REAL ESTATE INSTITUTE OF AUSTRALIA

REIA SUBMISSION TO THE STANDING COMMITTEE ON ECONOMICS INQUIRY INTO *AUSTRALIA'S FOREIGN INVESTMENT POLICY AS IT APPLIES TO RESIDENTIAL REAL ESTATE*

MAY 2014

PREPARED BY

Real Estate Institute of Australia (REIA)
PO Box 234
Deakin West ACT 2600
Amanda Lynch
Chief Executive Officer

@REIANational
REIA

REIA SUBMISSION TO THE STANDING COMMITTEE ON ECONOMICS INQUIRY INTO *AUSTRALIA'S FOREIGN INVESTMENT POLICY AS IT APPLIES TO RESIDENTIAL REAL ESTATE*

The Real Estate Institute of Australia (REIA) is the peak national association for the real estate profession in Australia.

The REIA's members are the State and Territory Real Estate Institutes, through which around 75 per cent of real estate agencies are collectively represented. The 2011 Census records the Rental, Hiring and Real Estate Services Industry employment sitting at a total of 117,880. By occupation the key data recorded by ABS Census were 64,699 business brokers, property managers, principals, real estate agents and representatives.

The REIA represents an important element of the broader property and construction sector which together makes a significant contribution to Australia's social climate and economic development. Property contributes $300 billion annually in economic activity.

Importantly, REIA represents an integral element of the small business sector. Some 99 per cent of real estate agencies are small businesses and 11 per cent of all small businesses in Australia are involved in real estate. Only 0.6 per cent of businesses employ 50 or more persons.

REIA is committed to providing and assisting research and well-informed advice to the Federal Government, Opposition, professional members of the real estate sector, media and the public on a range of issues affecting the property market.

The REIA welcomes the opportunity to make a submission to the Standing Committee on Economics Inquiry into *Australia's Foreign Investment Policy As It Applies To Residential Real Estate.*

Introduction

In noting that the objective of Australia's foreign investment policy, as it applies to residential property, is to increase the supply of new housing, REIA's submission seeks to analyse the available data to test whether foreign investment is directly increasing the supply of new housing which would benefit not only home seekers but also the domestic construction building industry. REIA's submission also explores whether the administration and compliance of Australia's foreign investment policy relating to residential property can be enhanced**.**

The REIA notes that the Inquiry is being undertaken against a background of rapidly increasing housing prices in some capital city locations, most notably Sydney and

Melbourne, with much speculation about the reasons for this, in particular whether foreign investors are responsible for the price increases that are preventing many prospective domestic buyers, including first home buyers, from entering the market. In that regard the REIA notes that the circumstances of this Inquiry are not dissimilar to those in 2010 when the foreign investment rules as they relate to residential real estate and a package of new civil penalties, compliance, monitoring and enforcement measures was introduced. At the time REIA welcomed the new rules.

Impact of Foreign Investors on Domestic Market

Extent of Foreign Investment in Residential Real Estate

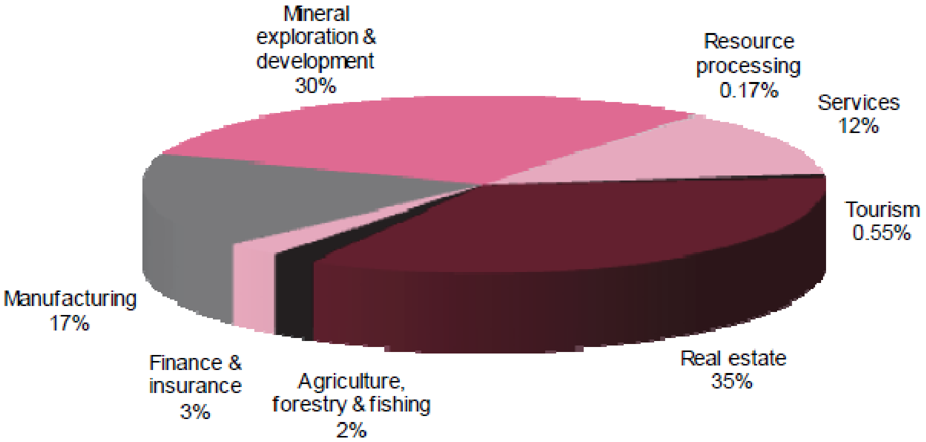
The 2012-13 Annual Report of the Foreign Investment Review Board (FIRB) indicates the following:

