

# FIRNS: Developing a Scottish source to sea, nature finance model

## Final Report

April 2024



*Tweed Eddleston Water Project*



*Sea Wilding Seagrass Restoration Project*

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**This project is supported by The Facility for Investment Ready Nature in Scotland (FIRNS).  
Delivered by NatureScot in collaboration with The Scottish Government and in partnership  
with the National Lottery Heritage Fund.**



## Executive Summary

Nature and the environment are in a poor state across the UK and the current levels of public funding are not sufficient to meet nature and net zero targets. The gap for Scotland between its committed and required spending for the delivery of its targeted nature-related outcomes over this decade has been estimated at up to £27 billion.<sup>1</sup>

Innovative funding mechanisms that combine public, private and philanthropic capital targeting the restoration of Scotland’s rivers, land and seas to good health can help to fill this funding gap. These mechanisms will be more successful if they are designed to accommodate the diverse needs and objectives of corporates and investors, including those driven by voluntary motivations such as Corporate Social Responsibility (CSR), Environmental, Social and Governance (ESG) investing and non-compliance related nature and climate disclosures; and those driven by regulatory requirements such as biodiversity mitigation payments.

The UK’s rapidly evolving natural capital markets are bringing about new opportunities to use public funding programmes strategically to crowd in private finance seeking returns on investment through selling ecosystem service-based products such as carbon and biodiversity credits in voluntary or regulatory markets. This approach has the potential to ‘stretch’ limited government budgets and increase the impact of public and philanthropic spending.

### Objectives

This project, ‘Developing a Scottish Source to Sea Nature Finance Model’ (“the Project”), investigated the potential for establishing a new funding model to support river catchment restoration activities in Scotland. The purpose of the Project was to develop funding model options to support sustainable investment in restoration activities across marine, freshwater, and connected terrestrial habitats. The Project recognised the inherent ecological linkages between these environments and the current failure to deliver the investment level required to meet Scotland’s specific ecological/environmental objectives relating to river catchment health. The Project assessed the risks and opportunities associated with three distinct funding models, in the process exploring options to build on the success of the Scottish Marine Environmental Enhancement Fund (SMEEF) and consider opportunities presented by emerging nature markets and related financing mechanisms.

### Implications for SMEEF

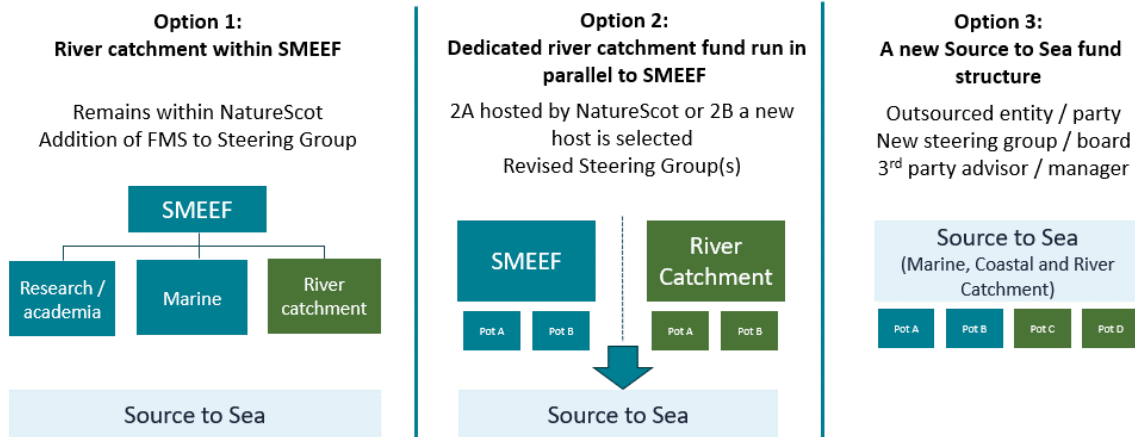
This Project aimed to inform the future development of SMEEF specifically and the opportunity to support river restoration activities. It should be noted that as far as the authors of this report are concerned, SMEEF is expected to continue to operate as usual in its current

<sup>1</sup> [Green Finance Institute, The Finance Gap for UK Nature \(2021\)](#)

form. The Project used learnings from SMEEF to inform its investigation of potential funding models.

## Summary of opportunities identified

The Project identified and assessed three distinct funding models targeting river catchment restoration opportunities in Scotland to support Source to Sea objectives, as follows:



### Option 1: River catchment within SMEEF

This model builds directly on SMEEF’s foundations and learnings, extending its current marine and coastal remit to incorporate river catchment opportunities alongside the fund’s existing marine and coastal targets.

### Option 2: Dedicated river catchment fund run in parallel to SMEEF

This model also leverages SMEEF’s foundations and learnings by establishing a dedicated river catchment fund to operate as a ‘sister fund’ under the same host as SMEEF. This fund would focus on river catchment and freshwater investments to complement SMEEF’s marine and coastal targets.

The sister fund could be developed alongside SMEEF within NatureScot, leveraging the infrastructure and governance provided by NatureScot (“**Option 2A**”). Alternatively, a new host could be appointed, one that is not a public body, to manage both ‘sister funds’ (“**Option 2B**”).

### Option 3: A new Source to Sea fund structure

The third model is an entirely new vehicle that serves as a single Source to Sea fund combining river catchment opportunities with SMEEF’s existing marine and coastal focus, where SMEEF could be transferred or absorbed into this new fund. This could be achieved using a trust structure consisting of a framework or funding aggregation vehicle that has the potential to use non-repayable capital strategically to crowd in repayable private investment to diversify

the range of funding sources available, and recycle any future earnings generated on public capital invested back into the vehicle’s mission.

### Summary of stakeholder and assessment findings

The table below summarises the analysis and assessment that the fund options underwent during the Project. The assessment was informed by the stakeholder and corporate engagement, with key learnings and findings from the in-person workshop used to inform the final analysis presented in this report.

| Criteria                                     | Relative Attractiveness (High = most attractive) |           |           |          |
|--|--|-----------|-----------|----------|
|  | Option 1   | Option 2A | Option 2B | Option 3 |
| Ability to attract different funding sources | Low  | Medium    | Medium    | High     |
| Costs and Complexity                         | High   | Medium    | Medium    | Low      |
| Focus & Flexibility                          | Low  | Medium    | Medium    | High     |
| Governance                                   | High   | High      | Medium    | Medium   |
| Impact                                       | Medium   | High      | High      | High     |
| Policy alignment                             | Low  | Medium    | Medium    | High     |
| Resourcing & Capacity                        | High   | Medium    | Medium    | Low      |

**The relative attractiveness score has been used to compare and contrast key criteria for the fund structure options. For ‘Resourcing & Capacity’, Option 1 is the most attractive of those presented as an addition to SMEEF’s existing structure, while Option 3 is the least attractive option given the additional complexity and need to create a new structure.**

The presentation and discussion of the options at the workshop indicated a preference for Option 1 & Option 2A, with limited interest in Option 3 owing to its additional complexity, likely increased cost, resourcing requirements and uncertainty around the development of markets to justify the process to set up the structure. Attendees acknowledged that Option 2B could provide the potential to navigate financial constraints imposed on NatureScot by the Scottish Public Finance Manual (SPMF), but uncertainty over the appointment of a new host organisation, and the impact on SMEEFs brand and identity were noted by attendees.

### Conclusions

Further assessment and consideration is needed to inform the design of a governance and funding structure that efficiently and effectively channels much-needed investment into the restoration of Scotland’s marine and river ecosystems. The appropriate funding model option will depend on the fund’s mission, objectives, and funding strategy, which in turn should be partly defined by the market need based on the nature of targeted mission-aligned projects.

Option 1 or 2A are the closest to ‘business as usual’, and to a certain extent can aggregate unrestricted contributions from corporates as SMEEF has to a limited extent to date. However, they may not be appropriate for attracting restricted contributions from corporates with project and location specific requirements. To attract these, a more sophisticated fund structure may be needed, such as Options 2B or 3, with a funding strategy aligned with policy and fully informed by the nature of the underlying projects and corporate demand, both of which require more detailed assessment.

