Financing Tribally Owned and Operated Wetland Mitigation Banks

Because of the revenue potential from mitigation banks, many tribes are exploring the possibility of establishing banks on their lands. But tribal governments face different financial challenges from private mitigation bank developers or state and local governments. This article looks at the various funding sources available to those tribes seeking to own or operate a wetland mitigation bank.

By Glenn Barnes

In 2012, the Lummi Nation became the first tribal government in the United States to launch a commercial Wetland and Habitat Mitigation Bank.1 Like all mitigation banks,2 the Lummi’s bank will allow the tribe to sell credits to developers to compensate for impacts on wetlands due to construction that cannot be avoided or mitigated on-site. The bank launched with Phase 1A in October 2012, an area of more than 800 acres. By the time the bank is completed, it will have thousands of acres of wetlands and, if all credits were sold at full cost, would bring in more than $100 million in revenue for the tribe.3

Because of the revenue potential from mitigation banks, many other tribes across the country are exploring the possibility of establishing banks on their own lands. But that revenue potential only comes into play once the bank itself is operational—that is, once land has been acquired and restored, once the tribe has reached an agreement with the U.S. Army Corps of Engineers (the Corps), and once the tribe has put into place all of the elements of mitigation bank administration including setting the credit prices and marketing. This can be a long and costly process for tribes. Mitigation banks also require ongoing maintenance and fund administration. What revenue sources can tribes use for these expenses?

Tribal governments operating wetland mitigation banks face different financial challenges from private mitigation bank developers or state and local governments. Tribal governments have taxing authority, for example, but most of the land on tribal reservations is held in trust by the United States government for the use of the tribal government or by an individual tribal member, and these trust lands are exempt from property taxes.4 Also, tribes can face difficult economic conditions such as high unemployment rates. In the most recent data from the Bureau of Indian Affairs, for 2005 nationally,5 the unemployment rate for tribal members was 49%, and 29% of tribal individuals were employed but earning wages below the poverty guidelines.

A wetland mitigation bank is in many respects like any other capital improvement and can be funded through conventional sources such as annual tribal revenue and reserve accounts. But the future revenue potential and ecology of the bank itself create other potential funding sources. This article will examine four of these sources in detail: securing debt with the anticipated future sale of mitigation credits; federal grants and loans; sales of carbon credits generated by the wetlands in the mitigation bank; and nature-based tourism opportunities. Tribes may find it necessary to combine conventional finance sources with one or more of these special finance sources to cover the full cost of the mitigation bank.

Securing Debt With the Anticipated Future Sale of Mitigation Credits

Debt is a common source of funding for capital projects—the borrower receives a lump sum of cash up-front to fund the capital project and then pays off the debt over the useful life of the capital project. Debt is an especially attractive funding option for capital projects that are anticipated to generate revenue once completed, such as water and wastewater treatment plants for local governments or hotels, gaming facili -

The fact that a mitigation bank might generate a lot of future revenue for the tribe, however, is generally irrelevant to lenders. In either the case of a loan from a bank or a bond from investors, the lending entity will assess how confident they are that the potential borrower will pay them back (the potential borrower’s “creditworthiness”) at the time the loan is made, regardless of whether the mitigation bank will generate any income in the future. Lenders will require the borrowing tribe to pledge some type of “security” or collateral for the debt in case of default. Tribes that are deemed to
be financially sound and therefore creditworthy can borrow money and pledge their “full faith and credit” as security—basically all of the assets and revenue from the tribe. They are likely to receive more favorable loan terms such as a lower interest rate or longer payback period. But tribes that are deemed to be less financially sound will face less favorable loan terms, assuming they are able to borrow money at all. This reality of borrowing is a major obstacle for tribes that are less financially sound.

One potential way to use the future sale of mitigation bank credits as collateral for debt is to “pre-sell” the mitigation bank credits to a developer or government agency before the mitigation bank is in place. If there is a contract in place for the mitigation credits, the lender may be willing to look at the creditworthiness of the purchaser of the credits in deciding whether or not to make the loan. Lenders will generally look for contracts that are for at least twice the amount of money the tribe is looking to borrow.

This method of pledging contracted future mitigation credit sales as security for a loan was used for the Rancocas Mitigation Bank in New Jersey. The Rancocas Mitigation Bank is privately owned and operated and was constructed at the behest of the New Jersey Turnpike Authority, which contracted to purchase 100% of the mitigation credits generated by the Rancocas bank before the bank had even been built. The financial institution that issued the loan was then able to use that contract for the purchase of future mitigation credits as security for the loan and looked at the creditworthiness of the New Jersey Turnpike Authority as part of their loan underwriting. The key for Rancocas to be able to secure the debt with future mitigation credit sales is that a creditworthy entity had already pledged to purchase them.

