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Can Economics Regulate the Environment?

The Biodiversity Offsets Market in NSW

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AIAL (NSW) and EPLA (NSW) Webinar

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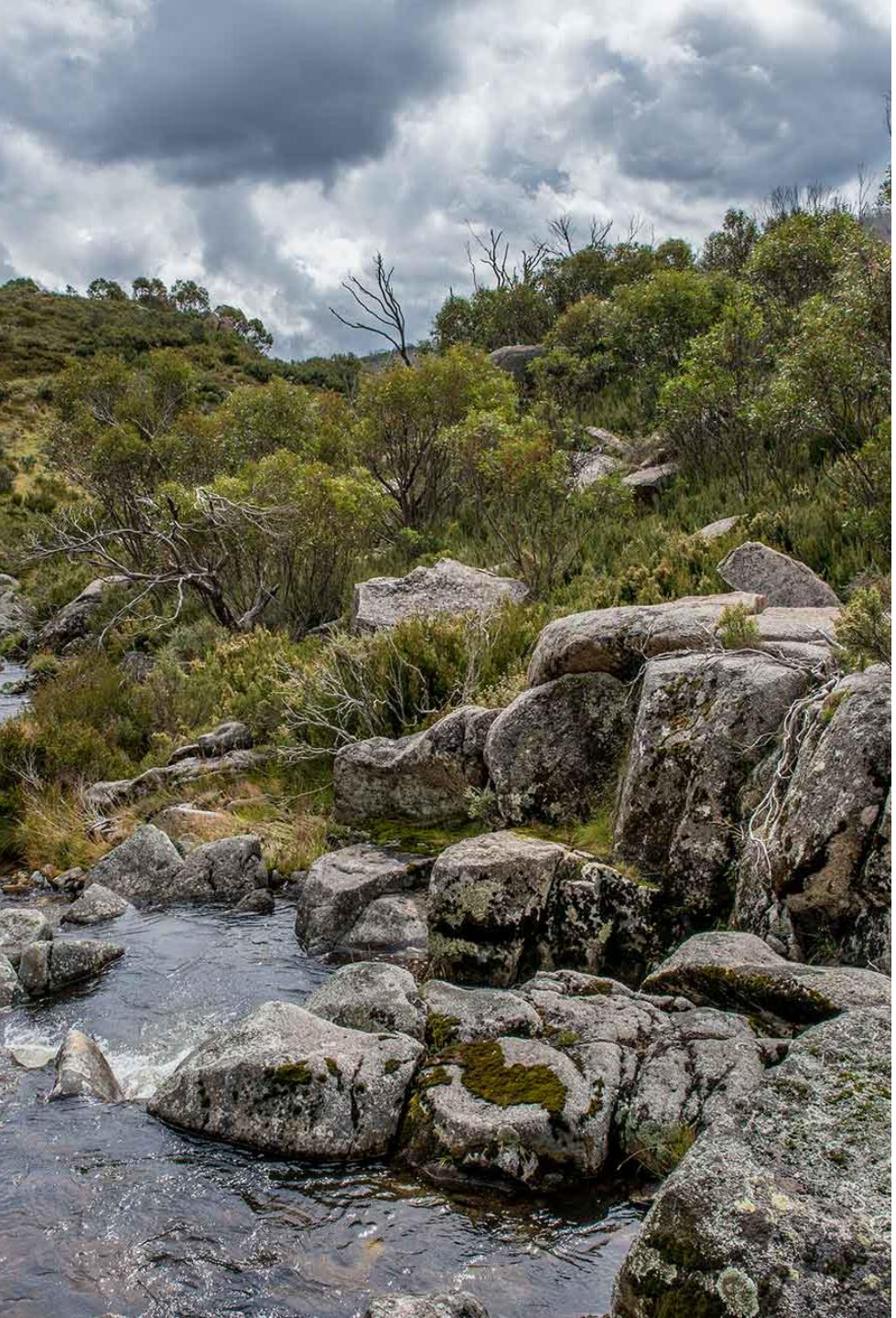


