PROPERTY COUNCIL of Australia

Australia's property industry
Creating for Generations

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10 November 2020

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

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

Dear Sir/Madam,

Foreign Investment Reform (Protecting Australia's National Security) Bill 2020 and Foreign Acquisitions and Takeovers Fees Imposition Amendment Bill 2020

The Property Council welcomes the opportunity to provide comments to the Senate Standing Committee on Economics in relation to its inquiry into the provisions of the *Foreign Investment Reform (Protecting Australia's National Security) Bill 2020* and *Foreign Acquisitions and Takeovers Fees Imposition Amendment Bill 2020* (the legislation).

We would like to draw the Standing Committee's attention to adverse and unforeseen consequences for the property sector in Australia that arise from the proposed changes to the fee regime and new national security framework. The Property Council does not oppose the Government's intention to provide a stronger security basis to the FIRB regime, but there are some significant implications of some aspects of the proposals – particularly the very large increase in FIRB fees for commercial property investors – which should be addressed.

Proposed fees impose a globally uncompetitive tax-like cost on real estate transactions

Fee amounts are not set out in the legislation but by way of FIRB fee regulations, and given that these regulations have not been finalised, our comments are based on the exposure draft regulations.

The cost of applying for FIRB approval for the average developed commercial property transaction under this draft fee regime is set to increase from $26,700 to $66,000 – an increase of almost 2.5 times. For investments valued at just below $1b, the proposed fee increase would be more than **nine times** the current level.

These very large cost increases for investment in commercial real estate – a very vanilla investment class from a security perspective – is not justifiable by any policy basis. These proposed increases go far beyond administrative cost recovery and would put Australia at a material investment disadvantage to other countries.

While the Government has repeatedly insisted the fees are 'consistent' with other nations, the FIRB screening regime in fact captures **40 times more** investments than the US-equivalent system and **90 times more** investments than Germany's screening process.

National security framework could capture vanilla commercial real estate transactions

Regarding the national security reforms, the Property Council respects the Government's intentions to strengthen the robustness of security assessments within Australia's foreign investment regime. However, we see no reason why much needed foreign investment in vanilla commercial real estate with little or no national security implications should be subject to the same scrutiny as investments in sensitive assets and incur the same level of FIRB fees.

The potential application of the national security test to acquisitions of commercial property which may contain sensitive data/operations appear to arise from a misconception about the nature of the landlord-tenant relationship. A landlord will very rarely, if ever, access a tenancy without the tenant present. In simple terms, while a landlord might own the 'box', it is the tenant who owns the contents. Thus, restricting the ability of foreign investors to purchase an asset because of the existing leases within that asset displays a fundamental misunderstanding of tenant rights in Australia.

Another aspect of the new changes that would materially inhibit capital to flow to the property sector is the removal of the moneylending exemption for assets deemed national security land/businesses. Trusted overseas investors, or local investors that use financing from abroad, would be disadvantaged in bidding for assets, while the fees levied on offshore money lenders would simply be passed on to Australian financiers, developers, companies and consumers.

Importantly, many of our concerns arise from the draft regulations that were released at the same time as the exposure draft legislation. These regulations fill in critical details of the overarching legislative framework, particularly with respect to the definitions of 'national security business/land' (as well as the new fees framework). The Committee should thus be aware that the final versions of the regulations have not been released and our comments in this submission are based on earlier drafts of the regulations.

Australia can and should meet national security needs without harming investment

The Property Council has concerns that some aspects of the legislation and regulation may have unintended consequences on the attractiveness of Australia for institutional, long-term investment.

These reforms, as drafted, introduce uncertainty and the additional burden of time, expense and legal risks for foreign investors, which in turn raises the risk premium of investing in Australia and deters offshore capital from making investments.

In the current economically constrained global economy, any policy change which unintentionally limits the ability for institutional investment to flow into Australia should be thoughtfully reviewed. We remain in a competition for global capital and must ensure that our investment framework is comparable to other nations with similar foreign investment review systems.

The proposed changes will reflect on Australia's standing relative to comparable jurisdictions. The new foreign investment review framework will move closer to a restrictive New Zealand-style system rather than the more open US regime, and this will have a knock-on impact on capital flows.

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Submission recommendations

In order to ensure these changes do not have unintended consequences on Australia's investment attractiveness, the Property Council's submission includes the following critical recommendations:

- Ensure the new fees framework does not impose disproportionate tax-like costs on real estate transactions, including consideration of different fee levels applied depending on the nature of the asset (i.e. whether it is deemed 'national security land/business' or not).
- Greater clarity and guidance provided in respect to the definition of 'national security business' and 'national security land' to ensure landlord transactions are appropriately differentiated from tenant/business operations particularly with respect to data centre assets. This would help provide a higher level of policy certainty to international investors that want to put capital to work in Australia.
- Reinstate the moneylending exemption for interests in national security businesses/land to keep debt financing available to these types of assets.
- Introduce an effective exemption or streamline regime to facilitate investment by trusted offshore investors, who are appropriately regulated and have a track record of investment in Australia.

International investors attracted to Australia have had to navigate a tumultuous market environment and greater policy uncertainty due to the significant foreign investment regime changes undertaken throughout 2020 and an increase in expected delays for gaining FIRB approval to up to six months. As a matter of priority, the Government should focus on implementing measures to attract and retain global capital to support jobs and investment in Australia as part of our post-COVID economic recovery.

