Property Council New Zealand

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Finance and Expenditure Committee
Wellington 6160
Parliament Buildings
Email: fe@parliament.govt.nz

Overseas Investment Amendment Bill (No3)

1. Recommendations

1.1. Property Council New Zealand ("Property Council") welcomes the opportunity to provide feedback on the Overseas Investment Amendment Bill (No 3) ("the Bill").

1.2. Property Council is generally supportive of the Bill. However, there are certain aspects of it that require further consideration and amendments to ensure it is fit for purpose.

1.3. Property Council recommends:

Overseas Investment Amendment Bill (No 3)

a. raise the screening threshold for leases to 15 years or more;
b. delete Section 38A which requires overseas investors to disclose tax information (e.g. capital structure for investment, description of activities etc.)

Additional suggestions for residential sector development

c. widen the exemption from the on-sale outcome to the "Build to Rent" asset class (including existing developments);
d. remove the maximum offshore sales threshold for residential properties of 60 per cent;
e. introduce an exemption for residential developers who have a proven track record, robust systems and high level of experience;
f. introduce more flexible requirements around living in purchased apartments (e.g. minimum number of rented days per year);
g. enable incentivisation of a wider range of residential developments by introducing an exemption for any new housing development regardless of the configuration and number of dwellings;
h. introduce an exemption for the first sale from the vendor to purchaser regardless of the building completion date; and
i. amend Schedule 1 AA, clause 6(7)(b) of the Overseas Investment Act to provide more clarity around an exemption relating to dwellings in large apartment developments where sales of dwellings have begun before assent date.

2. Introduction

2.1. Property Council's purpose is "Together, shaping cities where communities thrive". We believe in the creation and retention of well-designed, functional and sustainable built environments which contribute to New Zealand's overall prosperity. We support legislation that provides a framework to enhance economic growth, development, liveability and growing communities.

2.2. Property is currently New Zealand's largest industry with a direct contribution to GDP of $29.8 billion (13 per cent). The property sector is a foundation of New Zealand's economy and caters for growth by developing, building and owning all types of property.

2.3. Property Council is the leading not-for-profit advocate for New Zealand's largest industry - property. Connecting people from throughout the country and across all property disciplines is what makes our organisation unique. We connect over 10,000 property professionals, championing the interests of over 600 member companies who have a collective $50 billion investment in New Zealand property.

2.4. Property Council has a broad membership, which includes a wide range of commercial and residential property owners and developers in New Zealand. Several of our members are NZX listed companies and therefore attract overseas investment alongside investment by New Zealanders.

2.5. This submission provides Property Council's feedback on the Overseas Investment Amendment Bill No3). The submission also provides comments on the amendments in relation to residential developments introduced under the Overseas Investment Amendment Bill back in 2018.

Part I: Overseas Investment Amendment Bill (No 3)

3. Purpose of the Bill

3.1. Property Council supports the purpose of the Bill to ensure that risks posed by overseas investment can be managed effectively. In particular, we support measures to cut unnecessary red tape and streamline the process for investing in New Zealand (e.g. no requirement for screening lower-risk transactions and for repeat investors of a good character; simplified and clarified counterfactual assessment).

3.2. It is critical that the Government can manage the risks posed by overseas investment, but equally, that Crown intervention does not delay investment that protects jobs and economic growth. Overseas investment is critical to support New Zealand in the post-COVID-19 recovery, as it improves productivity and employment, enhances export opportunities, and brings with it new ideas, innovations and relationships.

3.3. While we support the Bill in principle, there are certain aspects of it that require further consideration to ensure the success of the overarching Overseas Investment Reform. The sections below outline our recommendations to ensure the Bill is fit for purpose and delivers on the objectives set by the Government.

4. Leases and other non-freehold interests

4.1. We support the Government's overarching intention to simplify the process for making productive investments in New Zealand by no longer requiring lower-risk transactions to be screened, including a lower threshold for short-term leases (i.e. currently, three-year lease threshold). In the past,

overseas investment has been deterred by the disproportionate cost, time and stringency of the screening process for leases. Despite the short-term nature of leases, these transactions are subject to the same scrutiny and compliance costs as higher-sensitive transactions that involve land leaving New Zealand ownership or control indefinitely.

4.2. Many leases in the commercial sector are longer than 10 years, as tenants require certainty for the business particularly if they need to make internal alterations (e.g. fit-outs, insulating machinery, etc.). Investors also find it difficult to demonstrate that short-term investments will deliver the benefits needed to satisfy the screening requirements particularly in cases where the applicant does not have full control of the asset. By the contrast, a long-term lease encourages overseas persons to invest in property and provide further economic benefit to the country.

