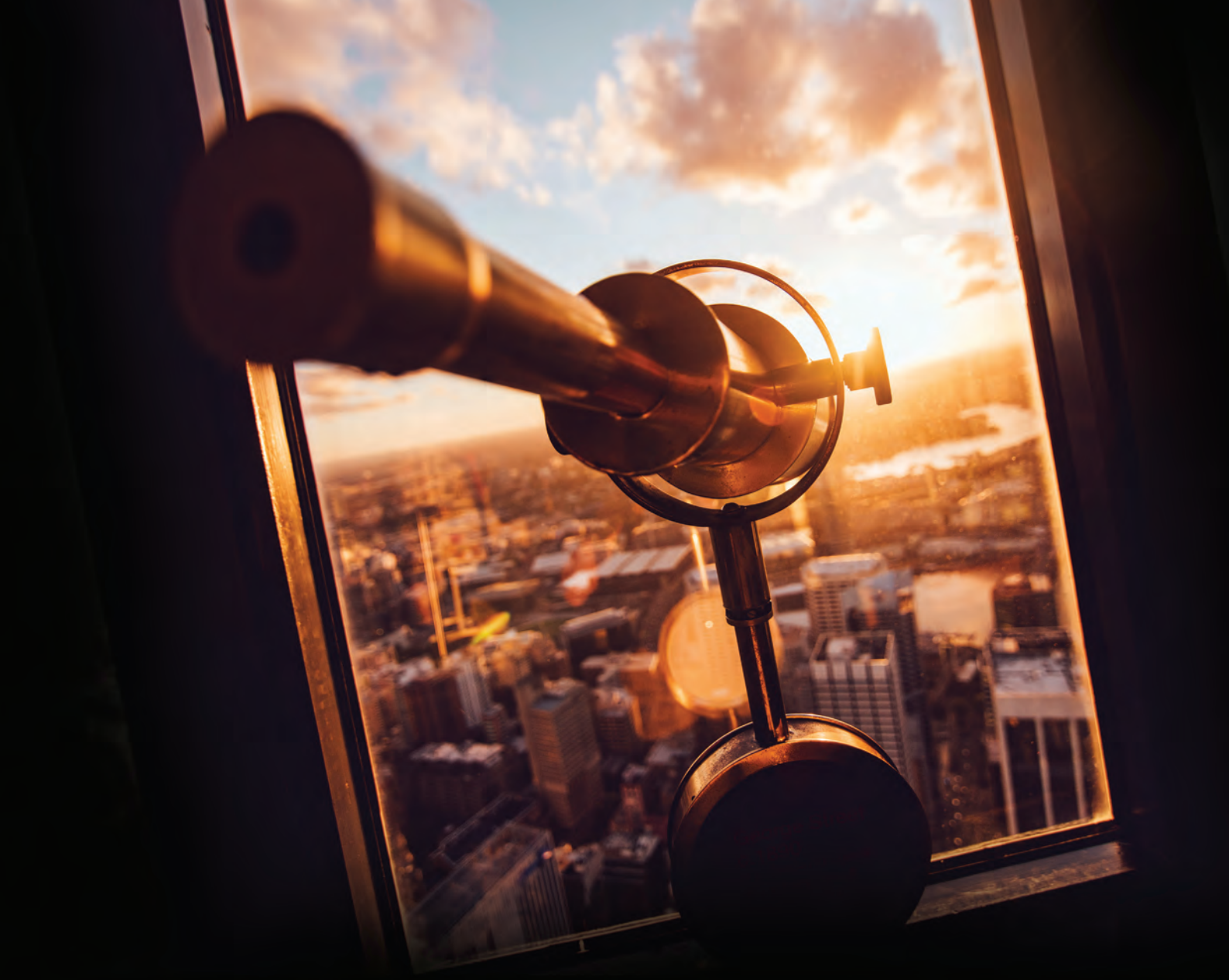


JOHNSON WINTER & SLATTERY

Investing in Australian real estate

June 2019

This guide is a general summary for overseas investors considering investment in real estate in Australia as at June 2019, and is not legal advice. Foreign investors should seek professional advice in relation to any proposed investment in Australia. Johnson Winter & Slattery would be pleased to provide you with advice in relation to any of the matters discussed in this guide.

Contents

Introduction

The Australian real estate market continues to be a significant destination for foreign investment as an attractive safe haven for overseas investors. A strong legal and regulatory framework coupled with a sophisticated and transparent market have combined to underpin an investment environment which is robust, positive and friendly to foreign capital. While there has been some cooling of the residential (development, investment and owner/occupier) sector in the past 18 months, most Australian real estate sectors have continued to perform strongly over an extended period and remain attractive to overseas capital looking for real estate assets which meet investors' criteria. Australia is the only country in the developed world to have achieved 28 years of uninterrupted economic growth.

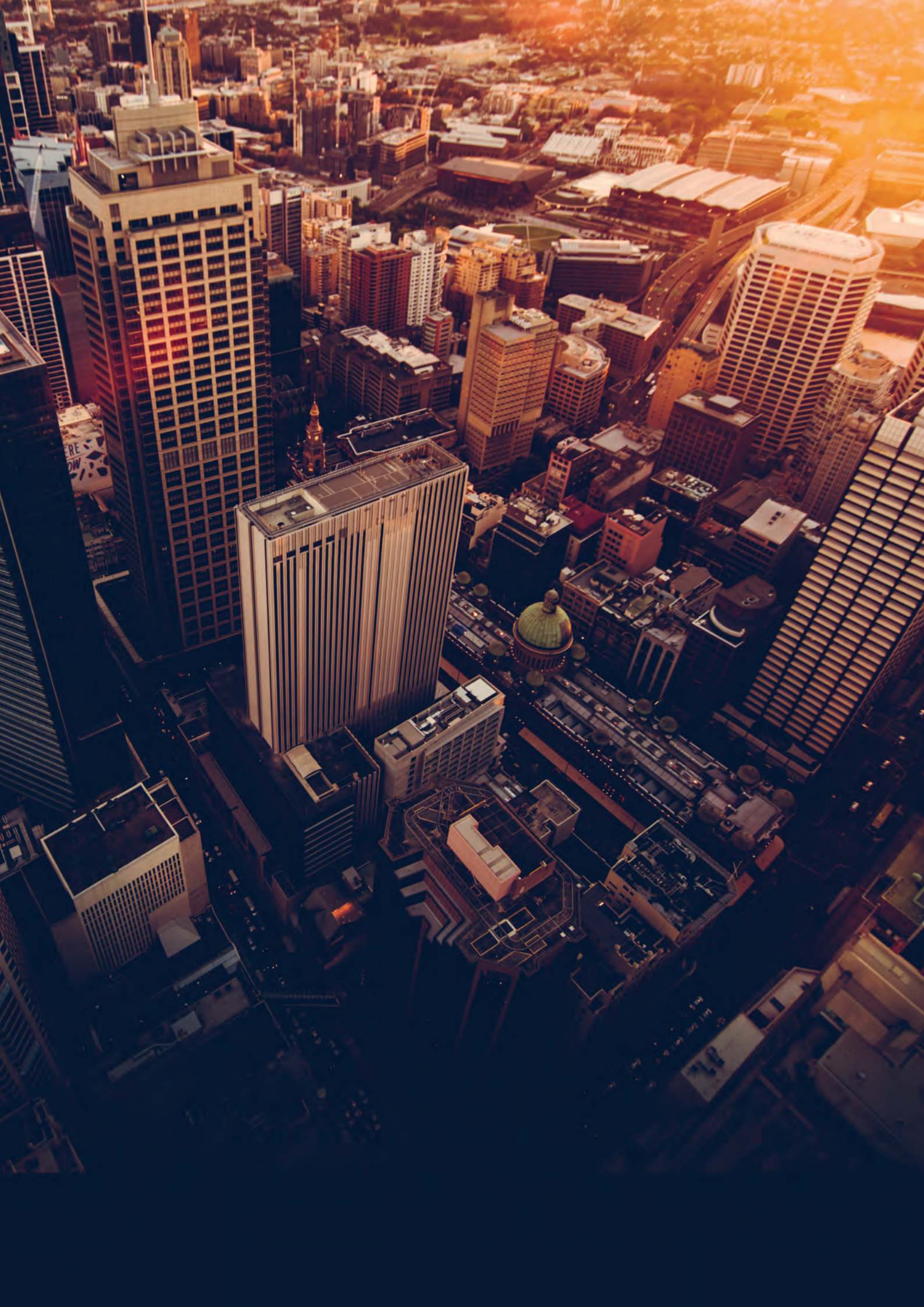
Overseas investors need and should demand clear advice on Australia's legal, regulatory and taxation systems from independent advisors who can advise, protect from risk and facilitate transactions.