- The real estate sector, residential and commercial, is the largest destination of foreign investors funds behind exploration and development and services (as shown in the chart below)
    - Of the 12,731 proposals receiving foreign investment approval 12,025, or 94 per cent, were for real estate
    - By value real estate accounted for $51.9 bn of the $135.7 bn, or over one-third
- By value, 2012-13 saw a drop in real estate approvals from the previous year's $59.1 bn
- By number, 2012-13 saw an increase in approvals from the previous year's 10,118
- Of the 446 proposals withdrawn, 76 per cent involved real estate
- Of the 12,731 approvals, 7,196 or 57 per cent were subject to conditions and all were in the real estate sector. The conditions include those relating to the period during which development must commence, requirement for temporary residents to reside in and sell established dwellings when they cease to reside in them, and reporting requirements
- There a number of categories that foreign investment approvals fall into
    - The category of *developed residential real estate* consists primarily of temporary residents in Australia acquiring one existing residential property for use as their residence in Australia. Such proposals are normally approved subject to conditions (such as, that the temporary resident sells the property when it ceases to be their residence). Temporary residents cannot buy established dwellings as investment properties. This category accounted for 5,091 approvals at an average of $1.064 m per property
    - The category for *vacant land* consists primarily of individual blocks of land purchased for single dwelling construction. These are normally approved subject to conditions (such as, that construction begins within 24 months). It also includes broadacre land for residential subdivision

and multiple-dwelling residential developments (such as townhouses and units). This category accounted for 1,821 approvals at an average of $764k per block

- o The *new dwellings and off-the-plan* category consists of applications by individuals to acquire newly constructed dwellings directly from developers and applications by developers to sell up to 100 per cent of new residences in a development to foreign interests (the developer is also required to market the dwellings locally). Applications from individuals, including temporary residents, are normally approved without conditions. If a developer is given approval, individuals need not apply for approval. There were 4,499 approvals for individual purchases of new dwellings at an average price $647k per dwelling. There were 50 applications for *off-the-plan* developments totalling $5.73 bn – making this the largest category. FIRB, however, notes that the approved investment figures for off-the-plan approvals for developers and annual programs overstate the likely extent of actual foreign purchases as the value of investment reported against annual program approvals represents the maximum amount foreign persons may acquire under the program
- o There were 189 approvals for *property for redevelopment* with an average price of $1.9m per property which involve the acquisition of existing property for the purpose of demolition and construction of new residential dwellings. These are normally approved as long as the redevelopment increases Australia's housing stock (at least two dwellings built for the one demolished) or where it can be shown that the existing dwelling is derelict or uninhabitable. Approvals are usually subject to conditions (such as, that construction begins within 24 months).

- The state distribution of proposed investment in residential real estate, by value, is focussed on the eastern seaboard with VIC, NSW and QLD accounting for 34 per cent, 32 per cent and 11 per cent respectively of all approvals.
- The three largest source countries of proposed investment in real estate, by value, are China, Canada and USA accounting for 11.4 per cent, 9.5 per cent and 8.5 per cent respectively of all approvals.



Note: Totals may not add due to rounding.

