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Carbon Credits

Senegal: World's First Private Sector ITMO Partnership

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Senegal: World's First Private Sector ITMO Partnership

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Alexis Leroy is the CEO and Founder of ALLCOT Group, a pioneer project development and sustainable services company.



Summary

We discuss the innovative partnership between the Government of Senegal, Carbon Growth Partners, and Allcot, which serves as a disruptive new paradigm to break the global deadlock on climate finance. Private sector investors take on the financial risk of Article 6 carbon projects, which allows the host country to negotiate the International Transfer Mitigation Outcomes (ITMO) process from a position of strength. **Watch the full discussion here**.

Key takeaways

- Senegal has signed an agreement with Australian investment company Carbon Growth Partners and Swiss carbon project developer ALLCOT for the World's First Private Sector ITMO Partnership. Internationally transferred mitigation outcomes (ITMOs) are offsets that count toward a country's Nationally Determined Contributions (NDCs) and support the overall mitigation of global emissions (for Article 6.4).
- The $20mm investment into the National Integrated Waste Management Company of Senegal will enable the development of waste management infrastructure at a time when many African governments are budget constrained. Being issued by the Senegal government, the credits are of high quality and will demand a significant premium to many existing issues.
- Once the credits are issued from these projects, they will be sold after undergoing corresponding adjustments to be made eligible for ITMO. There is flexibility regarding selling those credits. They can be sold under Article 6.4, Article 6.2, or to the Voluntary Carbon Markets. Government to Government transactions would be likely, with Singapore being the model for acquiring credits such as this
- Projects like this have been previously difficult due to bureaucracy, perceived credit risk in developing economies, and uncertainty about the broader Voluntary Carbon Markets. This transaction is the first of its kind and could be a road map to scale the VCM in the years ahead.

Paul's observations

With the Voluntary Carbon Markets (VCM) facing a slew of negative headlines about the quality and scientific rigor of the underlying projects, it was refreshing to see significant progress being made on a public/private partnership such as the World's First Private Sector ITMO Partnership between the government of Senegal. ALLCOT and Carbon Growth Partners. For credibility and scalability, the VCM will require more direct government involvement. The VCM requires more large-scale projects, be them working with governments on infrastructure like waste management or larger-scale nature-based solutions. While technology will greatly help the credibility of projects when determining baselines and the anticipated benefits, the market still needs to deal with a legacy of poorer-quality projects. This will be an overhang for years to come.
Quality and scale matter for the VCM. While many existing credits trade at dramatic discounts to newer, high-quality issues with strong scientific backing, concerns about the underlying quality imply that these discounts could persist. Without completely redrawing the baselines, investors should stick to only the highest quality credits from the most credible developers. The lingering effects of a checkered past could be a drag on previously issued credits for several years. High-quality future issuance such as this ITMO transaction should be the focus of investors.

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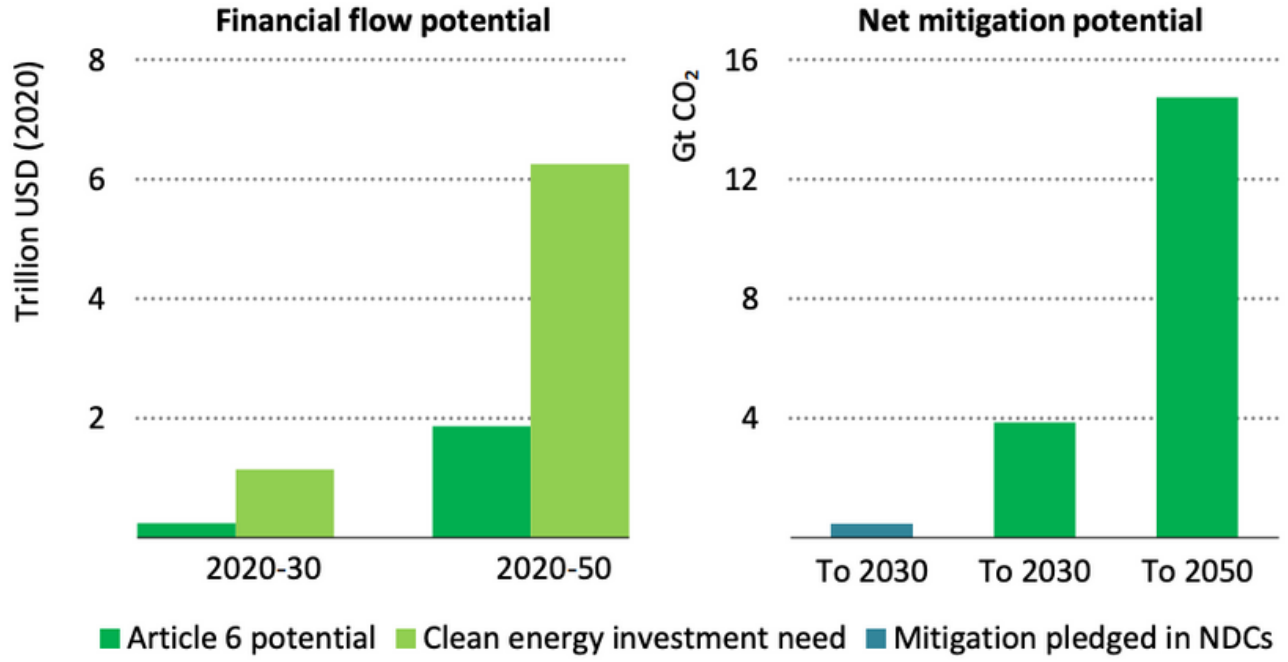
Article 6 financial flows and CO2 emissions reduction potential in Africa in the Sustainable Africa Scenario