If the purpose is to maximise the nature restoration opportunity across Scotland’s land, river and marine habitats and create a vehicle with the potential to bring together Scottish Government’s wider biodiversity goals and support mechanisms, then we would recommend exploring options that have the ability to attract repayable private capital and facilitate ecosystem service sales to generate financial returns in the future. In this case, Option 3 would be most the most suitable model, although it comes with higher complexity and costs.

## Project Introduction and Objectives

The Project was commissioned by Fisheries Management Scotland (FMS) and conducted by Finance Earth, with support from Howell Marine Consulting (HMC) in the Project's stakeholder engagement phase and marine policy considerations. The purpose of the Project was to inform the development of funding model options to support sustainable investment in marine, freshwater and connected terrestrial restoration activities, recognising the inherent ecological linkages between these environments. The Project assessed the risks and merits associated different funding models, each of which provided a route to delivering nature restoration across Scotland's rivers, land, and seas, from Source to Sea. The Project engaged with corporate contributors and investors to ascertain potential mechanism requirements, but the scope of the work did not include securing investment.

This Final Report is to be read in conjunction with Reports 1, 2 & 3 (described below) that provide additional background, findings, and information gathered during the Project by Finance Earth and HMC. The learnings included in these reports informed the development and refinement of the funding model options.

- **Report 1: Source to Sea - Corporate Engagement Report**, a summary of meetings conducted by Finance Earth with offshore and renewable energy companies, financial institutions ('investors') and SMEEF Steering Group.
- **Report 2: Source to Sea - Stakeholder Engagement Report**, a summary of nineteen stakeholder engagement interviews conducted by HMC, in addition to learnings transferred from the SMEEF Insights project undertaken directly for NatureScot.<sup>2</sup>
- **Report 3: Source to Sea – Learnings from the Source to Sea Workshop** summarises the assessment of fund options and workshop learnings. This included key policy and regulatory considerations framing the Source to Sea, the presentation of stakeholder engagement findings from HMC & Finance Earth, a presentation on ecosystem and community-benefits by FMS, and the presentation of three fund options by Finance Earth. The options were discussed and assessed in groups by attendees.

Concurrently to the Source to Sea Project, HMC undertook another project, 'SMEEF Insights', the purpose of which was to gain a clearer understanding of the influence SMEEF funding had on projects and organisations, to gain insights into project leads' experience in meeting SMEEF's requirements, identifying areas where SMEEF has been successful, and identifying areas or opportunities for SMEEF's development. HMC reported directly to NatureScot for the 'SMEEF Insights Project' and shared learnings with the Source to Sea project.

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<sup>2</sup> HMC have recently completed the Scottish Marine Environmental Enhancement Fund (SMEEF) Insights Project for NatureScot, reviewing the impact and functioning of SMEEF to date, and informing future design and monitoring strategy.

## Overview of the Project Approach

The Project conducted interviews with individuals, projects, stakeholders, and corporate partners engaged with SMEEF to assess the success of the fund and appraise learnings to inform the fund models assessment for a river catchment fund. Consideration was given to the existing Steering Group, approach to governance, and the ethical and due diligence frameworks that SMEEF has developed. These aspects of SMEEF provide assurance to voluntary contributors and are closely aligned with best practice and the development of high integrity standards. Additional engagement was conducted with investors and corporates to explore opportunities and requirements for attracting more capital into Scotland’s freshwater, terrestrial, marine & coastal restoration opportunities. Through these engagements the Project ascertained appetite for a fund that delivered Source to Sea opportunities and provided exposure to river catchment restoration projects. The Project also assessed the availability of capital from voluntary contributors relative to capital that could be raised from private investors targeting financial returns from a nature-based solutions investment opportunity.

Project learnings informed the fund model options that were presented and assessed at the in-person workshop, the purpose of which was to test the options, assess key findings, and refine the options. The Project concluded with the delivery of this Final Report which assesses the options, risks, and opportunities of different funding options, including resourcing and capacity considerations, the impact to SMEEF’s existing identity and brand, and considerations for the measurement, monitoring, and evaluation of impact.

## Stakeholder Engagement

Finance Earth and HMC conducted a series of interviews and calls with various stakeholders, corporates and investors in January and February 2024. Tables 1 & 2 below summarise the key learnings gained from the engagement to inform funding model assessment.

### Interview approach

Finance Earth and HMC conducted 28 interviews at the start of the Project, in January and February 2024. HMC engaged with a range of stakeholders, projects partners, recipients of SMEEF grants, and public organisations to appraise the learnings and lessons from SMEEF’s practice to date. Finance Earth interviewed corporates from the offshore wind and renewable energy sectors some of which provided seed funding to SMEEF and had provided contributions to SMEEF. Finance Earth also engaged with a range of financial institutions known to focus on nature restoration and natural capital opportunities that could function as investors in a fund.



At each interview, key project objectives and the opportunity to develop a river catchment funding model, with the possibility of establishing a Source to Sea nature finance model, were discussed. All the interviews were conducted on an anonymised basis to allow SMEEF grant recipients, corporate contributors and investors to share insights and experiences about SMEEF that informed the high-level fund structure assessment.

Finance Earth engaged with representatives from the following organisations:

- Energy Companies: Copenhagen Offshore Partners, Orsted, SP Energy Networks, SSE Distribution
- Investors: Abrdn, Aviva Investors, River Global
- Other: NatureScot, SMEEF Management Team, One Planet Consulting

HMC engaged with individuals and representatives from the following organisations, sharing findings with Finance Earth to incorporate in the final report and fund model design:

- Public Organisations: NatureScot (policy and fund management experts), Crown Estate Scotland, Scottish Government's Marine Directorate, River Fisheries Trusts, Environmental NGOs, and Community group representatives
- Landowners engaged in river restoration projects and currently working with Fisheries Management Scotland
- SMEEF Management Team

The detailed engagement findings are contained in Report 1: Source to Sea Corporate Engagement Report and Report 2: Source to Sea Stakeholder Engagement Reports. The following tables summarise the findings.

**Table 1.** Summary of key feedback from stakeholder engagement

| Key feedback   |
|--|
| <p>Integrating river catchment restoration into SMEEF or having two separate ‘sister’ funds that share an overarching governance structure could enable an efficient, joined-up approach to river and marine restoration.</p> <ul style="list-style-type: none"> <li>• <b>Options 1 &amp; 2 have advantages in terms of efficiency and set up costs.</b></li> </ul> <p>SMEEF’s model is understood and respected by corporates, but there is interest in a fund providing solutions that meet policy and regulatory requirements, such as compensation for marine or biodiversity for terrestrial. To achieve this, SMEEF will need to evolve to function as a key partner to corporates or the voluntary contribution model may become less attractive to corporate partners going forward. Alternatively, a new fund could be established that is specifically designed to partner with corporates to deliver anticipated regulatory requirements.</p> <ul style="list-style-type: none"> <li>• <b>Option 2B and Option 3 could better serve corporate needs relating to regulatory demand for compensation, subject to aligning the investment strategy with policy.</b></li> </ul> <p>Corporates recognise SMEEF’s market positioning, and the addition of rivers to SMEEF could dilute its brand which could impact the ability to attract corporate contributions to marine projects.</p> <ul style="list-style-type: none"> <li>• <b>Option 2 could address concerns over SMEEF’s market positioning. The objectives and investment strategy for any new funding solution will need to be effectively communicated to the market, in particularly how it aligns with and differs from SMEEF.</b></li> </ul> <p>Several corporates want to work with SMEEF and expressed an interest in a model focused on, or including, river catchment opportunities. However, adding a focus on river catchments to SMEEF may not suit all existing contributors and founding partners (e.g. offshore wind developers).</p> <ul style="list-style-type: none"> <li>• <b>There is no ‘one-size-fits-all’ solution, so a funding solution will need to have as much flexibility as possible to meet the bespoke and varied needs of potential corporate contributors.</b></li> </ul> <p>Several corporates are interested in funding specific initiatives through SMEEF, and several indicated a river restoration fund could also provide the opportunity to fund strategic initiatives particularly around biodiversity mitigation. A location-specific or geographic focus is important to several corporate contributors, especially where activities are linked to regulatory demand for compensation or aligned with an area or theme of strategic interest (such as seabed restoration in the North-East of Scotland and not the South-West).</p> <ul style="list-style-type: none"> <li>• <b>Aligning the funding strategy with corporate demand, regardless of fund structure, could increase the attractiveness of a new funding mechanism to the private sector. This should include facilitating restricted alongside non-restricted contributions. A standalone funding structure with ‘sub-funds’ to accommodate different capital requirements could best achieve this (Option 3), or a ‘sister fund’ structure with the potential to ‘crowd in’ private contributions at the project level, rather than the fund level could also achieve this.</b></li> </ul> |

Corporates understand that projects need multi-year funding and expressed an interest in setting up multi-year commitments to a funding model aligned with their respective strategic interests. While SMEEF can already provide funding to projects across financial years, it is constrained by its placement within NatureScot as public money cannot be rolled across financial years (SPFM). A new funding vehicle with greater flexibility, which may require a non-public fund manager, could attract greater corporate support, and enable project funding that supported multi-year project delivery.

