



2011- What a Year!

One thing is certain... we will be glad to see the back of this year.

It has been a tumultuous time for PFI having massive ructions thanks to Mother Nature, and the devastating slide in the carbon market.

The earthquakes have profoundly affected us, having lost our beautiful offices (140 year old Provincial Chambers), the destruction of homes, the departure of family/friends who have left the city for good, and the ongoing tremours that until recently (touch wood!) were a daily occurrence. We are however incredibly fortunate not to have suffered any deaths or serious injuries amongst our families or friends.

Despite the trials this year has brought we have also achieved some credible results, and had a lot of support from many of our clients. One thing which particularly struck us was the outpouring of concern and generosity from colleagues and clients after the events of September 2010, February, and June.

To all of you we thank you! Ollie, Mark, and Maria

**Postscript; having just written above we have been rocked by the most significant quakes since June. This meant the last afternoon of the year of work was spent in the Ferrymead office car park riding out the aftershocks and having a beer with frightened colleagues.*

Key Actions for PFSI Forest Owners in 2012

Below is a list of key things for PFSI owners to be mindful of in 2012. PFI can assist in all of these matters

- **Carbon claims:** can be filed from January for claiming carbon 01 Jan 2008- 31 Dec 2011
- **PFSI Registrations:** New PFSI projects will need to be registered prior to 15 December 2012 to claim 2008-2012 carbon. Otherwise the NZ government will use this carbon for meeting its Kyoto targets
- **Field Measurement:** Applications for FMA plots need to be applied for and measurements carried out in 2012. We can assist in both applications and measurement (we have recently carried out measurement on over 1000ha recently)
- **Insurance:** We worked closely advising an insurance company which developed a Permanent Forest Insurance product covering PFSI VERs and AAUs. We

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are not authorised insurance brokers but we can introduce PFSI participants directly to this company, and assist with forestry advice.

- **Management Plans:** All PFSI owners should update their forest management plans. Plans should be designed with long term permanent carbon strategy at its core to enhance sequestration and minimise carbon loss. PFI specialize in providing such advice

PFI Achievements

1. Completing trades and deadlines despite the tremours. Ollie's lasting memory is working from Marias damaged house two days after the major quake in February, driving for 2hrs (normally 10mins) over boulder strewn hill top roads to get there, then sitting amongst fallen bricks and chaos in Marias lounge with both laptops plugged into a diesel generator to complete carbon transactions. They then had to siphon petrol out of Marias boat (because the gas stations had run out) for the 2hr trip home.
2. We have recently sold our 700,000th carbon credit from PFSI Forests. This year we have continued to supply the market with voluntary and compliance units, into New Zealand, Japan, Singapore, Europe, and North America.
3. The PFSI Review Panel report favourably recommended the continuation of the PFSI as a complimentary mechanism to the ETS. We know PFI's submission was vital to achieving this outcome.
4. Our client base has extended considerably this year. We now represent over 35 PFSI projects totalling 9,000 ha across New Zealand. Clients include not-for-profit native forest restoration trusts, local government, and private landowners. The forest portfolio is comprised of 55% indigenous forest and the balance in planted species.
5. We are currently working on a whole range of new



projects for registration under the PFSI in 2012. Interest and applications have soared in the last four months.

The Rise & Fall of Carbon- What will 2012 Bring?

While the NZ carbon price started the year around the \$18/t mark, the reduction in prices due to anticipated NZUs issuance didn't happen. The devastating quakes in Japan in March and ensuing nuclear incidents put upward pressure on international carbon prices, as European countries announced low emission nuclear power was to be phased out. NZ carbon followed the trend peaking briefly at \$21/t before stabilising around \$20/t.

July saw prices start to slide, due to oversupply of credits (CERs) from international projects coupled with the worsening economic situation in Europe and consequent reductions in industrial output and GHG emissions. The slide in prices continued during the latter half of 2011 ending up around \$8/t.

As a result NZ forest carbon trading has pretty much died. NZ foresters have not been willing to sell at these low prices and NZ emitters have taken the opportunity to buy huge volumes of cheap overseas units to cover their NZ ETS obligations.

