



SUBMISSION BY THE
Housing Industry Association

to the
**House of Representatives
Standing Committee on Economics**
on the
Inquiry into Foreign Investment in Residential Real Estate
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HIA is the leading industry association in the Australian residential building sector, supporting the businesses and interests of over 40,000 builders, trade contractors, manufacturers, suppliers, building professionals and business partners.

HIA members include businesses of all sizes, ranging from individuals working as independent contractors and home based small businesses, to large publicly listed companies. 85% of all new home building work in Australia is performed by HIA members.



Introduction

The Housing Industry Association (HIA) welcomes the opportunity to provide comments to the House of Representatives Standing Committee on Economics in response to its 'Inquiry into Foreign Investment in Residential Real Estate'.

Achieving a level of housing stock that is commensurate with the number of homes demanded by the community is a challenge that has defeated policy makers for more than a decade. Failure to align the rate of new home building with the rate of population growth has seen growth in demand for housing out pace growth in supply. This has resulted in upward pressure on housing costs across all tenure types.

The undersupply of housing must be addressed if Australian households are to experience relief from the persistent deterioration in housing affordability. In doing so, policy makers must also ensure that housing remains a stable store of wealth for Australian households.

With regard to foreign investment in residential property, policy makers must ensure policy settings consistent with these objectives and provide adequate resources to ensure policies are implemented and adhered to. The need to increase Australia's housing stock and curtail growth in housing costs was a major consideration in the design of the existing policy settings relating to foreign investment in residential property.

Policy settings which favour investment in new housing has provided an important source of demand for the residential construction industry and resulted in the construction of many homes which would not have been built had the industry been dependant on domestic demand exclusively. Furthermore, the increase in housing stock cannot simply be estimated by summing together contribution of foreign buyers and the contribution from domestic buyers. As described later in the submission, the market structure is such that there would likely be fewer new homes built for domestic buyers in the absence of demand from foreign buyers.

The lack of sufficient reporting of information relating to foreign investment in residential property from official sources provides a challenge in providing evidence based responses to the terms of reference. To address the information deficit, HIA has liaised with businesses that operate in this market. A number of aspects of this submission draw from their experiences.

The following sections provide insight into the dynamics of the residential building market as it pertains to foreign investment and describes related policy reform measures which will assist to align policies with the objective of improving housing supply and slowing growth in Australian housing costs.

Residential Property Investment in the Global Economy

Since Australia is now well integrated into world capital markets, levels of investment are no longer as closely tied to domestic savings. Domestic property investors will only purchase property if they can receive an after-tax rate of return that is competitive with alternative investments, including those available in the share market. Required returns in the local share market and in other local investments are in turn closely linked to required returns in comparable overseas markets, as investors seek out the highest returns from all available options. Through these linkages between investment markets, international capital markets exert a strong influence on the amount of investment undertaken in Australia's housing market.

Many major developed economies and financial markets experienced economic shocks in recent years. Many of these shocks involved, or were precipitated by, activity within residential property markets. The relative stability of the Australian economy and the housing market within is likely to have lured investment to Australia that would previously have been more widely distributed across a range of developed markets.



Over time, the nascent recoveries currently evident in developed economies are likely to gain traction which will reduce the perception that economic conditions in Australia are uniquely favourable for investment. This development could well see the Australian residential property market face increased competition for capital flows from foreign investors in the future.

Demand for Australian residential property by foreign investors should be considered in this global context. Furthermore, investment in Australian residential property by foreign investors is more tightly regulated than the majority of other asset classes. High regulatory barriers provide a disincentive to invest.

There are anecdotes that foreign buyers have been able to circumvent the existing regulations in regard to established residential property. However, there is currently no evidence of widespread regulatory failure. Improved data collection and reporting of foreign buyer activity would no doubt assist authorities in ensuring regulatory adherence.

Preferences and Motivations of Foreign Buyers of Residential Property

Foreign buyers are typically individuals (the use of trust or company structures is very rare) and the majority would not be considered 'sophisticated investors' (as defined by the Corporations Act). The majority of foreign buyers typically fund the purchase using mortgage financing, around one third of foreign buyers do so without a mortgage. Of those using finance, borrowed funds typically account for between 50 per cent and 70 per cent of the purchase price. Borrowed funds are typically sourced from Australian financial institutions.

There appears to be a number of common motivations for investment in Australian residential property assets by foreign buyers. Around one third of properties are purchased by foreign buyers who retain the property for personal use after settlement. Inter alia, uses include occupation by family members who live in Australia, use by children being (or planning to be) educated in Australia, the property being used as a 'home-away-from-home' by buyers who are regular visitors to Australia as tourists or business travellers. In some cases there is a dual motivation whereby foreign buyers initially hold the property as an investment, but intend to migrate to Australia at some point in the future.