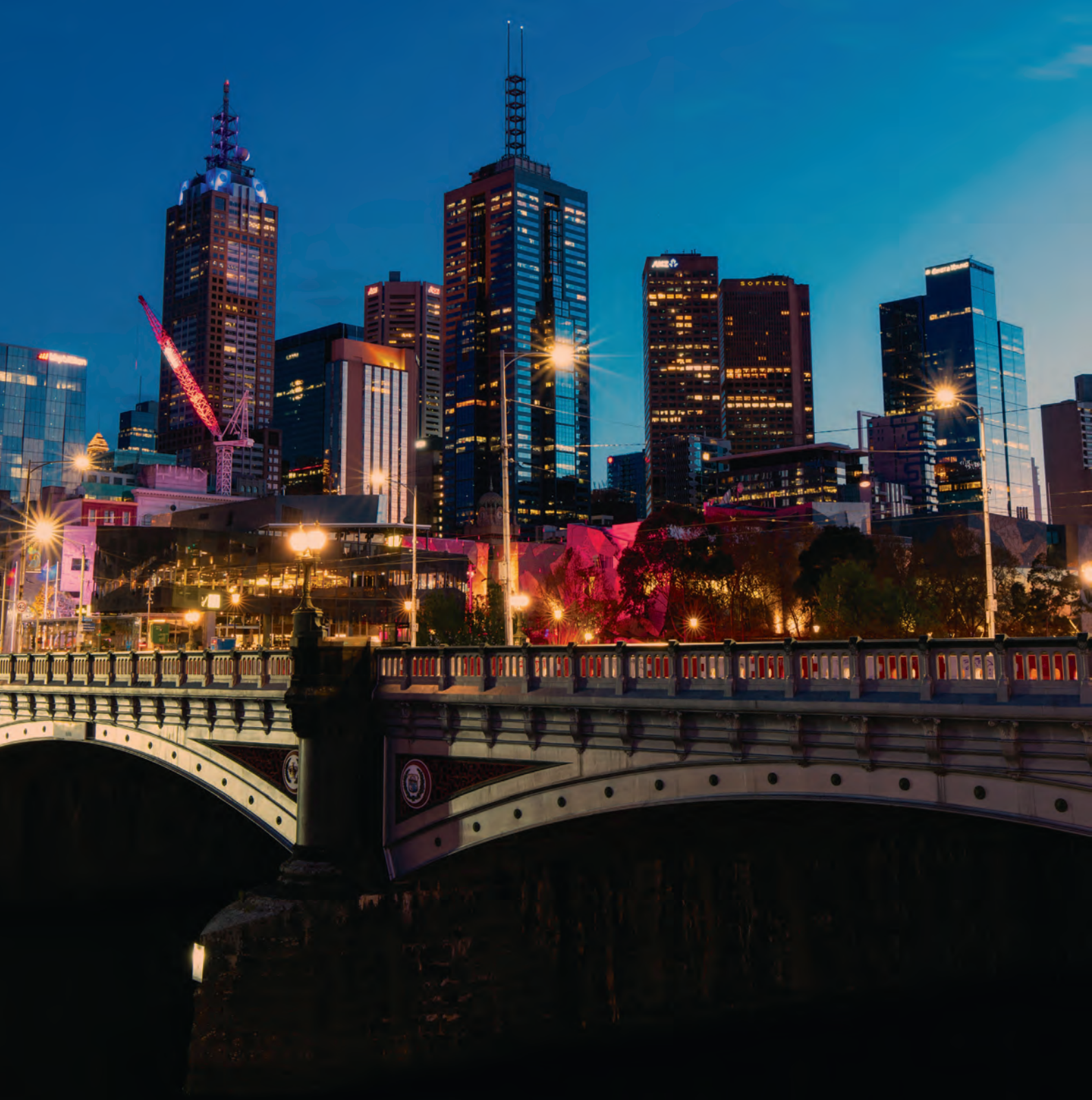
In this guide, our real estate, tax and corporate experts offer a practical overview to answer some of the questions you may have about real estate investments in Australia.

It provides a practical overview of the legal and regulatory environment you will face, offering practical advice for transactions.

If you would like more information, simply contact one of our partners.

Peter Slattery
Managing Partner
June 2019





Overview

2018 heralded heightened geo-political uncertainty and global trade tensions, which resulted in international investors narrowing their selection criteria for investment decisions and destinations. Outbound Chinese investment into Australia also slowed as authorities tightened controls over capital export.

For the first time since 2012–13, the USA surpassed China as the largest source for approved investment into Australia, due to an increase in US approvals and a decline in Chinese approvals. However, International Monetary Fund and Australian Bureau of Statistics data indicates that Australia has been impacted to a larger degree by the slowdown in outbound Chinese investment compared to other economies. The Australian real estate industry is in a healthy position albeit with demand in most sectors outstripping supply and so impacting on yields. But for smart investors that can move quickly, there are still quality assets to be found. Domestic and global commentators have pointed to strong investment fundamentals and an investor friendly framework. Domestic banks have tightened lending controls, but while some domestic investors have encountered difficulties in sourcing debt finance, this has created buying opportunities for foreign sources of capital. There is still a steady stream of inbound capital being invested into Australian real estate. Domestically, the A-REIT sector has emerged as a revitalised and recapitalised and in strong acquisition mode. This is resulting in restructuring of portfolios with changes to weightings of the different property classes and the release into the market of some good assets. The exponential growth in Australia's superannuation funds has fuelled a demand to invest directly in real estate, rather than indirectly via listed and wholesale funds. Foreign pension and sovereign wealth funds looking for stability are increasingly pouring into Australian real estate. It is important that they have accessible advisors on hand to move quickly when opportunities arise.

Market conditions now operate to support real estate's fundamental metrics, underpinned by a legal and regulatory framework which offers security to global investors. Traditional prime office, retail and industrial assets are strongly sought after but there are also opportunities in other asset classes.

Aligned with direct real estate investment, 2017–18 saw high profile major business acquisitions, including the acquisition of the Whyalla steelworks by British businessman, Sanjeev Gupta's GFG Alliance and the acquisition of Australia's largest diagnostic imaging provider, I-MED Radiology network by the European private equity firm Permira.

CONSIDER THRESHOLD ISSUES EARLY

We advise clients investing in Australian real estate to consider these threshold issues early:

- When looking at structuring options, consider whether a trust structure (which enables redistribution of income to others) or a company structure will be used.
- Where a trust structure is used, is it to be a managed investment trust (to take advantage of concessional tax rates)? If so, the number and composition of unit holders will be important and an Australian Financial Services Licence (AFSL) may be required.
- Where a company structure is used, advice should be obtained on whether to register as a foreign company operating in Australia or to establish a local subsidiary.
- Pre-deal due diligence should identify the transaction costs, duties and taxes which will need to be considered in the feasibility and financial modelling. A complete analysis will be required to ensure investment hurdles are met – both at acquisition stage and during the life of the investment.
- Whether Foreign Investment Review Board approval is required, based on the character of the investor or the nature of the real estate asset to be acquired.
- Apart from legal due diligence, which other consultants and professionals need to be engaged to help provide a comprehensive assessment?
- Does the proposed acquisition timetable allow sufficient time for all of these issues to be addressed and answered?

The choice of the best structure will depend on a range of factors including the specific commercial opportunity and consideration of all legal, accounting, tax and regulatory issues.

The choice of investment vehicle will be an important decision, and history shows that early advice in the decision-making process will minimise risk and limit any possible hurdles. After all, advice after the event is like rain after the harvest.

Australian property law

LAND LAW IN AUSTRALIA

Australia is a federation of six States and two Territories. The Commonwealth or Federal government derives its power from the Constitution to legislate in specific areas including trade and commerce, taxation, immigration, banking and foreign investment. In the second tier of government, the States and Territories make laws for their own jurisdiction, so it is State-based legislation which deals with most property matters such as land title and environmental issues. The third tier, Local Government (Councils), deals with more local issues such as land use, town planning and building and development approvals. Each State and Territory has its own land law, but there are general consistencies. For transactions, there are variations between States in contract and transfer procedures, but overall, most commercial transactions follow a similar path.

TORRENS SYSTEM

Australia operates a system of land registration known as the Torrens system. Under this system, title to or ownership of real estate is created by the act of registration in a central register. This means that on a sale of Torrens system land, the buyer obtains legal title on registration of the transfer, rather than on execution of the instrument of transfer.

The vast majority of the land in Australia is Torrens system land, but there are some areas where leasehold interests are common and some parts of Australia where long term leases of Crown land are the common form of ownership, for example, in the Australian Capital Territory and in some rural areas.

INDEFEASIBILITY

The Torrens system is underpinned by a principle known as 'indefeasibility'. Registration of title provides indefeasibility – so, once a transfer or grant of title to the land is registered then, as a general rule, the title cannot be defeated by other unregistered interests. On registration, the registered owner of the land acquires its interest subject to earlier registered interests but free from all unregistered interests. There is a limited number of statutory exceptions, such as fraud, short-term leases, easements, misdescription of boundaries and, rarely, adverse possession.

In practical terms, the effect of indefeasibility of title is that a buyer of real estate in Australia relies on the certificate of title as evidence of title. As a result, where the property is Torrens system land, title insurance is generally not obtained as part of real estate acquisitions.

STATE-BASED PUBLIC REGISTERS

There is no national land title registry. Each State or Territory maintains its own real estate title registry, which is a State government-run public record of information on real estate tenure. However, in 2017, the Commonwealth Government established an Agricultural Land Register and a Water Entitlement Register. From the end of 2018, the States collect and transfer to the Australian Taxation Office (ATO) data on sales and transfers of residential properties by foreign persons to the ATO. These new registers are discussed in more detail in the section on Foreign Investment Policy.

