Valuing carbon credits

As carbon markets in Australia and internationally continue to evolve, the policies, methodologies and Standards that support them are being improved and the market's understanding of what drives the price of each carbon credit is maturing.

Following the recent policy changes across Australia's compliance market and improved transparency in the international voluntary carbon market (VCM), we're getting a clearer picture of what investors place a value on when investing in carbon credits.

Using VAI data, this paper illustrates why some carbon credits trade at a premium relative to others, and illustrates the need to look past the benchmarks to reveal the true underlying value of individual projects.

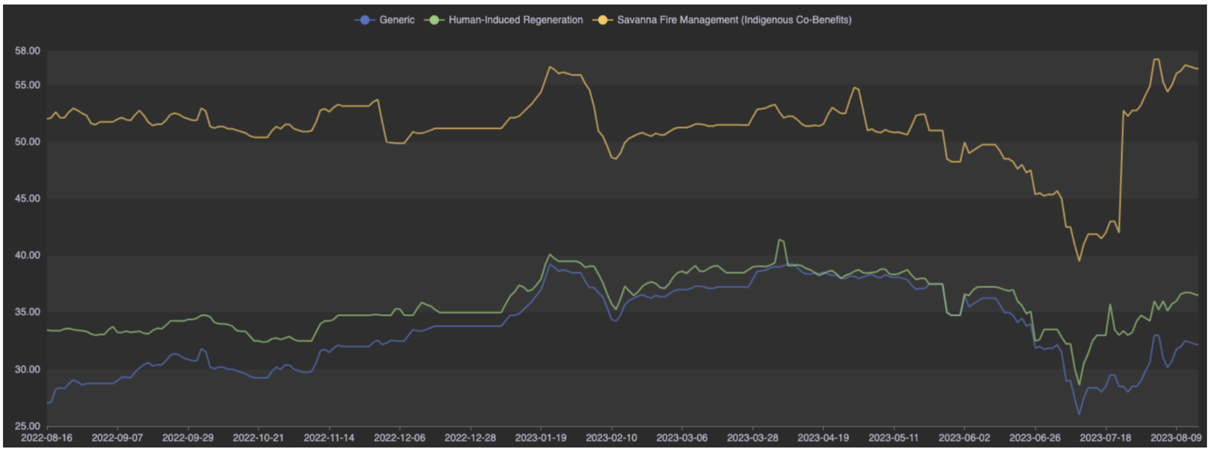
Policy and methodology changes

Following the implementation of the Chubb Review recommendations and the changes to the Safeguard Mechanism coming into force on 1 July, Australia's carbon market is continuing to improve.

At the heart of the market are the various Australian Carbon Credit Unit (ACCU) methodologies. In addition to their carbon avoidance or removal benefit, certain ACCU projects deliver unique industry and community benefits which the market places a discrete value on. With some methods expiring and others continuing to meet demand for key co-benefits, we're seeing significant price stratification across the market.

VAI data shows that credits generated under the Human Induced Regeneration (HIR) methodology are once again trading at a premium to generic ACCUs, being credits generated by avoided emissions-based projects, such as landfill gas and avoided deforestation. This differentiation became more pronounced in mid-June and has held relatively consistently over the past months. With the HIR method expiring on 30 September, it appears the future supply constraint is driving demand and the price of these credits.

Projects that deliver clear Indigenous benefits are continuing to trade at a significant price premium, with VAI showing ACCUs generated under the Savanna Fire Management (Indigenous Co-benefits) trading up to 73% above generic ACCUs.



