PROPERTY COUNCIL of Australia

Australia's property industry
Creating for Generations

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Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir/Madam,

Inquiry into foreign investment proposals – prioritising appropriate investment

The Property Council welcomes the opportunity to provide comments to the Senate Economics References Committee in relation to its inquiry into foreign investment proposals.

Attracting appropriate international investment has never been more important to the sustainability of the Australian property sector, job preservation and the health of the economy. Over $50b of foreign capital is invested in Australian real estate every year, creating much needed commercial and housing precincts, delivering significant economic contribution and supporting thousands of local jobs.

The recent global outbreak of the coronavirus has had a tremendous impact on the world economy. We now find ourselves in uncertain times, with the effects of this significant health crisis likely to be felt for many years. It is imperative that Australia sets itself up to manage both the short-term economic and social disruption and the medium and longer term recovery that will require increased business investment – leveraging both domestic and foreign capital.

Significant changes to the foreign investment framework were announced by the Treasurer on 29 March 2020, as part of the Government's response to the impacts of COVID-19. We understand these changes are temporary and within the scope of the Government's national interest considerations as the fallout from the COVID-19 pandemic impacts on the value of assets and businesses around the world. We have limited our submission to the broader foreign investment framework as it exists outside of these temporary COVID-19 related measures.

Australia has a robust foreign investment regime which has undergone a number of reforms over the last five years. We believe that the set of regulations (as they stood prior to significant changes announced in March 2020) is appropriate and sensible vis-à-vis the investment and employment demands of our economy, and the need for a robust and transparent regulatory framework to support future economic recovery. The appropriate application of the national interest test and the role of the Foreign Investment Review Board (FIRB) in scrutinising foreign transactions are two key elements of the current set of regulations that are working well from a property investment perspective.

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Ultimately, maintaining regulatory certainty is critical to ensuring Australia continues to attract and retain foreign investment, and therefore further restrictions on foreign investment should not be pursued and any unnecessary red-tape roadblocks should be removed.

Our submission highlights several themes that are important to consider in reviewing how foreign investment proposals operate with respect to the national interest test, in particular:

- The importance of foreign investment;
- The benefits of foreign investment in real estate to the Australian economy and particular sectors;
- The regulatory framework, including the role of FIRB and reforms to the foreign investment regime; and
- Areas for improvement to the framework, in particular:
  - greater levels of data around foreign investment to enable sound evidence-based policy making and increased public understanding of the benefits derived from foreign investment; and
  - a cohesive message from governments at the federal and state/territory level that Australia is open for business and open to foreign investment.

If you would like to discuss any aspect of this submission, please contact Kosta Sinelnikov on [redacted] and [redacted] or myself on [redacted] and [redacted]

Yours sincerely

[redacted]

Belinda Ngo
Executive Director, Capital Markets

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Submission

The Property Council of Australia champions the industry that employs 1.4 million Australians and shapes the future of our communities and cities. Property Council members invest in, design, build and manage places that matter to Australians: our homes, retirement villages, shopping centres, office buildings, industrial areas, education, research and health precincts, tourism and hospitality venues and more.

On behalf of our members, we provide the research and thought leadership to help decision-makers create vibrant communities, great cities and strong economies. We support smarter planning, better infrastructure, sustainability, and globally competitive investment and tax settings which underpin the contribution our members make to the economic prosperity and social well-being of Australians.

Our submission highlights several themes that are important to consider in reviewing how foreign investment proposals operate with respect to the national interest test, in particular:

- The importance of foreign investment;
- The benefits of foreign investment in real estate to the Australian economy and particular sectors;
- The regulatory framework, including the role of the Foreign Investment Review Board and recent reforms to the foreign investment regime; and
- Areas for improvement to the framework.

We believe that the foreign investment regime overall is well-functioning and fit for purpose.

However, the introduction of any further restrictions or rules to foreign investment on a permanent basis would create uncertainty for investors and providers of capital that are deemed foreign, thereby decreasing investment flows and negatively impacting on Australia's standing as an attractive investment destination and local jobs.

We would welcome the opportunity for discussion on these issues with the Senate Economics References Committee if required.

