The Treasury

Overseas Investment Act - Phase Two: Policy Advice December 2020 - April 2021 Information Release

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[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment

[36] 9(2)(h) - to maintain legal professional privilege

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[42] 18(d) - information requested is or will soon be publicly available

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Overseas Investment Amendment Bill: Updates to Departmental Report and Cabinet Paper

Date:	26 January 2021	**Report No:**	T2021/115
		File Number:	IM-5-3-8

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Note** the contents of this report.	N/A
Associate Minister of Finance (Hon David Parker)	**Agree** to lodge a revised Cabinet paper on 28 January seeking Cabinet's approval to agreed changes to the Overseas Investment Amendment Bill (No 3).	27 January 2021

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Ryan Walsh	Senior Analyst, International	[39]	n/a (mob)	✓
Thomas Parry	Manager International, International		[35]	

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: Yes (Cabinet paper and Departmental Report attached)

Treasury advice

On 20 January 2020, we sought your agreement to lodge a paper proposing a number of changes to the Overseas Investment Amendment Bill (No 3) (the Bill) for Cabinet's consideration on 2 February (T2020/3523 refers). This report:

1. seeks your agreement to minor amendments to these documents in light of your feedback and further analysis of the financial implications, and

2. provides talking points on proposals to amend the regulator's fee structure and not change the benefit to New Zealand test in case Minister O'Connor raises them with you (we understand that he will be briefed on these proposals tomorrow, 27 January).

Updates to the Cabinet paper and Departmental Report in response to your feedback

On 20 January 2020, you agreed to the majority of recommended amendments to the Bill. However, you queried two recommendations which we have since discussed with you, via your Office, and resolved.

1. You wanted to ensure that exempting passive foreign government investors[1] from automatic application of the national interest test (recommendation f iii in T2020/3523) would not change the treatment of investments in media entities.

   Following advice that this recommendation would not change the treatment of investments in media entities, you agreed to our proposal.

2. You expressed concern that allowing the Minister to not apply the higher farm land threshold to unproductive farm land slated for residential development (recommendation k in T2020/3523) could undermine the Government's restrictions on overseas people buying residential land. You did not have concerns about commercial or industrial developments.

   Through your office, we understand that you would be comfortable with this proposal if it was limited, in respect of residential developments, to large residential developments (that is, the construction of 1 or more buildings that, taken together, will consist of 20 or more new residential dwellings). This threshold is consistent with some of the special rules in the Act that can apply to large build-to-rent and shared equity developments.

   The attached Cabinet paper (Annex Two) and Departmental Report (Annex Three) reflect this position.

Updates to the paper's financial implications

We had advised that the proposal to not allow the regulator to recover deficit incurred more than four years ago (recommendation q in T2020/3523) would cost the Crown a maximum of $1.300 million (that is, the amount of deficit incurred more than four years ago).

Following additional analysis by LINZ about the interactions between this recommendation and previous Cabinet decisions, the financial implications are instead a maximum of $3.000 million. Despite this, we still consider it appropriate that this deficit is borne by the Crown because: the deficit that cannot be recovered is small; recovering that portion of the deficit would be inconsistent with the Government's Cost Recovery Policy; and

[1] That is, investors structured in a way that prevents a government from pursuing strategic objectives.

unconstrained deficit recovery would likely receive significant opposition from FEC members and investors.

We have updated the Cabinet paper to reflect this.

Talking points on proposals around the benefit to New Zealand test and the regulator's fees

We understand that Land Information New Zealand (LINZ) will be briefing Minister O'Connor on the proposals in your draft Cabinet paper tomorrow, 27 January. LINZ will likely focus their briefing on two issues:

1. Not requiring a full cost/benefit assessment as part of the benefit to New Zealand test. LINZ support this proposal due to the significant operational consequences that would result from such a change. In light of significant submitter support for a change and seeming openness from some FEC members, Minister O'Connor may wish to discuss the importance of this recommendation to LINZ with you.

2. Updating the regulator's fee provisions. LINZ have some outstanding questions about the proposed changes to their fee structure. In particular, they are concerned that the Crown will not be *automatically obligated* to fund any residual deficit that they have been unable to recover through an agreed deficit recovery process, and that they would therefore have to manage this portion through a budget bid or cost saving. Minister O'Connor may therefore raise some questions about these proposals with you.

