

4 April 2022

Mr Paul Elton
CEO
Biodiversity Conservation Trust

By email: paul.elton@bct.nsw.gov.au

Dear Paul,

RE: Proposed Changes to BCF Charge System Method

The Urban Development Institute of Australia NSW (UDIA) is the peak industry body representing the leading participants in urban development in NSW. Our more than 450 member companies span all facets of the industry from developers, consultants including accredited ecologists, local government, and state agencies. UDIA advocates for the creation of Liveable, Affordable and Connected Smart Cities.

UDIA and our members recognise and value the importance of biodiversity conservation, both for the liveability of our urban areas today, as well as to achieve intergenerational equity for current and future generations, and we support the principles of Environmentally Sustainable Development.

UDIA welcomes this opportunity to comment on the Biodiversity Conservation Trust's (BCT) proposed new method for calculating the charge for payments into the Biodiversity Conservation Fund (BCF) (new charge system method). Given the critical importance of this review and the complexities involved, we appreciate that the Minister for Environment has provided additional time for public comments beyond what was originally envisioned.

The urban development sector delivers housing and employment land and is one of the largest users of the Biodiversity Offsets Scheme (BOS). The proposed changes will therefore have meaningful impacts on our industry's ability to supply homes and employment land to support the NSW Government's strategic goals.

We have now reviewed the material provided and unfortunately, we believe the new charge system method has made an already fundamentally flawed system even more complex and expensive and has introduced more uncertainty and risk to timelines and outcomes for development.

UDIA does not support the new charge system method in its current form on the basis that costs will be higher, and the practical interaction with the system will add uncertainty, undermining housing supply and making housing less affordable. We understand that the new method is intended to drive proponents to use the offset credit trading market directly, in the hope this would stimulate that market. However, currently, and for many reasons, the offset credit trading market is not functioning. Therefore, many developers will be forced to use the BCF and pay the higher charges proposed by the new method, ultimately undermining the NSW Government's mandate to increase housing supply and provide adequate employment land to enable jobs growth.

UDIA offers the following recommendations, and our submission provides further supporting commentary.

- 1. The methodology should be modified to reduce the charge and the overall charge system method should be reviewed by the Independent Pricing and Regulatory Tribunal (IPART).**

2. The BCT delivery fee should be revised to ensure it is soundly and objectively justified, and should incorporate a maximum amount.
3. The risk margin should be reduced to reflect similar financial risk products. The risk margin should be soundly and objectively justified.
4. The period of validity for the BCF charge quote should be extended to a minimum of three (3) years, with any indexation based on and limited to changes in CPI.
5. The BCT should provide quotes for feasibility purposes and the availability of other meaningful market information should be facilitated and accelerated to replace the market information lost from the removal of the calculator from public view.
6. The Audit Office of NSW should conduct the annual assurance reviews to ensure the proper level of independent scrutiny.
7. The NSW Government urgently needs to make a significant investment to kickstart the offset credit trading market. The level of investment must be large enough to stimulate a market that will serve all users, including the development and resources industries as well as Government infrastructure projects.

Background

UDIA is increasingly concerned that the current system regulating biodiversity conservation in NSW is overly complex, is resulting in higher-cost sub-optimal biodiversity outcomes, and undermines government's strategic goals for conservation, housing and jobs because of the uncertainty built into it. The system is already a major constraint to delivering the jobs and housing expected by government, particularly in key regional NSW markets.

The weaknesses of the Biodiversity Conservation Act 2016 (BC Act) are becoming more apparent as it is now being applied to more land. Many projects in the NSW residential and employment land development pipeline were approved under the previous legislation and had minimal or no interaction with the BC Act. However, those older projects are being completed and development proposals for new housing or employment land encounter significant new costs and problems as they navigate the BC Act.

UDIA advocates for immediate and meaningful changes to ensure the biodiversity regulatory system is balanced, efficient and equitable. We are seeking system changes that will improve biodiversity outcomes; reduce the complexity of the system; and increase certainty for industry to help meet governments' strategic goals for housing that is affordable and close to jobs.

The risks and uncertainty built into the biodiversity conservation system can stifle a development project at multiple points and add considerably to costs for both private and public projects. The inefficiencies from the BC Act are undermining the delivery of infrastructure and adequate housing and jobs.

A fundamental problem with the system is that not enough land is being conserved under Biodiversity Stewardship Agreements (BSA) under the BC Act. Low participation by private landholders in establishing BSA sites translates into an undersupply of offset credits, leading to lower conservation overall. The undersupply of BSA sites/credits also leads to severe price volatility in the dysfunctional offset credit trading market. The lack of a functioning market means developers turn to the Biodiversity Conservation Fund (BCF) managed by the Biodiversity Conservation Trust (BCT) to acquit their offset obligations, and the BCT likewise finds it difficult to find available offset credits on the market.

