KEYNOTE INTERVIEW

The next wave of carbon investing

LPs are increasingly expecting their sustainable agriculture plays – including carbon sequestration – to generate attractive returns, say Roc Partners' Brad Mytton, Frank Barillaro and Sam Bayes

Sustainable investing has already come a long way, and in recent years it has become a multifaceted investment strategy in its own right, providing more and more large institutional investors with portfolio diversification.

As these investors' commitments to net zero grow, a significant shift in the agriculture investment landscape is underway, with bigger portions of capital being directed toward the carbon farming and sustainable forestry sectors.

Roc Partners' managing partner for food and agriculture Brad Mytton, partner for food and agriculture Frank Barillaro, and senior associate for responsible investment Sam Bayes, delve into the forces increasingly driving LPs toward carbon farming and forestry investments, and the broader implications for our planet and financial markets.

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Q What factors are behind the rising popularity of direct investments in the carbon markets, forestry and assets with low emission profiles?

Sam Bayes: At the macro level, there is increasing awareness of climate change and its potential impacts. The Intergovernmental Panel on Climate Change's latest findings suggest that there is more than a 50 percent chance that the global temperature rise will surpass 1.5C between 2021 and 2040, and we are not on track to meet our Paris climate targets.

Also, our stakeholders – members of superannuation funds and other institutional investors – are becoming increasingly vocal about their expectations around responsible investment practices and broader ESG integration.

Brad Mytton: Over the past 10 years, there has also been more regulatory focus on emissions monitoring and improving those baselines. Now we are seeing a shift among more forward-thinking investors towards where the opportunities are, especially with regards to higher integrity carbon methodologies.

Frank Barillaro: What we have also seen in the last decade is that what started out as an idea has matured into a market. People can now go from a starting carbon baseline to achieving accreditations and trading or monetizing carbon in a marketplace. Although there is still a long way to go in terms of development and maturity, we see that picking up over the next five to 10 years.

Q How are LPs trying to understand and mitigate their total carbon footprint?

SB: One of the key frameworks LPs are now using is the Global GHG Accounting and Reporting Standard for the Financial Industry, developed by the Partnership for Carbon Accounting Financials. It's a comprehensive methodology to accurately and consistently measure financed emissions, and it's targeted at superannuation funds, investment managers, banks and insurers. In my experience, both large and small LPs are on that journey, but larger ones are certainty further along.

Another key trend driving this is the mandatory climate-related financial disclosure regime coming to Australia. The bill proposes to introduce reporting obligations in three groups, over a four-year period based on revenue, assets, number of employees and whether the entity has existing climate reporting obligations. The first phase for large entities is planned to start from January 1, 2025 and we expect many LPs will be captured with that wave of reporting.

FB: In the agriculture and food production space, there will come a time when consumers will shape LPs' attitudes towards carbon emissions. It will come down to consumer preferences and whether they are willing to pay a premium for carbon-neutral food. So we see an opportunity to capture a price premium by ensuring we are able to continue to produce food with a zero, or at least a minimal, carbon footprint. We are in the early stages of that market developing.

Q How do you go about reducing portfolio emissions within Australian agriculture assets?

SB: Investing in certain agricultural practices like regenerative agriculture or nature-based solutions has the potential to sequester carbon. For instance, we did a carbon assessment on two of our portfolio companies – 555 Superfoods and Lachlan River Almonds (LRA) – with Carbon Friendly, and the report was independently verified by SGS.

For LRA, the assessment showed a net negative emissions value, indicating that the farm acts as a net sequester of carbon. Practices used on farm that helped achieve this included reduced herbicide use, mechanical weed removal and irrigation management tools.

At 555, when we compared FY21 to FY19, we found that the emissions intensity of the stone fruit orchards decreased by 50 percent because of initiatives implemented by farm management. That demonstrates that, depending on how engaged management is and how willing they are to invest in the farm, you can actually decrease carbon emissions profiles.

Q Are you seeing attitudes changing toward sustainable investments among all kinds of LPs, or only the larger ones? Are there any regional differences?