- **Option 2B and Option 3 are the most suitable solutions to delivering multi-year funding without SPFM restrictions if they involve procuring a non-public fund manager.**

Investor demand exists for projects that can generate financial returns, which for river restoration projects is likely to require engaging in ecosystem service markets such as carbon and biodiversity. This opportunity could attract significant private capital into Scottish nature restoration but would require a fund structure designed to use public capital to crowd in private investment which is typically needed in nascent natural capital markets where private investors are unfamiliar with.

- **Option 3 is most suitable for a fund seeking to engage with ecosystem service markets and target financial returns. This could also potentially be achieved with Option 2B.**

Any investment structure that engages with ecosystem service markets and attracts repayable private capital may require more detailed and/or bespoke monitoring and reporting at the fund level, and monitoring, reporting and verification (MRV) at the project level depending on the market(s).

- **All options proposed can develop bespoke monitoring and reporting, building off SMEEF's aggregated impact report. However, the options that facilitate ecosystem service markets is likely to require the most extensive approach to monitoring, reporting and project-level MRV (although the latter will be typically carried out by investees and collated, monitored and reported on by the fund management team).**

## Learnings from other FIRNS projects

Throughout the Project, Finance Earth actively engaged with other FIRNS projects to assess opportunities for collaboration and share learnings. This project principally engaged with two projects focused on activities linked to SMEEF and Source to Sea initiatives, namely the *Advancing the Saltmarsh Code in Scotland* and *Solway Coast and Marine* projects. These projects provided valuable learnings (included below) which are applicable to SMEEF and the development of future funding models. [Finance Earth] also engaged with the *Community Benefits Standard for the UK Nature Investment Market developed in Scotland* project, which corroborated findings from research conducted by Leah Reinfranck (FMS) into community and ecosystem benefits.

The *Advancing the Saltmarsh Code in Scotland* project recommended the creation of a Saltmarsh Action Fund to support projects interested in registering with the Saltmarsh Code. This Saltmarsh Action Fund would provide a mix of development funding, repayable

investment, and revenue support mechanisms to projects. The *Advancing the Saltmarsh Code in Scotland Project* team cited the role that NatureScot could play in the delivery of a saltmarsh support scheme and the potential to engage SMEEF in the initiative.

To deliver on these saltmarsh-specific recommendations, SMEEF could establish a funding initiative focused on saltmarsh projects. This could build on the precedent set by SMEEF's seabird resilience and seabed restoration pots and could function under Option 1 & Option 2. If demand for saltmarsh project grants increased and or engagement with corporates progressed to the delivery of additional services linked to saltmarsh restoration (namely carbon opportunities), the pot could evolve into a parallel fund alongside SMEEF. Alternatively, under Option 3, a dedicated saltmarsh strategy could be established allowing projects to engage with ecosystem service markets.

*Dumfries & Galloway, Solway Coast and Marine Project (SCAMP)* looked at developing “seascape” scale pilots to deliver coastal/marine restoration projects across the Solway Firth (both England and Scotland), focusing on oyster bed, saltmarsh, and seagrass restoration. SCAMP highlighted a requirement for dedicated funding for projects at an earlier stage of development and testing (i.e. those in pilot). Recognising a need for multi-year grant funding, the SCAMP project team questioned if SMEEF, or another fund, could function as a key development mechanism that would in time serve to build market capacity and deliver restoration plans. To deliver on these recommendations, SMEEF, or a single Source to Sea funding model could establish a funding pot focused on pilots to build capacity and sector opportunities towards investment readiness. This opportunity could be undertaken in partnership with additional FIRNS grants.

Similar recommendations and suggestions as provided by the Saltmarsh Code (Scotland) and SCAMP projects were also corroborated by HMCs stakeholder engagement which highlighted the need for a) development and monitoring grants, b) grants over multiple time periods aligned to project timelines, c) grants to build sector capacity and d) grants to ensure project resourcing.

### In-person workshop

On 11<sup>th</sup> March 2024, 32 individuals from a range of public and private sector organisations attended the FIRNS Source to Sea workshop. The objectives of the workshop were to share findings from stakeholder engagement, and to discuss and assess fund options.

The workshop included presentations from HMC on the key environmental policy considerations framing Source to Sea discussions such as Marine Restoration Plan, a Scottish Marine Recovery Fund (referencing developments in England), Strategic Compensation, Scotland's Wild Salmon Strategy, Scottish Biodiversity Strategy, and the National Planning Framework 4. HMC and Finance Earth presented stakeholder engagement findings to frame

the workshop’s objectives, and Leah Reinfranck (FMS) presented insights from a research project covering ecosystem services and community benefits.

Finance Earth presented three fund options and introduced the concept of governance models (Options 3) for the creation of a single Source to Sea. Each option was discussed and assessed by attendees, with responses used to refine funding model development and develop recommendations for future action.

The key learnings from the workshop were as follows:

**Workshop attendees were supportive of the opportunities presented for the evolution of SMEEF and the Source to Sea funding model. The following key points emerged during the workshop.**



A fund requires a clear **strategy and purpose** from which subsequent considerations can develop (governance, structure, engagement in ecosystem services, private markets and repayable finance)



**Multiple funding approaches and support mechanisms** may be required to deliver projects of varied sizes, as well as funding project development, capacity building and assisting with monitoring and maintenance costs



**Monitoring and reporting** requirements at both fund and project level can be significant to align with partner (or investor needs), a standardised approach could reduce the burden for the fund and projects



**Clarity over fund positioning and communications are** expected to be key to future success, both for the evolution of SMEEF and a Source to Sea funding model, building on SMEEFs existing brand and position



Integrating river catchment opportunities into SMEEF would be the most **cost effective** approach but requires an assessment of SMEEF’s **resourcing, capacity** and knowledge. A new fund is likely to be more expensive but may allow greater scope for expertise

**Next steps:** establish which fund option is most appropriate for a river catchment fund and develop a **roadmap** to delivery.

## Fund structure options

This Project investigated the potential to establish a new funding model to support river catchment restoration activities in Scotland, assessing the risks and opportunities associated with different funding models. These models built on the platform and progress to date of SMEEF, the creation of a similar river catchment fund, and the opportunity to merge these into a single fund or evolve as two ‘sister funds.’

### The Scottish Marine Environmental Enhancement Fund (SMEEF)

SMEEF was established in 2022 to play a key role in delivering policy areas such as Scottish Biodiversity Strategy (SBS)<sup>3</sup> and the Blue Economy Vision for Scotland.<sup>4</sup> SMEEF was developed in response to the decline in Scotland’s marine biodiversity, combined with increased awareness over the importance of healthy seas and the substantial funding gap required for restoring them.<sup>5</sup> SMEEF enables users of Scottish waters to voluntarily contribute to marine recovery efforts by pooling contributions into a single fund and strategically distributing grants to relevant projects across Scotland. Since inception, SMEEF has raised and distributed over £3.3m of non-repayable grants to 45 projects.