Introduction

- This presentation will focus on effect of the current NSW Biodiversity Offsets Scheme in under-valuing biodiversity credits, thereby disincentivising private land conservation.
- We will look at:
  - The effect of allowing payment into the Biodiversity Conservation Fund as an alternative to retiring credits;
  - Problems with the way the Offsets Payment Calculator calculates prices; and
  - Other disincentives to private land conservation

Relevant aspects of the Scheme

- Where development consent is granted for Part 4 development, proponents required to retire biodiversity credits or pay an amount into the Biodiversity Conservation Fund (the **Fund**).
- Offsets Payment Calculator is used as the basis for assessing amount payable to the Fund.
- No requirement to demonstrate attempt to find offsets before paying into the Fund.
- If proponent pays into the Fund, the Biodiversity Conservation Trust (**BCT**) is under obligation to later secure the required offsets.

Relevant aspects of the Scheme

- Biodiversity credits created through establishment of biodiversity stewardship agreements (**BSA**) over land.
- BSAs usually require the landowner to carry out management actions on the site in perpetuity.
- Creator of a biodiversity credit sells the credit on the market. Must pay a portion of the proceeds to the BCT to cover cost of management actions.

In-lieu payment into the Biodiversity Conservation Fund

- Why allow developers to pay into a fund in lieu of directly securing biodiversity credits at all?
- Policy justifications include –
  - economies of scale
  - strategic investment to maximise biodiversity gains.

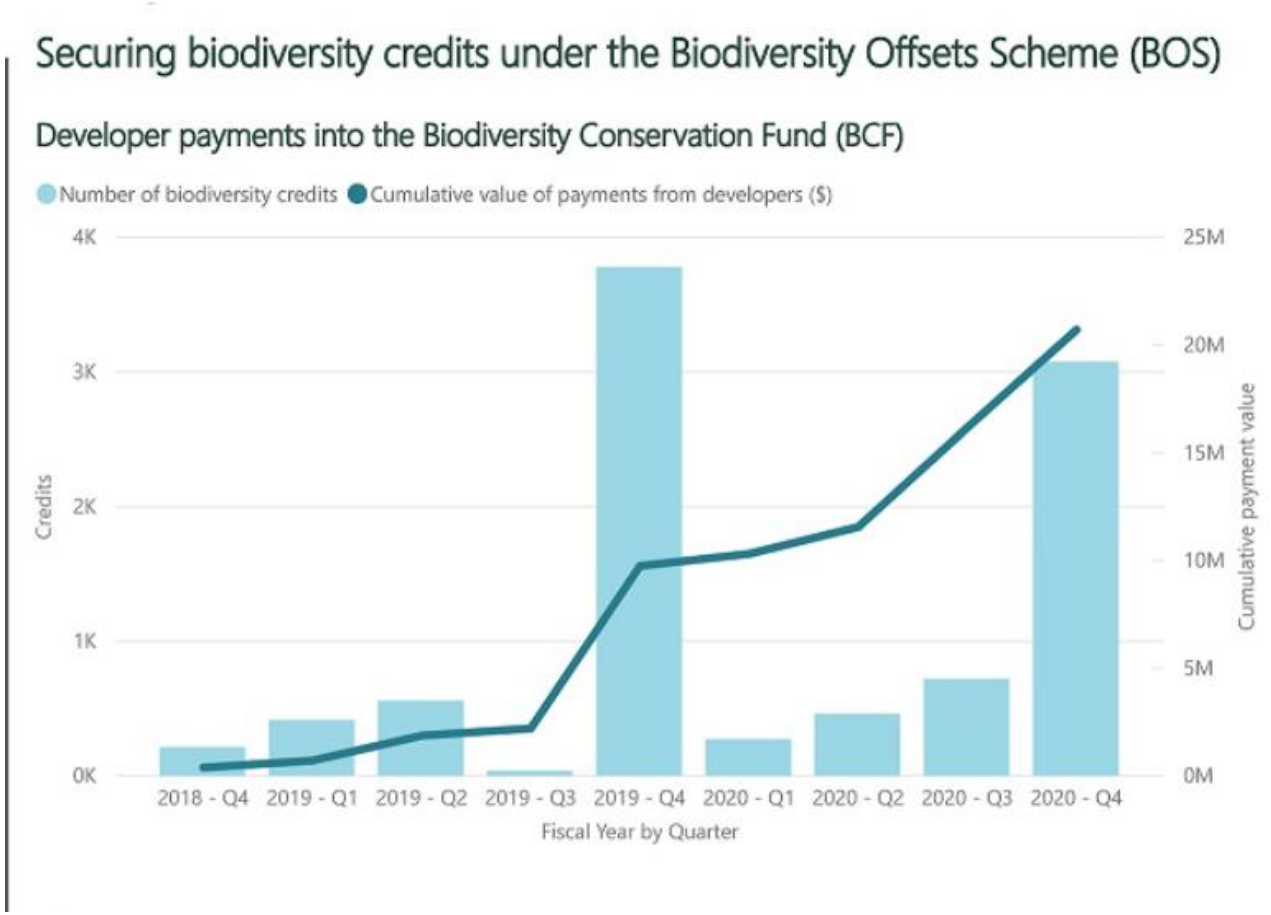
Significant take up of in lieu payment alternative

