Stage 2B Cost Recovery Impact Statement

Forestry in the Emissions Trading Scheme: Review of the annual charge and Field Measurement Approach reporting for the 2023-25 period

Climate Change (Forestry) Amendment Regulations (No 2) 2024

Agency Disclosure Statement

This Cost Recovery Impact Statement has been prepared by the Ministry for Primary Industries. It provides an analysis of options to reduce the annual charge for post-1989 forestry Emissions Trading Scheme participants starting in the 2024/25 financial year (on 1 July 2024).

There are caveats in the data and analysis. These are discussed in the CRIS in more detail as they arise. Major caveats are summarised in this disclosure statement.

Options have been developed and assessed for updating the per hectare annual charge for post-1989 forestry participants in the Emissions Trading Scheme (ETS) in accordance with the cost recovery principles of transparency, justifiability, efficiency and equity defined in relevant legislation and MPI's cost recovery guidance.

MPI considers that the cost recovery principles have been sufficiently met to progress the revised annual charge, noting that careful consideration has been given to the appropriateness of full cost recovery of club goods while the forestry ETS is still in transition (as a new online system and operating model are implemented following changes to the forestry ETS rules in 2023) and some Crown funding in the short term.

Submissions emphasised that a reduced annual charge is a step in the right direction but considered that the annual charge should be reduced further, removed entirely or include exemptions for indigenous forestry or forests that have reached their average age. Removing the annual charge entirely is inconsistent with cost recovery principles. Some of these suggestions are out of scope of this review but will be considered as part of the full 2025-26 review of cost recovery settings.

The increase in net present value between the status quo and the proposed annual charge ranges was modelled using best available costs estimates. There is considerable uncertainty about future New Zealand Unity (NZU) prices. There is a marginal benefit and any afforestation response to the revised annual charge cannot be definitively estimated because the increase in profitability is much smaller than the margin of error for afforestation models.

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Executive summary

New Zealand owners of post-1989 forest land can choose to become a participant in the forestry components of the ETS (forestry ETS), where they can acquire New Zealand Units (NZUs) for the carbon they sequester. As participants, they can then sell NZUs for financial benefit.

The Ministry for Primary Industries (MPI) provides the administrative services that allow the forestry ETS system to function[1]. These services include processing the applications, verifying the type and size of forests, and managing compliance. Administering the forestry ETS is modelled to cost MPI $20 million for the 2024/25 financial year.

Proposal 1: Reduced annual charge

In 2023, cost recovery was implemented for forestry ETS costs incurred by MPI via two tranches of changes to enable full recovery of costs chargeable to forestry ETS participants under fee-setting guidelines. These proposed cost recovery measures are split into service fees or an annual charge based on their private, public or club good. Tranche One increased seven core service fees and implemented two new core service fees. Tranche Two introduced new fees for 22 existing services and a new annual charge of $30.25 (excluding GST) per hectare based on aggregation of six club good components.

The first of two proposals is to reduce the per hectare annual charge for post-1989 forestry ETS participants from $30.25 to $14.90 (excluding GST) per hectare, starting in the 2024/25 financial year[2]. Of the $15.35 reduction, $6.53 is due to efficiencies realised, a revised cost model and the updating of the modelling assumptions[3]. MPI proposes that while the forestry ETS is in a transitional period the Crown covers an additional portion of the club goods (80 percent of IT system depreciation and capital charge, and legacy cases that pre-date the current emissions return period and cost recovery regulations), representing a $8.82 reduction in the annual charge participants would have to pay.

Proposal 2: Change to Field Measurement Approach (FMA) requirements

Forestry participants with at least 100 hectares of post-1989 forest land in the forestry ETS are required to use the Field Measurement Approach (FMA) to calculate carbon stored in their forests for their emissions returns. When the previous (2023) cost recovery regulations were enacted, they imposed a service fee that resulted in additional costs for participants who could reasonably rely on their existing data or use default carbon tables to calculate carbon stock, during the shorter reporting period.

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[1] MPI has delegated authority from the Environmental Protection Authority (EPA) who has legislated authority to administer the ETS.

[2] The financial year begins 1 July.

[3] For example, updated modelling assumptions use new values for anticipated area of forest registered in the ETS over time, based on information collected since the Tranche 2 modelling was undertaken.

The second proposal is that to address this issue, regulations will be updated so that all FMA participants submitting an emissions return covering all or part of the 2023-25 reporting period will be able to calculate carbon stock using:

a) the default carbon tables in the Climate Change (Forestry) Regulations 2022 (the Forestry Regulations) if they do not have FMA participant specific tables (PSTs); or
b) existing PSTs if they are available to the participant.

The structure of this Cost Recovery Impact Statement (CRIS)

This document follows the template for a Stage 2b CRIS, with the addition of a background section. Some of the sections of the template only relate to proposal 1 (the reduced annual charge). Table 1 outlines which proposal(s) are discussed in each section of the document.

Table 1: Structure of this Cost Recovery Impact Statement

Section of this document	Proposal the section relates to
1. Background	Proposal 1
2. Status Quo: The current annual charge	Proposal 1
3. Cost Recovery Principles and Objectives	Proposal 1
4. Policy Rationale	Proposal 1
5. The level of the revised annual charge and its cost components	Proposal 1
6. Impact analysis	Proposals 1 and 2
7. Consultation	Proposals 1 and 2
8. Conclusions and recommendations	Proposals 1 and 2
9. Implementation plan	Proposals 1 and 2
10. Monitoring and evaluation	Proposal 1

Consultation

MPI publicly consulted on the proposed changes between 12 October and 13 November 2024. Fifty-eight submissions were received from individuals, forestry companies, forestry sector organisations, territorial authorities and Māori and iwi organisations. In general, submitters were not in favour of any annual charge but some submitters indicated support of a reduced annual charge as a step in the right direction.

Submitters who commented on the FMA proposal agreed that the rules should be clarified to minimise costs for FMA participants during the shortened 2023-25 reporting period.

Conclusion

Proposal 1

The proposed $14.90 (excluding GST) per hectare annual charge best meets the cost recovery principles and objectives at this time because it reflects the 2024 revised cost model, updated modelling assumptions, and efficiencies realised in the system since the modelling was undertaken for the status quo annual charge. The treatment of IT system costs and legacy cases differs between the status quo and proposed revised annual charge. The proposed revised annual charge takes account of the forestry ETS registry[4] still going through a transition period, as IT and operating costs continue to stabilise, services continue to mature, and efficiencies continue to be gained and provides for some ongoing Crown funding during that period (noting a full review of cost recovery settings including service fees and the annual charge will be undertaken in 2025-26).

Proposal 2

The proposed approach for FMA participants in the 2023-25 reporting period to use existing or default carbon tables best addresses the policy because it aligns with the policy intent when the 2023 changes were made. The original policy intent was to provide options for FMA participants to reduce their operating costs during the shorter 2023-25 reporting period. It is also more efficient and equitable because it is a simpler approach for this shorter reporting period.

Implementation

The proposed revised annual charge and carbon measurement for FMA participants in the 2023-25 reporting period will be implemented through amendments to the Climate Change (Forestry) Regulations 2022 and publicly notified in the New Zealand Gazette. The changes will come into effect in quarter 1, 2025 (calendar year). MPI will notify post-1989 forestry participants in the ETS of the new rates and update existing forms and other material to include the appropriate rates.

The service fees that complement the annual charge and were updated in 2023 remain in place. The service fees and annual charge will be revisited to ensure they are appropriate when a wider review of cost recovery settings is undertaken from 2025-26.

[4] In this context, 'forestry ETS registry' means the forestry components of the ETS administered by Te Uru Rākau – New Zealand Forest Service, a branch of MPI.

Contents

1. Background

The New Zealand Emissions Trading Scheme (ETS) is a policy tool intended to help meet New Zealand's emissions budgets, domestic targets, and international climate obligations. By pricing greenhouse gas emissions, the ETS incentivises emissions removals through forestry. The ETS is optional for forests established after 1989 and forestry outside of the ETS also contributes to the above stated budgets, targets, and obligations.

In June 2020, the Climate Change Response (Emissions Trading Reform) Amendment Act 2020 (‘the Amendment Act’) was passed into law. The Amendment Act made extensive changes to the ETS for forestry participants to increase the incentive for afforestation and to simplify the ETS for participants. Changes to the forestry ETS included the introduction of averaging accounting, input returns and permanent forestry. Most of the major changes relating to forestry came into effect on 1 January 2023.

As regulator of the forestry ETS, MPI has undertaken a multi-year work programme (the Transformation Programme) to deliver a replacement operating model and technology platform for forestry in the ETS to deliver against the regulatory improvements. The business case detailing this programme signalled significant cost recovery for services provided would be required to sustainably support the funding of this programme and the wider forestry ETS.

The changes necessitated replacement of the forestry ETS IT system, which was no longer fit for purpose and beyond end-of-life. The new ETS online system, Tupu-ake, supports MPI in administering forestry ETS participation in accordance with the Amendment Act and the Forestry Regulations once fully implemented. It also helps enable participants to comply with their obligations through improved tools such as providing the ability to calculate a participant’s emissions return, based on the information in the system. The Tupu-ake system went live on 24 January 2023 to support the new requirements laid out in the legislative amendments.

The impetus to update fees and increase cost recovery grew due to increased costs, largely because:

- The number of registered post-1989 participants in the forestry ETS increased by 70.5% between 31 December 2021 to 31 March 2023 (from 2287 to 3900 participants);
- In the same period, forest area registered in the ETS increased from approximately 390,000 to 540,000 ha. These increases were driven by the increasing benefits participants can receive, primarily NZUs, which have gone from a low of under $2 per NZU in 2011 to a high of $86.60 in November 2022[5].
- There was a drive to register before the averaging accounting method came into effect.

[5] The spot price for an NZU was $64.90 on 18th November 2024 (https://coremarkets.co/resources/market-prices).

Legislative authority for Recovering forestry ETS costs

The Climate Change Response Act 2002 (the Act) provides the legal authority to recover costs for services provided in the forestry ETS and allows for flexibility in the type and level of charges that can be applied.

Section 167(4)(g) of the Act specifically allows for regulations to set an annual charge. Further detail on the legislative authority for cost recovery is set out in Appendix 1.

The Forestry Regulations, which are made under the Act, require MPI to invoice forestry participants for the annual charge, calculating the charge as soon as practicable after 30 June in the previous financial year.

Cost recovery changes updated service fees and introduced a new per hectare annual charge

Cabinet noted on 15 March 2023 [DEV-23-MIN-0022] that MPI's cost recovery principle of equity deems it fairest that ETS participants should bear the costs of funding the scheme's administration, as they are the direct financial beneficiaries of the scheme.

In 2023, cost recovery settings for administering the forestry ETS were amended across two tranches. These settings were intended to reflect the contemporary costs of administering the forestry ETS, and to represent the wide range of services provided by MPI. Prior to the 2023 changes, cost recovery settings had not been updated since 2011.

Tranche One changes revised the service fees for nine core services and came into effect from 12 January 2023[6]. Tranche Two changes introduced an annual charge of $30.25 (excluding GST) per hectare and expanded the service fees, which was a significant change. These amendments came into effect from 19 October 2023.

Forestry ETS participants initiated a judicial review

The forestry sector was concerned that the 2023 cost recovery amendments placed too high a cost on participants within the forestry ETS, that they would have a disproportionate impact on smaller-scale participants and Māori, and that they would have a detrimental impact on overall afforestation levels. Of particular concern was the introduction of the annual charge.

Forestry ETS participants initiated a judicial review and complaint to the Regulations Review Committee. The complaint was not upheld.

Removal of the annual charge for the 2023/24 financial year

Cabinet agreed to remove the annual charge for the 2023/24 financial year while the annual charge was reviewed. Removing it also enabled the current review of the annual charge to be

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[6] Information on Tranche One and Tranche Two changes can be found at: https://www.mpi.govt.nz/consultations/forestry-in-the-ets-proposed-updates-to-cost-recovery-settings/ and https://www.mpi.govt.nz/consultations/forestry-in-the-ets-second-set-of-proposed-cost-recovery-fees-and-charges/

completed without needing to consider the legacy of any over or under collection of revenue for the 2023/24 financial year.

Independent review initiated by the Government

As part of this Government's commitment to restoring certainty and confidence in the forestry and wood processing sector, an independent review[7] of the operational costs of the forestry ETS (Independent Review) was launched in March 2024. The report from the Independent Review was publicly released on 14 October 2024[8].