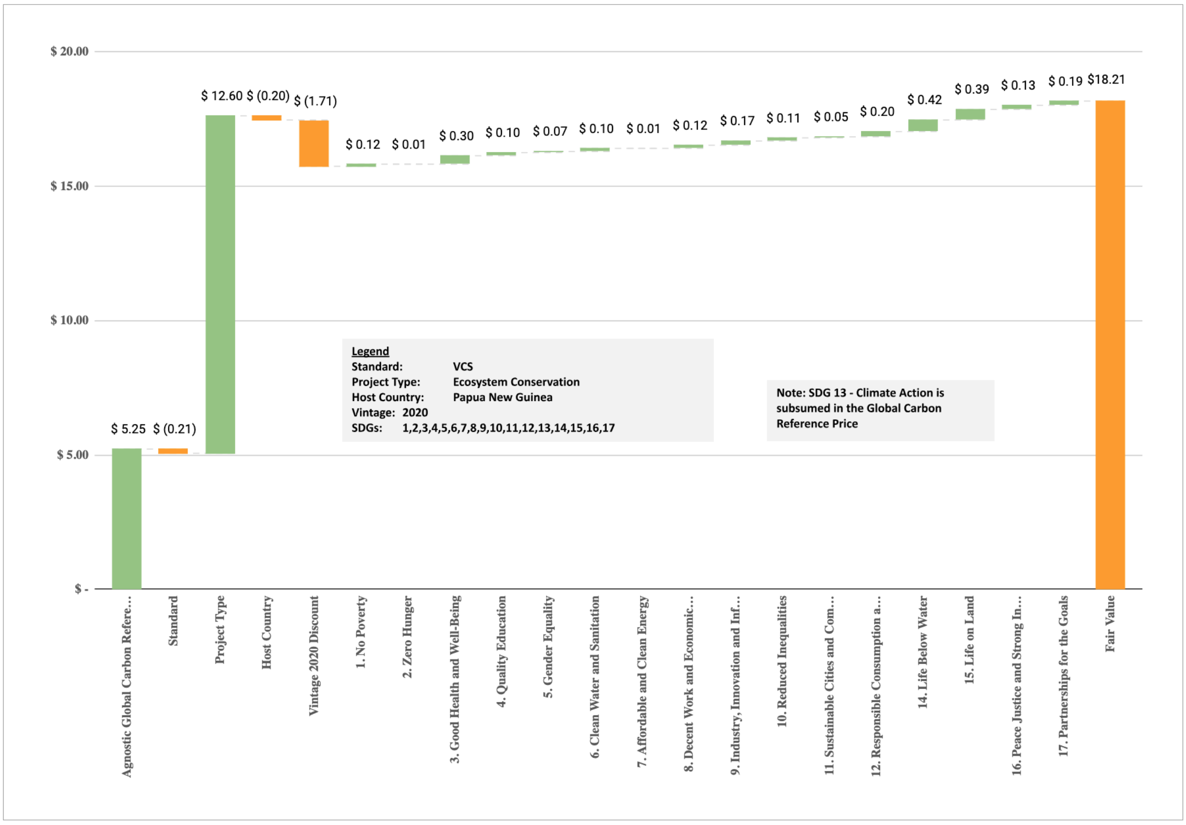
More than carbon

Much like projects with Indigenous co-benefits in Australia's compliance market, VCM projects which deliver for local communities should also be highly valued.

Effectively valuing carbon credits is key to helping the world achieve its climate targets while ensuring the U.N. Sustainable Development Goals (SDGs) are met. With the 17 SDGs "a universal call to action to end poverty, protect the planet and improve the lives and prospects of everyone, everywhere", it is vital to understand the unique impact of each carbon project.

Projects differ greatly in terms of which SDGs they focus on, and how they achieve those outcomes. Some may emphasise life below water (Goal 14), while others target improvements against Goals 5 and 8 (Gender Equality, and Decent Work and Economic Growth). Our in-house analysis shows that corporate buyers are selecting projects with SDGs that most closely support their sustainability goals, which often differ by sector.

For local communities, however, the SDGs a carbon project contributes to can be life changing. From installing clean water, sanitation and power systems for local communities to providing education scholarships (often focusing on education and training for women and girls), medical facilities and paid employment through ranger programs, SDGs provide key measurable benefits of carbon projects. To illustrate the impact SDGs can have, this hypothetical analysis using VAI data illustrates the positive verified impact of the 17 different SDGs on an example REDD+ project.



