

Developing Pay for Performance Contracting Mechanisms for Western States



PROJECT SUMMARY

Building resilient communities and environments requires everyone to work together. We need habitat for species to support functioning ecosystems, clean drinking water and swimmable rivers, and smart infrastructure to help economies thrive. To do so, we need better, more effective solutions.

Pay for performance contracts link payment to the delivery of measurable environmental outcomes, inspiring private-sector innovation to find and implement solutions that work. Combining the local knowledge of landowners, engineers, and ecologists with capital from private investors, pay for performance creates incentives for cost-effective and scalable solutions that improve the environment.

In 2015, the Partners for Western Conservation and Environmental Incentives team were awarded a Conservation Innovation Grant by the Natural Resources Conservation Service to further the use of pay for performance in western state conservation programs. This grant enabled the project team to support state agency buyers to procure on-the-ground conservation work using pay for performance contracts.

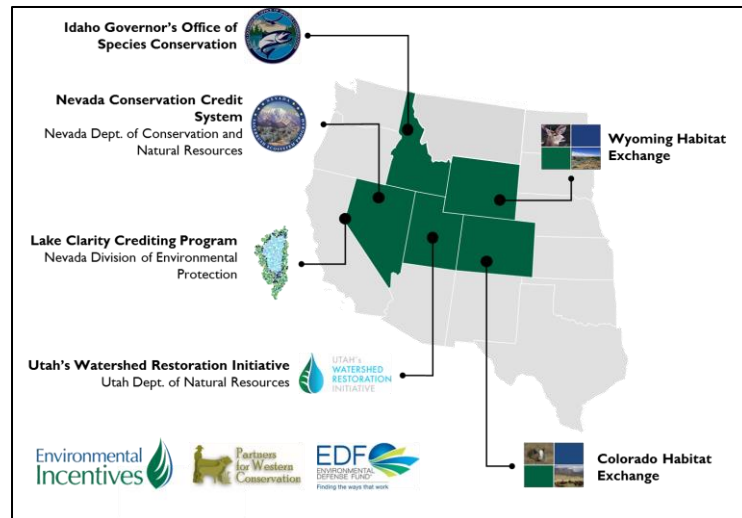


Figure 1: Project Partners and Participating Conservation Programs

PAY FOR PERFORMANCE

Pay for performance is an innovative contracting approach that links payment to the delivery of verified outcomes and is catching on as an effective way to ensure environmental projects produce meaningful results. Compared to traditional agreements that reimburse for actions, pay for performance creates incentives to cost-effectively produce and sustain habitat, water quality, and infrastructure projects.

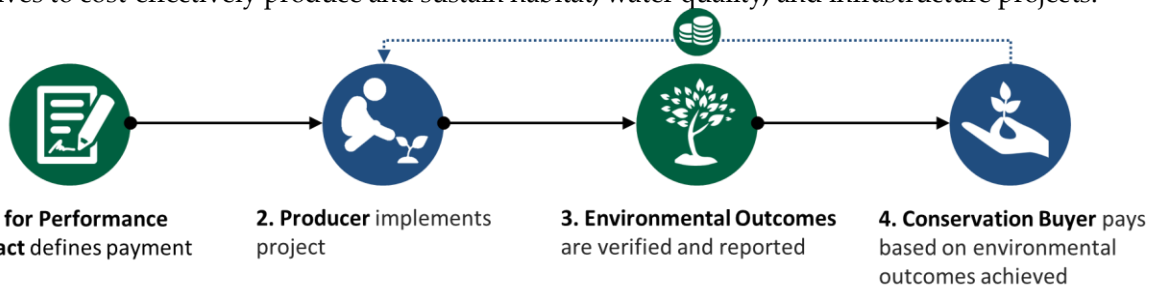


Figure 2: Simplified Structure of a Basic Pay for Performance Contract

KEY DISTINCTIONS

- Defined performance metrics tied to desired environmental outcomes
- Outcome-based payments
- Financial incentives for long-term stewardship

BENEFITS

Pay for performance maximizes the impact of often limited funding and enables rapid, landscape-scale conservation in regions where it is needed most.

- Reduces risk of funding ineffective projects by paying for environmental outcomes rather than actions.
- Enables rapid, large-scale conservation by leaving the details of project design and implementation to producers, reducing the need for costly project-by-project reviews.
- Achieves long-term stewardship by linking ongoing payments to verification of sustained environmental outcomes.
- Attracts private sector participation with opportunities for landowners, engineers, and investors to fund and implement cost-effective projects on private or public lands.
- Builds public support by clearly demonstrating the environmental and community outcomes achieved using taxpayer dollars.

