Is Australia selling off its real estate?

Angelo Karantonis
Associate Professor
University of Technology Sydney

Keywords: Foreign real estate investment, regulations and controls of foreign investment, affordability, residential real estate market.

ABSTRACT

In the recent Federal election campaign in Australia, the Greens political party and several other candidates from other political persuasion expressed a concern that Australia was opening up and selling off its real estate to foreign buyers. They also argued that this has resulted in making residential real estate unaffordable to the average person in Australia. According to the Foreign Investment Review Board (FIRB), the level of 'expected' foreign investment in Australian real estate has increased from $269 million to $45 billion over the past 30 years.

This paper will examine the regulations for foreign investment in the Australian real estate market and identify the critical changes to these regulations over the past three decades. It will also identify the changing investment patterns and the level of investment and see if there is a relationship between foreign investment and rising prices in the Australian residential real estate market.

INTRODUCTION

The move to more global economies had taken momentum in the1970s was the decade that the global economies began moving to more 'open' economies. By March 1973 many of the major currencies moved from 'fixed' exchange rates to 'floating' exchange rate. With this change also came the movement of capital across economies. Originally capital flowed 'cross border' into equities, it soon flowed into property financing (loans) as the finance sector began introducing new 'instruments' like bank and commercial bills. By the 1980s, capital began to flow directly into real estate to explicitly investment in it as an asset. In the five years to 1989 FDI grew three times faster than trade increasing at a rate of 29% pa reaching a cumulative total of $US1.5 trillion (The Economist Aug 24 1991).

Australia moved toward a more open economy in the 1980s with the deregulation of its financial markets. It began with the floating its currency (AUD) in December 1983 and allowing capital to flow in and out of its economy. It further opened its economy with the approval given to 16 Foreign Banks to open in Australia. Howe (1994) found that the deregulation of Australia's financial sector led to a large increase in foreign direct investment in the second half of the 1980s.

The amount of inward foreign direct investment (FDI) into Australia, increase from one per cent of GDP in 1976/77 to an average two percent of GDP from 193/84 to 1992/93 (Howe, 1994). Howe also noted that whilst manufacturing and mining were the major recipient sectors of FDI before the 1980s, services and later real estate emerged as the new industry sectors to attract FDI from the 1980s onwards. By 1990 Australia was ranked 7th as a destination for FDI in the world (Yang et al, 2000).

The shift to foreign real estate has been part of a shift of diversification, as pointed out by Baum (1995), who cites the pursuit of high return and low risk as the underlying factors for international property investment. This is further evident by Worzala (1994) in a survey of institutional investors, which found diversification, yields and low risk as the three main reasons. McAllister (1999) adds that the emergence of Property Trusts has eased the cost of information search and thereby should facilitate further foreign investment in property. Addae-Dapaah and Kion (1996) conducted a study using a range of countries, which included Australia and found that the potential gain from international real estate diversification is substantial. They concluded that investors "should consider purchasing foreign stocks to improve their portfolio efficiency". Hoesli et al (2004) conclude that when adding international real estate investment in a mixed asset portfolio, there is a risk reduction of between 10% and 20%.

At the turn of the 21st century total foreign investment in all sectors in Australia reached $613b (ABS, 2000). Australia perceived as a politically *safe haven* and ranked as having the highest transparency in its real estate markets, in the JLL Index (2010), has had the level of "expected" foreign investment in the Australian real estate increase from $269 million in 1980 to over $45 billion in 2008[1] (FIRB, 2009).

Over the period from 1980 to 2009, there has been a shift in the investment pattern of the foreign investors in Australian real estate, some of which has been influenced by the changes to the regulations and guidelines set down by the Australian government, other reasons being, normal real estate decision making by foreign investors and to some extent finding political safe environment in Australia.

In 2009 4,827 proposals were made for investment in Australian real estate, with nearly all being approved. 99.9% of all applications for all industries were approved, with only three applications rejected, all in the real estate sector. By far the largest number of overall foreign investment proposals involves the purchase of real estate (FIRB 2010).