When the BC Act was being developed, UDIA called for the creation of a simple, fast and affordable option for offsetting biodiversity impacts. The idea of the BCT and its Biodiversity Conservation Fund was welcomed at the time, and industry hoped it could fulfill such an option. However, we have expressed concern from the start about the complexity, unpredictability, and opacity of pricing under the BCF. UDIA therefore supported the consultation undertaken last year to consider improvements, and we called for changes that would bring more certainty and transparency to the pricing system.

The consultation was appreciated and conducted in good faith, although highly technical in nature, and we were unable until now to understand how the complex pieces of the new method would fit together and impact on the developer charge and overall system. We have now reviewed the material provided and unfortunately, we believe the new charge method has made a fundamentally flawed system even more complex and expensive and has introduced more uncertainty and risk to timelines and outcomes for development.

The new method's additional costs will reduce housing supply and increase house prices. Housing prices are already at record highs in NSW. With interest rates expected to start rising, housing affordability will become even more of a concern and increasing biodiversity offset costs will only exacerbate the housing affordability crisis in NSW.

Commentary and Recommendations

Adverse Impacts on Housing Supply and Affordability

UDIA's major concern with the existing BCF program and its use of the Biodiversity Offset Payment Calculator (BOPC) is the price volatility and uncertainty it has created for industry. We welcomed last year's consultation to address the price volatility and in general, we think the new method's use of three approaches – a cost structure tool, an econometric model and a market soundings approach – is a sound and rational approach to accommodating the current limitations of the offset credit trading market.

The new method is highly theoretical, and it is difficult to properly assess its practical implications, especially since the BCT does not want to provide new pricing data due to concerns about influencing the market. We have nonetheless done what we can to evaluate the new method and its impacts on development.

The BCT has provided a worked example on the new method which has enabled us to run a comparison of current pricing under the BOPC versus the new method. This example shows that the new charge can be expected to be much higher than current prices. The higher charge stems from the new method of calculating the credits themselves, plus the additions of the risk margin and delivery fee.

The worked example used Lower Hunter Spotted Gum Ironbark Forest (LHSGIF) which occurs in several plant community types (PCT) in the Hunter IBRA sub region. The current (as of 29 March 2022) BOPC pricing for those offset trading groups is \$3,033 per credit.

Using the worked example provided, the price would increase either 350% or 375%, from \$3,033 under the BOPC, to either \$10,500 (if paid immediately) or \$11,270 (for the deferred payment option) under the new charge system method.

We applied these charge rates to calculate the cost burden on a single new housing lot. We made assumptions on the number of offset credits required, based on the quality of vegetation on the site. We then calculated the cost burden of offsetting LHSGIF under the old and new systems, for a single new housing lot in a development yielding 20 lots per hectare. See Table 1 on the following page.

Table 1: Comparison of 29/3/22 BOPC Price vs New BCF Charge for LHSGIF

Vegetation Integrity Score	BRW	Credits /ha	BOPC Price per credit	BOPC Price/ha	BOPC Offset \$/lot (20 lots/ha)	New BCF Charge per credit	New BCF Charge/ha	New BCF Offset \$/lot (20 lots/ha)	% Increase
20 (Poor)	2	10	\$3,033	\$30,000	\$1,500	\$10,500 (immediate payment option)	\$105,000	\$5,250	350%
40 (Poor)	2	20		\$60,000	\$3,000		\$210,000	\$10,500	
60 (Moderate)	2	30		\$90,000	\$4,500		\$315,000	\$15,750	
80 (Good)	2	40		\$120,000	\$6,000		\$420,000	\$21,000	
80 (Good)	2	40	\$3,033	\$120,000	\$6,000	\$11,270 (deferred payment option)	\$450,800	\$22,540	375%

Under the current BOPC pricing, the offset cost would range from \$1,500 to \$6,000 per housing lot. Under the new method, using the lower price (immediate payment), the cost per housing lot would range from \$5,250 to \$21,000 per lot, or an increase of 350%. If we use the highest-cost scenario – with a vegetation integrity score of 80 and using the deferred payment option – the cost would be \$22,540 per lot, an increase of 375%.

We have been unable to find a justification in the material provided for the dramatic cost increase.

These additional costs will reduce housing supply and result in higher house prices. It is important to understand that housing prices are currently already at record highs in NSW. With interest rates expected to start rising, housing affordability will become even more of a concern and increasing biodiversity offset costs will only exacerbate the housing supply and affordability crisis in NSW.

Notwithstanding this example on LHSGIF, we acknowledge the theoretical possibility that other credit prices could work out to be lower under the new method. However, in general, it is observed that the cost structure tool seems to rely heavily on data from credit trades in Western Sydney Region which seem to have traded at high relative prices, and this would impact on the credit price estimates for the rest of the state.

