

Remove your ETS obligation for very little cost

Stuart Orme

It has been suggested that the ETS has passed its sell-by date and there is little more to say. I would suggest that this could be yet another view versus an informed opinion. Many forest owners missed out on opportunities compared with those who registered early into the ETS. Those who came late to the table, or decided not to register at all, missed out.

ETS up to the end of 2014

In May 2015 New Zealand will complete its wash-up period and the end of the Kyoto Commitment Period One influence will draw to an end. Until that time, assuming the rules do not change, emitters will be able to surrender cheap United Nations approved credits to meet their ETS commitments. These credits are known as CERs or ERUs and are comparable with, but different from, the New Zealand units or NZUs

Under international unit accounting rules it appears that New Zealand will be able to carry over 2.5 per cent of their initial allocation of 309 million UN approved units. Current thinking is that the government will carry over this amount which will be approximately 7.7 million of those units. Any private holders of these units may effectively have them wiped from their NZEUR accounts for emission returns for periods 2015 and later.

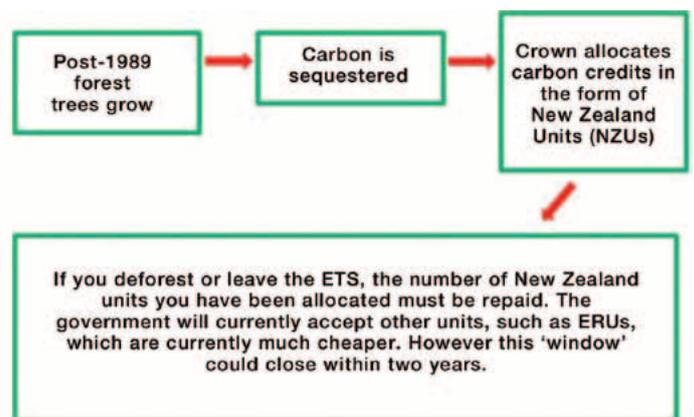
For emissions up until the end of 2014 it appears that ERUs and CERs will still be able to be used. In the last *Tree Grower* article we discussed using these units to remove pre-1990 forest obligations. This article focuses on how owners of forests planted after 1989, and who have registered for the ETS, can benefit from the same situation.

The future is uncertain

If emitters continue to surrender non-New Zealand units there could be as many as 100 million NZUs in the national accounts by 2015 when they become the only valid unit for surrender into the New Zealand ETS. New Zealand uses 16.5 million credits annually. Current NZU purchases appear to be being made by those taking a gamble on the NZU price increasing in the future, as opposed to emitters buying them for surrender when they have the option of handing back cheaper offshore units.

Owners of post-1989 forests understand that eventually they will have to surrender all or part of the units allocated to them when their trees are harvested. A concern is what will the price of those units be in the future? They have already plummeted from over \$20 to around two dollars in a very

short time. The current opportunity for registered participants is to remove the obligation on the credits they have by surrendering ERUs funded by cash or sale of less than 10 per cent of their NZUs allocated. If the rules do not change we believe this situation could exist until the end of 2014.



Potential decision model

We believe NZUs will remain good collateral into the future and agree with the Minister for Climate Change that in time the NZU price should improve.

A worked example

The following is a very basic example of how the above concept works. It assumes a current market price of the New Zealand unit is two dollars, and that the ERU is 20 cents, although at time of writing it is closer to 15 cents.

A sample participant invested in a small family forest as part of their retirement fund and entered into the ETS. They have received 10,000 units for carbon sequestered by their forest, which was planted after 1989, for the period from 2008 to 2012. This means that if they deforest, or decide to leave the ETS, they have an obligation to repay the 10,000 units.

Due to the current price difference between the two different units, the NZU and the ERU, the participant decides to remove their obligation to the ETS by surrendering 10,000 units as ERUs which have the lower value of 20 cents. To do

this they must exit the ETS in part or in full. This allows them to surrender ERUs or any other New Zealand approved unit.

With the significant price difference between the NZU and ERU, the participant needs only to sell 1,000 or 10 per cent of his NZUs to cover the purchase cost of the required number of ERUs. This still leaves 9,000 NZUs in the holding account to either sell or hold on to.

Number of units currently owned

10,000 NZUs at \$2.00 = \$20,000

Cost to purchase the 10,000 ERUs required for surrender

10,000 ERUs at 20 cents = \$2,000

Number of NZUs that could be sold to cover this ERU purchase

1,000 NZUs at \$2.00 = \$2,000

Number of NZUs remaining to sell or keep obligation free

9,000 NZUs at \$2.00 = \$18,000

After the above transfer, the participant may decide to put the forest back into the ETS to continue receiving annual credits.

Do it now or later?

The decision to neutralise the obligation to the ETS is logical. The only real question is should you do it now, or wait to receive additional NZUs in the 2013 and 2014 allocations hoping that nothing will change, and then look to exit and perhaps re-enter the scheme?

The ETS is a domestic government controlled scheme. The government has the ability to affect how it operates. In 2012 many advocated for a minimum surrender of 50 per

cent of New Zealand units, but this did not happen although it may do in the future. If you are unsure of policy intentions you may want to make sure obligations are neutralised sooner rather than later. You could aim to do the same again in early 2015 having received a further two years' worth of credit allocation.

If you are confident of no rule change and continued access to cheap units you may want to wait until the end of 2014 and exit the scheme in 2015. This is when unit allocations have been received but before ERU eligibility expires shortly afterwards.

Forest Measurement Approach comment

The Ministry for Primary Industries are starting to produce tables for forests that have been measured to determine their actual forest carbon yields as compared with the standard regional table allocations. The majority of the pine blocks seem to be around, or in excess of, the regional tables. One just worked on at the time of writing showing 179 per cent of regional table of carbon allocated. This was within 10 per cent of the predicted volumes using the forest calculation model available to NZFFA members.

Site factors have some effect, but the majority of the difference appears to be due to silvicultural treatment. Often the poorer exposed parts of a forest left at a high stocking carrying the majority of the carbon volume.

Indigenous yields seem more varied, as are the indigenous forests in general, with two results we have received showing 60 per cent and 130 per cent of national table allocation on two properties not too far apart. The good thing is that identifiable trends are evident and will help forest owners make better informed decisions.

The benefits of additional carbon allocated using forest measurement approach will last until the next emission return is required, or until the land is withdrawn from the ETS. If you are considering taking advantage of cheap units to remove your ETS obligations, be aware that if you exit now and re enter you will only be allocated the regional table volumes of carbon until the next inventory is carried out.

The PFSI as a short lived covenant?

There is not time or space to comment in full on the Permanent Forest Sink Initiative, or PFSI. I can only than note that there is a limited option until June 2013 to remove the PFSI covenant from your property.

For many who went into the PFSI with their eyes open this will be of little interest, but it does provide the opportunity to re-evaluate your position. Given the shifting focus that the government has placed on long term land use over the last two years, as a land owner you may want to review your options. If you choose to leave the PFSI, once again you will be able do so using the approach mentioned above with regard to the ETS in general. You can surrender ERUs or similar and then perhaps enter the ETS and continue to accrue carbon credits as New Zealand units.

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