SB: The Investor Group on Climate Change's latest report found that 80 percent of asset owners in Australia have set net-zero targets across all or in some parts of their portfolio, which indicates that it is not just the large LPs looking into this.

FB: Different investors in different jurisdictions will have different mandates. The European market is very advanced in this space, while the Australian institutional market is still developing its thinking around this. These two markets are at the forefront of trying to understand climate risk and its impact on their portfolios.

Q What role do carbon markets play in reducing portfolio emissions?

BM: The carbon markets are still quite young, but as reporting pressure ramps up, I think we will start seeing investors and corporates looking to offset more emissions. Australia's governance framework for this regime is well advanced by global standards, so now it's a case of how we can generate a supply of carbon credits to enable offsetting to start.

In most cases, the first step is to lower emissions through better practices, investing in energy efficiency and so on. Once that has been exhausted, then offsets will be the next best way to achieve net-zero targets.

As an agricultural investment manager, we want to help develop a carbon offset strategy and help generate that supply of Australian carbon units. For example, with our new fund – the Silva Carbon Origination Fund – we are looking to acquire a portfolio of mixed farming land and to plant out 20-40 percent canopy cover, to be run as carbon blocks in conjunction with the agri activities (cropping, cattle and so on). There will be many aspects to this – working with rural communities, monitoring bushfire risk, retaining jobs – but if we are able to get all the pieces in place, there are some wonderful returns and a surprising amount of carbon credits to be generated for the right projects.

I also think many of the usual benefits associated with agri investing – portfolio diversification, inflation protection – flow through this strategy as well, so this can be additive to people's portfolios.

FB: After spending several years investigating the carbon market, we learned that it is not just about taking short-term advantage of a trend but implementing long-term, sustainable measures.

We do not want to invest in carbon credit projects that might have zero value at the end of the project life. That means thinking about how we can combine sustainable farming practices with carbon farming, so that it leads to 50-200 years of value.

> *"What started out as an idea has matured into a market"*
>
> **Frank Barillaro**

Q When it comes to investing in carbon markets, are there other benefits for LPs beyond progressing toward net-zero goals?

BM: The tailwinds behind the carbon sector, and the environmental benefits, are really significant. But there is also a diversification benefit because the returns are often uncorrelated with the rest of an LP's portfolio.

Interestingly, some of the more forward-thinking LPs view this methodology as a co-benefit because it capitalises on the next wave of high-integrity carbon projects and offsets that are going to be generated in Australia – that is to say, their investment is actually enabling this next wave of taking carbon out of the atmosphere.

Q What are a few of the key considerations that institutional investors should keep in mind when evaluating carbon investment opportunities?

BM: There has been a lot of talk in the last few years around the integrity of some of the carbon credit methodologies in Australia. Some of the corporates and LPs are focused on 'headline risks.' The last thing they need is for their carbon investment activities to be found to be anything less than high integrity. Our focus is to make sure we are only playing with very high-integrity carbon methodologies and high-integrity partners to deliver a product that is of an institutional standard.

Another consideration is the quality of the carbon credits and the risks around land, planting trees, working in rural communities. All that needs to be well thought out and properly addressed beyond just understanding the regulatory framework. That is a common concern that dovetails with the question of methodology integrity. Spending a lot of money on a methodology that may only have a year or two to run is not necessarily the right answer – rather, it is about working with policymakers on what actually makes sense in the long term and focusing on those activities.

Q And lastly, how do you approach emissions within your own portfolio?

SB: It is imperative to try to reduce carbon emissions as a fundamental first step. We have been working with our portfolio companies to measure their baseline carbon emissions alongside our trusted partners. After that, our goal to do a bi-annual assessments to make sure that carbon emissions are reducing over time.

The next step is to look at carbon offsets where emissions are unavoidable in the business. Combining emissions reduction strategies with carbon offsetting can demonstrate a business's commitment to environmental stewardship.

FB: As the industry evolves, we will be able to see which players are managing their carbon-production balance better than others and benchmark relative to them. ■