



PROCUREMENT DOESN'T NEED TO BE A CHOKER POINT

Examples and recommendations for non-legislative
pathways to state Pay for Success contract authorization



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Housed within the Environmental Policy Innovation Center (EPIC), the [Restoration Economy Center](#) envisions a world where environmental restoration outpaces environmental impacts. We champion pathways to achieving greatly scaled environmental restoration outcomes.

The mission of EPIC is to build policies that deliver spectacular improvement in the speed and scale of conservation. We focus on a narrow set of strategies:

- Improving policies that allow private sector funding or stewardship to expand or supplant public or charitable conservation work
- Transforming government policies to focus on what matters—outcomes
- Eliminating the organizational barriers that prevent public agencies from adapting to 21st century solutions

We believe that innovation and speed are central to broadening efforts to conserve wildlife, to restore special natural places, and to deliver to people and nature with the clean water they need to thrive. To achieve those goals, conservation programs must evolve to accommodate our modern understanding of human behavior and incentives and the challenges posed by humanity's expanding footprint. We embrace experimentation with novel ideas in conservation policy, to learn quickly from mistakes and iteratively design effective approaches to be even more successful.

EPIC is a fiscally sponsored project of Sand County Foundation. Sand County Foundation is a nonprofit conservation organization dedicated to working with private landowners across North America to advance ethical and scientifically sound land management practices that benefit the environment.



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EXECUTIVE SUMMARY

States are major funders of ecological restoration, and they usually pay for that restoration through traditional procurement methods or by issuing grants. These approaches often involve arduous procurement and contract management processes for both the contractors and government staff, and don't guarantee the success of project delivery. However, some states have adopted [Pay for Success](#) contracting (PFS), [also known as](#) pay for performance or outcomes-based contracting, which is a procurement strategy that defines desired outcomes and invites the private sector to deliver those outcomes in advance of payment to ensure that only successful projects are funded. This paper highlights state Pay for Success efforts that did not require legislative action and makes recommendations for states interested in adopting Pay for Success programs through similar means.

Particularly, we explore:

- 1. The California Department of Water Resources Lookout Slough Project and recent efforts to proliferate PFS,**
- 2. North Carolina's Division of Mitigation Services In-lieu fee programs, and**
- 3. Washington state's in-progress discussions to issue their first state environmental PFS pilot program.**

Depending on state statute and the political landscape, sometimes legislation is required or highly encouraged for effective program adoption. The Restoration Economy Center's previous paper, [Purchasing Environmental Progress](#), focused on such legislative efforts.

Nationally, very few states are using PFS contracts for environmental outcomes. More often than not, states that have forayed into PFS have done so with social programs like pre-K education initiatives or recidivism reduction efforts. However, over the last few years there has been an uptick in the use of PFS for environmentally beneficial projects. We hope this paper helps proliferate this innovation in contracting, making ecological restoration projects faster, more cost-effective, and easier to manage for government agencies.

Recommendations for how your state can begin exploring PFS is provided under the *Learning More & Initial Investigations* section below.