On top of ecosystem credits, species credits could add substantially to the final offset cost burden on a new housing lot. Unfortunately, the species pricing cannot be determined from the exhibited information provided by the BCT. We would expect species credit pricing to also rise, especially as species credits are undersupplied in the market and difficult to generate in general.

Regardless of the base credit price, the new charge method would still add substantially to the final cost of any credit since it imposes a higher delivery fee of 15% plus a robust risk margin averaging 25%. Taken together, these components add an extra 40% to the base credit price, with no ceiling. UDIA does not believe such premium pricing has been justified.

In general, UDIA believes the new charge method will produce prices that are too high. We believe that a review by the Independent Pricing and Regulatory Tribunal (IPART) would be appropriate to ensure that the BCF does not impose unnecessary costs and reduce housing supply and affordability.

UDIA recommends:

- 1. The methodology should be modified to reduce the charge and the overall charge method should be reviewed by the Independent Pricing and Regulatory Tribunal (IPART).**

We do understand the BCT needs to cover its internal costs for administering the program, including labour costs to source credits and implement the credit purchase transactions. The new method imposes a flat 15% delivery fee, or minimum \$300 per credit, to cover these costs. These rates appear subjective and have not been justified. UDIA objects to a flat delivery fee with no maximum. The fee can very quickly escalate, despite

the fact there will be savings in scale particularly for large credit transactions. We believe a more objective and customer-focused approach should be developed for the delivery fee, including a maximum amount.

UDIA recommends:

2. The BCT delivery fee should be revised to ensure it is soundly and objectively justified, and should incorporate a maximum amount.

UDIA also understands the BCT needs to cover its exposure to future prices, and we acknowledge that in utilising the BCF option, developers transfer their own risk of finding offsets to the BCT. On that basis, the BCF operates similarly to an insurance product, and therefore some risk margin is appropriate. However, the risk margin should be reflective of the risk undertaken and the margin should be soundly justified. We do not see any evidence of either in the material that has been shared.

The BCT seems to have decided to impose a risk confidence level of 95% and calculated that they should impose a 25% risk margin on average. On what basis has this confidence level been determined? We are not aware of any insurance models that operate at such a high confidence level. If the pricing methodology is sound, as the BCT asserts, then it is not reasonable to impose such a high risk margin on the BCF's customers.

UDIA recommends:

3. The risk margin should be reduced to reflect similar financial risk products. The risk margin should be soundly and objectively justified.

Finally, we understand that Government's preference is for offsets to be acquitted through the private offset credit trading market, and we understand Government believes that a higher charge for payments into the BCF will act as an incentive to utilise the market directly, thereby stimulating a more mature market. UDIA agrees with this theoretical logic. Unfortunately, that logic is flawed because of this singular fact: currently, there is no functioning market for most credit types.

Without a functioning market, developers are forced to use the BCF to acquit their offset obligations. It is true that developers also have the option to set up their own offset sites; however, only a small segment of the development industry has the capital, expertise, and time to do so.

Hence, without a functioning market or other ability to deliver their own offsets, most developers will be forced to pay these much higher prices into the BCF. Those extra costs will kill some development projects outright, reducing housing supply and leading to increased housing costs.

The higher BCF costs will therefore reduce housing supply and reduce housing affordability. UDIA strongly recommends that the BCT find ways to adjust the method, so the charge is lowered.

Quotes for BCF Charges

During meetings with the BCT, EES and Ministers' offices on this topic, we have emphasised the need to provide industry with more certainty, increase the supply of available credits and improve government's understanding of the development sector's commercial requirements to support the Premier's objectives of increasing housing supply and addressing housing affordability.

The proposed changes would remove the Biodiversity Offset Payment Calculator (BOPC) from public view and replace that source of pricing information with a new quote system. Once a proponent has a Biodiversity Development Assessment Report (BDAR), they can request a quote from the BCT. The quote will lock in a charge per credit for a period of 12 months. Two prices are given: a base charge if paid within 45 days; and a

deferred payment charge if paid within 12 months, which builds in an extra year of indexation. The charge must be paid before commencement of construction.

During last year's consultation, UDIA explained that industry requires a long period of validity for any quote, to allow for the time it takes to negotiate a Development Application (DA) and prepare for construction. We recommended a period of 5 years. We are deeply concerned that a 12-month quote will be effectively worthless in a practical sense.

UDIA again recommends a period of 5 years. The BCT has indicated they could be willing to offer a quote for 3 years with annual indexation. UDIA would welcome that compromise, provided the indexation is based on and limited to changes in the Consumer Price Index (CPI).

UDIA recommends:

- 4. The period of validity for the BCF charge quote should be extended to at least 3 years, with any indexation based on and limited to changes in CPI.**

UDIA has grave concerns with the removal of the BOPC from public view.