To support a potential discussion between you and Minister O'Connor (or other Cabinet colleagues), Annex One includes talking points on these matters.

Next steps

If you are comfortable with how your decisions are reflected in the attached Cabinet paper, this should be lodged on 28 January ahead of Cabinet consideration on 2 February.

To support Cabinet's considerations of these proposals, we will separately send an Aide Memoire with talking points on other key proposals on Thursday 28 January.

Recommended Action

We recommend that you:

a **Note** that we have updated the Cabinet paper and Departmental Report sent to you on 18 January (T2020/3523 refers) in light of your feedback on specific recommendations and updated estimates of the financial implications.

b **Agree,** as a replacement for recommendation k in T2020/3523, to retain the No 3 Bill's more stringent tests for investment in farm land, but ensure they are not a barrier to productive development by expanding the Minister's discretion to not apply the more stringent benefit test to land that:

i. is not productive for farming (taking into account the land's current use and its productive capacity),

ii. is likely to be used for commercial or industrial development or a large residential development (that is, the construction of 1 or more buildings that, taken together, will consist of 20 or more new residential dwellings), and

iii. allowing the Minister to take into account the nature of the land when considering an exemption from the farm land advertising requirements.

Agree/disagree.

c **Note** that the financial implications of agreeing to recommendation q in T2020/3523 is a maximum of $3.000 million, rather than $1.300 million as previously advised.

d **agree** to seek Cabinet's approval to these changes and lodge the Cabinet paper (Annex 2) on 28 January, along with the draft Departmental Report (Annex 3) (subject to minor editorial changes and changes to reflect consultation with your Ministerial Colleagues).

Agree/disagree.

Thomas Parry
Manager International

Hon Grant Robertson
Minister of Finance

Hon David Parker
Associate Minister of Finance

Annex One: Talking points for potential discussion with Minister O'Connor

This annex provides background and talking points on two proposals currently scheduled for Cabinet's consideration next week, that Minister O'Connor (as Minister for Land Information) may wish to discuss with you. These are:

1. Your decision to not require a full cost/benefit analysis to be completed as part of the benefit to New Zealand test, and

2. Proposed amendments to the Overseas Investment Act's (the Act's) fee provisions.

Limit on the ability to negatively weight factors under the benefits test

Background

Consistent with Cabinet's direction, last week you reconfirmed that the Bill should clarify that when assessing applications under the benefit to New Zealand test,[2] the regulator will only generally be able to consider an investment's prospective benefits against directly comparable detriments (for example, a loss in jobs in one region against a gain in jobs in another).

A significant number of submitters supported instead requiring a full cost/benefit analysis. Some FEC members, including the Chair, asked submitters and officials a number of questions about this during hearings.

Due to the significant operational effects that adopting a cost/benefit model would have on LINZ, LINZ have verbally briefed Minister O'Connor in support of your recommended approach ahead of Cabinet next week.

Talking points

- I do not support adopting a cost/benefit model for the benefit to New Zealand test because:
  - it would require the Overseas Investment Office to duplicate a number of other regulatory regimes – like the Resource Management Act – that exist to manage other risks and undermine the Government's goal of streamlining low risk investment, and
  - where necessary, the national interest test enables the government to undertake a broader risk assessment and block transactions that are contrary to our national interest.

Proposed amendments to the Act's fee provisions

Background

The regulator's operational funding is largely recovered from applicants through fees. However, fees have not kept pace with costs and the regulator's deficit was $9.8 million as at 31 October 2020.

[36]

To resolve this issue, while creating additional incentives for the regulator to manage its memorandum account, you agreed to seek Cabinet approval to:

[2] Which applies to sensitive land and fishing quota.

- amend the fee provisions to allow fees to be collected to offset deficits/return surpluses, but only if the surplus or deficit occurred within four years prior to when the fees are set, and
- require a fee review to be commenced at least every four years.