The broad findings of the Independent Review were:

- The forestry ETS meets the needs but not the expectations of the sector, due to their views of costs and functionality.
- Tupu-ake (the new forestry ETS online system) and support processes are largely fit for purpose, but there are challenges with continued use of the older Climate Change Information System (CCIS)[9] for some functions such as FMA processing. Scalability and adaptability would require additional investment.
- The operation of the forestry ETS appears to be on track to achieve the intended benefit of the Forestry ETS Transformation Programme[10]. However, the "on-track" assessment of benefits is inconsistent with the perceptions of participants.
- It is too early to say whether Tupu-ake represents cost effective delivery.

Following the Independent Review findings, the Forestry Emissions Trading Scheme Registry Reference Group was established (Reference Group) to help ensure greater transparency, communication, and engagement on the forestry ETS registry[11]. The Reference Group is made up of representatives from sector organisations[12] which can provide expert advice to the Minister of Forestry and Te Uru Rākau – New Zealand Forest Service on how to improve the delivery of the forestry ETS registry.

The focus of this review is the annual charge

The conclusions of the Independent Review, and consideration of the concerns raised by the forestry sector, contributed to the proposal to reduce the annual charge to $14.90 per hectare. Cost recovery settings are usually reviewed on a three-year cycle but the significant change in the operating model in 2023 and progressive realisation of benefits made it appropriate to undertake a partial review of cost recovery settings ahead of the regular review time. The annual charge is the largest component of costs incurred by forestry ETS participants from the Government.

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[7] The independent review was undertaken by Grant Thornton, a national chartered accounting firm that provides audit, tax and advisory services.

[8] The Press release and Independent Review report are available at: https://www.beehive.govt.nz/release/government-and-sector-improve-forestry-ets-registry

[9] The Climate Change Information System is the IT system that pre-dates Tupu-ake.

[10] From 2020–23, MPI undertook a transformation programme to deliver system, regulatory and business changes.

[11] In this context, 'forestry ETS registry' means the forestry components of the ETS administered by Te Uru Rākau – New Zealand Forest Service.

[12] New Zealand Forest Owners Association, New Zealand Farm Forestry Association, Ngā Pou a Tāne, New Zealand Institute of Forestry, Climate Forestry Association.

A review of the full range of cost recovery settings, including service fees and the annual charge, will be undertaken in 2025-26. Progressing the review in 2025-26 will allow for the collection of data over several years of operations, a full reporting cycle and the cumulative delivery of ongoing efficiencies from the recent changes.

Urgent decisions are needed to create certainty for participants

If there are no changes made to the Forestry Regulations, MPI will be required to charge participants $30.25 (excluding GST) per hectare for the 2024/25 financial year (FY).

Amendments to the Forestry Regulations would be needed to enable MPI to invoice participants at the amended rate for the 2024/25 FY (1 July 2024 to 30 June 2025). If changes are not made, MPI will be required to invoice participants at $30.25 (excluding GST) per hectare for the 2024/25 FY.

If the amendment regulations would take effect later in 2025, invoicing for the 2024/25 FY annual charge could be delayed until April 2025 or later. As participants will also be invoiced for the 2025/26 FY annual charge after 1 July 2025, many participants would receive invoices for two annual charges during the 2025/26 tax year (1 April 2025 to 30 March 2026) that could cause risks to their cashflow.

To give the forestry sector certainty of costs for participants for the 2024/25 FY, amendments would need to be approved by Cabinet and notified in the Gazette by the end of December 2024, taking effect January 2025.

2. Status Quo: The current annual charge

For the purposes of this CRIS, the status quo is the $30.25 (excluding GST) per hectare annual charge currently in the Forestry Regulations. This rate was consistent with the modelling done at the time[13]. The modelling for the status quo is provided in the Tranche Two CRIS[14].

The annual charge covers the cost of the wider administration of the forestry ETS. It is applied where use of specific service fees would present natural justice issues or could reduce participant willingness to access services, for example, reviews of decisions by MPI.

The current annual charge component of cost recovery for forestry in the ETS covers six existing club goods services (services that provide benefits to participants as a whole) or where charging costs as service fees would create challenges. These services are shown in Table 2 below.

The $30.25 per hectare annual charge is set in the Forestry Regulations to apply for financial years starting on 1 July 2024. If no change is made to the annual charge, then MPI will be required to invoice participants at the rate of $30.25 per hectare for the 2024/25 FY.

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[13] Modelling conducted at different points in time is described in this CRIS. Many types of ETS figures change over time, the figures used in modelling represent the ETS at the point in time at which modelling was conducted.

[14] The Tranche Two CRIS is available at: https://www.mpi.govt.nz/dmsdocument/59314-Appendix-Three-Cost-Recovery-Impact-Statement

Table 2: Components of the existing annual charge for forestry in the ETS

Service	Description of service	Proportion of annual charge
Removal of Land Status Notice	The removal of a land status notice occurs when a forest is removed in full or part from the ETS.	0.8%
Request Review of a Decision	Formal mechanism for a party affected by a MPI decision to request it be reviewed. This service relates reviews of decisions requested by applicants and participants for standard and permanent post-1989 forests.	15.6%
Inter-agency reporting standard and permanent post-1989 forests only	All reporting by MP Ion the forestry component of the ETS to interagency partners including the Ministry for the Environment and the Environmental Protection Authority. Charged to standard and permanent post-1989 forests only.	7.3%
Compliance management	This covers compliance costs from various situations including formal deregistration of forest owners for continuous non-compliance with ETS rules and regulations, formal removal of a forest or participant's information if errors were made during application, compliance investigations on a range of matters to maintain the integrity of the forestry ETS.	18.8%
Administration and Management of Enquiries	Staff costs involved in processing refund requests from ETS participants for charges associated with ETS participation, temporary waivers from charges associated with ETS participation, and standard and permanent post-1989 participant enquiries on a wide range of issues, which Te Uru Rākau – New Zealand Forest Service considers and provides responses to. Includes processing responses to requests for carbon accounting records.	12.5%
IT System	The costs associated with the IT system: - Ongoing maintenance and operating costs including software licensing to ensure Tupu-ake can support the forestry aspect of the ETS; - Ongoing system enhancement costs including bug fixes and minor functionality improvements; - Staff costs for IT system testing; - Depreciation and capital charge to develop the IT system.	45%
Total Annual Charge	Summation of all annual charge components payable (rounded to the nearest cent)	$30.25 per hectare

3. Cost Recovery Principles and Objectives

Cost recovery plays a significant role in ensuring the quality of MPI services that support a forecast $54.6 billion (2023/24 FY) in primary industry exports, is maintained.

MPI generally recovers the costs from industry and individuals who benefit from the related services. In the 2023/24 fiscal year, MPI recovered 32 percent of departmental expenditure from users of its services from more than 300 fees and levies authorised under nine Acts.

Given the scope and significance of cost recovery, MPI maintains an ongoing work programme to ensure that its supporting systems and processes remain fit for purpose.

The scope and diversity of services MPI provides across different sectors means that it is not practical to adopt a 'one-size-fits-all' approach to cost recovery settings. Instead, MPI takes a principles-based approach[15], as described in its cost recovery policy guidance[16], and various MPI statutes. The principles are also consistent with guidance published by the New Zealand Treasury and the Office of the Auditor-General, as well as the various acts under which MPI recovers costs. MPI's four cost recovery principles (the principles) are defined in Table 3 below.

Table 3: Summary of MPI cost recovery principles

Transparency	Costs which are being recovered can be clearly linked to the service provision.
Justifiability	Costs which are being recovered are appropriate — that they relate to the service being provided and that they are not unreasonable. MPI also has a responsibility to ensure that services are both effective and efficient.
Efficiency	Costs should generally be allocated and recovered to ensure maximum benefits are delivered at minimum cost.
Equity	Costs are recovered in a way that is fair.

The principles build on each other with Transparency and Justifiability providing a foundation to the consideration of, and sometimes trade-offs between, Efficiency and Equity. Essentially, MPI can cost recover only if it has first sufficiently met the Transparency and Justifiability principles.

The Efficiency and Equity principles state that the beneficiaries of a service should generally pay for that service. That is, beneficiaries pay 100% of costs of a service they use unless

15 A principle is a general rule that should be used to guide cost recovery design, a feasible option must meet the stated principles. An objective is more of a goal that a specific cost recovery proposal should meet, the recommended option does not need to meet all of the objectives.

16 MPI's cost recovery guidance is available at: http://www.mpi.govt.nz/dmsdocument/30855/direct

there is a strong efficiency or equity reason for why they should not. Efficiency is about maximising benefits and minimising costs.

Costs should be charged to those who benefit from the service and/or whose behaviour generates the need for the service. Equity involves value judgements. It will normally be considered fair that beneficiaries or those whose behaviour generates the need for the service pay (in line with the Efficiency principle), but there may be reasons why governments might want to make a contribution. This could, for example, be because governments want to support small businesses or emerging industries, or because parties cannot afford to pay, and governments would rather not see parties stop operating. Additional information on the principles and how they relate to each other is available in Appendix 2.

Cost Recovery Objectives

The following four key objectives of this cost recovery proposal are directly derived from the aforementioned MPI cost recovery principals, but the definitions have been informed by the cost recovery objectives used for setting the Tranche Two annual charge:

1. Transparency - ensuring that recovered costs can be clearly linked to the service provision;
2. Justifiability - ensure charges for services reflect the costs of providing them and provide a fair way to minimise Crown funding requirements to maintain the ETS;
3. Efficiency - promote consistency by using a common approach to cost recovering for services of a similar nature and cost structure, to deliver maximum benefit at minimum cost and maintain simplicity of charges, by using fees and annual charges where appropriate;
4. Equity - apportioning costs between participants and the Crown in a way that is fair.

4. Policy Rationale

Apportioning costs between the Crown and participants

The economic characteristics of services provided in the forestry ETS vary. Broadly speaking, a service can be categorised as either a public, private or club good. A public good is generally funded by taxpayers. The costs of private or club goods can be more appropriately recovered from those who directly benefit from those goods, when cost recovery principles are met.

The description and rationale for the treatment of the costs of services in the forestry ETS is provided below:

- **Public goods** — services where excluding people from its benefits is either difficult or costly, and its use by one person does not detract from its use by another. **Public goods are funded by the Crown**. For the forestry ETS this includes, for example, the cost of inter-agency reporting and policy development.
- **Private goods** — services that directly benefit an individual or group, and where excluding people from its benefits is low cost, are usually paid for by those who benefit from them. For the forestry ETS, **these are recovered through service fees** for example, fees for applications to register in the forestry ETS.

- **Club goods** — services that benefit participants as a whole and where excluding people from its benefits is low cost, but its use by one person does not detract from its use by another. For example, compliance enforcement to ensure the integrity of the forestry ETS is maintained, and costs associated with responding to participant enquiries. **The recovery of club goods is generally done through the application of a levy or an annual charge**.

In line with these definitions, costs associated with the forestry ETS have been grouped as shown in Table 4. A more detailed description of each of the cost components is provided in Appendix 3. The components presented in the table were used for the 2024 modelling. The 2023 modelling grouped some of these components together. The differences are outlined in chapter 5.

Table 4: Forestry ETS operating components and descriptions, broken down by the nature of the good/service

Nature of the good/service	Forestry ETS Operating Component	Description
Club good	**Compliance Activities**	Compliance activities includes components of monitoring, enforcement, and education.
	Customer Enquiries	Customer Enquiries includes components of finance management, forestry ETS participant reports and customer enquiry responses.
	Reviews of a decision	A person who is dissatisfied with a decision under the forestry ETS participant provisions (for example, in relation to land eligibility assessments) may request that Te Uru Rākau – New Zealand Forest Service review that decision.
	IT system	IT system includes components of IT maintenance, improvements, depreciation, and capital charge.
Private good	**Fees for Services**	The forestry ETS has 32 services where a fee is applied, this includes emissions return applications, applications to register forest land and applications to change forest area(s).
Public good	**Inter-Agency Reporting**	Reporting enables collaboration between relevant government agencies and ensures that those agencies each have the information they need to meet their forestry ETS obligations under the law.
	Operational Policy Staff	Ministerial advice, administration of the legislation, regulations and standards relating to the forestry ETS (in relation to both post-1989 and pre-1990 forest land), and development of operational policies.

