CarbonCrop

Kia ora ,

Welcome to CarbonCopy, where we keep you up to date on carbon-y things that are relevant to you.

This time round:

1. Editorial
2. ETS Consultations
3. Carbon market commentary
4. Recent Announcements
5. Important dates
6. A Great Carbon Grab Ahead?
7. Things you might have missed

Climate Smart Forestry
The immediacy of forestry's importance in mitigating climate change is well accepted. Also well accepted is the fact that 'not all forestry practices are created equal'. Along those lines, a new term is starting to enter the conversation: Climate Smart Forestry (CSF), an approach that reduces carbon emissions, bolsters resilience to climate change, and supports sustainable forest economies.

What is Climate Smart Forestry?
Climate Smart Forestry brings together the threads of climate mitigation, adaptation, and socio-economic benefits into forestry practices. The

primary goals of CSF are:

- Reducing Carbon Emissions: By managing forests to increase carbon removals and reduce emissions, CSF can help combat climate change more effectively than traditional methods.
- Enhancing Resilience: Forests are long-term investments. Climate-smart forests remain healthier and more productive through changing environmental conditions.
- Supporting Forest Economies: Sustainable forestry must be economically viable. CSF promotes practices that make forestry profitable, ensuring long-term sustainability.

So far, so theoretical. Let's look at an example.

The Humphreys Bush Project

A prime example is the Humphreys Bush project in Northland. This 163-hectare property, formerly a struggling beef farm, has been transformed into a thriving example of climate smart forestry.

During the COVID-19 lockdown, the property's owners decided to pivot from traditional farming to forestry. With half the property already covered in beautiful, though damaged, native forest, they saw an opportunity to enhance both carbon sequestration and biodiversity. The introduction of Coast Redwoods, a species known for its high carbon capture and resilience, became the cornerstone of their strategy.

Over two winters, they planted 48,000 Coast Redwoods with help from the NZ Redwood Company. These trees sequester significant amounts of carbon and support the recovery of native forest understory by providing shelter and reducing competition from invasive species. This integrated approach illustrates how climate smart forestry can work in practice, balancing carbon capture with biodiversity and economic sustainability.

Why Coast Redwoods?

The choice of Coast Redwoods for the Humphreys Bush project was driven by their exceptional qualities:

- High Carbon Sequestration: Redwoods grow quickly and store large amounts of carbon, making them highly effective for climate mitigation.
- Longevity and Resilience: These trees can live for thousands of years and are more resilient to climate change impacts than many other species.
- Non-Invasive Nature: Unlike some exotic species, Redwoods do not spread uncontrollably, making them a safe choice for New Zealand's ecosystems.

- Support for Native Biodiversity: By creating a favourable microenvironment, Redwoods help native species thrive underneath their canopy.

Redwoods can be excellent candidates for climate smart forestry, particularly in areas where traditional native planting may not be feasible or cost-effective.

Overcoming Challenges in Climate Smart Forestry
Understandably, economic viability is crucial for climate smart forestry. Forestry projects must be financially sustainable to succeed in the long term. This means selecting species and practices that balance upfront costs with long-term benefits. Different environments require different approaches. Redwoods are suitable for certain areas, but other regions might need a mix of native and exotic species tailored to local conditions. Balancing carbon sequestration with biodiversity is also essential. Climate smart forestry aims to maximise carbon capture, but not at the expense of the health of the ecosystem. This balance requires careful planning and ongoing management to ensure forests remain healthy and productive.

Lastly, minimising risks such as fire hazards and pest is important. Regular monitoring and adaptive management strategies are needed to address these threats proactively.

The Way Forward
The Humphreys Bush project shows that with careful planning and the right species selection, we can create forests that sequester carbon, support biodiversity, and remain economically sustainable. And we can't rest on our laurels. We must continue to innovate and collaborate to make our forests as climate smart as they can be.

To stay up to date with the latest on the CarbonCrop platform, make sure to register your interest.

On May 15th the Ministry for Environment published two new consultations relating to the ETS.

One of these outlines a number of possible changes to the ETS regulations but excludes any forestry-specific proposals. Our view is that any decisions will have relatively minor and indirect impacts on forestry through changes in emitter NZU demand/entitlements. We will not be submitting on this consultation.