The majority of properties purchased by foreign investors are held as investments and buyers require returns commensurate with prevailing market rates. The major residential property developers who operate in this market tend to be vertically integrated businesses, offering clients who purchase dwellings as investments ongoing property management services. It is very uncommon for foreign investors to leave properties vacant for extended periods or be motivated by short term speculation on dwelling price movements.

Similarly to domestic buyers, foreign buyers seek 'good investments' which are typically properties with good amenity, such as those within close proximity to transport infrastructure, education institutions, hospitals and other economic opportunities. In addition, familiarity with the type of housing and location also plays a role in foreign buyers' preferences.

Industry liaison reaffirms anecdotal evidence that foreign buyers are far more active in the high-rise inner-city apartment markets. Although it should be acknowledged that this is not an exclusive preference. Businesses within the residential building industry also report demand from foreign buyers for lower-density multi-unit dwellings, and house and land packages.

Economic Benefits of Foreign Investment in Residential Property

Irrespective of whether the demand comes from domestic or foreign buyers, residential construction work is a strong driver of economic activity and employment growth in the Australian economy. Foreign investment in new residential property in Australia is contributing to a larger new housing stock.



The residential building and construction sectors interact with the rest of the Australian economy through a complex web of connections. HIA commissioned a report titled *Construction and the Wider Economy: a general equilibrium analysis* (prepared by the Centre for International Economics) which investigated what specific changes in residential building, and the broader construction sector, have on the rest of the economy and what impacts similar specific changes in the rest of the economy have, in turn, on residential building and construction.¹

The baseline assumption of the CIE analysis assumes full employment. Under this scenario, a 1 per cent increase in demand for residential building will add \$0.15 to GDP for every additional dollar of residential building work done. This is a relatively modest impact stemming from the fact that under a full employment situation, labour must be redirected into residential construction from other productive sectors of the economy, thereby diminishing the contribution to GDP by other sectors.

Variation of labour market assumptions to represent a situation where there is less than full employment shows an increase in demand for residential building provides a much stronger contribution to GDP. CIE's modelling indicates a 1 per cent increase in demand for residential building will add \$0.47 to GDP for every additional dollar of residential work done. The stronger contribution to GDP stems from the fact that under less than full employment the increase in residential building activity utilises the excess labour force capacity that would otherwise be unproductive. This situation is likely to be more representative of the current economic and labour market environment where construction labour demand within the mining sector is declining and unemployment rates are generally rising.

Foreign investors importantly provide additional demand for residential building which in turn provides an economic dividend throughout the economy, while also assisting to boost Australia's housing supply. However, there is a wide array of domestic policy reform options available to legislators. The positive impact of such reforms has the potential to eclipse the positive impact of demand from foreign investors. The CIE's findings show that the wider economic impact of an increase in residential building due to productivity improvements within the housing and construction sectors, or from reform of the inefficient taxes on housing, would be much greater than if the increase in residential building was due to an increase in demand alone.

Foreign Buyers within the New Apartment Market Structure

Foreign investors in the higher density segment of new residential property have played an important role in enabling developments to proceed. Providers of finance for large residential developments require the developer to demonstrate the viability of the project before finance is approved. Finance providers typically require the developer to provide evidence that a specified share of the dwellings within the development have been sold 'off-the-plan'. The share required to be pre-sold in order to access development finance has increased markedly in the post financial crisis era.

There are numerous situations where domestic buyers alone have been insufficient in number to reach the required level of pre-sales to access finance. Failure to achieve the required level of pre-sales to access finance typically results in the abandonment or deferral of the development. Pre-sales to foreign buyers complement pre-sales to domestic buyers and enable projects to go ahead that would otherwise have been abandoned or deferred.

In the process, as noted in the previous section, foreign investment in new residential property boosts domestic economic activity.

¹ Previous analyses have typically attempted to measure the effect of changes in one sector on the broader economy, expressed through a 'multiplier'. However, this approach has proven simplistic and ignores the complex relationship with other sectors.



Finance providers are cognisant that an over-reliance on demand from foreign buyers within an individual development may increase credit risk. Financiers are reported to address this risk by imposing a threshold on the number or share of pre-sales to foreign buyers that can be considered for the purposes of assessing pre-sales. Foreign buyers from regions where higher density types of housing are the norm are generally more familiar with the housing product they are buying and the 'off-the-plan' buying process. Nevertheless, the setting of a threshold naturally means that the remaining pre-sales need to be met from domestic buyers.