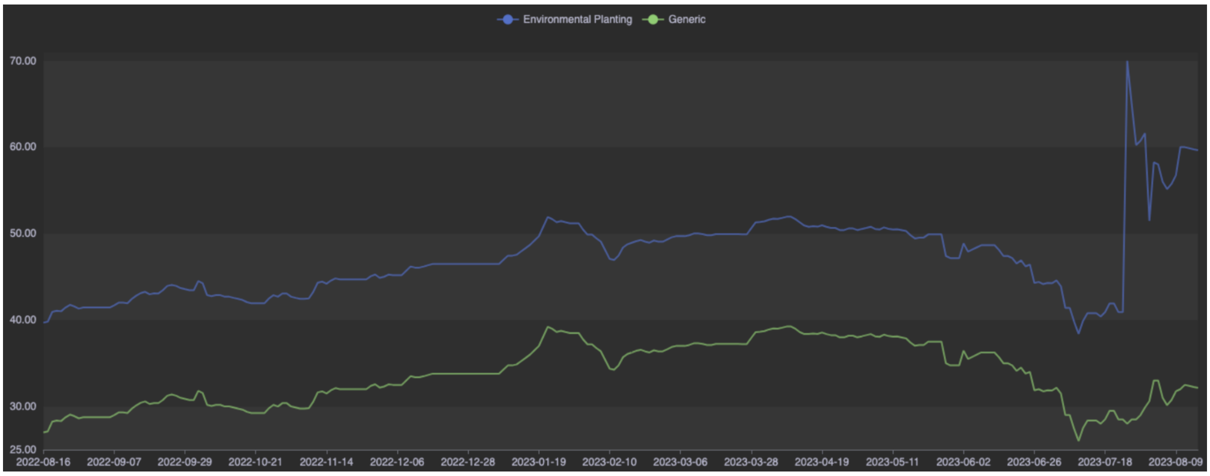
As carbon markets continue to mature, we are increasingly coming to understand the unique nature of carbon credits as an asset class. This is demonstrated through our research findings which shows that voluntary carbon credit buyers are most likely to prefer projects with Indigenous co-benefits.

In many ways, the various attempts to standardise carbon credit pricing around narrowly conceived delivery specifications has been an experimental failure. It has only served to undermine the prices paid for carbon credits and reduce the potential benefit for local communities.

To better value carbon credits and help educate the market about the unique value of each project, VAI provides pricing at an individual project level. This allows buyers to determine the value by vintage and SDGs a project delivers, giving them greater certainty about what they are investing in.

Quality is key

The ability for a carbon project to continue to demonstrate its effectiveness at delivering its stated co-benefits and carbon removal or avoidance impacts is key to it holding its value. One example of the value the market places on methodology can be seen on Australia's ACCU market. VAI data shows that over the past 12 months, ACCUs generated under the Environmental Planning methodology are up around 28% while generic ACCUs are down around 5%.



The challenge ahead

Carbon market policy and methodology progress in Australia and internationally have laid the foundation for the continued growth and improvements of the markets. Importantly, the changes provide project developers and investors with greater confidence to invest in vital carbon removal and avoidance projects. With the latest research from Oxford, Cambridge, Yale and East Angelia, "Rising Temperatures, Falling Ratings: The Effect of Climate Change on Sovereign Creditworthiness", finding that taxpayers around the world are facing more than AU$1.6 trillion a year in extra interest on government debt if temperatures continue to climb unabated, greater investment is needed in ACCU and VCM projects to mitigate climate related budget stress, and to urgently offset those emissions that cannot be immediately avoided or reduced. Importantly, with detailed project level pricing now available through VAI, investors can look past the benchmarks and access the detailed information they need to deploy capital to benefit the planet and fund SDG aligned programs that improve the lives of local people.