Source: International Energy Agency

Some Background
(From The United Nations Development Programme)

What are Internationally Transferred Mitigation Outcomes (ITMO)?

ITMOs use a carbon dioxide equivalent (CO2e) metric for a new set of market provisions or other greenhouse gas (GHG) mitigation outcomes that are defined under Article 6 of the Paris Agreement. Under Article 6.2, ITMOs differ from previous offset schemes, as they count toward countries' Nationally Determined Contributions (NDCs), support overall mitigation of global emissions (for Article 6.4) and involve more substantial government participation than under the Clean Development Mechanism of the Kyoto Protocol. Although the Paris Agreement rulebook is not finalized, enough has been agreed upon for some countries to begin engaging and planning for ITMO transactions.
A Government to Government transactions would be an example of this.

What is in Article 6.2 of the Paris Agreement?

Article 6 of the Paris Agreement makes provisions for voluntary international cooperation between parties to achieve NDC targets. Sub-section 6.2 calls for transparency and the avoidance of double counting when two parties engage in the international transfer of emission reductions known in the Agreement as Mitigation Outcomes. This sub-section implies that two parties can enter into an agreement whereby one party reduces carbon emissions and transfers those reductions to the other party, which counts towards its NDC targets. It is assumed that the receiving party will provide financial compensation to the transferring party.

How does Article 6.2 help a country achieve its NDC commitment?

Transferred mitigation outcomes contribute to the NDC targets of the party that purchases the ITMO. The selling party must make a corresponding adjustment, meaning it has to "un-count" these mitigation outcomes from the emission reductions that contribute to its NDC targets.

What are the benefits to the selling party and benefits to the purchasing party?

For the selling party, selling ITMOs is an innovative way to channel investments into low-carbon projects. The payments for the ITMOs can leverage finance and stimulate investment into projects that contribute to its sustainable development. As stated above, the ITMOs sold to the buyers cannot count towards the selling country's NDC, but mitigation benefits can be achieved long term. It is assumed that a contract for International Transferred Mitigation Outcomes (ITMO) is shorter (usually 5-6 years) than a mitigation project; therefore, when the ITMO contract expires, and the payments/ transfers stop, if the project continues producing mitigation outcomes, this will be accounted against the selling Party's NDC. For the buying country, buying the ITMOs enables it to meet its NDC target cost-efficiently.

Questions & Answers

Details of the transaction and how it came about

Stephanie Russo:

This transaction started from a partnership perspective. At COP27, fundamental discussions about the carbon markets were ongoing, including the roles of the government and private sectors. Our partnership with Senegal serves as an early risk position to support the development of carbon markets. We started this by looking at the opportunities to demonstrate leadership around the outcomes of the COP. Government and private sectors in various countries can take advantage of ITMO opportunities to meet their climate goals.

Alexis Leroy:

We wanted to position ourselves as early players in the field of meeting the Paris goals with the support of the private sector. The process was complicated because it involved transactions between different countries. Before COP27, we had a discussion with the government regarding the previous deals with various countries. Generally, not enough resources were provided, and transactions were difficult to execute. However, our experience with the private market has been constructive.
Upon mentioning our concerns to Carbon Growth Partners, they inquired about the types of projects where the private sector could make a difference and unlock government collaboration. We immediately thought about the projects with Senegal that deal with organic waste in 20 secondary cities with an average emission reduction of 35,000 tonnes. These reductions have corresponding adjustments and a greater impact. Countries like Singapore are willing to pay $35 to $40 per tonne for these offsets. The Capital Expenditure for these projects is $1 million, and the operating expenses are $300,000 a year. Carbon Growth Partners agreed to involve the private sector in the program. They provided the opportunity of financing the operating expenses. We can sell carbon credits at a higher price than Singapore indicated. The 35,000 tonnes of reduction granted great financial security to all parties. Behind that, the National Integrated Waste Management Company of Senegal generates 55,000 tonnes of compost yearly, assisting food security for the secondary projects. This creates ongoing benefits within local communities. It is one of the more accretive projects I have witnessed.

