

# **Strengthening Australia's Foreign Investment Framework: Options Paper, February 2015**

## **Submission by Ian Hundley**

**20 March 2015**

This submission addresses the issue of the purchase of residential real estate in Australia by foreigners. In the area in which I live in the City of Boroondara there are several evident effects of greater foreign ownership of residential real estate, and none of them are positive. These include a significant increase in the cost of land and an evident increase in the numbers of residences that are standing unoccupied or only occupied spasmodically. Many of the new dwellings are gruesome structures, oversized to the point where they occupy the whole site and of a design that is usually a caricature of a bygone age. The fact that these new dwellings have typically been built following the demolition of perfectly sound older dwellings means that there is no net addition to the housing stock, and all at the cost of significant production of greenhouse gases.

I firstly address concerns about the lack of timely access to publicly available data and then discuss elements of the 2014 report of the House of Representatives Economics Committee (hereinafter referred to as "the Committee"). Finally, I provide responses on a number of the proposals included in the Treasury's Options Paper (February 2015).

### **Data quality and availability**

I am increasingly concerned about the increasing levels of foreign ownership of residential real estate in Australia and the failure of the government to advise on trends in foreign ownership, in Australia as a whole, and more specifically in the area in which I live in the City of Boroondara which has seen large numbers of properties sold to ethnic Chinese in particular, some or many of whom may be foreigners.

I first raised the matter with the Foreign Investment Review Board (FIRB) in April 2010 when I asked for quite specific information on the sales of residential properties to foreigners, both at the national level and locally. I was advised by the FIRB that the only data that exists is in their annual reports. However, this consists of highly aggregated data of approvals only, not of residential real estate acquisitions, and it is not provided in any form to inform of local trends.

I raised the matter again in January 2014 with the Prime Minister, Tony Abbott, who I asked for:

"....the numbers of multi-occupancy and detached residential properties in the City of Boroondara (Victoria) and in postcode area 3104 purchased by foreigners in each of the years 2009, 2010, 2011, 2012 and 2013" and "....the number of purchases by foreign nationality in each of these residential property categories for each of these years."

I finally received a reply in June 2014 on behalf of the Treasurer, Joe Hockey, which advised, inter alia, that ".....the Government does not release disaggregated foreign investment data beyond that published in the Annual Reports because of the need to protect the commercial interests and privacy of individual investors. The disaggregated disclosure of foreign investment information by postcode may allow applicants to be identified in some instances."

It was admitted again by the Treasurer that this data related only to investor intentions and not property purchases.

In my view, the privacy rationale for non-disclosure was opportunistic and potentially well exceeds any privacy strictures that the ABS applies in the release of statistical information publicly. The matter of the provision of good quality aggregated and disaggregated data on foreign investment in residential real estate needs to be addressed urgently.

### **The House of Representatives Economics Committee report, November 2014**

I also have a number of concerns about the report by the Committee, some of which I will mention here. The Committee left many important questions unanswered, so much so that the matter will need to be addressed more comprehensively in the near future by the Commonwealth.

In this respect I have a particular concern that the Committee did not engage effectively with members of the general public and the report is much the poorer for it. The Committee appeared to approach the issue as a largely technical matter without human consequences. As far as I know the Committee did not call as a witness any member of the general public. It devoted its attention almost exclusively to organisations including public sector agencies, property development interests and industry groups. I made a submission in my own right to the Committee but when I inquired about appearing before the Committee I was told the Committee would not be back in Melbourne. It is regrettable that this narrow approach by elected parliamentarians has also spilled into this consultation process with it being directed to interested stakeholders, rather than members of the Australian society as a whole.

The Committee did not deal in adequate depth with the growing concerns about the issue of foreign investment in residential real estate in comparable locations, including the U.S., Canada and the U.K. There has been substantial media on this. See, for example, the "Towers of Secrecy" series by Louise Story and Stephanie Saul which was published in early February 2015 in the *New York Times*.

The potential knock-on effects of significant foreign investment in residential real estate for state and local government administration and the adequacy of their regulatory structures was not addressed. Their regulatory frameworks have been found wanting as well established and attractive neighbourhoods which previously attracted domestic homeowners are increasingly being compromised by "out-of-character" developments that were unimaginable ten years ago. There is a process of dispossession under way that comes with the large scale, character and rapid rate with which these developments are occurring which the Committee was strikingly unmindful of.