As at 30 June 2020:

- No. developer payments into the Fund = 108
- Cumulative value of payments into the Fund = $20 million
- 231 offset obligations transferred

More recent increase reflective of delay in application of scheme in growth areas.

Data current to 30 June 2020

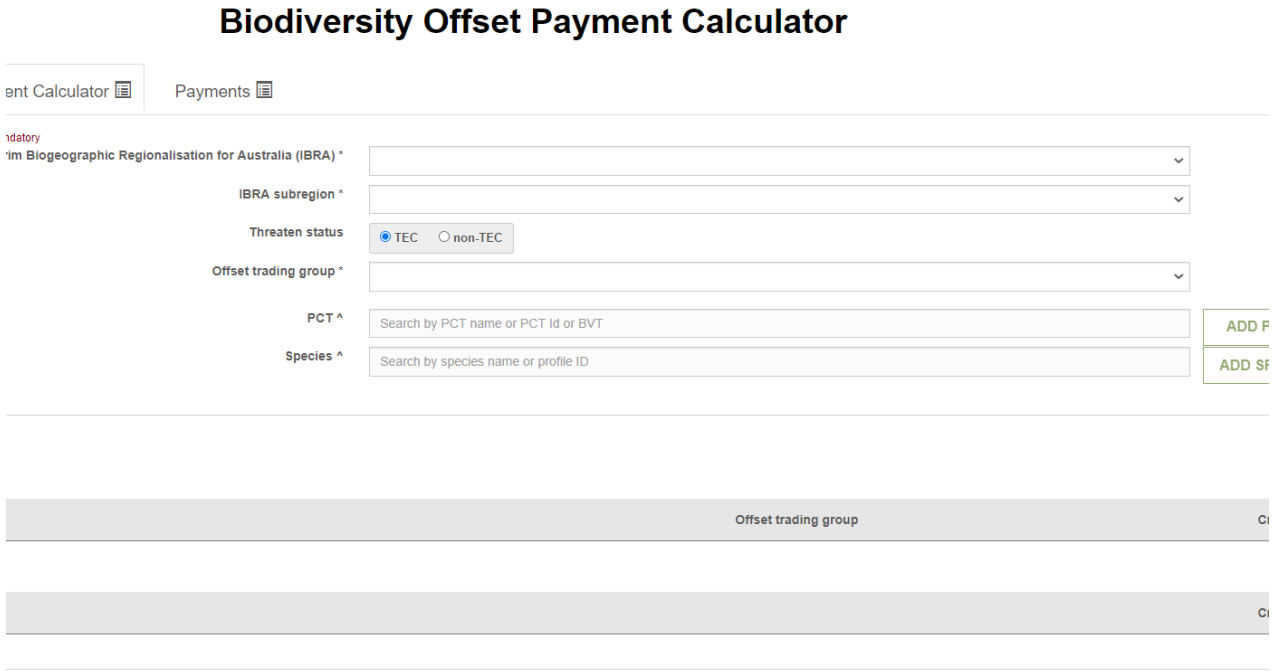


Source: Biodiversity Conservation trust (Link)