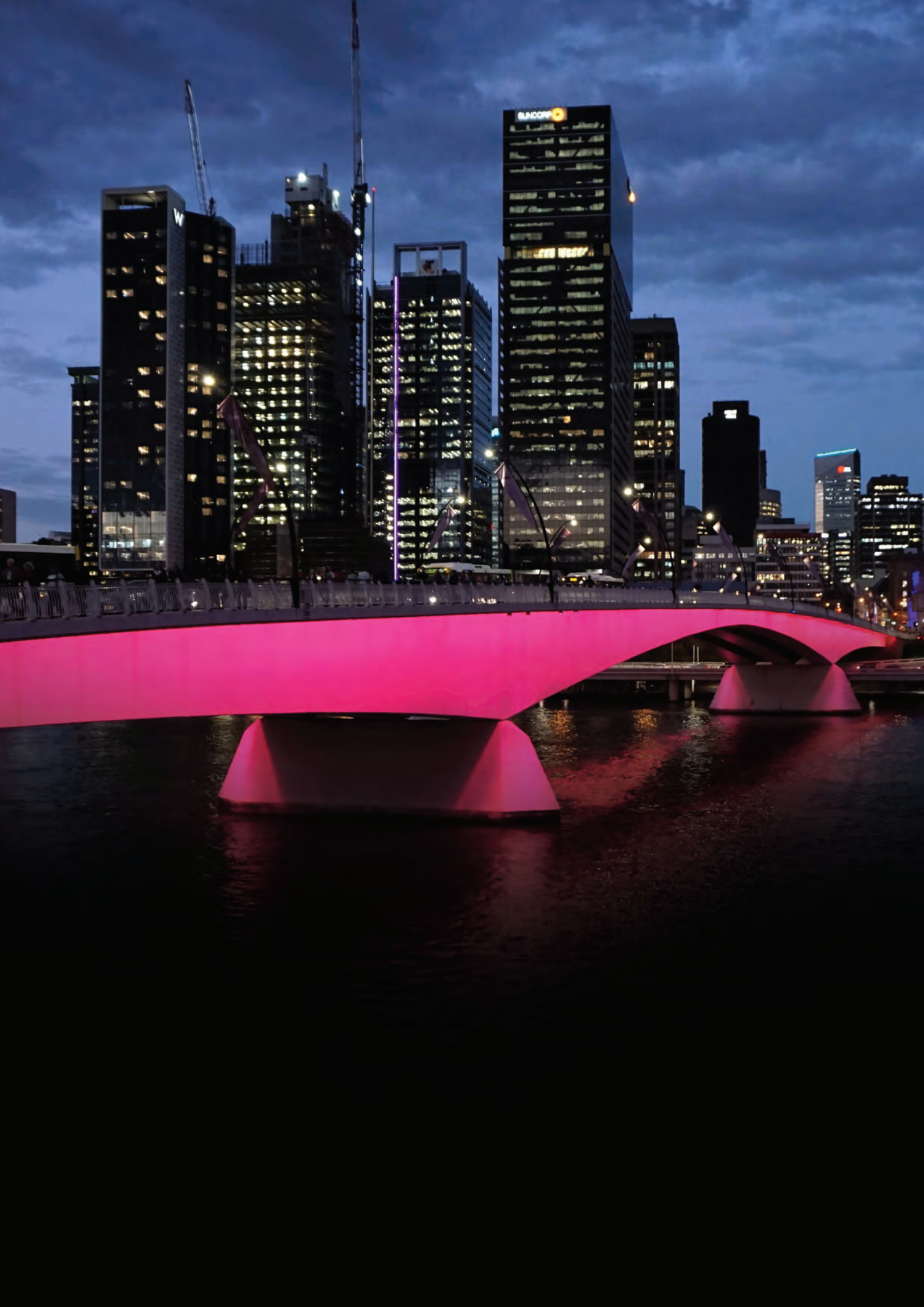
Although there are variations between States and Territories, each register contains title information and details of all registered interests affecting the land. Registration ensures protection of the interest. In order to obtain the protection, transfers, easements, restrictive covenants and mortgages must be registered. Additionally, in some States, leases must also be registered.

Title to Torrens system land is recorded on a certificate of title which is issued by, and kept at, the computer based registry. Most States have now done away with paper certificates of title. Information from the registries is publicly available and can be accessed online.

PEXA

PEXA (an acronym for "Property Exchange Australia") is an e-conveyancing platform which minimises the manual processes and paperwork associated with property settlements (closings) by enabling lawyers and financial institutions to transact together online. Instigated by the Council of Australian Governments (COAG), PEXA is built around an online network of members.

Currently live in five states, PEXA facilitates e-conveyancing and is a collaboration between industry participants, including financial institutions, lawyers, Land Registries and the Reserve Bank of Australia.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Preliminary transaction issues to consider

DUE DILIGENCE

Land in Australia is usually sold on an 'as is, where is' basis, so the principle of "buyer beware" applies. As a result, buyers will need to undertake their own due diligence investigations of a property. The extent of the due diligence will be determined by the type of asset, its location, past use, proposed use and future development of the property. So, any investment proposal should allow an adequate deal timetable to permit thorough due diligence and preconditions to be satisfied.

BUYER DUE DILIGENCE

Legal due diligence usually involves the buyer's lawyer conducting investigations on:

- Title
- Leases
- Registered plan and survey
- Planning and development approvals
- Property costs (e.g. land tax, water rates, council rates)
- Heritage and native title
- Encumbrances (e.g. mortgages, easements, restrictive covenants, etc.)
- Standard property enquiry searches from various authorities (e.g. rail, main roads, electricity transmission, etc.)
- Environmental issues (e.g. contamination)
- Service contracts (e.g. elevators, air conditioning, fire and safety)
- Litigation concerning the seller or the property.

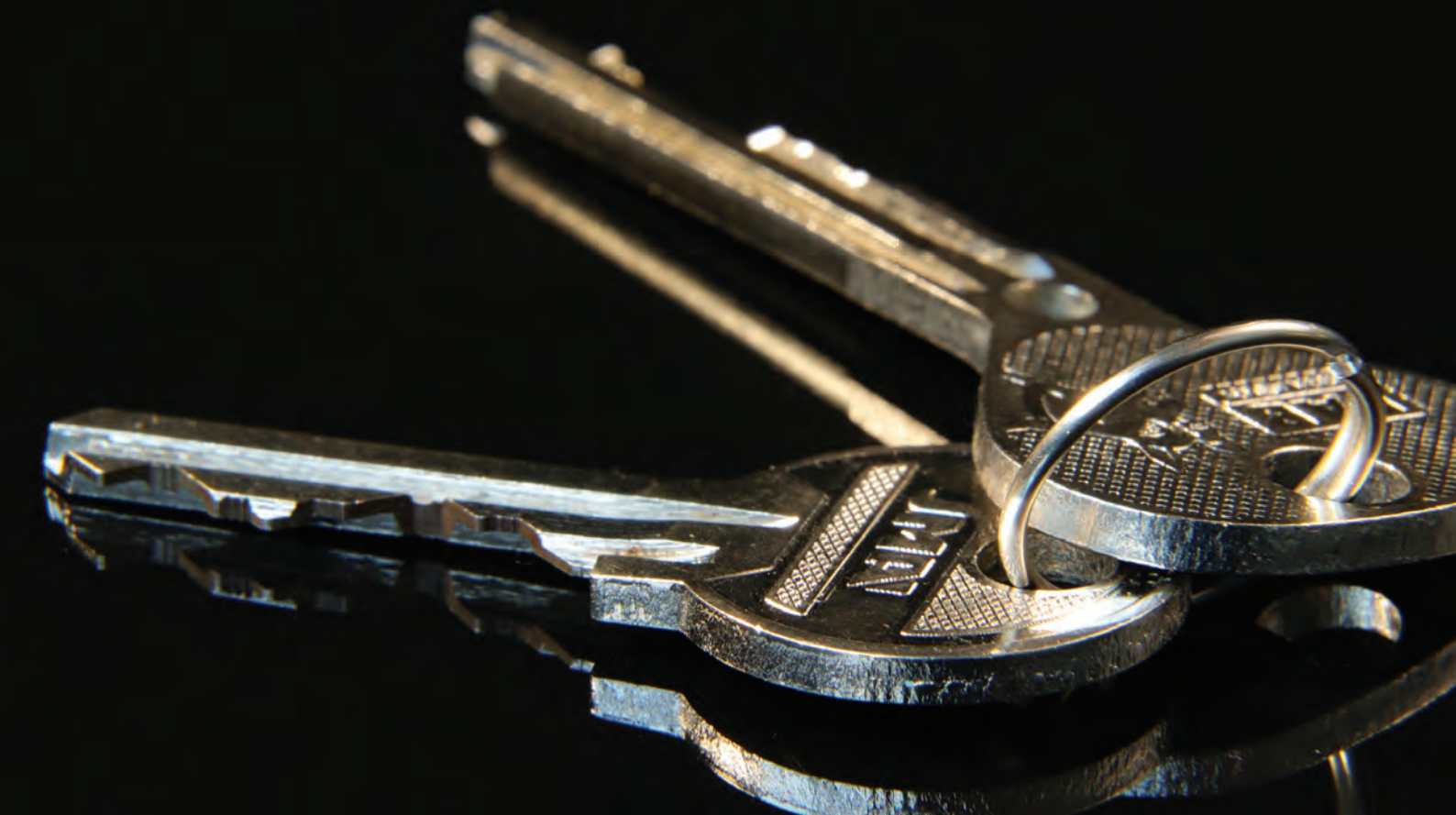
Buyers will commonly engage other consultants to undertake:

- A valuation of the property
- A physical inspection/assessment of the property, its services and equipment
- Investigations to identify future capital expenditure and tax deductibility of assets
- A report on the level of compliance with building codes
- Environmental due diligence
- A review of the financial accounts of the seller (i.e. if the acquisition is of an interest in a corporate or trust structure).

Financiers will often also undertake their own extensive due diligence on a property as a precondition of funding to ensure their security is valid, enforceable and any risks are identified.

Ways to acquire real estate

Apart from a direct transfer from the registered owner, there are other ways to acquire a real estate asset in Australia. For example, an acquisition of the shares in a company or units in a trust held by the owner, or a long-term lease. For each method, there are legal, regulatory and, critically, tax consequences so advice on these issues will influence the most effective method for overseas investors.



Real estate transactions

ACQUISITION PROCESS AND DOCUMENTATION

Normal sale processes are determined largely by the nature of the interest being acquired – ranging from off market or on market bilateral transactions, public auctions, expression of interest campaigns, open market tenders and primary or secondary securities offerings (which may or may not be underwritten).

Both the sale process and the legal documentation involved will also vary, depending on the nature of the interest being acquired. Direct investments in property will usually be documented using a standard form land sale contract with special conditions to reflect changes agreed between the buyer and seller. Put and call options are used where an acquisition is highly conditional or is subject to deferred completion.

Investments in securities are typically documented through subscription agreements where the investor acquires securities in the relevant investment vehicle.

Some typical features of a real estate investment acquisition include:

- Exclusivity: Sale contracts typically provide buyers with an exclusivity period to conduct due diligence enquiries
- Deposit: A deposit of 5 to 10% of the purchase price, payable on execution of the sale contract, is typical for direct property acquisitions
- Conditions: Completion of a sales contract is usually subject to satisfaction of certain conditions within an agreed timeframe (usually 30–120 days)
- Increasingly, sellers are accepting foreign investment approval conditions, allowing buyers to sign without having to delay while foreign investment approval is obtained
- Where external debt financing is required, the sale contract may be 'subject to finance'
- Warranties and indemnities: Since most transactions proceed on the basis that the buyer will conduct its own due diligence and will rely on its own enquiries, sellers are not usually required to provide warranties and indemnities, apart from limited warranties around the titles being acquired.

