



Australia's Carbon Pollution Reduction Scheme *Implications for Forest Landowners, Investors and Regulated Entities*

*The proposed Carbon Pollution Reduction Scheme (CPRS) is the Australian policy response to reduce the country's emissions of greenhouse gases. 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. Currently, further debate of the CPRS has been delayed as the Senate turns its attention to other legislative priorities in the wake of the incoherent outcome of Copenhagen and diminishing public interest in climate change policy. **This New Forests Policy Note outlines key facets of the CPRS as relates to the forestry sector and presents strategic opportunities for forest landowners, investors and regulated entities seeking to capitalise on the role of forests within the CPRS and Australia's climate solution.***

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.

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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