



Introduction- Seasons Greetings

Much has happened over the past four weeks. Mark attended the UNFCCC/Kyoto COP16 conference in Cancun, Mexico where there was positive progress on international negotiations. MAF put on hold the PFSI applications while it reviewed and amended some clauses of the forest sink covenant template. We undertook our first private tender for the sale of aggregated units and entered into a number of forward sales with different carbon buyers for aggregated PFSI AAUs. We co-authored a major report on NZ's climate change policies relating to forestry and agriculture published by CDC Climat, a subsidiary of European financial giant Caisse de Depots. MAF released consultation documents outlining the review of their Sustainable Programmes into which the Permanent Forest Sink Initiative falls. We urge everybody to take interest in this and make submissions.

Lastly from all of us at PFI we wish you a Merry Christmas and a successful New Year. We will be back from holidays from the 05 January 2011.

UN Climate Change Conference- Cancun, Mexico

Agreement reached at COP16 in Cancun on climate change exceeded expectations with a commitment to continue to work toward a Kyoto successor agreement with a more ambitious stabilisation target of 450 ppm, and a deeper commitment to project based offsets and market mechanisms.

There is now widespread acceptance that inclusion of forestry is essential if greenhouse gas mitigation is to be achieved. This requires trading of forest based offsets from afforestation, improved forest management and reduced deforestation and forest degradation. Under the existing Kyoto agreement forestry was marginalised, it will now become a central mechanism.

However considerable work is required before a Kyoto successor agreement can be agreed to, and it still looks unlikely a comprehensive global treaty will be achieved before end of 2012. A more likely outcome will be extending the life of the Kyoto Protocol while a more comprehensive agreement is finalised.

In addition it is becoming increasingly clear that domestic trading schemes will continue to develop with potential for bilateral linkages. The EU has committed their ETS out to 2020 while in New Zealand, Hon. Nick Smith, and Hon. David Carter both publicly reiterated the NZ ETS will continue post 2012.

Another major policy development over the past month has

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been in California, the world's 9th largest economy, where the State has adopted rules to implement a cap-and-trade scheme in 2012. It is predicted the market will be initially worth around US\$5 billion/year and will allow for some international offsets to be used. Avoided deforestation projects are high on the list but we also know that foreign reforestation projects are being considered. We have recently made contact with the California climate change policy team and introduced the PFSI to them as a reforestation mechanism they should consider.

At a professional level Cancun was useful to meet with carbon forestry project developers, financiers and market regulators. It was also very useful to spend time with representatives from the North American and European players who have purchased voluntary units from our community of PFSI project owners.

Buyers of PFSI VER's are comfortable with most aspects of New Zealand PFSI projects. However they would be even more comfortable to see deeper commitment by project owners to community (social) and conservation benefits, and more effective monitoring and reporting of benefits. My counter to this expectation is if we can pass through a higher price for these additional benefits there will be a stronger incentive for landowners to commit to manage their projects accordingly.

The level of commitment to community and conservation benefits is a major and ongoing development in the world of carbon forestry. The PFSI being a long term commitment provides a sound foundation for building surety around wider environmental and social benefits. We believe this provides an exciting opportunity for creative improved management. We look forward to working on this in 2011 with the community of PFSI participants.

PFI Carbon Sales - Review

Carbon prices in New Zealand are now on the downward trend having peaked briefly at the end of November above \$20.5/Unit for issued spot NZUs to now being priced in the low to mid \$19/Unit mark.

In our November newsletter we predicted carbon prices were nearing their peak and that prices would drop off in



the New Year due to issuance of NZUs to post-89 ETS forests, and allocation to pre-1990 forests. So while we expected prices to fall off, the rapidity of the downturn in the NZU price and the reasons for this came as a surprise.

The turn in the market was caused largely by the decrease in the price of the international CER unit. The lower CER price combined with the strong NZ dollar means that CERs have become affordable to NZ emitters. (Most) CERs have an advantage over NZUs/AAUs because they can be traded within the EU ETS. This gives NZ emitters the option to trade their CER portfolios into European markets if the price picks up, and buying cheaper replacement spot NZUs for their NZ obligations when the need arises.

Issued spot CERs are currently trading at EURO11.7/ (NZ\$20.52) while CER futures with delivery March 2011 are trading at EURO11.6 (NZ\$20.35), and CER futures with delivery December 2011 are trading at EURO11.2 (NZ\$19.7) (www.ecx.eu).