1. The importance of foreign investment

Australia has historically been a net capital importer. As the Reserve Bank of Australia's Deputy Governor discussed in a speech in August 2019,[1] our reliance on foreign investment is a consequence of economic strength rather than weakness:

> *Because there are a lot of profitable investment opportunities in Australia relative to the size of the Australian savings pool, we have sourced capital from the rest of the world either in the form of debt or equity. This is not because savings in Australia is particularly low; it is about on par with many other advanced economies. Rather,* ***it is because the share of investment in the Australian economy is higher than that in many other advanced economies, and foreigners were attracted by the investment returns on offer***. (emphasis added)

Foreign capital is therefore attracted to the investment opportunities that Australia has on offer, and that capital is critical to the continued advancement of the overall economy. The domestic property sector is particularly attractive for investors given its relative stability, maturity, and desirable risk-return profile.

According to the Foreign Investment Review Board, over $50b of foreign capital was invested in Australian real estate in 2017-18, out of a total of $163b in approved foreign investment across the

[1] Guy Debelle, Address to the Economic Society of Australia, Canberra – 27 August 2019, https://www.rba.gov.au/speeches/2019/sp-dg-2019-08-27.html

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economy.[2] These capital inflows delivered a significant economic contribution to cities, regions and communities and supported thousands of local jobs. FIRB Chair David Irvine AO has noted that firms with foreign direct investment support 1 in 10 jobs in Australia and 40% of Australia's exports.[3]

The Australian economy's structural reliance on foreign investment, and the significant investment flows cited above, underscore how important it is to maintain a stable and principled regulatory framework to manage foreign investment into Australia.

2. Benefits of foreign investment in Australian real estate

The benefits that foreign investment brings to Australia are well-established but worth reiterating.

As mentioned in the previous section, foreign investment fills the gap between our national investment needs and savings pool. According to the Department of Foreign Affairs and Trade, this gap is estimated to be on average around 4% of GDP.[4] Domestic capital alone wouldn't be sufficient to get the Australian economy to reach its full potential, fund the creation of new infrastructure and back existing and emerging industries. The higher economic growth driven by foreign capital results in higher productivity, greater employment opportunities and higher tax revenues for government.

Looking ahead, Australia's need for investment will continue to grow strongly – particularly as we look for opportunities to kickstart the economy following the COVID-19 crisis. Australia is the most urbanised country in the world and many of our cities are growing strongly. The resulting growth and change in our cities will increase the need for investment in these locations. For example, Sydney and Melbourne are expected to accommodate another three million residents by the mid-2050s while southeast Queensland and Perth are expected to add another two million each.

This growth will require significant investment in real estate and infrastructure to ensure our cities remain both liveable and continue to be engines of economic prosperity. We will need more homes, offices, retail centres, industrial sites, retirement living, student accommodation, hotels and community, cultural and sporting precincts.

Large institutional investors recognise the role that investments in real estate can play in a diversified portfolio. Commercial real estate is an attractive investment for long-term patient capital investors such as superfunds and sovereign wealth funds. It provides a relatively predictable rental income return and helps diversify portfolios beyond equities and bonds.

Australian superfunds play a significant role in financing the Australian commercial real estate sector – however, Australian superfunds cannot meet all of the potential investment opportunities available, and many superfunds are also looking to diversify their portfolios by investing in offshore markets.

Without additional international capital, many investment opportunities in Australia would be delayed or not proceed.

It is also important for Australia to have a deep and stable pool of investment capital which brings together both domestic and international sources of capital.

Without strong and stable flows of both domestic and international capital, the pressure to fund these significant investments will fall back to governments and will put further strain on government budgets. Or worse, Australians will simply not have the real estate assets needed to sustain our quality of life.

Industry understands that we need to have robust foreign investment policy settings to ensure we protect Australia's national interest. However, this must be carefully balanced with the critical need

[2] FIRB Annual Report 2017-18, p. 28

[3] Address by Mr David Irvine AO, FIRB Chair to the Australia-China Business Council, Monday 19 August 2019

[4] https://www.dfat.gov.au/trade/investment/Pages/the-benefits-of-foreign-investment

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to continue to attract and retain international investment to underpin our economic growth and prosperity.

For the property sector, the benefits of foreign investment are seen in both commercial as well as residential property.

Benefits of foreign investment in commercial property

Foreign investment in commercial real estate has a number of key benefits, as a 2017 study by ACIL Allen Consulting (commissioned by the Property Council) showed.[5] These include:

- helping to support construction activity, both by global capital directly investing in new construction and indirectly by supporting the financial position of domestic developers and enabling them to undertake additional construction activity,
- enabling domestic firms to diversify their portfolios by purchasing or developing buildings in other regions or sectors,
- enabling Australian commercial property and development companies to utilise their skills and resources across more assets,
- contributing to increased capital values through strengthened demand for commercial real estate, which provides further support to the financial position of domestic developers, real estate investment trusts (REITs) and investors,
- reducing the volatility of Australian property values to the extent that domestic business cycles are not perfectly correlated with those in other economies, and
- allowing Australian REITs to leverage their expertise across a larger asset base by entering into joint ventures with international players and diversifying their capital funding.

