

RESIDENTIAL RESEARCH



STRENGTHENING THE FOREIGN INVESTMENT FRAMEWORK

AUSTRALIAN MARKET INSIGHT MARCH 2015

THE AUSTRALIAN GOVERNMENT IS CURRENTLY SEEKING COMMUNITY COMMENTS ON PROPOSED REFORMS TO AUSTRALIA'S FOREIGN INVESTMENT FRAMEWORK.

KEY FINDINGS

The Government is seeking community comments on proposed reforms around Australia's foreign investment framework

The fees suggested to be payable on application, are significantly higher than the modest administration fee recommended by the House of Representatives Standing Committee on Economics

Reforms include increasing compliance and enforcement activities via a specialised investigative and enforcement area within the Australian Taxation Office

The Australian Taxation Office (ATO) is nominated to be the best place to enhance data collection across departments and capture purchaser information such as nationality

New civil and increased criminal penalties will be introduced for foreign investors and third parties breaching foreign investment rules and power given to the ATO

The closing date for submissions is Friday 20 March 2015; when submissions will be made available on the Treasury website



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THE CONSULTATION PROCESS BEGINS

The Government has reviewed the twelve recommendations put forward by the House of Representatives Standing Committee on Economics and delivered a reformed foreign investment framework for consideration by the Australian community.

After community pressure on the Government to provide clarification on the role foreign investment plays in residential property, on 19 March 2014, the Treasurer, the Hon Joe Hockey MP commissioned a study to be undertaken by the House of Representatives Standing Committee on Economics (the House Economics Committee).

For many years, the framework has been undermined due to poor data collection, along with lack of audit, compliance and enforcement by the Foreign Investment Review Board (FIRB). The committee stated that Australians are entitled to expect that the rules are properly enforced given that Australian taxpayers currently pay for administration costs, as no fees are currently paid for foreign investment applications or purchases.

The inquiry findings were delivered on the 27 November 2014, with support to retain the current framework with 12 practical recommendations (see page 6). After considering the recommendations, on 25 February 2015, the Government released an *Options Paper*, open for public discussion titled, "Strengthening Australia's Foreign Investment Framework".

Initial response from the property industry

Developers, agents and property industry bodies were surprised by the scale and extent the Australian Government are suggesting reforming the Australian Foreign Investment Framework after many years of loose policing. In many instances, the *Options Paper* is going above and beyond the recommendations suggested by the House Economics Committee, as outlined below.

The inclusion of commercial property

As expected the Government has included residential and agricultural properties in its proposed reform, but are now also proposing the framework extends to include the business and commercial real estate sectors.

The introduction of fees

The Government has proposed the introduction of foreign purchaser fees; varying for each sector (refer Page 5). At present, no fees are payable for foreign investment applications in Australia. The House Economics Committee recommended a modest AUD\$1,500 administrative fee to assist the current screening for all foreign purchases of residential real estate.

For residential real estate and rural land acquisitions, the fees start from AUD\$5,000 for properties valued under AUD\$1 million, to a fee of AUD\$10,000 for properties valued equal or greater than AUD\$1 million; increasing in increments of up to AUD\$10,000 for each additional \$1 million in property value.

For example:

- > Property valued at equal or greater than AUD\$2 million = AUD\$20,000 fee paid
- > Property valued at equal or greater than AUD\$4 million = AUD\$40,000 fee paid

It would be quite common that multiple applications would be required if a foreign purchaser is bidding at several auctions over a weekend. Given these proposed fees are structured to be paid

per property application, these fees could add up significantly without a property contract even being signed. The Government have acknowledged this scenario by stating that they will consider options to minimise the impact on these applicants, but have neglected to provide a solution to this issue within the proposed paper.

Business, commercial real estate and agribusiness investments would also be subject to application fees between AUD\$10,000 up to AUD\$100,000 depending on the size and sector.

The flat fee of AUD\$25,000 to be imposed for commercial real estate took many agents by surprise given the House Economics Committee were not asked to consider business and commercial real estate in their inquiry. This fee is likely to be a small percentage against the overall sale price and essentially a non-deterrent, but nonetheless, we don't feel an administration fee on commercial real estate was required given this market is already quite transparent.

Tightening off-the-plan certificates

Given foreign investors can only buy new properties and tend to be attracted to developments larger in scale, many will bypass a direct application fee as developers continue to apply for off-the-plan certificates on behalf of their buyers. So many of these fees are likely to be absorbed by the developer and/or incorporated into the purchase price.