If you have any questions in relation to this submission or would like further information, please do not hesitate to contact me directly or Richard Lindsay at [redacted] or [redacted] to arrange a time to discuss the matter further.

Yours sincerely

[redacted]

Ken Morrison
Chief Executive

Executive summary

The Property Council of Australia champions the industry that makes up 13 percent of our nation's GDP and generates over 1.4 million jobs, making this sector a bigger employer than mining and manufacturing combined. Property investment affects 14.8 million Australians through their retirement savings and is a massive driver of foreign direct investment into our nation.

The Property Council represents the leaders of this sector and has consulted widely with members, including listed and unlisted property groups, on this legislation. The comments contained within our submission highlight how the national security purpose of the framework can still be implemented without inadvertently disincentivising investment into Australian commercial property.

On behalf of our members – including institutional investors that deploy significant amounts of capital across the globe – we provide the research and thought leadership needed to help decision-makers create vibrant communities, great cities and strong economies. Crucially, we support globally competitive investment and tax settings which underpin the contribution our members make to the economic prosperity and social well-being of Australians.

In consulting with our members, we have identified a number of issues that must be addressed to ensure the legislation does not see capital driven into other international markets rather than Australia, at a time when investors are already struggling under poor pandemic economic conditions and considerable FIRB approval delays.

Aspects of the legislation and regulation could have unintended and far-reaching consequences on the attractiveness of Australia for institutional, long-term investment.

Proposed FIRB approval fees are tantamount to further taxes on foreign investors and put Australia at a material investment disadvantage. Application fees for the average developed commercial property deal are set to increase from $26,700 to $66,000 – an increase of almost 2.5 times. For investments valued at just below $1b, the proposed fee increase would be more than nine times the current level.

While the Government has repeatedly insisted the fees are 'consistent' with other nations, this ignores the fact that Australia's FIRB screening regime captured **40 times more** investments than the US-equivalent system and **90 times more** investments than Germany's screening process – meaning that the tax is levied against far more investors than in countries comparable to Australia. To claim that the new taxes are similar to other jurisdictions where far fewer investors are required to pay such levies is not entirely accurate.

Regarding the national security reforms, we respect the Government's intentions to strengthen the robustness of security assessments within Australia's foreign investment regimebut see no reason why much needed foreign investment in vanilla commercial real estate, which have little or no national security implications, should be subject to the same scrutiny as investments in sensitive assets and incur the same level of FIRB fees.

The potential application of the national security test to acquisitions of commercial property which may contain sensitive data/operations appear to arise from a misconception about the nature of the landlord-tenant relationship. A landlord will very rarely, if ever, access a tenancy without the tenant present. In simple terms, while a landlord might own the 'box', it is the tenant who owns the contents. Thus, restricting the ability of foreign investors to purchase an asset because of the existing leases within that asset displays a fundamental misunderstanding of tenant rights in Australia.

Another aspect of the new changes that would materially inhibit capital to flow to the property sector is the removal of the moneylending exemption for assets deemed national security land/businesses. Trusted overseas investors, or local investors that use financing from abroad, would be disadvantaged in bidding for assets, while the fees levied on offshore money lenders would simply be passed on to Australian financiers, developers, companies and consumers.

The new FIRB regime, set to start on 1 January 2021, will reflect on Australia's standing relative to comparable jurisdictions. The new foreign investment review framework will move closer to a restrictive New Zealand-style system rather than the more open US regime, and this will have a knock-on impact on capital flows.

Addressing any investor uncertainty should be a key priority for government at a time when Australian businesses are desperate for capital as they set themselves up for the post-pandemic recovery.

The Property Council recommends that:

- The new fees framework does not impose disproportionate tax-like costs on real estate transactions, including consideration of different fee levels applied depending on the nature of the asset (i.e. whether it is deemed 'national security land/business' or not).
- Greater clarity and guidance is provided in respect to the definition of 'national security business' and 'national security land' to ensure landlord transactions are appropriately differentiated from tenant/business operations particularly with respect to data centre assets. This would help provide a higher level of policy certainty to international investors that want to put capital to work in Australia.
- The moneylending exemption is reinstated for interests in national security businesses/land to keep debt financing available to these types of assets.
- An effective exemption or streamline regime is introduced to facilitate investment by trusted offshore investors, who are appropriately regulated and have a track record of investment in Australia.
- The new Register of Foreign Ownership of Australian Assets does not include interests which are not direct ownership stakes, e.g. leases.
- Provisions regarding buy-backs of securities and capital reductions are wound back or, at the least, no fees are imposed on impacted investors.
- Increase the ownership threshold for investments into locally managed AFSL-compliant funds where there is no involvement in the management and control of the fund by the foreign investor.
- Set the time limit for use of the 'call-in' power to a maximum of three years, rather than the proposed 10-year period.
- Other general areas for improvement to the foreign investment framework.

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1. Foreign investment into the Australian commercial property sector

Foreign investor demand for commercial property asset in Australia has been strong over many years. According to FIRB data, $242 billion of foreign investment in commercial real estate has been approved over the five-year period from 2014-2019.[1] This is a substantial amount of capital that has had a direct impact on the property/construction sector and the overall economy.