Practical effect of allowing payment into the Fund

- Offsets Payment Calculator sets “ceiling” prices for credits on the market.
- Payment into the Fund likely to be faster and easier than purchasing from the market, avoiding need to locate, negotiate with and enter into agreements with a seller.
- Developer can also establish own Biodiversity Stewardship Site.
- Price at which in-lieu payment is set is therefore pivotal to the success of the system.

The Offsets Payment Calculator

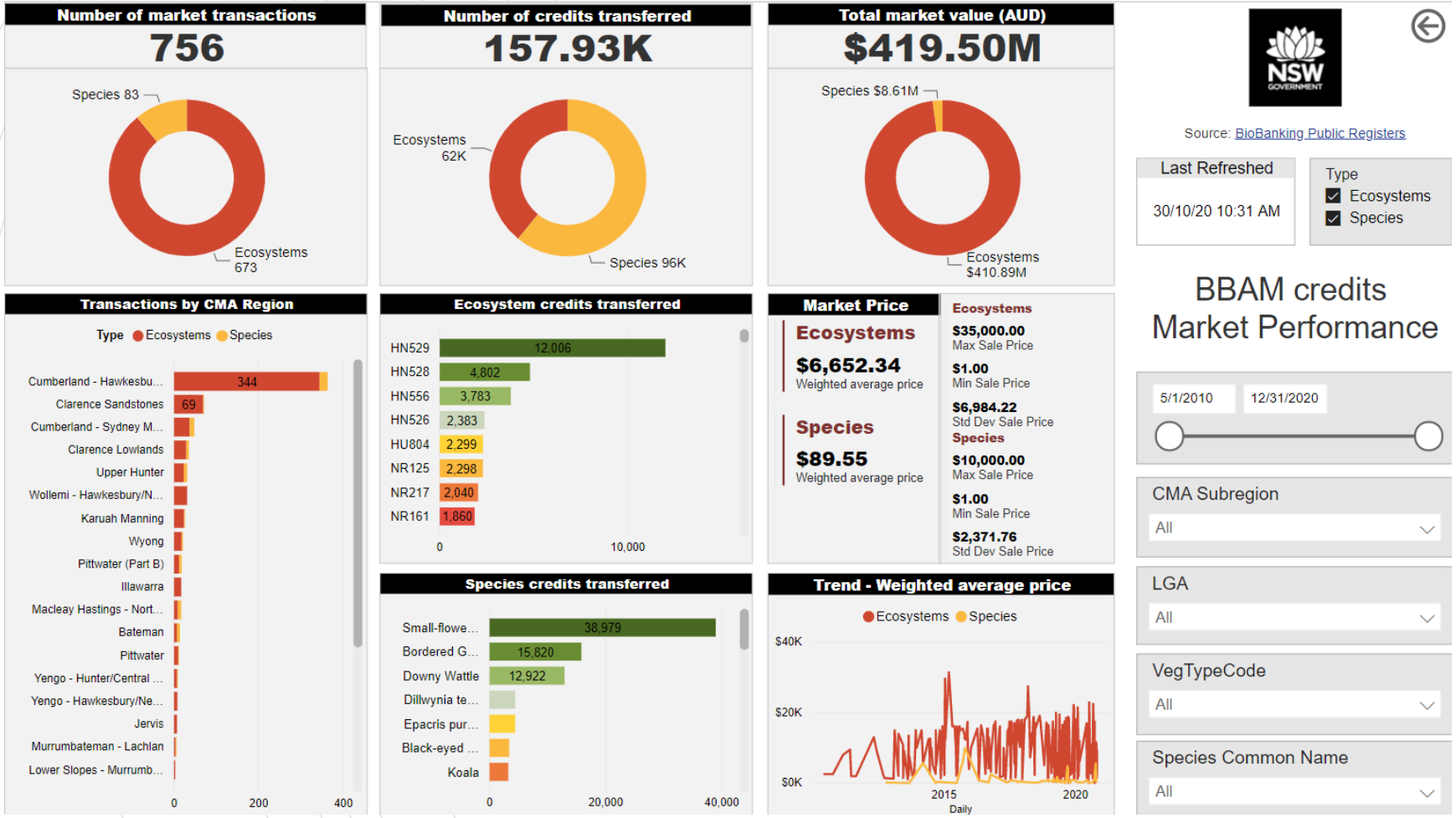


Biodiversity Offset Payment Calculator (Link)

Calculator comprises several components:

- a credit price model - predicts market price for credits based on observed trades;
- a “risk premium” margin - accounts for probability the market credit price paid by the BCT to landholders is different to predicted; and
- costs of the BCT administering the Fund.