PAY FOR PERFORMANCE TOOLKIT: A HOW-TO GUIDE

The [Pay for Performance Toolkit](#) was developed to help conservation, water quality, and community sustainability programs achieve better outcomes. It is the result of development, testing, and on-the-ground implementation of various pay for performance strategies. The Toolkit is an online platform that provides a central hub of resources with information on when to use and how to select different pay for performance strategies to address a spectrum of environmental issues. The resources provided support organizations funding, managing, and participating in environmental improvement projects.



STRATEGIES

There are several different ways to implement a pay for performance contract that vary by the degree that payments are linked to outcomes. As you move along the Pay for Performance Risk-Reward Spectrum (from left to right), the [pay for performance strategies](#) decrease buyer risk and increase the potential financial reward for producers that cost-effectively achieve environmental outcomes. The Toolkit defines the basic payment structure and distinguishing characteristics of each strategy.

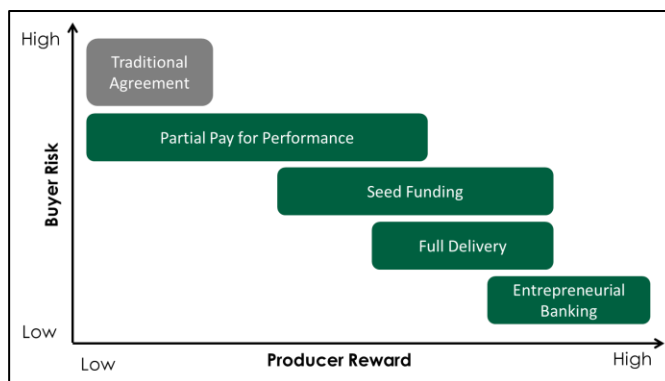


Figure 3: Pay for Performance Risk-Reward Spectrum

CONTRACT & SOLICITATION GUIDANCE

Contract terms in pay for performance transactions can be adjusted to balance the financial and performance risk between the buyer and producer. Striking the appropriate balance between risk and reward results in a vibrant competition to deliver environmental outcomes, inspiring private parties to identify high value conservation opportunities at reasonable costs.

The Toolkit provides a jumping off point to develop [pay for performance contracts and solicitations](#), with standard procurement terms and guidance on how to tailor the terms to the desires of the program.

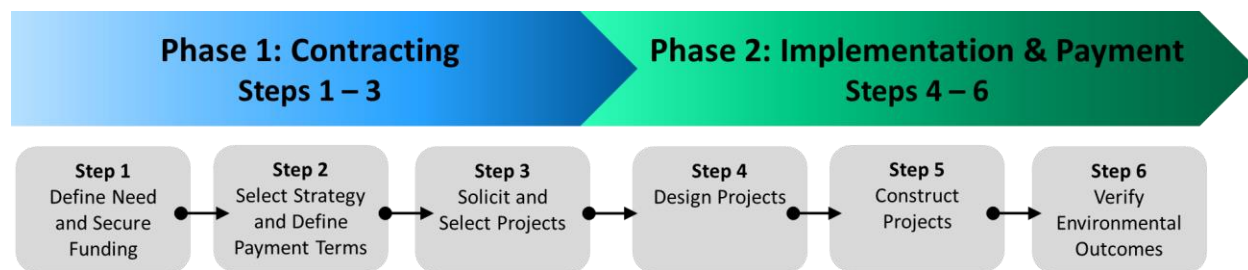


Figure 4: Project Life-Cycle of a Pay for Performance Contract

APPLICATIONS

Programs are already using pay for performance to meet voluntary and compensatory mitigation needs - from creating species habitat to wetland restoration and stormwater management. The Toolkit provides examples and case studies from real-world initiatives that are seeing results on the ground.

Nevada Conservation Credit System

The State of Nevada is using a seed funding pay for performance strategy to provide landowners upfront capital to produce sage-grouse habitat conservation projects. Habitat outcomes are verified as credits and made available to Bureau of Land Management permittees to fulfill their compensatory mitigation requirements.

OUTREACH

The Pay for Performance Toolkit was launched on March 19, 2018. To maximize awareness of the tools and resources available to organizations who fund, manage, and participate in environmental improvement projects, a broad distribution and outreach strategy was conducted. This included targeted email blasts, blogs, social media, and direct outreach to industry publications and organizations.