LINZ are concerned that:

- the Crown will not be *automatically obligated* to fund any residual deficit that they have been unable to recover through an agreed deficit recovery process, and that they would therefore have to manage this portion through a budget bid or cost saving, and
- more broadly, that while the proposed changes are consistent with Treasury's cost recovery policy they are inconsistent with Legislation Design and Advisory Committee (LDAC) guidance that deficits cannot be recovered through fees. They consider that this tension should be resolved.

Talking points

- [36]

- The proposed response was developed in consultation with LINZ, Legislative Design and Advisory Council (LDAC) and cost recovery experts within the Treasury. It is intended to balance the need to ensure that:
  - the government can manage deficits or surpluses, recognising that fees can never be set at the perfect level to offset costs, and
  - the fees payable are reasonably related to LINZ's costs in processing those applications, as required by our cost recovery policy. It would not be fair, for example, to make new investors pay an increased fee to offset deficit incurred eight years prior.
- Importantly, the proposal also creates new incentives for the regulator and relevant Minister to manage LINZ's balance sheet and ensure that fees and costs remain aligned. This is to help avoid the situation we are currently facing, where there is a large historic deficit, which Cabinet is soon likely to consider funding through budget.
- If, after attempting to recover a deficit through four years of higher fees, a deficit still remains, LINZ would either need to offset this residual amount through cost savings or a budget bid. This is consistent with how agencies ordinarily respond to funding pressures.

Back pocket questions and answers

- *It will not be possible for LINZ to recover the approximately $5.2 million in deficit accumulated over the last four years, over the four years following the next fees review. This will leave LINZ with a short fall to be managed.*

  Adopting this proposal does not bind the Government to either funding this amount, or recovering it through fee payers – it simply sets the outer limits of what can be achieved through new fees.

  When Cabinet considers what portion of LINZ's deficit should be recovered through fees, if any, it will require us to consider and balance:

- what amount of the accumulated deficit is attributable to new investors, and should therefore be recovered from them consistent with our cost recovery policy, and
- what effect increased fees will have on our investment attractiveness. A significant increase in fees would likely reduce our attractiveness. This would be contrary to the objectives of our reforms and could actually further increase LINZ's deficit (because application volumes would be lower).

- *If we cannot recover a deficit through fees, will Land Information New Zealand automatically be required to offset that amount through cost savings?*

  If there is a residual deficit at the end of a four year period that is not recovered through fees, LINZ will not have to automatically offset that through cost savings.

  Instead, consistent with how other agencies manage cost pressures, LINZ would have the option of applying to the Crown for further funding.

  This is consistent with best practice legislative design, because you should not use legislation to bind future governments to funding decisions and should establish strong incentives for active balance sheet management.

- *Why have you proposed only allowing deficits incurred in the last four years to be recovered?*

  Allowing unconstrained deficit recovery would mean that the government could charge new investors a fee to offset costs that LINZ incurred a decade ago. This would:

  - Be inconsistent with our cost recovery policy – there is no rationale for recovering costs not related to processing an investor's application from them, and
  - Not place incentives on future Minister's to manage LINZ's balance sheet (because they could always recover it from future fee payers).

- *Follow up: Why four years in particular?*

  Four years as a limit on deficit recovery lines up with the maximum period between fees reviews commencing. A maximum of four years between reviews is appropriate because:

  - it would generally require a review each Parliamentary term without the risk of the review having to be completed within a caretaker period or the early days of a new Government,
  - not preclude more regular fees reviews, where necessary to respond to changes in activity or costs, and
  - it is consistent with the operational forecast period and the required regularity of the long term fiscal plan (which also uses the once per Parliamentary term rationale).

- *Placing limits on the government's ability to recover past deficits may create incentives for Ministers to set fees higher than they should be to reduce the risk of under-recovery*

  Ministers should always attempt to set fees equal to an agency's costs. Setting fees higher than costs would:

- Be likely ineffective in the medium term, because under the government's cost recovery policy would surplus would need to be returned in the next fee cycle,
- Mean that the fees are technically a tax, making it transparent to investors that they are being overcharged, and therefore
- Be inconsistent with our objectives of improving our attractiveness to investment.

- *There is conflicting guidance from LDAC and Treasury on how deficits should be recovered through fees. How will this be resolved?*

  Treasury officials are developing a plan for engaging with LDAC on this, with the goal of ensuring that all government guidance on these matters is aligned.

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