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James McLean Dreyfus
A/Senior Adviser
Foreign Investment Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: FIRBStakeholders@treasury.gov.au

Dear James,

Major reforms to the Foreign Investment Review Framework

Please find enclosed the Property Council's comments on the exposure draft of the *Foreign Investment Reform (Protecting Australia's National Security) Regulations 2020* and the *Foreign Acquisitions and Takeovers Fees Imposition Regulations 2020*.

We welcome the opportunity to provide comments to Treasury on the second tranche of draft foreign investment regulations. However, we are deeply concerned about some of the provisions in the exposure draft, particularly in relation to the proposed FIRB approval fees which are tantamount to further taxes on foreign investors.

Australia's new regime puts our country at an investment disadvantage

Investors will be hit hard by these proposed increases in FIRB fees. Application fees for the average developed commercial property deal are set to increase from $26,700 to $66,000 – an increase of almost 2.5 times. For investments valued at just below $1b, the proposed fee increase would be more than nine times the current level.

The new fee regime puts Australia at an unprecedented international investment disadvantage. While the Government has repeatedly insisted the fees are 'consistent' with other nations, this ignores the fact that Australia's FIRB screening regime captured **40 times more** investments than the US-equivalent system and **90 times more** investments than Germany's screening process – meaning that the tax is levied against far more investors than in countries comparable to Australia. To claim that the new taxes are similar to other jurisdictions where far fewer investors are required to pay such levies is not entirely accurate.

A comparison table of different foreign investment screening regimes is provided below:

	No. of cases reviewed, 2018/19	Application fees levied	Real property assets require screening
Australia	9,466	Yes	Yes
US	231	Yes	Only property near sensitive locations and with certain rights
Germany	106	No	No
New Zealand	327	Yes	Yes
Canada	962	No	Yes

It is the view of our members that the proposed changes to FIRB application taxes, which see a significant increase in the quantum of fees being levied for mid-size and large investments, discourages the very investment Australia requires to support economic recovery and needs to be seriously reconsidered by the Government. These levy increases are the equivalent of adding an extra tax on foreign investment in Australia.

Taxing foreign money lenders will increase costs for Australian business and consumers

It is also the fear of the sector that the increase in taxes on foreign money lenders will have a direct impact on the availability of money and the fees paid by Australian consumers. Taxing the syndicates that lend to Australian developers, companies, business and consumers will simply 'cost shift' the tax on to the Australians who buy these financial products. At a time when the Government is introducing reforms to increase access to credit for consumers, it flies in the face of reason that they would also be increasing taxes on the very sector providing the credit. Financial institutions will pass on these additional costs on to maintain margins. The Government should be aware of these commercial realities.

The exposure draft released on 18 September not only adds an effective tax on foreign investment, but it also taxes the lenders who underwrite and support development in Australia. At a time when the big four Australian banks are drastically reducing their lending for commercial property transactions, partially or fully foreign owned lending syndicates have effectively been underwriting the commercial property sector. Adding an extra tax onto these lenders at a time of restricted domestic financial availability is a serious liquidity risk.

The new regime has created uncertainty in the market

The Government needs to understand that ongoing foreign investor uncertainty has arisen since the COVID-19 pandemic began, with the constant 'shifting of the goal posts' and the short consultation time frames set for major changes only adding to the sovereign risk for Australia. Long-term off-shore capital investors who make up the bulk of our foreign investment into property in Australia have been unsettled by the recent government appetite to hike taxes and delay investment, and remain nervous about what else may be on the horizon for investment in Australia. When there is uncertainty, investors simply put their capital into more predictable, lower-risk jurisdictions.

The combination of FIRB changes and foreign investment policy decisions made by the Government in recent months, when combined with the threat of greater regulation, slower approvals and now a heavy tax on investment has led to a 'chilling effect' for the sector (according to recent comments from the property head in Australia of one of the world's largest investment firms).

The Property Council and its members have developed several recommendations that would allow trusted companies and lenders with a strong track record of investment in Australian property to continue injecting capital into our sector. We understand the Government's desire to oversee foreign investment into sensitive security assets but believe this can be achieved without harming investment pipelines in low risk assets like commercial office and residential developments.