With the easing of the FIRB guidelines (2010), in particular residential real estate, the question of whether the easing of guidelines for foreign real estate investment has driven up residential prices in Australia and made it less affordable has become the focus of politician and the media (The Age, 2010, Domain, 2010) and the Reserve Bank Governor (Zippone, 2010). However, there is no evidence to either support or reject this theory, as the Governor stated, “hard facts about the trend are difficult to find”.

GUIDELINES - FOREIGN REAL ESTATE INVESTMENT IN AUSTRALIA

The Foreign Investment Review Board (FIRB) was established in 1976 by the Federal Government and charged with examining foreign investment proposals into Australia. The FIRB administers the policy as set down by the Federal Government under the Foreign Acquisitions and Takeovers Act 1975 as amended.

FIRB regulations apply to investments from "foreign interest". For the purposes of the FIRB, a foreign interest is defined as :-

* a natural person not ordinarily a resident in Australia

[1] From 2009, due to the changes in reporting by the FIRB, the 2009 figures are for commercial investment only.

* any corporation, business or trust in which a single foreigner (and any associates) has 15% or more of the ownership or in which several foreigners (and any associates) have more than 40% or more of the ownership (FIRB 2009).

There have been continuous changes to the regulations in respect to foreign real estate investment in Australia. Table 1 shows the chronology of changes that have taken place since the Act was enacted.

TABLE 1: CHRONOLOGICAL CHANGE TO RULES GOVERNING FOREIGN REAL ESTATE INVESTMENT IN AUSTRALIA

1975	• Foreign Takeovers Act 1975
1976	• FIRB established • New foreign investment had to yield net economic benefit • 1976-1983: FIRB approved 30%, 64% with conditions, 4% rejected
1978-1982	• Strict guidelines for foreign investment early 1980s • Individual acquisition of R/E $250,000
29 October 1985	FIRB approval thresholds increased: • 50% local equity for land (>$10million) bought for development (and subsequent resale), • Cumulative residential (from 1978) from $250,000 to $600,000 without notification
28 July 1986	• Abolished requirement for local equity for development of real estate, • Commercial real estate approved subject to 50% local equity
29 September 1987	• Abolition of the $600,000 cumulative exemption threshold that previously applied to foreign purchases of urban real estate. • (30 April) exempt from notification for real estate purchases <$5 million (rural, $3 million) • (29 Sept)$600,000 threshold on residential real estate abolished and all residential real estate acquisitions restricted and required approval regardless of value require approval, • **Off the plan initiated** – maximum of 50% can be sold to foreign investors.
25 July 1991	• Foreign investors may acquire any residential real estate (vacant land for development, units off the plan, or established properties) within a designated Integrated Tourism Resort (ITR) without the need to seek approval.
1 August 1991	• Act to be known as "Foreign Acquisitions and Takeovers Act"
26 February 1992	• Notification thresholds are $3 million for purchases of rural properties, $5 million for acquisitions of substantial interests in other existing businesses, $10 million for the establishment of new businesses and $20 million for offshore takeovers
1 April 1993	• 'off the plan' acquisitions to include acquisitions that are part of extensively refurbished buildings subject to the building's use changing from non-residential to residential and the costs of refurbishment to be at least 50 per cent of total acquisition costs; • proposals by foreign interests to acquire developed commercial real estate were no longer required to have 50 per cent Australian equity.
1 April 1999	• Ten or more dwellings are required for advanced approvals for developers to sell 50% of development to foreigners. Only under "special circumstances" will approval be given for more than four (as was previously the case).
10 September 1999	• Increased the threshold in commercial from $5 million to $50 million) except for heritage listing which remains at $5 million. • Permission to acquire strata titled hotel rooms with leases of 10 years or more with hotel management agreements.

