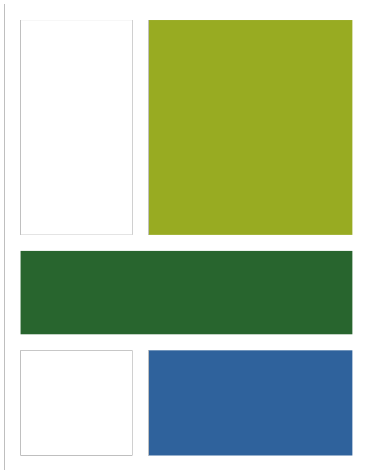


# Forest Carbon Market Update



## Global carbon prices lower

While forest carbon credits cannot (currently) be used in the EU ETS, it is still hard not to be concerned about the drop in prices in this market over the past twelve months. Prices for EU allowances were trading at approx. €7/ton at the start of 2012, down more than 50% from €15/ton at beginning of the 2011. Lower prices reflect concerns that allocations and the EU's economic slowdown have resulted in an oversupply of allowances. As a result, EU legislators are considering policy actions to reduce the supply of EU allowances.

CER prices have also fallen on concerns over EU ETS demand and the volume of recent and future issuances. CERs were trading at just €3/ton at the beginning of January, down from €10/ton at the start of 2011. New Zealand carbon prices, also linked to CER prices, have similarly dropped, trading at just NZ \$7/ton at the start of 2012, compared to NZ\$20/ton at the beginning of last year.

While stable for most of 2011, prices in North America's California carbon market have also recently come under pressure. Prices for California allowances, ended 2011 at \$16/ton (close to its initial trading levels in August. However, as 2012 started, prices fell to \$13-14/ton on concerns over a recent lawsuit challenging California's low carbon fuel standard would have potential implication on state's the cap and trade legislation. Prices for California offsets continued to trade at discount of nearly 30% to allowance prices due to perceived risk around future changes to offset rules and risk of buyer liability in event of invalidation.

By comparison, prices in the voluntary market remained relatively stable in 2011 and early 2012. While many forest carbon investors have pre-compliance motivations, there is no direct link to EU or California markets at this point. As mentioned in earlier updates, we expect the number of new voluntary projects and credit issuances to continue growing in 2012. Incremental sources of demand, including private REDD Funds and new emission reduction programs financed by the FCPF, will help influence prices in 2012.

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## 2012 Outlook

Our top 12 global and forest carbon developments to watch in 2012

1. Start of carbon pricing in Australia
  - Australia is set to launch a carbon tax starting in July 2012 that will be replaced by an emission trading scheme in July 2015. The carbon tax sets a fixed price of A\$23/ton (US\$24/ton), attractive by global carbon price standards.
  - Offsets from Australia's domestic Carbon Farming Initiative (CFI) can be used to reduce compliance obligation of firms by up to 5% during the carbon tax phase and by an unlimited amount in the emission trading phase. CERs will be allowed up to 50% in the emission trading phase. Linkages to the New Zealand market are scheduled for discussion in 2012.
2. Beginning of California allowance auctions, and more lawsuits
  - While compliance in the California cap and trade program does not start until 2013, the first allowance auctions are set to take place in August and November 2012.
  - The judge's ruling on lawsuit challenging the legality of the fuel standards component of California's AB32 legislation will be closely watched for its potential impact on the cap-and-trade component of the legislation. Additional lawsuits to stop the cap and trade component may anyways be filed in 2012.
3. First investments by FCPF Carbon Fund?
  - Selection and first investments in national or subnational REDD programs by the FCPF Carbon Fund could be announced in 2012.
  - Details on the price for emission reductions and where and how funds will flow in these programs will help inform pricing and design of project-based transactions.
4. REDD Fund Closings
  - Several REDD+ funds, which are in capital raising mode now, will be looking to close their first rounds of financing in 2012. See Durban update for a summary of these funds.
5. Progress of the Green Climate Fund, Durban Platform, and REDD+ discussions at UNFCCC
  - The newly formed working group on the Durban platform for enhanced action will begin its work in the first half of 2012. Details on the work plan for this group and submissions on how to increase the level of ambition are expected in early 2012.
  - Long term funding for the Green Climate Fund, including more details on how a private sector facility might work, will be further discussed during the year.
  - Voluntary submissions on REDD+ reference levels are also likely, and will also be of interest to project-based developers for insight

- into how national baselines are proposed and implications for nesting of project level baselines.
6. U.S elections
    - U.S. presidential and congressional elections will be held in November; while most do not expect cap and trade to be back on the agenda, domestic energy and clean air policies, and international climate change policy will likely be impacted by election results.
  7. China's implementation of cap and trade pilots
    - China's national plan includes targets to reduce carbon intensity by 40-45% by 2020. Seven Chinese provinces have announced plans for pilot emission trading schemes. Further details on these schemes, including use of offsets, is expected in 2012.
  8. Carbon markets in other emerging countries
    - While controversial in the developed world, cap and trade may be less feared in countries experiencing higher rates of economic growth. Several developing countries, including South Africa, Chile, and Brazil, will further examine emission trading schemes in 2012.
  9. Progress in other Western Climate Initiative (WCI) states
    - Quebec passed cap and trade legislation in December 2011, it expects allowance auctions to begin in 2012, and will begin discussions with California on linking in 2012.
    - Ontario may issue regulations in 2012 but has recently indicated it probably will not join WCI states, California and Quebec, in 2013.
  10. EU ETS Phase II comes to an end, policy actions to address oversupply?
    - 2012 will mark the end of Phase II of the ETS. Policy actions to address oversupply of allowances in Phase III will be considered by lawmakers.
  11. Launch of first national and sub-national REDD programs?
    - Details on some of the first sub-national and national REDD programs supported by the FCPF Carbon Fund may emerge this year and will be closely watched by all REDD project developers and investors.
  12. Guidance on nesting REDD projects into national and sub-national programs
    - The VCS Joint Nesting REDD Initiative (JNRI) will be publishing its recommendations in 2012. The guidance will be watched by both project developers and administrators of sub-national (and national) programs considering how projects might be nested into these programs.

## About TerraCarbon

TerraCarbon LLC is an advisory firm that supports the development of forest and land based projects that reduce greenhouse gases. We provide technical, transaction, and strategic advisory services to the world's leading conservation organizations, forward-thinking corporations, and environmental market investors. For more information, see [www.terraCarbon.com](http://www.terraCarbon.com).

## Contact

Scott Settelmyer  
[scott.settelmyer@terraCarbon.com](mailto:scott.settelmyer@terraCarbon.com)  
+1-309-693-9303

David Shoch  
[david.shoch@terraCarbon.com](mailto:david.shoch@terraCarbon.com)  
+1-434-326-1144