The other is "Annual updates to New Zealand Emissions Trading Scheme limits and price control settings for units 2024". As the name suggests, this is an annual consultation on key ETS price settings and unit availability, and so directly impacts the volume and pricing of supply. It is highly relevant to all ETS participants including forestry participants - it was the government's changes to these price control settings which were primarily responsible for the price crash at the end of 2022!

In evaluating options, it's important to remember that any approach that reduces the total available NZUs or increases the price at which NZUs are available will increase the incentives for emissions reductions, increase the value of NZUs, and increase the incentives for carbon removals (and so forest restoration).

We encourage ETS forestry participants to make submissions expressing their views on unit limits and price control settings. Of course, we have our own perspective on a couple of the points highlighted below.

Step 1: Align with climate change targets
The two options here, in addition to the status quo, both propose reducing the total budgeted emissions within the ETS—a good thing. We agree with MFE's scoring strongly and support **Option 3** - the minimum adjustments *plus* additional adjustments to manage the impact of 'non-ETS' policies. This must be done for there to be any consistency between the policies and the ETS as a **cap** and trade framework. The reasons are technical, but an example makes it clear - a good example policy is the NZ Steel Electric Arc Furnace project, funded out of the Green Investment Fund as an initiative to reduce emissions. The result of this project will be a reduction in NZSteel NZU demand (and associated emissions) of 800,000 tons/year. But unless the total NZ and ETS emissions budget is also reduced by 800,000 tons, the net reduction in New Zealand's emissions will be zero - those units will just become available within the ETS market and the market and prices will respond to allocate the emissions elsewhere.

This is part of the reason we opposed the GIF contribution to that project in the first place - our view is that the ETS incentives alone were more than enough to drive the investment by NZSteel. Of course NZSteel (owned by an Australian company) argues otherwise, but they would say that given it was the basis for their $140M grant application.
These adjustments must be made for the premise of the Green-Investment-Fund grants to have any integrity, and at least the reductions associated with all GIF grants should be included.

Step 5: Set the reduction volume to address the unit surplus
Skipping ahead a few steps, as we agree with the emissions budget allocation, technical adjustments, and industrial allocation adjustments. We welcome the acknowledgement that the surplus is significantly larger than has previously been modelled, and strongly support the CCC's recommendation of **Option 3,** being more rapid surplus reduction through further reduced auction volumes. Our view is that the models likely still underestimate the magnitude of the surplus, and that addressing this surplus is important for the proper functioning of the ETS and will actually materially *improve* the functioning of the ETS through the signalling of government commitment to core policy goals and principles. Both option 2 and option 3 are superior to the status quo considering proper ETS functioning - the current settings mean an ongoing risk of surplus unit supply, as evidenced in the market's response to the first ETS auction of 2024.

We also view auction volume adjustments downward to reduce the surplus as a 'low regret' measure by the government. If the market behaviour suggests a smaller than expected surplus, it is simple for the government to align emissions budgets by reviewing and revising upwards the auction unit allowances later in the reporting period - and this is likely to be fiscally advantageous due to the higher unit prices at that time. Selling an excess of units now, at low prices, is fiscally and environmentally irresponsible, and is *not* required or justified through supporting the proper ETS function.

Option 3 is the responsible choice, and whatever the true unit surplus, it will deliver the best outcome for New Zealand.

Price control settings
We're almost surprised this even came up, though it's a required part of the consultation process.

Given the current unit surplus, the necessary NZU price corridor for emissions reduction targets, and market dynamics, Option 1 is the only sane choice.

In the same way that actively limiting the auctioned unit supply to reduce the surplus is 'low regret', reducing the auction floor price or the CCR tier prices is 'nothing but regrets'! The last thing that NZ's climate change response needs is additional low cost units in the market (unless they're backed by durable removals - in which case bring them on, cheap high integrity removals are something we can't have too many of!)
We strongly disagree with MFE's assessments of the options in two respects:

- *"Support the proper functioning of the ETS"* - lower price control settings do not support the proper functioning of the ETS, given current dynamics and price levels. The last time the price control settings were lowered it led to a significant dysfunctional market response and was deemed sufficiently harmful to New Zealand's climate change response that the courts required the settings to be revised back upwards (Thanks again, Lawyers for Climate Action - top work!). The ETS will not function properly if the market cannot rely on NZU prices which sufficiently incentivise the necessary net emissions reductions - reducing the price corridor is actively counterproductive to perceived ETS integrity, and not just the marginal likelihood of abatement.