Source: FIRB Annual Report 2012-13

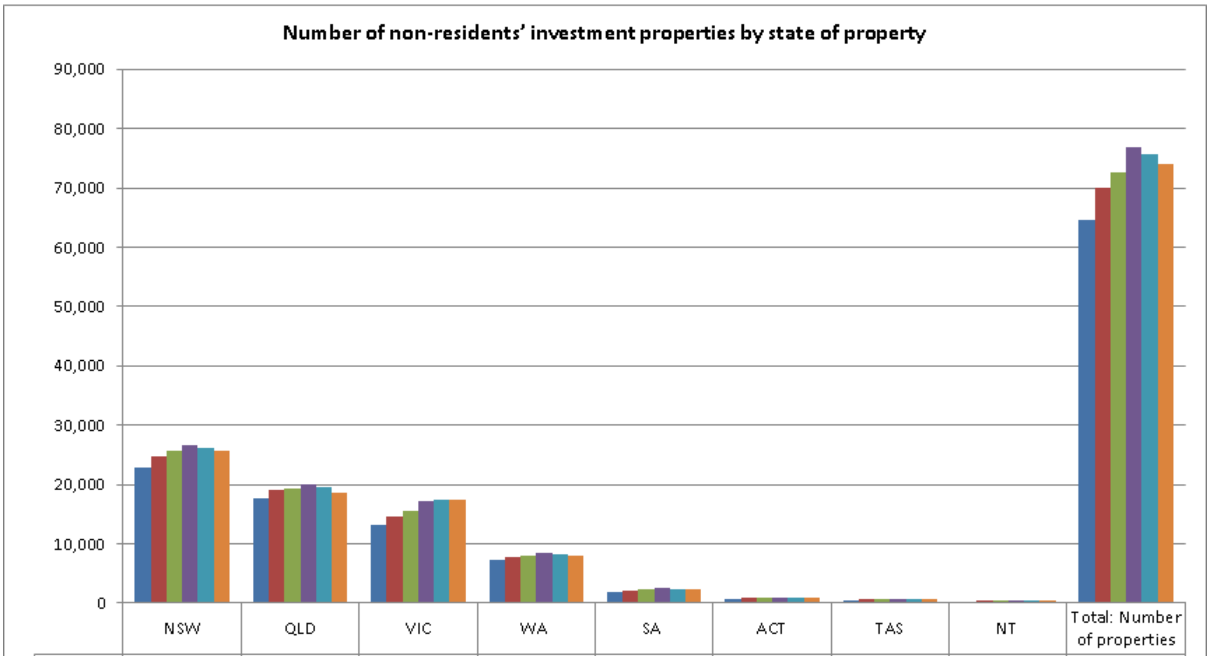
Whilst the FIRB Annual Reports provide the data outlined above, it is available nearly nine months after the close of the financial year. The REIA believes the timeliness of data and the detail of the data made publicly available could be improved thus assisting policy makers. Given the details sought from applicants the publicly available data could be enhanced.

REIA recommends that the level of data made publicly available and its timeliness be reviewed.

ATO Tax Returns

Another pointer to the extent of foreign ownership is provided by the individual rental property schedules tax returns to the Australian Taxation Office (ATO) which requires individuals, including non-residents, with an interest in a rental property to complete a rental property schedule for each property.

From the graph we see that the number of investment properties held by non-residents whilst increasing marginally over the six years to 2011-12 has been around an average of 72,000 properties. As the FIRB rules require non-resident foreign owners to purchase new properties, these statistics provide a guide to the extent that foreign investors are providing an increase in the number of rental properties.