4.3. Feedback from our members indicate that the 10-year term is too short and restrictive for most commercial leases. The most popular option is to consider longer terms ranging from 12 to 35 years.[1] Given this, we recommend the screening threshold for leases and other freehold interests be extended to 15 years or more. Our position aligns with the Treasury's recommendations to raise the screening threshold for leases to 15 years or more. This includes rights of renewals for all types of land, except residential land where the threshold would remain at three years. A raised screening threshold will better reflect the life of an investment and address concerns about uncertainty of shorter leases.[2] Longer leases will also better support overseas investment in productive land and deliver more predictable, transparent and timely outcomes.

5. New tax information requirements

5.1. The Bill will require overseas investors to disclose information relating to their proposed investment structure and tax treatment to Inland Revenue to support the integrity of New Zealand's tax system (Section 38A – information for tax purposes). We acknowledge that this proposal is in response to the public concern that overseas persons acquiring New Zealand assets are not paying their fair share of tax in New Zealand. This could be viewed as contrary to the overarching Act's purpose, which recognises that it is a privilege to invest in New Zealand.

5.2. We support the Government's intention to address the issues above. However, we are concerned that the proposal would result in unnecessary complexity of the application process without managing the risks posed by overseas investment. In practice, the proposal means that the prospective investors will have to design the investment structure much earlier than in the current process to be able to provide the required tax information. However, the reality is that the investment structure is often not considered until the final stages in the process (i.e. agreement is negotiated, and application is completed).

5.3. Treasury has released a summary of the information it expects will be required to be disclosed once that requirement comes into force (e.g. description of activities, capital structure for investment,

[1] Treasury. (2019). Overseas Investment Act Submissions Information Release. Retrieved from https://treasury.govt.nz/sites/default/files/2019-12/oia-tr-2019-1690.pdf

[2] Treasury. (2020). *Reform of the Overseas Investment Act 2005 – Phase 2: Regulatory Impact Assessment.* Retrieved from https://treasury.govt.nz/sites/default/files/2020-03/ria-tsy-os-invest-mar20.pdf

cross border related party transactions).[3] This provides some clarity to overseas investors. However, provision of some of the required information can be challenging, given the complexity of certain aspects of it (e.g. capital structure for the investment – use of hybrid instrument or hybrid entity for the investment).[4]

5.4. For these reasons, Treasury and Inland Revenue do not recommend introducing a new tax information disclosure requirement as it would marginally increase compliance cost for investors without substantially increasing New Zealand's ability to manage the risks associate with overseas investment.[5] This is simply because this information would not be considered as part of the screening process.

5.5. During the consultation, the business community strongly opposed the proposal to consider tax under the investor test given that the Overseas Investment Office ("OIO") does not necessarily have the relevant expertise and that the Act is not the best place to regulate tax compliance.[6] This aligns with the Treasury's rationale for not supporting the proposal of introducing a new tax information disclosure requirement. Tax law can respond to the issues above in a comprehensive and uniform way across all entities doing business in New Zealand.

5.6. Therefore, we do not support the proposal to require overseas investors to disclose tax information and recommend deletion of Section 38A. The Act only covers a small portion of overseas investment so can never be a complete response to concerns about tax compliance by overseas investors. Further to this, the previously introduced expansion of the good character component of the investor test already provides an option to manage the risks posed by the overseas investment.[7]

Part II: What should be done in the residential space

5.7. Property Council is encouraged by the changes the Government has made in relation to the overseas investment for the commercial property sector. However, more could be done in the residential property space, especially given the overarching Government's intention of building more housing quickly and at scale.

5.8. In 2018, the Government imposed a ban on overseas ownership of residential property in an attempt to reduce housing unaffordability. This resulted in adverse and unintended consequences such as abandoned pipeline projects, increased rental rates and less housing stock. For example,

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[3] Treasury. (2020). *Overseas Investment Amendment Bill 2020: Summary of approach to supporting regulations*. Retrieved from https://www.parliament.nz/resource/en-NZ/52SCFE_ADV_97805_FE26011/a10548a0d60902574c6246f729c98d45975a7814

[4] Note: to determine the use of a hybrid instrument or hybrid entity, there would be a need to consider New Zealand's anti-hybrid mismatch rules which are complex in nature (Source: Inland Revenue, Tax Policy) - https://taxpolicy.ird.govt.nz/publications/2016-dd-hybrids-mismatch/chapter-2