Utilising an annual charge based on per hectare of participation

The 2023 cost recovery review led to a decision to recover the cost of club goods through an annual charge based on per hectare of participation in the forestry ETS. It was considered the best way to cover club good costs that are appropriate to be recovered from participants as a whole. This is because it ensures participants with smaller forests are not disproportionately impacted by the annual charge compared to alternative approaches such as a flat fee.

Application of an annual charge reflects that typically there is greater administrative effort in providing services to larger forest holdings and reflects the benefit that forestry ETS participants gain in NZUs in relation to the size of their forest.

Alternative options to a per hectare annual charge were considered in 2023[17] including, for example, an annual charge based on the net unit entitlement of participants. However, annualised cost recovery across all forestry ETS participants based on the size of forest land they have in the ETS was preferred, as this determines the level of benefit they receive through NZUs.

Applying annual charge components to set fees and other options not involving an annual charge were also considered at that stage, but it was assessed that the annual charge approach was the most in-line with cost recovery principles to recover club good costs. On the information available at the time, alternative approaches raised issues which could negatively impact the efficiency of the forestry ETS, raise natural justice issues and create inequitable scenarios for participants. As outlined in Table 5, the approach for fees for private goods and annual charge for club goods aligns with MPI's cost recovery principles.

Table 5: Tranche Two (2023) assessment of proposed service fees and annual charge against cost recovery principles

Cost recovery principle	Assessment
Transparency – costs are transparent	**Strong alignment.** The costs for each of the services borne by the users are based on an average time (and therefore cost) to complete the service. The cost of each service will be publicly available. For the annual charge, it is clear what components need to be charged for, why this is the case, and how much the forestry ETS participant will need to pay.
Justifiability – costs are reasonable	**Strong alignment.** Fees had not been adjusted since 2011 while the cost of administering the system has increased, due to the increasing number of participants and the need to develop new administrative IT systems. Cabinet noted on 15 March 2023 [DEV-23-MIN-0022] that MPI's cost recovery principle of equity deems it fairest that ETS participants should bear the costs of funding the scheme's administration, as they are the direct financial beneficiaries of the scheme.
Efficiency – net benefits are maximised	**Strong alignment.** The charge and fees are split out based on private vs club goods. All post-1989 participants will contribute to club goods, while only those that use the services will need to pay service fees.
Equity – costs are fair	**Alignment.** All users of the system receive financial benefit from voluntarily participating. Cabinet [DEV-23-MIN-0022] noted that MPI's cost recovery principle of equity deems it fairest that ETS participants should bear the costs of funding the scheme's administration, as they are the direct financial beneficiaries of the scheme. Charges directly reflect the costs of providing services, by calculating fees based on time to complete the service. Māori forest owners are acknowledged as being disproportionately affected by any new or increased costs for advisory services (following up on applications and seeking clarification).

[17] Refer page 10 of the Tranche Two Cost Recovery Impact Statement: https://www.mpi.govt.nz/dmsdocument/59314-Appendix-Three-Cost-Recovery-Impact-Statement .

5. The level of the revised annual charge and its cost components

Design of cost recovery annual charge

In its recent review of the annual charge, MPI has used a revised cost model and updated modelling assumptions to calculate the recoverable amount of costs of administering the forestry ETS (Table 6). This is discussed in more detail below. The recoverable costs of operating the forestry ETS have reduced since it was reported as $19,422,397 in the Tranche Two CRIS.

Table 6: Updated cost recovery modelling for the annual charge

	2023 modelling (Cost $'000)	Updated 2024 modelling (covering the 2024/25 FY) (Cost $'000)
Total cost	$28,977	$20,056
Recoverable costs	$19,422[18]	$16,674
Recoverable cost related to service fees	$2,552	$1,484

The components included in the annual charge, which are also used as 'inputs' into modelling of forestry ETS costs, have been adjusted and updated compared to the six annual charge components currently prescribed in the Forestry Regulations. Table 7 below outlines how components of the current annual charge have been updated and split into further categories to increase transparency of what the annual charge is paying for.

An 80 percent share of IT costs associated with depreciation and capital charge (approximately 50 percent of overall IT costs) to reflect that the forestry ETS is in a transitional period and all of the costs of legacy cases have been excluded from the 2024 proposed annual charge. Inter-agency reporting and removal of land status notices have also been reassessed against cost recovery principles and removed, due to no longer being considered a club good.

[18] This figure has sometimes been referenced at $18.9 million, but this is the figure used in the Tranche Two Cost Recovery Cabinet Paper and represents the estimates of revenue raised by service fees and the annual charge, rather than reflecting the recoverable costs.

Table 7: Comparison of status quo, updated modelling and proposed annual charge components

2023 (Tranche Two) components	2024 modelled annual charge components	Cost per hectare			Percentage change in cost between 2023 and 2024proposed
		2023	2024 modelled	2024 proposal	
Compliance management	Assurance		$3.68	$3.68	
	Enforcement		$0.83	$0.42*	
	Education		$0.58	$0.58	
	Total	*$5.69*	*$5.09*	*$4.68*	-18%
Administration and Management of Enquiries	Finance management		$0.22	$0.22	
	ETS participant reports		$0.22	$0.22	
	Customer enquiries response		$1.43	$1.43	
	Total	*$3.78*	*$1.87*	*$1.87*	-51%
IT System	Maintenance		$4.48	$4.48	
	Improvements		$0.75	$0.75	
	Depreciation and capital		$8.80	$1.76	
	Total	*$13.61*	*$14.03*	*$6.99*	-49%
Request Review of a Decision	Request review of a decision	*$4.72*	*$2.73*	*$1.36**	-71%
Inter-agency reporting post-1989 forest land only	(excluded from annual charge)	*$2.21*	-	-	-100%
Removal of Land Status Notice	(excluded from annual charge)	*$0.24*	-	-	-100%
Cost per hectare		**$30.25**	**$23.72**	**$14.90**	**-51%**

The 2024 proposal excludes: *legacy cases; **80% of depreciation and capital

Updated modelling of costs

The updated modelling assumptions include recent insights into the direct costs to MPI associated with operating the forestry ETS, and the costs of MPI teams that support its operations and are funded by the Crown.

The revised cost model and updated modelling assumptions reflect efficiencies that are being realised due to implementation of a new operating model, new IT system and significant rule changes in 2023. Assumptions behind the modelling have also been updated to more accurately reflect the cost of operating the forestry ETS as these changes have been made. This has included updating the anticipated registered area of land in the forestry ETS and the number of full time staff.

There are some areas of costs and service delivery associated with the forestry ETS where MPI will refine its analysis and modelling further, ahead of the 2025-26 review of cost recovery settings. The assumptions used in the updated modelling are provided in Appendix 4.

Cost to deliver the forestry ETS

The total cost of delivering the forestry ETS for the 2024/25 FY is modelled to be $20 million. A breakdown of costs is presented in Table 8 below.

Table 8: Forestry ETS operating components for the 2024/25 financial year

Nature of the service	Operating Component	Description	FY24/25 Cost $'000
Club good	**Compliance Activities**	Compliance and operations staff time (with a share of overheads and operating costs). Compliance activities include components of assurance, enforcement, and education. Operations includes monitoring and auditing of activities undertaken by participants, amending incorrect emissions returns and education and engagement with the forestry sector to help improve ETS knowledge and compliance outcomes.	$3,585
	Customer Enquiries	Operations staff engagement with the sector on enquiries via phone, email and Tupu-ake. Queries can be simple (for example, how to register in the forestry ETS) or complex operational topics on a participant's specific forest holding. Customer Enquiries includes components of finance management, forestry ETS participant reports as well as customer enquiry responses.	$1,309
	Reviews of a decision	A person who is affected by a decision made by MPI about their forest land and the ETS, may ask MPI to review this decision. This is a right under section 144 of the Climate Change Response Act 2002.	$1,920
	IT system	Total cost of the IT system including Tupu-ake, the new online system that underpins the operation of the forestry ETS. Tupu-ake was implemented to increase processing efficiency and useability for forestry ETS participants. IT system costs include components of IT maintenance, IT improvements and IT depreciation and capital charge.	$9,860
Private good	**Fees for Services**	Fees are applied to 32 forestry ETS services. Services include submitting emissions returns, applications to register in the ETS with forest land, and applications to change forest area(s). This component covers the staff time for the processing of these applications.	$1,484
Public good	**Inter-Agency Reporting**	Reports enable collaboration between relevant government agencies (for example, between MPI and the Environmental Protection Authority) and ensure agencies each have the information they need to meet their forestry ETS obligations under the law.	$268
	Operational Policy Staff	Staff advise Ministers and administer the legislation, regulations and standards relating to the forestry ETS for both post-1989 and pre-1990 forest land. This includes development of operational policies to inform and guide Operations, Spatial Intelligence and Compliance staff in their work.	$1,593
Not recover-able	**Pre-1990 services**	Services relating to pre-1990 forest land are not cost recoverable under the Act. However, the forestry ETS teams undertake compliance actions and customer enquiries relating to pre-1990 forest land.	$37
ETS operations total			**$20,056**

The cost breakdown in Table 8 above includes operation of the IT system and the operational personnel that support participants, as well as the functions which ensure the administration of the forestry ETS by MPI is fit for purpose and meeting its requirements, such as operational policy and interagency reporting.

All costs are either met by the Crown or through cost recovery. The Crown meets the costs that are not recoverable, and the costs of public goods. Participants meet the cost of private goods through service fees. Another level of analysis is required to identify the portion of club goods it is appropriate to recover from participants through the annual charge.

Some club goods are still maturing or have costs that are not yet stabilised

While a cost has been assessed as a club good and potentially appropriate to be recovered from participants, it does not necessarily mean it is appropriate that participants meet the full cost. The next step is to assess those club goods against cost recovery principles to determine who will appropriately cover those costs.

IT system costs

A significant proportion of the costs of operating the forestry ETS are associated with the IT system, especially the build and running of Tupu-ake.

From 2020–23, MPI undertook a transformation programme to deliver system, regulatory and business changes. These changes included Tupu-ake and a new operating model for the forestry ETS. The previous online system was outdated and was not able to reflect the significant forestry ETS policy reform that was introduced from 1 January 2023 — including the new averaging accounting system. The total cost of this investment was $86.1m.

This was a significant and necessary investment which is already starting to deliver improvements in efficiencies and benefits for both participants and MPI. As Tupu-ake evolves, efficiencies will continue to be identified and implemented which will further reduce processing times and improve the user experience for participants.

Efficiencies provided by Tupu-ake to-date:

- **Processing times have reduced** by over 89 percent: The development of IT system generated emissions returns in Tupu-ake reduced processing times for 2023 final emissions returns from an average of 19 working days in 2018, to an average of 2 working days in 2023.
- **The level of compliance by participants has increased** (reducing the need for compliance enforcement): The new functionality of the Tupu-ake online system (including the in-built calculator for system generated emissions returns) has decreased the amount of incorrectly submitted returns and freed up staff time, allowing staff to focus on providing guidance and address enquiries. This has increased compliance by 57.8 percent in notifying MPI about transmissions of interest.
- **Faster response times to enquiries**: Enquiries take anywhere from 16 to 40 minutes of staff time to close, though some may take much longer. Prior to Tupu-ake, enquiries were managed externally and case closure was 15 to 20 weeks. Today,

calls are generally returned within one to three business days and enquiries are closed within five to 15 business days, depending on complexity.
- **Increase in successful applications to register land**: In 2022, applications to register land had an approval rate of 88 percent. Now in 2024, as a result of Tupu-ake and an improved understanding by applicants of the requirements, applications to register land have an approval rate of 93 percent.

The components of the IT system that MPI incurs costs for are presented in Table 9. Two of these relate to ongoing maintenance improvements and one is associated with the capital used to develop the IT system.

Table 9: Description of IT system components

IT system component	Description
Maintenance	Ongoing maintenance of Tupu-ake and operating costs including software licensing. This ensures Tupu-ake can support the 32 types of ETS service applications to support the forestry aspects of the ETS.
Improvements	Ongoing enhancements of the IT system including bug fixes which are needed as they are identified through operation, as well as minor functionality improvements to maintain its current level of service. Staff time required for IT system testing (both 'business as usual' testing and 'user acceptance testing[19]') to ensure improvements are successfully implemented. Significant IT system upgrades such as new features are not included within this category.
Depreciation and capital charge	Depreciation is the process of allocating the cost of developing Tupu-ake over its anticipated useful life of 10 years as opposed to an initial upfront payment. Capital charge is the cost of capital required to develop the IT system. These costs relate to the 2020 -23 system update.