The Property Council recommends that:

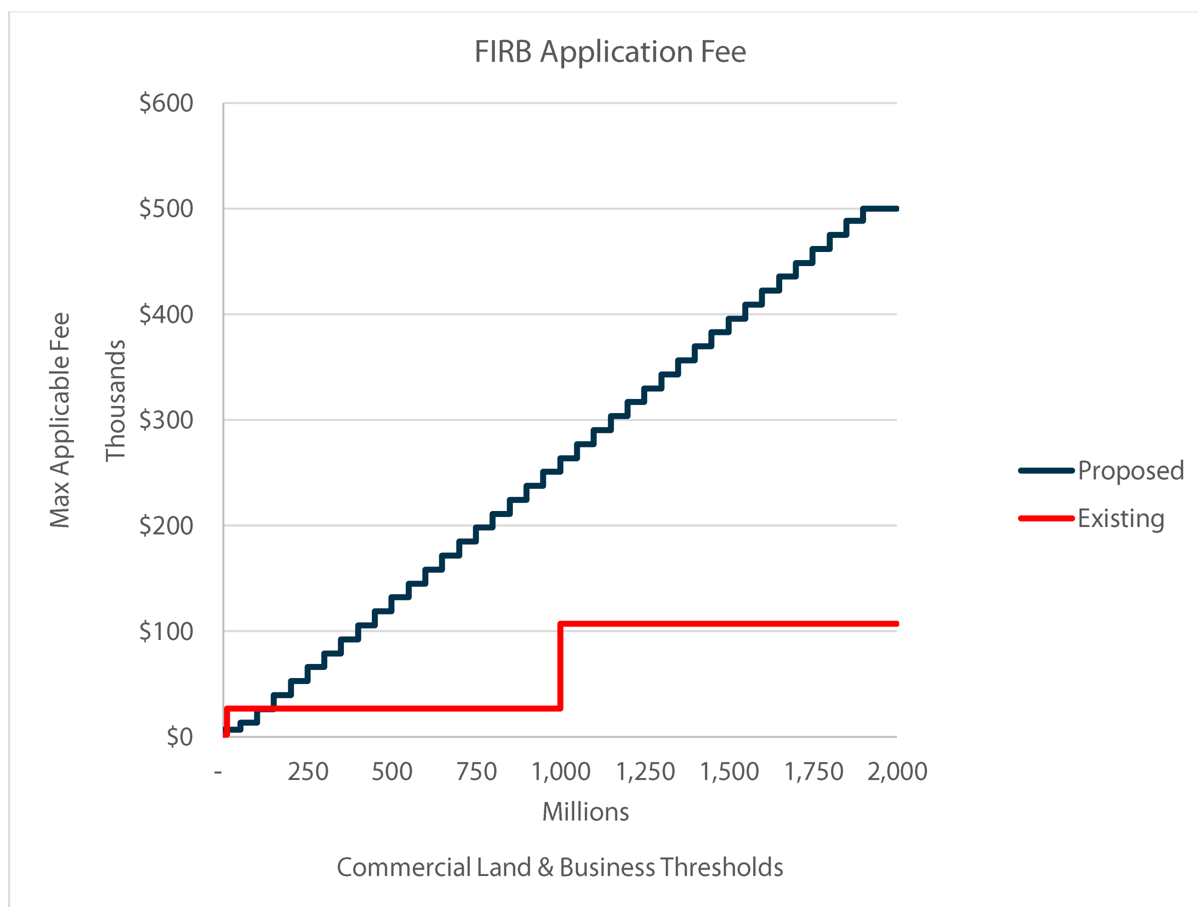
- The fees regime is restructured as follows:
  1. The Government's proposed fee regime remains but only applies to transactions which require full security assessment by Treasury and other agencies (e.g. sensitive land uses and transactions regarding national security assets.)
  2. A dedicated, lower cost pathway for trusted investors who are purchasing vanilla assets (e.g. office, residential, retail strip malls, etc.) or investing in funds run by AFSL-compliant managers is provided with lower fee levels.
  3. A discount is applied for recurring trusted investors who undertake a number of transactions a year to ensure they are not taxed multiple times a year.
  4. Interests acquired through a moneylending agreement – which are deemed notifiable actions with respect to national security businesses/land – should be exempt from fees altogether to preserve liquidity and reduce costs for consumers in Australia's property sector during COVID-19.
- Set the time limit for use of the 'call-in' power to a maximum of three years, rather than the proposed 10-year period.
- Increase the ownership threshold for investments into locally managed AFSL-compliant funds where there is no involvement in the management and control of the fund by the foreign investor.
- Reinstate the moneylending exemption for interests in national security businesses/land to keep debt financing available to these types of assets.