[5] Treasury. (2020). *Reform of the Overseas Investment Act 2005 – Phase 2: Regulatory Impact Assessment.* Retrieved from https://treasury.govt.nz/sites/default/files/2020-03/ria-tsy-os-invest-mar20.pdf

[6] Treasury. (2019). Overseas Investment Act Submissions Information Release. Retrieved from https://treasury.govt.nz/sites/default/files/2019-12/oia-tr-2019-1690.pdf

[7] Note: Section 18A of the Urgent Measure Bill expanded the good character component of the investor test to allow serious tax defaults and penalties for tax evasion and avoidance to be considered as part of the screening process.

Auckland CBD pre-construction pipeline (i.e. apartment projects that are either being marketed for sale off the plan, or have building consent, but are not under construction) totalled circa 1,800 units back in 2016. The total for 2019 was around 300 units.[8]

5.9. Overseas investment is a crucial source of capital given the limitations of New Zealand's small capital market. There are very few New Zealand domiciled companies of scale that have the capability to undertake large-scale residential developments and these companies require sufficient investment including overseas capital. Given the above, we need to get the balance right when regulating overseas investment in residential property to ensure we can achieve sustainable housing supply. The sections below provide further details on our recommendations for the residential development sector.

6. Build-to-Rent

6.1. Property Council is strongly supportive of the Government's plans to increase the housing supply across New Zealand. In addition to Kiwibuild, we believe 'Build-to-Rent' ('BTR') can add to the housing stock that otherwise would not be built given prevailing market conditions. It could also be an additional factor which would help achieve a number of the Government's housing goals, including improving rental affordability and quality of rental supply.

6.2. In a global context, although New Zealand's BTR market is in the beginning of its journey, investment in European BTR markets reached a new all-time high in 2019.[9] New Zealand needs to make the BTR sector attractive to overseas investors as well as domestic investors to help build BTR developments faster and at a greater scale. Overseas investors have access to much needed capital and are far more familiar with the BTR product offer (e.g. in United States and Canada (known as multi-family housing) and in the UK and Europe). Presently though, the 2018 amendments in relation to the ownership of residential land has created significant impediments for potential overseas BTR investors to develop and own scale developments in New Zealand. The Act is therefore an enormous barrier to this asset class and as a result, the flow of much needed large-scale overseas capital into this critical part of the New Zealand housing supply solution has significantly reduced.

6.3. Although it is appreciated that the Act includes an exemption from the on-sale requirement for BTR development (through Schedule 2, clause 20), this exemption in its current form creates a number of barriers for prospective overseas BTR investors. For example, the current wording of 'in the business of providing new residential dwellings' used to describe those who may seek the exemption is overly specific and therefore restrictive. In our view, this wording may exclude companies who are new to the New Zealand BTR sector or are experienced operators who do not undertake development themselves.

6.4. We note that officials' view is that Property Council's interpretation of this drafting is "unduly narrow" and have advised that they will engage to clarify that "eligible overseas operators and investors new to New Zealand market" can seek exemption under the existing drafting "provided that they have taken overt steps to establish a business". We consider that at the very least, a

[8] Sourced from CBRE, 2019
[9] Sourced from the Market Insight (JLL, 2019).

directive to the OIO on the Crown's interpretation may be necessary as in discussions with decision makers this broader interpretation was not necessarily shared by those responsible for interpreting the legislation. In other parts of the world, due to forward funding structures and the quantum of investment required, BTR assets can involve a developer, development fund and then investment fund as three distinct entities. In this respect, the Act's requirements would be overly simplistic and a barrier to attracting the range of capital and expertise to provide successful long-term housing. Ideally this definition would be amended, as even if the legislators' intention was the broader interpretation, strictly on the drafting there is a risk that the legislation will nevertheless be interpreted in the strictly narrow sense creating unnecessary barriers.

6.5. An even greater issue is that the current on-sale exemptions for BTR developments are limited exclusively to new developments. Once schemes are up and running, under currently rules they could only be sold to New Zealand or (assuming the land is not otherwise sensitive) Australian and Singaporean investors. The impact on liquidity in a global asset class of this restriction is catastrophic. While the intention is to hold assets for an extended period, this inability to buy and sell an existing development will need to be factored into the price of new developments, thereby fundamentally impacting financial viability and simultaneously discouraging investment despite the technical exemption of new BTR development under the Act. If the word "new" was removed from Schedule 2, clause 20(1)(b) of the Act this would allow a broader market for investors on-selling existing developments (with purchasers applying for exemptions still required to satisfy either the "increased housing" test or the "benefit to New Zealand" test).

