House of Representatives Standing Committee on Economics Inquiry into Foreign Investment in Residential Real Estate

Submission
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Introduction

SMATS Group is pleased to make this submission to the Standing Committee and feels we are well qualified in this matter having operated as an Australian Tax Agent that specialises in Foreign Investors and Expatriates. We commenced operations in 1995 and are headquartered in Singapore with offices in Hong Kong, Malaysia, Dubai, London, New York, Perth & Sydney.

We have been providing ethical advice and assistance to many foreign investors over that time in order to ensure their compliance with taxation laws and to enhance their level of understanding of the Australian property market and culture.

SMATS is a market leader with significant activity having arranged over A$1bn in lending for expatriate & foreign buyers and servicing thousands of landlord's annual tax returns.

We make this submission in the hope of contributing positively to a very important conversation that this committee is overseeing.

Yours faithfully

Steve Douglas
Executive Chairman
SMATS Group

Importance of the Foreign Investor

It is our strong opinion that the importance of foreign investors is not fully appreciated in Australia.

There are two major misconceptions in the community when it comes to Foreign Investors:

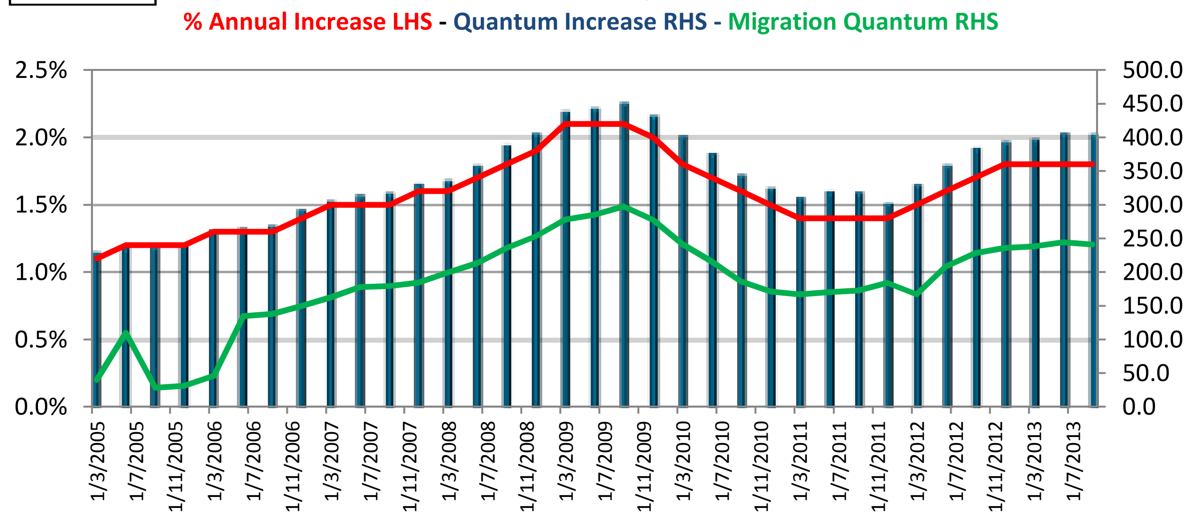
Misconception	Reality
Foreigners Are Buying All The Property At Auctions	Foreigners cannot buy established property under the FIRB Regulations, so the buyer must have held Australian Citizenship or Permanent Residency or if acquired under a Temporary Residency will need to sell the house on exit of Australia. It is more likely these are "new Australians" that have migrated and have appropriate permanent Visa status.
Foreigners Drive Up Prices	Improved Supply Stabilises Prices. In fact sometimes Foreigners have paid too much for Australian property then are willing to sell at a loss releasing lower value stock into the market.

The general community does not fully appreciate that the main driving force in property price increases is Australia's growing population, which rose 1.8% to the year 30th September 2013[1]. This equates to an additional 405,400 people and places enormous pressure in the property market for homes to accommodate this rising tide.

This has been a consistent tide for many years as can be seen in the below table.

Table A[2]

Annual Australian Population Growth



It is our opinion that Australia's strong population growth during the period of the Global Financial Crisis between July 2007 and March 2010 was a key contributing factor to Australia's economic resilience as it created "compulsory consumption" spending for new arrivals when domestic consumption fell away with economic uncertainty during the GFC.

[1] ABS – Australian Demographic Statistics September 2013
[2] ABS – Australian Demographic Statistics March 2005 to September 2013

That aside, the population pressure was naturally in the housing market up to June 2010 when population growth moved under 400,000 per annum. This cooled property markets for a period, however it proved to be short lived with current population growth now back near or above 400,000 per annum since December 2012.

