

CALIFORNIA OCEAN PROTECTION COUNCIL

Staff Recommendation
February 8, 2007

California Fisheries Fund - Capitalization

Developed By: Marina Cazorla and Becky Pollock

RECOMMENDED ACTION: Consideration of the California Fisheries Fund and possible 1) determination that it is a high priority project and 2) authorization for the council's Secretary to take actions needed to provide \$2,000,000 for its capitalization and implementation.

NEAREST OCEAN or COASTAL LOCATION: Statewide

AGENCY OR ENTITY RECOMMENDING PROJECT: State Coastal Conservancy and Environmental Defense

EXHIBITS

- Exhibit 1: [California Fisheries Fund Business Plan](#)
 - Exhibit 2: [September 2005 planning grant staff recommendation](#)
 - Exhibit 3: [Shorebank Enterprise Pacific success stories](#)
 - Exhibit 4: [Letters of Support](#)
-

RESOLUTION:

"The Ocean Protection Council finds pursuant to Sections 35600 *et seq.* of the Public Resources Code that the California Fisheries Fund, as herein described, is of high priority for ocean conservation and authorizes the Council secretary to take actions necessary for its implementation, including the allocation of \$2,000,000 in capitalization funds, provided that matching funds of at least that amount have been secured from non-state sources within one year."

PROJECT DESCRIPTION:

The proposed project would capitalize the California Fisheries Fund ("Fund") with a \$2,000,000 seed grant, provided that additional capitalization funding is obtained from other grants, private investment, or low-interest loans from private foundations. The Fund would offer loans to California fishing communities, groups, associations, and businesses to assist them with a transition to more environmentally and economically sustainable fishing practices and

CALIFORNIA FISHERIES FUND CAPITALIZATION

governance, where conventional investment capital or loans from traditional financial institutions are not available. Examples of potential projects that could be supported by the Fund include projects that: promote the transition to gear types that have less impact on bottom habitats and reduced bycatch rates; reduce fishing capacity in overcapitalized fisheries; support planning and implementation for management reforms for a particular fishery; improve marketing for sustainable seafood products or create sustainable seafood products that qualify for certification; or support fisheries-supporting infrastructure. The Coastal Conservancy will consider this project at its March 8, 2007 meeting, and is expected to authorize a grant to Environmental Defense to implement it.

Background

The California Fisheries Fund concept was developed by Environmental Defense in response to the lack of capital available for financing improvements in fishery management, processing, and marketing that could enhance conservation, profitability, and viability of fishing communities. Conventional sources of financing have not filled this gap for several reasons, including a lack of fisheries expertise, a lack of information to evaluate risk, and regulatory uncertainty. The Fund would provide a model for investment in California's fisheries, generate information that could be used to develop more robust analyses of cash-flow under various kinds of management regimes, produce data that could be used to assess risk and potential returns, and rationalize fishery management to stabilize the supply of seafood and improve conservation and economic performance, all of which are essential attributes of an investment opportunity that could attract private capital.

In September 2005, the OPC and Coastal Conservancy approved a planning grant to Environmental Defense, which resulted in the recently finalized California Fisheries Fund Business Plan (Exhibit 1). The Business Plan, which was presented to the council in November 2006, anticipates that a seed investment of \$2,000,000 can be leveraged into a much larger loan fund, using public and private sources of capital, so that it can pay its own administrative costs while continuing to invest in fisheries. It is envisioned that the state's leadership will attract other investors. Smaller loan funds would probably not be sustainable, and could not revolve because most or all of their capital would be tied up in a few investments. Mechanisms like the Fund will help address the scale of available financial resources to more closely match the scale of ocean management and conservation problems.

California Commercial Fishing – Regulatory and Economic Context

Commercial fishing has been an important part of California's history, economy, and culture, and continues to supply seafood to the state, the nation, and the world. However, many fisheries have suffered from boom-and-bust cycles or steady declines in fish landings, revenue, and employment. While some fisheries have flourished, overall commercial fishing in California has suffered a severe decline over the last 30 years due to fishing pressure and a variety of regulatory, economic, and environmental factors.