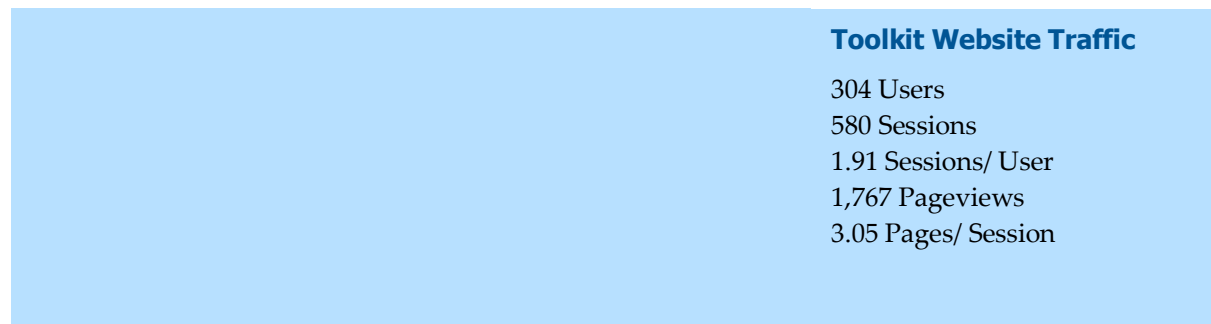


Figure 5: Pay for Performance Toolkit outreach activities and resulting website traffic

Learn more and access the Pay for Performance Toolkit: www.enviroaccounting.com/payforperformance

PAY FOR PERFORMANCE TOOLKIT PRODUCTS

PAY FOR PERFORMANCE TOOLKIT
Life Cycle of Pay for Performance Contracts

The life cycle of pay for performance contracts involves six key steps that are led by the buyer and involve the producer. As seen in Figure 1, these steps can be grouped into two distinct phases – Contracting, and Implementation and Payment.

PHASE 1: CONTRACTING

During the Contracting Phase, the buyer leads the process not only for increasing the producer on the delivery of measurable environmental outcomes, but also to gain buy-in within its own organization for pay for performance contracting. This phase is essential to align the expectations of all parties involved within both the buyer's and producer's organizations on the mechanics and benefits of pay for performance contracting.

STEP 1. DEFINE NEED FOR PAY FOR PERFORMANCE AND SECURE FUNDING

Defining the need for pay for performance contracting in the context of the environmental goal of a program requires efforts to secure funding. Program managers should consider the environmental need and benefits that pay for performance offers in achieving the program's goals, particularly through cost-effective, outcome-based contracting. In addition to defining the basis of the work, such as the geographic scope of the environmental issue, it is also important to consider the potential for pay for performance to influence the level of investment in the program through accountability for secure spend. In many cases, the program's funding will already be secured, however, thoughtfully considering these components and aligning them to the specific needs and context of a program helps secure future funding. These efforts are essential in setting the stage as the program defines outcomes and contract terms and seeks applications from potential producers.

STEP 2. DEFINE PAYMENT TERMS

Prior to soliciting applications, the buyer works with its procurement department to define payment terms that seek to align the organization's financial and legal needs and contribute to achievement of the goals of the program. Payment terms are tailorable in the degree to which they tie to project performance. Therefore, the buyer is able to balance the cost risk of funding projects that do not produce intended environmental outcomes with the producer's reward for cost-effective, measurable environmental outcomes to a degree that is detailed and agreeable to both parties. Specifically, the preparation of a contract that is contingent upon outcome-based performance versus outcomes linked to completion of actions can be adjusted to balance buyer risk and producer reward.

White Paper: Life Cycle of Pay for Performance Contracts

Describes the six primary steps involved in the life cycle of a pay for performance contract and provides an example payment structure for a partial pay for performance contract.

Fact Sheet: Key Distinctions of Pay for Performance Contracts

Highlights the primary differences for various contract elements between pay for performance contracts and traditional agreements.