The Committee report is somewhat naive in not recognising that relatively uninhibited foreign investment flows in residential real estate can carry significant cultural and social consequences which also have economic impacts. Some of these are quite direct in effect as exemplified by longer-term residents cutting their losses to sell up and move out because they no longer recognise and enjoy the place that they have lived in. Other effects are indirect, as the inertia of state and local land use and building regulation lags accelerating events. The built form then declines and collateral impacts such as the loss of canopy trees and other vegetation have increasingly adverse environmental consequences.

It may be said that these effects cannot all be attributed to increased foreign ownership of residential real estate in Australia. Maybe not. But we do not know otherwise either, as demonstrated by the inadequate responses I received to my representations, referred to above.

The Committee, I believe, was at best unkind to administrators in sheeting home to them most of the blame for the lack of robust data on actual foreign investments in residential real estate. The prime responsibility should, however, be borne by the governments of the day - Rudd, Gillard, Rudd and Abbott - who have presided over ever increasing foreign investment in residential real estate in recent times, seemingly indifferent to the negative consequences. This may well be the case in comparable external jurisdictions as well where growing public concerns about the negative effects on the housing market and the built and natural environment have until recently been regarded with indifference by their governments.

The Committee was also remiss in not more comprehensively addressing the relationship between immigration policy and the foreign ownership of residential real estate, especially as elements of Australian immigration policy are increasingly being couched in terms of its ability to attract capital. The idea that foreigners may with relative ease accumulate residential real estate primarily as a store of value and to spread financial risk has no real precedent in Australian history and should be looked on with considerable trepidation.

The Committee should have addressed both specific offshore "push" factors as well as the "pull" factors that are attracting foreign interest in residential real estate. The consequences of even further increases in Chinese investment, for example, and potentially from India, and its potential future growth unless mediated by much better regulation should have been addressed in detail.

The interplay of domestic and foreign influences on the market and its affordability should have been considered. There are significant weaknesses in the Australian domestic policy environment which adversely affect housing affordability. These include the current tax treatment of negative gearing for investment properties and the exemption from capital gains tax of the principal place of residence which serve to elevate prices and reduce affordability. It may well be found that increased foreign participation in the market is serving to compound these difficulties.

Finally, the Committee was remiss in not analysing the issue of phantom ownership on behalf of foreigners of Australian residential real estate. It appears that this could take several forms, including corporate structures such as shell companies or properties held in the names of trusted individuals, who may include long-term residents of Australia. It may include others such as relatives of non-residents who notionally could be the recipients, through passive ownership of title, of substantial holdings of residential real estate.

## **Responses to consultation questions**

### ***Compliance and enforcement capability***

Given unsatisfactory recent experience the government should, as a matter of urgency, proceed to establish a well-resourced and capable compliance and enforcement area. It makes sense that this capability should be in the Australian Taxation Office given the access to relevant and timely data and relevant experience in enforcement activity.

Having regard to concerns that trading in residential property is potentially a conduit for international criminal activity, including for tax avoidance and drug trafficking and possible links with terrorism, the involvement of the Federal Police and the Reserve Bank should also be recognised in this context.

### ***Timely access to relevant data***

Any legislative impediments to data sharing, not only between Commonwealth agencies, but also with state, local government, foreign government and international agencies that materially impede the identification of infractions of the law and successful prosecutions should be identified and remedied.

Within Australia an obligation should be placed on foreign purchasers of residential real estate to report to the land titles offices in the states and territories their national status and that this be recorded on certificates of title (see in particular Committee report, Recommendation 8, p. 75 and evidence by Mr Mahoney, ABS, p. 62 and Mr Wilson, FIRB, p. 65).

At local government level, this information should be recorded on the rates data base and be available to Commonwealth authorities upon request. I recently asked the Boroondara City Council about the proportion of rate notices for residential properties that they address to the owner at the property, another Australian address or to an overseas address but they advised that they have not extracted such information and they would find it difficult to accomplish. However, I am sceptical that this task would be so difficult and the onus should be placed on local government agencies to be at the ready to provide good quality data that would assist in enforcement activity in this area.

That the Australian government has no accurate or timely data that tracks foreign investment in residential real estate was one of the four key findings of the report of the House of Representatives Economics Committee. As a consequence, the Committee

concluded no-one really knows how much foreign investment there is in residential real estate, nor where that investment comes from.