As a consequence of these market dynamics, many residential development projects have proceeded, which despite healthy domestic demand, would otherwise not have gone ahead in the absence of demand from foreign buyers. Therefore, the increase in Australia's housing stock due to the presence of foreign investors in the market is greater than the number of dwellings purchased by foreign investors.

Foreign Investment in Land for Residential Development

Industry participants report strong competition from foreign buyers in the market for broad-acre land. This situation is in many instances perceived to inflate land prices. Furthermore, there are reports that some foreign buyers are undertaking investment in land yet to be zoned for residential use, speculating on the possibility that re-zoning may occur. This action is perceived to have had a distortionary impact on prices in non-residential land markets.

While anecdotal evidence alone does not provide sufficient evidence of a market or regulatory failure, were this market activity to become endemic within land markets there would be increased risks to the stability of supply and prices of residential land. Such an outcome is avoidable with the adequate measurement and reporting of residential land development and supply.

The assessment, development and delivery of new land to market can take over 10 years, yet accurate and holistic information about Australia's land supply pipeline is scarce. HIA recommends the federal government establish a mandatory national reporting framework for land supply as a matter of priority.

State and territory governments collect and publish information on land supply. However, in several instances it is not timely, in some cases it is not accurate, and in all cases it is not related to the projected housing delivery commitments envisaged in capital city metropolitan strategies.

The federal government needs to play a role in the co-ordination of this information, which is critical to supporting the delivery of homes to meet Australia's growing population.

The accurate collection of data on land supply needs to capture all stages of the land supply pipeline. This should include nationally consistent definitions to describe the various stages of the land supply pipeline. Timely periodic reporting should include information on land that has received 'works approvals' to more accurately identify any blockages in the planning process.

Much of the information needed to achieve a holistic grasp of land, infrastructure and housing supply is captured variously by local and state/territory governments. However, the scope of data collection and its interpretation lacks consistency and is rarely compiled and shared across agencies.

With limited analysis of residential land supply pipeline or foreign investment in residential land it is not possible to determine the impact that the presence of foreign buyers has in this market. This represents a substantial knowledge deficit in an area which has the potential to have significant impacts on Australia's housing supply. Hence this knowledge deficit needs to be addressed.



HIA supports the establishment of a national unit within Commonwealth Treasury with a primary purpose being to collect, analyse, interpret and report on both housing and land supply pipelines, with a terms of reference similar to those of the Indicative Planning Council for Housing, which undertook this important function during the 1980s and 1990s. Necessarily, the extent of foreign ownership should be a consideration.

Reporting of Foreign Investment in Residential Property

The lack of sufficient and accurate information available to assess the extent of foreign investment in residential land also applies to new residential property itself.

The Foreign Investment Review Board (FIRB) Annual Report is the only official source of statistics relating to the extent of foreign investment in residential property in Australia. Unfortunately, information which is essential to drawing meaningful inference from the data remains unreported. The situation enables widely varying interpretations of the reported figures.

The timeliness and quality of data collection and reporting must be improved to enable government to develop and implement informed policies, enable businesses to make informed investment decisions, and enable households to make informed housing choices.

The method of reporting within the FIRB Annual Report provides scope for the *actual* volume of foreign investment to deviate substantially from the *reported* volume of approved investment. This means the figures reported within the FIRB Annual Report provide little insight into actual activity. The data is reported in terms of the *number* of approvals and the *value* of approvals and there are issues with each.

The key problem with the reporting method used for the *number* of approvals is that a single approval can relate to multiple dwellings being purchased by foreign investors. The FIRB note that the 'developer off the plan' category includes "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)". This means a single reported approval (relating to the whole development) could potentially refer to as many as 500 dwellings and there is no way to determine how many dwellings were actually purchased by foreign buyers.

The problem with the reporting method used for the *value* of approvals is that it represents the maximum value of foreign investment that could potentially have occurred rather than the actual value of transactions. The 'developer off the plan' category reports the total value of the development for which approval has been granted irrespective of how many dwellings were actually sold to foreign buyers.

Depending on the assumptions applied, data reported in the most recent edition of the FIRB Annual Report could imply foreign investment in new homes potentially accounted for as little as zero or as high as 20 per cent of new homes built in 2012-13.

It would be highly beneficial for policy makers, the residential building industry, and the broader community to have a greater understanding of demand attributable to foreign investment. Based on the information we currently have, the extent of foreign investment in residential property is likely to remain an issue of contention.

