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IPART 2023-24 Biodiversity Market Monitoring Review

NSW Minerals Council Submission

The NSW Minerals Council represents the mining, minerals exploration and processing and mining services industry in NSW. Our members have been engaged with offsetting the biodiversity impacts of projects for over two decades under numerous state and federal regulatory schemes.

Our members are significant conservation land managers. In the Hunter Valley alone, the industry owns and manages more than 44,000 hectares of offsets. In addition, our members undertake restoration of mined land to end uses including ecological communities.

In developing this submission, we have interviewed several members about their current practices in relation to securing biodiversity credits and asked them to consider what is driving changes in those practices. Time and resources have not allowed us to undertake a detailed quantitative analysis, but many of the observations made warrant investigation by IPART which is well resourced to carry out appropriate research and we look forward to seeing the final review report address gaps in the analysis identified in this submission.

2022-23 Review

NSWMC reviewed the IPART's findings from the 2023 Biodiversity Market Monitoring Annual Report.

We note that many of the Review's findings assumed that the option to retire credits by way of payment to the Biodiversity Conservation Fund (BCF) is an affordable option, and that prices for credits though payment to the BCF is lower than would necessarily be set by the market. This conclusion seems to have been largely founded on consultation with landholders. The Review found that although some prices had increased after the change to the pricing mechanism, that this would not mean that the charges will continue to reflect necessary increases in prices which will be driven by the increasing scarcity of offsets. However, the inputs to the biodiversity charge including the cost of land will act to reflect increasing scarcity.

The assumption that the BCF under prices credits is not supported by the experiences of the NSW mining industry. In fact, the price set by the BCF charge model is many times higher than the cost of developing a credit. We suspect that the experience of other large green field developers including EnergyCo, NSW Transport as well as the operators of the Credit Supply Fund would support the finding that the charge overestimates, not underestimates the prices of credits.

There will be some developers that only require small numbers of credits for whom the costs (both financial and non-financial) and time delays of engaging with the private market or developing offsets, will be higher than the BCF. These non-financial costs are driven by the lack of ready supply. For developers seeking large numbers of credits, including mining, infrastructure and roads projects, developing offsets or seeking credits in the private market are less costly than payment to the BCF. The issue has been accessing those credits at an appropriate price given:

- The price signals set by the BCF (which include very high-risk premiums), which have given landholders an inflated sense of price.

- A lack of confidence in the scheme by landholders.

- Other barriers to entry already identified by IPART.

This assumption about low price being the main driver of the development (or under development) of the market veils the most significant barrier which is a lack of certainty and confidence from landholders that the very significant investment in creating the credits will be rewarded by a sale at the appropriate price. Without this it is difficult to interest landholders in the development of credits and buyers must be prepared to seek out landholders, broker an agreement and wait for a Biodiversity Stewardship Agreement (BSA) to be finalised. Only developers in search of large numbers of credits will be incentivised to undertake this task, and only where the costs both financial and nonfinancial are competitive with developing an offset. This is clearly supported by the evidence in the Discussion Paper that the significant uptick in traded credits in the last two years has been driven by just three infrastructure projects.

NSWMC agrees that the other four findings of the 2022-23 Review are highly significant drivers market development:

- High up-front costs and long credit generation times create a lag between credit demand and supply.

- Market participants lack accurate and timely information.

- High transaction costs and market complexity discourage participation.

- Stakeholders lack confidence in market oversight and governance, which hinders their participation.

Offsetting in the mining industry

The biodiversity market in NSW has been operational since the introduction of the voluntary BioBanking Scheme and then from 2017 through the Biodiversity Offsets Scheme (BOS). NSWMC and our members have been supportive of various government's attempts to build a sustainable market for biodiversity in NSW. NSWMC members voluntarily participated in the BioBanking Scheme, including testing the tools on the assessment of projects. Whitehaven Coal secured one of the earliest and largest BioBanking sites.

While NSWMC and members actively supported the BioBanking Scheme, it was very clear that unless individual projects sought out, brokered and paid for assessment of sites, the market simply was not mature enough to provide the number and type of credits sought by the industry. Industry experience of BioBanking land was that it was extremely complicated and time consuming, There were no clear advantages to undertaking this additional work instead of simply buying and managing offsets directly, which could be secured by a Conservation Agreement.

The NSW mining industry supported the establishment of the BCF. However, the evolution of the BCF from its stated purpose of supporting strategic conservation and removing the burden of developing offsets from developers, to one of being a premium option, means it hasn't been used significantly by mining projects. The function of the BCF for mining projects has been one of a last resort for small numbers of credits that are not present on mine owned offset sites and not readily available in the market, or in recent years through the Credit Supply Fund (CSF).

The price of securing credits through the BCF has always been and remains at a very high premium to the actual costs of developing and managing credits. The Biodiversity Offsets Payment Calculator (BOPC) which was the first price setting mechanism for the BCF produced prices which were often highly inaccurate, either significantly under-pricing or over pricing credits and was also very unstable. The BOPC was publicly available and provided a very poor price signal to the market and provided little certainty or confidence to landholders.

The BCF Charge System continues to charge a very high premium to the costs of developing and managing offsets. This charge is derived from a cost-based model, which is preferable to the econometric model of the BOPC. However, the credit prices set by the BCF Charge System overestimate many of the costs, including the allowance for management, risk and delivery. Estimates by NSWMC members that own offsets are that the BFC premium is up to 50% of the costs of developing the same credit through a BSA.

Current mining industry practices

Until recently the mining industry across the State has continued to buy land, develop and manage offsets as the primary method of offsetting. More recently different approaches are emerging which seem to be regionally driven (although it is difficult to be certain given numbers of operators, different cost, timing and strategic drivers of those operations).