2 December 2006 **23 April 2008**	• Australian USA Free Trade Agreement (FTA) increases threshold to $800 million for commercial (non heritage) indexed annually. • Extend time frame for development of commercial land from 12 months to five years.
18 December 2008	• $300,000 limit applying to foreign students is removed. • Extend time frame for development of residential land from 12 months to two years. • Definition of new dwelling to 'have not been sold and have not been occupied for more than 12 months'. • Removal of the 50% maximum to sell 'off the plan', provided the developer market the property locally as well as overseas.
31 March 2009	• Temporary residents are no longer required to notify proposed acquisitions

Source: FIRB Annual Reports (various years)

REAL ESTATE PROPOSALS THAT ARE NORMALLY APPROVED

Unless judged contrary to the National Interest the following acquisition proposals from foreign interests would normally be approved. The following must be reported to the FIRB:

Vacant Land

- Vacant land of all sectors requires approval. Requirement is that construction must begin within 24 months for residential and 5 years for commercial,

Residential

- all deals must be reported!

Off the Plan

- No restrictions on the number of off-the-plan dwellings in a new development sold to foreign persons, *provided marketed locally as well as ov*erseas

Developed Commercial

- all deals over $50 million (except heritage listed ($5 m)

Rural

- Primary production - Treated like commercial ($50m)
- Hobby farms, vacant rural - treated like "urban" - must report

Exemptions

Residential

- Australian citizens living abroad
- Foreign nationals purchasing (as joint tenants) with their Australian citizen spouse.
- New Zealand citizens
- Holding a permanent resident visa
- Purchasing new dwelling from a developer,
- Purchasing residential Integrated Tourism Resort

Commercial

- Acquiring developed commercial property valued at >$50m ($1004m for USA),
- $5 million for heritage listed properties where the acquirer is not a US investor;
- Acquiring developed commercial property for immediate use.

Residential real estate purchases are limited to the following categories:-

(a) land for development (with construction within 12 months), and subsequent retention or resale;

(b) intending migrants, temporary residents (with > 12 months), senior executives of foreign owned businesses (maximum of two);

Note:

- these must be sold once the status conditions no longer apply.
- Temporary residents need to receive approval

(c) property within the bounds of an "Integrated Tourist Resort" (can sell 100%); and

(d) 100% "off the plan" of new development of home units or condominiums (including "extensively refurbished developments"):

   a. have not previously been sold (that is, they are purchased from the developer); and
   b. have not been occupied for more than 12 months.

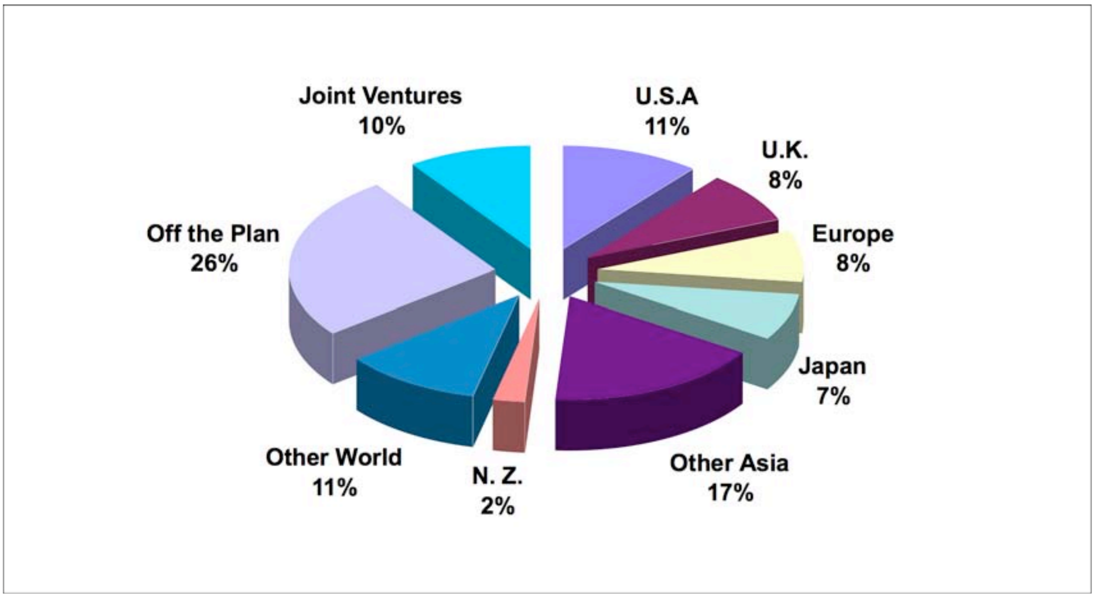
LEVEL OF FOREIGN INVESTMENT IN AUSTRALIA