Investors are drawn to Australia’s commercial property sector because of the scale of opportunities that are available across office, industrial, retail and more niche subsectors, and the professional management of both on-the-ground assets and the funds that invest in those assets. Australia’s profile as a mid-size developed and open economy with proximity to the Asia region is also a major drawcard for offshore capital.

According to RBA analysis, that strong investor demand has resulted in a stable market for commercial property, a rise in capital values over the long term, and had a positive effect on construction activity and employment.[2]

With more capital being invested into the Australian property sector from offshore every year, foreign policy changes have been undertaken over recent years to scrutinise investments that meet specific criteria. The sector in 2015 saw a number of foreign investment reforms, part of which focused on establishing monetary thresholds for determining which investments into commercial property would require FIRB approval.

Thresholds for foreign investment into land ranged from $50 million to $1,094 million depending on who was acquiring the land and the kind of land that was being acquired. For non-vacant commercial land, the monetary threshold was set at $252 million for most investors (i.e. those not from Chile, Japan, Korea, New Zealand or the United States), or $55 million from land where circumstances of particular significance existed – referred to as low threshold land. For example, land specifically fitted out for a business that provides storage of bulk data would be deemed low threshold land.

This essentially created a two-tiered system for foreign commercial property investors, with opportunities to invest into land that was deemed ‘sensitive’ (i.e. low threshold land) requiring careful consideration, including taking into account how long FIRB approval may take, before an investment would be made. But this was also a positive change as it allowed for more investment to flow to non-sensitive property assets.

Over the years, international investors have become more accustomed to Australia’s foreign policy framework and the two-tiered system for assessing investment opportunities in Australian real estate assets. However, the announced national security changes create another layer of complexity with the introduction of the concepts of ‘national security business’ and ‘national security land’. This is likely to cause significant confusion and uncertainty as investors would have to grapple with three layers of potentially overlapping categories when assessing the regulatory impact of a particular asset or investment opportunity. Adding additional

[1] *FIRB Annual Report 2018-19* and *FIRB Annual Report 2017-18*

[2] *Foreign Investment in Australian Commercial Property*, RBA Bulletin, September Quarter 2014

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complexity to a system in the middle of a global-pandemic that has pitted Australia in a fight for global capital only acts as a further deterrent for investors.

In section 4 of our submission, we make recommendations regarding the problems that may arise by instituting multiple definition and tiers of regulatory oversight.

How the proposed changes reflect on Australia's position compared with other jurisdictions should also be accounted for, as capital is fluid and will flow to jurisdictions depending on their regulatory settings and market. Below is a table which sets out how the proposed foreign investment review framework compares with the US and New Zealand (countries that are considered comparable markets by investors):

Feature of system	Australia	US	New Zealand
Maximum timeframe for a decision	90 days	90 days	No mandated timeframe
Monetary thresholds (real estate / commercial land)	• $0 for national security business/land, vacant commercial land, or for interests held by foreign government investors • $60m for low threshold land • $275m for most foreign investors • $1,192m for investors from agreement countries	No monetary thresholds apply	$0 for 'sensitive' land*
Review of property transactions	Yes for national security land or assets above monetary thresholds	Only for assets located near sensitive US military and government facilities or critical infrastructure	Yes for 'sensitive' land*
OECD FDI Regulatory Restrictiveness Index (higher number = more restrictive)	0.15	0.09	0.24

** The definition of 'sensitive' land in New Zealand is particularly complex and the Overseas Investment Office strongly recommends that applicants consult a lawyer (or other land professional) with significant experience in overseas investments if in doubt.*

New Zealand, despite its developed and market-based economy, has gained a reputation for being a restrictive market for foreign investment. According to the OECD's Foreign Direct

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Investment Regulatory Restrictiveness Index[3] for 2019, New Zealand ranked the most restrictive out of all other developed countries while Australia ranked 4th most restrictive.

The table above demonstrates that, while not as restrictive as New Zealand, Australia's foreign investment review system is more complex and has higher barriers than the US. As more regulation and oversight is imposed on flows of foreign capital into Australia, we run the risk of developing a reputation as a difficult market for investment that is best avoided. That would be devastating for a net capital importer economy like Australia.

As Australia's foreign investment policy framework has developed over recent years, international investors have become more attuned to the multitude of changes announced over recent months. Uncertainty due to ever-shifting policy settings and a volatile global market environment has also raised the opportunity cost for investors to buy assets in Australia compared with other jurisdictions.

It has also affected the ability of vendors, in most cases Australian businesses, to commercially negotiate with buyers because of the heightened risks and extended timeframes for approval. Australian businesses are losing out to jurisdictions that are able to offer less bureaucratic and quicker approvals, notwithstanding that some jurisdictions do not have any foreign investment review regime at all.