SMEEF is managed by a Steering Group of Scottish Government’s Marine Directorate, Crown Estate Scotland and NatureScot which provides governance, assurance, transparency, and technical guidance. The fund was launched with support from Scottish Government’s Nature Restoration Fund (NRF), in addition to voluntary contributions and seed funding secured from private companies operating in the offshore environment. SMEEF’s priorities were established to help deliver the SBS marine and coastal targets:

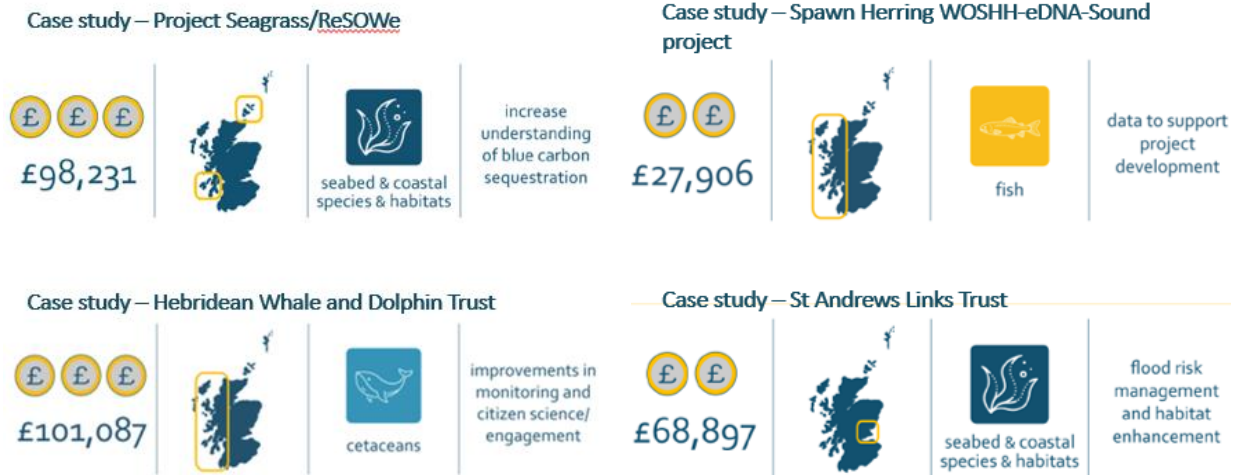
- Increasing the diversity, health, and resilience of ecosystems so they can deliver a wide range of ecosystem services;
- Recover the abundance and distribution of species and prevent any loss of diversity within species;
- Increase numbers of Scotland’s internationally important species;
- Deploy Nature-Based Solutions such as blue carbon habitat restoration to deliver Net Zero and adapt to climate change; and
- Manage harmful invasive non-native species (INNS) so they no longer degrade native habitats and harm native species.

<sup>3</sup> <https://www.gov.scot/publications/scottish-biodiversity-strategy-2045-tackling-nature-emergency-scotland/>

<sup>4</sup> <https://www.gov.scot/publications/delivering-scotlands-blue-economy-approach/pages/4/>

<sup>5</sup> <https://www.greenfinanceinstitute.com/wp-content/uploads/2021/10/The-Finance-Gap-for-UK-Nature-13102021.pdf>

The below graphic provides a snapshot of projects that have received grants from SMEEF covering marine and coastal opportunities.



Source: SMEEF Impact Report 2023

### Project examples for a river catchment fund

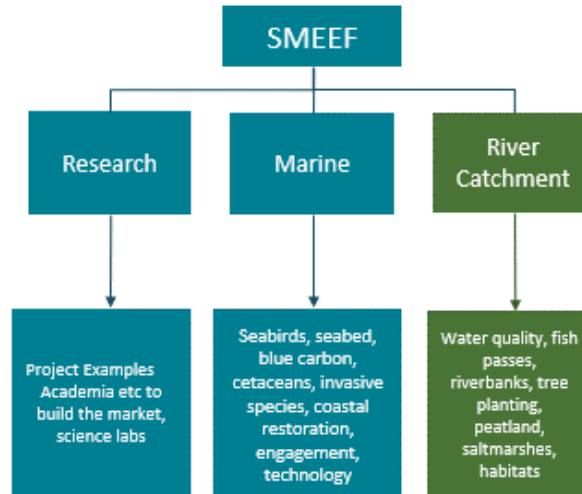
For the purposes of the Project, Finance Earth, HMC and FMS agreed that river catchment projects would target opportunities such as the restoration of natural river processes and riparian habitats, saltmarsh and estuarial systems where freshwater and marine habitats meet. Projects funded through Government schemes like the Forestry Grant Scheme for large scale woodland tree planting (within a river catchment) and the national programme, Peatland ACTION, to restore large swathes of peatland were not considered project opportunities for a river catchment fund.

The below graphic illustrate river catchment initiatives that could be targeted by a river restoration fund. The projects selected below have been funded by public grants such as NRF, the Biodiversity Challenge Fund and the National Lottery Heritage Fund.



## Option 1: River catchment within the existing SMEEF

Option 1 builds directly on SMEEF’s foundations and learnings, extending its current marine and coastal remit to incorporate river catchment opportunities. SMEEF would continue to operate as a pooled fund, aggregating voluntary contributions and strategically distributing capital to relevant projects and opportunities. This evolved strategy within SMEEF would allow a new river restoration strategy to benefit from SMEEF’s existing infrastructure and set up, enabling the strategy to be deployed quickly subject to the updating of key SMEEF documentation and additional resourcing to accommodate the extended remit.



Option 1 was developed based on stakeholder feedback confirming support for SMEEF’s model, approach and the assurance provided by NatureScot’s management role. This model is a simple and straightforward extension of SMEEF that takes advantage of its market recognition to date and seeks to replicate SMEEF’s ability to target specific subsectors of interest, such as seabird resilience, seabed restoration and coastal habitats.

The addition of river catchment to SMEEF could increase the opportunity to engage with corporates by introducing additional habitat targets such as river restoration, riparian woodland planting and wetland creation. The creation of such dedicated funding allocations remains at the discretion of the Steering Group and Grant Panel when they see alignment with SMEEF’s objectives.

### Assessment

| Criteria | Analysis | Relative attractiveness |
|----------|----------|-------------------------|
|----------|----------|-------------------------|



|  |   |        |
|--|---|--------|
| Ability to attract different funding sources | Private capital raising would likely be limited to voluntary contributions under the current SMEEF structure, as it has not been designed to 'crowd in' investment (for example, by providing concessionary forms of capital and supporting projects in accessing market-based revenues to generate returns).   | Low    |
| Costs & Complexity                           | Extending SMEEF is likely to be the most straightforward and cost effective of the three presented as it is unlikely to require the establishment of a new funding vehicle or an entirely new team.   | High   |
| Focus & Flexibility                          | Corporate engagement evidenced demand for bespoke funding mechanisms and grant flexibility to meet specific project requirements. Depending on the nature of underlying projects targeted for support in river restoration and their specific needs and barriers to investment, SMEEF may not be optimally designed and flexible enough for this new subsector. | Low    |
| Governance                                   | SMEEF's governance structure (Ethical Board, Grant Panel, Steering Group) and NatureScot's established [oversight] role of SMEEF provide comfort to contributors.   | High   |
| Impact                                       | Opportunity to build on SMEEF's track record to provide grants to projects with a river catchment / freshwater focus and provide critical funding to smaller river restoration projects that fall below the NRF threshold (<£25,000).   | Medium |
| Policy alignment                             | SMEEF's current structure is not well-suited to the delivery of outcomes that meet compliance-driven demand for mitigation of impacts on nature due to how specific those regulatory requirements tend to be; it is designed and better suited to meet voluntary corporate demand.  | Low    |
| Resourcing & Capacity                        | Additional resource will be required to manage the execution of a broader remit to include river restoration; this expertise may be already within the SMEEF team, or may have to be brought in. Resources will also be required for clearly communicating the strategy update to the market.   | High   |

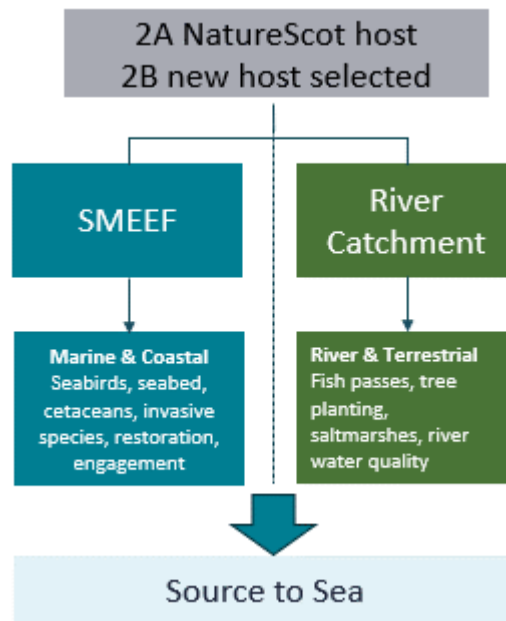
## Summary

Option 1 was a preferred funding model for some groups when presented and discussed at the workshop. Attendees recognised the benefits of simplicity and the continued focus on voluntary contributions and grants provided to projects. Option 1 could be implemented over a short time frame but would require close management of SMEEF communications to ensure clarity over a revised strategy.