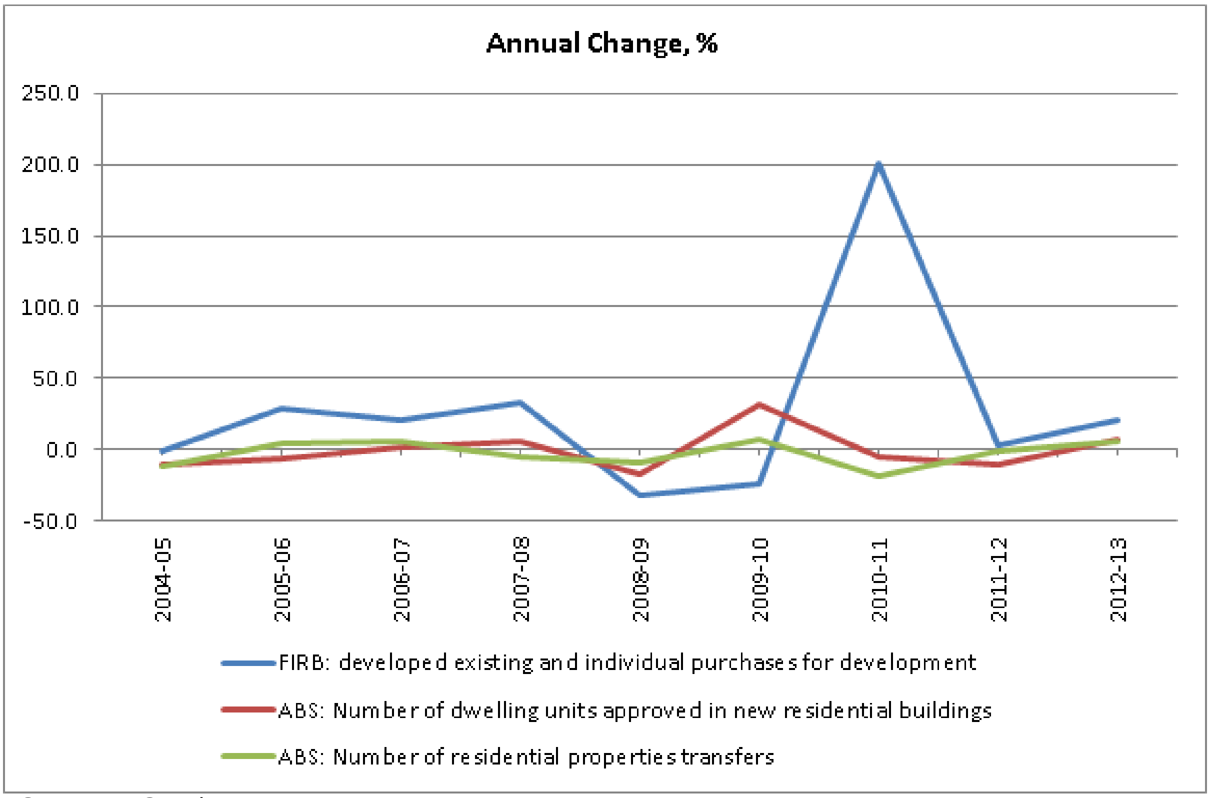
	NSW	QLD	VIC	WA	SA	ACT	TAS	NT	Total: Number of properties
2006-07	22,913	17,722	13,206	7,257	1,937	777	559	331	64,702
2007-08	24,675	19,078	14,526	7,715	2,218	853	587	367	70,019
2008-09	25,579	19,213	15,581	7,956	2,429	907	613	386	72,664
2009-10	26,632	20,109	17,129	8,464	2,483	996	685	410	76,908
2010-11	26,171	19,504	17,354	8,241	2,439	968	623	391	75,691
2011-12	25,788	18,595	17,396	8,073	2,271	962	599	365	74,049