Before looking at the impact of changing guidelines by the FIRB, it is relevant to see the level and the changing pattern of foreign investment into the real estate sector. However, the following limitations to the FIRB statistics need to be noted:

- FIRB statistics only included those reported.
- Reporting criteria has continued to change
- Statistics are 'expected' investment and not 'realised' investment.

The level of reported 'expected'' foreign investment in the Australian real estate market reached $323 billion since 1980. Figure 1 shows the investor country/region and as can be noted 'off the plan' attracts the largest individual investment, however, this category does not show the investor country. The largest region investing is Asian investment representing 24% of the total, whilst USA with 11 percent is the largest individual investor country.

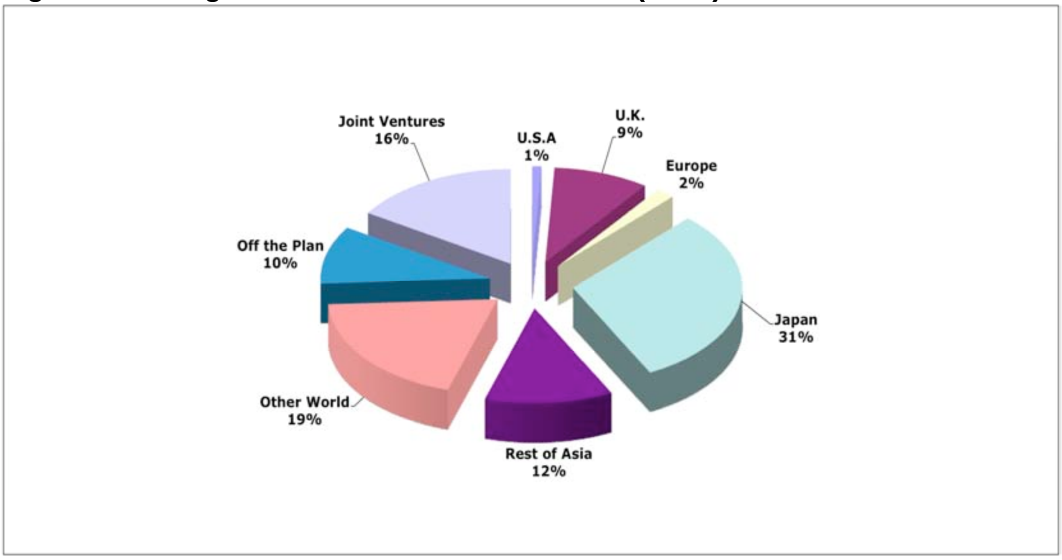
Figure 1: Foreign R/E Investment in Australia ($323b) 1980 - 2008



Source: FIRB Annual Reports (various years)

Although USA has continued to be a large foreign investor in Australia, it was not always a large investor in real estate in the past. Figure 2 shows the composition of investor countries in Australian real estate in the 1980s, where USA is only included in ‘other world’. Here we see Japan leading the investment with 31 percent of the total and rest of Asia an additional 12 percent. The Asian region is further enhanced when we consider off the plan and joint ventures, which are uncategorised regarding country. Accordingly to industry sources, both these areas have been predominantly Asian investment, off the plan from the NIEs (Hong Kong, Singapore, Malaysia and Indonesia), whilst joint ventures mainly Japanese.

