

The Treasury

Overseas Investment Act 2005 – Phase One Review Policy Advice (2017/18) Information Release

March 2019

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Treasury Report: Overseas Investment Amendment Bill - Further Design Details - Application of the investor test

Date:	24 April 2018	Report No:	T2018/1118
		File Number:	IM-5-1-1

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Note the contents of this report	None
Associate Minister of Finance (Hon David Parker)	Agree that overseas persons <u>do not need to pass the investor test</u> to acquire a unit in a large apartment complex (irrespective of whether the developer holds an exemption certificate).	By Friday 27 April to allow the proposed response to the Select Committee on outstanding issues with the Bill to be updated

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Ryan Walsh	Senior Analyst	[6]	n/a (mob)	✓
Thomas Parry	Team Leader, Overseas Investment	[6]	[6]	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Overseas Investment Amendment Bill - Further Design Details - Application of the investor test

Executive Summary

We are seeking your advice on responses to questions raised by the Finance and Expenditure Committee (FEC) on the application of the investor test to units purchased by overseas persons in large apartment developments.

The FEC has sought additional information on the application of the investor test, including the timeframes involved. In responding to these questions, we propose to outline factual aspects of this test based on current OIO practice, which indicate that applying the investor test to purchases of units in large apartment developments would involve:

- 21 working days processing time; and
- significant costs to applicants, including legal fees and application fees (currently set at not less than \$35,000 but likely to reduce over time).

Following Cabinet's decision to extend flexibility provided for large apartment developments beyond initial proposals (to allow sales of between zero and 100 percent of units in apartment developments of 20 units or more to overseas persons without requiring buyers to on-sell) and in light of the above information on anticipated timeframes and costs of applications, we recommend that overseas persons buying units in large apartment developments are not subject to the investor test.

Our reasons for this recommendation are:

- We understand Cabinet's decision to extended flexibility provided for large apartment developments was motivated by a desire to have tools in the Bill which mitigate against possible impacts on housing supply; and
- We believe that there are high risks that applying the investor test to sales of units in large apartment developments to overseas persons would reduce the attractiveness of these units, which would limit the impact of the flexibility against our understanding of Cabinet's objective for providing it.
- We consider existing mechanisms – such as anti-money laundering and other generally applicable rules – to be sufficient to mitigate potential concerns addressed by the investor test.

We also provide an overview of our proposed answers to FEC questions on the Office of Privacy Commissioner's concerns on the Bill.

Recommended Action

We recommend that you:

- a **note** the Finance and Expenditure Select Committee (FEC) is currently considering the Overseas Investment Amendment Bill and recommended amendments to the Bill contained in the Departmental Report and is scheduled to report back to the House on 31 May 2018;
- b **note** that the FEC sought clarification/additional information on a number of matters contained in the Departmental Report (including the application of the investor test to overseas persons seeking to acquire residential land);
- c **note** that our response to this request is due to be provided to the FEC by close of business on April 30 (next Monday);
- d **note** that Cabinet authorised you to take decisions on minor policy changes to the Bill (CAB-18-MIN-0118), but that it is not clear to officials whether your Cabinet colleagues would consider removing the requirement for overseas persons acquiring units in large apartment developments to satisfy the investor test (irrespective of whether the developer has an exemption certificate) a minor policy matter.

Recommended Policy Approach

- e If you would like to use your delegated authority, **agree** that Treasury's response to the FEC being amended to explicitly recommend that the investor test not be applied to overseas persons applying for consent to acquire an interest in a unit in a large apartment development (irrespective of whether the developer holds a new dwelling exemption certificate); OR

Agree/disagree

- f If you would like to seek Cabinet consent, **agree** to seek Cabinet consent on 30 April 2018 to Treasury's response to the FEC being amended to explicitly recommend that the investor test not be applied to overseas persons applying for consent to acquire an interest in a unit in a large apartment development (irrespective of whether the developer holds a new dwelling exemption certificate) as an oral item. \

Agree/disagree

- g **note** that if you do not recommend changes to the Bill, the FEC may independently recommend that the investor test not be applied to overseas persons seeking to acquire a unit in a large apartment development. This assessment is based on questions received during the select committee.