Currently, property developers can apply for advanced off-the-plan certificates for foreign investors in a development of 100+ apartments. Tightening the rules around off-the-plan certificates to ensure that developers comply with their obligations was raised by the House Economics Committee in November.

The Government has followed up by subjecting developers to both civil and criminal penalties under their new plan, as well as, limiting the value of all apartments purchased by a single foreign investor to \$3 million in any individual development. Individual approval can then be sought once the threshold is reached, increasing accountability.

Funds to support administrating better practice

The Government state that they continue to welcome foreign investment into Australia, given its significant role in stimulating the local economy. They say fees suggested are not designed to deter foreign investment, rather to build an administration fund towards a better collation of data and more efficient compliance and enforcement. Tracking foreign purchasers has long been overdue in the Australian market. Not having this historic data makes it incredibly hard to profile the foreign buyer and make sense of distinguishing between real foreign purchasers and third-generation Australians.

The Australian Taxation Office (ATO), in consultation with Treasury and other relevant agencies, has been nominated to administer the new compliance and enforcement area. Utilising the sophisticated data matching systems already available in-house to detect instances of potential non-compliance with the foreign investment rules, drawing on the states and territories, its own taxpayer information, foreign investment approvals data and immigration movements data.

If the pace of foreign investment continues to that experienced of late, the Government will be collecting a healthy untapped revenue. We hold hope this isn't a short-term revenue raising operation by the Government, in an East Coast heated market, and that this well-overdue system will be strategically designed to support a long term future use; even as the market ebbs and flows.

Penalties to reinforce the foreign investment rules

The Government is proposing that the *Foreign Acquisitions and Takeovers Act 1975* and the *Taxation Administration Act 1953*, an Instrument under the *Migration Act 1958* and any other relevant legislation, be amended to provide for increased criminal and new civil penalties and infringement notices. This extends to third parties who aid the foreign

purchaser in not complying with the rules. It is envisaged that possible breaches would be followed up by compliance staff within the ATO, with a new range of penalties to be applied. Refer to Page 4 for the proposed range of penalties.

What will be the impact going forward for residential property?

On announcing the *Options Paper* for discussion, the Government alluded to the struggle of local home ownership being a consequence of foreign investors breaking the current rules. The House Economics Committee report found that foreign investment had minimal impact on the ability for first time buyers to enter the housing market. So enforcing penalties and introducing application fees, will not necessarily result in, a surge in first time buyers.

Australia is not the only market that foreign purchasers are looking to invest globally, so if the issue of paying multiple application fees impacts the overall weighting to purchase price and the process becomes very hard to comply, then alternative countries may be considered to build property portfolios. We don't believe the proposed fees are as harsh as those foreign investors going into the Singapore and Hong Kong markets. Over the last year, many foreign investors have widened their scope to include Australia to avoid the higher costs associated with these countries. These fees were introduced as a cooling measure, which has greatly impacted local property markets.

A safeguard investment in the Australian property market, a rise in the middle class across Asia, a fall in the Australian dollar and the fear of political instability will continue to be main drivers for foreign buyers and many are willing to pay a premium for this security. Being predominately cash buyers, we don't feel an additional fee paid at the time of application, which is a small fraction of the overall purchase price, will deter those who desire the Australian lifestyle and buying into areas close to first-class education facilities for their children, and in clean environment for the family.

PROPOSED PENALTIES FOR BREACHING RULES

TABLE 1

Penalty Regime Under the *Foreign Acquisitions and Takeovers Act 1975*

Breach Of Current Rule— Residential

Proposed Penalties (To supplement the existing criminal penalties \$85,000, imprisonment of two years, or both)

- > Foreign person acquires new property without approval (approval would normally have been granted)
- > Temporary resident acquires established property without approval (approval would normally have been granted)
- > Non-resident acquires established property or temporary resident acquires more than one established property (not normally approved)
- > Temporary resident fails to sell established property when it ceases to be their principal residence (breach of conditional approval)
- > Developer fails to market apartments in Australia (breach of advanced off-the-plan certificate)
- > Property developer fails to comply with reporting conditions associated with approval (breach of advanced off-the-plan certificate)
- > Foreign person fails to comply with reporting conditions which requires them to notify of actual purchase and sale of established properties (a new rule)
- > Third party assists foreign investor to breach rules

