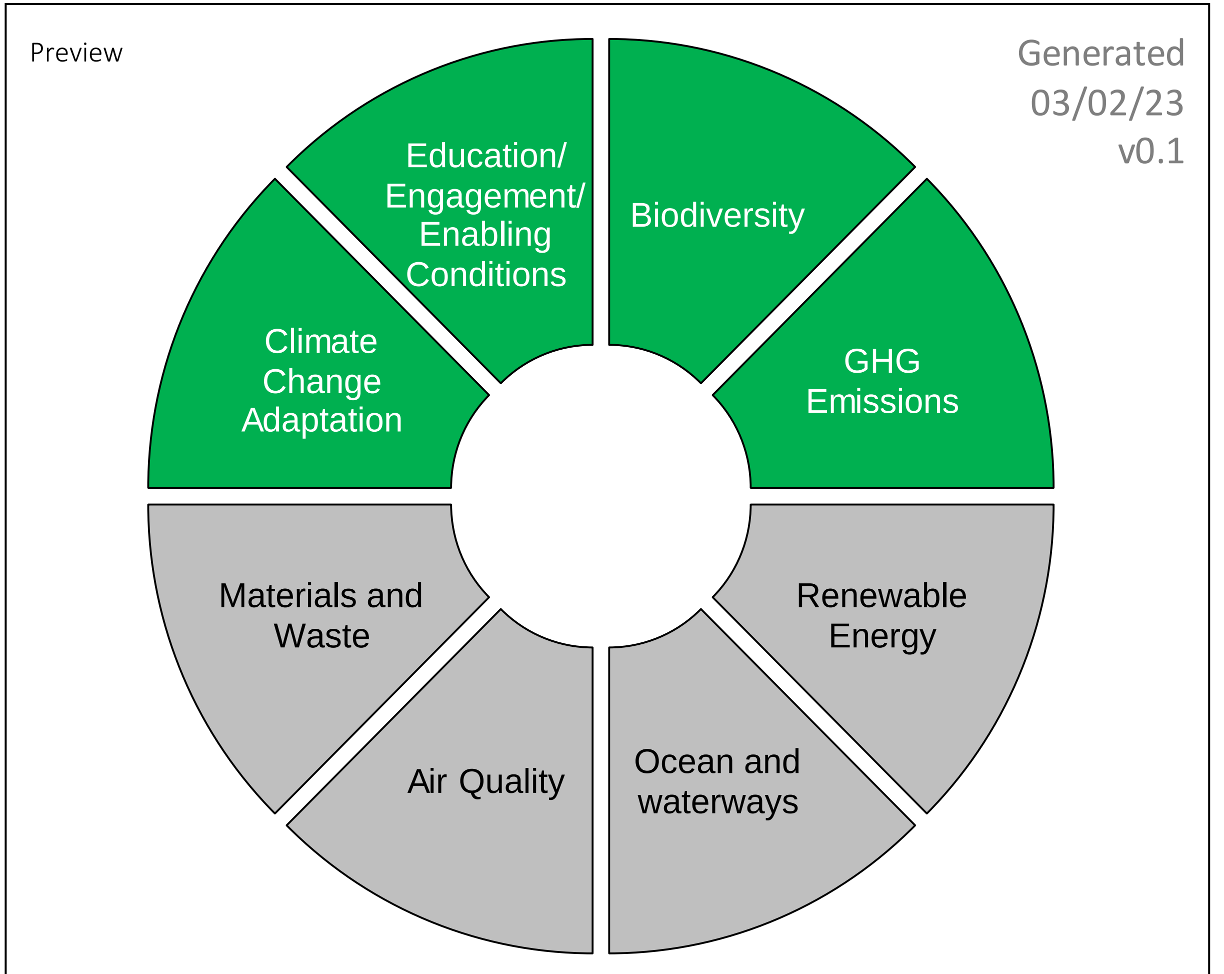
Risk	The HBV is not designed and structured correctly to meet PCC's requirements and compliance.		Low	High	Medium
Mitigation	External legal advice has been sought around the legal structuring and design of the HBV so that an appropriate governance structure is used. This work will continue into the establishment phase. Continued dialogue and engagement with PCC Finance and Legal to ensure compliance. Any surplus from the HBV will be ring-fenced through a possible endowment structure to ensure that it is re-invested to support Plymouth's green spaces in the long-term.		Low	Low	Low
Calculated risk value	£0 (no direct PCC expenditure; grant funded)	*Risk Owner*	Chris Avent		
Risk	Repayment risk to investors for external financing raised falls on PCC.		Low	High	Medium
Mitigation	By utilising the special purpose vehicle *option the* HBV is at an 'arm's length' from PCC and thus will be off-balance sheet for PCC. Finance Earth, an FCA regulated investment advisor and fund manager has been procured to advise on this phase of the work. The upfront project development costs are being provided through the Future Parks Accelerator (FPA) program and Defra's NEIRF grant scheme.		Low	Medium	Medium
Calculated risk value	£0 to PCC	*Risk Owner*	Chris Avent		
Risk	Lack of demand for BNG units or an inability to sell BNG units		Medium	High	Medium
Mitigation	Engagement with developers is underway to assess market demand for BNG units and the financial model has accounted for a £10k marketing budget to scale these		Low	Medium	Low