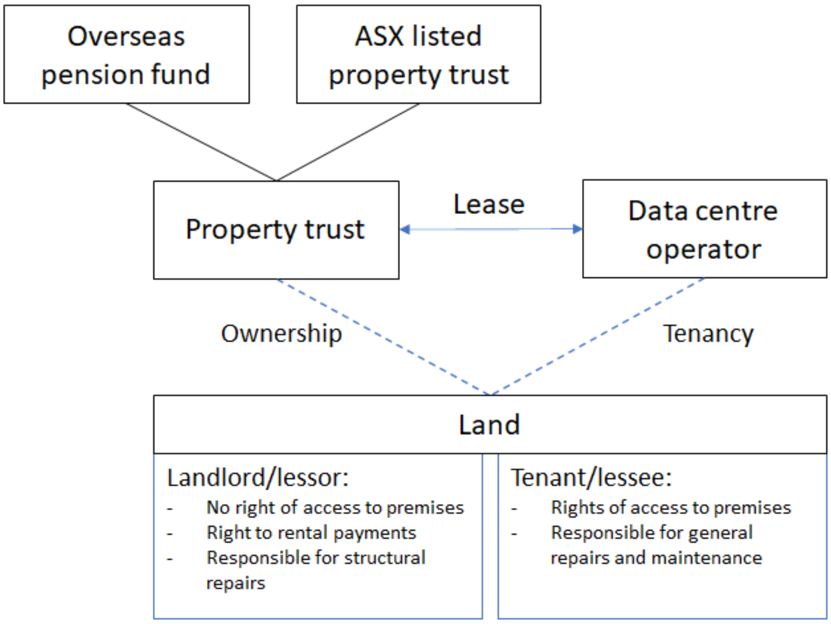
We urge the Government to be mindful of the commercial impact of policy design, particularly in a vital economic area like foreign investment as our economy begins the slow recover post-COVID.

2. The landlord-tenant relationship in the context of commercial property

It is important to understand the relationship between commercial landlords and tenants, and what role foreign investment plays in that relationship. Below is a diagram which sets out a typical arrangement between a property trust as the landowner and a tenant (in this case a data centre operator).

[3] https://goingdigital.oecd.org/en/indicator/74/

Commercial property ownership and lease example



It is helpful to highlight the rights and responsibilities of both a landlord and tenant under a standard commercial tenancy agreement. Landlords will generally have no rights of access to premises once the lease period begins, and only in extreme circumstances (e.g. premise abandonment or tenant bankruptcy) would a landlord be permitted unsupervised access to a leased property. Government tenants will also have their own set of terms and conditions that must be included in tenancy agreements; such terms and conditions can be particularly stringent given the sensitive nature of many government functions.

It appears that concerns around landowner access to sensitive data/operations arise from a misconception about the nature of the landlord-tenant relationship. A landlord will very rarely, if ever, access a tenancy without the tenant present. In simple terms, while a landlord might own the 'box', it is the tenant who owns the contents. Thus, restricting the ability of foreign investors to purchase an asset because of the existing leases within that asset displays a fundamental misunderstanding of tenant rights in Australia.

Foreign investment issues may arise with respect to both the landlord and the tenant in this arrangement if either entity is deemed a foreign person. For landlords, feedback from our members has noted that conditions imposed on landowning entities or entities further up the chain of ownership (e.g. an overseas pension fund, as shown in the diagram) are unnecessary. Examples of incongruous conditions include preventing access to land by directors of foreign entities that hold passive interests in pooled property funds. The implication that an international investment trust or its associates have any interest in the daily operations of a tenant who may or may not be a government agency or data centre operator highlights a fundamental misunderstanding of a landlord's commercial practices.

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This experience aligns with the views of the Productivity Commission,[4] which found that too many conditions were imposed through the foreign investment screening process. It stated that:

> *Conditions that duplicate existing legal requirements on businesses operating in Australia add to the regulatory burden without delivering additional benefits.*

In Section 4 of our submission, we make recommendations regarding the issue of conditions imposed as part of the foreign investment review framework.

Tenants that are deemed foreign have for the most part avoided the need to go through FIRB approval until the recent introduction of COVID-related temporary FIRB measures, namely the $0 monetary thresholds. At a time of falling rental incomes and asset values, this has added further complexity and undue compliance cost/burden on the property sector at a time when it can ill afford it. Another recommendation is also made with respect to the value of leases for fee calculation purposes.

3. Issues to address in the legislation or regulations

Set out below are the key issues that should be addressed in the legislation and draft regulations giving effect to these latest foreign investment reforms.

3.1 Definition of 'national security business'

The proposed definition of 'national security business', in the sector's view, runs the risk of being interpreted too broadly to capture interests and assets that wouldn't normally warrant national security concerns – including data centres, government office tenants and any operation that could, unbeknown to the landlord, house information considered sensitive.

It will be challenging for any investor to determine definitively whether a proposed acquisition falls within the definition given the absence of public registers for critical infrastructure, carriage services providers or land used for defence purposes.

We particularly highlight that our members and other institutional investors are not in a position to make an assessment on the detriment to national security in light of how broad and uncertain the definition is as currently drafted:

- a business which provides goods, technology or services for both civilian and military purposes may be captured under the criteria of "military end-use". The scope of the definition under these reforms is even broader than existing regimes such as Defence Export Controls, and
- the reforms tie the definition of a 'national security business' to a holder in a critical infrastructure asset as defined under the *Security of Critical Infrastructure Act 2018*. We note that the Department of Home Affairs is currently undertaking consultation on protecting critical infrastructure and systems of national significance, which could both increase the scope of the regime and uncertainty for our members.