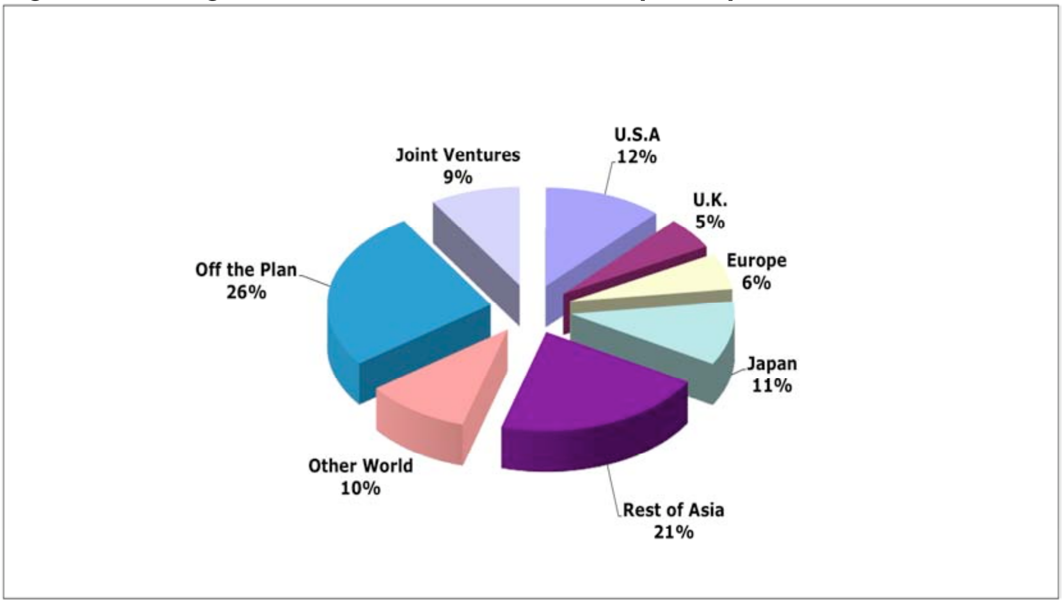
Figure 2: Foreign R/E Investment in Australia ($36b) 1980s



Source: FIRB Annual Reports (various years)

When we move to the 1990s, whilst the Asian region continued to be the leading area (32 percent), we see a shift away from Japan, decreasing to 11 percent (as their economy moved to a downturn) and the rise of USA (12 percent) with the announcement of Sydney getting the Olympic Games in September 1993. The FIRB reports show USA investment beginning to increase from that time onwards.

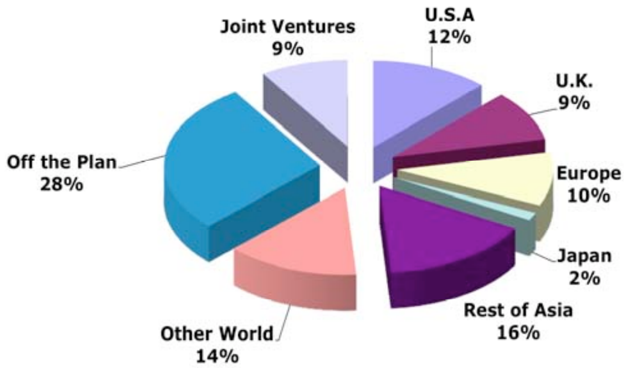
Figure 3: Foreign R/E Investment in Australia ($100b) 1990s



Source: FIRB Annual Reports (various years)

Moving to this decade, we see total investment nearly doubling for the nine year period, with Europe/UK becoming the leading region (19 percent) and USA maintaining the leading position.

