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Manager
Foreign Investment Policy Unit
The Treasury
Langton Crescent
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c/o: Adam McKissack

By email

Foreign Investment Framework 2017

Dear Adam

Thank you for the opportunity to provide our feedback on the *Foreign Investment Framework 2017 Legislative Package.*

The Property Council welcomes the opportunity to engage with the Treasury to ensure the FIRB rules operate effectively and do not unnecessarily impede the necessary flow of international capital into the Australian economy.

International capital is a critical factor in the development of the Australian economy and underpins the Australian property industry. We strongly support government initiatives to streamline the operation of the FIRB rules.

Throughout the consultation process we have raised and resolved many issues directly with Government which would have had significant adverse impacts on investment and Australian business.

Currently, there are several provisions and technical rules that inadvertently undermine the effectiveness of the regime that applies to residential and commercial property transactions. We are confident that the majority of these will be solved through your consultation process.

In particular, we note and commend Government on a number of policy proposals that significantly enhance the FIRB rules including:

1) Exemption certificates to pre-approve dwelling purchases and sell failed off the plan settlements, that will streamline markets;

2) Treating aged care, retirement villages and student accommodation as commercial land under the screening thresholds, which will aide supply in these critical sectors;

3) Removal or restriction of the sensitive lands provisions, which inadvertently jeopardise commercial investment by undermining the rules and screening thresholds;

4) Broad exemption of low sensitivity investment, to increase efficiency, reduce time and cost for government and industry;

5) Legislating fee waiver principles to enhance transparency in commercial markets.

In addition, we recommend an additional two technical solutions that will enhance the operation of the rules including:

1) Allowing agreement country investors, which use special purpose vehicles (**SPV**) to use the agreement country threshold as intended and remove a market contradiction; and

2) Streamlining the moneylending exemption so moneylending businesses can use an SPV under the exemption and take security over land without FIRB approval.

Once implemented, these proposed new measures will substantially improve the FIRB process and ensure there are no unintended impacts for international investors.

The Property Council looks forward to further engagement with Government as the Regulations to support this legislation are progressed.

In the meantime, if you have any queries, please do not hesitate to contact our offices on (02) 9033 1944.

Kind regards

Andrew Mihno
Executive Director – International & Capital Markets
Property Council of Australia

Submission:

Foreign Investment Framework 2017

27 March 2017

1. Residential Land

The Government should ensure that the foreign investment framework is operating efficiently and as intended. Unfortunately, changes to the residential land rules have resulted in unintended consequences. There is a strong case for government action to address the unintended consequences for residential land.

Overall **we prefer the implementation of options 2-4 (noting the specific comments made below including an extension of option 4 to all international persons).** This will align the exemption from notification with FIRB Guidance Note 15.

Set out below are the responses to each option in turn below.

Policy Option One: No Change

The Property Council **does not support** Policy Option One which will fail to provide any changes to the residential land rules. This policy will not address the administrative work-arounds for failed off-the-plan settlements that currently operate outside the regulatory framework.

Policy Option Two: Introduce a new exemption certificate(s) for new dwellings and vacant residential land

The Property Council **supports the introduction of a new exemption certificate(s)** which will allow international persons to receive broad pre-approval to purchase one new dwelling or vacant residential block rather than applying for each individual property they are considering.

This is a sensible policy response that will allow the market to clear efficiently (so it does not disadvantage domestic sellers), keep the integrity of the FIRB rules and treat all market participants fairly.

Policy Option Three: Introduce an exemption certificate for failed off-the-plan settlements.

The Property Council **strongly supports the introduction of an exemption certificate**, with no additional fee to be charged, to allow developers to sell dwellings to international persons which have been subject to a failed settlement.

This policy option should be clarified to allow international buyers to purchase an off-the-plan dwelling (as a new dwelling), when either an international or domestic purchaser has failed to reach settlement. In these circumstances, the title has never been transferred.

This ensures that market integrity is maintained and domestic sellers are not disadvantaged through an inadvertent error in a technical definition.

Policy Option Four: Amend the treatment of residential land used for commercial purposes

We support Option Four to amend the treatment of residential land used for commercial purposes.

The Property Council **supports amending section 52 of the Regulation** so that residential land that is an aged care facility, retirement village or student accommodation is aligned with the non-vacant commercial land screening thresholds (either $55 million or $252 million). If the international person is from an agreement investor country, the threshold is $1,094 million regardless of whether the land is low threshold land.

