RESERVE BANK OF AUSTRALIA

Submission to the Inquiry into Foreign Investment in Residential Real Estate

House of Representatives Standing Committee on Economics

Executive Summary

The available data, while incomplete, suggest that foreign residential investment in Australia has remained at most around 5–10 per cent of the value of dwelling turnover in Australia, and perhaps half of that share of the volume of dwelling turnover. 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.

Higher foreign demand for Australian dwellings can over time be matched by higher supply. While there have been improvements in the degree of flexibility in housing supply in recent years, some rigidities remain. Given this sluggishness, part of any increase in foreign housing demand may spill over into higher dwelling prices, though the data suggest that this has not been into the parts of the market where Australia's first home buyers are typically concentrated.

Foreign residential developers can increase innovation and competitiveness in the local construction sector; it is difficult to know, however, the extent to which they add to the overall supply of new housing.

Countries vary in the degree to which they permit foreign investment in their housing markets, with Australia among the more open countries only in respect of foreign purchases of new housing. The publication by the Foreign Investment Review Board of existing data in a more granular form could help to increase understanding of the trends in foreign residential investment. The benefit of any additional collection efforts should be balanced against the added administrative burden.

Legislative Framework and Available Data

Australia's foreign investment laws seek to channel foreign residential activity into new dwellings to promote local construction. The laws cover three broad groups: foreign developers of new residential projects; foreign purchases of new dwellings; and temporary resident purchases of new and established dwellings. In short:

- foreign-developed new residential projects are permitted and the resultant dwellings can be sold to either foreign or domestic buyers
- foreign individuals and temporary residents are permitted to purchase any new dwelling

- temporary residents with visas that allow them to stay in Australia for a continuous period of more than 12 months (such as some foreign students and some people on skilled business visas) are permitted to purchase one established home provided it is used as their principal place of residence while in Australia and is sold once vacated.[1]

Foreign investors and temporary residents require approval from the Foreign Investment Review Board (FIRB) prior to purchasing a dwelling or site for development, and most such applications are approved. FIRB is also responsible for monitoring compliance, and to this aim works with relevant members of the business community, government authorities, legal community and other government agencies (such as the Australian Federal Police, Department of Immigration and Citizenship, Australian Taxation Office and Australian Securities and Investments Commission). To strengthen the administration and oversight of the regulations, foreign purchase rules were tightened in 2010 and data-matching was expanded using FIRB data, state and territory lands and property office transaction data and citizenship data from the Department of Immigration and Citizenship. The penalties for not seeking prior approval can be quite severe.[2]

FIRB publishes data annually on the total number and value of the approvals it grants to foreign investors and temporary residents for the purchase of a specifically identified property or piece of land (the latest data available cover 2012/13). Setting aside any potential underreporting to FIRB, these data are likely to represent an upper limit on the actual level of foreign investment in Australia, since not every approval granted by FIRB results in a property sale to a foreign investor or temporary resident. In particular, there is no adjustment made to the published approvals data as to whether the proposed purchases were subsequently completed (i.e. whether a bidder was successful at an auction, a contract to purchase a specified home was completed, or a proposed residential development project was built). In addition, foreign or domestic developers of a proposed new residential project can receive pre-approval from FIRB to sell some or all of the resultant dwellings to non-residents, after which no further approval from the individual buyer is required. As a consequence, the published FIRB data do not reflect the share of new residential dwellings in these projects that was actually sold to foreign citizens or temporary residents or the timing of when the sales took place. Perhaps, more importantly, the FIRB data published reflect only gross approvals by foreign buyers; the subsequent sale of their properties to Australian citizens or permanent residents (required for instance when temporary residents vacate the property) is not included in the FIRB data. Other limitations of the FIRB data include the lag in its availability as well as series breaks, such as the changes to reporting requirements in 2009 and 2010 for dwelling purchases by temporary residents.

Despite these limitations, the FIRB approvals are the main source of data on the level of foreign residential investment in Australia. While there are published surveys of real estate agents' views on the share of foreign investment, it is not clear how the agents distinguish between sales to foreign investors as opposed to permanent residents and Australian citizens in these surveys. In addition to the FIRB data, this Submission draws on information gathered through the Bank's liaison with housing market contacts. This Submission does not cover the residential purchases made by permanent residents and citizens of Australia.

---

1 Foreign-owned companies can also purchase established properties to house their Australian-based staff; for a full set of definitions and the legal restrictions and allowances, see the FIRB website (www.firb.gov.au).

