

Creating a new asset class



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DAVID BRAND has built a company based on developing investment models that incorporate the value of nature's ecosystem services. He believes the world of environmental investment is poised for growth.

What is an EIMO and why does the world need them? EIMO stands for Ecosystem Investment Management Organization, an expansion on the Timberland Investment Management Organization (TIMO) model that is dominating private investment in forests worldwide. In contrast to the timber-focused TIMO model, EIMOs develop investment programmes that generate value based on the ecosystem services provided by forests. These ecosystem services are forming the basis of new markets and payment schemes for conservation, creating a new asset class of ecological products. Eco products include carbon credits from forestry and land management, endangered species banks, wetlands banks, water quality credits and other cutting-edge instruments for environmental transactions.

The development of eco products has initially been seen as a cottage industry. Firms involved in early carbon trading experiences, wetlands or endangered species projects and land conservation initiatives were often start-up companies or community-based organizations. In some cases, larger investors saw opportunities to add value to timber investments by selling conservation easements or developing carbon credit projects, but eco product development was not their core business.

Environmental markets are now growing up, and investors are taking notice. The global carbon market nearly tripled between 2005 and 2006 to trade over USD 30bn globally, and mitigation banking in the United States of America trades over USD 1bn per annum. With these volumes, EIMOs are starting to emerge to help large-scale investors capitalize on environmental market opportunities and expectations for growth. The three biggest environmental challenges of the century have been identified as climate change, the declining availability of fresh water and the loss of biodiversity. As these services become increasingly scarce, it can be expected that the underlying ecological assets will

body for the project's biodiversity and water quality benefits and an ability to trade in approximately 105 million litres of water property rights, which could be leased to downstream irrigators. There is also exposure to the state-based regulatory carbon market (the New South Wales Greenhouse Gas Abatement Scheme), and New Forests expects to generate reforestation-based carbon credits to sell into this scheme.

As investment capital moves into this space, it brings a host of new approaches such as aggregation of carbon pools or endangered species banks to reduce risk and volatility. Financial experts

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become increasingly valuable. Investors will want to be on the right side of this trend.

Developing the model

The rise of the EIMO will be driven by the proliferation of market-based or monetary approaches to valuing both environmental impacts and environmental benefits. In the past a landowner with endangered species, critical wetlands or native forest was saddled with a liability in financial terms; commercial development would be hampered or prevented in the name of conservation. Now these eco products are being priced through regulatory and voluntary market-based trading mechanisms, and they are moving from liabilities to assets.

New Forests Pty Limited is a company designed to foster and capitalize on these opportunities. The Australia- and US-based firm manages institutional and private equity investment and focuses on maximizing returns through sustainable timber production and exposure to ecosystem-based revenue streams. New Forests recently developed a project in Australia based on reforesting an 8,500 hectare cattle grazing property to native Eucalyptus species and expects to generate over half of the total returns from environmental revenue streams. These include a AUD 1m grant from the regional natural resource management

can also design financial products, such as securitization of eco-credits, which create liquidity and a capacity to expand financial options for project developers. These more sophisticated instruments will catalyze further investment and growth in the sector.

Rainforest conservation

While many of the emerging eco markets are largely in Australia, Europe and the U.S.A., there is increasing interest in how these concepts may be applied to emerging markets, particularly related to rainforest conservation. As carbon markets have grown, interest has turned to rainforest conservation as a future component of the global carbon market. Approximately 20% of the world's annual greenhouse gas emissions are a result of deforestation, so climate change solutions will need to encompass conservation in addition to reforestation.

Avoided deforestation is expected to be a front-and-centre issue at the next COP of the UN Framework Convention on Climate Change. The agribusiness sector is also coming under increased scrutiny for its ecological side effects, such as a land clearing for palm oil. Deforestation has a significant impact on endangered species, so while the climate change benefits are often a first-order issue, biodiversity is quickly becoming a central driver for efforts to conserve forests. This results in



EIMO investors considering projects that create conservation banks as the basis for selling offsets based on biodiversity impacts, for example to the bio-diesel supply chain. New Forests has been working with clients in Africa and South East Asia on projects that seek to develop these concepts and demonstrate that intact tropical rainforests could become assets in their own right for both carbon and biodiversity benefits. This model can also provide sustainable revenue streams to communities through annuity payments for forest preservation and maintenance.

Valuing nature's infrastructure

Ecosystems are our natural infrastructure. Much like airports and roads that provide services to transport, hospitals that provide services to human health and universities that provide the service of education, ecosystems provide regulation of our atmosphere, water quality and a healthy and resilient planetary life support system. Why shouldn't nature be priced like the other services that we require?

As the global economy grows from its current USD 50 trillion per annum to USD 100 trillion – and on to hundreds of trillions of dollars per annum – the weight of economic impact on ecosystems will grow, and the services provided by those ecosystems will come under pressure. This should translate into new valuable asset classes with new eco products that will steadily rise in value. Effectively, companies such as New Forests offer the opportunity for investors to go “long on ecosystems” and benefit from the rise of carbon, water and biodiversity related markets.

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