Breach Of New Rule—Business, Commercial Real Estate and Agricultural

Proposed Penalties (To supplement the existing criminal penalties \$85,000, imprisonment of two years, or both— with corporations subject to a multiplier of five)

- > Foreign person makes an acquisition without approval (approval would normally have been granted)
- > Foreign person fails to comply with condition of approval
- > Foreign person fails to comply with an order
- > Third party assists foreign investor to breach rules

Source: The Australian Government the Treasury (February 2015)

TABLE 2

Residential Sector

Type of Investment	Proposed Fee (of up to)
Residential real estate properties less than AUD\$1 million	AUD\$5,000
Residential real estate properties equal to or greater than AUD\$1 million	AUD\$10,000
Residential real estate properties equal to or greater than AUD\$2 million	AUD\$20,000
Residential real estate properties equal to or greater than AUD\$3 million	AUD\$30,000
Residential real estate properties equal to or greater than AUD\$4 million	AUD\$40,000
Residential real estate properties equal to or greater than AUD\$5 million	AUD\$50,000; then AUD\$10,000 incremental fee increase per additional AUD\$1 million in property value
For Developers: Advanced off-the-plan certificates	Fee based on rates above and number of units sold to foreign purchasers

TABLE 3

Business Sector

Type of Investment	Proposed Fee (of up to)
Commercial real estate	AUD\$25,000
Business acquisitions in non-sensitive sectors	AUD\$25,000
New business proposals	AUD\$10,000
Any other interest in urban land (except residential real estate)	AUD\$10,000
Business acquisitions in media; telecommunications; transport; defence and military related industries; and the extraction of	AUD\$25,000
Business acquisitions where the value of the target's assets are greater than AUD\$1 billion	AUD\$100,000

TABLE 4

Agriculture Sector

Type of Investment	Proposed Fee (of up to)
Rural land less than AUD\$1 million	AUD\$5,000
Rural land equal to or greater than AUD\$1 million	AUD\$10,000 incremental fee per AUD\$1 million in rural land value
Investments in agribusiness (As at 1 March 2015 — the threshold is reduced from AUD\$252 million to \$15 million)	AUD\$25,000 or AUD\$100,000 for agribusiness acquisitions where the value of the target's assets are greater than \$1 billion

Source: The Australian Government the Treasury (February 2015)

RECAP: INQUIRY BY THE HOUSE ECONOMICS COMMITTEE

The House Economics Committee Were Instructed to Examine:

- I. The benefits of foreign investment in residential property;
- II. Whether such foreign investment is directly increasing the supply of new housing and bringing benefits to the local building industry and its suppliers;
- III. How Australia's foreign investment framework compares with international experience; and
- IV. Whether the administration of Australia's foreign investment policy relating to residential property can be enhanced.

Findings By The House of Economics Committee on 12 November 2014:

- I. The current foreign investment framework applying to foreign purchases of residential real estate be retained in its current form, utilising the existing legislated prohibitions and restrictions on purchases of established dwellings, and encouraging foreign investment to increase Australia's supply of new housing
- II. The FIRB and the FITPD put in place appropriate processes for the purpose of audit, compliance and enforcement of the foreign investment framework. Such processes must accurately capture audit, compliance and enforcement data for the purpose of oversight of the FIRB and the Treasury.
- III. The Government apply a modest administrative fee to the current screening for all foreign purchases of residential real estate, including purchases by temporary residents. Fees collected should be hypothecated to the Treasury's FITPD for the purpose of funding audit, compliance and enforcement activities.
- IV. The Government introduce a civil penalty regime for breaches of the foreign investment framework as it applies to residential real estate, with the following features:
 - > pecuniary penalty orders imposed under this penalty regime to be calculated as a percentage of the property value to act as an effective deterrent; and
 - > the regime to apply to foreign investors and any third party who knowingly assists a foreign investor to breach the framework.
- V. The Government amend the *Foreign Acquisitions and Takeovers Act 1975* to provide that the criminal penalties for breaching the foreign investment framework as it applies to residential real estate, apply equally to any third party who knowingly assists a foreign investor in residential real estate to breach the foreign investment framework.
- VI. In any instance where a foreign owner divests an illegally held established property, any capital gain from the sale of that property be retained by the Government. Funds collected by this measure should be hypothecated to the Treasury's FITPD for the purpose of funding audit, compliance and enforcement activities.
- VI. That Australia's Foreign Investment Policy be amended to explicitly require a temporary resident to divest an established property within three months if it ceases to be their primary residence.
- VIII. The Government, in conjunction with the States and Territories, establish a national register of land title transfers that records the citizenship and residency status of all purchasers of Australian real estate. This information should be accessible by relevant agencies from a single database.
- IX. The Government establish an alert system for the expiry of temporary visas that can be used by the Treasury to issue property divestment orders in cases of non-compliance:
 - > by amending the *Migration Act 1958* so that the Department of Immigration and Border Protection must inform FIRB when a temporary resident departs Australia upon expiry of their visa; and
 - > by establishing effective and timely internal processes at the Treasury to receive and cross-check this information against its property databases to screen for compliance within the foreign investment framework.
- X. The Government amend the *Foreign Acquisitions and Takeovers Act 1975* to provide that residential property sold under off-the-plan certificates that is marketed for sale overseas, must be marketed in Australia for the same period of time. Breaches of this requirement should be subject to sanctions under the Act ranging from fines to the cancellation of a sale.
- XI. In light of the expected finalisation of the statutory review of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* in early 2015, the Committee recommends that the Government consider the purchase of residential property by foreign investors as a possible area of investigation when considering amendments to the legislation.
- XII. Treasury's FITPD make greater use of the databases held by Australian Transaction Reports and Analysis Centre (AUSTRAC), and also of other relevant Federal and State Government databases, to assist the FIRB in its duties and responsibilities.