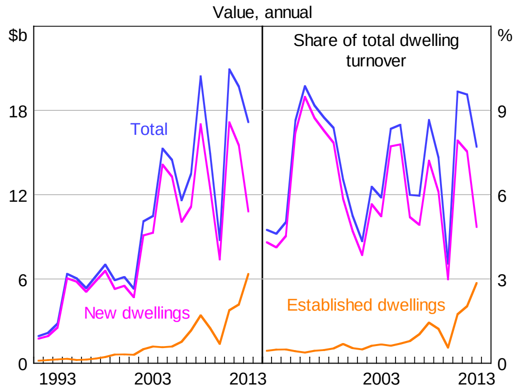
2 People who do not seek approval for foreign investment in Australia face a fine of up to $85 000 and two years jail, and the Treasurer has the right to order the sale of an acquisition that was not in the national interest. There have been some reports in the media of foreign citizens purchasing established properties through families and friends that already have Australian residency, whereupon the FIRB approvals data for this category would understate the level of 'effective' foreign investment; it is difficult to determine the extent of any such purchases.

Recent Trends in Foreign Residential Investment

While volatile from year to year, the FIRB data indicate that the *value* of approved foreign investment in residential property in Australia has increased, rising from around $6 billion annually in the 1990s to over $17 billion in 2012/13 (Graph 1). This increase has been driven mainly by approvals for new dwelling purchases and construction – which are by far the bulk of the approvals granted – though approvals to purchase established dwellings have also increased over time off a very low base. However, with overall dwelling prices and turnover having increased significantly in Australia over the past 20 years, the share of foreign residential approvals in the value of total dwelling turnover in Australia has remained broadly steady through time, fluctuating around 5–10 per cent, and in 2012/13 it was in the middle of that range. Over the past decade, the share increased modestly due to the rise in approvals to purchase established dwellings, although these still remain only 3 per cent of the value of total turnover. For the reasons noted earlier, these data are likely to overstate the actual share of dwellings purchased by foreign citizens, although by an unknown degree.[3]

Graph 1

FIRB Residential Approvals



Sources: FIRB; RBA; RP Data-Rismark

FIRB also publishes the *number* of its foreign approvals each year. Focusing first on the approvals granted to foreign individuals and temporary residents, the data indicate that both the number of new and the number of established dwelling approvals have increased over time, but are still each only around 1 per cent of total dwelling turnover in Australia (Graph 2). There is some additional turnover associated with approvals granted to foreign-developed residential projects, although this is difficult to estimate and depends very much on the assumptions used. FIRB grants just a single approval to a developer to cover the purchase of land that is subsequently subdivided for the development of multiple dwellings and also a single approval for developers who then can sell some or all dwellings in a new residential project to non-residents, such as for a new higher-density building. Assuming that the average price of the final dwellings associated with these projects were to be the same as that for the approvals granted to foreign individuals to purchase a new dwelling, then foreign-developed projects may collectively add a further 2–3 per cent or so to the dwellings that have obtained FIRB approval as a share of total dwelling turnover in Australia.

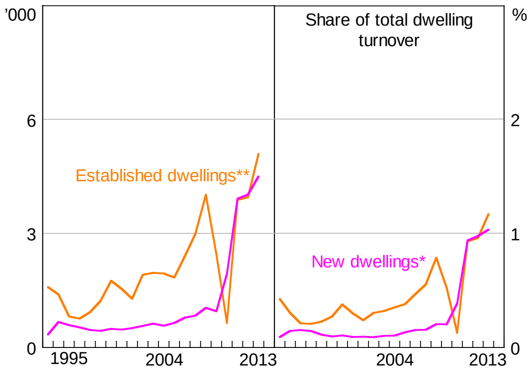
---

3 These estimates also assume that the year in which the proposed residential construction projects are approved by FIRB aligns with the year that the consequent dwelling purchases are settled.