New fees regime

We note with concern the significant application fee increases that will be imposed with the start of the new foreign investment framework on 1 January 2021 on transactions above $150m.

The FIRB Annual Report for 2018-19 shows that based on approvals, the average deal size in commercial developed property was $264m. Commensurate fees for the average developed commercial property deal will thus increase from $26,700 to $66,000 – an increase of almost 2.5 times. For investments valued at just below $1b, the proposed fee increase would be more than nine times the current level.

The chart overleaf demonstrates how disproportionate the proposed fees are compared to current fee levels:



Coupled with measures to extend the statutory decision period for some applications by up to 90 days, offshore investors will be faced with unreasonable fee increases and time delays when considering investing in Australia, motivating them to seek other investment destinations instead.

FIRB framework out of step with other jurisdictions

Statements made by the Government that the fees bring Australia into line with other jurisdictions ignore the fact that the Australian review framework captures far more investors, asset classes and types of investments or actions than other comparable states.

For example, in the USA far fewer transactions go through their screening processes because their requirements for approval are narrower. Latest available figures show that 231 transactions were reviewed under the CFIUS regime in 2019, compared to 9,466 by FIRB in 2018-19, almost 12,000 in 2017-18 and over 15,000 in 2016-17. Thus, even though our fees may be comparable per application, more investors will end up paying them than in other jurisdictions.

In Europe and the UK, there is generally no requirement to seek permission to invest in real estate funds at any threshold, including for foreign government investors. The review of investments under the US's CFIUS regime is typically related to foreign government investors only, not private foreign investors.

Impacts on local businesses and markets

Currently, foreign investors will often put in an early application to FIRB for competitive bids, in order to allow the approval process to be completed ahead of settlement. However, given the increase in fees for transactions that may not be successful, it is unlikely that investors will begin the approval process until they are certain the transaction will go through.

This means we will see time frames for transactions blow out as foreign investors apply for FIRB approval later in the process. Time frames will also increase in situations where FIRB approval is required because of foreign moneylending agreements.

This creates a downstream impact for Australian entities and investors because foreign bidders are disincentivised from competing in the Australian market and vendors of assets (typically Australian businesses) would lose much of the competitive and pricing tension that comes from a larger pool of potential buyers. Ultimately, local businesses and investors will lose out on getting the best possible price.

Restrictions on fund investments

Foreign investment into locally managed funds also have to get FIRB approval even in instances where those investors would have no influence or control over the fund.

Currently, there is an exemption from FIRB if an investor holds less than 5% in a wholesale fund, but we believe that this threshold should be higher (at least 10%). This would reflect the different risk profile of an investor coming into an Australian wholesale fund (thereby managed by an AFSL holder) and owning a minority position compared to a foreign buyer owning and controlling an asset directly without the oversight that an AFSL holder would abide by.

Moneylending arrangements

It appears the exemption for foreign money lenders has been removed, which now means syndicates with foreign lenders will be caught up paying these fees for investments in sensitive/national security assets.

Given the conservative lending habits of domestic banks towards commercial transactions since COVID hit, this could lead to a liquidity issue in Australia.

Further, it is likely that higher taxes on money lenders will simply mean that costs are shifted down the line, onto Australian financiers, developers, companies and consumers. As the Government understands, when costs are levied against financiers these new charges are ultimately born by the consumer. Given that the Government is trying to make it easier for Australians to access credit, the new taxes being applied to money lenders is contradictory to the very policies they claim to engender.

