© Shutterstock / Leonardo Gonzalez

Blue finance models and examples

Author: James Merchant

First published: February 2024

If you have any questions please contact
james.merchant@mcsuk.org

Real world examples of blue finance

The term *blue finance* is used quite broadly to refer to finance directed towards activities in the coastal and marine environment. In practice, there are many different ways in which finance can be channelled into the blue economy. This article aims to illustrate some of the different forms that blue finance can take and what they like in the real world.

Blue Finance Models

Some of the most common mechanisms for financing marine projects and activities are listed below. These are not necessarily mutually exclusive so the financing of real-world projects can be a mix of these different models.

Impact-only investment: Rather than expecting financial returns, impact-only investments intend to provide a positive and measurable impact to society or the environment. As they do not commonly offer an attractive or viable return on investment, they tend to take the form of public and philanthropic grants. Although small in scale, impact investments contribute one of the largest sources of investment in the blue economy.

Debt financing: Debt-based finance typically involves a fixed sum provided over an agreed period. In return, the payment of a given interest rate delivers a (generally low) return on the investment over time. This can be in the form of loans, bonds* or notes. In relatable terms, taking out a personal bank loan or a mortgage to buy a house are common examples of debt-financing. A debt-based finance model typically reflects a low-risk appetite from investors. These can be micro-finance loans (tens of thousands of pounds) or much larger-scale loans and bonds worth hundreds of millions of pounds. The lenders tend not to exert much influence on how the finance is used but can demand that sustainable standards are adhered to.

*Bonds are laden with financial terminology. The *borrower*, or *issuer*, creates a bond that is bought buy the bond holder. The value of the bond is initially called the *principal* and repayment of this value represents the bond *maturity*. The time it takes to reach maturity is the *term*, and the interest paid during the term is the *coupon*.

Equity: With an equity investment, the investor gets an ownership share in the asset or project and typically receives dividends (regular payments) from any profits generated. As such, it usually comes with higher risk and higher expectations of returns than debt models. Some impact investments can also be equity investments, in which case they tend to be longer-term investments that accept lower returns in favour of a sustainable or social purpose.

Blended finance: A blended finance model combines commercial investment with public or philanthropic grants which serve to de-risk projects or make up the shortfall where costs exceed returns. These can be particularly useful where projects do not offer viable financial returns by themselves, and public or philanthropic sources cannot make up the shortfall sufficiently to offer attractive returns at a large scale.

These are some of the main forms of financial capital available for blue finance projects. Which type is preferred depends largely on the objectives of investors, their appetite for risk and return, and the scale of investment. There is a general correlation between the level of risk attached to each type of investment and the potential returns it could yield. The figure below created by The Ocean Foundation outlines how these models differ in levels of risk, return and scale.

Impact-only investment makes an important contribution to funding environmental projects but is often limited in scale. Delivering returns on investment, potentially through marine natural capital markets, could be an important step for tapping into larger scale forms of finance. In the meantime, innovative finance mechanisms that involve public funding could also be used to reduce investment risk and increase investor confidence.