Managing fisheries as commons, where everyone has the same right to fish, presents individual fishermen with a strong incentive to beat others to the catch, known as the race to fish. Leaving

CALIFORNIA FISHERIES FUND CAPITALIZATION

fish in the sea to reproduce for the next season means it may be taken by another fisherman. Consequently, fishermen invest in vessels and equipment to better compete in harvesting from ever-dwindling fish stocks. The absence of incentives to leave fish in the water has resulted in overexploitation of many fisheries, and because of the race to fish, fish populations struggle while fishing fleets are larger and more expensive to operate than is necessary to harvest.

Many California fisheries, such as the nearshore, sea urchin and crab fisheries have become increasingly constrained in recent years. The precautionary harvest control rules embedded in the Nearshore Fishery Management Plan have reduced allowable catches in the live fish fishery. Very large areas have been closed to rockfishing to help recover these slow-growing stocks. These regulatory changes have made it difficult for many fishermen to make a living, and for ports to maintain revenues needed to support fishing infrastructure. As a result of all these factors and more, the fisheries and working harbors of California have become fragile – their health linked to increasingly stringent and changing fishing regulations, declining or highly variable fish landings, and reduced revenues. These factors in turn tend to discourage new investment and new business initiatives that are related to fisheries.

Many worthy ocean research, conservation and management projects will require grants, as they cannot generate revenue. However, investments in the state's fisheries tied to changes in management and markets could generate much higher economic returns to the state, while improving the conservation performance of fisheries (e.g., better compliance with allowable catch levels, lower bycatch and waste, reduced impacts on habitats). This conclusion is based on dozens of scientific papers, the local knowledge of experienced fishermen, and empirical evidence from hundreds of fisheries.

The transition to fisheries that generate more revenue, engage in less conflict, and protect ocean habitats and ecosystems will require strategic investments. The capacity to generate increased revenue from fisheries as a result of management improvements presents an opportunity for creating a sustainable source of financing for fisheries management. Smart investments in fisheries have the capacity to pay back investors, creating the foundation of a revolving fund that can attract private capital and invest in fishery after fishery. This is a way to leverage an investment by the state that would be aimed at rewarding and helping fisheries willing to transition and at proving the concept to attract private capital. This project may therefore provide incentives for fisheries governance reform while conserving marine resources through changes in fishing practices, both of which are goals of the OPC.

A new approach to fisheries management holds the promise of protecting our fish stocks for future generations of Californians. The Fund could transform the way we manage fisheries and better engage fishermen in the preservation of flourishing fish populations.

Scope of Project Work

As outlined in greater detail in the California Fisheries Fund Business Plan (Exhibit 1), the fund would be established in two phases:

- Start-up (2007-2010) designed to demonstrate success in three targeted fisheries;

CALIFORNIA FISHERIES FUND CAPITALIZATION

- Expansion (2011) taking the Fund to full operating scale and working with additional fisheries (estimated 10-12 fisheries, depending on specific attributes and needs of candidate fisheries)

The Council would seed the capital base of the Fund with its \$2,000,000 grant, which in turn will be used to leverage an additional \$6,000,000 in capital from private resources for a total of \$8,000,000 in start-up capital for the start-up (pilot) phase. Of this amount, \$5,000,000 would be grants (including the OPC grant), and the remainder loans, including low-interest program related investments (PRIs). Upon successful demonstration of reform strategies during the start-up phase, an expansion phase of capitalization would occur, with the ultimate goal of \$17,000,000 in total fund capital. The Fund is based on a principle of risk-sharing with participating fisheries and will incorporate repayment terms and loan loss reserves that reflect the uncertainty and risk associated with fish populations, management, and overall successes. The Fund has been carefully designed to address and manage these various types of risk.