Source: Australian Taxation Office

Impact on Domestic Market of Foreign Investors

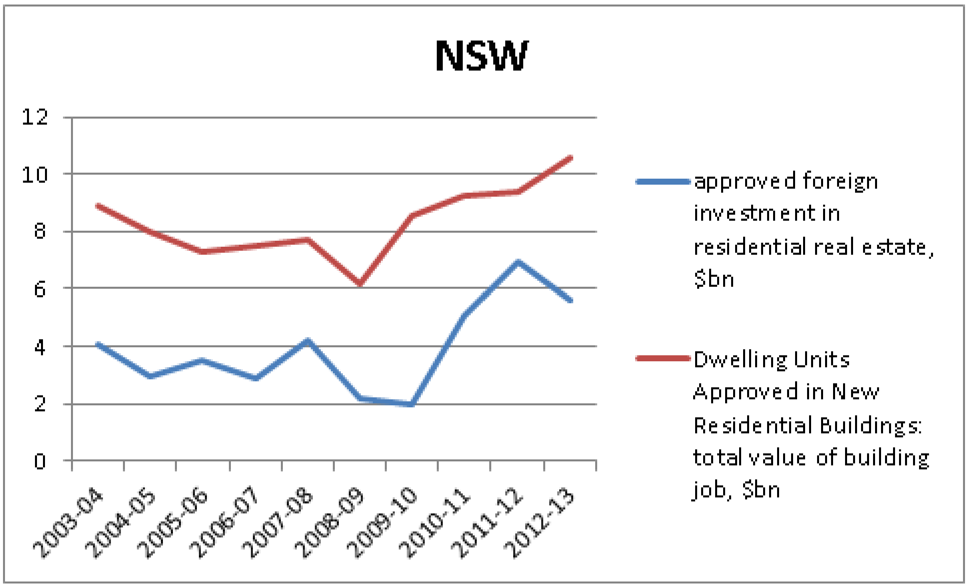
The graph below for Australia shows that the change in the level of approvals for foreign investment and the change in the number of residential buildings approved for construction follow similar paths suggesting that there is a relationship and that foreign investment, or at least the prospect of foreign buyers for new developments, is increasing the supply of new housing. This is supported by anecdotal evidence from the market which suggests that many, particularly large scale, developments would not occur had it not been for the prospect of foreign buyers.

With foreign investor activity being a very small proportion of the dwelling stock and the total level of sales – 0.1 per cent and 2.8 per cent respectively in 2012-13 – it is not surprising that, as shown in the graph, there is little relationship between foreign investment approvals and the number of total sales (transfers) of residential property. The ability of foreign investors to influence the market, at least in an Australia wide context is negligible.