This creates a demand driven property market and with the absence of adequate supply of housing stock, must inevitably lead to a lift in prices.

Foreign investors are an important part of the supply equation in Australia and provide two critical contributions to the Australian Property Markets as detailed below.

Improved Supply

With new people, it is essential to have an increase of supply otherwise competition will naturally lift prices through improved demand. For prices to remain stable, it is important for supply and demand to remain roughly in balance.

Under FIRB Regulations, foreign investors are required to buy brand new property and therefor provide the essential pressure release for increasing demand by increasing the supply.

Table B[3]: Investment in residential real estate by type of approval and number of proposals approved from 2009-10 to 2012-13

	2009-10		2010-11		2011-12		2012-13	
	No.	$b	No.	$b	No.	$b	No.	$b
Residential								
Developed								
- existing residential property	647	0.81	3,881	3.57	3,952	2.87	5,091	5.42
- annual programs	7	0.56	4	0.20	5	1.30	10	0.94
Sub-total 'Developed'	*654*	*1.38*	*3,885*	*3.77*	*3,957*	*4.18*	*5,101*	*6.36*
For development								
- vacant land	1,010	1.44	1,514	2.33	1,518	0.68	1,821	1.39
- new dwellings								
- individual purchases	1,937	1.20	3,911	2.46	4,022	2.54	4,499	2.91
- developer 'off-the-plan'	22	2.30	65	10.08	70	10.92	50	5.73
Sub-total 'new dwellings'	*1,959*	*3.50*	*3,976*	*12.54*	*4,092*	*13.46*	*4,549*	*8.64*
- redevelopment	92	0.34	171	0.45	191	0.50	189	0.36
- annual programs	8	2.11	10	1.83	10	0.89	8	0.41
Sub-total 'For development'	*3,069*	*7.39*	*5,671*	*17.15*	*5,811*	*15.52*	*6,567*	*10.80*
Total residential	**3,723**	**8.77**	**9,556**	**20.92**	**9,768**	**19.70**	**11,668**	**17.16**

Note: Totals may not add due to rounding.
The 2009-10 figures were impacted by changes to the screening arrangements for residential real estate, as announced in April 2010.

In 2012-13 the FIRB approved 11,668 applications for Residential property, and increase of 19.45% over the previous year; however the value of these applications actually decreased from A$19.7bn to 17.16bn.

[3] FIRB Annual Report 2012-13

This may well be attributed to the changes to Capital Gains Tax introduced by the then Labour Government under prime Minister Gillard which removed the 50% CGT Discount to Expatriates and Foreign Investors effective 8th May 2012.

This is a matter for further debate, but regardless of the quantum reduction the continued investment is critical in its economic value, multiplier effect and supply pressure relief. Our Submissions made on this issue have been included with this paper.

It is a general misconception that "foreigners" push prices up, where in reality it is more likely that they actually keep prices down for the vast majority of Australian's as the newly constructed dwellings of foreign investors provide important rental accommodation and expansion of projects and estates that may otherwise not attract sufficient pre-sales to permit financing to begin and allow many larger scale projects to move from concept to reality.

Economic Value

The introduction of A$17.16bn a year in foreign investment into the residential property market provides an enormous economic benefit to Australia in both the initial application of the capital and the ongoing effect which is almost impossible to quantify.

Construction

Development in Australia is not an easy pursuit. With limited quality sites, relatively high competition, cultural reluctance of buyers to buy "off-plan, high labour cost and union oversight, and long lead times between idea and delivery it is not surprising that there are few major players in the construction industry and a sad history of high levels of receivership.

Even though the Foreign Investment in Australia is at a very low level in the overall resale market (estimated at less than 5%) the 11,668 foreign buyers in 2012-13 were essential to the success of developments across Australia needing a contribution towards pre-sales and account for approximately 10-20% of the new build buyer pool.

This is largely because foreign investors are more comfortable buying "off-plan" as many major international capital cities have had significant expansion over many decades and market familiarisation is more attuned to the logical need to acquire newly built at an early stage of construction.

This combined with a positive affection of the stability of the Australian property market allows many foreign investors to seek long term opportunity in the Australian market.

In addition, many markets around the world have become so expensive due to population growth that Australia is an affordable option compared with property in the foreigners own country. In deed many foreigners acquire in the hope that may be one day they could relocate to Australia to make use of the property.