Importantly, ACIL Allen modelling from 2017 showed that, over the 10-year period from 2016-17 to 2026-27, a 20% fall in foreign investment inflows for the development of new commercial developments would:

- reduce Australia's economic output (i.e. real GDP) by a cumulative total of $21.4b;
- decrease employment across Australia by around 24,423 employee years of Full Time Equivalent (FTE) jobs, equivalent to losing around 2,442 FTE jobs per year; and
- decrease Commonwealth Government revenues by a total of $8.3b and state government revenues by a total of $1.9b.

Benefits of foreign investment in residential property

When discussing foreign investment in residential property, it is important to note the following distinction:

- Australian based developers that may be foreign owned or partner with global capital – regardless of the source of capital, these developers are creating much needed housing supply for all Australians and supporting local jobs; and
- foreign owners of residential dwellings – the current regulatory framework limits foreign residents to purchasing new dwellings, which supports demand for the development of new housing supply.

The main benefit of foreign investment in residential real estate is in increasing the amount of capital available for construction of new dwellings. As submitted by Treasury to the House Standing Committee on Economics' inquiry into *Foreign Investment in Residential Real Estate* in 2014, foreign investment in residential real estate:

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[5] *Benefits of Foreign Investment in Real Estate*, ACIL Allen Consulting, May 2017

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- increases the demand for, and supply of, housing stock,
- produces benefits for the construction industry, employment and economic growth, and
- increases government revenues in the form of stamp duties and other taxes, and from the overall higher economic growth that flows from the additional investment.

Apart from helping to increase the supply of housing, foreign investment in residential real estate can be an important factor in maintaining business confidence and giving developers the security to embark on new projects.

This investment can also contribute to additional economic activity in the construction industry and related upstream and downstream sectors by providing impetus for the development of related social infrastructure. Local governments can be more confident in receiving future revenues by way of council rates and levies, thereby encouraging them to ramp up the provision of social services and infrastructure to existing residents.

To the extent that materials used in construction are sourced domestically, an increase in building activity supports local suppliers of building materials whilst boosting demand for household and commercial durable goods.

Importantly, ACIL Allen modelling from 2017 showed that, over the 10-year period from 2016-17 to 2026-27, a 20% fall in foreign investment inflows for the development of new residential dwellings would:

- reduce Australia's economic output (i.e. real GDP) by a cumulative total of $14.8b;
- decrease employment across Australia by around 26,341 employee years of Full Time Equivalent (FTE) jobs, equivalent to losing around 2,634 FTE jobs per year; and
- decrease Commonwealth Government revenues by a total of $5.3b and state government revenues by a total of $1.1b.

3. Existing regulatory framework

Modernisation changes

Following an extensive series of inquiries and review, the foreign investment regime has undergone a series of reforms over the last five years to ensure the rules operate efficiently and effectively in the modern era (noting that the original framework and legislation was established in 1975).

Importantly, the current framework sets clear rules for commercial real estate, residential development, and residential dwellings – with different levels of FIRB approval requirements for each investment type to ensure FIRB's time and resources are appropriately targeted at issues that are of national importance. Clarity is also provided in relation to the types of entities that require FIRB approval, reducing the need for extensive investor tracing for listed entities and reducing unnecessary compliance and red tape.

These reforms have occurred in two stages – in 2015, a package of reforms was introduced to modernise the foreign investment framework, including:

- Australian listed entities could now disregard any foreign holding of less than 5% for determining whether they meet the aggregate substantial foreign interest threshold of 40% or more;
- Increasing the substantial interest threshold from 15% to 20%;
- Increasing the dollar thresholds which trigger FIRB approvals for commercial property investments by investors from certain countries that have signed free trade agreements with Australia;
- transferring all residential real estate investment screening to the ATO

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- stricter penalties that will make it easier to pursue court action and ensure that foreign investors are not able to profit from breaking the rules;
- introduction of stricter and additional penalties for breaching foreign investment rules;
- introduction of application fees to fund the cost of administering the foreign investment review and approval system;
- increased scrutiny around foreign investment in agriculture; and
- increased transparency on the levels of foreign ownership in Australia through a land register.