The Property Council **supports the introduction of an exemption notification for foreign government investors** when they make purchases as the operators of facilities that are of a mandatory buyback nature.

We feel however that the proposed exemption (outlined in paragraph 35) of the paper should **apply to all international persons, rather than only foreign government investors, to ensure it aligns with FIRB Guidance Note 15**.

The Property Council **proposes that student accommodation should be defined** as being premises purposely built or refurbished, and used predominantly, for the purpose of providing accommodation for students studying at a secondary or tertiary education institution.

We note generally, that although retirement villages are more appropriately defined as commercial residential premises, the proposed changes to the rules will be practically similar.

Policy Option Five: Introduce Options 2-4

Policy Option Five is the preferred policy response (noting specific comments made above) – allowing the adoption of all the proposed options to solve unintended consequences that arise from changes to the residential land rules.

2. Non-Vacant Commercial Land

Paragraphs 46 to 51 refer to the inadvertent errors created by the technical operation of the sensitive lands provisions.

The broad criteria used in these rules inadvertently jeopardise investment by unintentionally rendering the thresholds and other rules unusable for their intended purpose.

Reference is made in paragraph 47 to a number of sensitive land criteria that may have unintended consequences.

These include not only the prescribed air space issue but also where all or part of a building is leased to an Australian government agency or body or the land will have public infrastructure located on it. It also references the broader definition in the regulations.

More completely, the relevant unintended problems created by these provisions involve property:

a) **'under prescribed airspace'** - the strict application of the regulation erroneously bars the majority of commercial real estate acquisitions applying a threshold of $252 million. We acknowledge this is unintended.

b) **"leased to the Commonwealth…"** - bars all transactions relating to property with any government lease at all applying the commercial threshold of $252million, sharply escalating FIRB approvals, including for instance highrise buildings with a lease to a Medicare or Centrelink shop front or even, potentially, a lease to Ausgrid regarding a sub-station located on the premises. It is unworkable.

c) **"with public Infrastructure…"** - bars all building transactions with any utility or public transport attached to it applying the commercial threshold of $252million, sharply escalating FIRB approvals. This encompasses every building as they all have water, electricity, sewage and gas. Any building with a bus stop would similarly be caught.

d) **"fitted out for specific businesses"** – is too general and forces FIRB approval where, for example, businesses might just provide office space to HR or training to military or sale of walkie talkies, mobile phones or camping equipment.

e) **"storing materials regulated under law"** – can encompass almost anything from fire extinguishers to pharmacies forcing FIRB approval.

In each case, failing one of these criteria is very easy and means the $252 million threshold is unusable.

Overall **we prefer the implementation of Option Three – the removal of the low threshold land notification entirely.** All other options leave significant problems in place in part or in their entirety.

Set out below however, are the responses to each option in turn.

Policy Option One: No Change

The Property Council **does not support** Policy Option One which will fail to provide any changes to the sensitive lands provisions and will render the commercial threshold of $252 million effectively unusable.

Policy Option Two: Narrow the scope of the "low-threshold" non-vacant commercial land definition.

The Property Council **supports Policy Option Two in so far as it goes, but it is not a complete solution for the problems created by this provision** and there needs to be several specific amendments to limit the reach of the provision so it can function as intended.

Despite the broad range of criteria by which land may be regarded as sensitive, **Option Two** only refers to the removal of the prescribed air space criteria.

This essentially leaves in place several serious problems.

There are a number of criteria which should be removed or qualified to avoid the unintended consequence of forcing most applications for the acquisition of non-vacant commercial land subject to the $55 million threshold.

In short, each of the criteria need to be amended broadly to ensure they only operate in circumstances where the criteria is relevant to the majority of the land in question rather than something that is merely incidental to the use or proposed use of the land.

For example, on each of the issues raised at para 47:

a) the criteria relating to the leasing of the buildings on Australian government agency or body should be qualified to only apply if the majority of the floor space was leased to such entities.

b) where any public infrastructure is merely incidental to the operation of the building, it should not be regarded as sensitive land.

The suggested approach to each of the five relevant issues noted above are set out in the Table sent by the Property Council to Treasury on Friday 23 September 2016.

Policy Option Three: Remove the low threshold land notification requirement.

The Property Council **supports Policy Option Three as the most practical option to resolve the problems with this provision.**

This option recommends the removal of the requirements to notify for low threshold land. Non-vacant commercial land would be screened only if the $252 million or $1,094,000 threshold was breached.

It removes all unintended errors and restores the proper function of the commercial thresholds.

