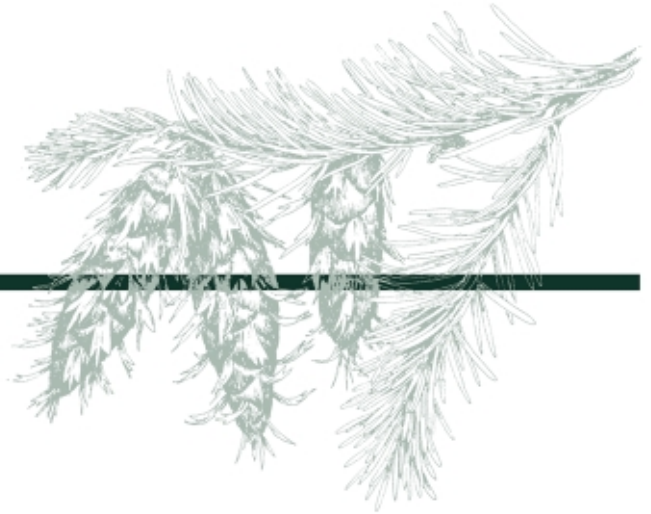


Hancock Forest RESEARCH *Brief*

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Backgrounder:

Investing in Forests as Part of the Response to Climate Change

September 2000

Introduction

Global climate change has emerged as one of the great challenges of the 21st century. At a recent meeting of the World Economic Summit in Davos, Switzerland, CEO's and political leaders identified global climate change as the most pressing issue facing the world today. Similarly the United Nations Environment Program polled the world's leading scientists and again found that over half viewed climate change as the most significant global issue. There is a growing consensus that the risk of climate change, and the potential impact on humankind, is sufficiently high to begin taking action. The environment is no longer a public relations issue—corporations and governments recognize that environmental impacts will reduce shareholder value and impact on the bottom line.

The role of forests in addressing global climate change is threefold:

- Forests and forest soils contain three times as much carbon as the atmosphere. As forests grow, they remove carbon dioxide from the atmosphere and give off oxygen. Planting new forests is often called a “carbon sink” because it will siphon greenhouse gases out of the atmosphere.
- The manufacture of wood products uses low amounts of energy and those products store carbon out of the atmosphere throughout their lifetime of use. As the world attempts to limit fossil fuel energy use, there will be a push to extend the use of products like wood in society.
- Finally, forests grow by absorbing sunlight and storing it as chemical energy. When we burn wood, we create energy by releasing that stored energy. Forests that are harvested and regrown can provide renewable energy as biomass energy, charcoal or ethanol. These energy systems are considered renewable as there is no net increase in atmospheric carbon dioxide where the forests are regrown.

Opportunities for Forestry Investment

As governments and business seek out ways to address climate change at the lowest cost to the economy, these three factors make the forest sector an attractive part of the solution. The Kyoto Protocol (an international agreement on climate change), for example, identified the establishment of new forests as a credit

against greenhouse gas emissions. This means that if a forest is planted and absorbs and stores 100 tonnes of carbon dioxide, a credit can be given against 100 tonnes of emissions. Most governments and businesses want to see emissions trading systems introduced that will allow greenhouse gas emitters to reduce their own emissions or buy emissions reductions or credits in the marketplace. This means that everyone has access to the same cost of reducing greenhouse gas emissions and that the market will seek out innovations and cost effective solutions, driving down the cost over time.

Many companies are already undertaking emissions trading and investment in carbon sinks. There is a belief by many businesses that early positioning on the climate change issue is part of their competitive strategy. Companies that are able to mitigate their risk exposure to the potential future price of carbon credits or emissions reductions will be more likely to maintain their commercial performance in an era of greenhouse emissions regulation.

Much pioneering work has occurred in the area of carbon sequestration in New South Wales, Australia. Carbon trades between forestry agencies and power companies occurred in 1998. The New South Wales Government introduced legal rights to the carbon stored in new planted forests in late 1998. A quantitative carbon accounting standard with specified errors and a carbon pooling mechanism have been developed. All these factors are leading toward the implementation of early carbon credit trading.

There is still some uncertainty in the area of greenhouse gas markets and the identification of the right business opportunities related to climate change. For this reason, mechanisms have been designed to allow investment in forests that can provide both timber returns and carbon credits. These investments provide a hedge against the future price of carbon credits. If carbon credits trade at our projected prices of \$US6 to \$8 per metric tonne of carbon dioxide, forestry investments may provide enhanced internal rates of return to investors. If the carbon market has a low price or is delayed, the underlying forestry asset still has value in the traditional timber markets.

Forests are not a panacea and will be only a part of the overall action on climate change. Even in Australia, where there is a need for millions of hectares of reforestation to combat land degradation, carbon sequestration will likely only contribute one-quarter of the effort needed to meet the Kyoto Protocol targets. However, with the emergence of risk management frameworks for carbon sequestration and effectively designed investment products, sequestration programs can be an effective part of an overall emissions management strategy.

Increasingly, forest managers see the potential to create carbon pooling vehicles that will balance the growth and carbon sink capacity of the forest with harvesting of forest products — with the goal to provide an optimum return to investors. It may also be possible to structure investment products that will bring together business and institutional investors into vehicles that increase the efficiency of generating carbon credits for business and providing financial returns to investors.

Toward a New Class of Forestry Investment

The Hancock Natural Resource Group announced in July 2000 that it would be establishing a new business unit in Sydney to offer investments related to potential climate change opportunities for current and new investors. The unit will design and market products based on establishing new forests in regions of the world to meet robust risk-return goals, and which fit within the rules for carbon sinks and carbon trading markets.

Our goal is to be the world's most effective advisory and management service to investors seeking sequestration related investments. In particular we are dedicated to provide:

- Capital protection and capital growth
- Acceptable liquidity for exiting the investment
- Full services related to carbon sequestration credit certification, registry, and project monitoring and reporting
- Assessment of environmental and social impacts of all projects before commencement to ensure a contribution to sustainable development

For further information, please contact:

David Brand
Director, Carbon Programs
Hancock Natural Resource Group

Phone 61 2 8850-5890
Fax 61 2 8850-5891
e-mail dbrand@hnrp.com.au