NORMAL SALE PROCESS

For a commercial asset, the normal sale process would be:

Prior to exchange

- Seller appoints agent
- Seller's lawyer prepares contract
- Buyer conducts due diligence
- Negotiate contract with buyer's lawyer
- Non-binding heads of agreement or letter of understanding can be signed to outline deal terms.

Exchange of contracts

- Seller and buyer sign contract
- Buyer pays deposit to agent or lawyer's trust account (normally 10%).

Pre-settlement

- Normally 30–45 days, depending upon conditions precedent (i.e. FIRB approval)
- Agree settlement adjustments and documents required for settlement
- Buyer pays duty
- Buyer signs finance documents and satisfies financier's pre-conditions.

Settlement

- Buyer pays balance purchase price in exchange for transfer of title
- Sign and exchange other transfer or settlement documents.

Post-settlement

- Register transfer documents in State registry
- Notify tenants and authorities of change of ownership
- Seller pays agent's commission.

PASSING OF RISK

Each State has its own form of standard contract usually produced by a Law Society or Real Estate Institute. These provide a useful benchmark as a starting point for contract negotiations. The standard form contracts provide for the timing of the passing of risk in relation to the property. In some jurisdictions the risk of the real estate passes to the buyer on exchange of contracts, while in other jurisdictions the risk passes at settlement. Again, this is negotiable and will depend on the nature of the asset. The buyer will usually insure the property from the date risk passes under the contract. Given the indefeasibility of title, title insurance is rarely used in Australia as a substitute for the buyer's due diligence enquiries.

DISCLOSURE REQUIREMENTS

Some States (New South Wales, Victoria and South Australia) require a seller to disclose detailed information on the seller's title, the planning controls and other matters relating to the property before the contract is entered into. In these States, if the seller fails to make the necessary disclosure by attaching the required documents to the contract, the buyer can rescind the contract within 14 days after the contract date.

CONTRACTUAL WARRANTIES

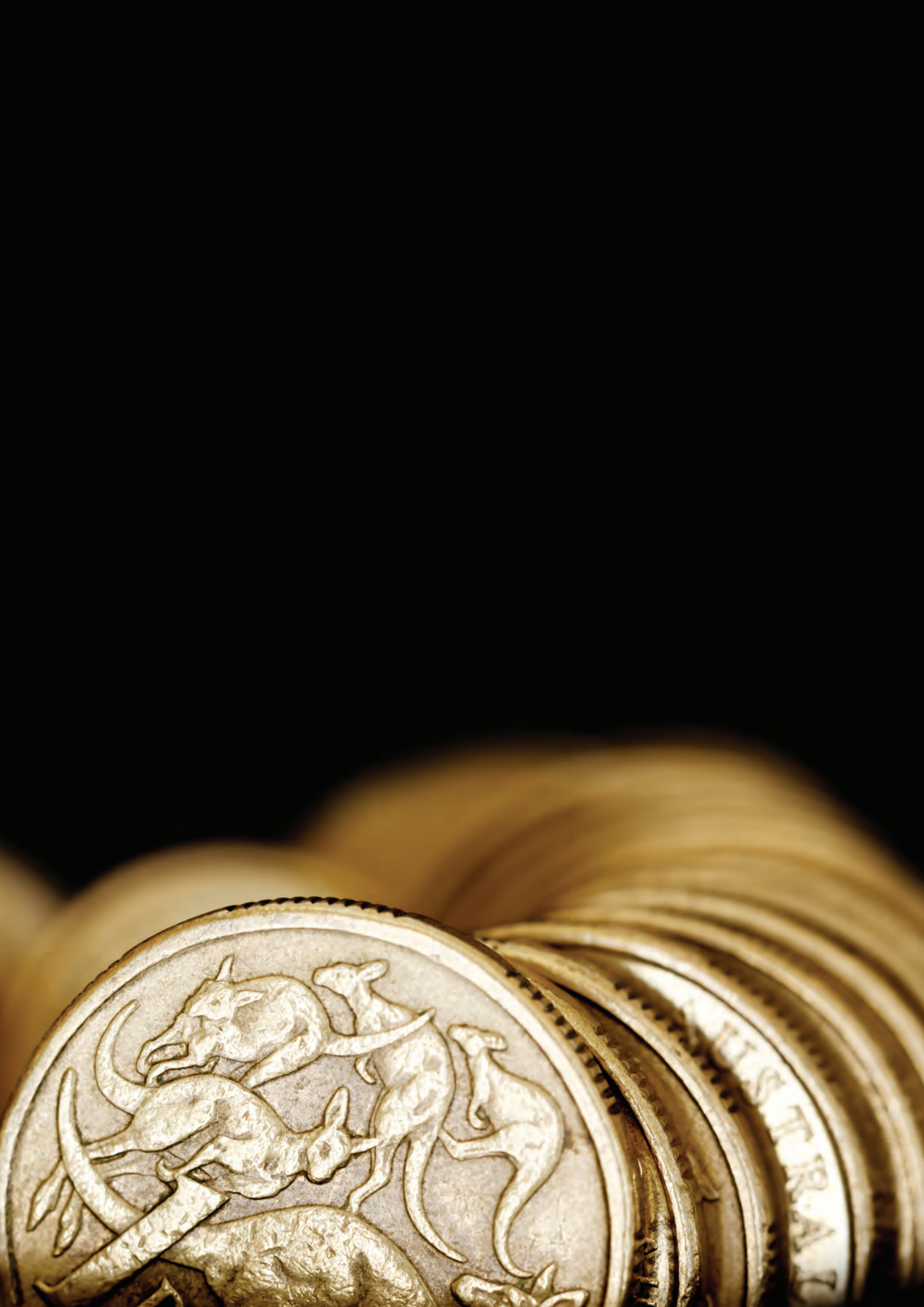
In commercial transactions it is not unusual for sellers to provide contractual warranties, which may include:

- Where a property is leased, warranties stating that the leases are in force, the tenancy details (including rent and outgoings payable by tenants) disclosed in the contract are correct and the seller has disclosed all material information concerning the leases and tenants.
- For industrial properties or where the land may have been exposed to contamination or possible contaminating uses, warranties relating to the state of the property and existence of contamination.

Damages are the usual remedy for breach of contractual warranties.

Warranties are used where the buyer has relied on information provided by the seller which the buyer has not been able to independently verify through its own due diligence investigations.

Generally, the seller's warranties are in addition to and not a completely effective substitute for comprehensive due diligence by the buyer.



Foreign investment policy

The Australian government recognises that foreign investment in real estate benefits Australia economically and socially. So, while there are some restrictions on foreign investment, the government actively promotes foreign investment so long as it is consistent with the national interest. Foreign investment proposals are reviewed by the Treasurer against the national interest on a case-by-case basis, rather than by applying definite rules.

THE PROCESS

Foreign Investment in Australia is regulated principally by the Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA) and the Federal Government's Foreign Investment Policy. The Australian Federal Treasurer administers FATA with the advice and assistance of the Foreign Investment Review Board (FIRB), a division of the Treasury.

There are specific circumstances where foreign investors can purchase residential real estate in Australia, but outside of these circumstances those purchases are prohibited. Investments in residential real estate are treated more sensitively under the foreign investment regime and, in most cases, will require prior approval. Non-residential real estate has a different set of criteria and will be generally be treated less sensitively than residential. In fact, acquisitions of developed commercial property generally do not raise national interest concerns. Following the significant reforms introduced in 2015–16 and the further refinements made during 2016–17, the Government announced a range of policy measures to provide for a heightened national security framework and a diversification of ownership of critical infrastructure. The Government also announced stronger rules for foreign investors owning Australian housing, including the use of residential dwellings and capping the level of foreign investment in new residential developments. These rules are designed to increase housing supply and affordability for Australians. Strengthening compliance with foreign investment rules and processes was a major focus for the Government during the 2017–18 year, with 11 audits relating to $25 billion of proposed investment conducted by the Treasury and 1400 investigations conducted by the ATO.

Foreign investors should regard the approval process as a hurdle to be cleared, rather than a probable prohibition to investment. The vast majority of applications receive a statement of no objections from the treasurer (commonly referred to as FIRB approval).

Commercial real estate

In 2017–18, foreign investment approval was given for 291 proposals valued at $39.5 billion in the commercial real estate sector, down from $43.7 billion 2016–17.

The decline in value was largely due to a significant decrease in approvals for existing commercial property. This may reflect the constricted capital outflow from China, which has resulted in a large decline in proposed Chinese investment worldwide. The total number of cross-sector applications received from China decreased by 30%, and the value of approvals decreased by 40%. This may also reflect the higher foreign investment screening threshold for Chinese investors as a result of the China-Australia Free Trade Agreement (ChAFTA) which came into force on 20 December 2015. Under the ChAFTA, Chinese investors are only required to obtain investment approval before purchasing developed commercial property valued at $1,154 million or above (previously $266 million). This is consistent with screening thresholds for many other foreign investors from countries with which Australia has established free trade agreements. So, the raising of the threshold has resulted in the decrease in applications for approval. The decrease in the number of commercial real estate approvals also reflects a shift toward the use of exemption certificates for commercial real estate purchases. Exemption certificates streamline regulatory requirements and reduce application fees by facilitating approval for a program of investments (i.e. multiple acquisitions) through a single application. Exemption certificates provide pre-approval for purchases within agreed categories, value parameters and time limits. Exemption certificates also contain conditions (for example, development requirements) in line with standard approvals. The decrease may also be offset by the ability to vary existing approvals, which alleviates the need for foreign investors to seek a new approval in certain circumstances.

Despite the decreased value of proposed investment in developed commercial property, approvals for vacant land for commercial development increased in value by $2.3 billion from the 2016–17 year.