In the absence of Option Three, the only option available is the qualification of each of the various sensitive land criteria as previously set out in the Table sent by the Property Council to Treasury on Friday 23 September 2016.

3. Low Sensitivity Business Investment

The FIRB should ensure that wherever possible, it streamlines processes to remove the need for unnecessary applications. This not only avoids wasting Government time and resources, but also saves businesses money and helps them remain nimble and efficient.

At the moment exemption certificates are only available in respect of acquisitions of interest in land not businesses.

The two exemption certificates contemplated relate to broad pre-approval for international persons acquiring securities and exemption of government investors acquiring businesses. In the alternative, simple broad exemption is suggested.

The **Property Council supports Option Three - the removal of notification requirements for acquisitions under $100 million providing there is also an amendment to regulation 37(4) to remove the 100 person test.**

The 100 person test is out of alignment with rules from ATO on widely held and means that the low sensitivity business exemption won't work unless there are 100 people in the fund. This mean that a very large number of unlisted funds will still be unnecessarily caught.

This is a far simpler exemption that is not prone to error.

In the alternative, if you cannot remove the 100 person test, it will be necessary to remove the $100 million threshold and replace it with a rule that says the exemption applies where the international investor has an investment of 5% or less in an unlisted fund, or 10% or less in a listed fund (in line with Reg 37(4).

Set out below however, are the responses to each option in turn.

Policy Option One: No Change

The Property Council **does not support** Policy Option One which will fail to provide any changes to streamline non-sensitive transactions.

Policy Option Two: Introduce new exemptions

The Property Council **supports the two exemption certificates contemplated** provided they are extended to investments in securities in land owning companies and trusts.

These exemptions are - pre-approval for international persons acquiring securities and exemption of government investors acquiring businesses.

It is not clear if the certificates will apply to portfolio investments in land owning companies or trusts.

This extension is necessary for the exemptions as there are examples where acquisitions by foreign government investors in unlisted Australian real estate investment trusts required FIRB approval even though they involved less than 3% ownership and the value of the investment was under $55 million.

Guidance Note 14 indicates that an investment of this nature would not require FIRB Approval however this is not supported by Section 37(4) of the Regulations which also requires that "there are or will be at least 100 holders of securities in the land entity". In the case of many wholesale funds, this requirement is usually not satisfied. Accordingly FIRB approval is required.

If the additional requirement of Section 37(4) of the Regulations mentioned above was removed, then there would be no need for the proposed exemption certificate to extend to portfolio investments in land owning companies or trusts.

In the absence of this change, the **Property Council supports exemption certificates for pre-approval of international persons (being either government or non-government investors) acquiring securities extended to portfolio investments in land owning companies or trusts.**
Each of the exemption certificates will be subject to reporting requirements and would cover actions against specified parameters (for example, total spend or percentage interest limits).

We believe $100 million threshold is a reasonable limit (although it should probably also be tied to a maximum percentage interest limit). However, as mentioned above, to be of practical use it should be clear that it applies to foreign government investors as well as other international persons and, should extend to investments in securities in land owning companies and trusts.

Policy Option Three: Exempt low sensitivity business from notification

The **Property Council supports Option Three - the removal of notification requirements for acquisitions under $100 million providing there is also an amendment to regulation 37(4) to remove the 100 person test.**

The 100 person test is out of alignment with rules from ATO on widely held and means that the low sensitivity business exemption won't work unless there are 100 people in the fund. This means that a very large number of unlisted funds will still be unnecessarily caught.

This is a far simpler exemption that is not prone to error.

In the alternative, if you cannot remove the 100 person test, it will be necessary to remove the $100 million threshold and replace it with a rule that says the exemption applies where the international investor has an investment of 5% or less in an unlisted fund, or 10% or less in a listed fund (in line with Reg 37(4).

a) The issue

Currently, there is a problem with FIRB Regulation 37(4), because in calculating whether there is 100 people in the fund there is no ability to look through the investors to determine if the trust is widely held. This means that an acquisition of a private international person cannot be exempt from notification unless there are 100 direct investors in the trust as required under Reg 37(4):

"The acquisition of the interest by a privately owned foreign person will be exempt from notification if all of the following apply:

(a) the acquisition is of an interest in Australian land that is an acquisition of an interest in shares or units in a land entity;
(b) the land entity is not, and will not be, listed for quotation in the official list of a stock exchange (whether or not in Australia);
(c) after the acquisition, the foreign person, alone or together with one or more associates, holds an interest of less than 5% in the land entity;
(d) the foreign person is not in a position:
- to influence or participate in the central management and control of the land entity; or
- to influence, participate in or determine the policy of the land entity;
(e) there are or will be at least 100 holders of securities in the land entity (the Widely Held Requirement); and
(f) the land entity carries on a business that does not include (other than incidentally) investing directly or indirectly in established dwellings."