Calculator relies on a limited data pool of trades



- As of end-October 2020, less than 10 trades of credits under BAM have been recorded.
- Only been 743 transactions of credits generated under BBAM since May 2010.
- As of October 2020, only 122 PCTs, out of a total of 1000+ PCTs, have been subject of BBAM credit transactions.

Source: Spot Price Index for Biodiversity (Biobanking) Credits (Link)

Credit Price Model is based on offset variation rules

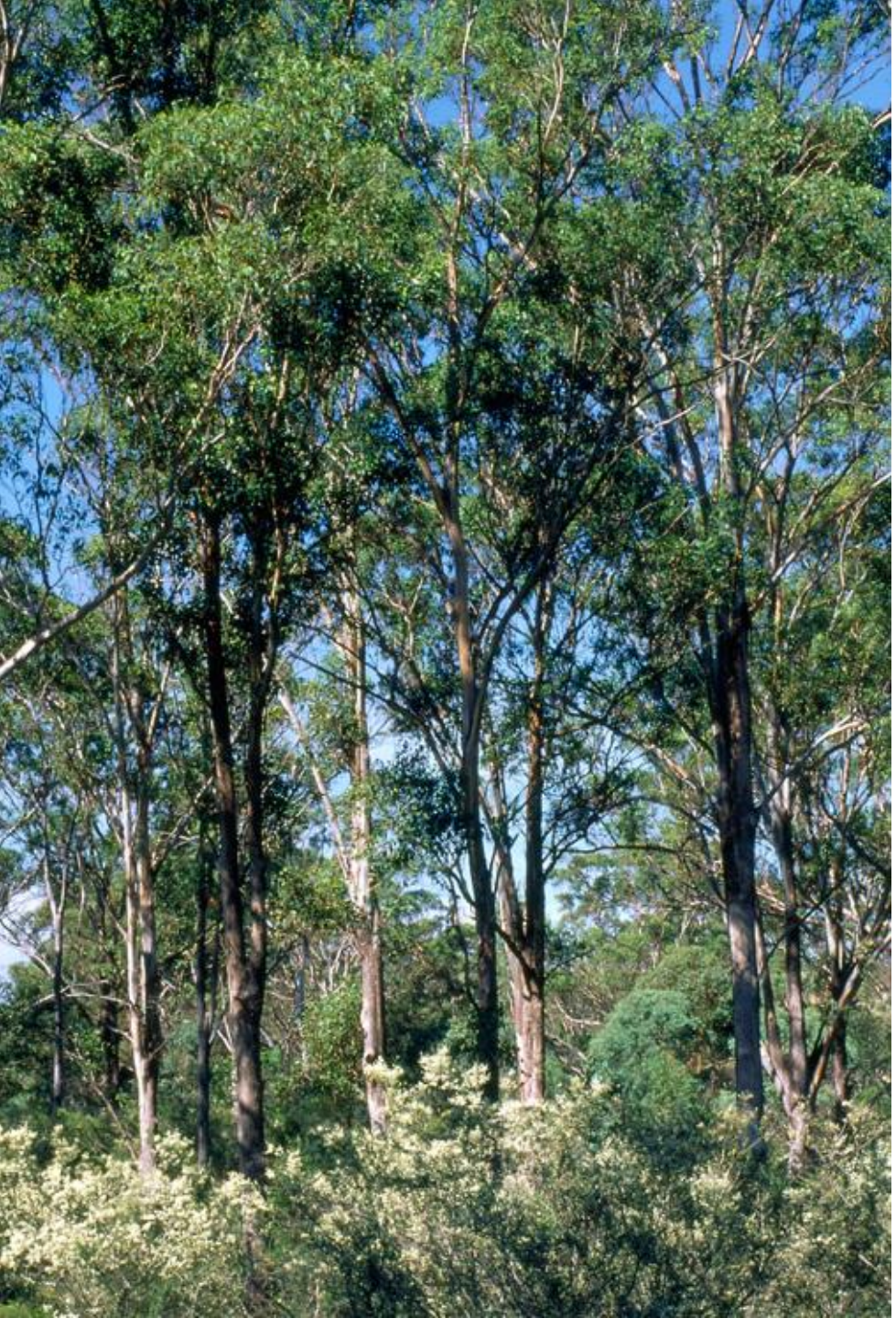
- Calculator predicts prices for biodiversity values without trades based on the like-for-like rules and the variation rules, which allow offsetting with a broader suite of biodiversity that is the same or more threatened than the biodiversity impacted.
- Use of variation rules is problematic because biodiversity values are non-fungible.
- Has potential to distort the market, particularly given the low number of trades undertaken.