Thomas Parry
Team Leader, Overseas Investment

Hon David Parker
Associate Minister of Finance

Treasury Report: Overseas Investment Amendment Bill - Further Design Details - Application of the investor test

Purpose of Report

1. This report provides you with advice on the application of the investor test (as it exists in the *Overseas Investment Act 2005* (the OIA)) to overseas persons seeking consent to acquire an interest in a unit in a large apartment development under the 'new housing' consent pathways. This advice has been prepared in response to questions from the Finance and Expenditure Select Committee (FEC).

Context for this Report

2. On 11 April 2018, Treasury Official's presented to the FEC on the recommendations contained in the Departmental Report to the Overseas Investment Amendment Bill (the Bill).
3. While the FEC signalled its commitment to adopt the majority of these recommendations, it did seek additional information/clarification on a number of issues, including:
 - a the outcomes of consultation with the Office of the Privacy Commissioner on the Bill;
 - b the proposed definition of large apartment developments that will be eligible to receive consent to have a portion of new units sold to overseas persons, without the overseas buyer then being required to on-sell the unit; and
 - c the appropriateness of requiring all overseas persons looking to acquire an interest in residential land to pass the investor test (as it exists in the OIA) to obtain consent.
4. Advice on these – and other – outstanding matters is due to be provided to the FEC on Monday 30 April.
5. Our view on these matters, and the appropriateness of the investor test in particular, have been informed by:
 - a Cabinet's decision to allow up to 100 per cent of units in qualifying large apartment developments to be sold to overseas persons, without the buyer being required to on-sell the unit soon after construction concluding (with this percentage initially set at 60 per cent), rather than the lower 20 per cent threshold proposed in the Cabinet paper; and
 - b further consultation with the Ministry of Business, Innovation and Employment (MBIE) and the Overseas Investment Office (OIO).

6. The investor test is a long-standing feature of the OIA, with assessments generally undertaken by the OIO (under delegation from the Minister). It has four core criteria.
 - a Business experience and acumen: Applicants must demonstrate that they/the relevant overseas person have business experience and acumen relevant to the overseas investment being made.
 - b Demonstrated financial commitment: Applicants must demonstrate that they/the relevant overseas person has taken actions that demonstrate commitment to the investment.
 - c Good character: Applicants must demonstrate that they are of 'good character'.
 - d Ineligible individual(s) under the Immigration Act: Applicants must not be of the kind referred to in section 15 or 16 of the *Immigration Act 2009* (the Immigration Act).
 - i Additional information on the Investor Test can be found in Appendix A.
7. We provided advice to you on this question in March 2018 (T2018/664) and did not take a view on the appropriateness of applying the investor test. However, Cabinet's decision to make a higher proportion of units in large apartment complexes available to overseas investors will increase the number of applications for consent that need to be processed and correspondingly increase any downside-risks associated with the test.
8. In considering this issue as it was raised by the FEC, we have also since conducted additional consultation with the OIO and MBIE and are more confident that the costs associated with the test are material.
9. Further, in light of our updated assessment of the costs of applying the investor test in respect of developments with new dwelling exemption certificates (where an overseas person will be able to retain an interest in the property long-term), we judge that the test should also not be applied in respect of overseas persons acquiring a unit in a large apartment development that does not have such a certificate. This is because the risks associated with this kind of investment are even lower, due to the requirement for the overseas person to on-sell the unit a short period after construction is complete.
10. Consequently, we have concluded that requiring all overseas persons to satisfy the test to obtain consent to acquire a unit in a large apartment development is not appropriate and do not support the inclusion of the investor test as a required component of obtaining consent in such circumstances. This is because:
 - a applying the test is expected to undermine the intent of the simplified consent pathways and, contrary to the Government's broader policy objectives, curtail investment in new housing supply;
 - b the test's requirements are disproportionate relative to the limited risks that allowing an overseas person to acquire an interest in a unit in a large apartment development presents to New Zealand (especially given the fact that an overseas person or their associates will be unable to reside in the unit); and
 - c these limited risks can be sufficiently mitigated against through generally applicable rules, such as our anti-money laundering regime.