How the IT system components are considered against cost recovery principles

Participants (and prospective participants) benefit as a whole from the use of the IT system and its use by one person does not detract from its use by another. The cost is therefore considered **primarily a club good**. There is some public good benefit of the IT system as it enables MPI to meet its reporting requirements and provide insight into policy development. However, this is not the primary purpose of the IT system and the public good benefit is considered to be only a small portion.

Proposed apportioning of IT system costs

MPI recovers IT system development costs from participants where it considers the recovery of these costs are appropriate when MPI's cost recovery principles are applied.

[19] User acceptance testing is undertaken to ensure the IT System works for participants.

MPI proposes that it is appropriate for participants to meet the Tupu-ake system maintenance costs and improvement costs (ongoing minor enhancements) because participants directly benefit from these components. MPI also proposes that participants meet 20 percent of the depreciation and capital charge costs (cost of ownership), as these reflect part of the overall costs of developing and delivering Tupu-ake (discussed further in the sections below). This results in approximately 50 percent of total costs of the IT system being cost recovered from participants. The rationale for this approach is:

- The Independent Review of costs identified that Tupu-ake was largely fit for purpose but that it did require further investment. It also noted that it was too early to determine if the operating costs were appropriate as those were still to stabilise.
- Work is continuing to develop the IT system and make improvements to ensure participants and the regulator can successfully complete the requirements at the end of the current 2023–25 reporting period.
- MPI considers more operating efficiencies are likely to be able to be identified where Tupu-ake has automated and streamlined some functions, but MPI requires the operating data from a full Mandatory Emissions Return Period (MERP) to confirm this.

With participants paying a proposed 20 percent of the depreciation and capital charge (cost of ownership), the Crown would cover the remaining 80 percent to account for the factors identified in the rationale for this approach. This represents $4,946,000 in Crown costs for the 2024/25 FY.

MPI considered other options for the depreciation and capital charge but for the same reasons as set out in the rationale above, these were not found to be justifiable while the forestry ETS is in a transitional period, when MPI's cost recovery principles were applied.

Maintenance costs and continuous improvement are part of the operation of any large-scale IT system, so these are proposed to be fully recovered.

Table 10 below summarises the costs of the IT system which are proposed to be covered by the Crown.

Table 10*:* IT system components and 2024/25 financial year costs proposed to be covered by the Crown:

IT system component	FY24/25 costs ($'000)
Maintenance	$0
Improvements	$0
80 percent of depreciation and capital charge	$4,946
Total Crown funded IT system costs	**$4,946**

Legacy costs associated with compliance and decision reviews

Compliance activities and the costs associated with participants choosing to seek reviews of decisions have been assessed as club goods. There are, however, portions of these costs that are appropriate for the Crown to fund. This is because they relate to operations prior to the introduction of Tupu-ake and the new operating model, and the cost recovery regulations, coming into effect in 2023. Some compliance enforcement and reviews of decisions cases relate to prior actions by participants, or outstanding cases relating to the previous reporting periods (before 2023), referred to as legacy cases.

MPI has manually reviewed the data and estimates that between 40–60 percent of the backlog of compliance enforcement and reviews of decisions cases fall into this category.

It is proposed that the Crown meets the costs of these legacy cases because:

- Assigning these costs to current participants might not be appropriate as they relate to activities in the previous reporting period so may not be current participants; and
- Legacy cases pre-date the new, more efficient Tupu-ake and business/operating model so MPI is incurring higher costs in resolving them than it does for cases post-2022.

It is therefore proposed that the Crown cover 50 percent of the costs of this backlog. This reflects a midpoint of the range of cases (40-60 percent) that are estimated to be legacy cases. Table 11 below outlines the costs of legacy cases, which is proposed to be covered by the Crown.

Table 11: Legacy cases and 2024/25 financial year costs proposed to be covered by the Crown

Legacy cases	FY24/25 costs ($'000)
50 percent of costs for compliance enforcement	$293
50 percent of costs for reviews of decisions	$960
Total crown funded legacy costs	**$1,251**

Summary of apportioning for club good components

Table 12 below outlines the total costs of club goods funded by participants, by the Crown and the total cost of club goods.

Table 12: Funding of club good components and costs broken down by participant and Crown funded

Club Good	Participant funded $'000	Crown funded $'000	Total $'000
Compliance Activities	$3,292	$293	$3,585
Customer Enquires	$1,309	$0	$1,309
Reviews of a Decision	$960	$960	$1,920
IT system	$4,915	$4,946	$9,861
Total	$10,475	$6,199	$16,674[20]

[20] Table does not sum due to rounding.

MPI considers that with the above proposed apportioning of IT system costs and legacy cases between participants and the Crown, the four cost recovery objectives of transparency, justifiability, efficiency, and equity would be met.

Proposal for a revised annual charge

The calculation of the annual charge is based on the per hectare costs of participation. Those costs of participation equal $23.72 per hectare per annum. To meet the amount of club good allocated to participants, MPI is proposing an annual charge of $14.90 per hectare per annum for post-1989 forestry ETS participants starting in the 2024/25 FY[21].

The proposed annual charge is a $15.35 reduction, of which $6.53 is due to efficiencies already realised, a revised cost model and the updating of the modelling assumptions[22]. MPI proposes that the Crown covers an additional portion of the club goods (80 percent of IT system depreciation and capital charge, and legacy cases), representing a $8.82 reduction in the annual charge participants would have to pay.

The components of the charge and the cost represented by each one is outlined in Table 13 below (further detail on descriptions of these components is provided in Appendix 3).

Table 13: Annual charge components alongside each of their costs and percentage of the total annual charge

2024/25 annual charge components	Costs	Percent of annual charge
Compliance activities		
Assurance	$3.68	25%
Enforcement (excluding legacy cases)	$0.42	3%
Education	$0.58	4%
Customer Enquiries		
Finance management	$0.22	1%
ETS participant reports	$0.22	1%
Customer enquiries response	$1.43	10%
Reviews of a decision (excluding legacy cases)	$1.36	9%
IT system — maintenance	$4.48	30%
IT system — improvements	$0.75	5%
20 percent IT system — depreciation and capital charge	$1.76	12%
Total	**$14.90**	100%

21 The indigenous exemption and part charges will remain in place as set out in the Forestry Regulations.

22 For example, modelling assumptions have used updated anticipated registered area.

Three year forecast

MPI based its modelling on the current level of participation in the forestry ETS of approximately 630,000 hectares at the time of modelling (23 October 2024). Cost recovery settings require consideration of what it is reasonable to assume the levels of participation will be over a three-year period.

The three-year forecast outlined in Table 14 below assumes a higher level of participation in the forestry ETS. The level of participation which underlies the annual charge modelling, is based on the initial registered area and 30 percent of the newly registered area in each year[23]. The Government consultation on the second Emissions Reduction Plan outlines the assumptions about the level of afforestation that it anticipates will occur[24]. This would spread the costs of operating the ETS across more participants and reduce the amount paid by each participant.

Table 14: The estimated number of hectares in the ETS over three different time periods [25]

	2024/25 modelling	2025/26 modelling	2026/27 modelling
Initial Registered area (ha)	650,000[26]	704,725	731,434
Afforestation[27] (ha)	60,806	29,699	27,032
ETS registrations during the financial year (ha)	54,725	26,729	24,329

MPI sets fees so that net revenue and expenditure tracks to zero over a three-year period. This means that the forecast of forestry ETS registrations is important.

The Forestry Regulations (15A and 15B) set out that a participant with land in the forestry ETS as at 1 July will be charged for the full year on that land, and a part charge on new land registered in the forestry ETS part way through the financial year.

Based on the projected future participation rates, revenue modelling outlines the degree to which the Crown will provide additional funding to cover some activities that would normally be cost recovered (Table 15). This is in addition to the existing public good services that the Crown has always funded, such as operational policy.

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23 The part-charge for registrations during the financial year only applies to participants with land registered in the ETS on 1 July in the financial year, not all new registered land (regulation 15B). From the data we have, since the start of the current 2023–25 reporting period slightly over 50% of newly registered land was to existing participants and around 60% of the land had its registrations approved in the first half of the financial year.

24 Information on the emissions reduction plans can be found on the Ministry for the Environment website at: https://environment.govt.nz/what-government-is-doing/areas-of-work/climate-change/emissions-reductions/erp/.

25 This modelling was undertaken on 1 July 2024. The afforestation rate used in this modelling is based on the central afforestation scenario used to support consultation on the Emissions Reduction Plan 2, with 90% of the area being registered into the ETS.

26 This number is higher than the number of hectares registered at the time, however an estimate had to be used for the 2024-25 financial year at the time of preparing the modelling. By the end of November 2024, the level of participation in the forestry ETS had increased to 653,000 hectares, exceeding the number used in the modelling.

27 Afforestation is how many hectares of new forest was established or is estimated to be established, inclusive of, but not limited to forest that is then registered in the forestry ETS as post-1989 forest land.

Table 15: The projected costs of club goods, to be covered by participants and to be covered by the Crown, over a three-year period

	Total amount per hectare	Revenue 24/25	Revenue 25/26	Revenue 26/27	3 year Average
Participant funded club goods	$14.90	$9.93m	$10.62m	$11.01m	$10.52m
Crown funded club goods	$8.82	$5.88m	$6.29m	$6.52m	$6.23m
Total	**$23.72**	**$15.81m**	**$16.91m**	**$17.52m**	**$16.75m**

6. Impact analysis

Proposal 1: Revised annual charge

The current annual charge in the Forestry Regulations is $30.25 (excluding GST) per hectare, with the $14.90 (excluding GST) per hectare proposed annual charge representing a reduction in the costs of participating in the forestry ETS. The annual charge effects 4,327 current post-1989 forestry participants in the ETS[28], representing 630,000 hectares of forests.

The proposal would likely have a positive impact on all forestry participants including Māori forest owners.

Impact on participation in the forestry ETS

Table 16 presents the impact of the proposed annual charge as a percentage of annual ETS revenue for participants in three post-1989 forestry scenarios. For both the large and small exotic foresters' scenarios, the impact of the proposed annual charge is less than 1 percent of annual ETS revenue. In the small indigenous forest scenario, the proposed annual charge represents 1.95 percent and 3.14 percent of annual ETS revenue at years 16 and 28 respectively.

[28] As of 23 October 2024.

Table 16: The proposed annual charge as a percent of annual ETS revenue in different scenarios at the 5th, 16th and 28th years of forest growth[29]

Scenario	Item	5th year	16th year	28th year
Small exotic forest Example of 31 ha Pinus radiata, Auckland region, default carbon tables.	Annual charge	$462	$462	$462
	NZU equivalent of annual charge at $60 per NZU[30] (approx.)	8 NZUs	8 NZUs	8 NZUs
	NZUs earned by forest in year	1,209 NZUs	1,209 NZUs	837 NZUs
	Value of NZUs earned at $60 per NZU	$72,540	$72,540	$50,220
	Annual charge as a percent of ETS revenue	0.64%	0.64%	0.92%
Small indigenous forest Example of 31 ha, default carbon tables.	Annual charge	$0[31]	$462	$462
	NZU equivalent of annual charge at $60 per NZU (approx.)	0 NZUs	8 NZUs	8 NZUs
	NZUs earned by forest in year	133 NZUs	394 NZUs	245 NZUs
	Value of NZUs earned at $60 per NZU	$7,980	$23,640	$14,700
	Annual charge as a percent of ETS revenue	0%	1.95%	3.14%
Large exotic forest (100ha+) Example of 310 ha of Pinus radiata. FMA applies.[32]	Annual charge	$4,619	$4,619	$4,619
	NZU equivalent of annual charge at $60 per NZU (approx.)	77 NZUs	77 NZUs	77 NZUs
	NZUs earned by forest in year	13,516 NZUs	12,958 NZUs	12,617 NZUs
	Value of NZUs earned at $60 per NZU	$810,960	$777,480	$757,020
	Annual charge as a percent of ETS revenue	0.57%	0.59%	0.61%

29 These values do not account for the liability to surrender some NZUs on harvest for participants under stock change accounting.