6.6. As evidenced by European BTR markets, overseas capital is crucial to the progress of BTR sector – this is a globally growing asset class funding a large number of new homes across the world. In the UK, for example, many BTR schemes have benefited from overseas funding during the development process, and/or are owned by overseas institutions. Research shows that the very large increase in BTR output in 2015/16 stems significantly from increased international investment.[10]

6.7. In our view, the Government has not given a proper consideration to the role of overseas capital for development of the emerging BTR market. Under the current Act, BTR developments are categorised as a residential property class, yet similar institutional grade living sector asset classes (e.g. retirement villages, rest homes and student accommodation) provides exemptions for overseas investors to purchase existing development.

6.8. International experience shows that institutional grade BTR assets are developed, owned, managed and operated as commercial investments by a single entity. They are also valued on the basis of long term cashflow in the same way other commercial assets are. An alternative to the proposed deletion of the word "new" in the BTR exemption from the on-sale requirement is to categorise BTR as a "long-term accommodation facility" under the Act and allow BTR developments to be treated in the same manner as retirement villages, rest homes and student hostels.

[10] Scanlon, K., Whitehead, C. & Blanc F. (2017). The role of overseas investors in the London new-build residential market. *LSE London.* Retrieved from https://www.lse.ac.uk/business-and-consultancy/consulting/assets/documents/the-role-of-overseas-investors-in-the-london-new-build-residential-market.pdf

6.9. To incentivise the provision of new housing supply and support housing affordability we believe there should be a fundamental shift in thinking about the role of overseas investment for BTR developments. For example, the New South Wales Government has recently announced a land tax discount for new BTR housing projects aimed at stimulating the economy with targeted support for the residential construction sector, and concessions from surcharge land tax for BTR properties owned by Australian companies who are "foreign persons"[11]. There has been an immediate response in increased interest in large scale BTR investment in the State. The proposed amendments (in addition to a number of other proposals within the Amendment Bill) are in response to the impact of COVID-19 and aim to remove barriers for investors to allow BTR segment of the market to growth. We believe that New Zealand should follow suit.

6.10. Given the above, BTR developments should be exempted as a separate type of development in a similar way the Government provides exemptions for retirement villages, rest homes and student accommodations. Otherwise, the Act will create a barrier to delivering the very objectives of increased levels of housing supply for New Zealanders to live in the Government has set for it. Therefore, we recommend the Government widen the exemption from the on-sale outcome to the BTR asset class (including existing developments).

7. Maximum offshore sales threshold

7.1. Currently, the Act allows developers of large apartment complexes to apply for an exemption certificate to sell 60 per cent of apartment units to overseas persons off-the-plans without needing consent under the Act. Our members believe that new build off-the-plan housing supply is being suppressed as a result of this 'allowance' as it is a barrier to entry for overseas investment. This is a complete opposite to the Government's intention of increasing housing supply.

7.2. Market feedback is that New Zealand is practically closed for business, as it is becoming too hard and complicated for overseas persons to invest in New Zealand residential property. As a result, overseas investment is looking to more accessible markets. New Zealand developers require a global market to obtain enough uncompromised off-the-plan presales to get large scale apartment developments funded. This is required to get their development underwritten for financial purposes.

7.3. Given the above, we recommend the Government remove the maximum offshore sales threshold of 60 per cent. This would incentivise overseas investment in the New Zealand residential property market and would likely increase the much needed housing supply.

7.4. Other more targeted measures to encourage the development include; introducing an exception for residential developers who have a proven track record, and for development on areas where high-density housing is a priority, such as areas identified in the National Policy Statement on Urban Development. These regulatory changes would better align the National Policy Statement priorities set under the Resource Management Act with overseas investment.

[11] State Revenue Legislation Amendment (COVID-19 Housing Response) Bill 2020. Retrieved from https://www.parliament.nsw.gov.au/bill/files/3770/First%20Print.pdf

8. Requirement for overseas persons not to live in purchased apartment

8.1. The Act dictates that the overseas purchaser cannot live in the apartment they purchased, but instead must rent it out on the open market. We oppose the proposal and believe that more flexibility should be provided in that space. We are concerned that enforcing such a restrictive use would significantly reduce offshore investment and capital flowing into New Zealand's economy.