[4] *Foreign Investment in Australia – Commission Research Paper*, June 2020, Productivity Commission

Thus, we believe that the proposed definition (as previously set out in the exposure draft regulation) doesn't conform to the policy intent of the broader reforms and would have unintended consequences for the flow of capital into Australia.

It further heightens uncertainty for investors about investing in Australia, reservations which have already been rising due to the temporary COVID-related FIRB measures. These temporary measures include the lowering of dollar thresholds to zero, and other provisions in the legislation such as the call-in powers that allow a review of any investment which is not otherwise notifiable or already subject to FIRB oversight on national security grounds.

Of most concern to the property sector are: (1) the treatment of data centres, and (2) the effect of having government agencies or national security businesses as tenants.

The broad nature of the definition also leads to extraterritoriality concerns. The application of the tracing rules to a "notifiable national security action" means that offshore acquisitions will be captured and the mandatory notification could be triggered by an acquisition of 20% or more interest in an offshore entity which has an Australian "sensitive national security business" within its controlled group structure. Even with prudent due diligence, the broad scope of the definition means there is uncertainty as it is not clear what is and is not caught by the reforms.

We believe it would be beneficial to amend the proposed definition or clarify its narrow scope via either the Explanatory Memorandum or a guidance note.

The treatment of data centres

Of prime concern is the potential impact on investment in data centres as a distinct real estate asset class. This arises due to the inclusion in the 'national security business' definition of entities that store or have access to sensitive information, including certain types of personal information. In comparable countries in our region (e.g. Singapore, Japan) no such provisions for specific real estate asset classes exist.

We do not believe it is the intent of the legislation to capture the ownership of land that is used as a data centre in the definition of 'national security business', noting that the party that only owns the land is in the business of collecting rent and not the provision of data storage services for sensitive information.

Data centres are growing in prominence around the globe. Demand for the sector is being driven by more people working from home with an increase in demand for cloud storage. Sydney alone saw total data capacity rise by 76% from Q1 2019 to Q1 2020.[5]

Noting this and the importance of the continued assembling of capital to invest in this vital economic infrastructure, we believe it would be beneficial to remove any confusion in this regard by way of clarification in either the Explanatory Memorandum or in a guidance note.

Government agencies or national security businesses as tenants

Further guidance is sought to help the property sector determine how having certain tenants would affect the landlord or asset that is being leased. The below example illustrates the need for greater clarity.

[5] *Asia Pacific Data Centre Trends*, H1 2020, CBRE Research

Office buildings with government tenants (e.g. national security agencies or government agencies that hold sensitive data) that provide onsite data storage facilities incidental to the office lease may fall into a category of 'national security business'. Thus, a foreign investor taking a direct interest in such an office building would need to seek FIRB approval. We believe that this case doesn't warrant FIRB notification because of the incidental nature of those data storage facilities and the inability (both legally and physically) of landlords to gain access to the facilities.

Nonetheless, we seek further clarity and guidance, particularly by way of examples of what would and would not be caught by the definition.

3.2 Definition of 'national security land'

The proposed definition of 'national security land' is likewise very broad. It is unclear whether this definition is met in certain circumstances.

For example, the second category – land in which an agency of the national intelligence community has an interest – could be interpreted to include office buildings which are leased to one of the ten agencies in the national intelligence community.

Separately, it is unclear if land that is adjacent to other 'national security land' would also be considered 'national security land'.

It is the view of the Property Council that the land in both of these cases should not be considered 'national security land' because of the incidental nature of those assets to national security matters. To use a previous analogy to illustrate this point, while a landlord might own the 'box', it is the tenant who owns the contents and landlords would almost never have access to those contents without a tenant's consent. The Property Council seeks further clarity and guidance regarding this definition, with clear examples provided.

In addition, there seems to be an inconsistency in the legislation as it sets out that a 'notifiable national security action' would involve a foreign person acquiring an interest in national security land, as opposed to a *direct* interest in a national security business.

The meaning of 'interest' in Australian land under the *Foreign Acquisitions and Takeovers Act 1975* is extensive and includes legal and equitable interests, options, and leases of greater than five years.

This wording could result in foreign investors that are seeking to hold indirect ownership (such as through a real estate investment trust or other pooled and professionally managed fund) in the relevant real estate being required to seek FIRB approval before investing in those trusts or funds. Foreign persons taking out leases in the same real estate would also be required to seek FIRB approval.

We would urge the relevant part of the legislation (Part 1 s.7 of *Foreign Investment Reform (Protecting Australia's National Security) Bill 2020: National security reviews and last resort power*) to be changed to the following:

> ***notifiable national security action*** *means any of the following actions taken, or proposed to be taken, by a foreign person:*
>
> > *(a) to acquire a direct interest in a national security business;*
> >
> > *(b) to acquire legal title to an interest in Australian land*

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3.3 New fees regime

We are deeply concerned about proposed FIRB approval fees which are tantamount to further taxes on foreign investors and put Australia at an investment disadvantage. Proposed fee amounts are not set out in the legislation but by way of FIRB fee regulations, and given that these regulations have not been finalised, our comments are based on the exposure draft regulations.

Investors would be hit hard by these proposed increases in FIRB fees. Application fees for the average developed commercial property deal are set to increase from $26,700 to $66,000 – an increase of almost 2.5 times. For investments valued at just below $1b, the proposed fee increase would be more than nine times the current level.