One drawback to pre-selling mitigation bank credits is that the tribe will be locked into a price for the credits for the length of the contract. It is possible that if the demand for wetland mitigation credits were to increase in their area, the price they received for the credits may end up below the market price.

**Federal Grants and Loans**

Many tribal wetland programs rely on federal grants for all or some of their program funding. For example, a 2009 survey of tribal wetland programs found that more than one-half of the 27 respondents funded their wetland programs completely from federal grants, while all but one of the respondents used federal grants for some portion of their program funding.

Many federal grants, however, cannot be used to pay for land purchase and restoration for wetland mitigation banks, except “where federal funding is specifically authorized to provide compensatory mitigation.” Wetland Program Development Grants, for example, specifically prohibit their use for mitigation banks.

But there are federal grants that specifically allow for compensatory mitigation. One example is the U.S. Department of Agriculture’s (USDA’s) Natural Resources Conservation Service (NRCS) Conservation Innovation Grant that was used to start the first wetland mitigation bank in South Dakota. The NRCS also provided technical assistance to help restore the wetlands that make up the mitigation bank. CIS grants are available to federally recognized tribes, and the grant program’s national priorities are set on an annual basis.

Wetland grants that cannot be used directly for the land in the mitigation banks may be used for activities that are “in conjunction with, but supplemental to, [mitigation bank] programs in order to maximize the overall ecological benefits of the restoration or conservation project.” For example, federal grants can be used to acquire, restore, and protect land located adjacent to a mitigation bank boundary that provides a buffer for the mitigation bank.

Some tribal economic development grants and loans may also be possible funding sources for mitigation banks. For example, the Indian Tribal Land Acquisition Program (ITLAP) provides loans for the purchase of land located within the tribe’s reservation that will be used for the benefit of the tribe. Funds can be used for title clearance, legal services, land surveys, loan closing, and cost of appraisal. However, to qualify for these loans, the tribe would have to prove that other funding sources are not available and also must demonstrate that three other lenders have denied them funding. This loan program provides funds for land acquisition only, not land improvements. Also, the Department of Housing and Urban Development’s (HUD’s) Indian Community Development Block Grant (ICDBG) funds can be used for land acquisition and economic development; however, tribes must demonstrate that the ICDBG funds primarily benefit families with incomes at or below 80% of the area median.

**Carbon Credit Sales**

Some types of wetlands sequester carbon dioxide and other greenhouse gases, depending on geography, hydrology, and other factors. If tribes are able to quantify the carbon sequestration of the mitigation bank and other wetlands, they can sell the resulting carbon credits to generate funds. Unless credits are pre-sold, this revenue source cannot be tapped until at least part of the mitigation bank has become operational.

In order for carbon credits to be traded in either regulated or voluntary markets, the seller must use an accepted protocol to measure the level of sequestration. In 2012, two protocols were adopted for the first time ever in the United States: one
for wetlands in the Mississippi Delta; and the other for any wetland in the United States. There are two regulated carbon markets in the United States—the Regional Greenhouse Gas Initiative (RGGI) in the northeast states, and the California program. Currently, neither program allows carbon credits generated by wetlands to be traded.

But carbon credits from wetlands can be traded on the voluntary marketplace through trading services such as the Verified Carbon Standard (www.v-c-s.org) or the Chicago Climate Exchange (www.theice.com/ccx.html). They can also be traded on international markets if those markets allow for carbon credits from wetlands. Tribes looking to sell carbon credits on the voluntary market would first use an independent entity to apply the protocol to their wetlands to determine baseline emissions and the number of carbon credits that will be generated. The tribes would then need to seek out potential buyers of those credits and agree on a price.

The revenue potential of selling carbon credits is uncertain, with prices per ton of carbon dioxide equivalent offset ranging from as low as $1 per ton to as high as $15 per ton. As a result, it is difficult to estimate how much money will be generated from the sales for the mitigation bank. If an interested buyer agrees, it is possible to arrange a pre-sale of carbon credits on the voluntary market, so that a project can move forward with more certainty about future carbon credit revenue, but tribes pre-selling credits would need to lock in a price, preventing them from changing the price if demand on the carbon market were to increase.

