



Carbon Comment

Unexpected surrendering

Higher Surrenders than Expected for 2019/2020 Emissions Year

After an initial sell-off due to the outbreak of Covid-19, the price of New Zealand Units (NZUs) on the New Zealand Emissions Trading Scheme (ETS) has continued to push higher over the past few months. Fears over the negative impact that Covid-19 would have on economic growth (and therefore a lower level of emissions generated), saw the New Zealand price for carbon fall to \$22.20 amid the Level 4 lockdown in April.

This timing coincided with the deadline for emitters to decide whether to surrender NZUs or pay the fixed price option (FPO) of a \$25.00 payment to offset their 2019 emission obligations. On face value we thought there was a chance that with a NZU price below the FPO and the growth outlook very uncertain, some would choose to utilise any NZUs they held rather than pay out cash under the FPO. The New Zealand Government recently released NZU and New Zealand Assigned Amount Units (NZ AAUs) holdings by category as at 30 June 2020, along with data on the latest surrender, allocations, and entitlements for 2019/2020. They made for interesting reading as they showed a much higher level of surrenders of NZUs than expected.

NZU and NZAAU holdings

As at 30 June 2020, there were 121,388,197 NZUs and NZAAUs, compared to 131,963,470 the prior year. The breakdown is below.

Account Holder Category	Holdings of NZUs & NZ AAUs
Forestry	66,028,941
Non-Forestry	25,239,307
Other	30,119,949
	121,388,197

Source: Salt Funds Management, Ministry for the Environment.

Forestry

This category reflects the number of NZUs, and NZ AAUs held by individuals or organisations involved in forestry. Of the 66 Mt above, 17 Mt is Pre-1990 forest landowners, which is assumed not for sale, and a significant portion of the remainder needs to be repaid at harvest.

Non-Forestry

This category reflects the number of NZUs, and NZ AAUs held by individuals or organisations who have at some stage registered for any other (non-forestry) activity; in other words, the emitters. The 25 Mt reflects what they have accumulated for current and future years.

Other

The number of NZUs and NZ AAUs held by individuals or organisations who are not involved in forestry and have never registered for any activity. Therefore the 30 Mt as at 30 June 2020 represents units held by everyone else that is neither an emitter nor a forestry company (such as the Carbon Fund).

Surrenders, allocations, and entitlements

The biggest surprise from the released data was the total number of non-fixed price surrenders for the 2019/2020 emission year. Net surrenders for the year nearly doubled from the prior year to 32 Mt, reflecting the highest surrender since the reduced obligation settings ceased in 2014. Subsequently, the Fixed Price Option (FPO) dropped by nearly half to 8.6 Mt (21%) of total surrenders. Of the 32 Mt surrendered, 21 Mt (51%) were Forestry NZUs compared to 8 Mt the prior year. The 13 Mt



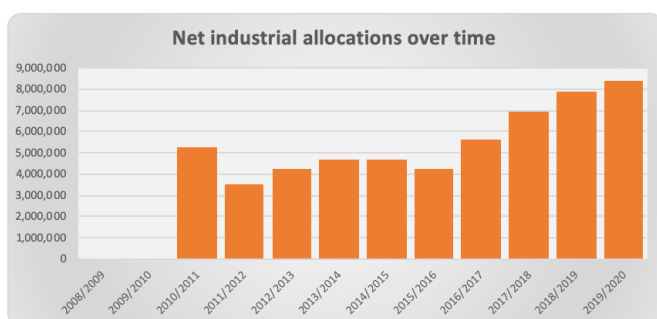
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increase in Forestry NZU surrenders most likely reflects the uncertainty from COVID-19, encouraging more NZU surrenders versus using the FPO to meet surrender obligations.

Unit Type	2019/2020 Net Surrenders	2018/2019 Net Surrenders	Change
Forestry NZUs	20,584,377	8,126,738	12,457,639
Other NZUs	10,998,234	8,239,654	2,758,580
NZ AAUs	71,387	286,423	- 215,036
Total non FPO surrenders	31,653,998	16,652,815	15,001,183
FPO utilised at \$25/ tonne	8,585,573	16,824,649	- 8,239,076
Money received by the Crown under the FPO	\$ 214,639,325	\$ 420,616,225	

Source: Salt Funds Management, Ministry for the Environment.

Net allocations of free NZUs to companies that are both emission-intensive and trade-exposed (EITE) have continued to increase, reaching 8.4 Mt for the 2019/2020 emissions year. The recent changes to the ETS will see industrial allocations decrease over time at a rate of 1% every year until 2030.



Source:Ministry for the Environment.

What does all this mean for the current emissions year?

Current industry estimates suggest a decline in emissions of 10-20% as a result of Covid-19, which would mean NZU surrender/FPO obligation decreases to between 32 Mt – 36 Mt for the current 2020/2021 emissions year.

Given the surge of Forestry NZU surrenders and increase in surrenders from other NZU holders (non-forestry and non-emitters), there is a smaller pool of NZUs left over for the current emissions year – remembering total NZUs and NZAAUs decreased by 10.5 Mt as at 30 June 2020. Emitters will either need to accumulate units at current market prices or pay the 2020/2021 FPO of \$35.

Looking ahead to the 2021/2022 emissions year

The first NZU auction is planned for first half 2021, with the intention of one per quarter. For 2021 emissions, there will be no FPO, so NZUs must be purchased to meet surrender obligations. Some commentators have forecast that surrenders will likely bump back up to between 35 Mt and 40 Mt, but it is difficult to say with the enduring Covid-19 backdrop.

The first emissions cap next year is set at 32 Mt. Of this, 19 Mt can be sourced from the auction and the balance of 13 Mt to come from the industrial allocation (~8 Mt based on prior years), forestry (post – 1989), "other" holders or from the Government's Cost Containment Reserve of NZUs if the auction price hits \$50.

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