30 $60 per NZU is a spot price representing the cost of an NZU at the time of analysis. As the ETS is a market-based mechanism there is no set cost for an NZU.

31 An exemption to the annual charge applies to indigenous forest less than 6 years in age.

32 Figures calculated using an area weighted average of all approved MERP3 participant-specific tables as at June 2023.

Impact on Māori

Māori have significant interests in forests as rangatira, kaitiaki, land and forest owners, workers, and business owners. Whenua Maori[33] (Māori freehold and customary land) is also disproportionately on remote, less versatile land compared to general land. This means that whenua Maori typically has limited land use options and forestry is generally the (marginally) best economic option. However, it is often held in smaller, fragmented titles, which can result in a higher cost per hectare with regards to cost recovery. Because nearly half of Māori freehold land is pre-1990 forest, this land falls out of scope of the revised annual charge, as the annual charge only applies to post-1989 forest land.

The Forestry ETS Registry Reference Group (Reference Group) was recently established to inform MPI priorities for delivering the forestry ETS and provide the sector perspective on forestry ETS function, operability and cost recovery. The Reference Group is made up of a blend of representatives across the forestry sector, forestry in the ETS and Māori forestry organisations. The Reference Group has been asked to consider a range of issues in 2025, including the application of cost recovery within the forestry ETS to Māori land that is not on a single title and therefore has additional challenges associated with forestry development. This matter will in turn be considered as part the 2025-26 review of cost recovery settings.

Impact on small land holdings

Participants with small land holdings make up the majority of forestry ETS participants. Feedback received on the 2023 cost recovery consultation noted concern for the perceived disproportionate impact of an annual charge on small forest owners. The recent consultation proposed a reduced annual charge per hectare, which would reduce the financial impact of the annual charge on small forest owners registered in the forestry ETS.

The annual charge is based on the forestry ETS participant's size of forest land area, in hectares. This has been done to ensure participants with smaller forests are not disproportionately impacted by the annual charge, compared to alternative approaches (for example, a flat fee for participation) and to reflect the generally greater effort required by MPI to provide the relevant services relating to larger forest holdings.

The per hectare annual charge reflects the benefit forestry ETS participants gain in NZUs in relation to the size of their forests. The benefit that a forestry ETS participant receives is likely to correlate with the total forest land they have in the forestry ETS, with larger forest holdings typically receiving a greater number of units compared to small forests. This is consistent with some submitters in the recent consultation commenting on the greater impact of the annual charge on small foresters due to receiving fewer NZUs. A per hectare annual charge means larger forest holdings bear a proportionately larger share of the annual charge.

Impact on the Crown

It is proposed the Crown would cover $6,199,000 in costs for the 2024/25 FY, that could otherwise be recovered. This would be 80 percent of depreciation and capital charge for the IT system (approximately 50 percent of the annual charge), and around 50 percent of compliance activities costs covering legacy cases, which are considered club goods and could be appropriate to cost recover if the forestry ETS was not in a transitional stage.

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[33] Reflects terminology used in the Te Ture Whenua Maori Act 1993.

This Crown funding is in addition to the $1.9 million per annum cost of delivering public good functions relating to the ETS for forestry (for example, operational policy development and reporting). As no annual charge was collected for the 2023/24 FY, the Crown has covered these costs to allow for further review of cost recovery settings. To ensure the cost of operating the forestry ETS can be met without reducing the level of service provided, it is essential that a portion of the costs of operating the ETS are recovered for the 2024/25 FY and onwards. The proposal to split the costs between the Crown and forestry ETS participants would enable services to continue to be provided at the current, or a similar level.

This allocation of Crown funding is expected to have an impact on the level of services and support that Te Uru Rākau – New Zealand Forest Service provides through its other functions in the short term. This will be mitigated if further efficiencies are found which will reduce the forestry ETS registry costs overall.

Impact on the net present value of forestry

The net present value (NPV) for eight forest scenarios is presented in Table 17, along with the change in NPV for each scenario in comparison to the status quo. There is a small improvement in NPV under the proposed annual charge setting.

Impact on afforestation and greenhouse gas removals

The degree of afforestation depends on many factors including the price of New Zealand Units (NZUs) which foresters receive, among many other factors and policy settings. The decrease in the annual charge will make participation in the forestry ETS marginally more profitable than under the status quo.

As the proposed annual charge is a reduction from the status quo, returns from forestry ETS participation are expected to increase slightly. MPI anticipates a marginal increase in afforestation with the intent of registering into the ETS.

The full implementation of the Tranche Two annual charge and services fees was modelled to result in only a small decline in afforestation of between:

- 1,030 and 1,330ha per year for exotic forests (between 1.4 percent and 3.7 percent). Modelled removals declined between 1.2 percent and 3.5 percent over the 50 years following the introduction of the charges.
- 280 and 360 ha per year for indigenous forests[34] (between 2.7 percent and 4.8 percent). Modelled removals declined between 2.7 percent and 4.8 percent over the 50 years following the introduction of the charges.

Table 17: Net present value (NPV) of proposed annual charge for different forestry scenarios

Accounting approach	Forest type	Forest size	NPV ($'000)	Percentage change compared to

[34] Not taking into account the indigenous exemption.

		(ha)	per forest	per ha	status quo
Permanent	*Pinus radiata*	5	124.4	24.9	0.9
		500	16,805.4	33.6	0.6
	Indigenous	5	33.0	6.7	2.5
		500	2,527.3	5.1	3.3
Averaging accounting	*Pinus radiata*	5	64.6	12.9	1.7
		500	8,647.4	17.3	1.2
	Indigenous	5	25.5	5.1	3.2
		500	1962.1	3.9	4.2

As shown in Table 17 above, the increase in net present value between the status quo and the proposed annual charge ranges from 0.6-1.7 percent for *Pinus radiata* forests and 2.5-4.2 percent for indigenous forests. This could result in an additional 200 hectares of additional afforestation per year, but we are unable to definitively estimate an afforestation response to the revised annual charge because the increase in profitability is marginal and much smaller than the margin of error for afforestation models.

As outlined in the Emissions Reduction Plan 2 discussion document[35], efforts to restore price stability and confidence in the NZ ETS and giving certainty to forestry, of which this policy is one small part, will have minimal impact on forestry removals for the first and second emissions budgets. Wider factors, such as carbon price movements, strong demand for timber, direct tree-planting incentives and regulatory uncertainty will have a more tangible impact on afforestation intentions. Successive afforestation and deforestation intentions surveys have identified the range of drivers for peoples afforestation intentions, including central and local government policies (and potential policy changes), ETS settings and carbon price, and the availability of key resources (for example, seedings in the preferred species). The impact these factors on afforestation intentions changes through time[36].

Deciding on an option for the annual charge

Two options for the annual charge are proposed:
- Option One: the status quo charge of $30.25 per hectare;
- Option Two: the proposed annual charge of $14.90 per hectare.

Of the two options, Option Two, the annual charge of $14.90 per hectare best meets the cost recovery objectives at this time. Table 18 below provides a comparison of the status quo and proposed approaches to the treatment of IT system costs and legacy cases in the annual

35 https://consult.environment.govt.nz/climate/second-emissions-reduction-plan/

36 See, for example, the Afforestation and Deforestation Intentions Survey 2023 on the MPI website https://www.mpi.govt.nz/dmsdocument/62313/direct

charge. It shows that the proposed approach for the Crown to cover most of the IT system depreciation costs and capital charge along with all legacy cases best meets the cost recovery objectives at this time.

Option One does not reflect the 2024 revised cost model and updated modelling assumptions. Cost recovery settings are usually reviewed on a three-year cycle but the significant change in the operating model in 2023 and progressive realisation of benefits made it appropriate to undertake a partial review of cost recovery settings ahead of the regular review time. In addition to adjusting the annual charge to reflect updated modelling assumptions, the treatment of IT system costs and legacy cases differs between the status quo and proposed revised annual charge (Option Two). The proposed revised annual charge takes account of the forestry Emissions Trading Scheme (ETS) registry still going through a transition period, as IT and operating costs continue to stabilise, services continue to mature, and efficiencies continue to be gained and provides for some ongoing Crown funding[37] during that period (noting a full review of cost recovery settings including service fees and the annual charge will be undertaken in 2025-26).

[37] Proposed Crown funding in the short term of 80 percent of IT system depreciation and capital charge, equating to approximately 50 percent of the total costs of the IT system (as it evolves to support greater functionality), and the cost of legacy compliance cases dating from before the new system was introduced in 2023.

Table 18: Comparison of status quo and proposed approach to treatment of IT system costs and legacy cases in the annual charge

Cost recovery objectives	Option One: Status quo annual charge of $30.25 per hectare	Option Two: Annual charge of $14.90 per hectare
Transparency - ensuring that recovered costs can be clearly linked to the service provision.	0 **IT system costs:** The forestry ETS is still in transition. This means that IT costs are yet to stabilise, and Tupu-ake requires additional improvements. However, the $30.25 per hectare annual charge would require participants to cover all of the IT system depreciation costs and capital charge. **Legacy cases:** This rate would capture costs of legacy cases which cannot in all instances be linked to current participants and may pre-date when cost recovery regulations came into force.	++ **IT system costs:** The forestry ETS is in a transitional period following the introduction of the new Tupu-ake online system and significant rule changes in 2023. This means that the full benefits and efficiencies of these changes have yet to be realised. With costs yet to stabilise and Tupu-ake requiring additional improvements, it is proposed that the Crown cover most of the IT system depreciation costs and capital charge at this point in time. The IT system costs proposed to be covered by participants in the annual charge and the Crown, along with the rationale for that split, are set out earlier in this document. **Legacy cases:**. As legacy cases relate to cases from prior to the current 2023–25 reporting period, and prior to cost recovery regulations coming into force, it would not be appropriate to charge participants for these costs.
Justifiability - ensure charges for services reflect the costs of providing them and provide a fair way to minimise Crown funding requirements to maintain the ETS.	0 **IT system costs:** Less justifiable because it would result in participants being charged for all IT system costs while the IT system is still maturing and requiring improvements. The status quo rate does not reflect the revised cost model and updated modelling assumptions. **Legacy cases:** It would not be justifiable to charge participants for legacy cases, which cannot in all instances be linked to current participants, and which pre-date when cost recovery regulations came into force. However, the status quo avoids the Crown fully covering the IT system costs which is not justifiable either.	++ This option aligns with the updated cost model. **IT system costs:** Crown funding is justifiable under the cost recovery principles because it will ensure participants only pay for services that can be shown to directly benefit them. Crown funding will cover a portion of the IT system costs until the 2025-26 review of cost recovery settings, where updated data will support costs to be assigned to specific services. **Legacy cases:** Charging participants for the costs of compliance enforcement and reviews of decisions is justifiable under the cost recovery principles as the need for the activity is generated by participants and maintaining confidence in the forestry ETS is of benefit to all participants.

Cost recovery objectives	Option One: Status quo annual charge of $30.25 per hectare	Option Two: Annual charge of $14.90 per hectare
Efficiency - promote consistency by using a common approach to cost recovering for services of a similar nature and cost structure, to deliver maximum benefit at minimum cost and maintain simplicity of charges, by using fees and annual charges where appropriate.	0 **IT system costs:** As the operating costs are still stabilising and net benefits are still to be maximised, it does not meet the principle of efficiency to recover all of the IT costs from participants at this time. **Legacy cases:** Status quo is less efficient as the $30.25 per hectare annual charge may capture cases which cannot in all instances be linked to current participants.	++ **IT system costs:** Under the efficiency principle, costs should generally be allocated and recovered to ensure that maximum benefits are delivered at minimum cost. As participants receive significant benefits from the IT system, it is appropriate for participants to pay for most of the costs of the IT system, however the Crown funding allocation is appropriate at this time as the operating costs are yet to stabilise and net benefits have not yet been maximised. **Legacy cases:** Under the efficiency principle, it is efficient for the beneficiaries of MPI services to pay for them. As legacy cases do not necessarily, in all instances, relate to current participants, they will not be charged for these costs.
Equity - apportioning costs between participants and the Crown in a way that is fair.	0 **IT system costs:** participants would cover the full costs of the IT system while it remains in transition, costs are yet to stabilise, and benefits are to be fully realised; and **Legacy cases:** participants cover costs of legacy cases where there is uncertainty that the costs directly benefit the current participants, and actions were made before cost recovery settings were regulated. However, the status quo avoids the Crown fully covering the IT system costs which would not be equitable either.	++ **IT system costs:** It is equitable that costs are shared between participants and the Crown to cover the cost of the IT system. It would not be equitable for participants to cover the full costs while the IT system remains in transition and costs are yet to stabilise. However, it is also not equitable for the Crown to fully cover these costs and effectively subsidise forestry ETS participation. **Legacy cases:** It would not be equitable for participants to pay for costs where there is uncertainty that the costs directly benefit the current participants, nor would it be equitable for participants to pay for services that relate to actions made before cost recovery settings were updated. As legacy cases relate to prior actions by participants or outstanding cases relating to the previous reporting period (before 2023), costs associated with these cases cannot, in all instances, be attributed to benefitting current participants.