However, it is unlikely that under the current structure, meaningful new sources of capital such as those from the private sector will be attracted into projects aligned to Source to Sea objectives, as SMEEF has not been designed or set up with the intention of mobilising private sector capital and supporting natural capital market development.

## Option 2: Dedicated river catchment fund run in parallel to SMEEF

This option builds directly on SMEEF’s foundations and learnings to establish a dedicated river catchment vehicle that could operate as a ‘sister fund’ to SMEEF underneath the same governance umbrella but with its own dedicated team and funding strategy focused on river restoration.



The sister fund concept was developed in response to stakeholder and corporate concerns raised that the addition of river catchment opportunities within SMEEF’s mandate may distort and dilute SMEEF’s established market position, threatening future contributions.

Under Option 2, a Source-to-Sea funding strategy consists of two ‘sister funds’, SMEEF and an aligned, dedicated river catchment fund. Both would function as distinct funds pooling contributions from corporates and distributing grants to eligible projects. Both funds could be placed within the NatureScot governance umbrella and would benefit from the oversight and expertise of the Steering Group. Alternatively, an external body could be appointed as host (Option 2B), which would allow the Source-to-Sea strategy to benefit from specialist expertise while reducing the resource requirement from NatureScot. Potential hosts could include Scottish Water, Crown Estate Scotland, or an arm’s length body of Scottish Government.

### Assessment

| Criteria                                     | Analysis   | Relative attractiveness |           |
|--|--|-------------------------|-----------|
|  |  | Option 2A               | Option 2B |
| Ability to attract different funding sources | Capital raising for Options 2A and 2B would likely be limited to voluntary contributions with repayable private capital unlikely if no financial return can be generated from underlying projects and no support is given to projects to access market-based revenues. However, this will depend also on the funding strategy of the new vehicle, which could potentially go beyond SMEEF to target the crowding in of other sources of capital. | Medium                  | Medium    |
| Costs & Complexity                           | Establishing a dedicated river catchment fund operating in parallel to SMEEF would require the establishment of a new funding vehicle, and Option 2B would require the procurement and agreement of a new host. Some cost efficiencies are likely by sharing across the two sister funds, such as administration, reporting and oversight.   | Medium                  | Medium    |
| Focus & Flexibility                          | Option 2 maintains SMEEF's identity and position within the market as a marine focused fund, while seeking to meet demand from corporates for a funding mechanism dedicated to riverine projects through a separate but associated fund. The design enables voluntary contributions and the provision of grants but is unable to provide a wide range of support mechanisms such as repayable grants.  | Medium                  | Medium    |
| Governance                                   | A sister fund leveraging the SMEEF governance infrastructure (Ethical Board, Grant Panel, Steering Group) is reassuring for corporate contributors. Option 2B could lack the assurance provided by NatureScot.   | High                    | Medium    |
| Impact                                       | A dedicated fund provides perhaps greater opportunity than Option 1 to provide sector-specific support. This can include funding to smaller projects that fall below the NRF threshold (<£25,000), as well as other forms of support such as investment readiness depending on the remit designed by NatureScot.   | High                    | High      |
| Policy alignment                             | If copying the funding strategy of SMEEF, a sister fund for river restoration may not be well-suited to attracting corporate contributions based on regulatory demand, such as from offshore developers, due to the specificity of regulatory requirements. However, the funding strategy of the new vehicle could be designed to maximise alignment with this source of demand.   | Medium                  | Medium    |

|                       |   |        |        |
|-----------------------|---|--------|--------|
| Resourcing & Capacity | Additional resource will be required to set up and manage a new funding vehicle for the execution of a broader remit beyond SMEEF to include river restoration; this expertise may be already within the SMEEF team, or may have to be brought in. Resources will also be required for clearly communicating the strategy update to the market. | Medium | Medium |
|-----------------------|---|--------|--------|

### Summary

Option 2A was a preferred funding model for two groups when presented at the workshop as attendees recognised that the introduction of a river catchment fund, in parallel to SMEEF, could potentially complement SMEEF’s offering. Option 2A could be delivered in the reasonably short term, with Option 2B taking longer due to the need to procure a new host. Option 2 provides a funding model that leverages SMEEF’s foundations to establish a dedicated river catchment financing mechanism with a new brand (to be determined) that would not be expected to negatively impact SMEEF’s market position.

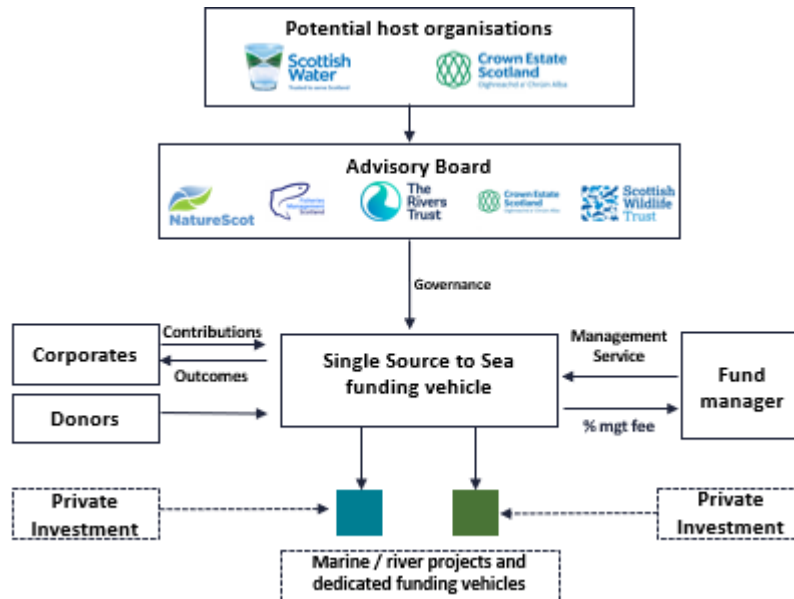
Option 2B may serve to address some of the restrictions imposed on SMEEF as a result of the SPFM and in particular the ability to carry capital and reserves across financial year(s) when hosted by a public body. Option 2B could also provide the structure to facilitate ecosystem service sales and the mobilisation of repayable capital, contingent on the nature of the underlying projects seeking funding, and the host’s appetite and ability to engage with natural capital markets and private investment.

### Option 3: A new Source to Sea fund structure

Option 3 proposes an entirely new fund and governance structure dedicated to delivering Source to Sea through funding river catchment work, and the marine and coastal restoration currently administered through SMEEF. This could be achieved using a framework and funding aggregation vehicle that seeks to use public capital strategically to unlock private investment into the delivery of Source to Sea objectives. If successful, additional investment mandates could be added into such a funding and governance structure as and when appropriate.

An example of such a structure successfully established is the Greater Manchester Environment Fund (GMEF), which supports projects that help to deliver on the region’s natural capital investment plan by aligning public, philanthropic and private sector funding streams. GMEF is a registered charity and is the UK’s first regionally focused environmental impact investment fund. The structure was developed by Finance Earth and established in partnership with the local Wildlife Trust and the Greater Manchester Combined Authority.