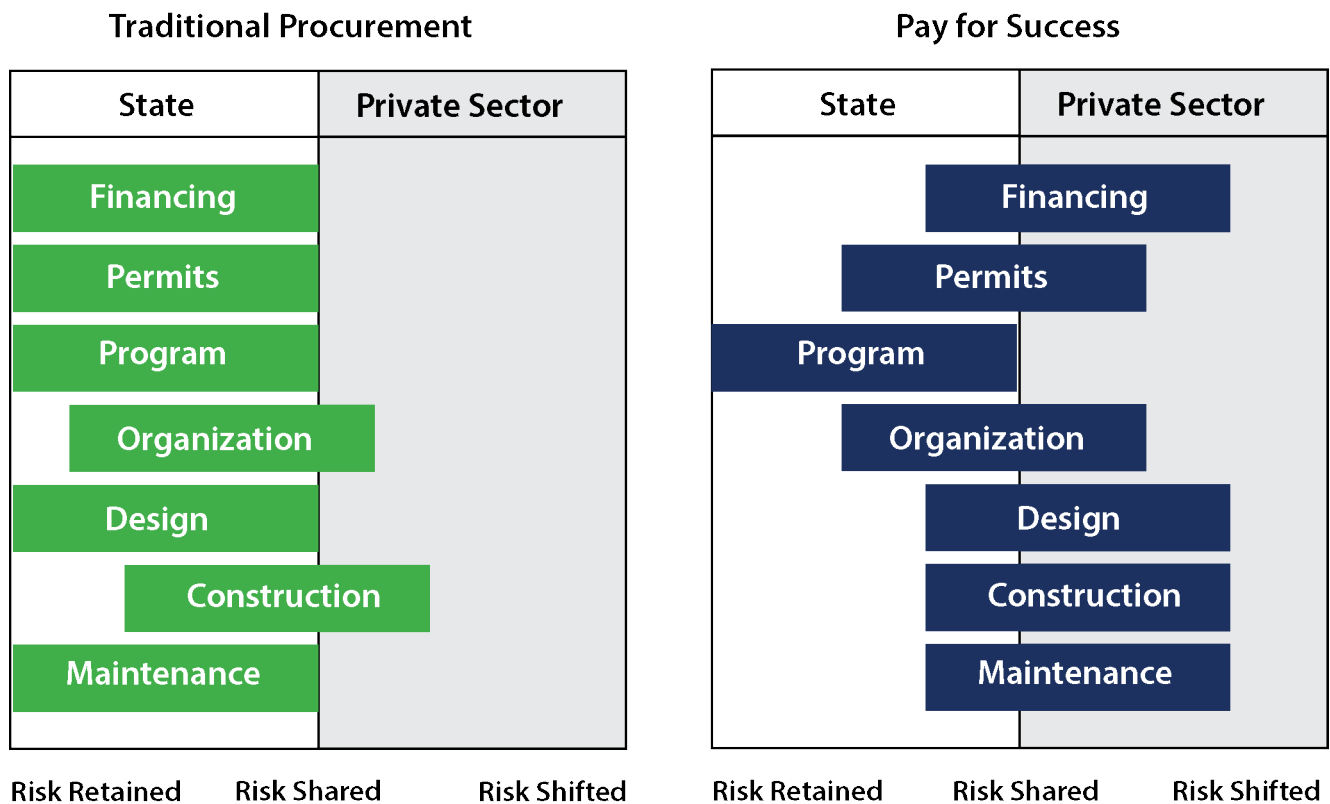
INTRODUCTION

[Pay for Success](#) contracting (PFS), also known as pay for performance or outcomes-based contracting, is a procurement strategy that defines desired outcomes and invites the private sector to deliver those in advance of payment to ensure outcomes are achieved. Instead of traditional invoicing and payment that happens on a regular basis (monthly, quarterly, etc.), a significant amount of the total payment for Pay for Success contracts is paid only when the project has been completed and verified outcomes have been measured or modeled, often by a 3rd party evaluator. This helps create positive economic pressure, allows the private sector to take on the risk of achieving project outcomes, and ensures that funding goes as far as possible. Payments are based on delivery and verification of outcomes, rather than on time and materials.

Currently, most government procurement works by issuing separate contracts to designers, builders, maintenance, etc. using the [design-bid-build](#) procurement process. This puts the government employees in the role of closely monitoring projects, where they hire out and oversee all contractors, using a significant amount of staff time to ensure projects move forward. Under-staffed and under-resourced local and state departments mention struggling to keep up with this work, a challenge only exacerbated by the huge influx of restoration dollars through recent federal legislation.

Using this traditional method, there are no guarantees that funded projects will succeed. Payments for design-bid-build projects are awarded throughout the project rather than upon delivery of successful outcomes. These projects are broken up into smaller contracts, one for the design, and another for construction elements. It is entirely possible for intermediate steps to be achieved, but for final project goals to remain unmet. This increases risk to taxpayers and keeps the majority of the responsibility for project implementation and success (or failure) on the government.

Figure 1: Risk Transfer¹



¹ Adapted from the [Clean Water Partnership](#)

Benefits

Not only are PFS contracts only paid out upon delivery of successful outcomes, thus reducing the risk to taxpayers, there is evidence that this innovation takes significantly less time. In Florida, traditional procurement has taken up to three phases funded over 16 years, compared to a new PFS contract that is shaving off a decade from the process.² Not only are they faster, they can also be cheaper. RFPs in Maryland show PFS contracts costing one third of past procurement, and a recent analysis done by UCLA Luskin School of Public Affairs graduate students show up to a 63% cost savings over 5-years. PFS contracts often can capitalize on economies of scale, by doing larger (or more) projects in one fell swoop.

Current Challenges

Dozens of interviews and analyses of state statute across the country indicate that the biggest challenges to PFS adoption come from insufficient government staffing capacity and a lack of expertise and confidence in trying out such approaches. Most states do not require legislative action or statutory amendments, rather just a change in practice by relevant agency staff.