There is also some dispute about whether selling carbon credits and selling wetland mitigation credits from the same set of wetlands counts as “double dipping.” The voluntary carbon markets report that there is no conflict in selling both carbon credits (primarily an air quality benefit) and also mitigation credits (primarily a water quality benefit), but some regulatory staff from EPA and the Corps disagree, arguing that the air quality benefits of carbon sequestration are inherent in the wetland function and are therefore included in the mitigation credit. Tribes considering selling carbon credits from mitigation banks should first consult their regulatory agencies.

Revenue From Nature-Based Tourism
Nature-based tourism is another potential revenue stream for mitigation banks, though like carbon credits, it requires at least part of the bank to be operational before any revenue can be generated. Any nature-based tourism activities in the mitigation bank must maintain the integrity of the wetlands. Nature-based tourism can be divided into two categories—“consumptive” activities such as hunting and fishing, and “non-consumptive” activities such as hiking, canoeing, kayaking, bird and wildlife watching, and guided boat tours. Tribal regulations will likely dictate which of these activities would be permitted in the wetlands.

Tourism is a key source of revenue for many tribes across the country, and several have nature-based tourism activities, including activities involving wetlands. For example, the Seminole Tribe offers airboat and swamp buggy trips into the Everglades through its Billie Swamp Safari venture. The Lac du Flambeau Band of Lake Superior Chippewa Indians offers nature walks and birding opportunities in its Powell Marsh Wildlife Area that includes 24,000 acres of wetlands. Kamilche Adventures is a business venture owned by a member of the Squaxin Island Tribe that offers guided hiking, biking, kayak, and canoe trips. Many other tribes offer guided nature tours, boating and rafting trips, hikes, and beach access for a fee.

Most of these nature-based tourism ventures, however, bring in modest revenue. They are generally seasonal businesses with a small number of employees and expenses in personnel, equipment (in particular for boating and rafting businesses), marketing costs, and insurance. Clemson University’s School of Government & Public Affairs created a comprehensive guidebook for starting a nature-based tourism enterprise. It provides a framework of considerations for defining the business and identifying expenses, startup costs, insurance, taxes, and regulatory requirements. Texas A&M has developed a finance tool that allows users to create a basic financial plan for development and operation of a nature tourism business that is freely available online after creating a free login.

Tribes interested in launching a nature-based tourism venture as part of a mitigation bank should take time to research existing nature-based tourism activities in their geographic area. A simple search of the phone book can reveal the number of local nature-based tourism ventures, but research through financial information databases such as Reference USA (www.referenceusa.com) and Hoover’s (www.hoovers.com) can provide other valuable information including number of employees, approximate annual expenditures in key budget categories, and total revenue. Tribes should use this information to avoid duplicating existing businesses, instead filling a gap in the current nature-based tourism market in their geographic areas.

Several tribes that have launched nature-based tourism ventures have often also measured tribal member attitudes to increased nature-based tourism prior to embarking on a new business venture. For example, an older study from 1989 found that about two-thirds of tribal members surveyed felt that tourism could bring positive economic benefits to the tribe, but roughly an equal number felt that tourists should
be excluded from certain areas of tribal lands or from tribal activities.

**Conclusion**

Wetland mitigation banks could potentially bring millions of dollars of revenue to tribal governments, but they can require large amounts of money for startup costs including land acquisition and restoration, and for ongoing administrative costs such as wetland maintenance and credit sale administration. Conventional sources of capital finance including annual revenues and capital reserves can be used for these costs, but mitigation banks have special finance options.

Debt is an attractive finance source for mitigation banks because the banks generate revenue over the course of their useful lives, but the availability of debt depends on the creditworthiness of the tribe. If a tribe can arrange a pre-sale of the mitigation credits to a creditworthy purchaser, a lender may be willing to secure the loan based on that contract. Federal grant and loan programs are somewhat limited in their use for mitigation banks due to federal statutes, but some grants and loans can be used for wetland mitigation banks. It may be possible to sell carbon credits generated from the mitigation bank on the voluntary carbon market and/or establish a nature-based tourism venture in the mitigation bank to generate additional revenue, but the level of revenue for both approaches will be limited. Both approaches also require at least part of the mitigation bank to be operating before any revenue can be generated, except in the case of pre-selling carbon credits.

Ultimately, tribes may have to layer several of these funding sources together to launch a wetland mitigation bank.

ENDNOTES

8. 33 C.F.R. §332.3(j)(2).
12. 33 C.F.R §332.3(j)(2).
17. See the most recent “AFOLU Requirements” document at http://www.v-c-s.org/program-documents (last visited Jan. 16, 2014).