Residential real estate

In 2017–18, a total of 10,036 residential real estate applications were approved for proposed investment worth $12.5 billion. This represents a decrease from the 13,198 approvals worth $25.2 billion in 2016–17 year by $17.5 billion. 88% of the decline in the number of approvals is directly linked to the decline in approvals for 'new dwelling exemption certificates' (NDECs) which pre-approve the purchase of residential real estate in a specific development for up to $3 million per foreign person. The reduction of the NDEC approvals in turn is partly attributable to the imposition of a 50% limit on the proportion of dwellings in a development that can be sold to foreign persons. The Treasury's business liaison program indicates that the introduction of application fees from 1 December 2015 remains a factor contributing to the reduction of applications. The introduction of fees resulted in investors only applying for properties they intend to purchase, discouraging multiple applications for prospective purchases. Other factors which may explain the decrease include Chinese capital controls, the introduction of State based taxes on foreign investors in 2016–17 and the increased foreign resident stamp duty.

The proportion of all residential real estate approvals for development remained relatively stable in comparison to the previous year and accounted for approximately 81% of the value of all residential approvals in 2017–18. Approvals for development include approvals for new dwellings, vacant land and redevelopment of existing residential property that increases the housing stock. In 2017–18, 1,615 approvals were given for established residential dwellings which, as a general rule, can only be purchased by temporary foreign residents while they remain in Australia. This is designed to support Australia's foreign investment policy, which seeks to attract investment that increases the housing stock, rather than encourage foreign buyers to compete with Australian buyers.

WHO NEEDS TO APPLY

Foreign persons (this term includes individuals not ordinarily resident in Australia, foreign government investors and an entity where a single foreign person and its associates hold 20% or more of the entity, or where two or more foreign persons and their associates in aggregate hold 40% or more of the entity) must obtain approval from the Australian Treasurer by applying to FIRB before acquiring an interest in Australian real estate (with some limited exceptions). Where it is necessary to notify FIRB, the notification to FIRB can be made in advance of the investment. The Act requires a decision to be made within 30 days after the relevant application fee is received by the Treasury. It is possible for foreign investors to sign a contract to acquire an interest in real estate subject to obtaining FIRB approval. Contracts should provide for a minimum of 45 days from date of lodgement for a decision from FIRB.

TRANSACTIONS REQUIRING APPROVAL

Foreign governments and related entities

If the entity acquiring the interest is a sovereign wealth fund or other foreign government investor (in general terms, an entity owned or controlled by a foreign government, or an entity in which a foreign government and its associates holds more than a 20% interest or if foreign governments of more than one foreign country and their associates hold more than 40%), then an approval is required before purchasing any real estate, regardless of value. A foreign government investor has a very broad interpretation and can capture, for example, pension funds of all levels of government or endowment funds of public universities.

Agricultural land

Agricultural land is defined as "land in Australia that is used, or could reasonably be used, for a primary production business". This includes cultivation of land for crops, stock, horticulture, forestry and dairy farming but does not include land used for mining, industrial estates, tourism, aquaculture or fishing.

The Treasurer announced that from 1 February 2018 the sale process will be scrutinised in applications for foreign investment of agricultural land, to ensure that Australians

have been provided with the opportunity to bid for the land. The policy change aims to introduce an appropriately balanced mechanism to ensure that the proportion of foreign investment is aligned with the national interest.

Proposed investments in agricultural land generally require FIRB approval where the cumulative value of the agricultural land holdings, including the consideration of the proposed acquisition, of the foreign investor (and any associates) is greater than $15 million. Proposals are normally approved without conditions.

Exceptions apply to non-foreign government investors from Chile, New Zealand and the United States, where a $1,154 million (non-cumulative) threshold applies and from Thailand where a $50 million (non-cumulative) threshold applies. Foreign investors may apply for an exemption certificate if the applicant intends to acquire a number of interests in agricultural land over a period of time. Applications are considered on a case-by-case basis; however, are often allowed when the total value of proposed acquisitions does not exceed $100 million over a three year period.

Where foreign persons propose to acquire an interest in agricultural land that will be used for a primary production business or residential development, they will need to demonstrate that the interest was offered for sale through an open and transparent sale process. As part of the national interest test, approval will only be granted if, having regard to the sale process, there was an opportunity for Australian investors to acquire the relevant agriculture land or agricultural land entity (unless an exemption applies).

Shares in company owning land

If the acquisition is of shares or units in a corporation or trust that has interests in Australian land that make up more than 50% of the value of its total assets, then an approval is generally required before making that acquisition. Monetary thresholds applicable for acquisitions of interests in Australian land entities will depend on type and composition of total land assets held by the relevant corporation or trust.

Vacant land for commercial development

Approval is required regardless of the value of the land, with approvals for proposals usually given subject to the condition that a certain percentage of the land price must be used to construct new improvements, that continuous construction of the development must commence within five years from the date of acquisition and that the investor does not sell the land until construction is complete. From 1 July 2017, land is not considered vacant if a wind or solar farm power station is located on the land.

Developed residential land

Approvals are not normally granted for the acquisition of developed residential land, except in limited circumstances. Normally, temporary residents are approved to buy one used dwelling only to live in. Non-resident foreign persons cannot buy used residential land as investment properties or homes. Foreign companies can acquire used dwellings for staff housing (subject to conditions).

Commercial real estate

For developed commercial real estate (shopping centres, factories, offies, warehouses, industrial properties, hotels and motels) approval will be required if the value of the property is $266 million or more (unless the proposed acquisition is considered to be sensitive, then a $58 million threshold applies). For agreement investor countries, a $1,154 million threshold applies. Agreement investor countries include Canada, Chile, China, Japan, Mexico, New Zealand, Singapore, South Korea and the United States. Proposals are normally approved without conditions.

New residential dwellings and vacant residential land

For the acquisition of new residential dwellings, approval is required, regardless of value. Proposals are normally approved without conditions.

For vacant land for residential development, approval is required regardless of the value of the land, with approvals for proposals usually conditional on construction being completed within four years from acquisition to prevent land banking. Developers of new residential developments that consist of 50 or more dwellings can apply to FIRB for an exemption certificate to sell a certain number of those dwellings to foreign persons without the need for each foreign buyer to obtain separate FIRB approval.

FIRB Policy – assessment and considerations

The Treasurer assesses proposals against a national interest test. There is no definition of "the national interest" and applications are assessed on a case-by-case basis. There are no hard and fast rules, so the process is a balancing act between community concerns of Australians and the economic and other benefits which arise from foreign investment. As a result, no precedent can be derived from prior decisions.

Once a proposed acquisition is notified to FIRB, the Treasurer has 30 days to decide whether or not to object to the acquisition and a further 10 days to notify the applicant of the decision. Where the Treasurer considers that further time is required to assess a proposal, a voluntary extension of time by the applicant may be requested. If a voluntary extension is not agreed, the Treasurer can make an interim order extending the decision making period by a further 90 days.

FIRB will usually circulate the proposal among relevant federal and State government departments and other bodies, such as the ACCC and the ATO, to ascertain their view as to whether the proposal is contrary to the national interest.

FIRB will consider a range of factors and their relative weighting will vary depending on the nature of the investment.

FIRB will typically consider the following:

- National security
- Impact on other government policies
- Impact on tax arrangements – particularly if a proposed transaction may result in the loss of a significant amount of tax revenue
- Character of the investor – do they operate on a transparent commercial basis with adequate corporate governance policies and practices
- Impact on the economy and community – the level of ongoing Australian participation and the interests of employees and creditors
- The quality availability of Australia's agricultural resources, land access and use, as well as employment and property in local and regional communities
- The existing level of foreign ownership in assets
- The level of concern from stakeholders and the broader community (i.e. public sentiment and opinion).

CRITICAL INFRASTRUCTURE AND NATIONAL SECURITY

In January 2017, the Attorney-General and the Treasurer announced the establishment of the Critical Infrastructure Centre within the Attorney-General's Department and proposed legislative measures to manage the complex and evolving national security risks to Australia's critical infrastructure. The Centre's initial focus was on the risks of sabotage, espionage and coercion in the highest risk sectors of telecommunications, electricity, water and ports.

The Security of Critical Infrastructure Act took effect from 11 July 2018, enhancing the capability of the Centre. It aims to strengthen Australia's ability to manage challenges in the electricity, gas, ports and water sectors and provide greater visibility of who owns and operates Australia's highest risk critical infrastructure assets. Telecommunications Sector Security Reforms also came into force on 18 September 2018 to more robustly manage security risks to the telecommunications sector. A function of the Centre is to develop coordinated, whole-of-government national security risk assessments on critical infrastructure assets to support Government decision-making, such as foreign investment decisions. The Centre complements the existing FIRB process, providing early and comprehensive advice on national security risks. The Centre's assessments include detailed consideration of the nature of assets themselves.

The Treasury works closely with the Centre and other security agencies to consider foreign investment proposals that may raise national security concerns. The changes in the geo-political environment for Australia have led to increasing complexity and usage of conditions to ensure that an investment can proceed, in line with Australia's position of welcoming foreign investment, while ensuring risks to the national interest are mitigated. For example, data conditions may be applied to manage risks associated with potential access to large holdings of personal, operational and network data for malicious purposes.

From 1 February 2018, all applications related to the sale and acquisition of electricity transmission and distribution assets, and some generation assets, attract ownership restrictions or conditions for foreign buyers. This approach is designed to maintain diversity of ownership of electricity and transmission infrastructure as they are critical national assets.

Case study

A case study involved the acquisition of Arrium Mining and Arrium Steel, in Whyalla, by British-owned GFG Alliance. In reviewing the application for approval, the FIRB gave significant consideration to the support of the local community, the regional location of the business, the economic benefit of the proposal for the whole community and the nature of the assets being acquired to ensure that the proposal was aligned with the national interest. Balancing the acquisition of Australia's main steel manufacturer and distributor against the $1.35 billion in investment and creation of jobs in a regional town which was under significant uncertainty after Arrium had been placed in voluntary administration, the FIRB decided that the beneficial impact on employees and the community was within the national interest.