While the Government has repeatedly insisted the fees are 'consistent' with other nations, this ignores the fact that Australia's FIRB screening regime captured **40 times more** investments than the US-equivalent system and **90 times more** investments than Germany's screening process – meaning that the tax is levied against far more investors than in countries comparable to Australia. To claim that the new taxes are similar to other jurisdictions where far fewer investors are required to pay such levies is not entirely accurate.

A comparison table of different foreign investment screening regimes is provided below:

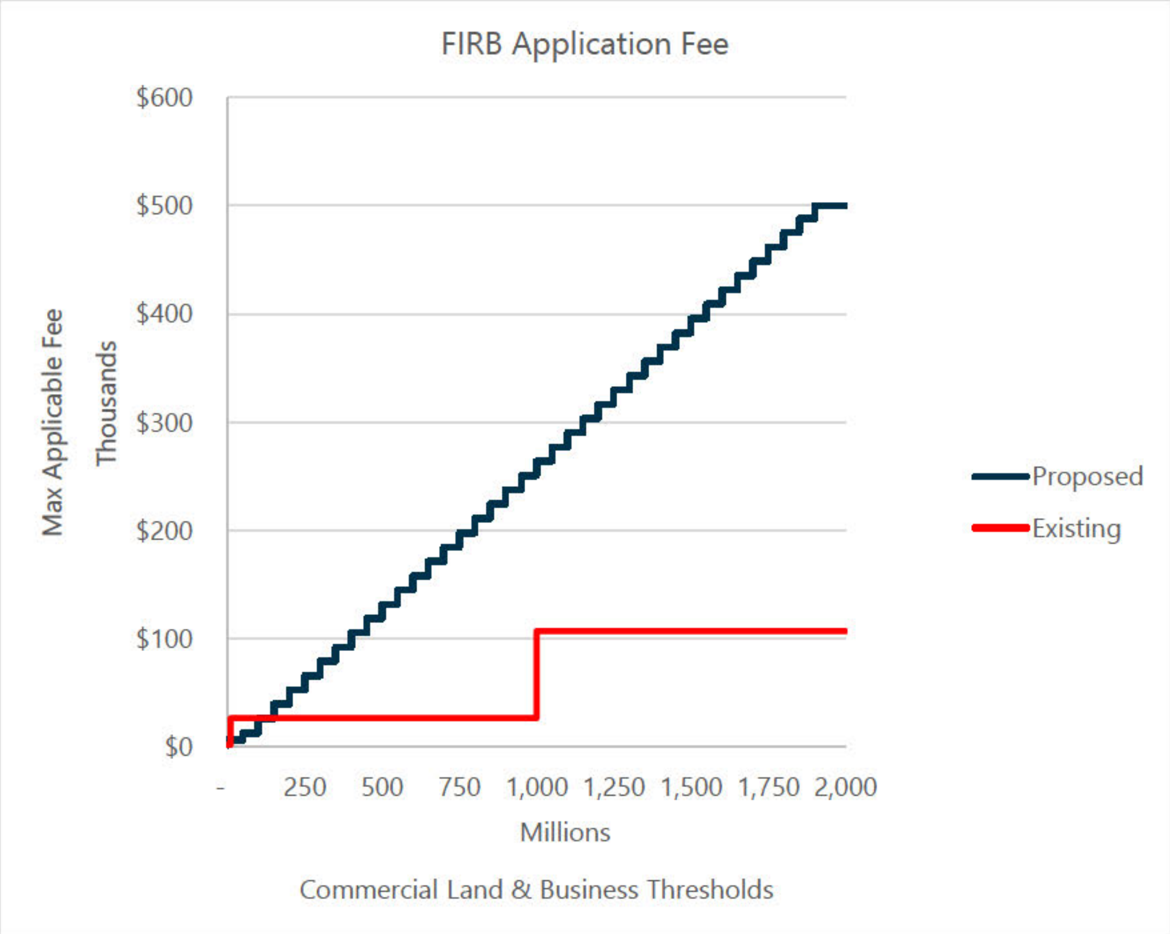
	No. of cases reviewed, 2018/19	Application fees levied	Real property assets require screening
Australia	9,466	Yes	Yes
US	231	Yes	Only property near sensitive locations and with certain rights
Germany	106	No	No
New Zealand	327	Yes	Yes
Canada	962	No	Yes

It is the view of our members that the proposed changes to FIRB application taxes, which see a significant increase in the quantum of fees being levied for mid-size and large investments, discourages the very investment Australia requires to support economic recovery and needs to be seriously reconsidered by the Government. These tax hikes are the equivalent of adding an extra stamp duty on foreign investment in Australia.

We note with concern the significant application fee increases that will be imposed with the start of the new foreign investment framework on 1 January 2021 on transactions above $150m.

The FIRB Annual Report for 2018-19 shows that based on approvals, the average deal size in commercial developed property was $264m. Commensurate fees for the average developed commercial property deal will thus increase from $26,700 to $66,000 – an increase of almost 2.5 times. For investments valued at just below $1b, the proposed fee increase would be more than nine times the current level.

The below chart demonstrates how disproportionate the proposed fees are for larger institutional-level investments compared to current fee levels:



Coupled with measures to extend the statutory decision period for some applications by up to 90 days, offshore investors will be faced with unreasonable fee increases and time delays when considering investing in Australia, motivating them to seek other investment destinations instead.