The outlook for 2012 is not looking so good. The fundamentals that caused the collapse (oversupply and economic recession) are likely to continue for some time. Having said that, carbon price has a history of volatility and unanticipated collapse and recovery.

We share the view of world thought leaders on climate change that the carbon price must greatly increase to be effective in reducing global emissions. Conversely if carbon price remains low then emissions trading mechanisms will fail to have any useful effect and may as well be scrapped.

The global political will has not wavered in support of the emissions trading market approach and so we believe we will see much more regulation of ETS markets so as to regulate supply and demand (at least indirectly) and increase prices.

Regulation and Intervention is already happening

In the last weeks two major developments have occurred in Europe and New Zealand.

Europe voted to withhold 1.4 billion EUAs from the EU ETS after 2012, and NZ has banned NZ emitters from purchasing industrial gas CERs from 23 December 2011.

Both are very positive developments; however the effects

may take some time to be felt. Particularly the NZ law which allows banned CERs that have already been bought by emitters to be used indefinitely into the future. We believe huge volumes of these CERs are in NZ emitter's pockets to cover them for many years ahead.

Other major developments which could affect price include the implementation of Australia's climate policies; and the latest talks to save the Kyoto Protocol in Durban.

Australia- will it link with NZ?

The last month has been abuzz with talk about a single trans-Tasman carbon market.

We think complete linkage unlikely. Why? Because Australia's scheme has so many fundamental differences to the NZ ETS. In our view major differences in the quality of units in the two schemes will make linkage difficult. Australia has taken great pains to put environmental integrity at the heart of its mechanism. Projects must not be business-as-usual, and importantly Australia has excluded domestic timber forests. Given that the NZ timber forest industry is the main supply of NZUs it is hard to see why Australia would accept these.

On the other hand the Permanent Forest Sink Initiative meets many of the Australian requirements for high integrity forestry offsets.

For the last 4 months, we have been talking with NZ and Australian officials and politicians, and Australasian emitters about possible acceptance of PFSI units into Australia. So far the response has been very positive. Amazingly NZ government officials have done nothing to promote the PFSI as mechanism. It is only because of our behind the scenes work that the Australians have become aware of this special mechanism.

We hope the NZ government will now actively promote the PFSI.

The Australian market is the one to access. The carbon price should be considerably higher due to their price cap of A\$23/t, the low forecast of domestic credits, and restrictions on use and quality of international units.

Has Kyoto been Saved? Outcomes of Durban

Total collapse of the UN negotiations to advance a global Kyoto successor agreement at Durban was averted at the last minute. The parties agreed to negotiate a new treaty in 2015 which would obligate all 194 nations to emission reduction targets aimed at stabilizing CO2 levels to limit temperature rises to 2 degrees C.



The outcome provides a glimmer of hope for recovery of a UN coordinated approach, however realistically the only certainty is continuation of a deeply flawed UN negotiating process (that requires unanimity to reach agreement) and the self-interested behaviours of negotiating nations. It is beyond comprehension an effective global treaty will be reached. As all know, climate action is needed now and Durban effectively represents a 10 year delay with effective abatement actions only starting after 2020. According to climate scientists this puts us firmly on the path to warming temperatures of over 3 degrees C.

Not surprisingly the news of the Durban agreement has not impacted on carbon prices. However it does salvage hope as it will challenge responsible nations to develop effective policies in preparation for their 2020 commitments. In the NZ context the maintenance of our ETS is more certain than ever, however the NZ Government has refused to publicly state a commitment to signing up to the new treaty, and has been identified as one country that severely undermined the talks in Durban.

An important outcome of the Durban hiatus is the encouragement of domestic emissions trading schemes, the so called 'bottom up' approach. There is acute awareness that linkages and coordination between different ETS schemes is necessary, which then raises the issue of the integrity of units being created in one national market and offered to another.

For PFSI carbon farmers there is good news in all this. Any focus on quality can only benefit the PFSI in terms of gaining access to more discerning markets and better pricing.