HIA proposes the following improvements to the reporting system:

- Reporting should clearly communicate the number and aggregate value of dwellings (new and existing) approved for purchase by foreign buyers in a specified period and the number of approvals that proceeded through to a completed transaction;
- Reporting should clearly communicate the number and aggregate value of vacant residential land approved for purchase by foreign buyers in a specified period and the number of approvals that proceeded through to a completed transaction. Reporting should



also disaggregate activity relating to titled individual residential lots from approvals relating to broad acre land for residential development;

- Adequately resource the Australian Bureau of Statistics and empower the agency to collect and report activity on a more timely basis. This should facilitate the most accurate concordance between existing housing data and data covering the activity of foreign investors in the residential property market.

The Imbalance Between Supply and Demand

Over the last decade there has been a persistent imbalance between growth in demand for housing and the slow rate at which the nation has added to the housing stock. Australia has experienced strong population growth in recent years driven primarily by a large contribution from net overseas migration. Combined with demographic changes, this situation has added considerably to the demand for housing.

In contrast, the annual number of new homes commenced over the period 2004 to 2013 declined in seven out of those ten years.

The net outcome of a divergence between strong population growth and a downward trend in new home commencements is an undersupply of adequate, affordable housing. Demand from foreign buyers has played and should continue to play an important role in addressing the undersupply of housing, and in doing so improve housing affordability.

New home building activity in Australia recently concluded its longest trend decline in Australia's post war history. A trend improvement in new home building is now underway again. Under current policy settings, this improvement will be insufficient to see Australia attain building levels commensurate with the requirements of providing an adequate and affordable level of housing to a growing and ageing population. Any trend improvement does, however, allow for the encouraging reference to the conclusion, rather than extension of, the extensive trend decline Australia experienced.

Over the ten years from 2004 to 2013, the period encompassing the long downward trend, Australia's new home commencements averaged a level of 156,330 per annum. Over the last 20 years this average was only slightly lower at 154,275. While much is quite rightly made of Australia's ability to withstand recession through a period stretching to over 20 years, new home building activity has experienced three subsequent episodes of recession since Australia's economic recession of the early 1990's - in 1996-97, 2001, and 2009 - while narrowly escaping a fourth episode in 2012.

Against this backdrop of empirical history it is intuitively impossible to have adequately supplied a level of affordable and accessible housing stock commensurate with the requirements of Australia's population.

While the exact quantum of Australia's current housing shortage can be a contentious issue, the key is to ensure Australia's recent historical experience in terms of residential building levels is not repeated over the next 20 years and beyond.

Under the most conservative estimate possible, Australia needs to achieve an average level of new home commencements of 180,000 per annum between now and 2050. The last time Australia exceeded this level of commencements was in 1994, although Australia (temporarily) came close in 2010 at the height of GFC-related stimulus measures.

Domestic demand for new homes is highly correlated with economic cycles; in economic downturns relatively few new homes are built, while in economic upswings a relatively large number of new homes are built. In addition to boosting the number of dwellings built, foreign investment can be an important source of demand for new dwellings which is less correlated with domestic economic cycles, thereby smoothing out the supply of housing across cycles.



Speculative Activity and Price Growth in Australia's Housing Market

Housing costs have grown at rates well above general inflation and household income growth. The chart below shows that residential property prices have grown by 62 per cent over the last decade while rents have grown by a similarly large 55 percent.

There has been some suggestion that the strong price growth has been due to speculative demand, and particularly by foreign investors. However, concurrent growth in home prices and rental prices is not consistent with the thesis that speculative activity is a primary driver of price rises. Rental prices reflect the value of housing services rather than any entitlement to future growth. Strong concurrent growth in home prices and rental prices is consistent with the demand for housing services exceeding the supply.

The housing undersupply that has manifested over the last decade has provided an environment where rising home prices has enabled some speculative investment strategies to yield substantial profits. However, the emergence of speculators in the market is a consequence of the significant price movements which stem from the imbalance between supply and demand, rather than being the primary cause of price rises.

The severe constraints on new housing supply in Australia have resulted in speculative investment being largely contained to the established home market (foreign buyers are generally excluded from the established home market). This is a relatively unique feature of the Australian market in the international context. Contemporary examples of excessive speculative activity in residential property markets in other countries shows price growth coincided with rapid expansion in new home building which saw the housing stock eventually exceed the level required by the population (e.g. Ireland, Spain, parts of USA).