In the last four weeks, to hedge against risk and lock in price certainty, we have entered into a number of forward sales with carbon buyers for the sale of aggregated PFSI AAUs with delivery/settlement set down for February-April 2011. The majority of PFSI forest owners that we represent have opted to forward sell at least a portion of their units.

Revised PFSI Forest Sink Covenant

In November MAF put on hold all PFSI applications while it reviewed and re-drafted certain aspects of the forest sink covenant template, which is the foundation contract between the Crown and a participating PFSI landowner.

That review has now been completed and a new template was authorised for use by MAF 20 December 2010.

The amendments relate to termination rights and obligations. MAF state *"the overall effect is that the covenant is now worded to allow the PFSI to continue if certain events relating to the Kyoto Protocol occur, and so maintain the permanent nature of a PFSI forest"*. It also means that in most circumstances termination by the Crown does not immediately trigger repayment of issued units. In these situations termination only ends the Crown's obligations under the covenant and does not terminate the covenant itself. The landowner is then given the discretion to decide when (if ever) it wishes to end the covenant and incur carbon replacement obligations.

We agree with MAF's view that on the balance these future changes will be beneficial for most landowners.

The changes will take effect for all new covenants entered

into. Existing PFSI landowners will need to enter into a variation covenant with the Crown to be covered by the new amendments.

We are happy to discuss these changes with landowners and how to apply to MAF for a variation covenant.

CDC Climat: Paper on Agriculture & Forestry

Mark Belton has co-authored a paper¹ with CDC Climat about New Zealand's climate change policies relating to agriculture and forestry, which was prepared for release at the UNFCCC conference in Cancun.

[CDC Climat](#), a subsidiary of French financial institute Caisse De Depots, is a major player in the carbon world. It provides carbon market services such as the [BlueNext](#) carbon exchange, invests directly in carbon reduction projects, and carries out research and provides policy advice for both the private and public sector.

The report describes New Zealand's experience to date with its ETS in relation to the land use sector and includes a comparative analysis of NZ's forestry mechanisms. The NZ ETS designs for inclusion of forestry and agriculture sectors are highly innovative and of great interest for other jurisdictions. France and other northern European countries are increasingly supportive of more effective inclusion of forestry in efforts to reduce GHG emissions. This support is important given EU ETS excludes forestry.

The paper is not yet accessible but it should be available for download early next year from the CDC Climat publications webpage ([link here](#)).

CDC Climat also hosts a carbon forest and wood club (Club Carbone Foret-Bois) for forest sector participants. Mark Belton is an expert advisor to the club.

MAF Review of the PFSI

The Ministry of Agriculture and Forestry have now announced the review of their Sustainable Programmes which comprises the East Coast Forestry Project, the Afforestation Grant Scheme, Sustainable Land Management Hill Country Erosion Programme, and the Permanent Forest Sink Initiative.

The terms of reference are quite broad and include assessing the PFSI's effectiveness for encouraging the establishment of new plantings.

¹ CDC Climat, 'Good Shepherd or Black Sheep? Tackling Forestry & Agriculture Emissions In New Zealand's New Carbon Market' Climate Report (No 26, Nov 2010)



We are quite concerned about how the review discussion document is framed in terms of the PFSI achieving this objective. The document states that of the 5318 hectares of forest currently registered only 147 hectares is newly established forest (approx 3%). This is incorrect. We are aware of at least 980 hectares (approx 18%) of PFSI registered forests that were planted specifically for PFSI registration. It should also be noted that the PFSI was responsible for 12% of all the new plantings in New Zealand from 2007-2009 and we know of at least another 350 hectares established this past winter which is intended to be registered under the PFSI.

We will be submitting on a range of subjects which will include carbon measurement (optional field measurement for smaller forests), tax matters (changes to rules on tax deductible expenditure), and procedural issues (request formal timelines on MAF applications).

It is also important the PFSI is emphasised for its independence from the NZ ETS and for its environmental integrity. The PFSI provides for a commitment to long term forest protection with a focus on management for carbon. Long term protection also provides the basis for stronger environmental outcomes. This needs to be recognised.

We strongly urge all interested parties to make submissions.

Parties can make online submissions and download the discussion documents at the MAF consultation webpage ([link here](#)). Submissions close 18 February 2011 and public hearings may convene meetings in most major centres in late February.

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