Exemption certificates

Fees for exemption certificates (ECs) amount to 75% of the fee that would be paid for an investment of a value equal to the monetary limit set under that EC. We believe that this is nonetheless a significant impost that an investor would have to pay upfront before a single investment is even made. Unforeseen circumstances or risks (including sovereign risks) may mean that the investments made under an EC are much lower than the EC's monetary limit. Thus, many investors would be deterred from taking out ECs altogether.

Further, investors who undertake a number of transactions a year and aren't able or willing to get an EC will be slugged multiple times – which is a huge disincentive for the large, trusted investors we need in Australia to re-boot the economy post Covid. The Government would effectively be 'double dipping' and taxing trusted and large-scale investors potentially several times a year.

Productivity Commission's views

The Property Council made comments regarding the proposed fees regime in our submission (dated 31 August) as part of the first stage of Treasury's consultation. We are again including some of these comments and the findings of the Productivity Commission regarding foreign investment fees.

While we understand that these major reforms will increase regulatory oversight and will require more resources, higher application fees would encourage investors to look at other markets that aren't as costly as Australia.

We are deeply concerned that the new fees framework creates significant misalignment of fees imposed on applicants with the cost of administering the foreign investment regime and will turn away investment at a critical time for Australia's economic recovery.

The Productivity Commission has recently highlighted how problematic foreign investment fees have become since they were introduced in December 2015[1]:

> *These are taxes, not a fee for service.* ***They are set at levels that are out of proportion with the cost of delivering the regulatory regime****. In 2017-18, the government collected $114 million in fee revenue, while the operational costs of FIRB and its secretariats in the Treasury and the ATO totalled only $14.7 million.*
>
> *They are also likely to be fairly inefficient taxes.* ***Taxing foreign businesses reduces foreign investment, leading to lower Australian wages and incomes****. The much higher fees on (small) agricultural investment applications than on other business applications have the potential to detract from growth in regional communities.*
>
> *The Commission, in its Regulation of Australian Agriculture inquiry, recommended that the Australian Government should set application fees for foreign investment proposals at the level that recovers the costs of administration, and closely monitor the fees so that there is no over- or under-recovery of costs.* ***The case for reform has not changed since that inquiry, and if anything, it has strengthened****. (emphasis added)*

We agree with the Productivity Commission's findings with respect to the fees regime and would urge Treasury and the Government to reconsider and restructure the proposed fees regime.

Further time delays

Currently, foreign investors will often put in an early application to FIRB when involved in competitive bidding processes, in order to allow the approval process to be completed ahead of settlement. However, given the increase in fees for transactions that may not be successful, it is unlikely that investors will put in a FIRB application until they are certain the transaction will go through.

This means we will see timeframes for transactions blow out as investors apply for approval later down the track, which would jeopardise successful deal completion and heighten sovereign risk.

Call-in power

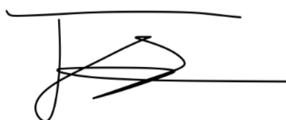
The Treasurer's 'call-in' power to review certain actions that don't fall under other national security provisions is an extraordinary measure that has increased investor concerns about Australia's sovereign risk.

Of most concern – apart from the broad discretion given to the Treasurer to call in investments – is the ten-year time frame set for the 'call-in' power. We believe that is far too long and, coupled with the broad nature of the power, creates significant investor uncertainty. The time limit should instead be set at a maximum of three years.

[1] *Foreign Investment in Australia – Commission Research Paper*, June 2020, Productivity Commission

The Property Council of Australia would like to meet with Treasury representatives to discuss the issues outlined in the submission and will be getting in contact to arrange an appropriate time. If you have any questions relating to this submission in the meantime, please contact Kosta Sinelnikov on 0422 168 720 and ksinelnikov@propertycouncil.com.au, or myself on 0422 608 804 and tbrown@propertycouncil.com.au.

Yours sincerely



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