# STRENGTHENING AUSTRALIA'S FOREIGN INVESTMENT FRAMEWORK

I am responding to the Government's invitation to comment on proposed reforms to strengthen Australia's foreign investment framework, particularly around residential real estate and agriculture. I note and have read the options paper available on the Treasury's website that forms the basis of the Government's consultation on these reforms.

I support the proposed reforms which include the creation of a specialised investigative and enforcement area within the Australian Taxation Office and the introduction of new civil penalties and increased criminal penalties for foreign investors and third parties who breach the foreign investment rules.

The proposed reforms go some way to addressing the problems around the notification and monitoring of foreign investment in Australian real estate. They may, however underestimate the constraints affecting the transfer of information between various layers of government. At the local government level, factors such as competition between different agencies and their policy objectives or limitations on local IT or other capabilities may deter councils from participating wholeheartedly in these processes.

In its submission to the House of Representatives Economics Committee Review of Foreign Investment in Residential real Estate, the Australian Bureau of Statistics (ABS) states:

> 'It is not feasible for the ABS to independently collect data on foreign investment in residential real estate. The ABS believes it would place a reporting burden on respondents who already report through administrative systems (FIRB and Titles)'.

The ABS highlights a potential mechanism for information transfer at the State level which does appear to have been picked up in the Treasury's options paper:

> 'Extensions on state transfers and titles offices administrative data have the capability to meet the ABS's requirements to derive high quality estimates. By extending requirements to collect Market value of property transacted, settlement date, residency of investor, residency status of purchaser, seller residency and purchaser type all required dimensions to generate quality estimates will be available.'

These reforms may have limited success in countering the efforts of those foreign investors who wish to conceal their identity and use complex and sophisticated measures to achieve this result. Mechanisms such as a shell company can effectively disguise ownership and facilitate the illegal transfer of money to more legitimate purposes while avoiding scrutiny by law enforcement.

My concern extends beyond these proposed regulatory reforms. In my view, both the report by the House of Representatives Standing Committee on Economics and the Treasury discussion paper adopt a rather uncritical attitude towards foreign investment in residential real estate.

The Economics Committee's rather shallow and self congratulatory report reflects the narrow focus of the review's Terms of Reference which required the Committee to report on:

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

The Committee's report appears to regard any increase in housing stock as an unqualified success. It fails to examine in any substantial way the nature and validity of these economic benefits nor does it expend energy on identifying the direct or indirect costs of this activity. Who are the real beneficiaries of this investment? In what way and to what extent do they benefit from the increased housing stock? Have these benefits been gained at the expense of other possibilities or led to significant costs?

In particular, the Committee's report fails to adequately address a number of major concerns the community has expressed:

- Its argument with respect to the impact on first home buyers is particularly simplistic and follows closely the line espoused by those with a vested interest in the sector.
- By ignoring the significant distortions this investment has had on the supply of affordable, diverse and appropriate housing in Australian cities, the Committee completely overlooks the social, environmental and land planning impacts of this activity.

The Treasury options paper simply accepts the Committee's recommendations and seeks comments on the best ways to implement the proposed regulatory reforms.

I live in the City of Boroondara, an area in Melbourne that has become a major target for the redevelopment of existing properties and the construction of an increased number of dwellings on each allotment. Anecdotal evidence suggests that a substantial proportion of this redevelopment is being funded by foreign investors who can seek approval under existing legislation to redevelop an existing dwelling provided it results in a net increase in available housing.

Local Government in this area has a reputation amongst residents of being sympathetic to property developers and for being relatively indifferent to the environmental impact of its planning approvals. Too often it appears to turn a blind eye to the destruction of inconveniently placed trees, the impact on the surrounding streetscape or how the placement will interfere with water drainage patterns, traffic flows or privacy.

**Attribution of economic benefits to housing construction**
There are deep flaws in using housing construction as a tool for economic policy in general. Housing is primarily a social good that provides shelter and the opportunity for people to create a healthy and secure life. Unfortunately, the old fashioned concept of a home is losing out to the current economic paradigm which sees a house as an asset or investment that will continually increase in value. A house is now regarded as a speculative asset, something to be valued for its capacity to attract financial gain rather than for its location within a neighbourhood and contributing to the growth of a family and a community.

As a policy lever, housing construction is subject to considerable time lags in improving economic activity and its multiplier effects are likely to more random and diffuse than other stimulatory measures.

The Economics Committee has too easily accepted the claim that foreign investment in real estate brings an economic benefit. The assertion needs to be treated with caution and greater effort put into quantifying the full range of pluses and minuses:

- With the increasing globalisation of the world's economies, it is likely that foreign investors will be affected by similar cyclic influences at home to those that apply in the destination country. No longer can we expect that foreign investors will act to cushion a slump in the local economic cycle.