FOREIGN OWNERSHIP REGISTERS

The Government has established agricultural land and water entitlement registers and is in the process of establishing a residential land register to provide greater transparency on foreign ownership on certain assets in Australia. The registers are used to create publicly available reports that contain aggregated data on the level of foreign ownership in these sectors in Australia.

Agricultural land register

Foreign persons with an interest in agricultural land are required to register that interest on the Agricultural Land Register, regardless of the value of the land. On 29 September 2018, the third report from the register was released (the 2017–18 Agricultural Land Report).

As at 30 June 2018, based on the registered properties, foreign investors held 13.4% of Australian agricultural land and approximately 80% of this was through leasehold interests. This is a slight reduction from 13.6% at 30 June 2017. The United Kingdom remains the largest foreign agricultural landholder (2.6% of agricultural land), followed by China (2.3% of agricultural land) and the United States (0.7% of agricultural land).

Water entitlement register

In such an arid country as Australia, water rights are essential for agriculture production. On 1 July 2017, the Government introduced a Water Entitlement Register to increase transparency around foreign ownership of water entitlements. The Register defines 'foreign ownership' as those entities with foreign ownership of 20% or more of the total shareholding.

As at 30 June 2018, foreign held water was estimated at 10%. China and the United States were the largest foreign water entitlement holders, each holding 1.9% of the total water entitlement. 44% of the foreign held water entitlement is within the Murray-Darling Basin, comprising 9.4% of the total Murray-Darling Basin water entitlement on issue.

Residential land register

From 1 July 2016, the Agricultural Land Register was updated to include data of foreign owned residential property. Aggregated data collected through the Residential Land Register of foreign owned properties was expected to be publically released in December 2018 by the ATO, but has not yet been released.

The Australian Government provided $16 million to the States and Territories under a National Partnership Payment to enable them to undertake systems changes to transfer the data on sales and transfers of real property involving foreign persons to the ATO. Many States had to implement legislative change to support this reporting, which delayed the establishment of the Residential Land Register.

Finance

AVAILABILITY

Australia's efficient Torrens Title system also provides security for both buyers of real estate and finance providers. A real property mortgage can be granted by the owner in favour of a financier and registered with a first ranking priority over the real estate title. The combination of a sophisticated banking sector, secure title registration systems and a robust legal system creates a highly efficient commercial and legal environment for financing real estate transactions.

Domestic banks are the most common financiers for real estate transactions. In addition to the banking sector, financiers in the non-bank sector include:

- Private lenders
- Family offices
- Merchant/investment banks
- Finance companies
- Building or cooperative societies, credit unions and friendly societies
- Mortgage originators
- Insurance companies
- Superannuation funds.

DEBT FINANCE

Even with recent volatility across financial markets, Australian financiers still have a strong appetite for real estate financing.

However, the current Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry has brought a sharp public scrutiny onto the sector, amid speculation that lenders will tighten their credit policies and lending criteria in the wake of the Commission's first round of hearings.

Well planned projects and competent developers with strong track records should have little trouble attracting debt finance. Despite this, Australian financiers are less aggressive in the real estate sector than they were before the global financial crisis. For example, most financiers will insist on equity as opposed to secured mezzanine finance. Leverage ratios have decreased in the case of residential developments and the required level of pre-sales has increased in recent years.

USUAL FINANCING TERMS

As a benchmark, financiers will require the following conditions to be satisfied:

a. A satisfactory valuation of the property

b. Compliance with the financier's "loan to value ratio" (LVR) requirements. The LVR depends on the financial standing of the borrower, the type of the property being acquired and the buyer's relationship with the financier

c. First ranking mortgage security in favour of the financier

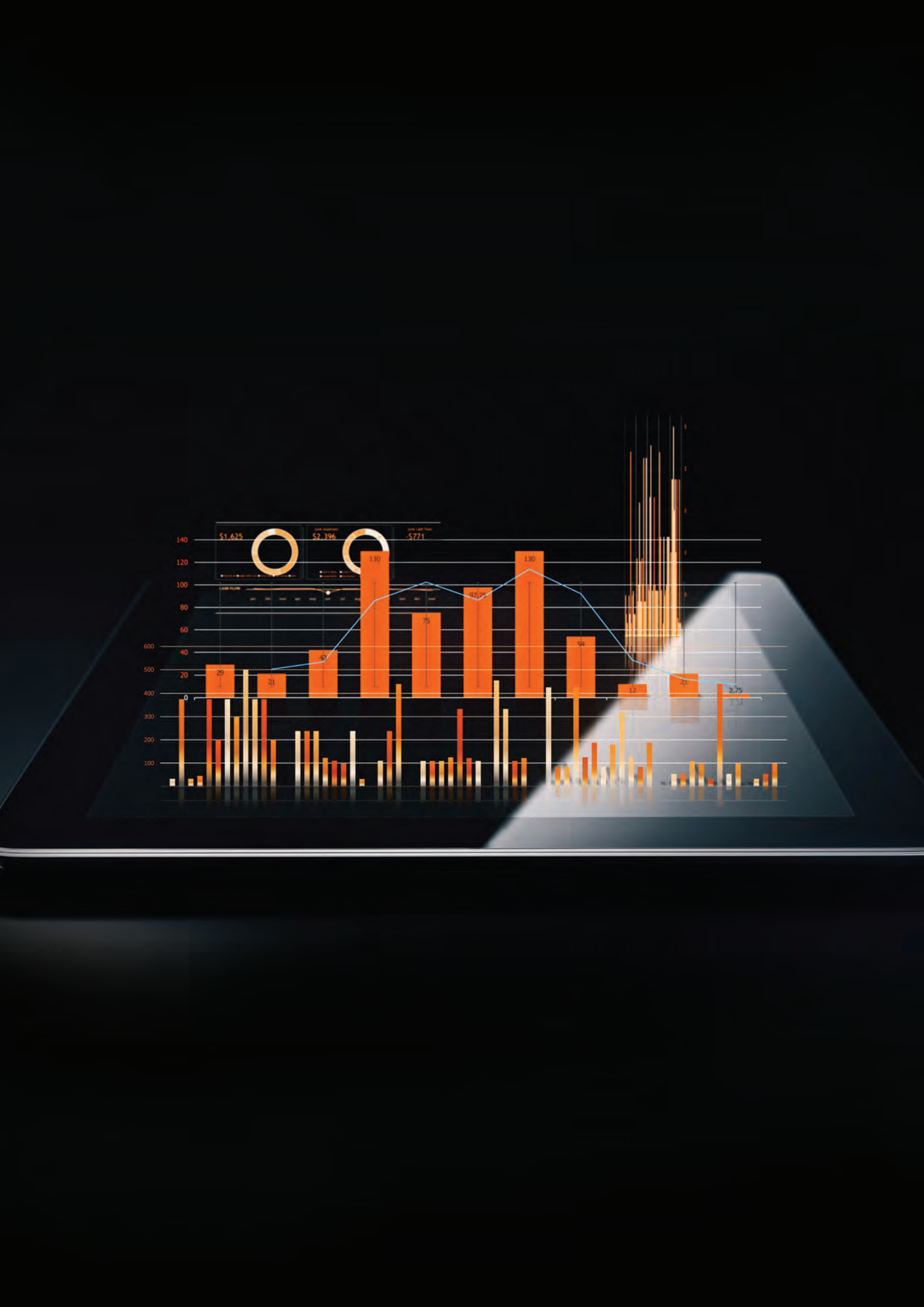
d. Insurance of the asset with an insurance policy which recognises the financier's interest

e. Satisfaction by the financier with its legal due diligence and the borrower's compliance with lending terms and pre-conditions to draw down.

Depending on the nature of the asset, the financier may require a tripartite deed with an occupier or operator of an asset (such as a hotel) giving the financier step in rights if the owner is in breach, to ensure the preservation of the occupier/operator arrangements.

The identity and structure of the borrowing entity and borrower group will be critical for lending to overseas entities to ensure that the entity holding Australian assets can be isolated.

For residential developments, the financier will need to be satisfied that the level of pre-sales is acceptable, and that those pre-sales are arm's length transactions. It is common for a financier to also place a cap on the number of acceptable pre-sales to foreign buyers, given the additional cost and procedural risk associated with attempting to enforce contracts of sale in other jurisdictions.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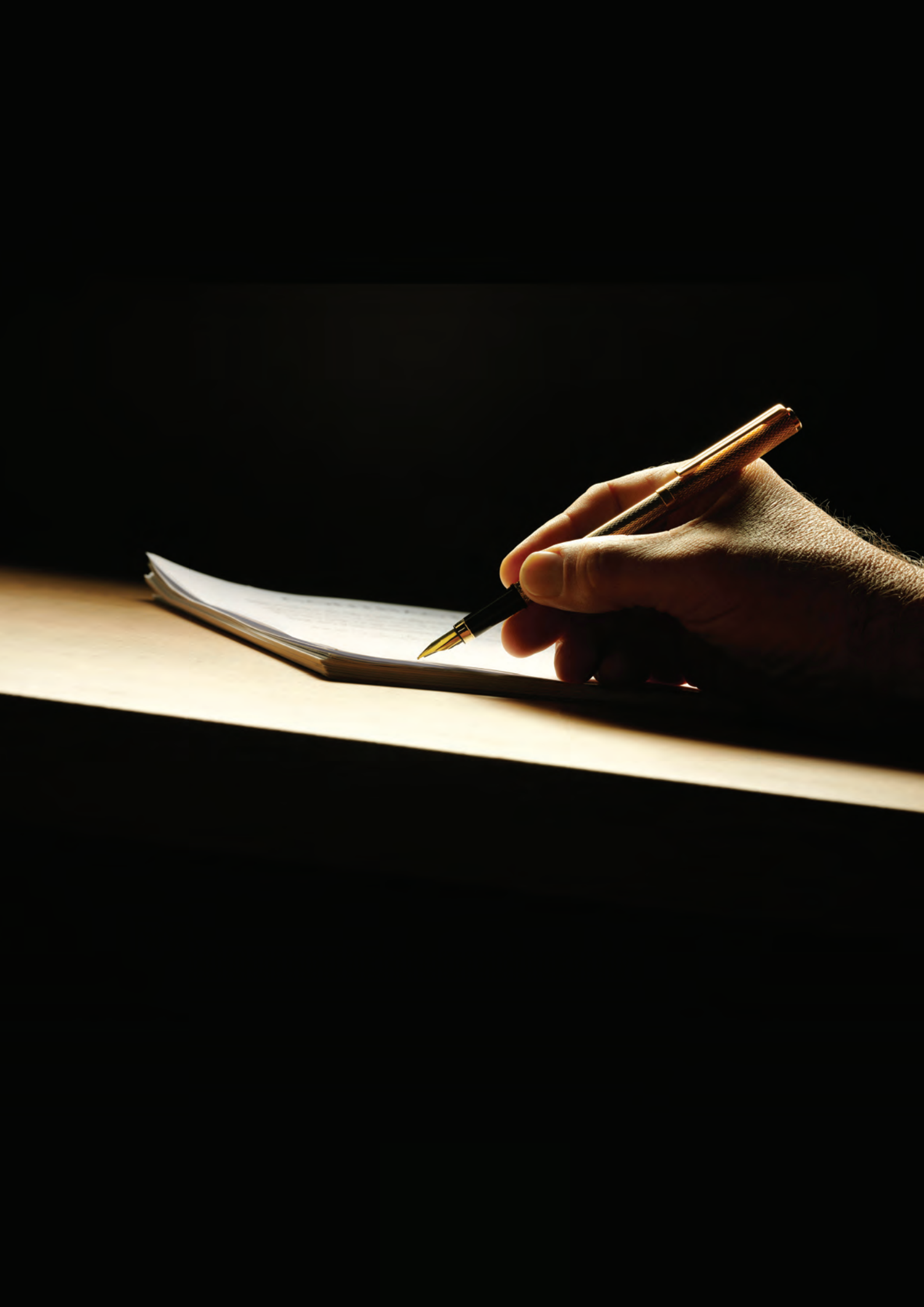