Idrissa Diatta:

This transaction is about the alignment of values. First and foremost, it is about what is best for African nations as the carbon markets evolve.

Use of Proceeds

Idrissa Diatta:

This investment came at the right moment because the Senegal government recently updated its zero-waste policy. Solid Waste Management Coordinating Unit (UCG), a national-level private entity in Senegal,

will leverage this investment to meet the zero-waste goal. Senegal is focused on managing waste, and UCG represents only 40% of all the programs.

This project has three components:

1. The organic waste management system for feeding the compost plant. This will create more than 100 jobs and be useful from a circular economy perspective.
2. Digitizing the entire value chain for transparency and integrating high-quality emission reduction activities as we aim to build carbon-neutral cities.
3. Capacity building enables all the stakeholders in the value chain to get benefit from the projects. We have targeted organic waste in the NDC to mitigate methane and carbon emissions.

The economics of the transaction

Stephanie Russo:

Carbon Growth Partners has committed the first $2 million, a part of which will be used to support the first site in Senegal. The balance of the investment will be used in the first three years of the operating cost of that facility, leading to a $20 million investment program over time to scale the technology. This investment will support eight to ten sites in the next few years.

We have used an embedded offset price in our assessment of the economics. This is not a traditional off-take deal, as we have not invested $2 million to access all of the returns. Instead, there is a profit-sharing arrangement. We based our analysis on the carbon price in Singapore, but in Senegal, additional revenue will be generated from compost and plastic waste management. However, we are mainly focused on waste management projects.

Once the credits are issued from these projects, they will be sold after undergoing corresponding adjustments to be made eligible for ITMO. There is flexibility regarding selling those credits. Therefore, we have not pre-determined their market. We can sell them under Article 6.4, Article 6.2, or to the VCM if they continue to expand the opportunities for the private sector and corporates.

These are premium quality credits, backed by the Senegal government with corresponding adjustments attached to them, and unique under Article 6.2. Therefore, they can be priced higher than others. Transactions such as this are a convergence between compliance markets and the VCM under Article 6.2.

"These are premium quality credits, backed by the Senegal government with corresponding adjustments attached to them, and unique under Article 6.2. Therefore, they can be priced higher than others."– Stephanie Russo

Why was Senegal the first government to embrace a program like this?

Alexis Leroy:

We made this transaction with Senegal because we have been working on their projects for many years,

so we have confidence in the government and its process. Secondly, African sustainability projects are growing rapidly. The whole West African basin is developing projects around waste management. In the Senegal project, sustainable finance gives us the luxury of time, allowing us to wait for the market to mature. As the market evolves, other countries will embrace programs such as this.

How much capital is required to meet Senegal's zero-waste goals?

Idrissa Diatta:

It is hard to mention the exact figure required to scale the projects to their full potential. Our projects generate revenue through composting and power production using organic waste treatment. We can build a sustainable infrastructure with $300 million, but currently, we want to build a capacity for the local private sector in Senegal. We choose to take a leading role in the sustainability space for the West African nations.

Why are carbon projects not getting billion-dollar investments?

Stephanie Russo:

Several factors are associated with a lack of heavy investments in carbon projects. Large funds, such as pensions or sovereign wealth funds, invest in a policy-driven market at scale. In the carbon market, policies remain inconsistent. This market is gradually scaling. There is uncertainty regarding the position of the market in the next decade, which also serves as a factor hindering billion-dollar investments. Some large carbon storage projects exist in locations that sovereign investors may have historically considered as risks. Now, governments are creating an environment of confidence for investors, as early funding is required for climate change. With our partnership with Senegal, we are trying to demonstrate the opportunities for the investors. Partnerships like this will change the shape of the market.

Does Allcot work with governments wholistically or for a specific project?

Alexis Leroy:

The market is constantly evolving, making it difficult to have a permanent investment plan. Political and corporate agendas can also be deciding factors for investing in new projects. There are numerous carbon sequestration projects, so focusing on one specific area can be tough. Working on any environmental conservation project requires building trust with the government.
Meeting the Paris Agreement goals will require carbon credits that can be vastly generated in countries like Senegal, Colombia, and Mexico. Therefore, climate investors like Carbon Growth Partners should consider investing in such countries to unlock the opportunities that will impact climate sustainability.