Currently, foreign investors will often put in an early application to FIRB for competitive bids, in order to allow the approval process to be completed ahead of settlement. However, given the increase in fees for transactions that may not be successful, it is unlikely that investors will begin the approval process until they are certain the transaction will go through.

This means we will see time frames for transactions blow out as foreign investors apply for FIRB approval later in the process. This creates a downstream impact for Australian entities and investors because foreign bidders are disincentivised from competing in the Australian market and vendors of assets (typically Australian businesses) would lose much of the competitive and pricing tension that comes from a larger pool of potential buyers. Ultimately, local businesses and investors will lose out on getting the best possible price.

This will also significantly disadvantage Australian property funds that rely on global capital partnerships to support their continued development and investment in the commercial real estate assets that are essential to our cities and regions.

Fees for exemption certificates (ECs) amount to 75% of the fee that would be paid for an investment of a value equal to the monetary limit set under that EC. We believe that this is nonetheless a significant impost that an investor would have to pay upfront before a single investment is even made. Unforeseen circumstances or risks (including sovereign risks) may mean that the investments made under an EC are much lower than the EC's monetary limit. Thus, many investors would be deterred from taking out ECs altogether. Further, investors who undertake a number of transactions a year and aren't able or willing to get an EC will be slugged multiple times – which is a huge disincentive for the large, trusted investors we need in Australia to re-boot the economy post-COVID. The Government would effectively be 'double dipping' and taxing trusted and large-scale investors potentially several times a year.

While we understand that these major reforms will increase regulatory oversight and will require more resources, higher application fees would encourage investors to look at other markets that aren't as costly as Australia.

We are also deeply concerned that the new fees framework creates significant misalignment of fees imposed on applicants with the cost of administering the foreign investment regime and will turn away investment at a critical time for Australia's economic recovery.

The Productivity Commission has recently highlighted how problematic foreign investment fees have become since they were introduced in December 2015[6]:

> *These are taxes, not a fee for service.* ***They are set at levels that are out of proportion with the cost of delivering the regulatory regime****. In 2017-18, the government collected $114 million in fee revenue, while the operational costs of FIRB and its secretariats in the Treasury and the ATO totalled only $14.7 million.*
>
> *They are also likely to be fairly inefficient taxes.* ***Taxing foreign businesses reduces foreign investment, leading to lower Australian wages and incomes****. The much higher fees on (small) agricultural investment applications than on other business applications have the potential to detract from growth in regional communities.*
>
> *The Commission, in its Regulation of Australian Agriculture inquiry, recommended that the Australian Government should set application fees for foreign investment proposals at the level that recovers the costs of administration, and closely monitor the fees so that there is no over- or under-recovery of costs.* ***The case for reform has not changed since that inquiry, and if anything, it has strengthened****. (emphasis added)*

[6] *Foreign Investment in Australia – Commission Research Paper*, June 2020, Productivity Commission

We agree with the Productivity Commission's findings with respect to the fees regime and would urge Treasury and the Government to reconsider and restructure the proposed fees regime.

Thus, we recommend that the fees regime is restructured as follows:

- The Government's proposed fee regime remains but only applies to transactions which require full security assessment by Treasury and other agencies (e.g. sensitive land uses and transactions regarding national security assets.)
- A dedicated, lower cost pathway for trusted investors who are purchasing vanilla assets (e.g. office, residential, retail strip malls, etc.) or investing in funds run by AFSL-compliant managers is provided with lower fee levels.
- A discount is applied for recurring trusted investors who undertake a number of transactions a year to ensure they are not taxed multiple times a year.
- Interests acquired through a moneylending agreement – which are deemed notifiable actions with respect to national security businesses/land – should be exempt from fees altogether to preserve liquidity and reduce costs for consumers in Australia's property sector during COVID-19.

3.4 Exemptions or streamlined approval for trusted foreign investors

The Property Council acknowledges the rationale for a strong national security framework and we believe that it can operate without resulting in undue costs and burdens that would discourage investment by foreign capital, particularly from institutional investors.

We believe that a broad, investor-specific exemption certification should be available to give investor certainty for low risk institutional investors who are appropriately regulated and have a track record of investment in Australia.

Any exemption should operate at the investor level, rather than at an asset or portfolio level, so that the managers may operate within reasonable cost and approval time parameters. The exemption should be granted on a case-by-case basis to each regulated investor once the Treasurer (on the advice of FIRB) is satisfied that the organisation does not pose a national security risk.

In relation to any exemption, the following factors would indicate that the investor does not pose a national security risk:

- is headquartered in a country with which Australia has a strong relationship with (e.g. the United Kingdom or United States); and
- is subject to a comprehensive and robust regulatory regime governing their funds management and investment activity, which would include in Australia by the Australian Securities and Investments Commission and in their home jurisdiction by equivalent regulators such as the Securities and Exchange Commission or the Financial Conduct Authority; and
- acts as a fiduciary that has a broad and wide client base and has statutory and common law duties to act in the best interests of their underlying clients - the primary objective is to secure better financial futures for their clients and the people they serve, rather than to pursue political or strategic objectives through their investments; and

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- has a proven track record in investing in Australian assets (including land).