Taxation

Taxation is an important consideration for any foreign investor considering the acquisition of a direct or indirect interest in Australian real estate.

The Australian taxation system is complex, with a variety of taxes imposed at Federal, State/Territory and Local Government levels. This complexity is compounded by the interaction between the Australian taxation system and the tax regime applicable in a foreign investor's home jurisdiction. Further, the structure adopted by the foreign investor for the investment can impact on the taxation outcomes (e.g. there are special withholding tax rates applicable to distributions of rent made by managed investment trusts to investors in certain jurisdictions). Below, we have briefly outlined some of the key Australian taxation considerations for a foreign investor in relation to the acquisition, holding and disposal of Australian real estate. However, specific taxation advice will be required in relation to any proposed acquisition with regard to the particular circumstances and investment structure of a foreign investor.

ACQUISITION TAXES

Each Australian State and Territory imposes stamp duty on direct acquisitions of Australian real estate at rates generally between 4.5% to 6%, plus any applicable surcharges. The duty is payable by the purchaser on the higher of the consideration (including goods and services tax (GST)) paid or provided for, or the unencumbered market value of, the land (including fixtures and certain goods). In all jurisdictions other than the Northern Territory and Australian Capital Territory, a surcharge applies to the acquisition of residential property (including land acquired for residential development) by a foreign person at rates of up to 8%. A land transfer cannot be registered until the duty is paid.

Under the landholder duty regimes operative in each Australian State or Territory, duty will also apply to certain indirect acquisitions (i.e. the acquisition of a significant interest in a company or trust that holds land in excess of a given threshold, which varies by jurisdiction). In Victoria, the acquisition of an "economic entitlement" (e.g. the right to participate in rent, proceeds of sale or capital growth) in respect of land is also dutiable.

A GST-registered supplier of land may be liable for GST at the rate of 10% on the supply of the land. Since 1 July 2018, a purchaser of land has been required to withhold, and remit to the Australian Taxation Office (ATO), the GST payable by the vendor in relation to most residential property dealings. Even where withholding does not apply, the vendor will usually seek to pass on the GST to the purchaser.

However, no GST will apply to the supply of certain land (e.g. farm land is GST-free, while the supply of existing residential premises is input taxed) or, in some cases, a concessional amount of tax applies (i.e. under the arrangement known as the margin scheme). If land is sold as part of a business sale, it may also qualify as a GST-free sale of a going concern.

No GST applies to the acquisition of shares or units in a company or trust that owns land.

A GST-registered purchaser may be entitled to input tax credits for any GST paid in relation to the purchase (except where the margin scheme applies) and associated costs (although there may be restrictions if the purchaser will use the land for making input taxed supplies, such as leasing for residential purposes, or where there is an indirect acquisition of land through a company or trust).

HOLDING TAXES

Each Australian State and Territory (other than the Northern Territory) imposes annual land tax at rates generally between 1% and 4% (plus applicable surcharges) on the owner of land in the relevant jurisdiction, subject to certain exemptions (e.g. for land used for primary production purposes). The regime and rates vary considerably by jurisdiction, with Victoria, New South Wales and Queensland imposing a 2% surcharge on foreign investors holding residential property and Queensland denying foreign investors access to the primary production exemption. In Victoria, the foreign investor surcharge can also apply to commercial property, and there is a separate surcharge on land owned by trusts (whether or not controlled by foreign investors).

In addition to land tax, Councils impose rates on land, generally based on a percentage of either the unimproved (land only) or capital improved (land and buildings) value of the land. Differential rates can be applied depending on the zoning and/or use of land.

A foreign resident investor will be subject to income tax on its Australian source income from the holding of property (e.g. rent or development profits) and will be entitled to deductions for its revenue outgoings (e.g. property management charges, staff salaries) and tax depreciation on buildings (over 40 years) and plant and equipment (over the useful life of the plant and equipment). Deductions are ordinarily available for interest on debt used to fund the acquisition of property, subject to the limits under the thin capitalisation regime (which allow a safe harbour 60:40 debt to equity ratio) and the potential application of:

- transfer pricing rules if the debt is borrowed from a foreign related party and the loan (including interest rate) is not on arm's length terms; and/or
- anti-hybrid rules if (broadly) the interest is deductible in Australia, but is not assessable to the recipient.

The rate of tax will depend on the nature of the investor.

For example, a company (whether Australian or foreign) is subject to tax at 30% on its taxable income (although a lower rate of 27.5% applies to companies with income less than $50 million), while a foreign resident individual will pay tax at marginal rates of up to 45%.

Withholding tax will generally apply at the rate of 10% to interest paid to a non-resident lender (whether or not related to the borrower), except where a lower tax treaty rate applies (e.g. US financial institutions may be exempt from withholding tax under the Australian/US tax treaty.