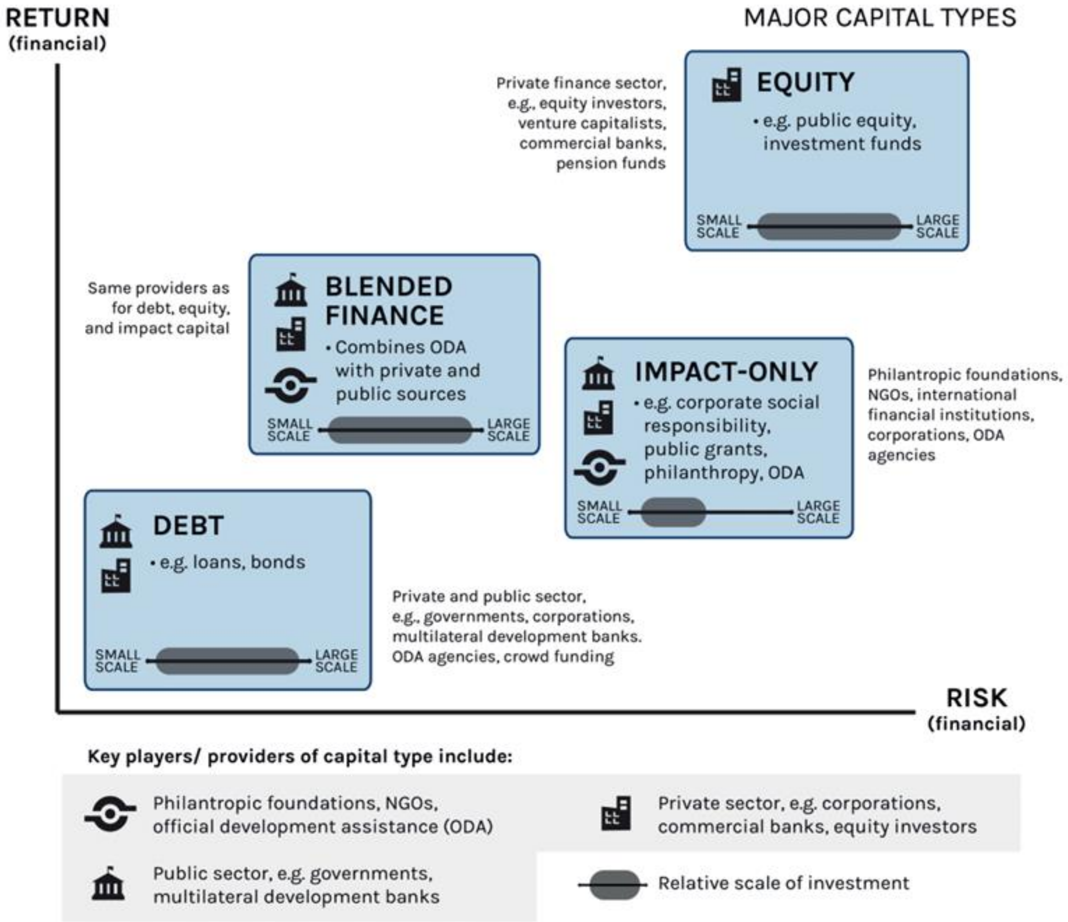

Figure 1: The different levels of risk and financial return associated with different investment models. There is a general correlation between levels of financial risk and return. Debt offers low risk and low returns while equity models can be riskier but with higher potential for financial returns. Source: The Ocean Foundation

Real-world examples

In recent years, a number of financial products have been created around the world to enable investment into the blue economy. The following list explores some of the most notable examples to date.

Blue bonds: As defined by the World Bank, a blue bond is "a debt instrument issued by governments, development banks or others to raise capital from impact investors to finance marine and ocean-based projects that have positive environmental, economic and climate benefits". In essence, they are debt-instruments with proceeds channelled into the blue economy. A bond is like a promise to pay back (with interest) at a future date in exchange for money now. In conventional bonds, companies or even governments will issue bonds to raise capital in the short term to invest in income-generating activity. However, in the case of a green or blue bond, this capital will go into things like marine restoration or conservation activity. To ensure this is delivered, they require a transparent reporting of the use, measurability and impact of the proceeds. Governments can issue sovereign bonds to raise public funds for this.

One of the leading examples of blue finance initiatives was the launch of a $15 million USD blue bond by the Seychelles in 2018. The finance made available from issuing the bond is used to expand marine protected areas, improve fisheries governance, and develop a sustainable blue economy. Subsequently, Belize has launched a blue bond worth $364 million USD that will serve specific conservation commitments including biodiversity areas and mangrove protection.

Between 2018 and 2022, $5 billion USD worth of blue bond transactions took place, however blue bonds make up less than 0.5% of the total market for sustainable debt.