Proposal 2: Change to Field Measurement Approach requirements

Diagnosing the policy problem

Forestry participants with at least 100 hectares of post-1989 forest land in the forestry ETS, at any time in the mandatory emissions return period[38], are required to use the Field Measurement Approach (FMA) to measure their forests and submit this information to MPI to receive participant specific carbon tables (PSTs). These participants are allocated sample plots by MPI to collect their forest information. They use these PSTs to calculate the carbon stock of their forest for emissions returns.

The collection of information by participants is costly and complex, imposing a cost burden to participants every reporting period. Processing the submitted data to generate PSTs is also costly and time consuming for MPI, and FMA participant are required to pay a service fee to request and obtain PSTs.

In 2022, changes were made to the Forestry Regulations[39] which included reducing the frequency of when FMA participants need to collect information and be issued new PSTs during the shorter 2023–25 reporting period. The intent was to provide options for reducing operational costs for FMA participants during this shorter reporting period.

When updates to the cost recovery settings were enacted in October 2023, the Forestry Regulations imposed a new service fee for requesting PSTs. This fee resulted in additional costs for participants who were required to request PSTs in order to use existing information for carbon calculations for the shorter 2023–25 reporting period.

The impact of this change is that around 570 FMA participants are facing significant additional costs in the current 2023–25 reporting period. This outcome is not consistent with the original policy intent of the Forestry Regulations to provide options for FMA participants to reduce their costs and to help improve efficiency during this shorter reporting period.

Deciding on an option for FMA participants

Option One – Status quo

The 2022 changes to the Forestry Regulations gave FMA participants more choices for measurement of carbon stock for emissions returns covering the 2023-25 reporting period. The choices available to FMA participants for returns covering the shorter reporting period are limited by their situation:

1. New FMA participants can choose to use the default tables to calculate carbon stock;
2. Existing FMA participants may request new PSTs using existing measurement information (based on existing rather than updated sample plot locations);

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[38] And those with two or more sample plots remaining on their land if the land no longer meets the threshold for using the FMA.

[39] On 27 September 2022 the Climate Change (Forestry) Regulations 2022 replaced the Climate Change (Forestry Sector) Regulations 2008.

3. If an existing FMA participant removed or added land in the 2023-25 reporting period and sample plots were not allocated due to the land changes, they can use existing PSTs or default tables if there are no existing PSTs available for the final emissions return.

FMA participants retain the option to choose to collect information from forest sample plots and request PSTs using that information if they wish. FMA participants who request PSTs in order to use existing information for carbon calculations for the shorter 2023–25 reporting period (point 2 above) are required to pay a fee of $1,980.00 plus GST[40].

Option Two – default tables or existing PSTs allowed for the 2023-25 reporting period

Due to the significant and unintended costs arising for affected FMA participants requesting PSTs using existing information, MPI proposes to update the Forestry Regulations so that all FMA participants submitting any emissions return that covers all or part of the shorter 2023–25 reporting period will be able to calculate carbon stock using:

- Default carbon tables (in the Forestry Regulations) if they do not have PSTs; or
- Existing PSTs if they are available to the participant.

This means that if participants do not have existing PSTs for the shorter reporting period:

- Participants who were using the FMA in the 2018–22 reporting period and already have PSTs for some or all of their forest types will be able to re-use the PSTs they have from that reporting period and not pay the service fee for new PSTs in the shorter 2023–25 reporting period; and
- Participants who were using the FMA in the 2018–22 reporting period, and who do not have PSTs for some or all of their forest types, may use the default carbon tables for those forest types they do not have a PST for, instead of requesting new PSTs and paying a service fee.
- FMA participants will still be able to elect to measure their forests in the 2023–25 reporting period and/or resubmit previous reporting period data for processing and production of PSTs by MPI. These actions will incur the service fees currently set in the Forestry Regulations

It is expected that FMA participants will not have to pay around $1.3 million[41] in service fees under this proposal. There is also a benefit that this will remove the need undertake field measurements to collect information if they do not hold a complete set of plot measurements.

Comparison of options

Option Two is likely to best address the policy problem, meet the policy objectives and deliver the highest benefits to FMA participants. This is because Option Two aligns with the policy intent when the 2023 changes were made (that is, to provide options to reduce operational costs for FMA participants during the shorter 2023-25 reporting period). It is more efficient and equitable because it is a simpler approach and the impact of the fee is spread over eight years instead of three years. A comparison of Option One and Options Two is

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[40] https://www.mpi.govt.nz/forestry/forestry-in-the-emissions-trading-scheme/ets-forms-fees-and-policies/service-fees-for-forestry-in-the-ets/#field-measurement-approach.

[41] This was not included in the 2024 modelling supporting the annual charge.

presented in Appendix 5, along with the marginal costs and benefits of Option Two. The key benefit is the avoided cost of $1.3 million to FMA participants.

7. Consultation

MPI released a Discussion Document to publicly consult on the proposed changes to cost recovery for post-1989 forestry participants in the ETS. Consultation ran for three weeks between 23 October 2024 and 13 November 2024. As part of this consultation, MPI hosted two online webinars and an online hui (for whenua Maori) to ask questions and provide feedback on the proposals.

The first of two proposals was to reduce the per hectare annual charge for post-1989 forestry ETS participants from $30.25 to $14.90 per hectare, starting in the 2024/25 FY. This reduced annual charge has partially been achieved due to efficiencies being realised, a revised cost model and the updating of the modelling assumptions. It was also proposed that while the forestry ETS is in a transitional period, with a new online system and significant rule changes introduced in and around 2023, that the Crown covers:

- a portion of the cost of the IT system in the short term, and
- costs associated with 'legacy cases' that pre-date the current emissions return period and cost recovery regulations.

Forestry participants with at least 100 hectares of post-1989 forest land in the forestry ETS are required to use the Field Measurement Approach (FMA) to calculate carbon stored in their forests for their emissions returns. When the previous (2023) cost recovery regulations were enacted, they imposed a service fee that resulted in additional costs for participants who could reasonably rely on their existing data or use default carbon tables to calculate carbon stock, during the shorter reporting period.

The second proposal was to update regulations to provide options for FMA participants to reduce costs when completing emissions returns for the shorter 2023-25 reporting period., all FMA participants will be able to calculate carbon stock using:

a) the default carbon tables (in the Forestry Regulations) if they do not have FMA participant specific tables (PSTs); or
b) existing PSTs if they are available to the participant.

Overview of submissions

In total, 58 submissions were received. Feedback was received from 26 individuals, 12 forestry companies, 3 Māori and iwi organisations, 3 territorial authorities, and 14 forestry sector organisations.

Annual charge proposal

Submitters were asked if they supported the proposal to reduce the annual charge from $30.25 to $14.90 per hectare:

- Of the 58 submitters, 43 answered this question directly;
- Of these 43 submitters, 23 indicated that they did not support the proposal;
- Of these 23 submitters, 15 commented that there should be no annual charge.

Twenty submitters were in support of the proposal, however 16 of these submitters indicated the proposed per hectare charge is a step in the right direction, preferring either a further reduction, no annual charge or exemptions to the annual charge for indigenous forests and forests under averaging accounting that have reached their average age. The other four submitters in support of the proposal did not provide further comments.

Of the 58 submissions received, 17 submitters suggested a different approach to the proposed per hectare annual charge. Proposed alternative options from submissions were:

- No annual charge – the Government pays all costs that would be covered by the annual charge.
- A reduced annual charge or full exemption for indigenous forests.
- An annual charge that ceases when forests under averaging accounting reach their average age.
- A levy charged on NZUs when they are issued instead of an annual charge based on the number of hectares of registered land.
- Charging emitters based on the number of units they are required to surrender annually instead of an annual charge on foresters.

Some of these suggestions are out of scope of this review or inconsistent with cost recovery principles but will be considered as part of the full 2025-26 review of cost recovery settings.

After analysis of the consultation comments, MPI believes that proceeding with the proposed change to the annual fee is the most fair and equitable way to recover costs from participants. The rationale for these decisions and responses to consultation feedback are provided in Table 19.

Table 19: Response to consultation feedback

Theme	Summary of feedback	Response
Reduce further or remove the annual charge	Twenty-three submissions noted that the annual charge was still too high, or called for it to be removed entirely.	To further reduce or remove the annual charge and maintain the same level of MPI services, additional Crown funding would be needed which would effectively subsidise participation in the forestry ETS for those who directly benefit from the club good services and also receive New Zealand Units from their participation in the ETS. This approach would not align with MPI's cost recovery principles.

Theme	Summary of feedback	Response
Alternative considerations for Indigenous forestry	Twenty submitters noted that the annual charge would disproportionately impact indigenous forests, which earn significantly less units than exotic forests. Submitters expressed that the annual charge would disincentivise indigenous afforestation. As such, submitters have proposed that Te Uru Rākau - New Zealand Forest Service consider either a full exemption to indigenous forests (of all ages, instead of the existing exemption for indigenous forests under the age of 6), or a reduced annual charge for indigenous forests.	The consultation proposal is that the exemption from the annual charge will remain in the regulations for indigenous forestry under the age of 6 years. A wider exemption for indigenous forestry would result in participants with exotic forest paying for the costs of services provided to indigenous forestry participants, or additional cost on taxpayers. This would be inconsistent with the cost recovery principles of equity and justifiability. Options for potential incentives for indigenous forestry may be considered in the future. This could include policy settings inside and outside the forestry ETS. The newly established Forestry ETS Registry Reference Group will inform this topic in the future.
Alternative considerations for averaging accounting forests	Eighteen submitters noted concerns about the annual charge being applied in perpetuity for forests registered under averaging accounting, where forests no longer earn NZUs once they have reached their average age. Submitters proposed that the annual charge ceases for forests under averaging accounting that have reached their average age.	Options for how the annual charge applies to participants with forest land registered in averaging accounting that is older than the average age or on a subsequent rotation, will be proposed as part of the 2025-26 cost recovery review. The review will include assessing forestry ETS service delivery data and identifying what compliance monitoring may be needed to address this issue before forests reach their average age.
Alternative considerations for Māori foresters	Seven submitters discussed the disproportionate impact the annual charge would have on Māori foresters, noting that Māori forest land warrants different consideration, for example, Māori freehold land is near impossible to sell due to the Te Ture Whenua Maori Act 1993, meaning Māori forest owners rely on stable long term economic opportunities for their lands. Some of these submitters proposed an exemption to the annual charge for Māori foresters.	While MPI understands the significant impacts changes to forestry settings have on Māori, a majority of Māori forest land relates to pre-1990 forest land, which is not subject to the annual charge. Under cost recovery principles, costs should be paid for by the person or group who is benefitting from the services, as such no exemption for Māori land has been proposed.

Theme	Summary of feedback	Response
Alternative considerations for small forestry participants	Three submissions noted the annual charge would have a disproportionate impact on small foresters, proposing that small foresters should not have to pay the same rate, with one submission suggesting a minimum number of hectares of forest be required before the annual charge applies.	The 2025-26 review of cost recovery settings will enable the collection of data over several years of operations, a full reporting cycle and the cumulative delivery of ongoing efficiencies from the recent changes. This will provide better data on how small forestry participants interact with services which will inform any changes to cost recovery settings. Under cost recovery principles, costs should be paid for by the person or group who is benefitting from the services, as such no exemption, or reduced rate for small forestry participants has been proposed.
Alternative approach to the annual charge: charge emitters	Nine submissions supported an alternative approach to the annual charge. These submitters outlined emitters as the beneficiaries of the forestry ETS, and therefore should be charged some or all of the operational costs of running the ETS. Some of these submissions suggested emitters be charged based on the number of units they are required to surrender annually.	The forestry ETS is designed so emitters must meet their legal obligations to offset their emissions and are required to do so by sourcing units. There is no legal authority[42] to recover the costs of operating the forestry ETS from emitters because the costs are a product of size and complexity of forests in the forestry ETS, and relate to services specific to forestry ETS participants, rather than the use of units to offset emissions. In line with cost recovery principles, it is equitable and efficient to charge the direct beneficiaries of services. There is also no restriction on where emitters can source units for example, through an auction, industrial allocation, or being a forester

[42] Charging emitters is outside of the scope of the empowering provisions that are limited to charging only in relation to removal activities.