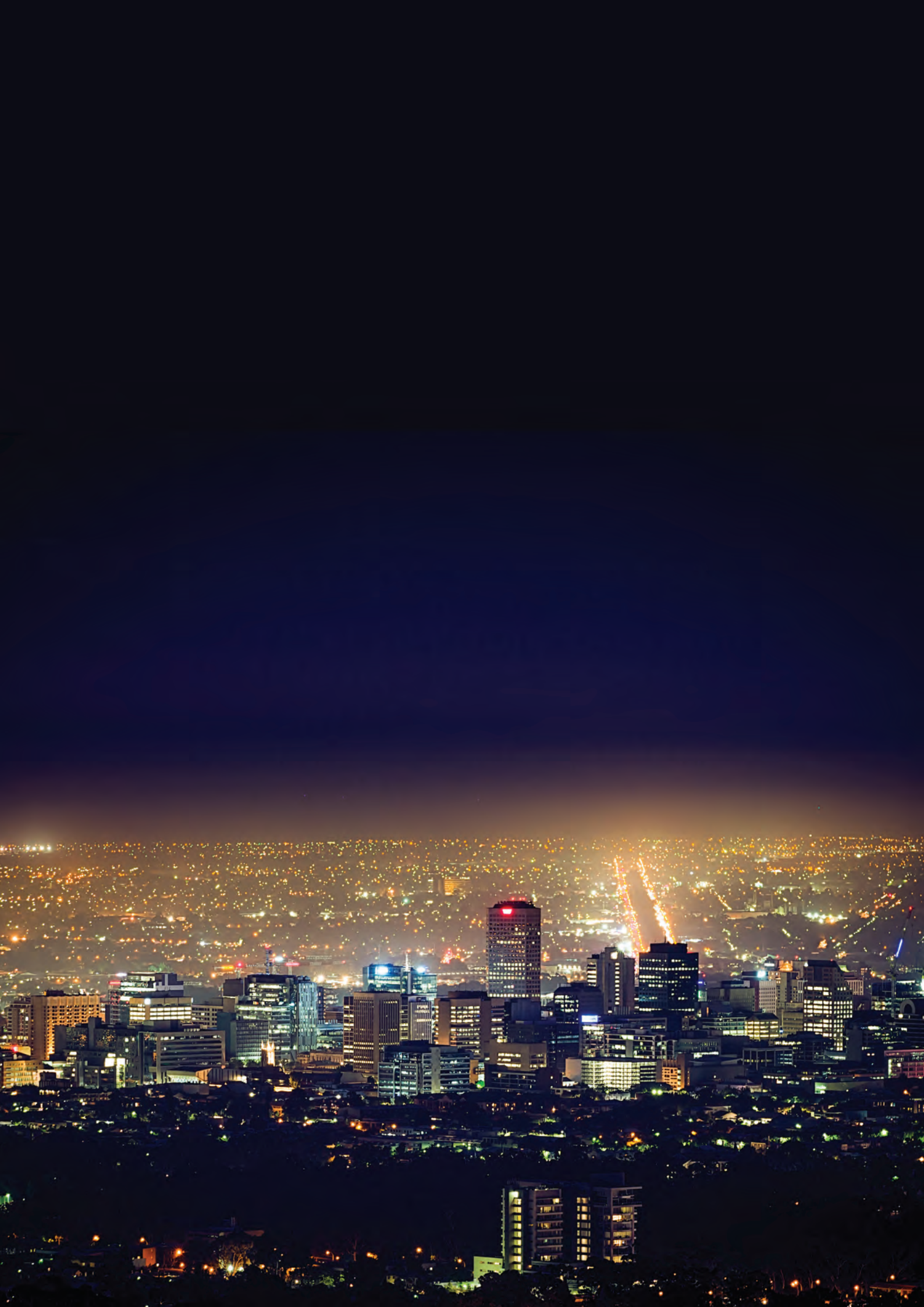
DISPOSAL TAXES

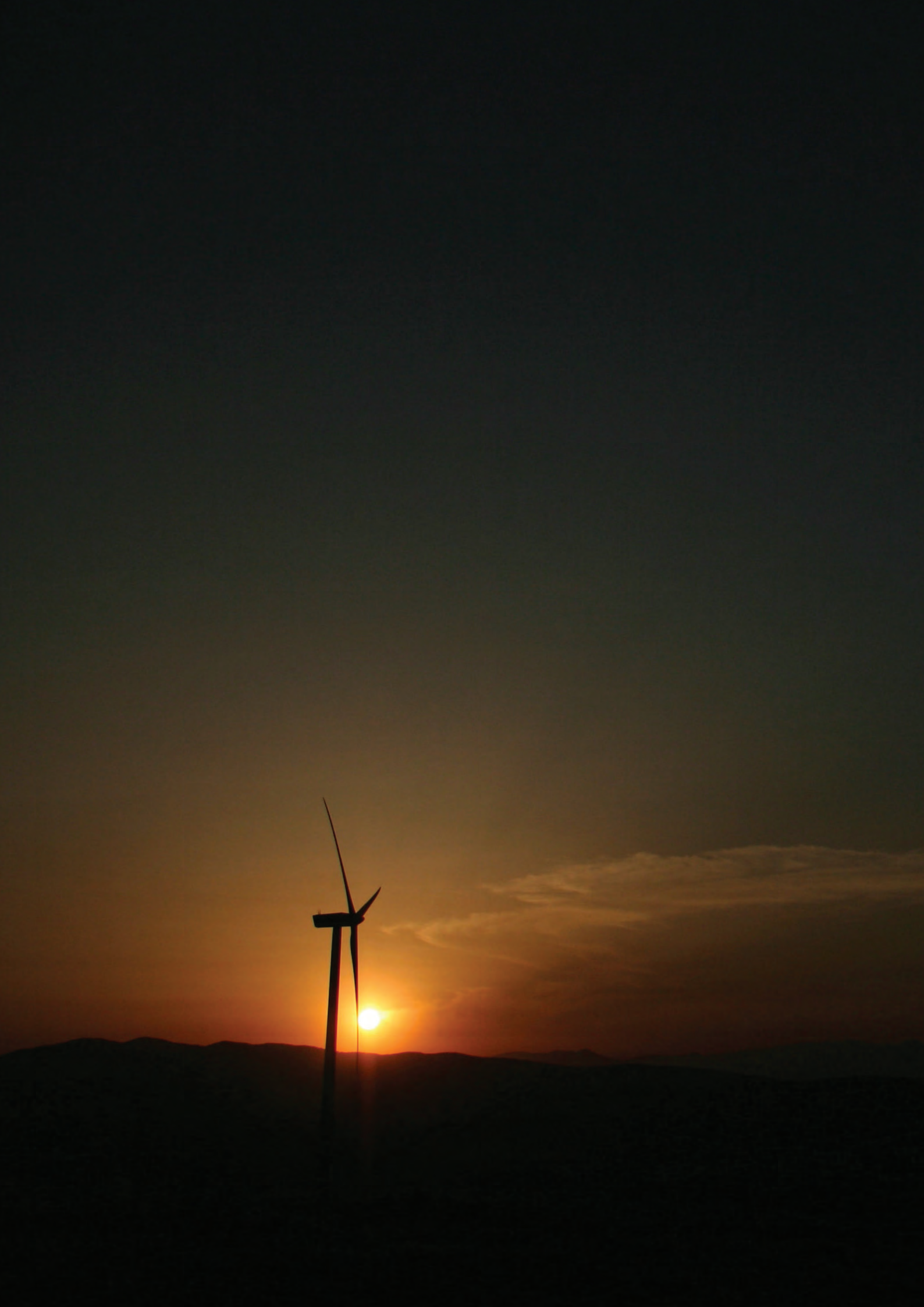
A foreign investor will generally be subject to income tax on any revenue gain (e.g. on land held for development or profit making by sale) or capital gain relating to the sale of direct interests in Australian land. The rate of tax on any gain will depend on the nature of the investor. For example, a foreign company would be liable for tax at 30% (or 27.5%) of the gain, but an individual may be taxed at marginal rates of up to 45%–47%.

A foreign resident capital gains withholding regime applies, requiring a purchaser of land valued at $750,000 or more to withhold 12.5% of the sale proceeds if the vendor is a "foreign person" (effectively this is any vendor that does not obtain a clearance certificate from the ATO that it is an Australian resident for tax purposes).

A foreign investor will also be subject to tax on any capital gain arising from the sale of a non-portfolio interest (i.e. greater than 10%) in a company or trust, the underlying assets of which are predominantly Australian real estate (traced through subsidiaries). The foreign resident capital gain withholding regime can also apply to dealings in the shares or units of such companies or trusts.

If the foreign investor is registered (or required to be registered for GST), then it may be liable for GST on any sale of the land. As noted above, this GST obligation may be subject to withholding (in the case of residential property) and is commonly passed on to the purchaser under the relevant contractual arrangements. No GST applies to the sale of shares or units in a company or trust.





Planning and the environment

PLANNING

Each State has its own planning law system, which heavily regulates the use and development of land. In broad terms, each parcel of land will be in a planning scheme which will specify which uses are permitted, permitted with approval, or prohibited. The planning schemes are extensive and may also contain restrictions or limits on design, height, impact on native vegetation and consideration of local amenity.

Land planning law is undertaken at the Local Government (Council) level in consultation with other State and Local Government authorities (e.g. water, power and road authorities). Some larger and significant projects may be dealt with at State level. There are generally appeal rights to State courts for interested parties (such as adjoining owners, neighbours and the local community) before a final decision is made regarding proposed developments. Local Government decisions are subject to review by tribunals and courts in each jurisdiction.

ENVIRONMENT

Public interest in environmental issues has spawned a complex legal regime operating through all three levels of government.

Federal controls

The Federal government exercises control over:

- Matters of national environmental importance (i.e. where proposals or activities may have a significant impact on something of national importance, for example declared World Heritage areas, threatened species, Commonwealth marine areas, the Great Barrier Reef and coal seam gas and coal mining developments which could impact water resources)
- Carbon pricing legislation
- National Heritage places
- Wetlands of international importance
- Nuclear resources such as uranium mines
- Activities which may affect land owned by the Commonwealth.

State controls

Despite the Federal government's over-arching regulation, the main power to regulate environmental mattes rests with the State and Territory governments. Heavy regulation of this level extends to:

- Land use planning, building and development control
- Waste management including pollution and contamination control
- Management of environmental impacts of projects and developments
- Flora and fauna conservation and protection
- Natural resources protection, exploitation and management
- Transport and handling of dangerous goods
- Regulating water allocation schemes and water resource management in regional areas.

Local government

For most projects, control of land use and development is predominantly done by Local Government or Councils. Councils are established and regulated by State government legislation. For most commercial activities such as land development, the local Council will be the primary approval authority for:

- Land use and town planning
- Land subdivision
- Building approvals
- Development approvals and control.

For major development proposals of significant value, the State's relevant minister may often assume the role of the approving authority. Examples where this has occurred are infrastructure or mining projects, major residential, industrial or commercial developments and development in coastal or other environmentally sensitive areas.

2019 and beyond

Global real estate investments continue to rise, sustained by steady economic and employment growth in major global markets. And this is despite caution over a flattening yield curve, some country tax reform moves, the growing threat of trade tariffs as well as the uncertainty of Brexit in Europe. In the current environment, mature markets have the widest appeal. So, Australia stands out as a popular choice, and in terms of capital flows, it continues to see large investments into real estate assets. Despite the tightening of the regulatory crackdown in China, which saw marked declines in the flow of outgoing capital in 2018, other capital from Singapore and the United States has stepped into its place. Australia's deep and liquid markets offer global investors a port in a storm.

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Carrie advises on the legal aspects of investment, operations, supply and management in the agribusiness sector across Australia. Her expertise includes advising on the ownership and management of water entitlements and to the plantation forestry sector.

The majority of Carrie's clients are US based investors in Australia as part of global investment strategies. Carrie's clients include investment and asset managers, private equity investors, pension and endowment funds, overseas and domestic corporates and Government.

Carrie is recognised in the market as a leading plantation forestry and agribusiness specialist. She is consistently listed in Best Lawyers Australia in both real estate property and agriculture sectors.

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David is a real estate lawyer specialising in property investment and development, major projects and joint ventures.

David has a reputation for facilitating transactions, combining experience with intuition. He brings a refreshing commercial perspective to property deals and understands the importance of timing. David has a strong appreciation of the need for lawyers to be nimble and astute and, as a result, he focuses on "getting the deal done".

David's legal skills embrace acquisitions and sales, development projects, comprehensive due diligence, joint ventures, leasing and project work. His commercial skills include negotiation, facilitation and execution, structuring transactions, project management and astute risk identification.

He has been described in Asia Pacific Legal 500 as a Leading Individual in Real Estate and is recognised in Best Lawyers Australia.

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Peter is a real estate lawyer specialising in property development, asset and site acquisitions and sales, real estate co-investment, corporate accommodation and commercial and industrial leasing. He brings a wealth of experience representing REITs, sovereign wealth and pension funds, fund managers, large national and multi-national companies and property developers.

Peter is consistently recognised by his peers and clients as one of Australia's top real estate lawyers in directories such as Best Lawyers, Chambers Asia Pacific and The Asia Pacific Legal 500. In Chambers 2019, Peter is described by his clients as "personable, practical and a deal-maker."

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