Even with its severe limitations, the BOPC is the only available tool to understand offset credit trading market pricing information.

It may be true that the public BOPC has corrupted the offset credit trading market, as the BCT suspects. However, we do not believe the new method will alleviate that issue; pricing information from the BCF quotes will be available to some credit suppliers through their contacts and they will make their own pricing decisions with this information. At least under the BOPC, everyone has access to the same information. Under the new method, there will be asymmetric information which will present its own challenges for the market.

UDIA is concerned that without the public BOPC, developers have no means of evaluating the feasibility of a potential development site.

We appreciate that Environment, Energy and Science (EES) at the Department of Planning and Environment (DPE) is working to establish public registers of credit sales. However, these are difficult to engage with and inadequate. We also appreciate that the BCT intends to publish developer charges at the time they retire them. However, there will be a lag of years before that historic data accumulates. The BCT and EES should work together urgently to enhance the scope and useability of the public registers and find other ways to replace and facilitate public access to market trading information. We would be pleased to engage in that work.

In discussions with the BCT, we have discussed the possibility of quotes for feasibility purposes. This was favourably received and UDIA strongly recommends that this service be established. Quotes could be provided on a fee-for-service basis, with a modest and affordable fee to cover staff's time. Quotes should be available for any level of basic ecology study performed by an accredited assessor, noting that these studies will not be as comprehensive as a BDAR, but would identify the potential credit types that may later be proven to exist on the site.

UDIA recommends:

- 5. The BCT should provide quotes for feasibility purposes and the availability of other meaningful market information should be facilitated and accelerated to replace the market information lost from the removal of the calculator from public view.**

Assurance Reviews

Under the proposed charge system method, the BCT's implementation of the BCT Charge System will be subject to annual independent assurance reviews commissioned by the Department of Planning and Environment.

UDIA agrees with the importance of assurance reviews, and these must be truly independent. We are concerned that commissioned consultants may not bring the necessary level of scrutiny. We recommend that the Auditor-General under the Audit Office of NSW be utilised for this function, which would fit squarely within their remit.

UDIA recommends:

- 6. The Audit Office of NSW should conduct the annual assurance reviews to ensure the proper level of independent scrutiny.**

Government needs to invest to Kickstart the Market

The fundamental problem with the Biodiversity Offsets Scheme (BOS) is the lack of offset credit supply. This stems from a lack of understanding of the credit demand leading to a reluctance of landowners to enter the offset credit market by establishing Biodiversity Stewardship Sites (BSA). The lack of offset credit supply must be urgently addressed for the BC Act to succeed in achieving conservation outcomes, while enabling ecologically sustainable development and growth for NSW.

UDIA commissioned an issues paper on the BOS last year, with the ecology firm EMM. We outlined a series of recommendations to remove obstacles to establishing BSAs. Read the EMM paper at this [link](#). One of the major constraints to credit supply is insufficient information on credit demand.

In our *Pre-Budget Submission* to the NSW Treasurer this year, we recommended the NSW Government make a significant investment to kickstart the market by establishing a government program to guarantee the purchase of credits from BSA landholders. Government could then warehouse credits and on-sell them at cost to developers and others seeking offsets. We understand that this idea is being actively considered and we are hopeful such a program will be funded this year. Read our *Pre-Budget Submission* at this [link](#).

Importantly, any such guaranteed-purchaser program must be large enough to ensure adequate credits for all users, including not only government infrastructure projects, but also projects in the development and resources industries and other private entities. A substantial investment would demonstrate the NSW Government's commitment to the environment as well as housing supply and economic prosperity.

UDIA recommends:

- 7. The NSW Government urgently needs to make a significant investment to kickstart the offset credit trading market. The level of investment must be large enough to stimulate a market that will serve all users, including the development and resources industries as well as Government infrastructure projects.**

Conclusion

The NSW Government has acknowledged that the BOS should be improved to bring more certainty and transparency of pricing. UDIA commends BCT for the important and significant work undertaken to reduce the price volatility under the BCF specifically. The new methodology offers potential improvements.

We are concerned, however, that BCT may be overcompensating for its perceived risk exposure and imposing unjustified costs on its customers. Ultimately, the higher costs will adversely impact housing supply and affordability, in opposition to the Premier's mandate to increase housing supply.

We would like to work with BCT to find ways to reduce the charge itself and improve the charge system's practical aspects. We also urge that the methodology be appropriately reviewed by IPART.

Thank you for the opportunity to engage on the new BCF charge system method. Should you have any further questions or to arrange a meeting, please contact UDIA Regional Manager Elizabeth York on eyork@udiansw.com.au.

Kind Regards,



Steve Mann
Chief Executive
UDIA NSW

Cc: Minister James Griffin MP
Minister Anthony Roberts MP