*This is an indicative Source to Sea fund governance structure, (organisations represented are for illustrative purposes only)*



This new fund structure has the potential to attract a range of sources of capital within the structure. Non-repayable restricted and unrestricted funds can be received in the governance vehicle for distribution in line with the vehicle’s well-defined funding strategy. Repayable finance from the private sector can potentially be mobilised into dedicated sub-funds that sit underneath the governance vehicle as and when a specific sub-strategy becomes commercially viable. This structure is attractive for private investors as it allows the ringfencing of risks into a dedicated vehicle, with avoided exposure to other investments that do not generate returns on investment. The structure is therefore potentially more appropriate where there is significant ambition for long term financing of the whole sector. SMEEF could be moved wholesale to sit within this structure (subject to expert legal advice). Option 3 is also a potential solution to the SPFM constraints faced by SMEEF and Options 1 & 2A.

Typically, a specialist fund manager would be procured to manage the vehicle; this may be a not-for-profit that is experienced in managing such vehicles (hence the local Wildlife Trust in the case of GMEF). For commercial investment strategies that sit within the fund architecture, for example a dedicated Saltmarsh Carbon fund when that market becomes established, specialist regulated fund managers are likely to be required. This structure would require the establishment of an Advisory Board for the vehicle. SMEEF’s Steering Group of NatureScot, the Scottish Government’s Marine Directorate and Crown Estate Scotland could all retain positions on the Advisory Board, providing continuity and assurance to SMEEF’s existing corporate partners and contributors.

## Assessment

| Criteria                                     | Analysis   | Relative attractiveness |
|--|--|-------------------------|
| Ability to attract different funding sources | Depending on the funding strategy and fund design, the new fund structure could crowd in private investment to deliver on Source to Sea objectives, e.g. by providing concessionary forms of capital and supporting projects in accessing market-based revenue streams to generate returns on investment. Specialist fund management would facilitate this access.   | High                    |
| Costs & Complexity                           | Developing a governance structure for a single Source to Sea fund is likely to be the most costly and least straightforward of the three presented, requiring a host, a board, and a fund manager. No public organisation can retain a controlling position if the restrictions of SPFM are to be avoided.   | Low                     |
| Focus & Flexibility                          | The funding strategy of a new Source to Sea vehicle could be designed to provide a range of repayable and non-repayable funding to a range of project types, to maximise the opportunity for corporate partnerships. Dedicated sub-funds can be set up to meet specific market needs, such as a Saltmarsh Assistance Fund (as recommended by FIRNS Saltmarsh Code).  | High                    |
| Governance                                   | Option 3 requires a brand-new governance structure technically outside of NatureScot, with a host, advisory board (which could effectively be the same Steering Group as Options 1 or 2) and external fund manager. This structure can be designed or procured by Scottish Government to meet its objectives, although it risks being perceived by corporates as providing less assurance due to being further removed from NatureScot. To avoid SPFM constraints, governmental or public bodies would not be able to have a controlling interest. | Medium                  |
| Impact                                       | Depending on the commercial viability of underlying investments and the opportunity to attract private investment, a new fund structure has a greater potential to blend private and public capital to scale investment into ecosystem restoration if well-designed.   | High                    |
| Policy alignment                             | The funding strategy of a new fund could be designed to closely align to compliance-driven demand for mitigation of impacts on nature. The structure could establish a partnership with the Scottish Marine Recovery Fund for compensation or partner with the NRF for terrestrial and freshwater opportunities that reach investment readiness.   | High                    |

|                       |  |     |
|-----------------------|--|-----|
| Resourcing & Capacity | The new governance structure is likely to have the largest resource requirement of the three options to set up, oversee the structure and procure specialist management. | Low |
|-----------------------|--|-----|

### Summary

Option 3 was the least preferred of the models presented and discussed at the workshop. This was due to concerns relating to moving SMEEF outside of NatureScot, as well as around complexity, cost and whether natural capital markets were significantly developed to make it worthwhile. The workshop did note however the attractiveness of greater flexibility and the longer-term opportunity that Option 3 provides.

Option 3 would require clarity in messaging to potential corporate partners to continue to benefit from the existing SMEEF brand while attracting new interest into the expanded remit of the overall fund. It would also potentially require regulated fund management expertise where a blended finance approach is pursued and to maximise the chances of being able to attract private capital. However, of the three options, it has the greatest potential in the long term to bring together Scottish Government’s varied support programmes and objectives to do with the natural environment under one aligned umbrella structure in a cost efficient manner to provide the mix of repayable and non-repayable capital needed to catalyse the growth of the whole sector.

## Next Steps – Detailed Options Assessment

Further assessment and consideration is needed on the following aspects to properly inform the design of a governance and funding structure that efficiently and effectively channels much-needed investment into the restoration of Scotland’s marine and river ecosystems.

### *Mission, Objectives and Strategy*

Defining and fully aligning on the mission and key objectives of the river catchment programme is an essential step towards designing a funding strategy to deliver on the objectives. If the objectives and mission are the ‘what’ and the ‘why’, the funding strategy is the ‘how’, which will determine the appropriate fund structure. This is because the unique risks and rewards of the underlying projects and interventions targeted by the funding strategy will determine the appropriate form of capital, whether it’s purely public and philanthropic, or a mix of public/private/philanthropic, and whether the support is for project development, capacity building, training / development, investment readiness, funding for delivery, or revenue support mechanisms like guarantees. As different capital providers have different requirements around risk, return and governance, only once the appropriate form and mix of capital has been identified should the design of the governance mechanism be finalised that seeks to pool together those sources of funding as efficiently as possible.

One relevant consideration in this regard is whether the objectives of the programme are aligned with and could be designed to support the delivery of regulatory requirements such as offshore and terrestrial development compensation (e.g. as established by the National Planning Framework 4). Another is how the funding strategy can be designed to strategically align with other funding mechanisms such as the Nature Restoration Fund rather than competing with them.

An important aspect of the funding strategy will be whether it aims to facilitate the growth of Scotland’s nascent ecosystem service markets, and the extent to which it aims to participate in each market depending on their commercial maturity. A well-designed funding strategy seeking to operate in and accelerate private markets introduces opportunities to attract private repayable capital into the structure, effectively allowing public funds to stretch further and deliver greater impact. The appropriate fund structure will depend on the targeted capital mix, which in turn is defined by the nature of the underlying interventions it is aiming to support. These factors will also define the reporting requirements of the fund, typically driven by investor needs, whether they are providing repayable or non-repayable funding.

**Recommendation:** Define the strategy, objectives, and purpose (the ‘what’, ‘why’ & ‘how’) to inform the appropriate fund structure for a river catchment financing mechanism or single Source to Sea fund.



### *Understand the project pipeline and requirements*

SMEEF has established a clear market position in terms of its mission to support marine restoration, but there is uncertainty in the market as to how it can deliver on its mission. Stakeholders requested that funding mechanisms provide clear guidance on priority areas, the duration of funding (single year or multi-year) and the nature of support whether it be development funding, project and restoration costs or maintenance payments.

Several other considerations were highlighted during stakeholder engagement and the workshop, including:

- Funds should focus on a clear gap in the market; this could be to support large-scale project development and delivery to maximise restoration impact, or to focus on small-scale projects that existing funds such as the Nature Restoration Fund cannot support.
- Funds should support project development such as baseline data collection, stakeholder participation, project design, business model development and contracting to enable more projects to reach ‘investment readiness.’
- Corporates are increasingly seeking outcomes as regulatory demand for mitigation increases which introduces opportunities for a project portfolio to generate returns on investment (public or private) by selling verified outcomes over time.
- SMEEF operates with a special agreement from the Scottish Government to carry up to £2 million of capital raised from private partners across financial years. This special allowance only applies for private contributions raised by SMEEF and does not apply to any public funds received (such as NRF). The agreement increases SMEEF’s flexibility to provide multi-year funding, but it is unclear if the arrangement will be in-place for the long-term.

**Recommendation:** Undertake an assessment of project demand across marine and river catchment opportunities to understand the development stage of projects and enhance the understanding of the funding need. This will inform the selection of the optimal structure for a new funding model and is needed to understand the development stages of projects, their funding need, and the opportunity to generate returns on investment through outcome payments to corporates seeking to meet regulatory requirement.