The exemption certificate would need to be practicable for the exempted entity, acknowledging that such investors would be practically restricted in the number of transactions that are completed each year and the number of assets or interests that are held in each underlying fund or portfolio.

It is also important to note that whilst these professional investors will often have a clear set of investment criteria, they may not know the exact investments or the sub-sectors that they wish to invest into.

Alternatively, streamlined approval should be given to these institutional foreign investors whenever an individual application is made, as part of the Government's measures to streamline less sensitive investments and similar to the proposed streamlining of investments made by some investment funds that are currently defined as 'Foreign Government Investors'.

3.5 Register of Foreign Ownership of Australian Assets

We have strong concerns about the provisions relating to the Register of Foreign Ownership of Australian Assets, establishing a register to record certain events such as the acquisition or disposal by a foreign person of interest in land or water, an Australian business, agribusiness or entity.

These provisions would unduly increase the compliance burden and cost on existing foreign investors. They are retrospective in nature as they would impose an obligation related to past actions that were made prior to the prospect of a register.

It may also deter future investment as prospective investors may have concerns that the register could be used outside of its stated mandate or even made public in the future.

At the very least, the register shouldn't include interests which are not direct ownership stakes but which may still be considered interests (e.g. leases of over five years).

3.6 Capital reductions and buybacks

The Property Council has concerns with the provisions related to capital reductions and buybacks. These proposed measures would have the effect of capturing some foreign investors and their interests even though no action has been taken by those investor (e.g. by not participating in a share buyback).

This is an unreasonably onerous piece of compliance for investors to abide by given the passive nature (i.e. *inaction*) of what would constitute a notifiable and/or significant *action*. We recommend that these provisions are taken out of the final version of the legislation.

Fees would also be payable in such circumstances, which we believe is inequitable for the impacted investors. At the least, no fees should be imposed on impacted investors.

3.7 Restrictions on fund investments

Foreign investment into locally managed funds also have to get FIRB approval even in instances where those investors would have no influence or control over the fund.

Currently, there is an exemption from FIRB if an investor holds less than 5% in a wholesale fund, but we believe that this threshold should be higher (at least 10%). This would reflect the different risk profile of an investor coming into an Australian wholesale fund (thereby managed

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by an AFSL holder) and owning a minority position compared to a foreign buyer owning and controlling an asset directly without the oversight that an AFSL holder would abide by.

3.8 Moneylending arrangements

The existing exemption for foreign money lenders will be removed, which would mean that syndicates with foreign lenders will be caught up having to seek approval and paying FIRB fees for investments in sensitive/national security assets.

Given the conservative lending habits of domestic banks towards commercial transactions since COVID hit, this could lead to a liquidity issue in Australia.

Further, it is likely that higher fees on money lenders will simply mean that costs are shifted down the line, onto Australian financiers, developers, companies and consumers. When costs are levied against financiers these new charges are ultimately born by the consumer. Given that the Government is trying to make it easier for Australians to access credit, the new taxes being applied to money lenders is contradictory to the very policies they claim to engender.

3.9 Call-in power

The Treasurer's 'call-in' power to review certain actions that don't fall under other national security provisions is an extraordinary measure that has increased investor concerns about Australia's sovereign risk.

Of most concern – apart from the broad discretion given to the Treasurer to call in investments – is the ten-year time frame set for the 'call-in' power. We believe that is far too long and, coupled with the broad nature of the power, creates significant investor uncertainty. The time limit should instead be set at a maximum of three years.

4. Other recommendations to improve the foreign investment framework

The Property Council offers a series of additional recommendations to improve the foreign investment framework separate to our comments and recommendations in the preceding section.

4.1 Adjusting asset categories

Firstly, the issue discussed in Section 1 of this submission covers the multiple definitions and tiers of regulatory oversight that have been created as Australia's foreign investment framework has evolved over the years.

To address the confusion and uncertainty faced by foreign investors as a result of multiple and overlapping definitions and categories for property assets, and allow FIRB to allocate their resources to higher priority matters, the Property Council recommends that:

(a) the pre-COVID monetary thresholds with respect to non-vacant commercial property are increased to minimise FIRB approval requirements for non-sensitive commercial transactions, and

(b) that the 'low threshold land' category is rationalised to remove any overlap between that category and the national security land/business categories.

4.2 Avoiding imposition of unnecessary conditions

Secondly, the issue discussed in Section 2 of this submission focuses on unnecessary conditions being imposed as part of the FIRB approval process. In line with the views of the Productivity Commission, the Property Council recommends that conditions which duplicate existing legal requirements are not imposed as part of giving FIRB approval. Conditions which are incongruous with standard agreements and commercial practices should also not be imposed, or good reasons should be provided to applicants about why such conditions are necessary.

4.3 Calculating the value of leases

The method of calculating the value of leases for fee purposes and future threshold purposes is also a challenge for investors and we recommend that a net present value for leases be adopted instead of the current method described in FIRB Guidance Note 33.

4.4 Increasing data and awareness

Firstly, we would be supportive of government providing greater levels of data on foreign investments – properly anonymised to not disclose commercial in confidence information.

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.

4.5 Clear messaging that Australia is open to investment

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.

Policy 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 tax surcharges 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 affected Australia's standing as a jurisdiction with low political and government risk for investors.

It is now 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.