Regardless, the volume and value of foreign investor activity allows projects to be constructed which creates thousands of jobs in the construction industry and provides regular and stable business opportunities for materials suppliers, contractors, architects, cabinet makers, tradesman and labourers.

As with all markets, Australian property does move through cycles of soft and strong activity, and the underlying consistency of foreign investment underpins the slow times to ensure that projects can proceed at all stages of the cycle.

Support Services

Construction is the obvious economic injection from the billions of dollars of foreign investment, but many fail to see the support industry created on an indefinite basis from the fact that Australia's reputation as a "buy and rent" market rather than a speculative "buy and sell" environment.

As such, the great majority (estimated at well over 90%[4]) of Foreign Buyers hold their property for a considerable period after settlement, choosing to rent the property out for extended periods.

This renewable economic value is worth billions to Australia each year and creates thousands of jobs in services and tradesman through property management, insurances & maintenance, whilst at the same time increasing the rental property pool to service the increasing populations' accommodation needs.

The fact that the overwhelming majority of foreign investors retain their property for long term period post settlement is also a stabilizing factor in both the property industry and also the property market as a whole.

In many international markets, speculative foreign investor buying and selling activity leads to "boom to bust" markets that leave the economy in poor shape and a property sector that can take years to recover.

Consistent acquisition, long term hold and efficient utilization through rental are all positive economic and market influences that Australia has enjoyed over decades from a sensible and well regulated foreign investor activity.

[4] SMATS Group 20 year experience opinion and client analysis

Current FIRB System Issues

It is our contention that the current FIRB Regulations appropriate, however there are some areas that may require tightening up and improving.

Australia's policy is very clear and easy to understand.

Anyone that is not an Australian Citizen, New Zealand Citizen or holder of a Permanent Resident Visa in Australia is required to only purchase:

- Newly constructed property
- Off-plan property (pre-construction commencing)
- Vacant Land provided they begin construction within 2 years
- Established property by consent where they commit to redevelop

There are limited exceptions for Temporary Residency holders on property they intend to use themselves while living in Australia.

Many foreigners would prefer to acquire established property. In our 20 years of experience in this field in which we have assisted well over 5,000 foreign investors we have found little complaint once they understand the primary motivation of the regulations that:

- Protect the Australian resident against competing with more affluent foreign investors
- Ensure all Foreign Investment spending is in creation of economic activity through construction which supports and creates jobs
- Ensure an increase in the housing stock to support a growing population

The current laws are generally adequate and the banking and legal system ensure little opportunity for abuse of the system which has proven adequate over a considerable period of time.

We consider there to be only limited problems in the current system as detailed below:

Temporary Visa Acquisitions

Students on Temporary Visas are allowed to acquire established property with requirement that it must be sold on completion of studies.

Unfortunately this area is ripe for abuse as it would seem there is little follow up resources to check and ensure compliance is maintained. In addition, there is no current cap on the amount that can be spent so it has the capacity to distort markets in the short term.

100% Off-Plan Sales

Up until 2009 any newly constructed buildings had a limitation of no more than 50% sales to foreign investors. This was removed by the then Rudd Government.

It was considered to be a stimulating change that would allow more construction projects to commence with the support of foreign sales, however in hindsight it would seem to have been detrimental as it can alter the type of housing stock.

Under the old rules, the fact that half of a project needed to be sold in the local market meant that projects were designed to satisfy the local buyer through type, size and price.

Being able to sell the entire building overseas means that we may have increase of housing stock but it may not be desirable or practical for the expanding pool of tenants in Australia.

A classic example of this is small sized student accommodation which has a very limited demand on resale markets, difficult to finance and with an apparent oversupply in some markets due to these rule changes.

Significant Investor Visa

This is a very new class of Visa offering wealthy individuals the ability to obtain Permanent Residency with the investment of A$5 million in approved investments.

Being granted PR means they can now acquire established property and with their apparent wealth, we may see a genuine distortion in the middle to upper markets as these Visa holders enter property markets that were not previously obtainable.

There may also be some misconception in the Real Estate industry as there is anecdotal evidence that some property agents advise their clients that the $5m can be used for residential property acquisition, where the laws clearly state this is not the case. Some education and enforcement may be appropriate in this regard.

Overall it would seem little evidence of abuse for foreign buyers in Australia, however to date the Foreign Investment Review Board would appear to have limited activity in cross checking and policing acquisitions.

Recommendations

There is no doubt that the Committee should lead the argument to support Foreign Investment into Australian real estate provide it is productive, expansionary and of economic value to Australia.