[1]

11. [1]

12.

13.

14. **Financial costs are likely to be material.** The fee associated with applications for consent under the OIA is currently set through regulations on a cost-recovery basis as at least \$35,500. While it may be lower under the new regime due to economies of scale, we expect that it will remain high.

15. This fee is therefore likely to represent a significant financial burden that will reduce demand for these units, given that:

- a MBIE expect the average cost of qualifying units is expected to be between \$700,000 and \$800,000 (making the fee nearly five per cent of the sale price on average and commensurately higher for the types of cheaper units proposed as a solution to supply and affordability issues in Auckland); and
- b the annual rate of return on property investment has historically been around 6 to 7 per cent (excluding the anomalous 2011-2016 period).

16. [1]

17.

The benefits associated with the investor test are limited

¹ This does not include time taken by applicants to complete the application. MBIE have advised that obtaining criminal background checks and similar documentation can be a prolonged process [1]

18. While imposing significant costs on overseas persons seeking to acquire an interest in relevant units, the test only offers limited benefits in respect of this type of investment.
19. The investor test is most appropriate for overseas persons seeking to acquire an interest in existing classes of sensitive assets (that is, sensitive land, significant business assets and fishing quotas). This is because these assets:
 - a often operate/exist for extended periods of time;
 - b are often commercial in nature with significant complexity; and
 - c make a material contribution to the overall wellbeing of New Zealanders (with clear downside risks to wellbeing if they are mismanaged).
20. These factors do not necessarily hold for the types of investments being considered under the new regime and therefore applying the test offers only limited benefits in terms of ensuring that those investing in New Zealand are of a high calibre.
21. For example, while demonstrating relevant 'business experience and acumen' is rightfully central to an application to acquire a gold mine, it is not clearly applicable to investment in a unit (a unit that would only be able to be maintained as an investment in limited cases, with units purchased under most consent pathways required to be sold soon after construction is complete).
 - a The OIO's approach to assessing an applicant's 'business experience and acumen' for the purchase of small lifestyle properties illustrates this. In such cases, the OIO generally only investigates matters such as previous property ownership to satisfy this criterion. This is not a material threshold and it is difficult to conclude that this assessment has a meaningful impact on the calibre of persons investing in New Zealand.
22. Similarly, while demonstrating long-term financial commitment is sensible in respect of an investment in forestry or fisheries (given that there can be limited market pressures to ensure that businesses operate in a sustainable fashion and having sufficient financial resources to comply with any environment-related conditions (for example) are critical), this is not true of investment in a unit where market discipline effectively ensures that only viable transactions proceed.
23. In respect of the other two components of the test ('good character' and eligibility under the Immigration Act), we are sensitive to the fact that New Zealand's foreign investment regime is underpinned by the idea that purchasing sensitive New Zealand assets is a privilege and not a right (as laid out in the OIA's purpose) and that the application of these two criteria are consistent with this objective.
24. However, requiring Ministers (or the OIO under delegation) to complete these assessments in respect of the acquisition of a unit – given the Government's objective to channel foreign investment into this type of development to increase housing supply – is out of step with the risks that the ownership of such an asset presents given that any risks are already mitigated against by:
 - a generally applicable rules relating to resource management and anti-money laundering;² and
 - b the requirement for overseas buyers to on-sell the unit a short period after construction is completed under most consent pathways (that is, even if a person was of 'poor character', they would not be able to maintain a long-term investment footprint in New Zealand) and not occupy the unit under any pathway.

² Other features of the Bill itself, such as the on-sell conditions to be imposed on overseas persons acquiring residential land under most consent pathways, will also limit foreign persons' ability to 'park' the proceeds of illicit activity in New Zealand for an extended period and to that extent could reduce some types of money laundering at the margin.