- *"Manages overall costs to the economy and households"* - assessing a lower price corridor as beneficial to the economy or households involves a short term perspective. New Zealand is exposed to significant potential international liabilities in connection to our Paris Agreement commitments. On current trends, it is highly likely that any 'savings' through reduced unit prices (which are kept in New Zealand in any case and generate revenue which can be recirculated) will be outweighed by increased international obligations to balance our failures to achieve targeted emission reductions (and that transfer of funds hits our international trade deficit… which is already bad enough without help!).

It is extremely important that the government signals to the market a strong commitment to rising costs of emissions, and hence NZU pricing. Coincidentally, doing so will also increase the probability that the government realises forecast ETS auction revenues more in line with their targets, rather than the fiasco of 2023 and the only marginal improvement of the first auction of 2024.

What else?
Our understanding is that in parallel with the above work is ongoing within the ministries / government in relation to the previously indicated

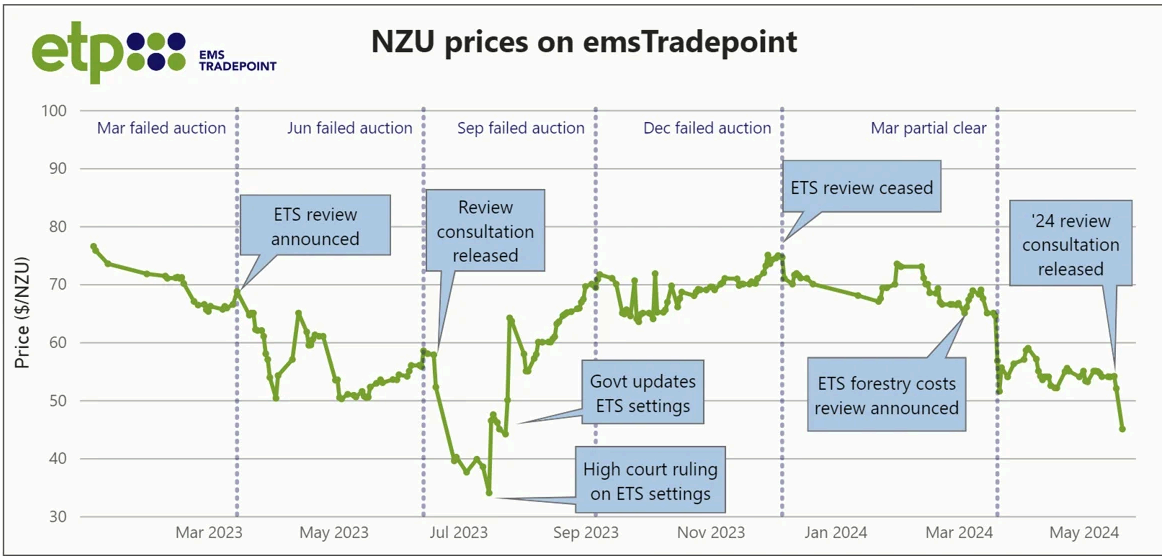
policy around possible restrictions to exotic forest eligibility for registration in the ETS.

Stay tuned!

Carbon Market Commentary

emsTradePoint

- Over the last quarter, carbon prices have decreased from around $70 per NZU, down to $45.
- March's auction partially cleared, with just under 3 million units sold at the floor price of $64.
- The secondary market responded to the auction with the price decreasing to about $55 (down 21%).
- The Government opened consultation of its annual review of ETS settings on May 15. The consultation closes in June, with finalised ETS updates expected in September.
- Among other things, they are seeking feedback on reducing the auction floor price.
- Like last year, the release of Government's ETS proposed changes has created uncertainty. The secondary market has responded by a further price decrease to around $45 (down a further 18%).
- No update on the independent review of forestry ETS costs that was expected to be release last month.



