Submission No 100

INQUIRY INTO INTEGRITY OF THE NSW BIODIVERSITY OFFSETS SCHEME

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Submission into the inquiry into the integrity of the NSW Biodiversity Offsets Scheme

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Upon commencement in 2008 biobanking was a voluntary scheme that was later mandated into major infrastructure projects via the *NSW Biodiversity offsets policy for major projects* in September 2014 and flagged to become compulsory in 2017. In 2017 the original biobanking scheme (hereon referred to as the 'old scheme') was modified and the 'new scheme' became compulsory for a broader class of developments via the *Biodiversity Conservation Act*. The old scheme was generally working well with supply steadily increasing in response to demand, and with checks and balances in place to protect 'red flags' and ensure like for like offsets. Credit prices were publicly available via the credit transactions register and rose to a level that made participation in the scheme attractive to landholders and in the case of Western Sydney the market was well informed of likely demand through publications including;

- $397.5 million Growth Centres Conservation Fund – published in 2006
- Annual reports on the Growth Centres Conservation Fund including a 10 year forecast of offset demand. Published every year since 2009
- Guide to establishing a biobank site. Published in 2009
- Northern Road Upgrade Review of Environmental Factors – published in 2012
- Western Sydney Infrastructure Plan – Announced April 2014
- NSW Biodiversity offsets policy for major projects – published in September 2014
- Macarthur South announcement – September 2015
- $140 million offset for Western Sydney Airport (EIS) – published in October 2015
- Western Sydney Infrastructure Plan – published in October 2015
- M12 Options report – published in December 2015 (contained clearing estimates)
- M12 Strategic route analysis – published November 2016
- Information contained in the public biobanking credits wanted and EOI registers

However the old scheme was not perfect and indeed biases within the scheme lead to certain classes of credits rapidly appreciating in price, this was particularly evident in Western Sydney where prices for shale plains woodland rose from $2,653 in May 2010 to a peak of $35,000 in March 2018. This rate of increase was not sustainable and the Office of Environment and Heritage (OEH) rightly commenced a review of the old scheme. The unique factors of the old scheme that lead to the $35,000 peak were;

- Splitting Cumberland Plain Woodland into the hills and plains sub-associations
- *Environment Protection and Biodiversity Conservation Act, 1999* (EPBC) approvals restricted EPBC offsets to the highest quality vegetation
- EPBC approvals expressed in hectares, pushing EPBC offsets towards biobank sites with the lowest number of credits per hectare (eg Council reserves)
- Approvals to clear (demand) were issued within 1 month, whereas it was taking over a year to register a biobank site (supply)
- Impending changes under the new scheme made entering into Stewardship Agreements unviable, impacting supply

There were many changes made in the new scheme, the most significant were;

1. Substantial reduction in credits issued to stewardship sites (initially cut by approximately 70%)
2. Credit prices were capped in the Biodiversity Offsets Payments Calculator (BOPC) based on an econometric model using data on 'old scheme' prices, without taking into account the significantly reduced number of credits being issued to stewardship sites or the opportunity cost of 'sterilising' land
3. Developers were able to satisfy their offset obligations by paying into the BOPC at an unrealistically low price
4. Substantial flexibility in avoiding like-for-like offsets was incorporated into the scheme
5. Red flags were replaced with the less onerous and more subjective Serious and Irreversible Impact (SAII) test

These changes had the effect of making stewardship agreements unviable (BOPC prices were initially below the cost price of generating credits). This lead to credit prices under the old scheme being pushed up in the short term as the supply pipeline was reduced and it encouraged clearing and associated increased offset demand due to the artificially low price.

Typically in a normally functioning supply/demand market, credit prices in this scenario would increase and this would encourage increased supply. However with the BOPC capping prices at an artificially low level (based on a flawed econometric model) supply was drastically cut, predictably leading to market failure. As indicated in the Biodiversity Conservation Trust's (BCT's) annual report (2020), only 4 Stewardship Agreements were signed over the year. There were 231 offset obligations held and 18 offset obligations met, indicating that whilst developers offset obligations were being satisfied via BOPC payments, only a small proportion of offsets were actually being met, this is a far cry from the objective of 'no net loss'.

In 2020 the BCT increased the number of credits issued to stewardship sites and has allowed some gradual increase in credit prices, indeed the first Cumberland Plains Woodland transaction under the new scheme occurred in November 2021. However the longer lasting effect of sovereign risk associated with government demonstrating they will modify the scheme to the detriment of stewardship site owners is likely to deter participation in the scheme until a risk premium is incorporated into the price, or guarantees are provided to scheme participants.