Credit Price Model is based on the BCT's offset variation rules

- The BCT has more flexible variation rules in applying the amounts paid into the Fund than those applicable to proponents - can retire credits generated from anywhere in NSW.
- It is the BCT's version of the variation rules that are built into the Calculator.
- Arguable that the value of credits should be tied to the offset rules required to be followed by proponents.
- Unfairly reduces the value of credits held by landowners.

Risk Premium Model does not factor in true environmental risk

- Calculator does not take into account environmental costs when offset obligations not met at time biodiversity destruction authorised.
- The longer the time lags between payment into the Fund and securing the relevant offset, the scarcer the biodiversity resources will be.
- Increasing payment into the fund over time will therefore make the true worth of biodiversity credits higher.



Issues with credit equivalence calculations

- Calculator must account for a different number of credits being generated under the BAM compared to the BBAM.
- Would expect a functioning credit equivalence model to produce price roughly around the average pricing that BBAM credits have previously sold for, just adjusted for the different credit ratios.
- Calculator consistently under-estimates the value of some biodiversity credits, resulting in lower prices than under the previous BBAM system.

Other disincentives to private land conservation

- Reduced Credit ratios under BAM – requiring greater amount of land to be locked up to meet offset obligation (although this is supposed to be addressed in a new draft BAM).
- Cost of biodiversity assessments (higher than under previous biodiversity methodology) barrier to entry into the offsets scheme.

Other disincentives to private land conservation

- Due to change in calculation of the amount to be put aside for future management of a Biodiversity Stewardship Site, profit margins on credits have decreased.
- Calculator does not directly factor in the cost of the management actions required or value of land.
- In-perpetuity management obligations lock development potential of land forever, without corresponding compensation tied to the cost of management actions or the unencumbered land value.

Growing environmental debt

- As at October 2020, only 4 Biodiversity Stewardship Agreements entered on the public register (not including previous biobanking agreements).
- The BCT has secured or is in the process of securing biodiversity credits to meet only 18 of 231 offset obligations transferred.
- Currently offsets secured are like-for-like, but high probability that BCT will need to resort to variation rules.
- Reliance on variation rules will give the BCT a level of financial protection, but contributes to dysfunction in the Scheme as offsets used are progressively less equivalent to the values lost.

Conclusion

- Biodiversity Offsets Scheme in NSW is still fledgling, so premature to make any firm assessments of the Scheme.
- But we are seeing some troubling trends, with increasing threats to biodiversity from deregulation and climate change fuelled natural disasters.
- Market mechanism needs to be redesigned to provide greater incentives for landowners to invest in biodiversity conservation.