The Committee noted that a national register of land title transfers that records the citizenship and residency status of all purchases of Australian real estate would resolve this major informational failing and would allow facts to be injected into discussions about foreign investment, rather than 'best guestimates'. The Committee concluded a national register would also help with compliance and enforcement with the foreign investment framework by permitting data to be compared easily. This measure should be pursued as a priority.

I have undertaken random searches of a small number of the title documents of residential properties in the North Balwyn areas which indicated that the ownership information currently recorded on title would be inadequate for this purpose. However, it would not require a major effort to improve the quality of the information on title for future property transactions for the purpose of meeting the requirements of a sound reporting system for future property sales.

Under current arrangements local government authorities are arguably in the best place to verify the bona fides of investor activity in the special circumstances where an established dwelling is permitted to be purchased by a foreign investor: That is if it is to be redeveloped and replaced with at least two new residences or if a derelict residence is to be redeveloped to become habitable (See p. 11, Committee report). This is potentially an area of significant non-compliance. I recently asked the City of Boroondara whether they had confirmed derelict status for any properties that are owned by foreign investors and the officer I spoke to advised me that he could recall no such case over the last five years, the period in which foreign investment in residential real estate has increased significantly.

The number of residential properties that have been left vacant or are occupied spasmodically in the area in which I live has increased substantially in recent years. A significant number of these properties are falling into disrepair. This behaviour, to the degree that they are the result of foreign investor activity compromise the intent of Commonwealth policy to increase the aggregate stock of housing.

### ***Access to banking information***

Conflicting evidence was presented to the Committee on sources of funds for the foreign acquisition of residential real estate with banks saying that most of it was sourced offshore and property industry representatives indicating most of it was sourced from the Australian banking system (See Committee report pp. 67-70). Whatever the truth of the matter, one could expect that the funds would at some stage be held by Australian banks, whether as cash deposits or for property mortgages. The cash deposits are likely to have been the subject of international transfer. Banks should be obliged to disclose to the Treasury details of moneys used to pay for property purchases including details of mortgages on properties owned by foreigners.

### ***Funding of compliance and enforcement activity***

The establishment and maintenance of an effective new compliance and enforcement area in the Commonwealth should be funded through the introduction of application fees on foreign investors. As it is likely this activity will not be self-funding from this source at the outset, adequate seed funding should be allocated from the Consolidated Fund until such time that sufficient funding is generated from application fees from foreign investors and from the confiscation of properties illegally held by foreigners.

It is noted that the Property Council and the Future Melbourne Committee (Melbourne City Council) has been campaigning against the introduction of application fees, principally on the grounds that it would be a disincentive to foreign investors in the economy at large. These concerns should be discounted on the grounds that the application of user pays charges in this area is not relevant to the environment for foreign investment in productive sectors of the economy. Further, given the particular status of residential real estate it is not required to meet the competitive neutrality tests often required by trade and investment agreements.

### ***Penalty regime***

The proposed sanctions are insufficient to deter illegal behaviour. Whilst civil or criminal penalties are pitched to be proportionate to the severity of the offence to act as a deterrent against such activity by others, in cases of illegal foreign ownership of residential real estate that there should be a uniformly high penalty regime.

The basic penalty imposed on an investor for the illegal purchase of a property, whether new or established, should be the forfeiture of the property to the Commonwealth. Any person found guilty of such an offence should be prohibited from owning residential real estate in Australia.

This measure would provide an unambiguous incentive for conforming behaviour. It would also be a major simplifying measure for administration. The administration of any such provision should deal sympathetically with any bona fide tenants of the property to secure the maintenance of their tenancy and to minimise hardship on them.

Revenues that accrue from the disposal of properties that have been illegally acquired should be hypothecated to the Treasury for the purpose of administering the compliance and enforcement functions.

Under current arrangements this should also apply in cases where a foreign property developer fails to market apartments in Australia. However, the current arrangement should be modified in favour of a requirement that the great majority of such developments be sold to Australian residents.

Criminal penalties for the illegal purchase of residential real estate by foreigners which involve custodial sentences should not be instituted but a criminal offence should be recorded against those who offend. The establishment of intent may be difficult, expensive and time consuming in many cases. It also costs Australian society as a whole a substantial

amounts of money to maintain persons in prison. Average annual expenditure for maintaining a prisoner in jail may be in the order of \$100,000 at a time when the growth in the Australian prisoner population has been significant. Forfeiture of illegally purchased properties to the Commonwealth provides a simple and most effective disincentive to control illegal purchase of real estate by foreigners.

Third parties who facilitate or otherwise aid and abet such activity should be dealt with by large fines.