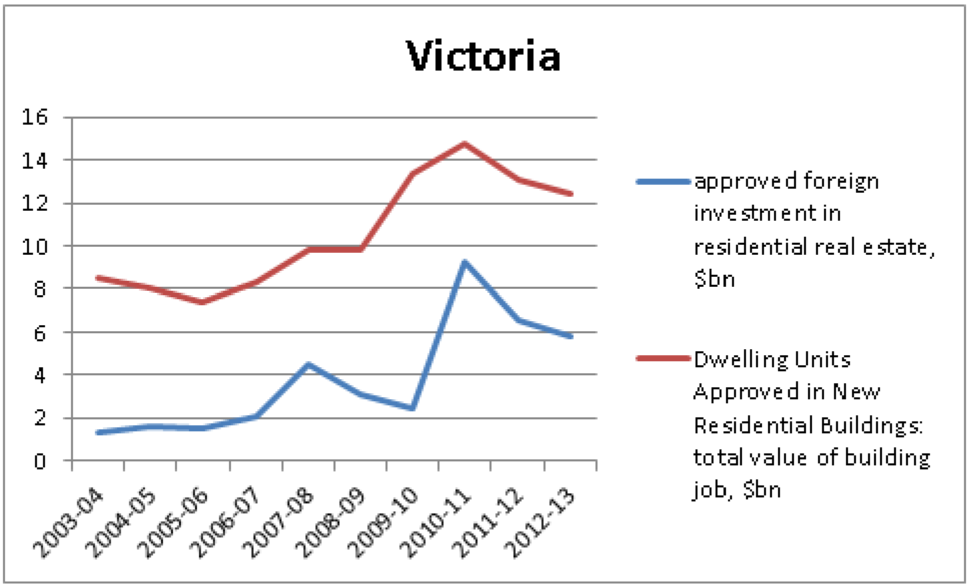


Source: ABS and FIRB

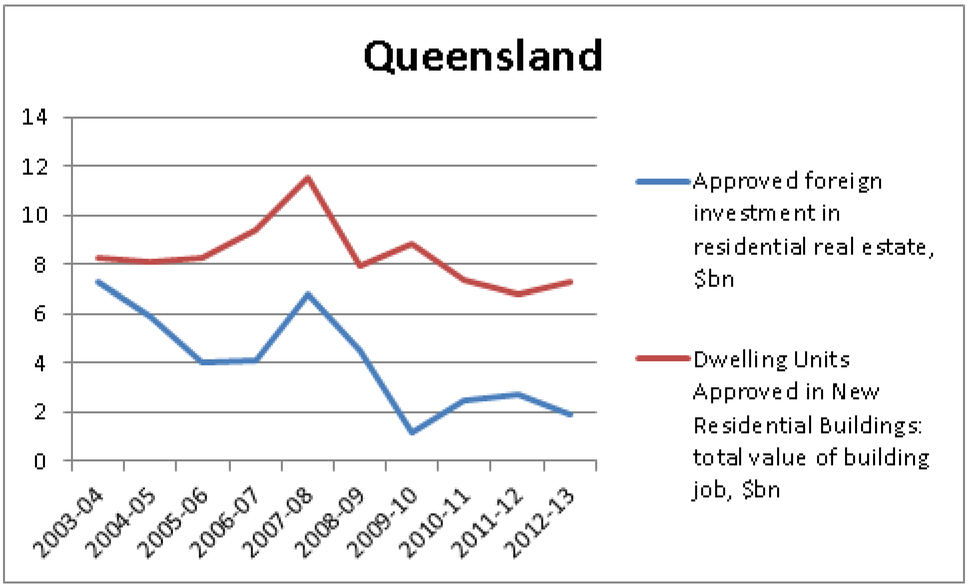
The three graphs below for NSW, VIC and QLD show that there is a much clearer relationship in these two states between the level of foreign investment approvals and building activity and thus supply of new dwellings.



Source: ABS and FIRB



Source: ABS and FIRB



Source: ABS and FIRB

For VIC, NSW and QLD the level of foreign investment as a proportion of the value of dwelling stock whilst much higher than the Australian average it is still at a level where the ability of foreign investors to influence the market is negligible - in NSW the proportion in 2012-13 was 0.33 per cent, in VIC it was 0.48 per cent having dropped from 0.8 per cent two years earlier, and in QLD it was 0.24 per cent..

The broad conclusions from the perspective of an impact on the domestic market are that: the FIRB guidelines of increasing the supply of housing are being met; the market segments of existing dwellings and vacant land are in a price category well beyond median prices and are not likely to compete against "average" buyers or first home buyers; new dwellings and off-the-plan purchasers appear to be in a price category higher than the median for units.

REIA recommends that the policy relating to foreign investment in residential real estate remains unchanged.

Whilst it can be concluded that foreign investment in residential real estate is achieving the objectives of the Government's foreign investment policy by increasing supply, the converse argument that Australia's shortage of housing can be resolved by foreign investment is not true. Supply has been unable to keep pace with demand due to a number of reasons: land availability; taxation policies; length and cost of planning process; zoning policies, and environmental regulations. Furthermore, unless supply is addressed the gap between supply and demand is forecast to widen to 375,000 dwellings by 2015. A major contributor to increases in house prices and declining affordability is the undersupply of housing.

At an industry roundtable on housing affordability convened by the REIA in March 2014 one of the factors highlighted as a major driver of increasing house prices and declining affordability is the undersupply of housing. This was identified as a priority policy issue.

It is fair to say that it is because of an inadequate supply of housing that questions are raised from time to time about the efficacy of foreign investment. Addressing housing supply would avoid any future questioning about impact of foreign investors in residential real estate.