Specifically, the challenges that bubble up to the surface tend to be:

- 1. Limited agency staff capacity.** Swapping to a new contracting method requires up-front investment in learning a new process, drafting new contracts/RFPs, legal reviews, etc. Agency staff workloads prevent them from “taking on anything extra” (in their words), even if it would be a major time and energy saver in the long run. These agencies want to be more efficient, but don’t have the capacity to adopt new approaches.
- 2. Lack of in-house knowledge.** Administrative staff, state lawyers, ecologists, and environmental department leads are not familiar with outcomes-based procurement in the environmental sector. There’s general apprehension around the idea. The limited capacity mentioned above means that staff do not have time to learn about new contracting methods, even if those methods could reduce the workload.
- 3. Maintaining the status quo.** Change is difficult for many government agencies to accommodate. In some government employees’ eyes, maintaining the status quo is preferred because it is a known approach that is perceived as preventing public backlash and prevents project failure.



Pathways to Adoption

Despite existing challenges, states are beginning to overcome the activation energy needed to execute PFS contracts. It has become increasingly prevalent over the last three to five years. State programs interested in adopting PFS contracts for environmental outcomes can explore two avenues to do so.

1

The first is taking legislative action. By enacting an explicitly clear law, like [Maryland's Conservation Finance Act](#), state agencies get the green light to move forward. Having this explicit permission in state statute removes much of the apprehension government agency staff may have without clear authorization. The risk associated with going out on a limb to try something innovative is largely mitigated.

Even federally, this approach is gaining momentum. In the past two years, three separate bills have been introduced that include outcomes-based environmental procurement elements. Most recently, the [Protect the West Act of 2023](#) definitively calls out Pay for Success contracts as an authorized method.

To learn more about examples and recommendations under this pathway, see EPIC's previous publication, [Purchasing Environmental Progress](#). This paper reviews eight state case studies that underwent, or are primed to undergo, legislative action for environmental contracting reform.

2

The second, which this paper focuses on, is practice changes. If a review of the statute confirms that PFS is legal under current state law, environmental agencies can work internally to shift towards outcomes-based procurement without taking legislative action.

The following section of this paper walks through three examples of this non-legislative pathway to adoption, one of which is currently underway.

It is important to note that legislation can still be very helpful to the proliferation of innovative procurement structures, even if it is already completely legal without it. Two of the three states featured here are considering legislation as well.

Why would they do this? Big hurdles to restructuring government contracts are personal attitudes, preconceived ideas, and inertia of government agencies as mentioned above. Legislation helps give the official green light, sometimes requiring agencies to execute a contract via a pilot program, which helps overcome these barriers.

Urgency

The Infrastructure Investment and Jobs Act ([IIJA](#)) will send as much as \$9.8 billion flowing toward ecological restoration through projects like dam removals, abandoned mine remediation, salmon recovery, and stormwater management over just five years. Overall, the IIJA authorizes over \$1 trillion in funding, of which \$550 billion is new spending. This money will be distributed across federal agencies, trickling down through a variety of pathways including existing state programs. While the IIJA presents a funding influx that alleviates a major barrier to restoration efforts; the long and complicated traditional government procurement approaches will not be sufficient to spend these funds at the speed and scale this act, and the climate, clean water and endangered species crises, necessitate. We need innovative strategies, like Pay for Success, to deliver these outcomes or risk losing the money to the tight spending timelines.

The three case studies below are state programs that can expedite the expenditure of federal funding through existing innovative procurement pathways.

CASE STUDIES



CALIFORNIA

The California Department of Water Resources (DWR) has led the way for the state's effort in performance-based contracting without explicit authority written in statute. DWR has successfully contracted for three projects through a pay-for-success model, the most complex effort known as [Lookout Slough](#) which is a large-scale habitat restoration and flood improvement project. This effort will provide the state with high-quality Delta Smelt habitat to help the state meet the requirements of an [Endangered Species Act biological opinion](#). DWR used the biological opinion crediting model to define habitat criteria which then the private sector could propose projects to meet.

The restoration firm Ecosystem Investment Partners (EIP) is under contract to provide DWR with full-delivery of this effort through a PFS model. Under this model, DWR has contracted with EIP to deliver units of habitat for a fixed price. EIP's responsibilities under the contract include land identification, land acquisition, restoration design, permitting, construction, posting financial assurances, and monitoring through final approval of as-built results. DWR provided oversight and support on the schedule, and in some cases led coordination with regulatory agencies.