*These prices are emsTradepoint Daily Volume Weighted Average Prices (VWAP). Please see the indices calculation methodology on **our website** for more information.

- ***February 2024:*** **ETS enquiry into pricing**
  The forestry component of ETS will be reviewed to address forest owners' concerns about excessive costs and ensure the scheme's efficiency. It will evaluate the operational costs and adjust the funding model to restore confidence and ensure the sector's contributions to emissions reduction are supported effectively.
  Check out the announcement here

- ***May 2024:*** **NZ ETS Unit Settings and Annual Regulatory Updates 2024**
  NZ ETS limit and auction price control settings for units are set in regulations for five years in advance. These need to be reconsidered, and added to, every year.
  Read more here.

19th June 2024 - Next ETS Auction
Although forestry NZUs are not sold in these auctions, the results of the auction can affect NZU prices on the secondary market.

30th June - Provisional Emissions Returns (PER)
If you want to access your carbon revenue for the carbon your forest removed in 2023, you can now file your PER. As a CarbonCrop customer we sort this out for you, so you don’t have to worry about anything. If you’ve not received an email from your Account Manager, please reach out.

If you've already completed your PER and are looking at what's next, check out our "selling credits" page to see what options are available to you.

14th June 2024 - NZ ETS Unit Settings and Annual Regulatory Updates 2024 Consultation
On May 15th, the Ministry for Environment released a consultation related to the New Zealand Emissions Trading Scheme (ETS).

The first part discusses general updates to the ETS. The second part, focusing on annual updates to ETS limits and price control settings, directly influences the supply and pricing of NZUs. This has an impact on all ETS participants, especially those in forestry. You can read more on the consultation here and our co-founder Nick Butchers thoughts here.

Supply chain carbon removal insetting programs are bubbling away just below the surface in the primary sector, left, right, and centre.

Export market access, customer pressure, regulation and compliance are motivating like never before.

The reality is that a finite pool of carbon removals on private farmland is available to benefit these processors. In a fairly short period of time, this will become a competitive space... and an opportunity for farmers to generate and diversify revenue streams and build more resilient businesses.

But not all carbon programs are created equal.

Farmers need to make sure they're not getting locked into programs that are unfair or unethical.

That's a carbon grab.

Farmers need to keep control of their carbon - to decide who gets what carbon, from where and when. That's carbon sovereignty.

It's fantastic to see carbon opportunities outside of the ETS. Non-ETS-eligible native forests in New Zealand play a vital role and are under enormous pressure from pests.

Supply chain carbon removal programs are an option to generate income to help protect and restore these precious native ecosystems.

We'll discuss this at an upcoming CarbonCurious webinar. Register here.

Related Links:

- Report from Aotearoa Circle and Champman Tripp that said 80% of NZ's exports are going to countries with mandatory climate-related disclosures (CRD), either planned or already in place.

- Synlait partnership with Nestle for removals
- Mars announces intention to partner with suppliers
- The opportunity for native forests on farms for supply chain decarbonisation

---

Things You Might Have Missed

External

- Climate Change Commission's advice for ETS review
- OECD Picks Apart the ETS Approach
- UK commodity house to launch carbon trading platform in New Zealand
- March ETS auction result?
- [PODCAST] credits for planting native bush rather than pine trees on farms

Internal

- The opportunity for native forests on farms for supply chain decarbonisation
- What are carbon removals?
- Climate smart forestry - going beyond carbon
- How our tech works
- Poplars in pastures - shade and carbon credits

If you found this helpful, please feel free to forward on to others. They can subscribe **here** to receive the newsletter directly.

The CarbonCrop Team

www.carboncrop.com

If this email has reached you in error, no action is needed on your part. You can simply delete it, but we'd be grateful if you could let us know to avoid us sending you future emails.

You're receiving this email as you've opted in to receive communications from CarbonCrop as a CarbonCopy Newsletter subscriber. To ensure you continue to receive our emails directly to your inbox, please add hello@carboncrop.com to your address book or safe senders list. This helps prevent our messages from being mistakenly marked as spam. To manage your subscription preferences or unsubscribe, you can do so below.

CarbonCrop, 322 Hardy St, Nelson, Nelson Tasman 7010, New Zealand