Figure 4: Foreign R/E Investment in Australia ($189b) 2000s



Source: FIRB Annual Reports (various years)

IMPACT OF THE FIRB GUIDELINES CHANGES TO RESIDENTIAL PROPERTY

From the above chronology of FIRB changes, we can note that the more recent changes have made Australian real estate more accessible to foreign buyers. Commercial real estate required 50 percent Australian joint venture has been removed and in addition, notification is now only required for investments of over $50 million ($1.04 billion for USA investors). In residential real estate, the changes now allow for 100 percent of new developments to be sold to foreign buyers and the period classified as new has been broadened to allow the property to have a tenancy to a maximum of 12 months.

Examining the disaggregated foreign real estate investment since the introduction of 'off the plan', we see 56.2 percent flowed into residential real estate and 43.8 percent commercial. Table 2 shows the break up of this investment as well as developed and developing in both residential and commercial respectively. As noted, residential attracted 56.2 percent of the investment, with the largest investment being 'off the plan' (28%), which is purchasing new home units. Overall, investment flowed into developed or newly developed real estate, with 38.3 percent (19.9 percent for residential and 18.4 percent for commercial) flowing into property development.

Table 2: Disaggregated of Real Estate Investment in Australia

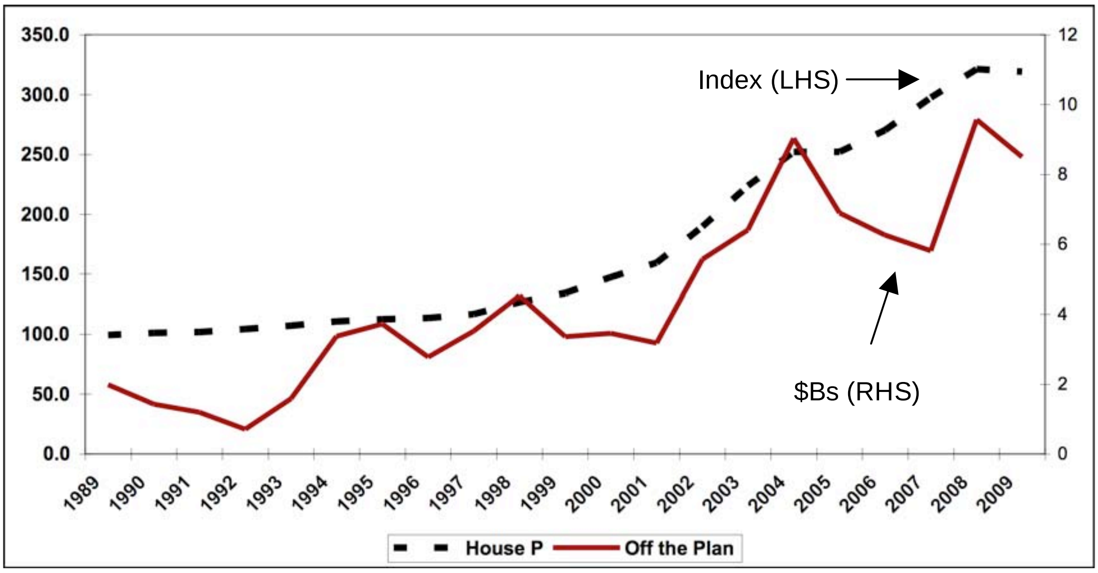
	$ billion	$ billion	%
Off the Plan	92.81		28.8%
Residential Development	64.05		19.9%
Developed Residential	24.20		7.5%
Total Residential		**181.1**	**56.2%**
Commercial Development	59.19		18.4%
Developed Commercial	81.95		25.4%
Total Commercial		**141.1**	**43.8%**

Source: FIRB Annual Reports (various years)

Is this level of purchasing residential real estate been responsible for driving Australian residential prices even further up and thereby making affordability even harder for the local buyers?

Figure 5 shows the price movement in all capital cities in Australia and the off the plan purchases by foreigners. Residential prices in most capital cities in Australia have had a sustained growth over the period, whilst off the plan purchases have fluctuated over this period. Some of these fluctuations can be attributed to other factors, such as the Asian Crisis (1996 onwards), post Olympic Games (2000) and the Global financial crisis (2008), all of which could be regarded as exogenous factors. As can also be noted that prices continued to increase despite falling off the plan purchases.