The contract provides nearly 40% of DWR's required biological opinion compliance by providing habitat restoration that offsets impacts from State Water Project operations to the endangered Delta smelt and other species of concern in the Sacramento-San Joaquin Delta. The State Water Project is one of the largest public water and power utilities in the world, providing water for more than 23 million people. The restoration of tidally influenced wetlands at Lookout Slough also creates 40,000 acre-feet of water storage to prevent dangerous flooding and protect neighboring communities and infrastructure and is consistent with the State's Central Valley Flood Protection Plan.

While not authorized in state statute, DWR has deemed PFS a viable contracting method and has successfully completed two smaller habitat restoration projects using the same model in 2018 and 2020. While California does not have explicit PFS authority, DWR and California Natural Resources Agency worked with the Department of General Services to create this new hybrid template (first of its kind contract).

As Wade Crowfoot, California's Secretary of Natural Resources succinctly put it, "Winning slowly is still losing. We're still losing if we're winning in tiny bites. We need to be doing much bigger things faster."

The success of these efforts is built on the following foundation:

- 1. Support from the top.** DWR and California Natural Resources Agency leaders have been supportive of state government innovation to accelerate environmental outcomes.
- 2. Solutions-oriented mindset.** In the face of obstacles, agency staff considered challenges with a solutions-oriented attitude and a willingness to try creative solutions. This was key to the success of this initiative. DWR recognizes the urgency of the environmental challenges they face. They know that not doing anything, or acting too slowly, isn't an option.
- 3. Clear Roles and Responsibilities.** Trust based on good communication and clear roles and responsibilities between DWR and the contractor(s) has helped create a model that can be built upon.

DWR is currently negotiating additional contracts for enhancement and grant funded projects using this method based on their previous success, and considering the need for legislation to help spread the use of PFS contracts throughout the state. EPIC has been assisting by answering questions, brainstorming solutions, conducting initial legal reviews of state statute, and providing template legislation language.










NORTH CAROLINA

To many professionals in the restoration field, North Carolina is viewed as the progenitor of environmental Pay for Success. The state’s Division of Mitigation Services in-lieu fee (ILF) programs purchase environmental outcomes to enable environmentally responsible economic development. These state-wide programs are designed to help both private and public entities meet stream and wetland mitigation requirements under the federal Clean Water Act, using a watershed approach to maximize the environmental returns of mitigation investments.

In-lieu fee programs aggregate funding from permittees (e.g., private companies, transportation agencies, etc.) who need to offset their impacts to wetlands, streams, riparian buffers, or water quality. Funds are used to carry out restoration projects in the same watersheds (Huc8 in this case) in which the impacts are occurring. Because ILF programs aggregate funding, they can create larger and more ecologically beneficial restoration than one-off restoration projects. ILF restoration credits also transfer legal liability of restoration success from the permittee to the ILF program.

North Carolina’s decades-strong programs have restored and/or protected over [4.2 million feet of stream and 29,000 acres of wetlands](#), allowing the creation of over 7,000 development projects like community infrastructure and housing developments. When stream or wetland credits are unavailable from mitigation banks in an area, a permittee can submit a request for mitigation from the state ILF. After collating these requests, the [DMS determines](#) where and how much mitigation is needed.

Mitigation Completed via DMS’s ILF (2000-June 2023)

	Stream	4,278,572 feet
	Riparian Wetland	15,957 acres
	Non-Riparian Wetland	13,954 acres
	Coastal Marsh Wetland	508 acres
	Riparian Buffer	82,766,825 square feet
	Nitrogen	1,545,153 pounds
	Phosphorus	15,668 pounds

Data provided by the NCDEQ

*Components of North Carolina’s In-lieu fee programs were also featured in EPIC’s previous report, [Purchasing Environmental Progress](#). The below programs were created via legislative authorization; however, the specifics of their Pay for Success elements (outlined below) were not.

“Prior to the formation of the Ecosystem Enhancement Program (now named the NC Division of Mitigation Services), Over 40% of all NCDOT transportation projects were in delay due to mitigation issues. Since 2003, NCDOT has not experienced a single transportation project delay due to mitigation.”
-Jim Stanfill, Deputy Director of NCDEQ Division of Mitigation Services

The PFS aspect of the ILF programs lie in the way the Division of Mitigation Services creates ILF credits. The majority of the state’s cumulative [\\$601 million in contracting](#) for their ILF is for full delivery of restoration outcomes (\$398 million, or 78%), and another \$5.6 million (1%) is the purchase of outcomes from mitigation banks.