The three types of projects envisioned to be eligible for Fund loans are:

1. **Fishery Foundation Loans** – These loans would be made to existing organized fishing cooperatives or other entities representing a single seafood product or geographic area that have the ability to leverage assets and have repayment mechanisms in place. The loans would be used to support development of detailed reform plans for their fishery, including fishery research, science, business planning, and implementation planning. Entities receiving these loans would hold the funds in “Fishery Foundations.” The availability of funds is likely to attract fishing groups interested in transforming their fisheries into sustainable fisheries.
2. **Infrastructure Loans** – Loans of this type would be made to ports, communities, and other organizations that support fisheries reform but require infrastructure investment at the fishery level. For example, infrastructure improvements could include increased off-loading capacity, ice machines, minor cold storage, or processing.
3. **Business Loans** – These loans would finance efforts by individual businesses to add value to seafood or achieve other goals consistent with the purposes of the Fund, such as equipment change, product innovation, or marketing development.

As grantee, Environmental Defense will incubate the Fund during its start-up phase. It is anticipated that after a successful performance over the first three years, the Fund will be established as a stand-alone non-profit organization. To ensure sound and prudent management of the investment process and loan portfolio, Environmental Defense will contract for services from ShoreBank Enterprise Pacific, an accredited Community Development Financial Institution, which will act as Fund Manager. These fund management services will include underwriting the credit process, loan portfolio management, and risk management.

An annual third party audit of the Fund’s financial performance will be required.

Environmental Defense responsibilities will include:

CALIFORNIA FISHERIES FUND CAPITALIZATION

- Oversee and manage all aspects of start-up and operations
- Lead development and implementation of capitalization strategy
- Advise on and contribute to development of an investment pipeline
- Assure loans are consistent with criteria associated with each source of loan fund capital
- Establish committees to advise on program development and provide general oversight (see Advisory Committees below)
- Develop and submit reports on progress with mission impacts and business performance.

ShoreBank Enterprise Pacific responsibilities will include:

- Underwriting
- Credit recommendation
- Staffing support to Fund Credit Committee
- Loan closing and servicing
- Risk Management
- Compliance management
- Portfolio management

Advisory Committees

For oversight and participation with the Fund, two committees will be established.

The Fund Advisory Committee (FAC) will focus on general oversight of the Fund during the three year project start-up phase. The FAC will develop recommendations for Fishery Foundation loans, will vet all Fishery Foundation loan applications, and provide recommendations for approval prior to review by the Fund Credit Committee. The FAC will not control the finances of the Fund or make final decisions with respect to loan approvals or rejections. It is expected the FAC will include between eight to ten members and have appropriate representation of various stakeholders including fishermen, management agencies, industry groups, nongovernmental organizations, and community representatives. Two FAC positions will be reserved for state staff. The grantee will identify and appoint all other FAC members and provide staffing support to the FAC. A majority of FAC members will not be employed by the grantee.

The role of the Fund Credit Committee (CC) would be to review and approve all loans made by the Fund. All CC appointments are the responsibility of Environmental Defense, with ShoreBank Enterprise Pacific providing assistance with identification of experienced individuals for consideration as CC members. Members of the CC will have an understanding of conservation issues and community development lending. ShoreBank Enterprise Pacific would provide staffing support to the CC.

All major decisions will be made by the FAC, CC, and ED, as the Fund's governing bodies. Prior to entering an agreement with the grantee, OPC staff will define "major decisions," including under what circumstances the Fund should terminate and the process by which money remaining in the Fund should be disbursed.

Project Participants

CALIFORNIA FISHERIES FUND CAPITALIZATION

Environmental Defense (ED) is a nonprofit organization that is well suited to undertake this project. It originated the fisheries revolving loan concept and has conducted extensive research on fisheries management, with a focus on the linkage between economic incentives, financial performance, and conservation performance. Environmental Defense will work with ShoreBank Enterprise Pacific to manage the Fund.