Administration of Foreign Investment Policy

In 2010 the *Foreign Acquisitions and Takeovers Act 1975* (FATA) was amended to provide wide-ranging powers for enforcement including the ability to: order the unwinding or divestment (by requiring the parties to sell shares, assets or property) of transactions that have gone ahead, without prior foreign investment approval having been obtained, where that purchase was contrary to the national interest; prosecute a foreign person (including a natural person or a company) that failed to obtain prior approval; prosecute a foreign person that failed to comply with an order to sell shares, assets or property; and prosecute a foreign person that failed to comply with conditions attached to any approval granted under the Act.

At the time a civil penalties regime applying to breaches of the foreign investment in Australian real estate was introduced covering: sanctions for purchasers, sellers and agents for being involved in transactions in breach of FATA; an explicit compulsory divestment requirement where property has been purchased in breach of the real estate investment regime; and an additional monetary penalty equivalent to any capital gain made by the breaching purchaser at the time of the forced sale, with the capital gain to be measured in accordance with the relevant tax legislation. Non-compliance with notification to acquire an interest in real estate also carry penalties on conviction for a natural person and a corporation of a maximum of 500 penalty units – currently $170 per unit or a maximum fine of $85k.

Expanded monitoring and compliance activities were also introduced in 2010 including: monitoring to ensure that foreign persons are complying with the conditions of their approvals - this involves cooperation with relevant members of the business community, local government authorities, the legal profession and the general public; systemic investigations of compliance performance, including through data analysis and interpretation of trends using internal as well as external information sources - these investigations include regular monitoring of property market leasing activity; interagency cooperation and liaison with a range of government agencies including relevant national security agencies, the Department of Immigration and Border Protection, the Australian Taxation Office, the Australian Securities and Investments Commission and the Australian Federal Police; and case investigations triggered by information received from members of the public.

Prior to 2010 there were an, albeit small, number, of prosecutions made. Since then there has not been any public evidence of significant non-compliance despite the introduction of new measures in 2010. This could be for a number of reasons including; adherence by foreign investors to the requirements of the law; effectiveness of the penalties in discouraging non-compliance; a reluctance to prosecute; under resourcing and thus perhaps ineffectiveness of the monitoring and compliance activities of FIRB; or alternatively, the effectiveness of the monitoring and compliance activities in getting non-compliant foreign investors to rectify breaches. Whatever the reasons are, individually or collectively, they are unknown. A review after four years following the introduction of the current arrangements appears warranted to guide an informed decision.

REIA recommends that the powers of enforcement, the penalties and the compliance and monitoring activities of the FIRB introduced in 2010 be independently reviewed as to their effectiveness and appropriateness.

The REIA notes that the maximum penalty for non-compliance with notification to acquire an interest in real estate is currently $85k. The REIA believes that the effectiveness of this as a deterrent will depend on the value of the property concerned. For the purchase of a new dwelling at the average price of $647k, identified above, this represents 13 per cent of the price. For a multi-million dollar this will only be a much smaller proportion and may be considered by some as part of “the cost of doing business” and not an effective deterrent.

A fixed percentage, possibly above a certain minimum value, such as 10 per cent of the value would be a more effective deterrent and would better reflect changing market conditions and the differences between properties in question.

REIA recommends that penalties applicable under the FATA be reviewed with consideration being given to an ad valorem rate and that this rate is set at 10 per cent.

Recommendations

REIA makes the following recommendations

- ***That the level of data made publicly available and its timeliness be reviewed***
- ***That the policy relating to foreign investment in residential real estate remains unchanged***
- ***That the powers of enforcement, the penalties and the compliance and monitoring activities of the FIRB introduced in 2010 be independently reviewed as to their effectiveness and appropriateness***
- ***That the penalties applicable under the FATA are reviewed with consideration being given to an ad valorem rate and that this rate is set at 10 per cent.***