8.2. We recommend the Government introduce a minimum number of rented days per year. This would allow for flexibility whilst still achieving the Acts core objective of adding to the long-term housing supply. For example:

- an overseas person who spends several weeks here each year should be able to stay in their property, then rent it out as short or long stay accommodation for the remainder of the year; and/or
- an overseas person who has a child that is studying in New Zealand should be able to purchase a property for their child to live in during their study here.

9. Types of residential developments

9.1. The legislation in its current form only incentivises the development of high-rise residential apartment buildings, while unnecessarily carving out other housing forms (e.g. standalone housing). We believe that enabling a wider range of residential development would positively contribute to New Zealand's residential stock. Particularly, more targeted thresholds could be implemented which would incentivise large scale sub-division developments which would be beneficial to both developers, and the government in terms of increasing housing stock. For example, standalone housing developments must be over 150-200 dwellings in order to be exempt, be contained within one resource / building consent and must be completed at one time.

9.2. Given the above, we recommend the Government introduce exemptions for any new housing development regardless of the configuration and number of dwellings (e.g. terraced housing and/or standalone houses of at least 20 residential dwellings). This would incentivise a broader range of residential developments in New Zealand.

10. Exemption for the first sale

10.1. Currently, the exemption expires on the issue of a code compliance certificate.[12] This provides little flexibility to overseas investors, particularly where a purchaser fails to settle a unit they purchased off-the-plan.

10.2. We recommend the Government adopt the Australian approach by introducing an exemption for the first sale from the vendor to purchaser, regardless of the date the building is defined as completed (if an approved exemption is in place). This amendment would allow the dwelling to be sold to another overseas person under the provisions of the exemption certificate without being limited to a specific time frame.

[12] Note: the code compliance certificate is issued if the building work complies with the building consent.

11. Exemption for dwellings in large apartment developments

11.1. The OIO has taken the position that any nomination does not form part of the legislation (Schedule 1 AA, clause 6(7)(b) of the Overseas Investment Amendment Bill). In particular, to be part of the first sale of a property, a nomination/assignment must be to a person closely related to the original purchaser (e.g. a closely-held company, family trust, or spouse). A nomination/assignment of an unrelated third party would be the second sale of the property. However, many nominations have no net affect. For example, the sale of the property may be at the same purchase price to another overseas person on the same terms as the original agreement.

11.2. Our members expressed the concern that ambiguous clauses such as these only slow down the developer's ability to make quick decisions, operate with confidence, and secure settlements in a timely manner, and therefore, create major delays at completion.

11.3. This is a major unintended consequence, considering that the off-the-plan sale is going to end up in the hands of an offshore purchaser regardless. This is also problematic for transitional exemptions, where the intention of the Act was to totally exempt developments that have already begun (and have obtained presales) before the legislation came into force.

11.4. Given the above, we recommend the Government amend Schedule 1 AA, clause 6(7)(b) of the Bill to provide more clarity around the process to allow for flexibility so that settlements can be secured in a timely manner.

12. Conclusion

12.1. Property Council commends the Government on proposing the introduction of the Bill. We are supportive of its purpose and the positive outcomes it is aimed to deliver. While we support the Bill in principle, there is a need to work through the detail of legislation to ensure it delivers on the objectives the Government has set for it.

12.2. We recommend the Government take further actions to simplify application process by:

- raising the screening threshold for leases to 15 years or more; and
- deleting the requirement to disclose tax information.

12.3. The Government could also take a more targeted approach to supporting the residential development sector by, for example:

- introducing the exemption for the BTR asset class as a separate type of development;
- removing the maximum offshore sales threshold for residential properties of 60 per cent;
- introducing an exemption for residential developers with a proven track record, robust systems and high level of experience;
- introducing more flexible requirements for living in purchased apartments;
- enabling incentivisation of a wider range of residential developments;
- introducing an exemption for the first sale from the vendor to purchaser regardless of the building completion date; and
- amending the Act to provide more clarity around an exemption for dwellings in large apartment developments where sales of dwellings have begun before assent date.

12.4. Property Council would like to thank the Finance and Expenditure Committee for the opportunity to provide feedback on the Overseas Investment Reform in general and Overseas Investment Amendment Bill (No3) in particular. We also wish to be heard in support of our submission.

12.5. Any further queries do not hesitate to contact Natalia Tropotova, Senior Advocacy Advisor, via email: natalia@propertynz.co.nz or cell: 021863015.

Yours sincerely,

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