Regional factors appear to be having an impact on the maturity of the market. The facts below are observed by NSWMC members, and warrant consideration and further investigation by IPART.

In the Upper Hunter Valley, some operations report being able to secure credits for whole projects, at a cost below the BCF price and similar to the costs of generating credits directly (by the mine) through the use of brokers. Even where private prices are higher than the costs of the mine generating the offsets, there is a premium that operators are willing to pay for the convenience of purchasing credits (this has been the position of the NSW mining industry through consultation on pricing mechanisms over the last 10 years).

There are several reasons why the market in the Hunter Valley may be maturing:

- The value of land has increased making purchase of land to develop offsets by mining projects less attractive.

- The Hunter Transmission Project means that there is more than one potential buyer for credits leading to greater certainty for suppliers leading to increased supply.

- The Credit Supply Fund and several brokers are active in the region, creating greater certainty for landholders and increasing supply.

In the north of the NSW in the Narrabri/Boggabri area, there are not the same signs of market maturity. Operations in the area report that the cost of securing credits by creating an offset (including the costs of assessment, land purchase and Total Fund Deposit) are approximately 50% lower than purchasing a credit privately, and lower again than the BCF charge for the credit. There are several factors that impact:

- There is a small concentration of sellers who have set prices below the BCF charge price, but not at commercially competitive rates.
- There are limited buyers (for example there is no local Renewable Energy Zone (REZ) project), so there is a lack of confidence and certainty of sale for new landholders to generate credits.
- Land values have not seen the significant increases that have occurred in the Hunter Valley.

Operations in the region report being able to obtain most credits through development of mine owned offsets and using the CSF to source small numbers of residual credits.

2023-24 Discussion paper analysis

The assessment undertaken by IPART of trades in 2022-23 and 2023-24 supports the proposition that market maturity is probably different in different regions. Those regions with large scale developments, such as the REZ projects, and more than one potential buyer, provide greater certainty for landholders and will have greater maturity. It is suspected that in many regional areas the market remains small and tightly held, and supply is depressed, and prices continue to be high.

The analysis of both the 2022-23 and 2023-24 markets data also needs to consider the significant time lags that are built into the identification of land, assessment and approval of BSAs. IPART should consider the impact this multi-year process has had in relation to lack of supply over the early years of the scheme (in addition to the lack of confidence which was driven by a number of factors including the volatility of pricing under the BOPC).

IPART should consider how much the uptick in the market in the last two years is because of finalisation of agreements, and then trades, which have been many years in the making. IPART should consider to what extent the current upturn reflects current conditions and confidence versus the effects of the time lag in relation to the commencement of the BOS and the time taken to react and create credits.

As in the discussion of the 2022-23 review above, IPART should also consider whether the identified maturing of the market will assist all potential buyers and sellers, or whether it is largely driven by and beneficial to large scale projects. It would be useful to analyse to what extent in those regions where the market has grown, are sellers undertaking assessments and offering credits for sale versus credits being developed at the request and with some form of underwriting by a developer.

The 2022-23 Report noted that prices will become higher because of scarcity. This may be true in the long run, but as information and confidence increases among landholders, supply should at least in the initial years of maturity of the scheme reduce as supply increases from low rates at the outset of the scheme.

Credit Supply Fund

Although the NSW Government's Credit Supply Fund (CSF) has been successful in sourcing credits for some areas of the market, the small amount of the CSF - $160 million - reduces the capacity of the fund to undertake demand analysis, purchase and hold credits for an appropriate period to meet demand to act as a warehouse or trading house to support the credit trading market to mature.

Although the Government has considerably reduced the time to approve BSAs, the process is still complex and time consuming. There can be there can be long delays in sourcing credits through the CSF - up to 18 months in one case.

Biodiversity Conservation Fund

As a result of the recommendations of IPART's 2023-24 report the current Biodiversity Conservation Amendment (Biodiversity Offsets Scheme) Bill 2024, proposes amendments to the Biodiversity Conservation Act 2016, to provide that restrictions can be imposed on payment to the BCF. The NSW Government advises that those proposed restrictions are subject to an economic analysis but are likely to restrict payment into the BCF to circumstances where credits are not available on the market.

This will be very difficult to manage and will need to have reasonable caveats to protect buyers from gouging. But most importantly it will expose the BCF to higher risk as the obligations it will be required to accept will all be in the higher risk category and not offset by lower risk obligations also being accepted by the BCF.

Recommendations

- To inform the report IPART should undertake further analysis in these areas:
  - The impact of regionalisation on the biodiversity market.
  - The impact of time lag in the development of offsets (particularly in the early years of the scheme) on the market data for the last two years monitored years.
  - Consider further the impact of large infrastructure projects on the market and the different experiences of different scales of developer.
  - What impact the restrictions proposed on the BCF could have on the risk to the BCF.
  - Directly survey mining and large infrastructure projects on the price of developing credits versus payment into the BCF to develop a better understanding of how BCF pricing drives market behaviour.
  - Undertaken analysis of the impact of supply in a maturing market on the price of credits in the short, medium and long term.

- The role of the BCF should not be reduced, or restricted. The market does not appear to be maturing at the same rate in all areas. Where drivers are present to increase supply at an appropriate price, the market is beginning to mature, but this not happening in all areas.

- The BCT should use the variation rules provided by the legislation to acquit offsets.

- The CSF should have its funding increased to allow it to buy and hold credits to act as a warehouse or trading house to support the credit trading market to mature.

- There should be further consideration of streamlining the process of assessing offset sites and finalising BSAs.

NSWMC Minerals Council
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