



BY STUART ORME

## TIME TO LEAVE THE ETS?

Five years ago we would never have dreamed we'd be advising our clients to leave the ETS. But times, politics and markets have changed.

**E**mitters in the NZ ETS have the ability to surrender NZ units (NZUs) or any verified Kyoto unit.

Approved Emission Reduction Units (ERUs) are one such unit and although they initially traded at 30% above an NZU in the early days, their oversupply has led their (and the NZU) price to spiral downward.

When forest growers or landowners who are ETS participants exit the ETS they effectively become an emitter and can surrender ERUs to neutralise their ETS obligation, instead of NZUs, should they so wish.

The NZ ETS will accept ERUs for emitter surrender up until the end of May 2015. After that, current indications are that NZUs will be the only collateral accepted.

The strong advice we are giving ETS forest-related participants currently is:

- complete your Emissions Return for the year ended 31 December 2013
- gain your 2013 NZU credits
- exit by surrendering Emission Reduction Units (ERUs) currently priced between \$0.25 and \$0.35/ERU.

Once out, the obligations against any post-1989 forest will be removed and any NZUs sold or still held effectively become "freehold".

For larger forest owners, the recommendation is to re-enter the ETS on the basis that "if you have credits, you have options" and there may be the opportunity to repeat the exercise in 2015 and effectively gain freehold credits for the 2013 and 2014 period as a new participant.

The danger if you delay until 2015 is that the Crown may not be able to process your exit application and issue the required surrender notice before 31 May 2015 when the ability to use ERUs to defray your ETS obligation is expected to end.

Smaller forest owners (circa under 25–30Ha), once they freehold their 2008–13 credits, have the option to monitor where the ETS goes between now and 2017 and if happy with what unfolds, look to re-enter and claim their credits back to 2013 for the 2013–17 period.

**WHY IS THE ERU SO MUCH CHEAPER THAN THE NZU?** There are a large number of "Pending Eligible" ERUs in Europe that may/will not be tradeable there in the future. It has tended to be these Pending Eligible ERUs that have reached New Zealand shores of late.

As of mid-March 2014, these Pending Eligible ERUs are selling at around \$0.25–\$0.35/ERU in New Zealand, with future contracts (May 2014) in Europe available for Eligible ERUs at \$0.34/ERU (numbers in NZ\$).

Over the past 12 months we have seen ERU spring from \$0.12 through to \$0.70/ERU. The price drivers always seems to be supply related. The fewer ERU available, the higher the price. This may be simplifying the situation a bit, but is effectively the advice we get from the wholesale buyers in this space.

Currently there is minimal volume of the Pending Eligible units coming to market as the owners look to see if they will be "eligible" and have until 2015 to make a decision to act on the verification.

Table 1: Example for a stand of 1995 P radiata planted in the Lower North Island

| Example for a stand of 1995 P radiata planted in the Lower North Island |                       |        |             |              |                    |              |  |
|---|-----------------------|--------|-------------|--------------|--------------------|--------------|--|
| 6 Years<br>2008–13<br>HA  | 1 Years<br>2013<br>HA | NZU    | Exit only   |              | Exit then re-enter |              |  |
|   |                       |        | Surplus \$  | Freehold NZU | Surplus \$         | Freehold NZU |  |
| 4.5   | 27                    | 1,000  | \$2,545.56  | 849          | \$1,983.34         | 661          |  |
| 9   | 54                    | 2,000  | \$5,295.56  | 1,765        | \$4,733.34         | 1,578        |  |
| 13.5  | 81                    | 3,000  | \$8,045.56  | 2,682        | \$7,483.34         | 2,494        |  |
| 18.2  | 108                   | 4,000  | \$10,795.56 | 3,599        | \$10,233.34        | 3,411        |  |
| 23  | 135                   | 5,000  | \$13,545.56 | 4,515        | \$12,983.34        | 4,328        |  |
| 45.7  | 271                   | 10,000 | \$27,295.56 | 9,099        | \$26,733.34        | 8,911        |  |
| 68.5  | 405.5                 | 15,000 | \$41,045.56 | 13,682       | \$40,483.34        | 13,494       |  |
| 91.5  | 541                   | 20,000 | \$54,795.56 | 18,265       | \$54,233.34        | 18,078       |  |

The above table assumes MPI administration costs to affect the indicative outcomes noted but does not include professional support costs that will differ between service providers. The advantages of the scenarios above will change on a client-by-client basis and we recommend you contact your professional forestry adviser to discuss your individual situation.

### NEUTRALISING THE ETS OBLIGATION

This table looks at how much forest is required to generate a particular number of NZUs, together with other information relevant to quantifying a decision about whether or not to neutralise the ETS obligation.

The table is based on a stand of P radiata planted in 1995 in the North Island utilising MPI's H/SNI region table for NZU entitlement.

The information in this table can assist in making decisions such as whether it is worth neutralising an ETS obligation for one year only if your client has already left the ETS once and re-joined after the end of 2012.

This is a series of examples.

The six years column is for the period 2008 to end of 2013 and is the area (Ha of 1995 forest) required to generate the number of NZU in the NZU column adjacent to it over that period.

The one year column shows how much more forest is required to generate the various amounts of NZUs for the 2013 year only, compared with the six years from 2008 to 2013.

The following columns are based on an NZU price of \$3.00 and an ERU price of \$0.25/ERU.

- The surplus \$ columns estimate the amount of dollars remaining after costs incurred to "exit the ETS" and also to "Exit and re-enter the ETS" if all the NZU are sold and the estimated costs taken from the amount paid.
- The freehold NZU columns indicate how many NZU might remain freehold if a portion of the NZU received are sold to bankroll the transactions. Those remaining NZU are effectively freehold and have no ETS obligations attached to them and hence can be sold at a time most convenient to the participant's circumstances.

By surrendering ERUs it will:

- for those that have previously sold NZU, remove the need for them to surrender that same number of NZU to the Crown when their forests are felled (at what will likely be a higher purchase price)
- for those that have NZU in their account, effectively freehold their NZU which they can sell without ETS obligations attached at a time convenient to their cashflow requirements.

### WAS IT EVER WORTH JOINING THE ETS?

We have just worked the numbers on removing our smallest client from the ETS and will do so once they receive their 2013 credits.

They have a bit over 2 Ha of forest and after costs will be in a cash or credit positive situation with no ETS obligation on their land.

The ETS may have been a very disillusioning piece of legislation and an exercise in frustration for many along the way but, for those who have engaged and been involved, upon exiting utilising the emission reduction units available, it should be a cash flow positive exercise.

**EMISSIONS RETURNS FOR FELLED POST-1989 FOREST**  
This seemed a long way off in 2008 but last year has seen several post-1989 forests felled to take advantage of positive harvest revenues and land use change opportunities.

There is not time or space in this article to go into how the diminishing credit allocation is handled other than to say that it is "different" from what you have been used to and if doing your own Emissions Return for a stand such as this you may want to get advice before proceeding.

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