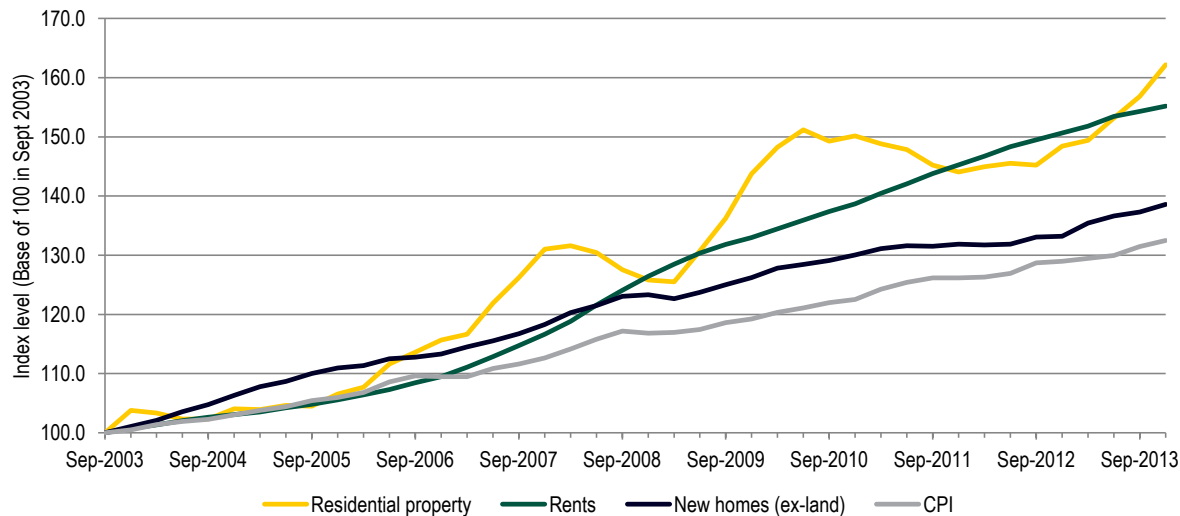
The price of new homes, excluding the cost of the land, has also grown at a rate above the rate of overall inflation (CPI) over the last decade, but the margin above overall inflation is far less conspicuous. The price of new homes (ex-land) grew by 39 percent, a growth rate only modestly higher than overall inflation where prices increased by 33 per cent. There have been innovations in building methods and materials during this period which have delivered efficiencies and acted to contain price growth. However, there are many factors that have contributed to the faster rate of inflation of new dwelling prices relative to CPI. Inter alia, technological advances, quality improvements, and energy efficiency improvements. Throughout the last decade there have been consistent developments in the regulatory environment for building new homes and these have also contributed to price inflation.

It is useful to compare the price growth of new homes (ex-land) with the broader measure of residential property price growth. The price index of new homes reflects the cost of the dwelling structure and is not affected by changes in the price of land, whereas the residential property price index reflects the combined changes in the price of the dwelling structure and land. The price of new homes (ex-land) grew by 39 per cent whereas residential property prices grew by 62 per cent. The margin by which growth in the residential property price index has exceeded growth in the price index of new homes (ex-land) provides a good proxy for the appreciation in home prices attributable to growth in the price of residential land.



Housing Price Growth Over the Last Decade

Source: HIA Economics, ABS 6401.0, ABS 6416.0



Restoration of equilibrium between supply and demand over time will reduce the profitability of speculative investment strategies; this would inevitably see a reduction in the presence of investors implementing short term speculative strategies.

Industry participants report that foreign investors in residential property tend to do so with a long term investment horizon; it is uncommon for buyers to be motivated by short term speculation on dwelling price movements.



Conclusion

In a supply constrained market additional demand is likely to contribute upward pressure to prices. This is broadly the situation in Australia's housing market; strong rates of population growth and an inadequate response in housing supply has precipitated strong price growth. If supply was able to appropriately respond to variations in demand it would enable greater price stability.

Foreign investment in residential property has, and should continue to, provide demand for residential building. The additional demand for residential building has a positive impact on the residential building sector and also contributes to higher levels of economic activity elsewhere in the economy.

Demand from foreign investors has a positive impact on the supply of housing in Australia beyond the number of dwellings purchased by foreign investors. In some circumstances foreign buyers use the property for their personal use, although the majority add to the stock of private rental accommodation. There is no evidence of widespread speculative investment activity by foreign investors in the Australian residential property market.

To improve policy measures relating to foreign investment in residential property the Commonwealth Government must first collect, collate and report accurate and timely data relating to foreign investment activity. Only when this information is available can there be a properly informed debate around policy direction.

Encouraging and facilitating private investment in owner-occupied and private rental housing can contribute significantly to the expansion of Australia's housing stock. Foreign investment has an important role to play in this. By responding to the range of matters outlined in this submission, Governments can contribute to improving the affordability of new housing and housing affordability more broadly.



References

The Centre for International Economics, 2012, *Construction and the Wider Economy: A general equilibrium analysis*, Canberra and Sydney.