### *Policy alignment*

- Alignment with marine, freshwater and terrestrial policies will be important in ensuring the success of the chosen funding mechanism. Stakeholder engagement evidenced the opportunity for SMEEF, a dedicated river catchment fund or a single Source to Sea fund to support the delivery of compensatory nature-positive requirements to fulfil compliance requirements driven by offshore wind power development and National Planning Framework 4. Aligning investment strategies with

relevant policies could make the planning system more efficient and support sustainable development across Scotland by providing developers seeking mitigation with a clear route to high integrity compensatory projects via a government-approved mechanism.

- The development of a compensation focused Marine Recovery Fund in Scotland (like that proposed in England) could represent an opportunity for SMEEF to act as the delivery partner and funding mechanism for marine compensation requirements without duplicating market mechanisms.

**Recommendation:** Fund partners (FMS / NatureScot) should monitor and assess the implications of regulatory and policy developments in Scotland in relation to SMEEF and a river catchment investment programme.

Collaborative engagement with the offshore development regulators and offshore developers should be undertaken to identify the opportunity for the existing SMEEF infrastructure and future extension to river catchments to be adapted or upgraded to serve the expected need for compensatory restoration.

### Governance

SMEEF has the support of a government-backed body and governance structure that provides assurance to corporate partners. Establishing an equally robust governance structure for any new funding mechanism was a key takeaway from the workshop.

Two options presented and assessed at the workshop (Options 2B and 3) were developed to address the constraints of the SPFM by establishing a new non-public host (Option 2B) or an outsourced fund management arrangement (Option 3). Crown Estate Scotland could play an important role given their responsibility as both land and seabed owner given its leasing arrangements with key sectors including fisheries, aquaculture and offshore wind, and its engagement in strategic planning for these sectors and grant-making for community activities such as via the Sustainable Communities Fund.<sup>6</sup> Further discussions with Crown Estate Scotland or Scottish Water could be explored to act as host, where this arrangement avoids the SPFM restrictions.

**Recommendation:** A detailed assessment should be conducted on the advantages and disadvantages of other public, quasi-public bodies, philanthropic and private sector hosts. This should take into consideration management costs, attractiveness for private sector investment, capacity, and capabilities and SPFM implications.

Fund partners (FMS / NatureScot) should engage with non-governmental bodies to assess the appetite, capacity, and opportunity to act as host.

<sup>6</sup> <https://www.crownestatescotland.com/our-projects/sustainable-communities-fund>

### *Branding and Communications*

NatureScot has successfully created a brand and identity for SMEEF, and stakeholder engagement highlighted its industry recognition. SMEEF received seed funding and voluntary contributions from the offshore wind sector and its focus was understood by the selection of energy and financial corporates engaged with for this Project. Further stakeholder and project level engagement highlighted the positive identity and brand that SMEEF has built with project developers since inception, but also raised concerns over any changes that could impact the strength of SMEEF's brand and identity. A key point of discussion from the workshop was the risk posed to SMEEF through the evolution to include a river catchment strategy (Option 1) or the potential confusion posed by the creation of a Source to Sea fund that covers marine and river catchment ecosystems (Option 3). Option 2A is expected to be the least impactful to SMEEF's existing brand or identity, with a replicable river catchment fund established alongside SMEEF as a 'sister fund'.

**Recommendation:** SMEEF, a river restoration fund and/or a single Source to Sea fund will require strong branding, communications, and marketing to retain position in the market or establish a clear role and position with both corporate partners and project partners. The optimal fund option can leverage SMEEF's brand platform, but will require clear messaging and communication to retain and build corporate support.

### *Resourcing and Capacity*

SMEEF is currently managed by NatureScot and a team of three full-time employees (FTE). All the options developed are expected to have an impact on SMEEF's resourcing and team capacity, with the introduction of river catchments expected to require additional specialism and knowledge that might not exist in the current FTE.

- Option 1: with the expansion of SMEEF to include river catchments, this will add additional reporting, management, and engagement duties to the SMEEF team.
- Option 2: cost savings and efficiencies could be shared between 'sister funds' but the creation of a dedicated river catchment fund, run in parallel with SMEEF, introduces additional management requirements and capacity is expected to be restricted within SMEEF's existing team. Managing a fund in parallel is expected to increase the requirements for reporting, communication, and corporate engagement and increase the resourcing need.
- Option 3: a new governance structure is likely to have the largest resourcing of the three options and will require a new set up, the procurement of specialist management and ongoing management. The new structure will also require river and marine specialism, and evidenced by workshop feedback will require additional resource to ensure clear communications and market positioning to build on the success of SMEEF.

Increased project reporting requirements to meet corporate demand for CSR or ecosystem sales will increase the level of work for both the SMEEF team and project leads to collate, assess, report, and communicate on projects. This will require a greater internal capacity, both in terms of the number of people and skillsets. Resourcing considerations apply to all the options presented, with the understanding that Option 3 would outsource the management of a combined Source to Sea fund to a new entity that was resourced to manage the marine, terrestrial, coastal, and freshwater brief.

**Recommendation:** A resources gap analysis should be conducted for each option, assessing the capacity and capability within NatureScot, a new host or a new fund structure to manage a fund with increased requirements. Indicative costs for resourcing could be collected for Options 1 & 2A / 2B and quotes for the management of Option 3 could be collected from suitably qualified not for profits organisations.

### **Fund reporting requirements**

Defining the mission, objectives, and funding strategy of will inform the reporting requirements based on the nature of contributions or investment targeted from private investors and companies. To date SMEEF has had a light touch approach to reporting and conducts this on an aggregated level, as detailed in the SMEEF Impact Report 2023. This approach is suitable for the current structure and existing corporate engagement, but where higher levels of contributions, funding or investment are provided, this is expected to require greater monitoring and reporting (from the fund and projects). Projects selling ecosystem services would be required to undergo detailed monitoring, reporting and verification (MRV) of actions to ensure compliance with regulated codes. This would also apply to the delivery of statutory responsibilities.

**Recommendation:** Additional corporate engagement should be undertaken to understand and assess fund reporting requirements. This should include engaging with both the CSR / sustainability representatives from financial institutions and investment teams to understand the anticipated reporting requirements for different capital (voluntary / investment).

Further engagement should also be conducted with the renewable energy sector, covering both regulated and unregulated business divisions to assess differences in reporting requirements linked to voluntary contributions and compliance markets.

### **Risk Considerations**

The three structural options explored each have different fund-level risks associated with them and varying ways to mitigate such risks including through fund design, operational processes and contracting. While there are many risks to consider, a comprehensive risk register including mitigations should be established as part of a detailed options assessment.

These can broadly be split into the following main categories: governance, legal, strategic, and reputational.

There will be many other project-level risks that will depend on the funding strategy chosen, the underlying investments and how the fund interacts with those. To an extent these will be able to be mitigated through appropriate governance design and set up of the fund, for example to ensure it does not invest or provide capital into projects that introduce unacceptable levels of risk. In order to understand these project level risks, a detailed risk assessment of the potential project pipeline is needed, and they can be expected to include those relating to land tenure, land ownership, land right, interactions with other national grant schemes where applicable such as Peatland ACTION and the Forestry Grant Scheme, market risk, delivery risk and broader environmental risk (e.g. extreme weather events) to name a few. For each risk, there are typically a range of mitigation options, many of which can be built into the strategy to ensure there are red lines and guardrails in each of these areas to ensure risk is appropriately mitigated and transferred to third parties where appropriate (e.g. through agreement or contract terms). It would typically be the responsibility of an 'investment committee' or similar body to approve proposed investments and ensure they do not step over any of these red lines. A well-designed investment appraisal process and a suitably qualified investment committee or equivalent, and a regulated fund manager particularly where private investment is being sought, are key governance features of a fund and serve to mitigate many risks.

Legal risks are relevant to the structure of the fund as well as individual investments, and so external expert legal advice is advisable to inform a final decision about fund structures. Typically, a fund will consult again for each proposed investment depending on materiality and project-level risks requiring expert input. In terms of the structural options, option 3 is likely to have the greatest need for external counsel as a brand new, independent structure, with particularly in regard to opining on the SPFM restriction implications.

