



Forest Carbon Market Update

2nd Quarter 2011

International Update

Bonn talks produce little progress

UNFCCC negotiators gathered in June in Bonn, Germany for the second time this year. Like the first round of climate talks earlier this year, negotiators devoted most of their time to agenda and procedural issues, and made scant progress on substantive issues and text that could be presented for decision at the Conference of Parties later this year in Durban, South Africa (COP 17). Debate on extension of the Kyoto Protocol continues to dominate the talks, despite clear signals over the past two years that most developed and advanced developing countries are unwilling to commit to legally binding emission limits after the protocol expires in 2012. Negotiators claimed progress on technical fronts, although significant work remains on details of the pledge and review system and new mechanisms such as NAMAs and a REDD+ that were outlined in Cancun.

The Subsidiary Body for Scientific and Technological Advice (SBSTA) of the UNFCCC also met in Bonn in June. With respect to the proposed REDD+ mechanism, SBSTA requested submissions from countries and accredited observers on safeguards, reference levels, and MRV by mid-September. While considered progress by some, it seems very little in the months since Cancun. SBSTA plans to meet once more before COP 17.

FCPF operationalizing Carbon Fund

In early June, Norway and Germany announced that they would contribute \$50 million and \$30 million, respectively, to the Carbon Fund of the World Bank's Forest Carbon Partnership Facility's (FCPF). The Carbon Fund, which now has more than \$200 million of commitments, is intended to support results-based activities, and will target payments to about five emission reduction programs in countries that have made considerable progress in REDD readiness. The programs supported could be either national or sub-national programs that are consistent with national strategies. Further details regarding reference levels and

MRV for sub-national programs, and the price for emission reductions, still need to be worked out and will be closely watched by market participants.

U.S. Update

California cap-and-trade delayed

In late June, the chair of the California Air Resources Board (ARB), Mary Nichols, announced that California was planning to delay its cap and trade program until 2013. The program, which had been originally scheduled to begin in 2012, is being postponed to provide more time to develop rules and regulations for the program. The emission caps for 2013-2020 will not change as result of the delay, and therefore, the impact on demand for offsets from eliminating the 2012 compliance year of the program is expected to be minimal.

As reported in our last update, California's cap and trade program is being challenged in court on the grounds that other alternatives to cap and trade were not adequately considered. ARB has appealed the judges' initial ruling and obtained a stay to be able to continue its work until the appeal is heard. ARB has also recently completed an options paper that evaluates other alternatives and concludes that cap and trade is the best option for reducing GHGs.

In the meantime, ARB is continuing its preparations on several fronts, including on offsets. US forestry offsets are among four types of offsets currently allowed by the draft offset rules. Offsets issued under the Climate Action Reserve (CAR) are eligible for conversion into compliance offsets if the project started after Jan. 1, 2005, although ARB may require projects to revalidate their projects to ARB standards, potentially requiring changes to included carbon pools, baselines, and buffers. International REDD credits are also being considered (likely in 2015 or after), and discussions are underway with the states of Chiapas (Mexico) and Acre (Brazil) regarding potential linkages to jurisdictional REDD programs that may be established in those states.

Voluntary Market Update

Voluntary market grows slightly in 2010

The State of the Voluntary Carbon Markets 2011 report produced by Ecosystem Marketplace and Bloomberg New Energy Finance was released in June. The report, based on the results of surveys completed by market participants, estimated that more than 131 million mtCO₂e were traded in the voluntary market in 2010, up from 98 million mtCO₂e in 2009. Excluding a one-off transaction of 59 million mtCO₂e of CCX instruments, the volume of the voluntary, over-the-counter market was estimated at 69 million mtCO₂e last year (55 million mtCO₂e in 2009).

The Agriculture, Forestry, and Other Land Use (AFOLU) sector lead all sectors in terms of volume accounting for 28 million mtCO₂e in 2010 (8 million mtCO₂e in 2009); REDD alone accounted for more 18 million mtCO₂e (3 million mtCO₂e in 2009). Latin America and the United States were the primary project locations, for AFOLU and all sectors, accounting for 16 million and 6.5 million mtCO₂e respectively. The Verified Carbon Standard (VCS) and the Climate, Community, and Biodiversity (CCB) Standards were the most popular standards used by voluntary participants, accounting for 34% and 19% of credits respectively. The average price paid for voluntary credits was reported at about \$6.00/ton in 2010 (\$6.50/ton in 2009). Average prices for REDD credits in 2010 were reported at \$5.00/ton; average prices for IFM and AR credits were slightly higher at \$6/ton and \$9/ton respectively (albeit on lower volumes). The range of reported prices varied based on marketplace, co-benefits, project risk, and transaction structure.

VCS updating AFOLU requirements, new AFOLU projects registered

In early June, the VCS issued draft revisions to update its AFOLU Requirements that were issued in March 2011. The revisions would add Avoided Conversion of Grasslands and Shrublands as an approved AFOLU project category, and clarify methodological requirements for estimating market and non-market leakage. The VCS is also developing a tool for estimating market leakage that it expects to release for public comment in mid-2011. The public comment period for the revisions is open until July 23rd.

The number of registered VCS AFOLU projects registered grew to twelve in the second quarter, with the addition of eight more AFOLU projects, including the first two IFM projects. The new VCS AFOLU projects registered in 2Q2011 are summarized below.

Name	Country	Project Type	Description	Est. Annual Volume
Darkwoods Forest Carbon	Canada	IFM	Logged to Protected Forest	125,000 tons
Kasigau Corridor – Phase II	Kenya	REDD	Avoiding unplanned mosaic deforestation	1.6 million tons
TIST Program	Kenya	AR	Small scale AR (4 projects)	55,000 tons
Protection of Tasmania Native Forest	Australia	IFM	Logged to Protected Forest (2 projects)	60,000 tons

Source: VCS Project Database; Est. Annual Volume is derived from Ex Ante Estimates in the Project Description, and is estimated before buffer withholding.

Market Price Update

California: Allowances prices rise, offsets trading at discount

Prices for California allowances for delivery in 2012 were quoted at \$16.75-\$17.25/ton at the end of June, up from \$13.75-\$14.25/ton at the end of March (source: Point Carbon). The price rise is attributed to increased clarity on the start of the cap and trade program, and an increased premium being placed on allowances relative to offsets. As reported last quarter, California offsets are trading at a steep discount to allowance prices due to the risk of offset invalidation, or the risk that buyers may need to replace California offsets submitted for compliance in the event fraud at the offset project level. Prices for guaranteed offsets were being quoted at \$10-12.50/ton in mid-June (source: Point Carbon). Prices for CAR credits that may be converted into ARB credits are trading at a further discount, in the range of \$7-8/ton, given additional uncertainty regarding rules and process for conversion into compliance offsets (see above).

VCS: Prices steady

Prices for VCS AFOLU credits continue to be quoted in the \$5-10/ton price range, in line with last quarter, and consistent with the price ranges reported in the State of the Voluntary Carbon Markets (see above). Point Carbon reported that REDD credits are being quoted at \$5-8/ton, with one transaction reported at \$7/ton. Point Carbon also recently reported that VCS AFOLU credits have been quoted at \$3-5/ton for US projects and \$6-9/ton for international projects.

About TerraCarbon

TerraCarbon LLC was established in 2006 as a carbon markets advisory firm specialized in the agriculture, forestry, and other land use ("AFOLU") sector. We provide a range of technical, transaction, and strategic advisory services to project developers and investors in the carbon market. We operate across all AFOLU project types and all carbon markets. For more information, see www.terracarbon.com.

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