Graph 2

FIRB Residential Approvals

Number, annual



* Only includes approvals for individual purchases

** Excludes approvals for 'annual programs'

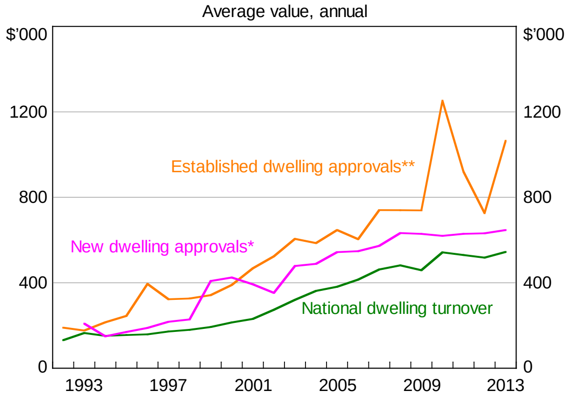
Sources: FIRB; RBA; RP Data-Rismark

Overall, these data suggest that foreign residential approvals have remained relatively steady as a share of the housing market in Australia and hence are unlikely to have been the main driving factor behind the recent increase in overall activity. Nonetheless, there is evidence that foreign purchases play a more prominent role in some parts of the housing market than in others. Focusing on approved purchases by individuals of new and established dwellings, the FIRB approvals data indicate that the average purchase price in 2012/13 was around $650 000 for a new dwelling and over $1 million for an established home. For both new and established dwellings, over time the average prices for approved purchases have consistently been much higher than the average actual sales price nationally (Graph 3). Taken at face value, this suggests that the purchases by foreign and temporary residents tend to be concentrated in the higher-priced parts of the housing market, although it is possible that this average is somewhat elevated by a few approvals to purchase very high-priced homes.

Graph 3

FIRB Residential Approvals and Dwelling Turnover

Average value, annual



* Only includes approvals for individual purchases

** Excludes approvals for 'annual programs'

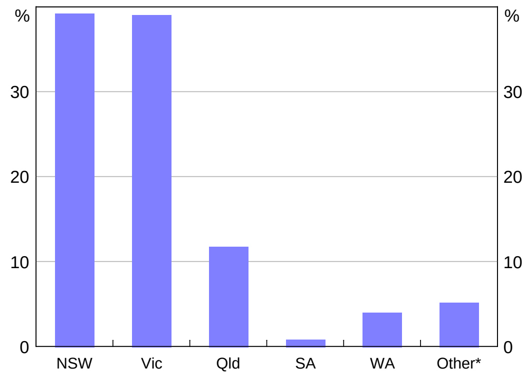
Sources: FIRB; RBA; RP Data-Rismark

Moreover, the FIRB approvals data suggest that foreign investment in new dwellings is concentrated in New South Wales and Victoria. In 2012/13, investment in new dwellings in these two states accounted for almost four-fifths of the total value of foreign residential investment approvals, much larger than the three-fifths share that these states have in the overall stock of housing in Australia (Graph 4). Bank liaison with industry participants suggests that much of this investment has been for the purchase of higher-density dwellings located in inner-city areas of Sydney and Melbourne, as foreign buyers and temporary residents typically prefer dwellings close to the central business districts, major universities and public transport infrastructure. Nonetheless, there is some evidence from the Bank's liaison with residential builders that foreign investment has started to broaden out into other areas of Sydney and Melbourne and to a lesser extent to other state capitals. The data for the approvals to purchase established dwellings are more evenly distributed among the states.

Graph 4

Value of FIRB Approvals for New Dwellings

Share of total approvals for new dwellings, 2012/13



* Includes FIRB approvals where the proposed investment is to be undertaken in more than one state or territory

Sources: FIRB; RBA

Bank liaison with housing market contacts suggests that, rather than being for short-term speculative purposes, foreign purchases of dwellings in Australia generally reflect a decision to invest for the longer term. In particular, these purchases appear to be motivated to meet housing needs for business persons located temporarily in Australia, for children studying in Australia, to acquire a second residence (possibly for eventual migration) and/or to diversify holdings of wealth geographically. There is little indication from the Bank's liaison with industry contacts that the level of foreign demand for Australian housing is significantly affected by fluctuations in the exchange rate, except perhaps for a few high-priced homes.

Economic Effects of Foreign Residential Investment

An increase in the level of demand for new or established Australian dwellings is likely to eventually lead to an increase in housing supply, although the increase in supply may ultimately not be in the same location because of constraints on land availability. In this respect, the key issue is the flexibility of housing supply in terms of its quantum and timeliness. Previous Bank research has suggested that supply impediments in the housing construction market have been significant in some states – reflecting the lack of suitable brownfield and greenfield land for development, difficulties in planning coordination, and resistance by local residents to new housing projects – which have added to the time to build and the cost of new housing.[4] More recent Bank liaison with housing participants suggests that the coordination of planning processes in some greenfield land areas has improved, though other rigidities remain.[5] In this regard, the recent interest in converting older office buildings in the CBD to higher-density residential buildings may help to offset the shortage of land available in well-located areas of the capital cities. Nonetheless, to the extent that the housing supply response is

4 See Hsieh W, D Norman and D Orsmond (2012), 'Supply-side Issues in the Housing Sector', RBA *Bulletin*, September pp 11–19.