The changes under the new scheme appear to be based entirely on improving the demand side of offsets and at the same time had a negative impact on the supply side of offsets. A summary of key issues in Western Sydney and the changes made to address them in the new scheme is provided below;

DEMAND Issues	Change under new scheme
Cumberland Plain woodland was split into the sub-associations Shale Hills and Shale Plains. Most clearing was occurring on plains, most biobanking was located on hills	Combined into single trading unit
Commonwealth requirement to meet EPBC condition	Commonwealth have endorsed NSW offsets as satisfying EPBC requirements
EPBC offsets expressed in hectares whilst NSW offsets expressed in credits	
Offsets in Council reserves issued lower number of credits per hectare, making them cheaper for developers to meet EPBC offset obligations, thus pushing up prices	
Approval for clearing obtained within a month via a biobank statement (rapidly increasing demand)	Approvals for clearing are still rapid
Approvals for conservation (biobank sites) were taking over a year (slowly increasing supply)	Approvals for stewardship sites are taking longer

SUPPLY Issues	Change under new scheme
Part A (Total Fund Deposit) must be met first	No change
Taxation point is upon signing the agreement, not selling the credits	No change
No guarantee of being able to sell credits	No change
Number of credits issued to stewardship sites	Worse off
Establishment costs to enter into an agreement	Worse off
Loss of future upside	No change
Sovereign risk – there are in excess of 66,000 'equivalence credits' from the old scheme listed on the credit supply register	Worse off

In essence, the new scheme encourages clearing, discourages stewardship agreements and will either need tax payers to partially fund developers impacts if like for like is to be met, or the environment to 'fund' the impacts if the BOPC payments are used for non-like for like offsets.

It is noted that the BCT is undertaking a thorough review of the scheme, hopefully this will redress supply-side issues and lead to a better functioning credit market.

With regards to other changes made in the new scheme, it is noted that the avoid/mitigate/offset hierarchy has statutory teeth as shown in recent Land and Environment Court cases;

- Tomasic v Port Stephens Council (2021)
- Planners North v Ballina Shire Council (2021)
- IRM Property Group v Blacktown Council (2021)

The statutory mechanism is there, however it would appear that there needs to be greater industry education to ensure this process is implemented appropriately.

There is now substantial flexibility in acquitting offset obligations via non-like for like offsets. This not only fails the no net loss test, but undermines the integrity of credit markets. It effectively provides an extinction mechanism for ecosystems and species located in high value real estate markets (eg. Cumberland Plain, Central Coast, Hunter Valley, Illawarra, Southern Highlands etc).

Way Forward

In my opinion a focus on the supply-side of offsetting will reduce the risks to the tax payer as well as increasing the ability of offsetting to meet the objective of no net loss. It requires a fundamental shift in thinking by government towards accepting (or sharing) the risk on conservation (assets) and moving away from accepting developer risk on clearing (liabilities).

Others have suggested that the BCT should be purchasing land and establishing its own stewardship sites, broadening the BCTs role from market facilitator into market creation. Under this scenario the BCT would have increased control over all aspects of the market and would require a large capital investment by government in order to make a meaningful contribution to credit supply. It would also require additional financial resources in order for the BCT to manage an expanded portfolio of properties.

I am of the belief that a better process would be to underwrite the risk to landholders of entering into a Stewardship Agreement through 'credit offtake contracts' or similar. Essentially, the BCT would guarantee a fixed per hectare return to landholders for entering into an agreement and would also contribute to the cost of establishing a Stewardship Agreement. The credit offtake contract could run over a number of years, with a substantial upfront payment in order to cover the Total Fund Deposit (TFD) and tax liabilities associated with entering into a Stewardship Agreement.

The process would operate along the following lines;

1. Identify target credits based on an analysis of likely future demand
2. Run an expression of interest program with landholders nominating their required per hectare return from their land
3. Undertake a preliminary analysis of shortlisted properties to obtain estimates on credit generation and TFD costs
4. Enter into options agreements with landholders to establish Stewardship Agreements, that upon exercise would guarantee a fixed return for landholders over a set period of time (say 5 years)
5. Pay for the cost of applying for the Stewardship Agreement

This process should;

1. Provide a pipeline of credits for the BCT, without the BCT having to invest capital in land ownership
2. Provide an accurate pricing mechanism for the BOPC, as the BCT would know exactly how many credits they could secure over the medium term and the price of those credits
3. Reduce risks to the taxpayer of having to subsidise under-priced BOPC payments
4. Provide a 'bridge' between the rapid timeframes of obtaining approvals to clear compared to the extended timeframes of entering into a Stewardship Agreement
5. Underwrite landholder risk and increase the likelihood of land owners entering into Stewardship Agreements, thereby increasing supply and reducing the risk premium in credit prices
6. Increase the ability for asset rich, cash poor landholders to participate in the scheme
7. Improve access to like for like credits

Concurrently the BCT should:

1. Work with the Australian Taxation Office to modify the *Income Tax Assessment Act 1997*, with the goal of taxation points occurring when credits are sold, not when they are created
2. Reduce sovereign risk by incorporating a no-worse off clause in the *Biodiversity Conservation Act, 2016*. The objective would be to guarantee that if there are changes in the scheme than Stewardship Agreement participants are no worse off
3. Reduce the complexity and cost of the assessment process, there is currently;
    a. 150 page methodology
    b. 5 day training and accreditation program
    c. Operational manual
    d. In excess of 28 technical 'guidelines' issued
4. Review the SAII test (potentially reinstate red flags)
5. Reduce the scope for non-like for like offsets