Figure 5: Foreign 'off the plan' vs property price (Australian Capital Cities)



Source: FIRB Annual Reports (various years) & ABS (2010)

Before, addressing the question above, it should be noted that Treasury (2009) continues to state in its Reports that:

> *"The Government seeks to ensure that foreign investment in residential real estate increases the supply of dwellings and is not speculative in nature. The policy seeks to support foreign investment in the housing sector that directly increases the supply of new housing (that is, new developments such as house and land, home units and townhouses) and brings benefits to the local building industry and its suppliers.*
>
> *The effect of the more restrictive policy measures on developed residential real estate is twofold. Firstly, it helps reduce the possibility of excess demand building up in the existing housing market. Secondly, it aims to encourage the supply of new dwellings, many of which would become available to Australian residents, either for purchase or rent. The cumulative effect should be to maintain greater stability of house prices and the affordability of housing for the benefit of Australian residents."*

Increasing the supply of dwellings by foreigners would come through 'residential development' and as noted from Table 2 above, amounted to $64.05 billion since 1989. But, the largest investment ($92.81 billion) off the plan, can have both positive and negatives for demand and supply to the local players in the market. The negative aspect is that off the plan purchases add to the demand to local buyers thereby help drive up prices. The positive aspect is that off the plan sales, help maintain a positive rate of return to developers and thereby can increase further development by both foreign and local developers, thus increasing an accommodating supply.

PRELIMINARY ANALYSIS

Whilst this is not an econometric paper, it may be useful to undertake a couple of preliminary test and see their results.

Whether off the plan led prices or vice versa is not easy to determine, especially given the limited nature of the statistics available. Firstly, the FIRB off the plan figures are expected investment over the period and are calculated based on the assumption that the developer would sell 50 percent offshore, thus are overstated. Secondly, we only have 20 periods and they are annualised figures, and thirdly, the FIRB figures do not state the destination (city) of the investment. Hence, the Governor of the Reserve Bank's statement, "hard facts about the trend are difficult to find" (Zappone, 2010). Accordingly, the following analysis and results should not be seen as absolutes

Table 3 shows the correlation between housing prices (Capital Cities Index) and the three categories of residential foreign investment. All three have a positive correlation with price, particularly 'off the plan' investment, which as has a strong correlation of 0.909 with price. However this does not tell us if price is leading the investment or vice versa.

Table 3: Correlation price & foreign residential investment

	Price	Off the Plan	Developed	Development
Price	1			
Off the Plan	0.909	1		
Developed	0.671	0.740	1	
Development	0.727	0.661	0.240	1

A test that can be applied to the question as to whether increased off the plans sales lead to increased prices or vice versa is Granger Causality Test. Using Eviews, Tables 4(a) and 4(b) shows the results for the Granger Causality Test for prices, off the plan, developed residential and residential development with a one and two year lag respectively.

The results in Table 4(a) shows that both off the plan investment and residential development **do not** Granger cause residential prices. In all other cases the null hypothesis is rejected, which means prices Granger cause off the plan investment and residential development. In the other criteria, developed and prices have a two way Granger cause.

Table 4(a): Pairwise Granger Causality Test 1989 – 2009 (one year lag)

Null Hypothesis:	Obs	F-Statistic	Probability
OFFPLAN does not Granger Cause PRICE	20	1.32658	0.26536
PRICE does not Granger Cause OFFPLAN		7.34211	0.01487
DEVELOPED does not Granger Cause PRICE	20	9.37927	0.00705
PRICE does not Granger Cause DEVELOPED		16.3449	0.00084
DEVELOPMENT does not Granger Cause PRICE	20	0.08292	0.77685
PRICE does not Granger Cause DEVELOPMENT		23.4338	0.00015

Examining Table 4(b), we see the null hypothesis rejected in all cases. This means that in each case, there is a two way Granger cause

Table 4(b): Pairwise Granger Causality Test 1989 – 2009 (two year lag)