5 More broadly, a range of structural factors related to Australia's urban environment impede the flexibility of housing supply; for a detailed discussion, see RBA (2014), 'Submission to the Inquiry into Affordable Housing', Submission to the Senate Economics References Committee, 14 February 2014.

inherently sluggish, an increase in housing demand – whether from foreign or domestic sources – will increase dwelling prices, at least temporarily until higher prices induce an increase in housing supply.

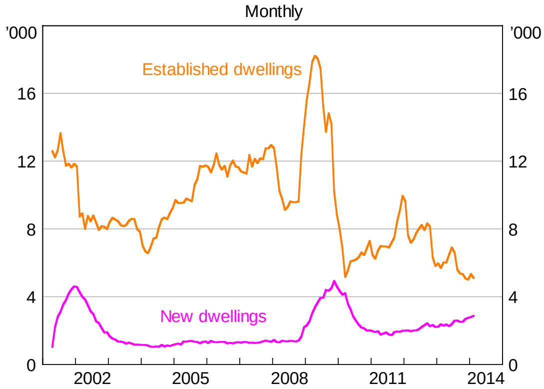
Whether the purchase of a property by a foreign citizen represents an increase in overall demand for housing depends on a number of factors. For example, if the dwelling is purchased to house a child studying in Australia who would otherwise have had to rent a home, or if the property bought by a foreign citizen is subsequently rented out, then the purchase itself does not represent an addition to demand for housing in Australia. Conversely, if a dwelling is kept vacant after being purchased by a foreign citizen then there will be a net increase in demand for housing. The overall impact on the housing market of ownership by foreign citizens also depends not only on their purchases, but also on their subsequent sales. If the flow of purchases and sales by foreign citizens roughly balance, then there is likely to be little effect on overall demand and house prices from foreign participation in the housing market. Furthermore, it is important to note that purchases of dwellings by foreign citizens and temporary residents who subsequently become permanent residents have simply shifted forward their housing needs. While there are no comprehensive data on how foreign residential investment is divided between these various categories, it seems likely that there has been some net increase in demand for housing by foreign citizens and temporary residents given the increase in wealth over recent decades of countries relatively close to Australia.

Some commentators have noted a potential for foreign residential housing demand to push up the price of housing for first home buyers. However, the data available – while incomplete – suggest that first home buyers have generally purchased established rather than new dwellings, and purchased dwellings that are cheaper than the overall national average (Graphs 5 and 6). As noted earlier, both of these are parts of the overall housing market where foreign residential purchasers do not appear to have a major presence.[6] While state incentives for first home owner grants have recently shifted toward the purchase of new rather than established dwellings – and hence to the area where foreign buyers generally have a greater presence – this effect is still likely to be fairly small.

Graph 5

First Home Buyer Activity*

Monthly



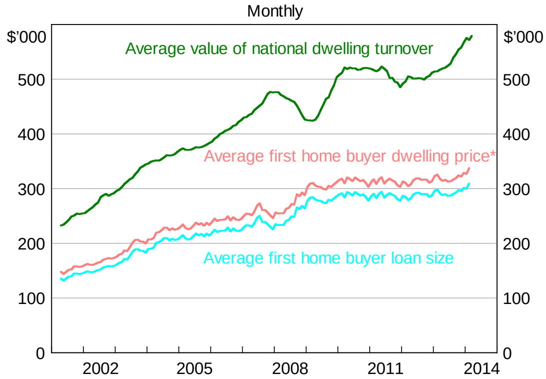
* Estimated using first home buyer loan approval and first home owner grant data

Sources: ABS; NSW Office of State Revenue; RBA

Graph 6

First Home Buyer Activity

Monthly



* Estimated using first home buyer loan approval data and average first home buyer loan-to-valuation ratio at origination over the past decade

Sources: ABS; HILDA Release 12.0; RBA; RP Data-Rismark

In addition, some of the foreign residential investment has been associated with the large increase in the number of temporary students in Australia during the 2000s and more broadly with the increased

6 Bank liaison suggests some foreign purchases of inner-city apartments close to universities are to house foreign students studying in Australia; anecdotal reports suggest that these properties are also not a large part of the first home buyer housing market for Australian citizens.

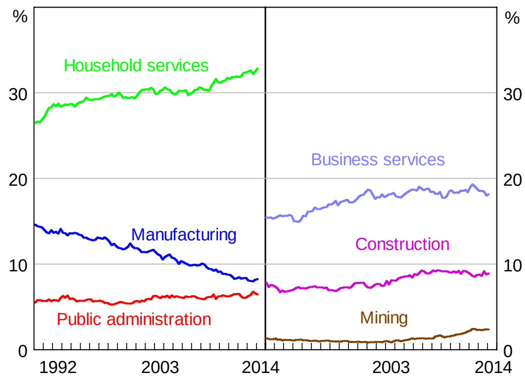
integration of Australia with economies in emerging Asia, which is boosting income and activity throughout the economy. This effect seems likely to continue for an extended period as the number of people in the middle class in Asia increases.