Strategic risk, i.e. the risk the funding solution does not meet the strategic goals, is best mitigated through a well-defined and thought through funding strategy, which will determine what projects receive investment. In order to fully inform the design process for the funding strategy, it is necessary to not only have a clear mission and objectives, but also a clear understanding of the potential project pipeline, so it is clear to the future funding team which projects lie within and which outside of the funding remit.

Stakeholder and corporate engagement undertaken through this Project evidenced risks to corporate contributors from reputation risk and the investors (non-delivery of outcomes and return of capital) or delivery groups should be undertaken to inform the optimal fund structure.

Finally, reputation risk is an important consideration that feeds into the design of the governance structure, the funding strategy and the management team, as this risk derives from not only the quality of the investments ultimately made (i.e. how appropriate is the funding strategy), but also on how closely the funding strategy is adhered to (i.e. the robustness of governance and capability and capacity of the management team to ensure it is followed in full).

**Recommendation:** A risk register should be established and maintained. A detailed funding strategy should be designed that is fully aligned to a clearly defined mission and set of objectives, and a suitably qualified management team should be put in place to execute the funding strategy.

## Conclusion

This project investigated the potential for establishing a funding model to support river catchment restoration activities in Scotland. Building on the success of SMEEF, the Project assessed funding structure options to support sustainable investment in restoration activities across marine, freshwater, and connected terrestrial habitats, recognising the inherent ecological linkages between these environments. Finance Earth and HMC conducted stakeholder engagement to assess the success and learnings of SMEEF, and collate feedback from stakeholders, SMEEF grant recipients, corporate partners (including financial institutions and current contributors from the renewable energy sector) to inform the high-level assessment of the three fund structure options. This engagement confirmed corporate support for SMEEF as well as for a new or expanded existing funding model that includes river catchment restoration within its remit.

Further assessment and consideration is needed to inform the design of a funding and governance structure that efficiently and effectively channels much-needed investment into the restoration of Scotland's marine and river ecosystems. The appropriate structure will depend on the targeted capital mix, which is defined by the nature of the underlying interventions it is aiming to support. These factors will also define the reporting requirements of the fund, typically driven by investor needs, whether they are providing repayable or non-repayable funding. If the purpose is to function as an aggregator of voluntary contributions that provides grants to recipients, Option 1, and Option 2A would be suitable models. If the purpose was to maximise the nature restoration opportunity across Scotland's land, river and marine habitats, then SMEEF and/or Source to Sea should explore options that have the ability to attract repayable private capital and facilitate ecosystem service sales to generate financial returns, which could be Option 2B (depending on its design) or Option 3.

The introduction of regulatory demand drivers for environmental impact for the purposes of biodiversity mitigation, in combination with the corporate disclosure regimes such as the Taskforce for Climate Related Disclosure (TCFD), Taskforce for Nature Related Disclosure (TNFD), the Science Based Targets Initiative (SBTi) and Science Based Targets for Nature is increasing corporate scrutiny and awareness of nature-related risks and impacts across supply chains. This in turn is leading to growing demand for the ecosystem services generated from terrestrial, freshwater, marine and coastal nature-based solutions projects. This presents an opportunity for a fund or funds such as SMEEF, a river catchment fund or Source to Sea, to develop and position a strategy that supports the development and delivery of projects that can sell these ecosystem services into these areas of growing corporate demand to generate financial returns.

In order to determine the appropriate funding structure for a river restoration funding model or single Source to Sea fund, it is first necessary to develop a clear mission and objectives, and then to understand the ‘market’ of projects that can potentially deliver on such objectives. This would include key information like funding need, potential for generating income, potential for blending with other grant programmes, key barriers to investment and details around the counterparties and project developers. Once this is understood, a funding strategy can be designed to best address such barriers and meet clearly identified funding needs, while establishing the exclusions and areas clearly outside of the strategy. Only at this point should the governance structure be designed, as it will then be clearer what the right type and blend of capital should be for such projects, whether private, philanthropic or purely public, and in the case of the latter, the form of funding, whether for development, delivery, to support revenue streams, repayable or non-repayable. The selected preferred structure should be properly resourced and managed by a suitably experienced and skilled manager.

## Appendix

### Additional documents

- Source to Sea - Corporate Engagement Report – Finance Earth
- Source to Sea - Stakeholder Engagement Report – HMC
- Source to Sea – Workshop Learnings

### Summary of meetings conducted

#### FE led-interviews and informal calls

| Organisation                                       | Date of Meeting |
|--|-----------------|
| Copenhagen Offshore Partners                       | 19/02/2024      |
| Scottish & Southern Energy Networks (Distribution) | 26//01/2024     |
| Orsted   | 29/01/2024      |
| Scottish Power Energy Networks                     | 01/02/2024      |
| Aviva Investors                                    | 02/02/2024      |
| Abrdn  | 06/02/2024      |
| River Global                                       | 12/01/2024      |
| One Planet Consulting                              | 26/01/2024      |
| NatureScot   | Ad hoc calls    |
| SMEEF Committee                                    | 06/02/2024      |

#### HMC led-interviews and informal calls

| Organisation                             | Date of Meeting |
|--|-----------------|
| NatureScot                               | 18/12/2024      |
| Crown Estate Scotland                    | 19/12/2024      |
| SMEEF Management Team                    | 20/12/2023      |
| Scottish Government's Marine Directorate | 15/01/2024      |
| Fisheries Management Scotland            | 17/01/2024      |
| NatureScot                               | 19/01/2024      |
| Kyle Fisheries Trust                     | 26/01/2024      |
| Clyde River Foundation                   | 26/01/2024      |
| One World Consulting                     | 26/01/2024      |
| Scottish Wildlife Trust                  | 29/01/2024      |
| Landowner                                | 30/01/2024      |
| Flora & Fauna International              | 31/01/2024      |
| Atlantic Salmon Trust                    | 31/01/2024      |
| Spey Fisheries Trust                     | 01/02/2024      |
| Crown Estate Scotland                    | 01/02/2024      |



|                     |            |
|---------------------|------------|
| Marine Directorate  | 02/02/2024 |
| Dee Fisheries Trust | 02/02/2024 |
| Forth Rivers Trust  | 02/02/2024 |

## Record of workshop attendees

The following organisations attended the in-person workshop at The Scotsman Hotel in Edinburgh on Monday 11<sup>th</sup> March 2024.

|           | Group 1  | Group 2  | Group 3   | Group 4  |
|-----------|--|--|---|--|
| Attendees | <ul style="list-style-type: none"> <li>Fisheries Management Scotland (Chair)</li> <li>Forth Rivers Trust</li> <li>Scottish Government Finance</li> <li>Scottish Wildlife Trust</li> <li>Copenhagen Offshore Partners</li> <li>NatureScot</li> <li>Scottish Government</li> <li>Fisheries Management Scotland</li> <li>Finance Earth</li> </ul> | <ul style="list-style-type: none"> <li>NatureScot (Chair)</li> <li>Crown Estate Scotland</li> <li>Scottish Land &amp; Estates</li> <li>Scottish Government</li> <li>Scotland's Rural College (SRUC)</li> <li>NatureScot</li> <li>Scottish &amp; Southern Energy (SSE)</li> </ul> | <ul style="list-style-type: none"> <li>NatureScot (Chair)</li> <li>Howell Marine</li> <li>Marine Directorate</li> <li>Scottish National Investment Bank (SNIB)</li> <li>Crown Estate Scotland</li> <li>Dumfries &amp; Galloway Council</li> <li>Scottish Environment Protection Agency (SEPA)</li> <li>Finance Earth</li> </ul> | <ul style="list-style-type: none"> <li>One Planet Consulting (Chair)</li> <li>Marine Directorate</li> <li>South of Scotland Enterprise</li> <li>NatureScot</li> <li>Highland and Islands Enterprise</li> <li>Scottish Power Energy Networks</li> <li>Howell Marine Consulting</li> </ul> |

## FIRNS Confirmation

FIRNS is acknowledged as part of all the deliverables that were created in this project. Moreover, during the engagement meetings conducted by Finance Earth and HMC, and at the in-person workshop in Edinburgh, the FIRNS funding was explicitly named, explained and the logos were used.

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