This is different from the ATO widely held requirement for MIT purposes.

What this means is that even though the trust is widely held for MIT purposes, it is not for FIRB and notification applies.

If you have (say) a $6.6bn asset unlisted fund and someone wants to make an investment of 5% - under the ATO rules that is widely held and meets MIT tests - but under FIRB there is a different test for approvals of 100 people to determine if you are exempt as widely held.

In this case, you would not be able to use the new exemption because $100m limit will not be enough. It undermines the new exemption.

For tax reasons the ATO looks through the immediate investors to ascertain whether the units in a trust are widely held whereas FIRB does not do so.

Neither FIRB nor an investor would want to have to do the analysis as to whether the existing unitholders in an unlisted REIT meet the widely held test and thereby satisfy the minimum 100 person test in Regn 37(4). Indeed, most new investors would not have or be able to get this information and would be at risk if they took a view which then proved to be incorrect.

b) In the Alternative

We have raised the issue around the 100 person test previously. If however that requirement is not dropped and only the exemption certificate proposal was followed, even with a $100m limit, the threshold would be too small to prevent large portfolio investments being forced to seek FIRB approval.

The only way to maintain the integrity of the proposal is to drop the 100 person limit from Regn 37(4). The other criteria in the regulation, which must be met should be seen as sufficient protection against any control of the REIT being transferred to the investor.

If that can't be done, then FIRB should drop the $100m threshold in the exemption for low sensitivity business, and have a threshold of say 5% for unlisted and 10% for listed investment instead.

4. Commercial Fees

There is a need to **reconsider the practical implementation processes relating to fees and assessment of applications.** A critical problem (given the complexity of transactions to develop land as well as the significant importance placed on meeting condition precedent deadlines in most land transactions), is the time taken to obtain approval for purchases. International purchasers often need to comply with their own internal requirements to enable them to pay the fee.

Delaying commencement of an assessment until the application fee is paid can create flow on problems for the transaction and meeting deadlines. **FIRB approvals could be streamlined by allowing applications to be assessed so long as the fees are paid prior to release of the determination.**

Policy Option One: No Change

The Property Council **does not support** Policy Option One which will fail to provide any changes to the commercial fee rules and fee waivers.

Policy Option Two: Minor changes to the fees framework

Overall the Property Council **supports legislating existing fee waiver principles**, which will increase the transparency of the regime.

There are disproportionate fee outcomes for business acquiring land for commercial purposes. The residential land fees (tiered at around $10,100 per million and uncapped) were aimed at individuals purchasing residential land. As the residential fees are uncapped, there have been examples of very large fees (up to hundreds of thousands of dollars) being paid by property developers seeking to acquire multiple titles of residential land for commercial purposes.

This hits against Government efforts to ease affordability and efficient supply of property product to the market.

The **policy options presented in the paper to do not clarify how these exceptionally large fees would be assessed** except for legislating existing fee waiver principles.

This needs to be reconsidered.

We also **support expansion of the definition of internal reorganisation**.

We agree that the definition of internal reorganisations should be expanded as suggested in both paragraphs 99.3.1 and 99.3.2. We note however that in relation to paragraph 99.3.2 more clarity will be required as how broadly the definition of non-subsidiary will operate. Presumably, in order to be reorganisation there needs to be some commonality of ownership both before and after the relevant transaction.

Policy Option Three: Streamline the fees Framework

Given a lack of information, the Property Council is **unable to support Policy option 3**.

Firstly, the Property Council **does not support** any changes to the fees for an exemption certificate in relation to a program to acquire interests in Australian land.

Secondly, the proposed options presented are unclear - it notes that residential land would not be included under a flat fee structure, but appears to indicate residential land would be included under a tired fee structure.

This must be clarified for an industry position to be put forward. What we can say based on the information supplied is **that Property Council does not support a flat fee structure** as it appears to disadvantage vacant land that is currently only subject to a $10,100 fee.

The Property Council cannot support the tiered fee structure on the existing information, but makes the following comments:

- the tiered fee structure should not apply in circumstances where a fee waiver principle would apply.

- the suggested tiered fees would result in substantially more fees being paid to FIRB than under the current fee calculation methodology. For example, currently the fee payable in respect of non-vacant commercial land (of any value) is $25,300 whereas under the proposed tier-based structure, it could be up to $100,000.