This was followed up by another extensive round of reforms in 2017 as part of the 2017-18 Federal Budget. These reforms included:

- changes to standardise the commercial fee framework and provide some fee relief;
- introducing a new business exemption certificate, allowing pre-approval for multiple investments in the one application;
- introducing two new Residential Exemption Certificates for developers and individual buyers;
- amending the treatment of residential land used for commercial purposes;
- narrowing the scope of the 'low threshold' non-vacant commercial land definition; and
- amendments to clarify the treatment of developed solar and wind farms as commercial non-vacant land rather than vacant land and agricultural land, reducing unnecessary red-tape.

The reforms of 2017 were introduced partly to mitigate some of the unintended consequences that the earlier reforms had created.

Nonetheless, both of these rounds of reforms brought significant changes for investors, advisers and domestic entities that work or partner with foreign capital providers. It has taken some time for investors to bed down processes and become familiar and comfortable with the current system for gaining approvals.

We believe that the current framework and system for foreign investment approval of commercial and residential real estate is appropriately targeted and doesn't need an overhaul. Any future changes to the system, if any, should be measured and designed to attract more investment rather than discourage offshore capital to invest in Australia.

The role of the Foreign Investment Review Board and other agencies

One of the central pillars of Australia's foreign investment framework is the vital role played by FIRB in assessing and advising the government on foreign investment applications.

The legislative component of the framework includes the *Foreign Acquisitions and Takeovers Act 1975* – which enshrines in legislation the application of the national interest test – and the *Foreign Acquisitions and Takeovers Fees Impositions Act 2015* and their associated regulations.

FIRB reviews foreign investment proposals and advises the Federal Treasurer on the national interest implications of each proposal. This is done with the input, support and advice of other government agencies, namely Treasury, the Australian Taxation Office (ATO), the Australia Competition and Consumer Commission (ACCC), and security agencies.

The responsibility for determining whether a particular investment is contrary to the national interest and making final decisions on investment proposals rests with the Treasurer.

The involvement of the government agencies mentioned above ensures a rigorous screening process for applications. Crucial aspects of an application are assessed by these agencies, such as (in the case of the ATO) the source(s) of funding for the investment and who the ultimate beneficiaries are, or (in the case of the ACCC) the effects of the transaction on competition and market dynamics in a particular sector. Sensitive and detailed information is requested from applicants to ensure rigour and thoroughness in the screening process.

The need to engage with different agencies and provide large amounts of detailed and sensitive information can often extend the time for a foreign investment approval to be granted to several months. It also places a resourcing strain on the applicant to be able to satisfy multiple information requests. Feedback gathered from our members shows that the stringency of the approval process can even create a level of uncertainty for investors.

We believe that raising further screening requirements to mitigate the concerns raised within the inquiry's terms of reference would increase government risk and in due course be detrimental to Australia's investment needs, particularly in the current climate of heightened economic uncertainty.

4. Areas for improvement or consideration

We believe that there is scope for improving the existing foreign investment framework in two aspects:

- greater levels of data and awareness around foreign investment, and
- a cohesive message from governments at the federal and state/territory level that Australia is open for business and open to foreign investment.

Increasing data and awareness

Firstly, we would be supportive of government providing greater levels of data on foreign investments.

This can increase public understanding of the benefits derived from foreign investment and would enable government and stakeholders to gain insights into how foreign investment flows are changing over time, which sectors and types of investments are reliant on foreign capital, and to identify barriers to investment that could boost economic and jobs growth.

It would also allow for the development of evidence-based policy to drive further changes and improvements to the foreign investment framework. For example, a greater wealth of data would aid the National Housing Finance and Investment Corporation to tackle issues around housing supply and improve housing outcomes for Australians.

Clear messaging that Australia is open to investment

Secondly, we would be supportive of moves by the Federal Government to work with their state and territory counterparts to ensure there is clear messaging that Australia is open to investment.

A number of developments over recent years have had a detrimental impact on Australia's reputation regarding foreign investment policy certainty. At the state level, foreign investor tax surcharges for stamp duty or land tax have been introduced across the country.

These often come with definitions that differ from one another (and from the definitions used by FIRB), which creates complexity and further uncertainty for offshore investors looking for investment opportunities here. This lack of cohesiveness across states and territories, combined with other changes over the past 10 years such as the introduction of withholding tax for certain types of foreign investors, has had a detrimental impact on Australia's standing as a jurisdiction with low political and government risk for investors.

At a time of heightened economic uncertainty globally, it will be more critical than ever for Australia to distinguish itself from other markets and strongly reinforce that we are a stable and desirable investment destination for long-term patient capital. This will be essential to creating much needed commercial and housing precincts, delivering significant economic contribution and supporting local jobs.