The ILF programs create strong demand for restoration outcomes, and provide an easy way for permittees to comply with mitigation requirements. For example, the North Carolina Department of Transportation (NCDOT), the largest buyer of ILF restoration credits (at one point up to [85%](#)), claims the ILF has resulted in higher quality restoration as well as faster project timelines, which both NCDOT and the regulator appreciate.

While the establishment of the Division of Mitigation Services is in [state statute](#), the decision to use Pay for Success was done without legislature involvement. These conversations were held in the late 1990s through the early 2000s, so much of the nuance to this story is not digitally documented. However, through a series of interviews, EPIC captured the essence of the underpinnings of this innovation.

In the year 2000, Governor Easley was elected, beginning his term in January 2001. Easley began a dialogue with the Department of Environment and Natural Resources (now named the Department of Environmental Quality) and the Department of Transportation to rethink how compensatory mitigation works. At the time, NCDOT’s transportation program was stalled, NCDOT was operating its own permittee responsible mitigation program. Every permit was resolved using a case-by-case mitigation approval framework with the regulatory agencies. Over 40% of transportation projects were being delayed due to lack of mitigation.

This delay, and dissatisfaction of Governor Easley, led to a cross-agency effort including NCDOT, The Army Corps of Engineers, The Department of Environment and Natural Resources, and others to rework how mitigation is conducted. Meeting frequently over a two year period, consensus was reached in the summer of 2003. Today, private





*Jim Stanfill. In-Lieu Fee Mitigation: A Review and History in North Carolina.
Used with permission.*

development is also eligible to meet their compliance needs as well.

This [Memorandum of Agreement](#) was signed by the involved parties. It did not pass through the legislature or require any additional approvals, and began the 'Ecosystem Enhancement Program', which is essentially still intact today.

Based on a series of interviews, there are a few keys to the success of this effort:

- 1. Support from the top.** Governor Easley really pushed this forward, essentially ordering the Department of Environment and Natural Resources and NCDOT to come together to find a new solution. This support kept the initiative moving forward.
- 2. Inter-agency cooperation.** Stakeholders from multiple agencies came together regularly for productive dialogue. By involving all relevant parties from the beginning, the solutions that worked for everyone emerged.
- 3. Ability to issue contracts.** Before this effort began, the state Department of Administration had already given approval for the Division of Mitigation Services to issue their own contracts in the late 90s. This authority cut through the red tape, streamlining the procurement process on the back end. It is unclear whether or not this was a formal process DMS went through, or if it was more of an informal approval.



WASHINGTON

The state of Washington has many state agencies who work on environmental projects (Department of Ecology, Department of Fish and Wildlife, Puget Sound Partnership, Recreation and Conservation Office, Department of Natural Resources, and others). This distribution of resources creates a hefty challenge for grantees, who must combine funding from upwards of 10 grants from various sources to get a project in the ground. Different agencies have different reporting requirements, timelines, etc. which according to practitioners means it can take over a decade to complete a project. This creates an immense administrative burden to the grantees and headaches for the managing state agencies as well.

This struggle is further complicated by the immense amount of cash coming into the state through the Infrastructure Investment and Jobs Act and the Inflation Reduction Act. Hundreds of millions of newly allocated funding dollars are eligible for ecological restoration, a marked increase from years past. The capacity of staff and administrative constraints of current processes aren't currently sufficient to get this huge amount of money out the door and into high-quality projects within the designated time frame.

EPIC, along with a suite of state and NGO partners, see PFS as an important tool to solving this problem. Since January 2023, partners have been discussing the legality and potential mechanics of a PFS pilot program. Here's a breakdown of the steps taken to date:

STEP 1: Initial Conversations & Assessing Interest

EPIC has had a series of conversations with Puget Sound Partnership, Bonneville Environmental Foundation, Department of Ecology, Department of Fish and Wildlife—as well as local implementers—to strategize about whether and how PFS could lead to faster funding deployment.