ShoreBank Enterprise Pacific is a non-profit community development financial institution that invests in people and their communities to create economic equity and a healthy environment. It has invested over \$30 million in 245 ventures throughout the Pacific Northwest over the last decade. Shorebank has invested in business, social, and civic ventures that represent new strategies for economic security and ecological health, and has provided expert advice in matters concerning business strategy, non-profit organizational capacity, new product development, and real estate development. Their capital investments and services have affected more than 1,500 jobs, and leveraged an additional \$20 million in investment by others. As a coastal institution, it has developed extensive expertise and experience with west coast fisheries. ShoreBank Enterprise Pacific's successful fisheries investments (Exhibit 3) have been aimed at improving both conservation and financial performance through a blend of policy expertise, knowledge of fisheries and markets, and a commitment to the triple bottom line: social equity, economic prosperity, and a healthy environment.

PROJECT FINANCING

Possible Funding Sources:

Ocean Protection Council/Coastal Conservancy	\$2,000,000
Sources to be identified by grantee	<u>\$6,000,000</u>
Total start-up capital (2007-2011)	\$8,000,000

Staff anticipates that this project will be funded by tidelands oil funds appropriated to the Secretary for Resources in FY 04/05 for projects authorized pursuant to the Ocean Protection Act. The Resources Agency has entered into an interagency agreement with the Coastal Conservancy to administer these funds on behalf of the Council and recommend projects for funding. These funds are to be expended by the Conservancy in concert with the Council for programs and projects that the Council finds to be of high priority. If authorized by the Council, Conservancy staff will recommend a grant of \$2,000,000 to Environmental Defense for consideration at the Conservancy's next public meeting on March 8, 2007.

The grantee may not use more than 15 percent of the State's grant for administrative costs of operating the fund.

Risk

The business plan outlines the risk involved in the proposed project. When Environmental Defense secures \$2,000,000 in non-state funding, thus triggering the state's matching funds, ED will need to obtain another \$1,000,000 in grant funding and \$3,000,000 in program related investments to reach the full capitalization amount of \$8,000,000. If ED does not secure the

CALIFORNIA FISHERIES FUND CAPITALIZATION

matching non-state \$2,000,000 by March 30, 2008, this OPC authorization will lapse. ED may at that point return to OPC for an extension.

If the governing bodies decide to terminate the Fund based on the conditions determined in the grant agreement after the State has disbursed funds, the State shall be reimbursed the balance of \$2,000,000 less any expenditures made in loans or other allowable costs in proportion to the amount invested in the Fund by other entities.

There is a risk that, despite the best efforts of the ED team, Fund loans will not achieve the desired results. The Fishery Foundation Loans are the riskiest of the three types of loan products. While the reserve ratio for these loans is deliberately very conservative, there is a risk that these unsecured loans will not be repaid.

Although high risk, the benefits of a successful California Fisheries Fund are substantial. If even one of California's fisheries is transformed in the way the Fund envisions, California will have made a solid investment. Moreover, the team ED has assembled is impressive. It includes ShoreBank Enterprise Pacific, the University of California at Santa Barbara, and the National Center for Ecological Assessment and Synthesis (funded primarily by the National Science Foundation). This team has already received \$500,000 in grant funds to be used to help pay the administrative costs associated with starting up the California Fisheries Fund.

CONSISTENCY WITH OCEAN PROTECTION COUNCIL STRATEGIC PLAN: The project is consistent with Section II, Priority Goals and Objectives, Goal E, Objective 4 of the OPC Five-Year Strategic Plan (adopted by the Council in June 2006) which states that OPC “will support innovative approaches to fisheries management by working cooperatively with fishermen and their communities and applying market-based approaches.” It also consistent with the Action identified to implement this objective, which is to “develop a California Fisheries Fund or similar strategy that will facilitate a transition to improved fisheries management and sustainable fishing practices, including new fishing techniques to reduce bycatch.”

The California Ocean Protection Act specifically authorized use of funds for “the creation of revolving loan programs for the purpose of implementing sustainable fishery projects.” [Public Resources Code §35650(b)(2)(B)]