Are these projects registered?

Stephanie Russo:

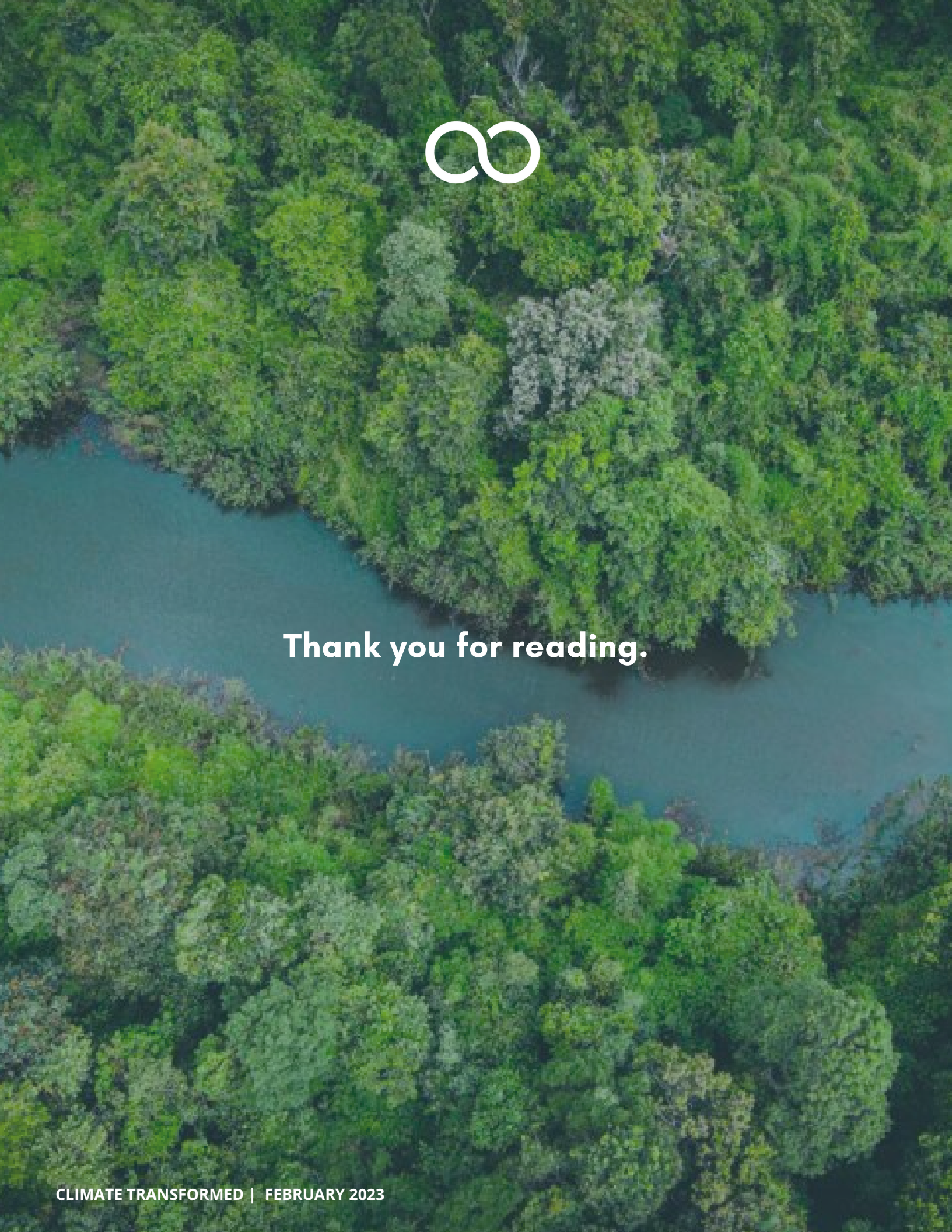
Not necessarily. We are incorporating the MRV while building the project as required by Articles 6.2 and

6.4. The credits with corresponding adjustments will need to be incorporated within Senegal's inventory. Meta registry for the Article 6.4 is not available yet. A lot of work is being done on leveraging the infrastructure of the VCM to ensure these credits go through an appropriate methodology. We see great value in verification and evaluation processes and support the narrative of quality and integrity around the carbon credits. To maximize the pathway into Article 6.2, 6.4, or the VCM, we can take different approaches to ensure a transparent measurement and verification of the carbon.

What does the future hold for Senegal's climate ambitions?

Idrissa Diatta:

We look forward to saving the planet while creating jobs and wealth for Africa. We will be leveraging this partnership to build concrete projects for moving forward toward sustainability.



Thank you for reading.