PAY FOR PERFORMANCE TOOLKIT
Key Distinctions of Pay for Performance Contracts

CONTRACT ELEMENT	PAY FOR PERFORMANCE	TRADITIONAL AGREEMENT
Contract Summary	Performance Metric: A contract performance metric (measured as a relative gain or loss) is established based on a baseline goal to determine initial goals. The same performance metric is used to compare multiple projects using different contract terms.	Fixed/Fee Metric: A fixed fee metric is used to compare the work across projects. The specific contract method may not be directly linked to the final performance metric and outcomes goal and may be fixed.
Definition of Performance Value	Market Incentive Value: The performance metric is used to determine the maximum value of a project, ranging from high to low and applied consistently with the quality of the project.	Market Incentive Value: The performance metric may be used to determine the maximum value of a project, ranging from high to low and applied consistently with the quality of the project.
Payment Terms	Outcome-Based: At least some portion of payment will be linked to the achievement of the performance metric. Payment is not made until the project is completed and the performance metric is achieved.	Advance-Based: Payment is made in advance of project completion. Payment is not made until the project is completed and the performance metric is achieved.
Marketing, Solicitation, and Selection	Outcome-Based: The contract is awarded to the producer that achieves the highest performance metric. The contract is awarded to the producer that achieves the highest performance metric.	Fixed/Fee Metric: The contract is awarded to the producer that achieves the highest performance metric. The contract is awarded to the producer that achieves the highest performance metric.
Management Plan	Outcome-Based: The contract is awarded to the producer that achieves the highest performance metric. The contract is awarded to the producer that achieves the highest performance metric.	Fixed/Fee Metric: The contract is awarded to the producer that achieves the highest performance metric. The contract is awarded to the producer that achieves the highest performance metric.
Long-Term Viability	Outcome-Based: The contract is awarded to the producer that achieves the highest performance metric. The contract is awarded to the producer that achieves the highest performance metric.	Fixed/Fee Metric: The contract is awarded to the producer that achieves the highest performance metric. The contract is awarded to the producer that achieves the highest performance metric.
Reward/Incentive	Outcome-Based: The contract is awarded to the producer that achieves the highest performance metric. The contract is awarded to the producer that achieves the highest performance metric.	Fixed/Fee Metric: The contract is awarded to the producer that achieves the highest performance metric. The contract is awarded to the producer that achieves the highest performance metric.

PAY FOR PERFORMANCE TOOLKIT
CONTRACT TERMS & GUIDANCE

Environmental Incentives

Guidance Document: Pay for Performance Contract Terms and Guidance

Provides guidance and tailorable contract and payment terms specific to pay for performance contracts. Also, provides necessary components to include in pay for performance solicitations.

Technical Brief: Pay for Performance Strategies for Western States

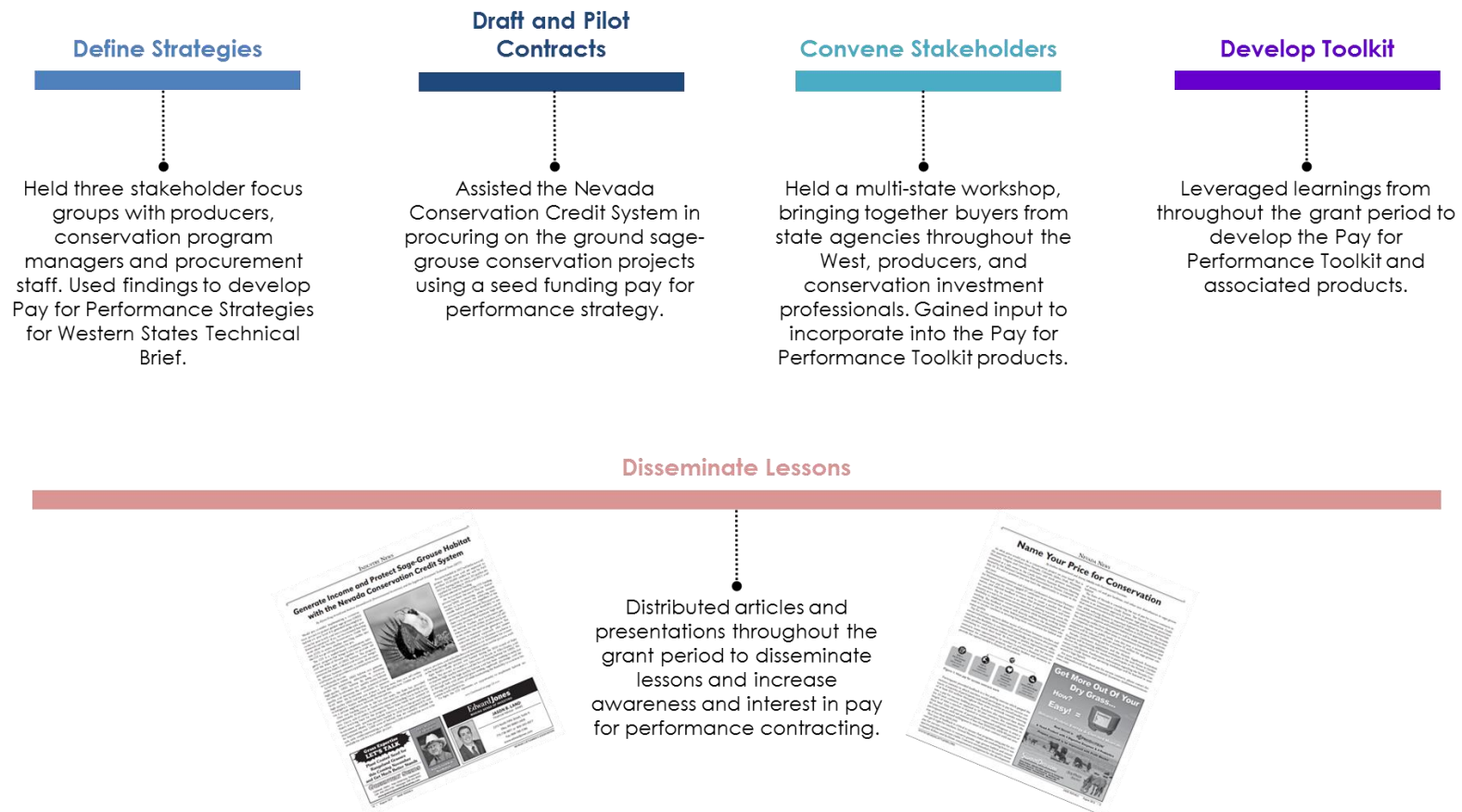
Describes four pay for performance strategies in relation to a set of factors that help buyers determine the context in which pay for performance strategy is likely to be successful.