- **If a tier-based structure** by reference to consideration is to be used, **we suggest different tiers be used, as previously proposed by the Property Council**.

5. Miscellaneous Technical Issues and Ideas for Further Reform

a) Special Purpose Vehicles

Why use an SPV?

There is a critical issue with the conflict between the agreement countries threshold of $1.094bn, the operation of property investment vehicles generally and the Managed Investment Trust rules specifically.

Domestic and International investors who want to invest in Australian property under a pooled fund, will do so through a Real Estate Investment Trust (REIT), in order to hold the land in question and appropriately divide the rental income from the investment. Typically, the majority of Australian commercial property is held in a REIT structure onshore.

REIT's are required by law to have the majority of their management domiciled in Australia under the Australian Managed Investment Trust rules (MIT) that allow flow-through and withholding tax at appropriate rates. This is effectively an Australian Special Purpose Vehicle (**SPV**).

This however directly conflicts with the FIRB rules for agreement countries, which requires the International investor to hold the property investment directly in an offshore domiciled entity. They cannot hold the property in an SPV without losing the agreement countries threshold.

Most international investors, including those from agreement countries, invest in Australian real estate through an Australian SPV. This SPV can be a company, although it is more often a unit trust. SPV companies are often used in development transactions.

The additional benefits for an investor in using an SPV are:

- It provides them with flexibility to sell down their interest in the land which is better for the market. If an investor itself purchased the land, any sell down will generally have to be via a full sale of its interest in the land (which may not be possible or desired), or a sale of an interest in the investor itself. As the investor itself will generally have other investments and carry on other business, this is not an acceptable option.

- By owning the SPV, which in turn is the owner of the interest in Australian land, the investor can wholly or partially sell down its interest in the land without affecting any of its other investments merely by selling the desired percentage of its interest in the SPV.

    - By being able to introduce other investors into an SPV which is a unit trust, the SPV can obtain MIT status for tax purposes which would have beneficial tax outcomes for the international investors. It would not be generally acceptable for an international investor to introduce other owners into its own corporate structure, especially where such investors are only to be involved in a particular asset.

Detailed Issue regarding thresholds

Unfortunately the $1.094 billion threshold for land described in paragraph 52(3)(a) of the Foreign Acquisitions and Takeovers Act (**FATA)** (as set out in Item 1 of the table to Section 52(5) of the FATA Regulations), only applies if the land is being acquired by an agreement country investor.
The definition of agreement country investor does not extend to an Australian SPV established by an agreement country investor. This is not generally known by agreement country investors or their non-legal advisers potentially resulting in confusion and unintended breaches of the law.

In addition, this approach appears to be inconsistent with Regulation 56(3) which provides that a significant action or notifiable action will not occur in respect of an acquisition of a direct interest in an Australian entity by a foreign government investor if the foreign government investor acquires a direct interest in the Australian entity by establishing a new wholly owned subsidiary.

Suggested solution

The issue is easily fixed by **allowing SPV's created by an agreement country investors (if that investor holds at least 95% of the equity in the SPV) to be subject to the agreement countries threshold**.

The SPV then should be treated no differently to the situation where such investment was made directly by the relevant agreement country investors. We refer to 95% rather than 100% as there is a need to introduce nominal unit holders to ensure the entity meets the requirements of trust, corporations and /or tax law (as may be applicable).

If any of the agreement countries investors in such SPV was to sell down its interest in the SPV other than to another agreement country investor, the sell down would be subject to the operation of the FATA and FATA Regulations as would apply to the acquisition of an interest in an Australian land corporation or Australian land trust by a non-agreement country investor.

We recommend the law should be amended to minimise any conflict with existing investment laws and allow the $1.094bn threshold for agreement countries to operate appropriately.

b) Money lending exemption

The money lending exemption contained in section 27 of the FATA Regulations needs to be clarified.

Specifically, the **Property Council recommends that the regulations are amended to allow international entities (who are in the business of lending) to establish an SPV to provide debt finance** for a transaction without the need for FIRB approval for the SPV.

If the same transaction was entered into by the parent entity of the SPV , the money lending exemption would clearly apply.

The establishment of the SPV merely gives greater flexibility for divestment options available to the international entity in the future.

The only interest in the land is the taking of security. In the absence of default the lender would not have any power over the land. In addition, if enforcement did occur, it would generally require the land to be sold to a third party to recover the amount owed.