Repeal of the Laws Relating to Removal of CGT Discount for Foreign Investors

As I have always contended, there is a real risk of reduced activity and revenue once the full understanding of the CGT change comes in which will undoubtedly hurt the long term prospects and reputation of Australia.

The complication and negative perception of this change should be removed to ensure Australia is seen as fair to all – Australians and Foreigners – when it comes to investment and the actions show we are indeed "open for business".

We have included our significant submissions on this matter as the issue is far more complex than can be discussed in this brief.

The reduction of almost A$3bn of sales activity for Foreign Buyers since the introduction of this change supports our contention that the law is of grave danger to the Australian economy.

The loss of sales is compounded by the loss of State Government Stamp Duty Revenue, GST on the Build and lower sales, construction and investment in the Australian property sector.

All of this at a time we cannot afford to risk any level of economic activity in the Australian economy.

Introduce a Foreign Buyers Fee

Currently there is no cost associated with an FIRB Application so there are limited financial resources for the department to police the current regulations and the bulk of their activity remains in processing.

Our experience suggests a modest FIRB Application Fee would be acceptable to overseas buyers that are often subject to fees in other international property markets.

Provided it remains realistic, it should not have a detrimental impact on the current buyer activity levels, especially if it is balanced by the return of the CGT 50% discount and fairness is restored to previous legislation.

We do need to appropriately police the fairness of the FIRB regulations and protect the market from abuse and speculation. A modest fee (on the approximate 10,000 residential purchases) would fund this and allow the FIRB to be properly resourced to investigate illegal activity – without introducing any new restrictions.

This would be logical, acceptable to the market and also easy to police with a simple "Statement of Residency" at any property settlement confirming FIRB compliance and then lodging for spot checks with FIRB.

To provide perspective of the actions of other countries, Singapore now has a 15% Additional Stamp Duty for foreign investors[5] to cool activity from speculative and potentially damaging investment rushes.

Hong Kong also has a 15% Buyers Stamp Duty for foreign buyers[6] and additional selling fees as well if properties are bought and sold too quickly by speculators.

These markets are very different to Australia as they are significantly more speculative and can have foreign investor activity at or above half all market activity at times, far greater than Australia's foreign investor activity. They also do not have a dependence on foreign investment to support a rising housing stock for population growth, such as experienced in Australia.

It does show a modest fee would be acceptable by international standards and could be set at a realistic level of say:

- A$2,000 for acquisitions under A$500,000, and
- A$3,000 for acquisitions over $500,000

These fees could be directed to FIRB for process improvement and policing activity to ensure the current regulations are enforced.

Improve Temporary Visa Application & Enforcement

With or without the introduction of a Foreign Buyers Fee, the FIRB should be properly resourced to ensure it can adequately monitor activity by Temporary Visa buyers and ensure that they fully comply with current regulations of disposal of the property at the conclusion of their period of residency.

It may be considered appropriate to enforce a spending cap on established property approved under this area, although that may be difficult to apply as it will have a state by state variance.

An appropriate manner may be to set the price cap to an amount no greater than two times the Mean Price of Residential Dwellings which currently stands at $546,500[7].

Limit Significant Investor Visa Holders to New Property

This sector has the potential to influence Australian home prices more than any other.

The affluence in many countries is increasing rapidly and the ability of a foreigner to move quickly into important Australian established property markets with this Visa could have immediate and long lasting impact on affordability for Australian citizens.

There Visa Class could easily be excluded from the FIRB approval guidelines and hence ensure any valuable capital they bring to Australia continues to improve the economy and housing stock like other Foreign Investors. If they are permitted to direct their capital to the established property market then a damaging effect will occur as competition increases without regulation and supply in this market sector remains limited.

[5] Inland Revenue Authority of Singapore http://www.iras.gov.sg/irasHome/page04.aspx?id=12832
[6] Inland revenue Department Hong Kong http://www.ird.gov.hk/eng/faq/bsd.htm
[7] ABS Residential Property Price Indexes: Eight Capital Cities, Mar 2014

Re-Instatement of 50% Sales Cap

It may be appropriate to bring back the maximum 50% sales to foreign investor restriction.

This would ensure all projects would have to appeal to local market demands and price requirements and provide a higher level of stability and protection to Foreign Investors as the projects they invest in will have natural appeal in the local market for resale and rental.

These are but a few practical suggestions that could be made to protect the domestic market while still encouraging ongoing strategic foreign investment into the Australian property market.