- Many of the benefits associated with housing construction such as jobs and increased demand for materials are short term and follow the same cyclic pattern as the rest of the economy. If too much stimulation is given to this particular part of the economy, it is possible that it will divert resources away from other areas that could bring about a quicker recovery.

- The construction of a house can be considered a final good which apart from providing shelter and lifestyle for its occupants makes a lesser contribution to economic productivity than other activities which employ similar resources while facilitating further production.

- With the completion and occupation of a dwelling, demand shifts away from construction materials towards consumer goods to fit out the new residence. Increasingly, items such as furniture, electrical appliances, electronic equipment, textiles and household utensils are imported and so further add to Australia's current account deficit.

The reasons why foreign investors are putting their money into real estate in Australia are varied and may have little to do with the rate of return they can expect on their funds. These motivations will reflect a range of push pull factors including the cultural and economic conditions of the investor's home country, foreign exchange conditions or the desire to move 'hot' money.

We are being naive if we do not recognise that this can and has led to undesirable activities such as highly mobile money intent only on exploiting local markets and maximising financial returns, corruption and other criminal activities such as money laundering, the costs of which will far outweigh any supposed benefits these investments may produce.

**Affordable diversified housing**

The claim that foreign investment is justifiable because it adds to the housing stock shows no appreciation of the complexity of the housing affordability problem facing Australia. Housing of sufficient physical and environmental quality that adds to the diversity available and is within the reach of most home seekers' budgets is crucial to the health and vibrancy of our society.

Dr Ian Winter of the Australian Housing and Urban Research Institute points out in his submission to the House of Representatives Standing Committee on Economics Review of Foreign Investment in residential real estate that:

> 'The causes and nature of Australia's affordable housing problems are complex, diverse and interact differently in different parts of Australia. Housing markets have a strong geographical dimension to them. This means there is not one Australian affordable problem. As there is not one problem, there is not one solution.'

He also states:

> ... the evidence finds that the causes and the solutions of Australia's affordable housing problems also lie beyond housing policy. The financial system, taxation arrangements, federal-state relations, income support, land use planning and public infrastructure all have a bearing on housing affordability.'

As noted by the Reserve Bank in its submission the Economics Committee, much of the foreign investment:

> '... appears to be concentrated in some parts of the overall housing market, particularly in new rather than established dwellings, in higher- rather than lower-priced dwellings, in medium- and high-density rather than detached dwellings, and in inner-city areas of Sydney and Melbourne rather than other geographic areas.'

This concentration on certain segments of the market suggests that any additions to the housing stock are meeting the needs of only a small segment of the Australian market. This type of construction only adds to the stock of more expensive rental properties and does nothing to provide the diversified and affordable range of housing that significant parts of the population are seeking.

This point is noted in Dr Winter's submission. He lists a number of factors relating to potential impact of foreign investment on undersupply of housing including:

> 'Market failure at the bottom end of the private rental market with supply unresponsive to demand despite a context of growth in the relative size of the private rental market – in 2006 it was estimated there was an undersupply of 298,000 private rental properties affordable and available to households in the lowest 40 per cent of the income distribution. By 2010 this is estimated to be over 500,000 buildings.'

In the area in which I live, this type of development is having rather detrimental effects on the neighbourhood.  For example:

- The requirement that existing properties can be redeveloped provided it results in additional housing stock has led to the construction of environmentally unsuitable buildings that have a significantly greater footprint than the original residence and cause considerable damage to vegetation cover and water drainage.  With so little land remaining, there is no room to plant trees or to maintain a traditional garden.

- Young people who have grown up in this area have no prospect of ever owning a property close to family because much of the new construction is directed towards meeting the needs of a different demographic.  The same problem applies to older residents who may want to downsize but not move out of the area.

- The focus on the house as an investment encourages the development of large, poorly designed houses that cannot operate without heating or air-conditioning. These houses make no concessions for the local topography or climate and are completely out of character with the neighbourhood.  They are built to maximise the amount of space both inside and outside with no thought to imaginative and innovative solutions.  Invariably, this results in a series of obscenely large and ugly boxes tarted up to mimic some architectural style of no relevance to local conditions.

If the Federal Government is seeking to solve the affordability question surrounding Australian housing, it needs to look elsewhere.  Foreign investment will never be a satisfactory way to expand the amount of affordable, diversified housing stock that many home seekers are searching for.  At the same, foreign investment in residential real estate brings with it a range of problems that are difficult to specify or to manage and will be extremely costly to rectify over the long term.

Joy Mettam
19 March 2015