TECHNICAL BRIEF
PAY FOR PERFORMANCE STRATEGIES FOR WESTERN STATES

Environmental Incentives

PROCESS

Throughout the grant period, the project team solicited information and input from key audiences in order to develop tools and resources that fulfill needs of state agency and private buyers. The process began with the team defining an assortment of pay for performance strategies with input from key stakeholders and then assisting the State of Nevada to solicit sage-grouse conservation projects using a seed funding pay for performance strategy. The team then convened key stakeholders for a 2-day workshop in Reno, Nevada to further hone in on the needs and perspectives of buyers, producers and other conservation professionals. The input received throughout the grant period and during the workshop was used to inform development of the Pay for Performance Toolkit. Throughout the grant period, various articles, publications and presentations were delivered in order to disseminate the lessons learned and create interest in pay for performance.



OUTCOMES

The Nevada Sagebrush Ecosystem Program (SEP) utilized a seed funding pay for performance strategy to solicit \$2,000,000 in sage-grouse habitat conservation projects in 2016 and 2017. A portion of this seed funding procurement strategy was designed with funding support from this Conservation Innovation Grant. The seed funding contracts defined payments associated with key milestones, rather than reimbursement of costs as typically seen in traditional agreements.

Reimbursement of state funds and purchase of credits by mitigation buyers are based on

credits generated under the seed funding contracts. This seed funding strategy, as illustrated below, incentivized producers to maximize environmental outcomes at the lowest cost, allowed the SEP to fund the projects expected to generate the greatest number of CCS credits per dollar of state funds, and minimized financial risk and outcome uncertainty for the state.

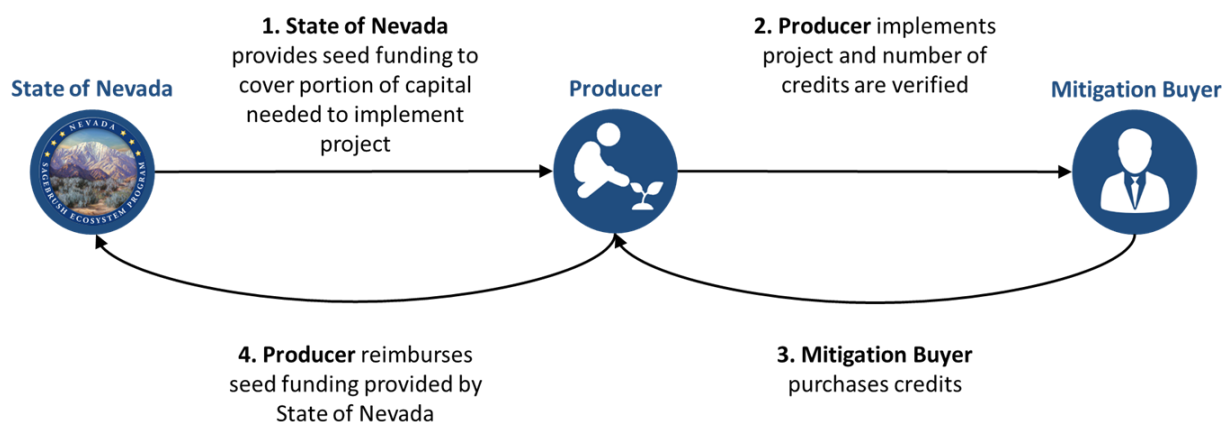


Figure 6: Illustration of pay for performance procurement strategy utilized by the State of Nevada (Source – [State of Nevada Conservation Credit System 2017 Performance Report](#))