Theme	Summary of feedback	Response
Alternative approach to the annual charge: charge at issue or sale of NZUs	Eight submissions supported an alternative approach to the per hectare annual charge, that would see forestry participants charged a levy on New Zealand Units when they are issued or sold, instead of basing the charge on a per hectare rate.	Charging a levy on NZUs when they are issued or sold is not a viable option for cost recovery and would not be consistent with cost recovery principles. Cost recovery linked to the variable market for units would be inconsistent and lead to variation in funding to support the services used by participants in the forestry ETS. In addition, the number of units earnt does not change the benefits received by participants from these services.

FMA proposal

Submitters who commented on the FMA proposal were largely supportive with 32 out of 33 submitters agreeing that the rules should be clarified to minimise costs for FMA participants during the shortened 2023-25 reporting period.

8. Conclusions and Recommendations

The status quo $30.25 per hectare annual charge was calculated from the information available at the time whereas the proposed $14.90 per hectare annual charge is based on revised data and modelling. In the interim between the status quo modelling and the modelling for the proposed annual charge there have been efficiency gains in the administration of the forestry ETS. The proposed annual charge also reflects a reallocation in the funding of IT costs and legacy reviews from participants to the Crown. This is appropriate because the IT system is still in a transitional period. Crown funding for legacy cases ensures that costs recovered from participants can be clearly linked to service provision. For these reasons, the proposed annual charge of $14.90 per hectare best meets the cost recovery objectives of transparency, justifiability, efficiency, and equity at this time.

The proposed approach for FMA participants in the 2023-25 reporting period to use existing or default carbon tables best addresses the policy problem because it aligns with the policy intent when the 2023 changes were made and is more efficient and equitable because it is a simpler approach for this shorter reporting period.

MPI recommends updating the Forestry Regulations to reflect:

1. the proposed annual charge of $14.90 (excluding GST) per hectare to match the annual charge cost recovery settings to the contemporary costs of administering the forestry ETS;

2. the proposed approach to allow FMA participants to use existing or default carbon tables in the 2023-25 reporting period.

9. Implementation Plan

The revised annual fee will be implemented through amendments to the Climate Change (Forestry Sector) Regulations 2022 and publicly notified in the New Zealand Gazette.

To give the forestry sector certainty about costs in 2024/25, amendments will need to be approved by Cabinet and notified in the *Gazette* by the end of December 2024, taking effect January 2025 (there is a mandatory minimum 28-day period for cost recovery regulations to take effect). This timeframe will enable MPI to invoice participants at the amended rate for the 2024/25 FY (1 July 2024 to 30 June 2025) starting in February once the annual charge regulations are in force.

To mitigate cashflow and accounting impacts for participants, MPI will phase invoicing for the 2024/25 FY and 2025/26 FY annual charges to ensure they are not invoiced in the same tax year. The tax year (1 April to 30 March) differs from the Government financial year (1 July to 30 June).

If the amendment regulations take effect later in 2025, invoicing for the 2024/25 FY annual charge could be delayed until April 2025 or later. As participants will also be invoiced for the 2025/26 FY annual charge after 1 July 2025, many participants would receive invoices for two annual charges during the 2025/26 tax year (1 April 2025 to 30 March 2026) that could cause risks to their cashflow.

Once the amendment regulations are notified in the Gazette, MPI will communicate the upcoming changes via its website and the ETS Alert email newsletter which has a large number of forestry ETS participants and consultants as subscribers.

Under section 163 of the Act, changes to the FMA methodology have a minimum three-month post-Gazette implementation period. This does not pose an operational issue for FMA participants nor MPI because the FMA is reported for the last day of the mandatory emissions reporting period (31 December 2025) which will fall after the FMA changes have been implemented.

Risk mitigation

As with any implementation, there are risks involved with the new cost recovery settings. MPI will ensure due diligence is managed and implement mitigations where reasonably able to. MPI has identified the risks and for each, an appropriate mitigation (Table 20).

Table 20: Risks and mitigations associated with the proposed reviewed annual charge

Risk	Mitigation
Risk that participants will not pay when they are required to.	Mitigated by using standard MPI debt recovery processes. In addition, all fixed fees are required to be paid as part of the application lodgement process.
Risk that the annual charge over or under recovers against the intended amounts.	Mitigated by reviewing fees once every three years and updating where appropriate.

Ongoing operational risks will be managed through existing governance processes.

Enforcement strategy

To ensure the updates are implemented and enforced in support of achieving the policy objectives, MPI will manage the recovery of any outstanding debt in line with the existing debt management policy.

10. Monitoring and evaluation

MPI recognises that monitoring and evaluating the impact of this revised annual charge is a critical component in providing transparency to industry and other interested parties, as well as ensuring ongoing system efficiency. This is explicitly acknowledged in MPI's cost recovery policies.

When the *Forestry in the Emissions Trading Scheme: Proposed updates to cost recovery settings (Tranche Two)* annual charge was set MPI identified FTE allocation and application volumes as a key metric to be used when measuring and managing the implemented cost recovery settings as it was crucial in the development of the proposed fees and annual charge. Therefore, ongoing monitoring and evaluation of FTE allocation and application volume throughput was, and will continue to be, routinely undertaken to ensure efficiency and appropriate allocation of resource.

As part of its comprehensive monitoring of fees, MPI also monitor payment of the annual charge through its invoice system. Information collected will inform the next full cost recovery settings review in 2025-26. The new annual charge will remain in place until the next cost recovery review is completed.

MPI recognises that timely reporting on this is a critical component of providing transparency to ETS users and other interested parties and will continue to work closely with industry to ensure that the performance information reporting is meaningful.

11. Review in 2025-26

Forestry ETS cost recovery will be reviewed starting in 2025 to be completed in 2026. This review will update the costs for participants in the 2026/27 FY. Work on the cost efficiency of the forestry ETS will commence in 2025, leading to a full review of the forestry ETS cost recovery settings, including the annual charge and service fees in 2026. The 2025-26 review will enable the collection of data from a full mandatory emissions return period (MERP) cycle and will also be informed by the realisation of further efficiency gains in the forestry ETS registry. Most of the issues raised by submitters will be considered over the next 12 months to inform the 2025-26 review.

The Minister of Forestry and MPI will engage with the Forestry ETS Registry Reference Group on this work, providing greater transparency and engagement on the forestry ETS and building sector confidence in the forestry ETS registry.

MPI use memorandum accounts to track the revenue and expenditure relating to cost recovered services. The memorandum accounts are monitored to ensure that significant deficits or surpluses do not occur (over or under-recovery of revenue in relation to expenditure).

Our standard review period for fees and charges is once every three years, however these may be amended more frequently if required. The review will consider both cost recovery policy settings (who should pay for services, and how) and the amount of fees/annual charges made to ensure they sufficiently cover the costs of service provision. Where efficiencies have been made and the memorandum account is not in deficit it is likely the fees or annual charges will be reduced. Where additional costs are being incurred to provide the services, these will be identified and rates increased as appropriate. The industry will be consulted on any proposed changes to fees and annual charges.

Fees and annual charges can be updated outside of the standard review cycle if a material surplus or deficit accumulates in a memorandum account or if structural changes are being proposed (changes to the structure of fees or annual charges, the type of fee or charge, additions or deletions). MPI aims to set fees and annual charges at levels that ensure memorandum accounts trend towards zero over a three-year period, however the annual charge will not be updated until the 2025-26 review has been completed.

Version control

Other version	Date	Link

Appendix 1: Legislative authority to recover costs

The Climate Change Response Act 2002 is the authorising legislation which provides broad regulatory powers to create regulations to[43]:

a) specify the persons or classes of persons by whom any fees and charges prescribed or fixed are payable; and
b) provide for partial cost recovery from one class of persons and full cost recovery from another (if this is desirable to further the purposes of this Act); and
c) prescribe the matters for which direct and indirect costs may be recovered; and
d) prescribe a scale of fees and charges, or a rate based on the time involved in carrying out the function or duty or in exercising the power; and
e) prescribe a scale of fees and charges, or a fee or charge for a prescribed function, power, or duty; and
f) prescribe a formula for fixing fees and charges; and
g) prescribe an annual fee or charge, or classes of fees or charges, payable by participants or classes of participants; and
h) prescribe the time of payment of fees and charges, the means of collection of fees and charges, and the person who is responsible for paying a fee or charge; and
i) authorise the EPA to recover the full costs of services from third parties (other than services in respect of which a fee or charge is prescribed) in circumstances prescribed in the regulations; and
j) authorise the EPA to grant, in whole or in part, an exemption, waiver, or refund in relation to any fee or charge.

The Act provides examples of the kinds of costs which can be recovered, such as the cost of processing applications and returns, and the costs of providing, operating, and maintaining systems, databases, and other processes in connection with the making of emissions rulings and input returns[44].

There are currently two sets of regulations under the Act that provide for forestry and related activities, the Forestry Regulations, and the Climate Change (Emissions Rulings: Fees and Charges) Regulations 2010.

Schedule 6 of the Forestry Regulations prescribe fees for certain services related to post-1989 forest land. These include fixed fees for core services.

MPI may, in whole or in part, waive or refund the payment of any fee or charge payable under these regulations if MPI is satisfied that either the services performed do not justify the payment or the payment in full, or the waiver or refund is reasonable in the circumstances[45].

[43] Section 167(4).

[44] Section 167(3).

[45] Regulation 16.

Appendix 2: MPI's approach to cost recovery[46]

Definitions are provided below:

Principle	Definition	Discussion
Transparency	Costs should be identified and allocated as closely as practicable in relation to tangible service provision for the recovery period in which the service is provided.	This is about ensuring that recovered costs are clearly linked to the service provision (including the time period in which they are incurred). Transparency also means that adequate information is available to ensure that those impacted by charges can understand and have an opportunity to comment on the basis on which charges are calculated and imposed.
Justifiability	Costs should be collected only to meet the reasonable costs (including indirect costs) for the provision or exercise of the relevant function, power, or service.	This is about making sure the costs which are being recovered are appropriate — that they relate to the service being provided and that they are not unreasonable. MPI has a responsibility to ensure that services are both effective and efficient. Justifiability and transparency work together to ensure that MPI is accountable for the way it manages expenditure and revenue.
Efficiency	Costs should generally be allocated and recovered in order to ensure that maximum benefits are delivered at minimum cost.	This is about value for money. There are different types of efficiency that can be relevant: • *Productive efficiency* — maximising outputs at minimum costs. • *Allocative efficiency* — encouraging users to make the best decisions about whether to use a service, and influence longer term supply. • *Dynamic efficiency* — improving productive efficiency over time. • *Administrative efficiency* — having charges that are easy to understand and implement, and minimise transaction costs for all parties.
Equity	Funding for a particular (or class of) functions, powers, or services, should generally, and to the extent practicable, be sourced from the users or beneficiaries of the relevant function, power, or service. This funding should be sourced at a level commensurate with their use or benefit from the function, power, or service.	This is about the fair distribution of resources in the economy, for example, whether cost recovery for a service is fairer than tax payer funding. Discussion of equity can include consideration of other principles and tensions. For example, when there is geographical cost variation or efficiency it could be considered equitable to charge all customers the same. Alternatively, differential pricing could be equitable because people pay in line with the cost of providing the service, regardless of location.

46 As outlined in MPI's Cost Recovery Policy Guidance: https://www.mpi.govt.nz/dmsdocument/30855/direct.

Relationship between the cost recovery principles

The principles build on each other with Transparency and Justifiability providing a foundation to the consideration of Efficiency and Equity.

