

SUSTAINABLE LAND MANAGEMENT & EMISSIONS TRADING POLICY ANNOUNCEMENT

On 20 September 2007 the Government announced its long-awaited position on initiatives to address climate change. For the benefit of our clients and associates, we will briefly summarise the key features of the announcement, and where possible, provide advice on any action that we feel you, as forest owners, should take as a result. We stress, however, that there is considerable detail still to be decided, and until legislation and regulation is passed, there are many unknowns.

Resources for research – we encourage you to research the material fully yourself to gain the best understanding of how you could be affected.

The following website has good information: www.maf.govt.nz/climatechange .

Key features of the scheme are:

- The Emission Trading Scheme (ETS) will allow forest owners who planted trees onto pasture land since 1st January 1990 to attain and trade NZ units (NZU). Each unit will represent 1 tonne of CO₂ sequestered by the trees (includes roots, branches and material on the ground).
- Units will be able to be “banked” (held) or sold on a domestic and international market.
- The scheme is being designed to have a long life. With or without the Kyoto protocol the NZ government intends to continue it into the future.
- The scheme appears to have multi-party support, further increasing its likely longevity.
- Forestry enters from 1 January 2008 (other sectors in later years).
- The Government will also allocate free NZUs to the landowners of pre-1990 forests worth an estimated \$585/ha at \$15/t CO₂ price (preliminary estimate only). Initial indications are that these units will be allocated based on area of pre-1990 forest land owned.
- Pre-1990 forests that have not been granted an exemption, (see below), will be subject to emission liabilities if they are deforested (harvested and not replanted in forest) after 1 January 2008. The liability will be based on the CO₂ released – estimated at around \$12,000/ha at a \$15/t CO₂ price.
- The deforestation liability will reside with the landowner unless the decision to deforest is made by the lessee or transferee (if forest is held under a lease or forestry right).
- Landowners with less than 50 ha of pre-1990 forest on 1 September 2007 can apply to be exempt from the deforestation liability. *PF Olsen is currently seeking clarification that the 50 ha limit excludes indigenous forests.*
- Forest Owners will not have to report deforesting of less than 2 ha of their total pre-1990 forest landholding during the first five years of the ETS.
- Owners of post-1989 forests established on pasture land can choose to participate in ETS and receive carbon credits for the CO₂ stock changes from 2008 on. They would also take on the liability for losses from harvesting, fire or wind (risks which are likely to be insurable).
- Where a lease or forestry right exists the administering agency will need written confirmation that both parties agree to enter the ETS. In this case the lease/forestry right holder will take responsibility for CO₂ stock changes until expiry of the term of the lease or forestry right, when the landowner will take over those obligations.
- Annual returns will be required after an initial 2-year period.
- Apart from the loss issues such as fire, single or few-age class forests will have added risk. If the price of CO₂ goes up the total compounded value of emission units sold during the life forest could be less than the market value of NZUs that have to be surrendered at time of harvest.
- There is also a new planting subsidy available (on a tender basis) for those who do not wish to participate in the ETS.

Further interpretation

A massive campaign run by Kyoto Forestry Association (KFA) has clearly been influential in the public, media and government thinking on the principle of the rights of post-1989 forest owners to benefit from carbon credits earned from 2008. For this we all owe Roger Dickie and his core support team a vote of thanks. The support of opposition parties must also be acknowledged.

Whilst government has clearly listened to our messages via KFA, the impost of a deforestation tax is unfairly retrospective and creates a significant impediment to changing land use. The effect will be to drive up the value of farm land and drive down the value of forest land that has pre-1990 forest on it. Our primary concern is that government intervention in land use of this nature creates a considerable level of sovereign risk in the minds of potential forestry investors. This may work against the government's stated goal of establishing 250,000 ha of new forest by 2020. The allocation of "free" NZUs will benefit some forest landowners but not others.

The positive aspects of the scheme are that CO₂ credits will accrue to post-1989 planted forests. Supporting programmes around the NZ Wood campaign, increased Research and Development expenditure, programmes addressing avoided deforestation and illegal logging in other countries and international tariff reduction and trade liberalisation efforts by government are also to be applauded.

A radiata pine forest absorbs around 30 tonnes of CO₂ per hectare per year on average over a typical rotation. At \$15/t, this equates to a potential additional revenue stream of \$450/ha/year. At harvest, roughly two thirds of this will be lost (assuming replanting) and will need to be repaid. If the forest is not replanted, then all the units issued will have to be repaid. Government has negotiated internationally that emission liabilities (in units of CO₂) cannot exceed credits earned for post-1989 forests and adopted this rule for the ETS (for both harvesting and deforestation).

Post-1989 forest owners who sell credits face the risk that when they need to buy back units to surrender for harvest emissions the price may be higher. This risk will be greatest for single or few-age class forest landowners who do not have new or additional growing forest earning credits at the time of harvest. *PF Olsen is examining opportunities to reduce or eliminate this risk via pooling plus introduction of new planting investors.*

Two other big unknowns at present are the measurement methodologies and administration costs which will have to be paid by those electing to join the ETS. *We expect to get more certainty around these costs within the next few months.*

Action you need to take

If you think you are eligible for an exemption from ETS for pre-1990 forest (i.e. less than 50ha) you will have to apply for an exemption within 18 months on the legislation being passed. *There is some talk of shortening this period so that government can more precisely estimate the credits it must hold back to cover the exempted forests.*

For post-1989 forests, you have 18 months to opt into the scheme after the legislation is passed.

Accurate stocked areas based on orthophotos and GIS shape files will be required. Accurate direct field inventory at, or near the commencement and allocation dates (i.e. 2008, 2010, 2011 and 2012) will result in a higher number of credits being allocated.

P F Olsen will continue to engage with government officials and monitor the situation closely to support our client forest owner interests. If you have any enquiry, doubt, concerns, or great ideas about how the new Emission Trading Scheme could or might affect you, please give us a call. We suggest that you do not join or sign up to a carbon pool before checking with your PF Olsen manager what we can offer our clients.

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