Debt-for-nature swaps: These swaps allow a country to offset foreign debts in exchange for commitments to invest in nature recovery. This is particularly favourable when a country is unlikely to meet debt payments and is incurring increasingly high interest rates. In order to secure some level of repayment, the original lender may be willing to sell the debt at a lower rate supplemented with environmental commitments. This is rather contingent on the indebted nation having sufficient natural assets that can be restored or conserved as part of the conditions for the swaps.

In 2023, the world's biggest debt-for-nature swap to date effectively allowed Ecuador to buy back $1.6 billion of debt for $656 million while committing to invest $323 million into marine conservation in the Galapogos Islands. The Galapagos Marine Bond was created by Credit Suisse to allow the exchange of the debt (in the form of $1.6 billion of international bonds) for a $656 million loan. The bonds were sold below their true value because it was unlikely that Ecuador could repay the full value. Instead, the debt is replaced by the Galapagos Marine Bond which is more manageable and the Ecuadorian government has pledged to spend $18 million a year on conservation in the Galapagos Islands for the subsequent 18 years. The

> *Explainer*: The principle of these swaps is simpler than it perhaps sounds. Imagine that you once borrowed money from your eco-conscious neighbour, and you are now struggling to repay the loan. Being environmentally minded and recognising your struggles, your neighbour may suggest that you only repay half of the loan if you agree to create a wildflower meadow in your garden to support biodiversity in the neighbourhood.

loan is insured by the US International Development Finance Corporation, while a guarantee is also provided by the Inter-American Development bank.

Payments for ecosystem services: Projects can receive payments for one or more of the natural benefits they provide. Commonly, this involves projects selling carbon credits – valued by the amount of carbon sequestered - to be used for buyers offsetting emissions elsewhere. Revenues from the credits could be used to service the underlying loans or investors behind the projects. Mikoko Pamoja, a community-led mangrove restoration and conservation initiative in Kenya, was the world's first blue carbon offset project. 117 hectares of state-owned mangroves are conserved and the revenues from the sale of carbon credits (approximately $24000 per year) are reinvested into development projects for the community and local biodiversity.

Impact-only investment: Climate Impact Partners launched the *Million Mangroves* program in 2018 that offered a no-regrets strategy for corporates to buy a product that supports environmentally positive outcomes. This was sold to clients as catalyst product, with funds helping to scale up projects around the world and being used to advance the market for mangrove restoration. Rather than receiving carbon credits, the corporate funders pay to plant a certain number of trees or fund conservation programmes as part of their corporate social responsibility (CSR) work. These projects are particularly appealing because they demonstrate co-benefits linked to the UN's Sustainable Development Goals, including improved livelihoods. For the project developers, these initiatives can be an effective tool for generating finance for blue carbon projects that are not yet able to sell blue carbon credits.

Insurance: In 2019, The Nature Conservancy (TNC) led an initiative to create the first insurance policy on natural assets for part of the Mesoamerican Reef in the Mexican Caribbean. The policy secured funding for reparation of storm damage to the reef following extreme weather events. Hotel owners pay taxes to a coastal zone trust fund who in turn pay insurance premiums to SwissRe. SwissRe then pay out in the event of extreme weather damage and the trust fund uses the funds to maintain and restore the reef. Similarly, Swiss Re and TNC were amongst several partners to develop reef insurance in Quintana Roo in Mexico.

Expanding investment in the blue economy

Blue finance mechanisms are essential tools in delivering a sustainable blue economy - an economy centred around protected and valued marine ecosystems. However, a collaborative approach is needed to unlock this potential. A starting point is to create robust policy measures that offer meaningful protection to the marine environment. This in turn protects the value of financial investments and increases investor confidence. Combined with public funding that helps to scale-up and de-risk projects, this could create the foundation for greater levels of finance to flow into the blue economy. Over time, with the delivery of successful pilot projects that can demonstrate financial viability, blue finance can start to play a transformative role in preserving and enhancing our marine environment.