	engagement efforts. A 10% BNG unit redundancy rate has been assumed within the model which acts as a risk buffer in case BNG units are not generated or sold. The chosen sale strategy will have several implications. For example, taking a Habitat Banking sales approach may reduce risk exposure with units being sold only after the target habitat condition is verified. On the other hand, a land banking approach, especially in the short term, ensures that units are available to meet immediate demand and enables transactions in a nascent market. Additionally, forward contracts may also be signed with potential off-takers to further reduce the risk.				
Calculated risk value	**£0 (no direct PCC expenditure; grant funded)**	***Risk Owner***	**Chris Avent**		
Risk	**Project operation and maintenance risks e.g. contractor failure.**		**Low**	**Medium**	**Medium**
Mitigation	**The HBV will sub-contract site maintenance to PCC or an independent 3rd party and to minimise risk, fees will be paid in arrears.** **Insurances will be obtained by PCC (e.g. management liability) and the HBV (e.g. extreme weather insurance, asset related insurances).**		**Low**	**Low**	**Low**
Calculated risk value	**£0 (no direct PCC expenditure; grant funded)**	***Risk Owner***	**Chris Avent**		
Risk	**Covid-19 (or other unforeseen macroeconomic events) delay project delivery and take-up of services.**		**Low**	**Med**	**Low**
Mitigation	**Covid-19 RA in place to manage risk with partners.** **Business Continuity Plans to be established for HBV operations**		**Low**	**Low**	**Low**
Calculated	**£10k**	***Risk Owner***	**Chris Avent**		

risk value					
Risk	Implication of requirement for BNG affecting viability of housing development particularly affordable housing		Low	Med	Med
Mitigation	Soft engagement with affordable housing developers and Housing Delivery team already underway to ensure HBV design is complementary and identifies mechanism to control this risk. Arms-length HBV option gives stronger ability to price units appropriately		Low	Low	Low
Calculated risk value	Not quantifiable	*Risk Owner*	Chris Avent		
Risk	Risk of property issues e.g. existing rights over the land or covenants against using it except for particular purposes, existing designations or conflict with existing rights holders. This could interfere with the principle of granting a lease to HBV for that site.		Medium	Medium	Medium
Mitigation	Extensive due diligence is being carried out on the chosen pilot sites and in case of any property risks, they can be easily replaced since a total of 29 sites have been identified within the LNRN.		Low	Medium	Medium
Calculated risk value	Low IRO £10k	*Risk Owner*	Chris Avent		
Risk	Risk that the HBV becomes insolvent.		Low	Low	Low
Mitigation	The financial model includes a minimum working capital buffer to mitigate for insolvency risks. This includes the proposed annual expenditure on habitat maintenance and services such as accounting.		Low	Low	Low
Calculated	£0 (we are confident that a	*Risk Owner*	Chris Avent		

risk value	**12 month working capital buffer is suitable to meet wind up costs).**				
Risk	**Risk that PCC is not able to deliver contracted services to required KPI's and HBV Board award contract to 3rd party contractor leading to reduction in financial benefit to PCC**		**Low**	**Med**	**Low**
Mitigation	**Member Rep appointed to deal with any performance issues and conflict of interest**		**Low**	**Low**	**Low**
Calculated risk value	**£0 (we are confident that a 12 month working capital buffer is suitable to meet wind up costs).**	***Risk Owner***	**Chris Avent**		

Appendix 2 – Climate decision wheel



PCC has committed to being a carbon neutral organisation by 2030 (6 years and 10 months away).