As a consequence of these various effects, foreign demand for Australian dwellings can – and has – provided a stimulus to the local residential construction industry, which accounts for around 9 per cent of total employment in the Australian economy and is more labour intensive than most other industries (Graphs 7 and 8). In addition, to the extent that materials used in the construction industry are sourced domestically, an increase in residential building supports local suppliers of building materials and can boost demand for household durable goods. The Bank's liaison contacts report that foreign residential demand has been especially helpful in boosting construction activity in the current stage of the economic cycle, with developers reporting little difficulty sourcing the skilled labour required for the construction of new dwellings, especially given the softening of investment in the mining industry.

Graph 7

Employment by Industry

Share of total, quarterly

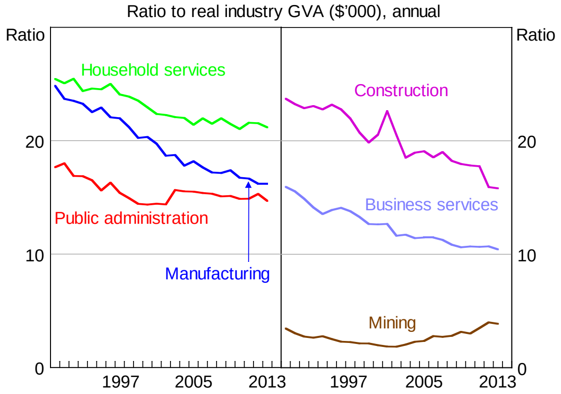


Sources: ABS; RBA

Graph 8

Number of Hours Worked by Industry

Ratio to real industry GVA ($'000), annual



Sources: ABS; RBA

The impact of foreign residential developers in adding to the overall supply of new dwellings in Australia is more difficult to determine, although on balance it is probably positive. In principle, the residency of a developer should make little difference to the magnitude of the supply response following an increase in demand for new housing. In practice, foreign developers may introduce new technology and skills to the Australian market and increase competition. In addition, foreign developers often fund projects using offshore financing, which diversifies the source of funding and at times may increase the overall level of funds available for dwelling investment in Australia. Finally, foreign developers often market their projects to potential buyers located in their own home country, which may at the margin increase the level of foreign demand for Australian dwellings and hence construction activity over what it would otherwise be.

Nonetheless, dwelling purchases and construction by foreign residents can increase the exposure of the Australian housing market to business cycles offshore. This may amplify Australia's business cycle to the extent that economic cycles are synchronised globally, but may act to dampen the effect on local activity to the extent that business cycles are idiosyncratic across countries. It may also be amplified to the extent that, unlike domestic developers, foreign developers pre-sell a large share of new dwellings to non-residents and may have to therefore increase substantially the number of dwellings for sale in Australia should these foreign purchase intentions not be followed through.[7] Further, as for any net capital inflow, foreign-financed residential investment may increase the value of the Australian dollar, although these inflows appear to have been relatively small to date.

International Comparisons

Foreign participation in the housing market has not been limited to Australia. For many decades, non-residents have purchased homes in global cities such as London and New York. According to industry reports, in most English-speaking countries – including Canada, New Zealand, the United Kingdom and the United States – there are very few restrictions on foreign purchases of residential property. Unlike Australia, these countries appear to make little to no differentiation between foreign purchases of new or established dwellings and there are very few reporting requirements. More recently, partly in recognition of the current weak activity in their housing markets, European governments have been looking at ways to increase foreign residential investment from outside the European Union. The situation in Asia varies across countries: Hong Kong, Malaysia and Singapore have comparatively minimal restrictions on foreign investment in their new and established housing markets – though some have increased property taxes in an effort to slow the pace of house price growth – while in China, India and Indonesia non-residents are generally not permitted to purchase residential property. It is also worth noting that some Australians purchase property in other countries, which can reduce their own demand for property in Australia.

Administration of Australia's Foreign Residential Investment Policy

To enhance understanding of recent trends, a case could be made to publish more granular – and more timely – data that are already being collected by FIRB. While other efforts could also be taken to shore up foreign purchase reporting requirements and data, the value of any such changes would need to be carefully balanced against the added administrative burden.

Reserve Bank of Australia
9 May 2014

[7] Local developers usually cap the share of foreign buyers at around 20–40 per cent of total sales, partly reflecting limits placed by Australian banks; the share is reportedly much higher for several foreign-developed projects.