Recommended approach

25. Given the significant costs and limited benefits associated with the investor test and the Government's secondary objective of increasing housing supply (particularly units in large apartment developments), we recommend that it not be applied to overseas persons seeking to acquire an interest in a unit in a large apartment complex.

Next steps

26. We are due to provide our response to the FEC on outstanding issues, including the application of the investor test, by close of business Monday 30 April 2018. Delays in resolving this issue beyond this date could negatively affect delivery of the final Bill.
27. If you accept our recommendation to remove the investor test, there are broadly two options to ensure that this is reflected in the Bill:
 - a If you would prefer to use your delegation for minor policy matters, Treasury can formally recommend that the FEC remove the requirement for overseas persons applying for consent under the 'new housing' pathway to pass the investor test; or
 - b If you would prefer to take this matter to Cabinet, you take the proposal forward as an oral item for consideration on Monday 30 April 2018 and obtain consent for us to formally recommend that the FEC remove the requirement for overseas persons applying for consent under the 'new housing' pathway to pass the investor test.
 - i If this was your preferred approach, we would liaise with your office to ensure that you had all the materials that you required ahead.

Other issues to note – consultation with the Office of the Privacy Commissioner

28. Following the finalisation of the Departmental Report on the Bill, we conducted additional consultation with the Office of the Privacy Commissioner (OPC) on the proposed revisions to the OIO's information gathering powers.
29. Despite substantially limiting the power relative to the Bill as introduced (broadly allowing the OIO to only gather information necessary to monitor compliance with, or enforce, the OIA rather than also administer the OIA), the OPC continue to argue that the power should not be expanded at all (despite the significant increase in the OIA's scope).
30. Consistent with our earlier advice, maintaining the status quo would significantly undermine the integrity of the Bill. It is important that the OIO have the explicit power to gather information necessary to monitor compliance with, and enforce, the OIA to ensure that the regime is sufficiently robust to incentivise overseas persons' ongoing compliance.
31. Consequently, we recommend no change to the recommended approach based on OPC's feedback.

32. Under the Bill as drafted, overseas persons looking to acquire residential land under the increased housing consent pathway will need to satisfy the investor test. The test has four core criteria.
- a Business experience and acumen: Applicants must demonstrate that they/the relevant overseas person have business experience and acumen relevant to the overseas investment being made.
 - b Demonstrated financial commitment: Applicants must demonstrate that they/the relevant overseas person has taken actions that demonstrate commitment to the investment – for example, incurring due diligence costs and engaging professional advisers.
 - c Good character: Applicants must demonstrate that they/the relevant overseas person is of ‘good character’. This test requires the OIO to consider offences or contraventions of the law (by an individual or by another entity where the individual applicant had a 25 per cent or more ownership or control interest) but is not limited to just these matters. Other factors, including mitigating factors, deemed relevant by the OIO can be considered in determining whether the applicant is of ‘good character’.
 - d Ineligible individual(s) under the Immigration Act: Applicants must not be of the kind referred to in section 15 or 16 of the *Immigration Act 2009*. These sections broadly provide that no visa or entry permission be granted, and no visa waiver may apply, to any person who:
 - i has been sentenced to more than five years’ imprisonment or more than 12 months’ imprisonment in the previous 10 years;
 - ii has been the subject of a removal order;
 - iii has been removed or deported from any country;
 - iv is likely to commit an offence that is punishable by imprisonment;
 - v is or is likely to be a threat or risk to security, public order or the public interest; or
 - vi is a member of a terrorist entity designated under the *Terrorism Suppression Act 2002*.
33. While the criteria applied are fundamentally the same for all applications, in assessing applications the OIO has flexibility to ensure that its assessment is commensurate with the risks associated with each individual application.
34. This flexibility is particularly apparent in respect of the “business experience and acumen” component of the test, where more or less specific expertise may be required depending on the investment’s nature.
35. The fee associated with applications for consent under the OIA is currently set through regulations as not less than \$35,500.