Transparency and Justifiability come before considering Efficiency and Equity

MPI cannot be confident that the efficient way of cost recovering has been identified if costs have not been sufficiently justified or affected parties have not had a reasonable opportunity to test the costs. For this reason, Transparency and Justifiability come before Efficiency and Equity. MPI can only consider how best to meet the Efficiency and Equity principles after sufficiently meeting the Transparency and Justifiability principles.

There will sometimes be trade-offs between Efficiency and Equity

The Equity principle says beneficiaries will generally pay. This is consistent with the Efficiency principle.

Sometimes the Government will decide, for fairness reasons, to charge someone other than the beneficiary (e.g., general taxpayers). In this situation, there is a trade-off between Efficiency and Equity — the Government prefers a certain outcome which it deems more equitable and is willing to lose some efficiency to achieve it.

Memorandum accounts

MPI generally uses memorandum accounts to track revenues and expenditure associated with cost recovered services. Memorandum accounts record the accumulated balance of surpluses or deficits incurred in providing cost recovered services. In general, MPI aims to set charges at levels that ensure memorandum accounts trend towards zero over a three-year period.

Appendix 3: Detailed description of components and performance

Compliance

Under the new operating model, MPI takes a risk-based regulatory approach for the forestry ETS and ensures the right compliance tool is used, the participants are treated consistently, and provides feedback for continued systems and process improvement for the forestry ETS.

Effective compliance enforcement and assurance ensures a more effective and efficiently administered forestry ETS that is easy to comply with and hard to offend against. This leads to better climate change outcomes for New Zealand, ensures that all participants comply with their obligations under the CCRA and provides an incentive for voluntary compliance. This makes compliance costs a 'club good' due to it being a service that provides benefits to participants as a whole.

Maintaining the integrity of the forestry ETS through compliance benefits participants as it ensures an effective, robust scheme that encourages participation. Participants also benefit from compliance education both directly and indirectly. This is by ensuring participants have the information they need to comply, while enabling MPI to identify what most queries relate to and where further resources and education could benefit participants as a whole.

Compliance assurance

As a regulator, MPI needs to ensure that what is being submitted meets the requirements under the Act. To achieve this, a risk-based regulatory approach is used which includes auditing applications to ensure the accuracy of submissions and allowing errors in applications to be amended. This auditing approach focuses on the applications that present the highest risk to the delivery of forestry ETS outcomes.

Compliance enforcement

MPI takes a graduated response to compliance enforcement using a range of interventions. This supports consistent enforcement and enables appropriate intervention across a range of options, from information and education through to prosecution.

Lower-level compliance measures, such providing information and guidance are cost-effective in achieving compliance for most people. Prosecutions and other more stringent enforcement measures may be necessary for individuals and businesses that deliberately choose not to comply. Intermediate level measures, such as infringement notices, may be used if the risks posed by non-compliance can be satisfactorily managed without more stringent measures.

Compliance and enforcement are not the end goal of regulation. They are part of a cycle that ensures the best result for New Zealand and the regulated community. Achieving results is the basis for MPI's core decisions and will help achieve reductions in greenhouse gas emissions.

As of 11 June 2024, there are 404 Compliance action cases with on average 30 new cases per month. Compliance action cases consist mostly of historic unresolved transfers of participation, completing assessments on behalf of participants who have failed to submit an emissions return, and amending incorrect emissions returns. These cases often have multiple factors and issues for investigation. Analysis of processing timeframes indicate compliance enforcement cases will require a minimum of three weeks to complete. The average duration for a case is 100 working days, due to the robust checks required across different teams and notice periods for participants to provide additional information.

Compliance Education

Forestry ETS Operations has historically engaged with participants and the general public on a 'pull' model. Those that need information or assistance must either make direct contact or 'pull' information from MPI. The increase in participants in the forestry ETS during the 2018-2022 mandatory emissions return period, and the changes to legislation in 2023, resulted in this engagement method being no longer fit for purpose. To apply the new risk-based regulatory approach under the VADE model, MPI will place education and engagement as a priority to support compliance alongside a move towards a strategic engagement model with a 'pull' and 'push' model of engagement to achieve goals.

Education and engagement help provide the means for participants to comply with their obligations, it ensures that participants are aware of what their obligations are and know how to comply. Providing guidance to participants on how to submit applications or forms, means that staff can provide an extra level of support for those participants who are new to the forestry ETS or are having technical difficulties. These measures are especially important as they improve efficiencies and reduce non-compliances, spending the time to educate a participant on how to comply involves less time and resources than taking compliance action if that participant failed to comply with their obligations.

Management of enquiries

Management of enquiries has been broken into three categories under the proposed components of the annual charge:

- Finance management
- Forestry ETS participant reports
- Customer enquiries response

One of the most frequent ways in which operations staff engage with the sector is through enquiries. Management of enquiries occurs across three pathways: phone, email, and through Tupu-ake. This includes the active monitoring of the queues to ensure timely responses. Forestry ETS participants, consultants, and the general public, can submit queries to forestry ETS Operations, or by calling the forestry ETS Message Service who, if required, will refer their query on to forestry ETS Operations.

These queries range from simpler topics, such as querying how to register into the forestry ETS, to more complex operational topics regarding a participant's specific forest holding. There is no set fee associated to submitting an enquiry to forestry ETS Operations, as charging a fee per request would disincentivise interaction with the ETS, and the circulating of requested information can benefit all forestry ETS participants. The timely and effective resolution of these queries ensures participants are getting information more quickly, it helps to increase understanding of forestry ETS obligations, decrease general non-compliance, and decrease incorrect or incomplete applications that are submitted.

Enquiries and calls take anywhere from 16 to 40 minutes of staff time to respond to and close, though some may take much longer. The time taken to resolve these queries is dependent on the topic. Prior to Tupu-ake, enquiries where managed externally and case closure rate for enquiries was between three to four weeks. Today, calls are generally returned within one to three business days and enquiries are responded to and closed within five to 15 business days, depending on their complexity.

Reviews of decisions

A person affected by a decision under the forestry ETS participant provisions who is dissatisfied with the decision may request MPI to review this decision under section 144 of the CCRA. Following a review, MPI may confirm, revoke, or vary the decision in the manner that it thinks fit.

Typically, a review request will centre on the following decisions:

- Land eligibility assessments.
- Emissions return amendments and their associated penalties.
- FMA processes.

Providing reviews of decision upon participant request is an important part of administering the forestry ETS, charging a set fee for reviews of decisions would create financial disincentives and natural justice issues.

The most common review type is land eligibility assessments, of which there are currently 243 applications in the queue[47].

If a review of decision results in MPI revoking or varying a decision, the outcome of this review will be back-dated to the original decision.

For example, if areas of land were originally found ineligible in a registration application, but additional land is found eligible as a result of the review due to new evidence being provided, then this land will be considered to have been registered from the date of the first decision. NZUs will be earned retroactively for these areas. Often, varied decisions on land eligibility will result in thousands of additional NZUs being allocated. The financial impacts of these decisions mean it is imperative that forestry ETS Operations is well resourced in order to complete these reviews in a timely manner.

Historically, completing reviews of decisions has been a lengthy process due to the complexity of the analysis required, including a full audit of the initial decision. A review may also require participants or MPI to gather more information, which can be time-intensive. However, comprehensive work has gone into streamlining these processes, including the publication of new operational processes and policy. We expect that these measures, along with increased efficiency in Tupu-ake, will significantly reduce the time taken to complete reviews of decisions compared to in previous years.

Typically, MPI expects a straightforward registration application representing 10 hectares of forest land to take eight hours. Comparatively, MPI expects a 10 hectare review of decision

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[47] As at 26 September 2024.

application to take three to four hours and the time to review the deicsion per case to vary from 40-60 hours as shown in the table below.

Review of decisions		
Workstream	**Resources available**	**Time per case**
Operational decisions	6	40 hours
Land eligibility decisions	6	60 hours
Penalty decisions	7	60 hours

IT system — maintenance

IT system maintenance costs cover the ongoing maintenance of Tupu-ake and operating costs including software licensing. This ensures Tupu-ake can support over 30 types of applications to support the forestry aspects of the ETS. The costs associated with improvements, depreciation and capital charge of the IT system are not included in this proposed annual charge.

IT system — Improvements

This covers the cost of ongoing system enhancements including both the development of new functionalities and bug fixes. Also included in this category is the cost of staff time required for IT system testing (both 'business as usual' testing and 'user acceptance testing') to ensure improvements are successfully implemented.

IT system – depreciation and capital charge

Depreciation is the process of allocating the cost of developing Tupu-ake over its anticipated useful life of 10 years as opposed to an initial upfront payment. In addition to depreciation, the capital charge encompasses the cost of capital required to develop Tupu-ake.

Appendix 4: Annual charge modelling assumptions

Hourly Rate	$165 per hour for all models
Hours required to complete services	Based on 2022 modelled hours
Inflation	Based on Treasury guidelines and cost recovery policy
Future policy changes	Not modelled
Discounts for pre-1990 forestry	3% discount applied to 'compliance enforcement'
	3% discount applied to 'Customer Enquiries'
	0.5% discount applied to 'Inter-agency reporting'
Productivity	80% productivity hours for fees
Annual Charge	Made up of 11 components
Discounts for legacy	50% discount applied to 'Compliance enforcement' applied after the previous 3% discount
	50% discount applied to 'Review of decision'
Hectares for annual charge	650,000 hectares
Part charge	Not modelled
Indigenous exemption	Exempt area included in area used to determine charge (650,000 hectares have not been reduced to reflect indigenous exemption)

Appendix 5: Analysis of Field Measurement Approach proposal

Comparison of the status quo and default tables or existing PSTs allowed for the 2023-25 reporting period

Cost recovery objectives	Option One – Status Quo	Option Two - default tables or existing PSTs allowed for the 2023-25 reporting period
Transparency - ensuring that recovered costs can be clearly linked to the service provision.	0 Fee is transparent for requesting PSTs (as the participant is directly paying for the service rendered).	0 There is no change to transparency as the fee still applies for those who chose to request PSTs.
Justifiability - ensure charges for services reflect the costs of providing them and provide a fair way to minimise Crown funding requirements to maintain the ETS.	0 The fee is justifiable as outlined in the Tranche Two analysis which introduced this fee[48].	+ There is no change in the fee. Staff time will be freed up, removing staff operational burden of creating PSTs, but it is not clear if this will reduce costs to the Crown overall.
Efficiency - promote consistency by using a common approach to cost recovering for services of a similar nature and cost structure, to deliver maximum benefit at minimum cost and maintain simplicity of charges, by using fees and annual charges where appropriate.	0 This option is more complex because different FMA participants have different choices available to them about the carbon tables they use to calculate carbon stock relating to the 2023-25 reporting period. There is a higher operational burden for affected participants and the Crown.	+ This option is more efficient and simple because every FMA participant will have the same options available to them in terms of the carbon tables they use to calculate carbon stock relating to the 2023-25 reporting period. This is operationally more straight forward for participants and the Crown.
Equity - apportioning costs between participants and the Crown in a way that is fair.	0 Some FMA participants would incur fees for requesting PSTs during the 2023-25 reporting period, who could reasonably rely on their existing data or use default carbon tables to calculate carbon stock for emissions returns relating to that reporting period.	+ FMA participants can choose not to request new PSTs during the 2023-25 reporting period. This greater alignment with the policy intent of the 2023 changes is also fairer.

48 https://www.mpi.govt.nz/dmsdocument/59314-Appendix-Three-Cost-Recovery-Impact-Statement

Marginal costs and benefits of the Field Measurement Approach proposal compared to taking no action

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
FMA participants	No additional direct or indirect costs. Affected FMA participants will have the option to reduce their costs for emission returns relating to the 2023-25 reporting period under the proposed change.	Low	High
Tangata whenua	No direct or indirect costs identified (unless FMA participants, see above)	Low	High
The Crown	No additional direct or indirect costs	Low	High
Total monetised costs	N/A	N/A	N/A
Non-monetised costs	N/A	N/A	N/A
Additional benefits of the preferred option compared to taking no action			
FMA participants	Significantly reduced costs, saving an estimated $1.3 million in service fees. Consultancy costs for measurement also saved.	High	High
Tangata whenua	No direct or indirect benefits identified (unless FMA participants, see above)	Low	High
The Crown	Streamlined operations.	Low	Med
Total monetised benefits	$1.3 million for participants	High	High
Non-monetised benefits	Benefits associated with ability to streamline delivery of the 2023–25 reporting period	Low	Med