Source: FIRB & Department of The Prime Minister and Cabinet (2014)

NON PERMANENT RESIDENT

- > Must apply and **gain approval from the FIRB prior to purchasing property in Australia.**
- > Applications are **generally approved if the property purchased adds to the housing stock**, including new dwellings that are yet to be occupied or sold, off-the-plan properties under construction or yet to be built, or vacant land for residential development where ongoing construction begins within 24 months.
- > **Forbidden to purchase established dwellings as investment properties or as homes.** Although there could be an exception if the established dwelling is being redeveloped into multiple dwellings, and as a result, there is an increase in the dwelling count. Over the development period, the house must remain unoccupied.

FOREIGN COMPANY WITH A SUBSTANTIAL AUSTRALIAN BUSINESS

- > Acquiring second-hand dwellings for the purpose of **providing housing for their Australian-based staff normally meet with no objections** subject to the conditions set by FIRB.
- > The company must sell the property if it is expected to remain vacant for six months or more.
- > In remote and rural locations foreign companies may rent out dwellings acquired under this category only where they are unable to sell the property.
- > Whether a company is eligible, and the number of properties it may acquire under this category, will **depend upon the scope of the foreign company's operations and assets in Australia.**
- > Foreign companies would not be eligible under this category where the property would represent a significant proportion of its Australian assets.

TEMPORARY RESIDENT

- > A temporary resident is a person who is residing in Australia and holds a temporary residency visa which permits them to stay in Australia for a continuous period of more than 12 months (regardless of how long remains on the visa); or has submitted an application for permanent residency and holds a bridging visa which permits them to stay in Australia until that application has been finalised.
- > **Are required to notify FIRB prior to purchasing property in Australia**, including an established dwelling, a new dwelling that has been purchased directly from the developer and has not been previously occupied for more than 12 months in total and vacant land for residential development where ongoing construction begins within 24 months.
- > **May acquire one established dwelling only and it must be used as their main residence (home) in Australia.** Such proposals normally meet with no foreign investment objections subject to conditions; such as, that the temporary resident sells the property when it ceases to be their main residence.
- > **Are not permitted to buy established dwellings as investment properties.**

HIGH NET-WORTH INDIVIDUAL

- > **The Significant Investor Visa (SIV)** scheme was introduced on 24 November 2012 and is operated by the Department of Immigration and Border Protection. The SIV is intended to target the migration of high net-worth individuals to Australia with the longer-term aim of transferring wealth of international businesses and individuals to benefit Australian businesses and the broader economy. Investment migrants under this scheme **are required to invest at least AUD\$5 million into complying investments in Australia for a minimum of four years** before becoming eligible for a permanent visa.
- > This process was refined during 2014/15. **A Premium Investor Visa (PIV)**, offering a more expeditious, 12 month pathway to permanent residency for those meeting an **AUD\$15 million threshold will be formally introduced on 1 July 2015.**



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