Washington's priorities & big picture questions that arose from these conversations include:

- 1. How can they guarantee capturing all the federal money coming down the pike?** The state is in a “use it or lose it” scenario and certainly doesn't want to lose any of the funding.
- 2. Pay for Success can alleviate some of the state's major pain points** (long contracting timelines, different reporting requirements across agencies, streamlining permitting), but they need to figure out what outcome metrics would make sense for all parties.
- 3. If payments are held until the outcomes are verified, how will the state get the money off the state books?** There are 2-year budget cycles and future funding is not guaranteed.
- 4. Is this already legal in Washington?** Is a formal legal determination from the Office of Financial Management or the State Treasurer's Office needed to confirm?
- 5. How would this look in terms of the flow of money?** To make it easier on practitioners, and to help state agencies learn the process, the state might need to aggregate funds from multiple sources on the back end, so their application processes are easier. At least for a pilot approach until agencies are comfortable with PFS.
- 6. What sources of funding would they pull from?**

STEP 2A: Legal Review

The question of legality took precedence. If PFS isn't legal in Washington, then the rest is moot unless legislation is

**This project is currently underway. What is captured here reflects progress made as of July 2023, roughly covering a six month period. Please reach out to [Grace](#) for an update, if interested.*

passed. EPIC, private sector partners, and state agency staff all independently reviewed state statute to gather an initial impression of the legality of Pay for Success. All came to the same conclusion– PFS seems to be legal under current statute. However, we needed verification from the State Office of Financial Management that this is true in order to proceed.

Puget Sound Partnership took the lead on this effort, and have received tentative written confirmation that PFS seems to be legal. They will continue to work to secure official documentation and carry out a full review.

STEP 2B: Continued Refinement

Simultaneously, our organizations continue to check in and chip away at developing solutions and strategies that could potentially work. Bonneville Environmental Foundation has taken the lead in organizing meetings and outreach to potential pilot project locations.

The big discussion topics include (1) where the pooled funds will live, (2) the right pilot communities, and (3) defining the specific outcomes that would be purchased to satisfy multiple agencies' needs.

Like California, Washington is also interested in pursuing legislation to help give the clear, green light to state agencies. While not technically required, it will still be helpful in the proliferation of PFS by providing confidence to state agencies, especially after a successful pilot project has been completed.



LEARNING MORE & INITIAL INVESTIGATIONS INTO PAY FOR SUCCESS

If a Pay for Success approach sounds interesting and helpful for your state environmental programs, the initial steps outlined below can help assess whether legislative action is required. When in doubt, please contact [Grace Edinger](#), who can guide you toward relevant information for your specific situation.

Step 1

Conduct an initial review of state statute in order to determine how PFS is treated. Is it explicitly forbidden, permitted, or simply not referenced? Each state organizes their code in different ways, so be sure to read chapters on procurement and contracting, as well as the environmental agency's responsibilities and organization. If your state agency has the authority to buy toilet paper, computers, etc. for a fixed price, it's likely you have the authority to buy an environmental outcome. Confirm there's nothing else in statute that prevents it specifically.

Look for contracting authority language, restrictions on which agencies can issue their own contracts, etc. Most states will let you search for specific terms. We recommend searching the following list:

- Pay-for-Success
- Outcomes-based
- Pay-for-Performance
- Pay for Performance
- Pay for Success
- Full Delivery
- Alternative Delivery
- Alternative Procurement

It's very possible that no mention of PFS or its synonyms will be mentioned. That's not a bad sign. Ambiguous code language is not necessarily a roadblock to doing PFS contracting.

Step 2

If, after a review, you believe that PFS is legal, the next step is to speak to those who could implement the strategy. If you are a government employee at a natural resource agency, speak with your leadership, procurement officers, and departmental legal team. If you work outside of government, many environmental NGOs like state environmental councils have lawyers on staff who can help.

Step 3

Determine what outcomes would be most appropriate to suit the needs of potential state agency buyers. A key component of PFS is clearly defining what success means, or what specific type of outcome you want to achieve. Things like pounds of nitrogen prevented from entering waterways, impervious acres treated, tonnes of carbon, etc. are common environmental outcomes purchased through PFS contracts. Best practice tells us that these outcomes need to be either measured directly or modeled with significant accuracy.

Step 4

Develop a pilot. Starting small makes it easier to test the concept and go through one or more rounds of program iteration to tweak contract/RFP language. Begin by identifying potential funding sources.

CONCLUSION

There are many bottlenecks when it comes to getting environmental projects in the ground. Procurement and contracting doesn't need to be one of them. North Carolina, California, and Washington are exploring the use of this time- and cost-saving contracting approach for their environmental programs within existing authority. But these three examples are not exhaustive, and other states are considering PFS, too.

If you're interested in, and in a position to consider PFS for your own state program, EPIC would welcome the opportunity to answer questions, brainstorm ideas, and assist your efforts.