Null Hypothesis:	Obs	F-Statistic	Probability
OFFPLAN does not Granger Cause PRICE PRICE does not Granger Cause OFFPLAN	19	5.67335 6.67303	0.01568 0.00922
DEVELOPED does not Granger Cause PRICE PRICE does not Granger Cause DEVELOPED	19	16.9460 10.0738	0.00018 0.00195
DEVELOPMENT does not Granger Cause PRICE PRICE does not Granger Cause DEVELOPMENT	19	4.19255 10.0139	0.03743 0.00200

CONCLUSION

This paper has shown the changes of FIRB guidelines in regards to foreign investment in Australia's real estate markets. The changes have mostly been more favourable for foreign investors and in particular the more recent changes for the residential real estate sector. Other than the restriction on "used" or "second hand" residential property, Australia has an "open door" policy on foreign investment in real estate investment.

The paper also showed the changing pattern of foreign investment over the past three decades. The increase in investment has been similar to that occurring in many other parts of the world, due to deregulation and the move to more globalised investment markets.

Some of the movement has been attributed to exogenous factors such as Sydney Olympic Games, the Asian Crisis and the more recent Global Financial Crisis. The former *spurred* on by the granting of the Sydney Olympics. whilst the latter two had negative effects and had nothing to do with the price of Australian real estate..

Finally, the paper did some preliminary tests, using correlations and the Granger Causality Test. The correlations showed there is a close correlation between price and expected 'off the plan' selling, but it cannot be concluded that the foreign sales off the plan impacted on residential prices in Australia. The Granger Causality Test indicated that price Granger caused off the plan sales after one year and that there was a two way Granger cause between off the plan and prices after two years. However, as noted, these results are base on FIRB figures, which are annual 'expected' investment and on the assumption that the registered developers sell 50 percent offshore and are therefore 'overstated'. Further statistical information is required to undertake a proper analysis.

REFERENCES

(ABS) Australian Bureau of Statistics (2000) *"Balance of Payments & International Investment Position"* Cat 5362.0, Canberra.

Addae-Dapaah K and Kion C B (1996) *"International Diversification of Property Stock - A Singaporean Investor's Viewpoint"* Real Estate Finance, Fall, pp54-66.

Baum (1995) *"Can Foreign Real Estate Investment Be Successful?",* Real Estate Finance, Vol 12, pp 81-89.

Domain (2010) http://blogs.domain.com.au/housing_affordability/

(FIRB) Foreign Investment Review Board (1981-2010) *"Annual Reports"* Various Years, AGPS Canberra.

Hoesli M, Lekander J and Witkiewicz W (2004) “International Evidence on Real Estate as a Portfolio Diversifier, Journal of Real Estate Research, Vol 26, No 2.

Howe J (1994)”Internationalisation, Trade and Foreign direct Investment” in International Integration of the Australian Economy, Conference Proceedings, p111-155, Reserve Bank of Australia, Sydney

(JLL) Jones Lang LaSalle (2010) “*Global Real Estate Transparency Index 2004”,* LaSalle Management, Chicago

McAllister P (1999) *“Globalization, Integration and Commercial Property: Evidence from the UK”,* Journal of Property Investment & Finance, Vol 17, No 1, pp 8-26.

The Age (2010) “RBA watching foreign investment in housing”, The Age, 26 March, Melbourne.

The Economist Aug 24 1991

Treasury (2009) “Australia’s foreign Investment policy”, Foreign Investment Policy Division, ACT.

Worzala E (1994) *"Overseas Property Investments: How Are They Perceived by the Institutional Investor?"* Journal of Property Valuation & Investment Vol 12,No 3,pp 31-47.

Yang J, Groeewold N and Tcha M (2000) *"The Determinants of Foreign Direct Investment in Australia",* The Economic record, Vol 76, No 232, Australia, pp45-54.

Zappone C (2010), “Housing affordability hits wall”, Sydney Morning Herald, 22 February, Sydney