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NewForests

Australia's Carbon Pollution Reduction Scheme

Implications for Forest Landowners, Investors and Regulated Entities

The proposed Carbon Pollution Reduction Scheme (CPRS) was designed to be the Australian policy response to reduce the country's emissions of greenhouse gases; however, at the end of April 2010 the Rudd government announced its delay until at least 2013. The Prime Minister cited the lack of support in the Senate and the lack of a comprehensive international agreement as the main reasons for shelving the CPRS for the time being. The move comes amidst falling public approval ratings and opponents labelling the CPRS "the great big tax on everything."

In the two years before Copenhagen, there was a growing momentum for the implementation of an Australian carbon market generating significant interest by large emitters and saw the emergence of businesses focusing on carbon. However, after passing the Lower House in June 2009 through the Government majority, the CPRS legislation was voted down by the Senate in August 2009. The CPRS failed to pass through the upper house of government for a second time in December 2009, caused by a sudden change in Liberal leadership that effectively nullified a deal that had been negotiated between Government and Opposition. In February 2010 the bill was once again put before the Senate, but debate of the bill was delayed and then cancelled with the government opting to defer it until 2013 and review the plan in light of any international agreements.

The CPRS and Forest Carbon

The CPRS is a cap-and-trade system that would incorporate most business sectors and require regulated entities (e.g. large-scale manufacturers, energy providers, etc.) to surrender permits in exchange for emitting greenhouse gases. Under the current proposal for the CPRS, the majority of these permits would be auctioned, creating an active market for permits across the range of business sectors. Initial modeling suggests that the market price for permits will increase in real terms over time due to increasingly stringent limits on emissions and the fact that the lowest cost options for abatement will be taken up first.

Forestry is included in the CPRS through a voluntary opt-in arrangement for afforestation/ reforestation projects. Project proponents will be allocated permits based on reforestation of areas that were not forested in 1990, and these permits can be used by entities to meet liabilities under the CPRS. According to the legislation as it passed the Lower House, forestry can generate tradable permits starting July 1, 2010 and can register and sell those credits at the starting date of the scheme on July 1, 2011. Forestry permits are fully bankable and can be sold in the market.

While deforestation is not covered under the CPRS, projects that avoid domestic deforestation shall be eligible to generate offsets if they follow applicable methodologies approved by the Minister. The provision to include offsets from activities that are not covered under the CPRS but that can still be counted towards Australia's international accounts was added after negotiations with the Opposition. The potential of actual offset projects will be highly dependent on the details in the future regulations.

Compliance Options through Forestry Permits

Entities facing compliance obligations can ensure a future supply of permits at a known price (determined by the underlying forestry fundamentals) by investing in forestry projects, rather than being subject to potentially large fluctuations in the market price of permits. This allows businesses to take a direct position in the carbon market, managing their compliance and market risk whilst taking part in Australia's vibrant forestry sector. The economics and carbon profiles of forestry projects depend on a variety of parameters, including land price, site conditions, tree species and management regime. These differences present unique investment options for generating carbon permits.

There are two general approaches to directly invest in the forestry sector for sourcing permits for compliance purposes:

- Commercial forestry: Sustainable tree plantations can be managed for timber production and carbon simultaneously in order to optimise overall returns from both revenue streams.
- Revegetation: Planting native species on marginal or low-production sites sequesters carbon with minimal ongoing intervention, accruing carbon with low management costs and supporting Australian environmental rehabilitation by excluding harvest.

Opportunities

The CPRS, once implemented, will provide a clear route to market for domestic carbon from reforestation activities. This new market for an ecosystem service allows landowners and land managers to incorporate this additional revenue stream to develop more sophisticated business models. Via direct investment or other commercial structures, investors and businesses can partner with landowners or undertake strategic forestry investments to provide a long-term hedge against future carbon pricing, effectively securing low-cost option values today on the carbon revenue of tomorrow. Forest landowners and managers can begin evaluating how they may benefit from taking part in the CPRS. New Forests has in-depth experience in developing commercial structures to maximise value from sustainable land management.

Apart from direct investment, New Forests particularly sees opportunities in the following:

- Commercial carbon: Co-investment in forestry via commercial structures that separate the carbon rights from forestry management can secure carbon benefits while minimizing investors' exposure to the risk from the underlying forestry markets.
- Carbon Pooling: developing structures for contracting carbon rights across landholdings, e.g. via signing up small forest owners or farmers to plant marginal tracts of land and thereby aggregating land to generate large amounts of permits.

New Forests can help capture value from forest carbon under the CPRS in a variety of ways. Specifically, landowners, investors and regulated entities may consider:

- Developing carbon strategies to benefit from inclusion of forest carbon
- Optimising returns from investments in forest carbon by designing innovative commercial structures

For a more detailed discussion or to discuss specific opportunities, please contact:

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