And in the big picture, with the delays in implementing effective actions across the global economy, the price of carbon will need to go much higher so as make up lost ground and pull back from dangerous climate change. The recovery from the overshoot in greenhouse gas levels under the current path will require massive reductions. Removals require growing more forests, and ensuring sequestered carbon is secured for long periods of time.

Our view is quality of forest carbon offsets will be under closer scrutiny, and pricing of carbon will increase significantly to drive required changes across the global economy. The greater the delays the higher the price of carbon required to do the job.

PFI Marketing Summary

As many of you know we work tirelessly to market PFSI as a high quality carbon product. We have been successful at

this but it has been tough. Particularly in the New Zealand market where NZ emitters typically look to buy the cheapest, least cost unit, with little interest in quality.

Many NZ companies represent environmental sustainable growth as being important to their ethos, however to date very few put any real commitment to development of meaningful actions, and unfortunately the NZ ETS has only encouraged company treasuries to be given the task of commodity trading so as to minimise cost without any thought to environmental outcomes.

For over 18 months we have been in discussions with iconic NZ companies about 'greening' their carbon portfolios. We have proposed these high profile companies source at least some percentage of their compliance requirements from NZ permanent forest conservation projects, directly assisting environmental projects that provide real long lasting benefits to NZ ecology and the climate. After all PFSI project owners have made a significant long term commitment to the environment, unlike NZ timber ETS foresters who can harvest/deforest as they please.

It has taken a long time for NZ companies to get their heads around quality but it is beginning to happen. Discussions are progressing well and we are hopeful that constructive long term relationships and transactions will result.

On the international front we are currently in discussions with a number of European buyers about carbon sales into the future. These discussions are centred on the failure of carbon prices to incentivise quality forestry projects, and the need to reward PFSI projects.

Realistically though it is unlikely any trades will result from these discussions in the first months of 2012.

Lastly, demand for voluntary pre-compliance PFSI VERCs remains strong into 2012.

Permanent Forests- 'Best Practice Carbon Forestry'

Readers will notice a change in PFI's footer in the New Year from '*Leaders in Carbon Forestry*' to '*Leaders in Best Practice Carbon Forestry*'. The focus on best practice is exactly what we have always been about, and we now think it is important to bring this into sharp focus.

There are many pitfalls and skulduggery in the world of carbon. Forestry has been high on the concern list leading to being seriously marginalised in the Kyoto agreement, totally excluded from the EU ETS, and excluded from coverage by Gold Standard, a leading voluntary carbon market standard.

Notwithstanding these handicaps a group of NZ officials in



2002 started working on the design of a credible forest carbon mechanism that would address the concerns around permanence, additionality (not a business as usual activity), measurement, monitoring and verification of carbon stocks. And so it was the Permanent Forest Sink Initiative was developed.

It is not well known that we strongly lobbied all political parties to support the creation of the PFSI and it was gratifying to see the enabling legislation passed in November 2006 without a single dissenting vote, a rare event in NZ Parliament.

Early this year we faced the PFSI Review premised with the question as to the need to continue the PFSI given the existence of NZ ETS forestry. We made a major submission in support of the PFSI as a standalone mechanism with international credibility. It considerably helped that the Danish Government JI/CDM program had declared the PFSI as a world leading best practice carbon forestry scheme following its due diligence on the PFSI and embracing nine PFSI projects under its JI/CDM program as a source of units. Much to the relief of many, the Review Committee recommendations supported continuation of the PFSI under its own legislation.

Our enthusiasm for the PFSI is based on our conviction that it is a robust and credible mechanism for carbon sequestration. We also know from our overseas marketing work that the PFSI is regarded as a world leading mechanism because it requires commitment to maintaining forest cover. This long term commitment ensures that nature gets time to deliver the benefits that only comes from forests that are long lived. It means more carbon is sequestered, and more biodiversity, improved wildlife habitat, and more character.

We are intent on maintaining and improving the PFSI's positive attributes. We will continue to monitor and submit on any changes in government policy that might affect the integrity of the PFSI. We encourage participants to commit to undertake good protection management of their forests. It is all about best practice forestry for carbon and environmental benefits.

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